

Section 6: Trading blocs, WTO and EU

Customs union
EMU- economic monetary union
-If trade creation > trade diversion then customs union increases welfare

Trade creation (+ve)
-Movement from a high cost domestic producer to a low cost producer within the customs union
-Trade is created with all members of the union when it is joined

Trade diversion (-ve)
-Movement from a low cost non-member to a high cost member of union

Disadvantages of customs unions
-members have to negotiate collectively as a union and cannot have individual trade deals
-Difficult to allocate tariff revenue
-Lots of negotiations take place before common tariff levels are set

Why WTO is against protectionism policies
-Free trade enables gain of comp ad
-Tariff may enable inefficient industry to hide from competition= bad for productivity
-Specialization enables gains from EOS
-Protectionism may spur ongoing retaliation

Roles of WTO
-Resolve trade disputes (e.g. dumping)
-Enforces rules on international trade
-Helps trade be as free as possible
-help developing countries benefit from trade
-Provides forum for negotiating

WTO and trading blocs impact on developing countries
-Trading blocs limit free trade if there is too much trade diversion
-CAP uses subsidies on goods protecting domestic workers, harming farmers outside EU who cannot compete with low price
-Prevents developing economies from diversifying away from agriculture as they can't compete

Advantages
-Can trade freely (regionalization of trade) where there is an increase in intensity of trade between countries within the same region
-Increased EOS and price competition = lower prices
-Migration brings skilled workers/ low cost labour
-Freedom to work and live in any member country
-Increase EG as workers migrate to the UK and greater FDI investment acting as injection into the economy

Disadvantages
-Compliance with laws/ product standards and reg adds costs to business costs
-Risk of unemployment if firms cannot compete with member states
-Cannot restrict migration for EU

Economic effects of UK leaving EU
-Less free trade with the EU so less imports/exports (when UK leaves they may not be able to negotiate deals with all the 27 countries leading to negative impacts such as trade diversion)
-Lower inward investment as EU firms return to within EU border as they find it less attractive to invest in UK
-Less flexible labour market so difficult for UK nationals to work in EU
-Brexit has resulted in devaluation of pound= cost-push inflation= lower standards of living

-Lower external tariffs on non-member nations so can negotiate better trade deals with other nations that are not in the EU
-UK can pursue its own agricultural policy not the inefficient EU one
-Less strict regulation to follow (EU has strict regulations)

Changes in pattern of trade
-UK used to have comp ad in manufacturing and most trade took place between developed and developing countries
-Now developed countries have comp ad in tech advanced, capital intensive products while developing countries have comp ad in low value, labour intensive products
-China and India are important global traders (China is world largest exporter)
-China exports electronic equipment and machinery
-India exports fuels, materials, glass

UK trade patterns
-Fall in exports due to competition from newly industrialized economies like China
-Rise in imports due to goods being cheaper abroad
-Exports: cars, pharmaceuticals (to Germany US and EU)
-Imports: vehicles, pharmaceuticals, manufactured goods, F and B (from Germany, China and EU)

Types of trading blocs
-Achieves WTO objectives: leads to trade creation
-Conflicts with WTO objective: lead to trade diversion

Free trade areas

Where barriers of trade are removed

Customs unions

Free trade areas are areas where standard tariffs are imposed on non-members

Common markets (single markets)

A customs union with the addition of free movement of FoP between members (e.g. Single European Markets SEM)

Pros of SEM
-Trade creation
-Exploitation of EOS= lower prices
-Common product standards
-Tech transfer between members= increase capital mobility
-Transfer of skills due to increased labour mobility
-Increased remittance flow

Cons of SEM
-Trade diversion occurs crowding out more efficient non-members
-Migrant labour drives down wages
-Negative externalities like pressure on infra + healthcare+ schools
-Trade rules favor some members and sectors over others
-Lost opportunities to exploit trade relationships through free trade deals

Economic unions

-Trading blocs more integrated + cities adopt similar policies and regulations

Monetary unions (Euro)

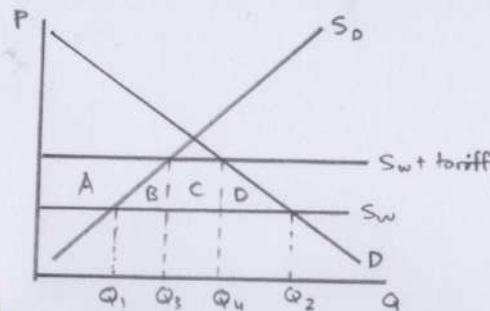
same central bank, member have single currency, common monetary policy, these union are usually within an economic union as well

Economic integration- where countries coordinate to reduce trade barriers and harmonize fiscal and monetary policy

Advantages
-(SR impact) Trade creation as tariffs are removed so consumers switch to low cost products= low price= lower CS
-(LR impact) More trade= more efficiency due to greater comp, specialization and EOS
-Non-members gain from cheaper exports from the trading bloc

Disadvantages
-PS and govt rev reduce as tariffs are removed
-(SR impact) Trade diversion where trade barriers imposed on more efficient non-members= decrease efficiency

Trade creation graph



Winners

- Gain in consumer surplus (of ABCD) due to price reduction
- By joining increase in welfare to BD
- Helps most efficient firms in the union as tariff no longer provide artificial protection to inefficient firms

Losers

- Loss in PS of A due to price reduction

- When UK joins EU there is a common external tariff put on Thailand goods
- Thailand has the comparative advantage in this case
- This makes the more efficient non-member's (Thailand) products look less competitive
- UK supply increases to Q₂
- UK demand contracts to Q₄
- Now excess demand of Q₄-Q₂ is satisfied by imports from EU NOT Thailand anymore as trade has been diverted away from Thailand

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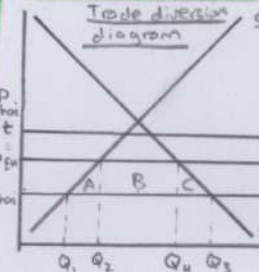
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A = loss of domestic efficiency
B = loss of EU efficiency
C = pwl of CS

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