

Trading Blocs, U.S. Exports, and World Trade

Penelope Hartland-Thunberg



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Among the numerous trading blocs that have appeared since the late 1950s, only the European Economic Community (EEC) has had a significant impact on the volume of either world trade or U.S. exports. Dr. Hartland-Thunberg points out that although the total trade volume of the blocs that involve less-developed countries (LDCs) has increased, this is due at least as much to a particular bloc-member's economic growth as it is a result of the trading bloc per se. Despite this caveat, she predicts that the rapid economic growth of these individual countries and the tendencies of corporations to invest or license in them could well make ASEAN and LAFTA increasingly strong forces in world trade.

Dr. Hartland-Thunberg is director of economic research at Georgetown University's Center for Strategic and International Studies. She has previously been a member of the U.S. Tariff Commission and the Council of Economic Advisors.



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 **Routledge**
Taylor & Francis Group
LONDON AND NEW YORK

First published 1980 by Westview Press

Published 2019 by Routledge

52 Vanderbilt Avenue, New York, NY 10017

2 Park Square, Milton Park, Abingdon, Oxon OX14 4RN

*Routledge is an imprint of the Taylor & Francis Group,
an informa business*

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Library of Congress Cataloging in Publication Data
Hartlund-Thunberg, Penelope.

Trading blocs, U.S. exports, and world trade.

(Westview special studies in international economics and business)

Bibliography: p.

Includes index.

1.Commercial policy. 2.International economic relations.

3.United States--Foreign economic relations. I.Title.

II.Series.

HF1411.H328

382'.3'0973

80-16379

ISBN 13: 978-0-367-21188-2 (hbk)

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Preface

The impact of trading blocs, which have multiplied in number during the postwar years, on the volume and direction of world trade is a subject that has been widely ignored by both economists and foreign affairs analysts. Neglect by the former is perhaps more easily explained than neglect by the latter; in either case the neglect is not excusable. This volume, in exploring the impact of world trading blocs on U.S. foreign economic relations, fills part of the research and analytic gap.

The main body of this book is properly concerned with U.S.-European relations. Of special significance to one whose primary interest lies in U.S. relations with the Third World, Dr. Penelope Hartland-Thunberg's study emphasizes the reasons for the ineffectiveness of Third World trading blocs today. In so doing it underlines the importance of the quality of leadership and the dangers of bilateral jealousies and fears in the success of the developing world's struggle to improve its own economic well-being.

Michael A. Samuels
Executive Director
Third World Studies
January 1980

This study was partially financed by a grant from the Westinghouse Corporation, an indication of their continuing interest in U.S. international relations.



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Introduction

The spate of trading blocs that have appeared on the world scene since the late 1950s has had -- with one gargantuan exception -- virtually no impact on the volume of world trade or the level of U.S. exports. For the United States, its greatest impact has been on the composition of exports, and that effect has been marginal.

The exception is found in the European Economic Community (EEC), which today accounts for more than one-third of world trade (compared with a U.S. share of 12 percent) to which one-quarter of U.S. exports are directed, where over 40 percent of U.S. direct foreign investment in manufacturing is located, and with which more than one-third of U.S. licensing agreements for manufacturing abroad have been negotiated. Since its creation over 2 decades ago, the EEC has been a dynamic force in the world economy altering the geographic and commodity patterns of world trade and U.S. trade. Prior to 1973, the impact of the EEC on U.S. exports and direct investment was magnified by the existence of an overvalued dollar exchange rate.

The increase in the total trade volume of the trading blocs which involve less developed countries (LDCs) is at least as much the consequence of a bloc member's rapid economic growth as it is of the trading bloc per se. The two LDC blocs that loom largest in world trade -- the Latin America Free Trade Area (LAFTA) and the Association of Southeast Asian Nations (ASEAN) -- have as members some of the world's high-growth countries. Investment and licensing activities in these blocs have largely been directed toward politically stable, high-growth countries. The fact that they were also members of a trading bloc appears at the best to have been marginal in the decision of the U.S. company to invest or license there.

