

## 5.1: Chapter Introduction

### Global and Regional Economic Cooperation and Integration

#### WHAT'S IN IT FOR ME?

1. What is international economic cooperation among nations?
2. What is regional economic integration?
3. What is the United Nations (UN), and how do the UN and peace impact global trade?

Following World War II, there's been a shift in thinking toward trade. Nations have moved away from thinking that trade was a zero-sum game of either win or lose to a philosophy of increasing trade for the benefit of all. Additionally, coming out of a second global war that destroyed nations, resources, and the balance of peace, nations were eager for a new model that would not only focus on promoting and expanding free trade but would also contribute to world peace by creating international economic, political, and social cooperative agreements and institutions to support them. While this may sound impossible to achieve, international agreements and institutions have succeeded—at a minimum—in creating an ongoing forum for dialogue on trade and related issues. Reducing the barriers to trade and expanding global and regional cooperation have functioned as flatteners in an increasingly flat world. [Section 5.1](#) and [Section 5.2](#) review the specific economic agreements governing global and regional trade—the successes and the challenges. [Section 5.3](#) also looks at the United Nations as a key global institution and its impact on free and fair global trade. To start, the opening case study assesses one of the more important trade pacts of the past fifty years, the European Union (EU). What has been the impact of the 2010 debt crisis in Greece on the EU, its members, and its outlook?

#### Did You Know?

Before the twentieth century, states (nations) usually increased their power by attacking and absorbing others. In 1500, there were about 500 political units in Europe; by 1900 there were just 25—a consolidation brought by (royal) marriage and dynastic expansion but largely through force. Richard Rosecrance, “Bigger Is Better: The Case for a Transatlantic Economic Union,” *Foreign Affairs*, May/June 2010, accessed January 2, 2011, [www.foreignaffairs.com/articles/66225/richard-rosecrance/bigger-is-better](http://www.foreignaffairs.com/articles/66225/richard-rosecrance/bigger-is-better).

#### Opening Case: Making Sense of the Economic Chaos in the European Union



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In Chapter 2, you saw how political and legal factors impacted trade. In this chapter, you'll learn more about how governments seek to cooperate with one another by entering into trade agreements in order to facilitate business.

The European Union (EU) is one such example. The EU started after World War II, initially as a series of trade agreements between six European countries geared to avoid yet another war on European soil. Six decades later, with free-flowing trade and people, a single currency, and regional peace, it's easy to see why so many believed that an economic union made the best sense. However, the EU is facing its first major economic crisis, and many pundits are questioning how the EU will handle this major stress test. Will it survive? To better answer this question, let's look at what really happened during the financial crisis in Europe and in particular in Greece.

At its most basic level, countries want to encourage the growth of their domestic businesses by expanding trade with other countries—primarily by promoting exports and encouraging investment in their nations. Borders that have fewer rules and regulations can help businesses expand easier and more cheaply. While this sounds great in theory, economists as well as businesspeople often ignore the realities of the political and sociocultural factors that impact relationships between countries, businesses, and people.

Critics have long argued that while the EU makes economic sense, it goes against the long-standing political, social, and cultural history, patterns, and differences existing throughout Europe. Not until the 2010 economic crisis in Greece did these differences become so apparent.

What Really Happened in Greece?

What is the European debt crisis? While experts continue to debate the causes of the crisis, it's clear that several European countries had been borrowing beyond their capacity.

Let's look at one such country, Greece, which received a lot of press attention in 2010 and has been considered to have a very severe problem. The financial crisis in the EU, in large part, began in Greece, which had concealed the true levels of its debts. Once the situation in Greece came to light, investors began focusing on the debt levels of other EU countries.

In April 2010, following a series of tax increases and budget cuts, the Greek prime minister officially announced that his country needed an international bailout from the EU and International Monetary Fund (IMF) to deal with its debt crisis.

The crisis began in 2009 when the country faced its first negative economic growth rate since 1993. There was a fast-growing crisis, and the country couldn't make its debt payments. Its debt costs were rising because investors and bankers became wary of lending more money to the country and demanded higher rates. Economic historians have accused the country of covering up just how bad the deficits were with a massive deficit revision of the 2009 budget.

This drastic bailout was necessitated by the country's massive budget deficits, the economy's lack of transparency, and its excess corruption. In Greece, corruption has been so widespread that it's an ingrained part of the culture. Greeks have routinely used the terms *fakelaki*, which means bribes offered in envelopes, and *rousfeti*, which means political favors among friends. Compared with its European member countries, Greece has suffered from high levels of political and economic corruption and low global-business competitiveness.

What's the Impact on Europe and the EU?

