Worlds major trade blocs currency zones and the amero

As the world integrates through the creation of new intergovernmental agreements, known as trading blocs, every country expects to obtain and economical and financial benefit. This report describes the major trading blocs in the world, such as NAFTA, EU, MERCOSUR, and ASEAN, as well as their positions in the international scenario. It also argues the relationship between trading blocs and currency zones, whereas a trading bloc eventually evolves into a currency zone, or vice versa, a currency zones evolves into a trading bloc. Finally, a section analyzes the possibility of currency integration in North America involving Mexico, United States, and Canada, called the Amero. Such integration might not seem to be as unviable in the future as it might look in the present. However, the global amalgamation of countries might force other regions to form same alliances in order to maintain commercial and financial leadership in the geopolitical environment.

Introduction

From an economic perspective, the rationale behind freer trade rests on the existence of economic gains. Countries liberalize trade because they expect gains for their economies through different mechanisms. Moreover, economic integration is developing around the globe at an unprecedented pace. However, trading with a foreign country does not necessarily mean that it will be beneficial both parties. In effect, not every country might be the perfect trading partner nor not all individuals within an economy automatically become better off with trade liberalization. Thus, countries with cultural similarities, similar economic size, interests, or with geographic closeness form trading blocs.

The history as well as the positive and negative criticism for trading blocs, agreements between states or countries to reduce trade barriers, will be analyzed in this report. Moreover, the major Trading Blocs in the world, North America Free Trade Agreement (NAFTA), European Union (EU), Mercado Comun del Sur (MERCOSUR), and the Association of Southeast Asian Nations (ASEAN) will be explored throughout the paper.

Where a trading bloc exists, the possibility of developing or creating a common currency is present as well. This has been the case of the European Union and others. This report will argue the relationship between trade and currency zones and if a trading bloc should evolve into a currency zone or vice versa, a currency zone transforming into a trading bloc. If we take into consideration the first assumption, a good example to analyze through the report will be the AMERO, an hypothetical single currency for the members of the North America Free Trade Agreement.

A final section of this report will contemplate the Amero, which has been a controversy and a myth since the NAFTA agreement was signed. With the intention to replace the Canadian Dollar, the U. S. Dollar, and the Mexican Peso, the Amero has received positive as well as negative criticism. Both perspectives, in favor and against it, will be examined.

World’s Major Trading Blocs

With the purpose of lowering trade barriers and to stimulate trade between member countries (trading partners), autonomous nations create free trade agreements usually on a regional scale. Member countries belonging to the free trade areas trade freely with each other while maintaining trade barriers and tariffs for non-member countries. Usually, trading blocs are seen as having a positive impact on economic growth, especially for the smaller countries in the agreement. However, others who oppose to free trade agreements argue that trading blocs break the world economy into pieces, creating a multilateral trading environment versus a homogenous arena.

History

As early as of 1834, countries started to give preferential treatment to other countries in terms of trading. However, it was not until the end of World War II that there has been a significant support, especially from the United States (U. S.) to eliminate artificial trade barriers and to impulse a greater liberalization of international trade. The General Agreement on Tariffs and Trade (GATT) was created after WWII and it was made up 23 countries. By 1995 GATT was replaced by the World Trade Organization (WTO) who deals with the global rules of trade between nations. Currently there are 148 member nations as part of the WTO.

However, due to the increasing number of members with their own views and requirements, the round of negotiations for multilateral trade continues to drag on. As a consequence countries interested on increasing trade get around the delays by making their own agreements. These agreements have resulted in some of the major trading blocs in the world, NAFTA, EU, MERCOSUR, and ASEAN.

North America Free Trade Agreement

The diverse culture and perspectives of the countries involve in NAFTA (Canada, United States, and Mexico) make this agreement different from other trade blocs. Canada has a small population of only about 32 million, about 90% of them from European origin and the rest largely Asian, living in a country half the size of South America. On the other side, Mexico has a population of 110 million, 60% of them being an ethnic mixture of Native Americans and Spanish, 10% of European origin and the remainder Native American, living in a land three times the state of Texas.

Even though before the agreement Canada and Mexico’s economic relations were almost none, both countries saw necessary the signing of the agreement by the three countries. At the moment Mexico wanted to get into negotiations with the U. S., Canada already had an agreement with the U. S. Thus in order to avoid the U. S. becoming a “ hub” Canada asked to be included in the negotiations with Mexico and the U. S.

It is hard to identify and quantify what improvements in the economy of the U. S. have been a result of NAFTA. However, after 5 years when NAFTA was implemented, domestic product increased from $7. 1 trillion to $8. 5 trillion, employment increased from 109 million to 127 million, unemployment dropped from 7% to 4%, inflation was low, and the national budget became a surplus. NAFTA’s combined GDP is estimated to be $16. 61 trillion as of 2009, and represent the largest trading bloc in the world even before the European Union. Additionally, an expansion of NAFTA transforming into the Free Trade Agreement for the Americas (FTAA) is expected in the future.