Despite its recent and projected enlargement, the EEC is unlikely to be the dynamic force in the world economy of the next 5 years that it has been in the past. The stimulating effects on production, trade, and investment of its formation have about run their course; meanwhile, deep-seated problems of financial and structural maladjustment are plaguing Europe and the United States. Assuming that these maladjustments do not cause Europe and the United States to turn inward and pursue a highly protectionist course, the high-growth countries of the future will continue to be the high-income developing countries. Singapore, Thailand, and Malaysia will then make ASEAN an increasing force in world trade. Brazil, Mexico, and Venezuela, to a lesser degree, are likely to do the same for LAFTA. If a new generation of statesmen should take over leadership of LAFTA, its future could be considerably brighter.

Penelope Hartland-Thunberg

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Trading Blocs: Their Impact on U.S. Exports and World Trade

Introduction

The long era of postwar prosperity that finally came to an end in 1973-1974 was marked by high rates of economic growth around the world, rapid technological change, and a sustained rise in the volume of world trade that was probably unprecedented in history. World trade, which expanded 5-fold between 1950 and 1970, was a leading force in the expansion of world production by 4.5 times. The pace of world trade in the post-war era was about double that of the first quarter of the twentieth century, which in turn was roughly double the pace of the last quarter of the nineteenth century.

World economic expansion quickened after 1960. Between 1960 and 1972, world trade grew by an average rate of 7.9 percent a year, world GNP by an average of 5 percent. The heightened pace of international trade after the 1950s was the result especially of the completion of postwar reconstruction in Europe and Japan, the reestablishment of currency convertibility at the end of 1958, the (General Agreement on Tariffs and Trade) GATT-sponsored reductions in tariff barriers that had accumulated through the six rounds of negotiations extending from 1947 through 1967, and the establishment in the Treaty of Rome, signed in late 1957, of the European Economic Community (EEC).

The birth of the EEC on January 1, 1958 marked the start of a proliferation of preferential trading arrangements that has pervaded world trade even since. In 1955, about 90 percent of world trade was conducted on the basis of nondiscriminatory most favored nation (MFN) tariff treatment; by 1970 MFN-based trade accounted for only 75 percent. Today that figure is probably no more than 50 percent (the computation has not been made since 1970). In fact, today, the United

States, Canada, and Japan are the only important trading countries whose products are dutiable in Western Europe. (Annex I lists those trading blocs officially recognized in the Tariff Schedules of the United States in 1978.* Annex II contains their vital statistics.)

Preferential trading arrangements -- embodying national policy that discriminates in favor of imports from one or a group of countries over those from other sources -- were by no means new on the world scene. The proliferation of customs unions and free trade areas during the 1960s, however, was in contrast to the basic philosophy and practice of the GATT era. The General Agreement, the basic purpose of which was to establish rules of proper conduct to govern international commerce, stated in Article I a policy of non-discriminatory, most favored nation treatment as the fundamental guiding principle for world trade. Other articles, however, stated permissible exceptions, notably Article XXIV pertaining to customs unions and free trade areas.

Outside of Europe, the proliferation of trading blocs was largely a response of the developing countries (LDCs) to the EEC model and to the frustrations of their perceived lagging growth. Despite the fact that as a group their rates of economic growth, both in aggregate and in per capita terms, were substantial, they were not high enough to diminish the chasm between their living standards and those that prevailed in the industrial countries. A free trade area, with or without a customs union, was generally viewed as a form of self-help available to the developing countries, especially if associated with an industrialization and investment program assigning a new industry to one of the members whose output would be marketable duty-free within the larger market of the entire bloc. Eleven of the present 13 trading blocs are in developing areas.

The motivating force behind the EEC was as much political as economic -- the vision that an economically interdependent Europe would lead to a politically harmonious Europe, thereby negating the possibility of another major war arising from intra-European conflicts. The EEC was planned as both a free trade area with a common tariff schedule for

*Although there seems to be disagreement among U.S. government officials about the content of the list and the focus of responsibility for changing it, the list embodied in the Tariff Schedule of the United States Annotated (TSUSA) is the only one published by the U.S. government. It is the basis for the data pertaining to trading blocs in this paper.

trade with the rest of the world and a common market -- an area within which the same price would everywhere prevail for the same commodity or service. Although it has yet to achieve a common market in any significant industry, as a customs union and free trade area, the EEC has been enormously successful. Trade among members (intra-bloc trade) rose from just over one-third of their total exports before 1958 to over one-half in the early 1970s just prior to the oil price rise. Today it is just 50 percent. (Table AII, Statistical Annex).