In the ashes of Europe's debt crisis, some see the seeds of long-term hope. That's because the threat of bankruptcy is forcing governments to implement reforms that economists argue are necessary to help Europe prosper in a globalized world—but were long viewed politically impossible because of entrenched social attitudes. "Together, Europe's banks have funneled \$2.5 trillion into the five shakiest euro-zone economies: Greece, Ireland, Belgium, Portugal, and Spain." Stefan Theil, "Worse Than Wall Street," *Newsweek*, July 2, 2010, accessed December 28, 2010, [www.newsweek.com/2010/07/02/worse-than-wall-street.html](http://www.newsweek.com/2010/07/02/worse-than-wall-street.html).

So if it's just a handful of European countries, why should the other stronger economies in the EU worry? Well, all of the sixteen member countries that use the euro as their currency now have their economies *interlinked* in a way that other countries don't. Countries that have joined the euro currency have unique challenges when economic times are tough. A one-size-fits-all monetary policy doesn't give the member countries the flexibility needed to stimulate their economies. (Chapter 6 discusses monetary policy in greater detail.) But the impact of one currency for sixteen markets has made countries like Portugal, Spain, and Greece less cost competitive on a global level. In practice, companies in these countries have to pay their wages and costs in euros, which makes their products and services more expensive than goods from cheaper, low-wage countries such as Poland, Turkey, China, and Brazil. Because they share a single common currency, highly indebted EU countries can't just devalue their currency to stimulate exports.

Rigid EU rules don't enable member governments to navigate their country-specific problems, such as deficit spending and public works projects. Of note, a majority of the sixteen countries in the monetary union have completely disregarded the EU's Stability and Growth Pact by running excessive deficits—that is, borrowing or spending more than the country has in its coffers. Reducing deficits and cutting social programs often comes at a high political cost.

As Steven Erlanger noted in the *New York Times*,

The European Union and the 16 nations that use the euro face two crises. One is the immediate problem of too much debt and government spending. Another is the more fundamental divide, roughly north and south, between the more competitive export countries like Germany and France and the uncompetitive, deficit countries that have adopted the high wages and generous social protections of the north without the same economic ethos of strict work habits, innovation, more flexible labor markets and high productivity.

As Europe grapples with its financial crisis, the more competitive, wealthier countries are reluctantly rescuing more profligate economies, including Greece and Ireland, from fiscal and bank woes, while imposing drastic cuts in spending there. Steven Erlanger, "Euro Zone Is Imperiled by North-South Divide," *New York Times*, December 2, 2010, accessed January 2, 2011, [www.nytimes.com/2010/12/03/world/europe/03divide.html?\\_r=1&ref=stevenerlanger](http://www.nytimes.com/2010/12/03/world/europe/03divide.html?_r=1&ref=stevenerlanger).

Early on, EU critics had expressed concern that countries wouldn't want to give up their sovereign right to make economic and political policy. Efforts to create a European constitution and move closer to a political union fell flat in 2005, when Belgium and France rejected the efforts. Critics suggest that a political union is just not culturally feasible. European countries have deep, intertwined histories filled with cultural and ethnic biases, old rivalries, and deep-rooted preferences for their own sovereignty and independence. This first major economic crisis has brought this issue to the forefront.

There were two original arguments against the creation of the EU and euro zone: (1) fiscal independence and sovereignty and (2) centuries-old political, economic, social, and cultural issues, biases, and differences.

Despite these historical challenges, most Europeans felt that the devastation of two world wars were worse. World War I started as a result of the cumulative and somewhat convoluted sequence of political, economic, and military rivalries between European countries and then added in Japan and the United States. World War II started after Germany, intent on expanding its empire throughout Europe, invaded Poland in 1939. All told, these two wars led to almost one hundred million military and civilian deaths, shattered economies, destroyed industries, and severely demoralized and exhausted the global population. European and global leaders were determined that there would never be another world war. This became the early foundations of today's global and regional economic and political alliances, in particular the EU and the United Nations (UN).

Of course, any challenges to the modern-day EU have brought back old rivalries and biases between nations. Strong economies, like Germany, have been criticized for condescending to the challenges in Greece, for example when German commentators used negative Greek stereotypes. Germany was also initially criticized for possibly holding up a bailout of Greece, because it was unpopular with German voters.

European leaders first joined with the IMF in May 2010 and agreed on a \$1 trillion rescue fund for financially troubled countries. Then, Greece announced deep budget cuts, Spain cut employer costs, and France raised its retirement age. France also joined Germany and the United Kingdom in imposing harsh budget cuts. Governments now face a crucial test of political will. Can they implement the reforms they've announced? The short-term response to those moves has been a wave of strikes, riots, and—in Spain, Italy, Ireland, and France—demonstrations.