European Union

After decades of friction, including military action, between European powers, countries had to overcome differences and learn how to work together. The first European agreement was the European Coal and Steel Community, designed to avoid Franco-German conflict in the respective coal and steel industries. Later on, Belgium, Italy, Luxembourg, and the Netherlands joined the new consortium. By 1958 the agreement had expanded and became the European Economic Community. After the Atomic Energy Community was created and joined together with the European Community and the Coal and Steel Community, the present form of the structure of the European Union was created.

The economic purpose of the European Community was to eliminate tariff and nontariff barriers between members and make all of its member's territories a single market. Over the years, the European Community has achieved closer union, and in 1987 the Single European Act was created. This act is the most closely integrated and developed supranational organization in the world with more than 20 nation members. The GDP combined of all the members is close to the $16. 24 trillion USD as of 2009.

Mercado Comun del Sur

MERCOSUR was created in the 1980s when Brazil and Argentina signed a number of trade protocols. By 1988, Brazil and Argentina set up a common market between the two countries and in 1991 Paraguay and Uruguay join as full members. Brazil is the biggest nation in MERCOSUR.

MERCOSUR has almost already nearly eliminated tariffs between its members and has reported developments in lifting non-tariff barriers to trade. MERCOSUR's influence in the foreign scenario is greater year by year. Associate members include Bolivia, Ecuador, Chile, Peru y Colombia, while

Venezuela has already signed a contract as full member. Moreover, Israel and Egypt (not being in located in South America) do have status of trading partners. MERCOSUR's combined GDP is close to $2. 5 trillion and it has demonstrated to be more integrated than NAFTA.

Association of Southeast Asian Nations

Created with the purpose of accelerate economic growth, social progress, and maintain stability in the region, ASEAN was created with 15 nation members. English language is used as the official language of the region.

Southeast has enjoyed a without equal and surprising economic growth in the past three decades since the establishment of ASEAN. In 1967, the region's overall trade was worth $10 billion. In 2003, total trade reached $758 billion. The combined GDP of all members is close to $1. 5 trillion.

Disadvantages of Trade Blocs

The use of regional partners might divert the world from multilateral negotiations and create rivalry between trading blocs. Moreover, the exploitation of developing countries by industrialized countries; environmental concerns as production moves to less regulated countries; concerns over fair wages and transfer of jobs from industrialized to developing countries, and political concerns all influence negotiations between partners all around the world.

Advantages of Trade Blocs

The greatest benefits of trade agreements are the increase of imports and export of goods. Since not all countries have the same production skills and capabilities, free trade agreements let countries to focus on produce what they produce best, and be able to acquire goods and services at lower prices. Access to raw materials, education of the workforce, and necessary levels of technological development all have an impact on developing a product or service. By being open for free trade decreases the changes for monopolistic activities.

Currency Zones

The main issue to argue about currency zones is whether a trading bloc should evolve into a currency zone. Since there is no a clear set of guidelines that are internationally agreed upon and enforced for the purpose of regulating exchange rate management, exchange rate policy will always be used as a tool for trade protectionism.

If the real purpose of a trade agreement is to eliminate all trade barriers for free trade, goods and services should be exchanged not only free from tariff, but also from other protectionist maneuvers such as exchange rate manipulation. However, some people argue that in order to keep national sovereignty and to minimize economic costs of dealing with demand and supply shocks (balance of payments), a country should retain autonomy and flexibility of the exchange rate. On the other hand, several countries and regions that do not exert the power to adjust exchange rates have been successful in minimizing the costs of dealing with demand and supply shocks.

Conversely, a manipulation of the exchange rate with the purpose of dealing with demand and supply will have no effect on the balance of payments.

Only a rise in private savings, a cut in private investment, or an increase in the government’s budget surplus will have an effective change or influence in the balance of payments.

On the contrary, policies that allow independent manipulation of the exchange rate tend to shift the cost to other countries, via currency appreciations. These countries with financial discipline and achieved structural productivity advances will have to accept the costs. Unless these countries in the trade zone are willing to accept this unfair sharing of costs, a free trade zone with independent exchange rate policies will not endure.

Once it has been agreed to form a currency zone, the next issue to resolve is what type of currency will best work for the members. Miguel Mancera gives us a broad perspective of the possibilities, ranging from a loose pegging policy to some form of monetary union. However, in order to identify which one is the most viable, the differences in economic size, geographic, or cultural contiguity and on policy objectives between the member nations have to be taken into consideration. Some of these objectives include the following:

Member countries might find in their mutual interest to have a common policy to face major currencies of the rest of the world so as to enforce some degree of seigniorage in international monetary relationships.

Countries may share the common goal of a complete integration of their economies. The case of the European Union.