The decision of six major trading countries of Europe (France, Germany, Italy, Netherlands, Belgium, Luxembourg) to form a customs union and free trade area, the exclusion of Britain from the group and the apprehensions of the rest of Europe -- especially Scandinavia, Switzerland, Austria, and Portugal for each of whom the other six European countries represented major markets -- over the impact of the new bloc on their export industries led the United Kingdom to undertake the initiative in the formation of the European Free Trade Area (EFTA). The seven EFTA countries established a free trade area amongst themselves on January 1, 1960. They did not attempt to unify their tariff schedules vis-a-vis trade with the rest of the world.

Since the establishment of the EEC, the proportion of world trade imported at MFN rates has declined steadily. Trade under preferential tariff arrangements has grown more rapidly than world trade and in addition, the share of the EEC (original six countries) in total world preferential imports has increased. Between 1955 and 1970, the EEC's preferential imports (imports at less than MFN rates) rose from 17 percent of the six countries' total imports to 65 percent and the share of total world imports made up by EEC preferential imports, from 2 percent to 16 percent. Over the same interval, EFTA's preferential imports as a share of world total imports rose from a negligible amount to 3.5 percent (which amounted to more than 14 percent of world preferential imports).

Although the data have not been extended beyond the year 1970, it is clear that the importance of preferential imports in the world total has continued to mount. The United Kingdom, Denmark, and Ireland joined the EEC in 1973; at that time, the remaining EFTA countries negotiated significant preferential arrangements with the EEC which taken together mean that the industrialized countries of Western Europe now form a huge free trade area in industrial goods. In addition, the EEC has set up preferential arrange-

ments with most of the Mediterranean countries and with 52 developing countries in Africa, the Caribbean, and the Pacific (ACP), most of which were formerly colonies of the EEC members.*

*The ACP countries are not included in the U.S. list of trading blocs although the Lomé Convention which established the special relationship between the 52 (then 46) ACP countries and the EEC provides more justification for such inclusion than the conventions establishing some recognized trading blocs. The Lomé Convention is a vast and comprehensive agreement on cooperation in economic development that was signed in 1975 to run for a period of 5 years. It was renegotiated by the signatories for another 5 years commencing in 1980. Its implementation has been so sufficiently successful that some of the ACP countries consider it a model for the future development of North-South economic relations.

The most popular provision of the Convention is the STABEX fund for the stabilization of commodity export earnings. The aid program and the special measures for industrialization have also been effective. The EEC grants duty-free access to the products of ACP with the exception of agricultural products and does not expect preferential treatment for its exports in return. The EEC has recently agreed to treat the ACP countries as a single customs area for purposes of establishing rules of origin; thus products successively processed in more than one ACP state will be eligible for duty-free treatment provided the value added in all ACP countries together meets the prescribed level.

The main complaint of the ACP countries concerns the dilution of their preferences in the EEC market that results from the EEC's association with Third World countries and from its granting of generalized preferences to all LDCs. They also complain about the EEC tariff structure which levies higher rates on processed rather than on unprocessed goods, thereby discouraging manufacturing in the ACP countries, it is claimed.

Despite the generally favorable reception accorded the Lomé agreements, EEC-ACP trade has grown less rapidly than the total trade of either group. In part at least this is due to the low level of development of most ACP countries, their lack of infrastructure and skills, and the specialized nature of their exports.

The only other trading blocs that have approached achieving total free trade in their internal exchanges are the Central American Common Market (CACM) and the Caribbean Common Market (CARICOM); trade in nearly all the goods that are exchanged among the members is duty free. The other blocs have done little other than exchange preferences for a few products. The ineffectiveness of most trading blocs among developing countries is traceable to great differences in the economic structure of members, to their having established no agreed schedule of intra-bloc duty reductions, and/or to political disputes and jealousies among members. Originally both CACM and the East African Common Market (EACM), for example, contained much promise for successful regional integration, but as a result of mounting political controversy among members in the late 1960s, each began to disintegrate. Today intra-block trade is smaller than before the formation of EACM. The intra-bloc share of CACM trade has declined since the "soccer war" of 1969 after which Honduras and El Salvador refused to trade with one another. For other members, it is still an effective organization, although the recent upheaval in Nicaragua puts its future in doubt.