Yet supporters of the EU argue that the mutual common interests of the EU countries will ensure that reforms are implemented. Memories of the fragility of the continent after the wars still lingers. Plus, more realistically, Europeans know that in order to remain globally competitive, they will be stronger as a union than as individual countries—particularly when going up against such formidable economic giants as the United States and China.

What Does This All Mean for Businesses?

The first and most relevant reminder is that global business and trade are intertwined with the political, economic, and social realities of countries. This understanding has led to an expansion of trade agreements and country blocs, all based on the fundamental premise that peace, stability, and trade are interdependent. Both the public and private sectors have embraced this thinking.

Despite the crises in varying European countries, businesses still see opportunity. UK-based Diageo, the giant global beverage company and maker of Ireland's famous Guinness beer, just opened a new distillery in Roseisle, Scotland, located in the northern part of the United Kingdom.

The new distillery is a symbol of optimism for the industry after the uncertainty of the global economic downturn. The scotch industry had been riding high when the financial crisis hit and the subsequent collapse in demand in 2009 ricocheted through important markets like South Korea, where sales contracted by almost 25 percent. Sales in Spain and Singapore were down 5 percent and 9 percent respectively. There was also evidence of drinkers trading down to cheaper spirits—such as hard-up Russians returning to vodka.

David Gates, global category director for whiskies at Diageo, says emerging markets are leading the recovery: “The places we’re seeing demand pick up quickest are Asia, Latin America and parts of Eastern Europe. Southern Europe is more concerning because Spain and Greece, which are big scotch markets, remain in very difficult economic situations.”...

The renaissance of Scotland's whisky industry has had little to do with Scottish consumption. Drinks groups have concentrated on the emerging middle-class in countries such as Brazil, where sales shot up 44 percent last year.

In Mexico whisky sales were up 25 percent as locals defected from tequila. Zoe Wood, “Diageo Opens the First Major New Whisky Distillery for a Generation,” *Guardian*, October 3, 2010, accessed January 2, 2011, <http://www.guardian.co.uk/business/2010/oct/03/diageo-roseisle-distillery-opens>.

While Europe continues to absorb the impact of the 2008 global recession, there is hope for the future.

It is too soon to write off the EU. It remains the world's largest trading block. At its best, the European project is remarkably liberal: built around a single market of 27 rich and poor countries, its internal borders are far more porous to goods, capital and labour than any comparable trading area....

For free-market liberals, the enlarged union's size and diversity is itself an advantage. By taking in eastern countries with lower labour costs and workers who are far more mobile than their western cousins, the EU in effect brought globalisation within its own

borders. For economic liberals, that flexibility and dynamism offers Europe's best chance of survival. "Staring into the Abyss," *Economist*, July 8, 2010, accessed December 28, 2010, <http://www.economist.com/node/16536898>.

### Understanding the Basics of Why Countries Borrow Money

Governments operate first from tax revenues before resorting to borrowing. Countries like Saudi Arabia, Brunei, or Qatar that have huge tax revenues from oil don't need to borrow. However, countries that don't have these huge tax revenues might need to borrow money. In addition, if tax revenues go down—for example in a recession or because taxes aren't paid or aren't collected properly—then countries might need to borrow.

Countries usually borrow for four main reasons:

1. **Recession.** During a recession, a country may need to borrow money in order to keep its basic public services operating until the economy improves and businesses and workers can resume paying sufficient tax revenues to make borrowing less of a need.
2. **Investment.** A country may borrow money in order to invest in the public sector and build infrastructure, which may be anything related to keeping a society operating, including roads, airports, telecommunications, schools, and hospitals.
3. **War.** A country may borrow in order to fund wars or military expansion.
4. **Politics.** A country may borrow money in order to reduce tax rates either because of political pressure from its citizens and businesses or to stimulate its economy. Usually countries have a much harder time cutting government spending. People don't want to give up a benefit or service or, in the case of a recession, may need the services, such as food stamps or unemployment benefits, thus making it very difficult to cut government programs.

When countries borrow, they increase their debt. When debt levels become too high, investors get concerned that the country may not be able to repay the money. As a result, investors and bankers (in the form of the credit market) may view the debt as higher risk. Then, investors or bankers ask for a higher interest rate or return as compensation for the higher risk. This, in turn, leads to higher borrowing costs for the country.

The national deficit is the amount of borrowing that a country does from either the private sector or other countries. However, the national deficit is different from the current account deficit, which refers to imports being greater than exports.

Even healthy countries run national deficits. For example, in the case of borrowing to invest long term in domestic facilities and programs, the rationale is that a country is investing in its future by improving infrastructure, much like a business would borrow to build a new factory.

### Opening Case Exercises

(AACSB: Ethical Reasoning, Multiculturalism, Reflective Thinking, Analytical Skills)

1. What are two reasons for the creation of the European Union (EU)?
2. What are four reasons a country might have for borrowing money?

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