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Evenett



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Introduction to the Special Issue

Antoni Estevadeordal * Simon J. Evenett†

*Inter-American Development Bank, antonie@iadb.org

†Said Business School, Oxford University, sevenett@mindspring.com

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Introduction to the Special Issue

Antoni Estevadeordal¹ and Simon J. Evenett²

This special issue of *Business and Politics* is devoted to examining the factors that account for the current strength of trans-pacific commercial linkages. To sharpen the hypotheses presented in the five papers published here, the authors were asked to consider the effects of the creation of a Free Trade Area of the Americas (FTAA) on the nature and strength of those linkages. A related goal, therefore, was to gauge the effects of implementing an FTAA on the decision-making of managers of multinational corporations (MNCs) that are based in East Asia; the latter being one important set of “third parties” to regional integration in the Americas. More generally, the papers in this special issue can be seen as contributing to the literature on third party effects of preferential trade liberalization, which has experienced a resurgence in recent years.

Recognizing the fact that regional integration and its effects on business decision-making can be seen through the lens of a number of academic disciplines, the papers published here were written by scholars of political science, comparative political economy, international trade, industrial organization, and international business management. As will become evident to readers these scholars also have considerable knowledge of Latin America and East Asia. Moreover, the different levels at which their analyses are conducted (namely, regional, national, and sectoral) highlight the relative strengths of the different mechanisms at work.

Witold Henisz examines the various historical, linguistic, institutional, economic, and political factors in Latin America that account for the present extent of business linkages with East Asia. In doing so, Henisz formulates five distinct hypotheses concerning the likelihood of an FTAA being implemented in Latin America and on the potential for any subsequent policy reversals. He foresees considerable problems in both respects which forward-looking managers of East Asian MNCs are likely to take into account when determining their investment and operational decisions in Latin America. While recognizing the diversity of national experience in Latin America, Henisz’s sobering analysis points to the ramifications of the current backlash against free market reforms for the viability and sustainability of new initiatives to integrate the Americas.

James Markusen examines the effects of implementing a FTAA on the means by which East Asian multinational corporations supply markets in North and Latin

¹ Principal Trade Economist, Integration and Regional Programs Department, Inter-American Development Bank. Email address: antonie@iadb.org. ² University Lecturer in International Business, Said Business School, Oxford University and nonresident Senior Fellow, Brookings Institution. Email address: sevenett@mindspring.com
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America. His analysis draws on recent developments in the theory of MNCs by international trade economists. These theories give pride of place to barriers to international trade in final and intermediate goods, to firm-level economies of scale, and to an MNC's production location decisions. Two of the three effects of forming a FTAA that Markusen identifies are beneficial to East Asian MNCs. He shows that the terms upon which the American affiliates of East Asian MNCs can import intermediate goods (such as parts and components) from their home countries plays an important role in determining whether such affiliates benefit *on net* from the creation of a FTAA. Markusen notes that this factor may encourage East Asian nations with substantial commercial interests in Latin America to seek preferential trade agreements with the latter nations. Another implication of Markusen's analysis (which is not mentioned in his paper) is that East Asian MNCs will have a strong incentive to make any further investments in Latin America conditional on obtaining duty-free access for their imports of intermediate goods. The latter is not an atypical demand of foreign investors to potential host governments.

Yasheng Huang, Randall Morck, and Bernard Yeung consider the extent to which the creation of a FTAA represents a threat to the flow of foreign direct investment (FDI) to the Association of South East Asian Nations (ASEAN) countries and, therefore, to their long-term economic performance. They note that such a threat comes on top of growing competition for FDI engendered by China's rise and the after effects of the 1997-8 financial crisis; both of which, they contend, reveal considerable institutional weaknesses in all but one of the economies of South East Asia (the exception being Singapore.) By institutional weaknesses they are referring to a history of state activism, poor property rights protection, and underdeveloped corporate governance, all of which retard the development of local entrepreneurship. In such an institutional milieu inward FDI is said to substitute for domestic business initiative rather than acting as a long-term means to nurture it. Huang, Morck, and Yeung argued that a FTAA would cast the institutional deficiencies of South East Asia in a relatively worse light, resulting in less FDI going to the ASEAN nations. Although these authors recommend that the ASEAN nations respond by remedying their institutional deficiencies, they expect that entrenched domestic business interests in the ASEAN nations (especially politically-connected local entrepreneurs) will frustrate reforms that would spur the entry of new domestic rivals. Instead, it is argued, ASEAN nations are more likely to seek to integrate their markets with larger North East Asian economies, such as China. The latter response is likely to stem some of the loss of FDI to the Americas.

In the first of two papers undertaking sectoral analyses, Claudio Frischtak examines the ways by which MNCs in the automobile, electronics, and apparel industries responded to the creation of the North American Free Trade Agreement (NAFTA) and to the implementation of the Common Market of the South (MERCOSUR). He then examines the consequences for MNCs operations in these industries of the rise of China and other fast-growing East Asian economies as well as exploring the potential effects of the formation of a FTAA. Frischtak shows that in all three industries the relocation of MNC activities within North America was an important consequence of NAFTA's formation. In contrast, such relocation only occurred in the automobile industry in the aftermath of the creation of MERCOSUR. Turning to the formation of a FTAA, Frischtak argues that even though the rise of China with its substantial pool of cheap and educated labor will continue to encourage the relocation of production of electronics and apparel from the Americas, the pace of such relocation will be moderated. Frischtak's analysis is an important reminder that an increasing number of MNCs have adopted a global perspective when deciding on the type and location of their commercial operations and, therefore, that developments in any

one region are significant in so far as they affect the relative profitability of operating in different locales.

Lourdes Casanova examines three of the rationales for MNCs operating in Latin America and the factors which together account for the success of otherwise of those operations. Drawing on the experience of a number of leading international companies, including Sony, Telefónica, and the China National Petroleum Corporation, Casanova argues that the degree of geographical proximity and the sharing of a common language or history between a MNC's home country and a host economy are important determinants of corporate performance in Latin America. In addition, Casanova provides five recommendations to managers of Asian MNCs that have established (or are considering setting up) operations in Latin America. One of those recommendations relates to the opportunities created by the potential formation of a FTAA, although the latter is seen as just one of the important elements of the commercial landscape in Latin America.

These papers and two others were commissioned by the Inter-American Development Bank (IADB) as part of a project titled Trans-Pacific Business Links and Integrating Markets in the Americas (FTAA): Economics, Politics, and Business. This project was generously funded by the Japan Program at the IADB. In addition to being refereed by this journal, the papers were presented and critiqued at a multi-disciplinary conference in Tokyo, Japan, on 9-10 December 2003. We would like to thank the conference discussants, the Editor and referees of this Journal for their comments, advice and guidance in the revision of these papers for publication. Also, our thanks to Nohra Rey de Marulanda, Toshio Kobayashi, Robert Devlin, Fausto Medina Lopez, Kaname Okada, Veronica

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