These countries might aim at counterbalancing their loss of autonomy in macroeconomic policymaking, caused by the presence of an overwhelming economy within the area of partnership.

Countries may pursue a strategy to reduce uncertainty of currency realignments. This uncertainty may affect the maximization of trade opportunities a distort capital movements.

A single currency will eliminate the cost of currency conversions, thus reducing transaction costs, maximizing the potential of trade liberalization to promote trade. In the existence of only one currency and only one monetary policy for the whole trade zone, savings and investments will flow freely across countries depending on productivity and after-tax profitability. As a result, the idea of balance of payments inside the region would lose policy significance.

The North American Currency: Amero

The Amero is the hypothetical substitution of the three currencies existing in the NAFTA region. It is based in the concept of the Euro. However, it is still doubtful whether a monetary integration would be beneficial or detrimental for the North American Trading Bloc. Thus a close analyses of the economic issues is required.

Possible Benefits of Currency Integration in NAFTA

The change into a single currency in North America has the potential of benefiting three nations. Herbert Grubel has divided the range of potential range of benefits into static gains, dynamic gains, and other gains that required discussion. Static gains arise directly out of the elimination of exchange rates, while dynamic gains accompany the process.

Static gains.

Interest rates and exchange risk. Since there will be only a single currency, currency risk, exchange rate fluctuation, risk of debt default, and bond liquidity all will be improved, thus lowering interest rates in Mexico, and probably in Canada as well.

Foreign exchange dealings. Currency integration will reduce the risk and volume of currency exchange, consequently reducing transaction costs.

Price stability. Minimal fluctuations in the price level as a result of low inflation and low disturbances in trade and output. Price stability translates into encouragement for economic growth and efficiency.

Dynamic gains.

Expansion of trade. A study by Anderson and van Wincoop state that international borders reduce trade by about 30% and by 44% between Canada and the U. S. A portion of these costs is derived from the existence of different currencies. Thus currency unification may have the potential to increase trade.

Price structure. A single currency would result in a more efficient price structure throughout the three countries. Different currencies confuse price comparison. By having a single currency, helps to increase trade by reducing confusion and increasing equal prices of goods across the region.

Other gains.

Credibility and stability in monetary policy. When the currencies of different countries convert into one, the inflation rates start to converge. As a result, stability will remain since Canada has low inflation rates, and Mexico recently controlled inflation rates.

Fiscal responsibility. Since the three countries will be bound by a single currency, all members will be more cautious on their decision towards monetary and fiscal policies.

Confidence. Confidence will be felt from the international community towards the countries members of the agreement, increasing investment inflows into the region.

Possible Disadvantages for Single Currency in North America

Optimal currency area criteria: does one size fit all? If a single currency arrangement does not fit one or more of the countries to share one currency and one monetary policy, major economic costs may arise. This question focuses in what should be the correct geographical domain for a single currency or its fixed exchange rate.

Openness and regional interdependence. A flexible exchange rate is most useful to relatively closed economies in keeping external balance and internal price stability. On the other side, very open economies, will be benefited from fixed exchange rates or currency union, with their major trading partner. The action of one country will affect the other partners.

Seigniorage. Seigniorage is the revenue that governments get from issuing currency. In a single currency scenario, all countries will retain a percentage of the revenue.

The lender of last resort. Since the central bank acts as the lender of last resort, every central bank will disappear, but only one central bank will serve as the lender of last resort for all of the three countries.

In conclusion, it seems technically possible for Canada, U. S. and Mexico to adopt a single currency policy. Nevertheless, the economic gains are still hard to identify and quantify. The costs for adopting this strategy will be high, at least in the near future. In addition, the U. S. dollar exchange rate still plays a very important role in the international arena. And, in regards to the economic performance for the past decade, all countries members of NAFTA have shown a significant growth rate without the need of having monetary integration, yet.

Conclusion

In conclusion, there exists empirical evidence that suggests that liberalization of trade has lead to economic progress in almost all countries of the globe. The different trade agreements catalyze economic growth and maintain social stability in the regions. However, there exist disadvantages, but these are outweighed by the advantages.

Nonetheless, once a trading bloc has gotten to a high level of integration, a single currency might be the next development in order to improve trade relations and integration. While eliminating conversion and transaction costs, the promotion of trade maximizes. In the existence of only one currency and only one monetary policy for the whole trade zone, savings and investments will flow freely across countries depending on productivity and after-tax profitability. As a result, the idea of balance of payments inside the region would lose influence over monetary and fiscal policies.

Finally, as a hypothesis, the Amero appears to be a potential substitute for the dollar, and the peso. But, the profits or advantages of this change are still blurry, and unpredictable. The U. S. dollar still enjoys a leading position, although its influence is declining in some regions of the world. An adoption of the Amero might be a correct choice in the near future, but a sense of integration between the three countries would be necessary to come first.