Table I (page 6) shows the share of world trade accounted for by each trading bloc in 1976. In the aggregate, these blocs represented more than half of world trade, but excluding the European blocs they accounted for only 11 percent of world trade. Annex tables A-1 show the slow growth of intra-bloc trade in relation to total exports for each trading bloc.

The successful accomplishment of the basic goal of trading blocs, the stimulation of intra-bloc trade through the reduction of tariff levies among members, is perhaps the most significant indication of their effectiveness. Looking at the LDC trading blocs in the aggregate, the relative importance of their intra-bloc exports to their total exports rose from 7 percent in 1965 to 12 percent in 1975. In largest part, however, this increase is accounted for by the importance of petroleum in the intra-bloc trade of the two oil-producing blocs, ASEAN and LAFTA. Omitting these two from the totals, intra-bloc trade as a share of the total remained roughly constant between 1965 and 1975. (The data show an increase from 5 percent to 7 percent. See Notes to Annex III).

The huge increase in petroleum prices and also in certain commodity prices (e.g., groundnuts, timber, nickel, cocoa) between 1965 and 1975 served to increase the values of non-bloc imports and exports and thus to reduce the importance of intra-trade in which the

Table I

Exports of World Trading Blocs as Share
of World Exports, 1976

(\$ million and percent)

BLOC	Bloc Total Exports	Bloc Exports as % of World Exports
OCAM	5,312	1
ANCOM	15,229	2
ASEAN	25,984	3
CARICOM	3,224	.5
CACM	3,012	*
Council of the Entente States	1,970	*
EACM	1,646	*
EEC	328,182	36
EFTA	58,279	6
LAFTA	32,991	4
MAGHREB GROUP	7,383	1
UDEHC	1,889	*
CEAO	2,321	*
Total Trading Blocs	487,422	54
Total World Exports	906,000	

* Less than one-half of 1 percent.

Source: IMF, Direction of Trade

large commodity staples of the LDC's (except for oil) play little role. The ineffectiveness of LDC trading blocs is apparent in the relative level of intra-bloc trade.

In contrast, the intra-bloc trade of the EEC and EFTA has grown both in relation to their combined exports and to total world exports. The combined intra-trade of the European trading blocs rose from 34 percent of combined total exports in 1960 to 41 percent in 1965 to 45 percent in 1975. (It reached a peak of 47 percent in 1973.) In relation to total world exports, the combined intra-trade of the EEC and EFTA rose from 13 percent in 1960 to 20 percent in 1975. In view of the inflationary boost to the value of world trade given by the 1974 quintupling of petroleum prices, this increase in the relative importance of European intra-bloc trade is the more impressive.

Trading blocs, if effective, will generate an increase in production within member countries as a result both of the enlarged market available to producers and the stimulus this will provide to investment. The latter may be the indirect consequence of expanding markets or the direct consequence of bloc industrial cooperation and investment agreements. The record of trading blocs in regard to cyclical and secular output expansion is also mixed. Members of the EEC and EFTA (almost all industrial countries) did not suffer as deep or prolonged a decline in output (GNP) as did the United States during the 1974-1975 recession. The relative stability of Europe in these years is traceable in significant part to their export industries (a much larger fraction of GNP than is true in the U.S. economy). Both total exports and intra-bloc exports of EEC and EFTA continued to grow in 1975 although exports to the United States declined. Also, important in Europe's success in maintaining export markets at that time was the continued increase in the imports of certain rapidly developing LDCs (e.g. Brazil, Singapore, Taiwan) whose growth helped to sustain the intra-trade of the blocs of which some of them are members. The two blocs containing the most rapidly growing LDCs are LAFTA and ASEAN whose intra-trade did not rise as much in 1975 as total imports and whose exports to the world declined. In view of the fact that the EEC and EFTA in 1975 were still benefiting from the trade-diverting effects of the reduction in duties on industrial goods between them, the evidence most probably should not be interpreted as suggesting that membership in a free trade area can help to stabilize cyclical swings in income and production.