

# What Are the Benefits of the Single Market?

- + Increased competition
  - Lower prices
  - Wider choice of products and services
  - More jobs

- + Easier travel

- + More opportunities to live, work and study in other EU countries



## ■ The Theory of Economic Integration



The Theory refers to the commercial policy of discriminatively reducing or eliminating trade barriers only among the nations joining together. It includes the preferential trade arrangements to free trade areas, customs unions, common markets, and economic unions.

- **Preferential trade agreements**

They provide lower barriers on trade among participating nations than on trade with non-member nations. It is the loosest form of economic integration. Such as *British Commonwealth Preference Scheme* established in 1932.

## ■ The Theory of Economic Integration



- **A Free Trade Area**

**It is the form of economic integration wherein all barriers are removed on trade among members, but each nation retains its own barriers to trade with non-members.**

**Such as *European Free Trade Association (EFTA)* formed in 1960 (U.K, Austria, Denmark, Norway, Portugal, Sweden, and Switzerland); *North American Free Trade Agreement (NAFTA)* formed in 1993 ( U.S., Canada, Mexico); *Southern Common Market (Mercosur)* formed in 1991 ( Argentina, Brazil, Paraguay and Uruguay)**

## ■ The Theory of Economic Integration



- **A Customs Union**

It allows no tariffs or other barriers on trade among members, and in addition it harmonizes trade policies toward the rest of the world.

Such as *European Union (EU)* or *European Common Market* formed in 1957 (West Germany, France, Italy, Belgium, Netherlands and Luxembourg)

- **A Common Market**

It goes beyond a customs union by allowing the free movement of labor and capital among member nations.

Such as EU in 1993

---

## ■ The Theory of Economic Integration



- **An Economic Union**

It goes further by harmonizing or even unifying the monetary and fiscal policies of member states. It is the most advanced type of economic integration. Such as EU.

- **Recent Tendency—Duty-Free Zones or Free Economic Zones**

These zones are areas set up to attract foreign investment by allowing raw materials and intermediate products duty-free.

## ■ Trade Creation



Take the customs union as the example to analyze the effects of the economic integration. It has two kinds of effects: trade creation and trade diversion.

### 1. Trade Creation

It occurs when some domestic production in a nation that is a member of the customs union is replaced by lower-cost imports from another member nation (assuming that all economic resources are fully employed before and after formation of the customs union);

It increases the welfare of member nations because it leads to greater specialization in production based on comparative advantage.

---

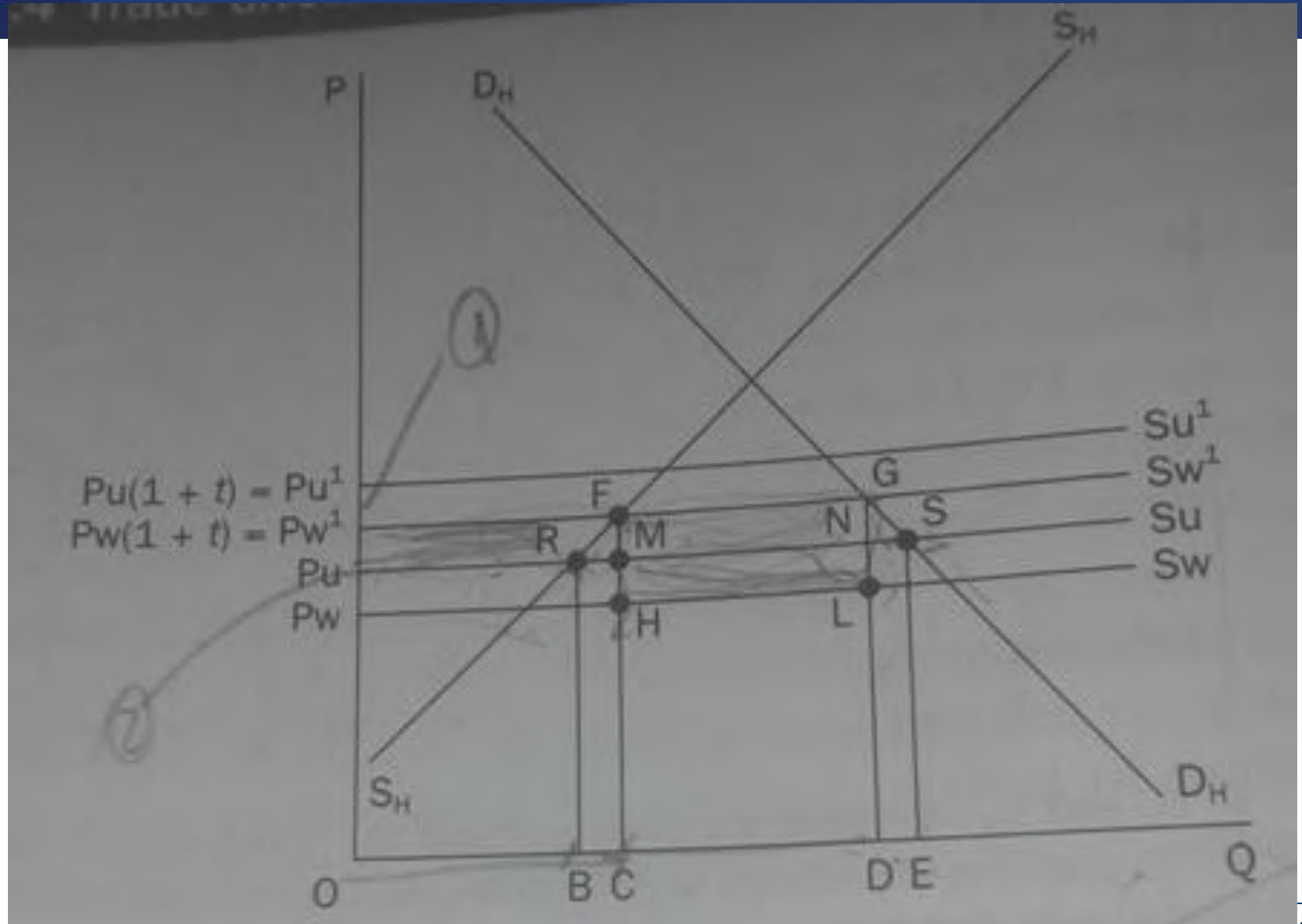
## ■ Trade Diversion



- **Trade Diversion**
  - ◆ It occurs when lower-cost imports from outside the customs union are replaced by higher cost imports from a union member
- **Trade Diversion and Welfare**
  - ◆ Trade diversion reduces welfare because it shifts production from more efficient producers outside the customs union to less efficient producers inside the union
- **Trade Diversion and Resource Allocation**
  - ◆ Trade diversion worsens the international allocation of resources and shifts production away from comparative advantage



# Trade diversion



# ■ Illustration of a Trade-Creating Customs Union



- **Explanation of Figure 1**
- ◆ **With Tariff, the nation's production surplus increases while the consumer surplus decreases, the deadweight loss is the total of protection effect and consumption effect. And it reduces the national welfare;**
- ◆ **The formation of a customs union, no tariff, it can increase the national welfare, it is the total of protection effect and consumption effect.**

# ■ Illustration of a Trade-Creating Customs Union



- **Theory of A Customs Union**
- ◆ **Viner, who pioneered the development of the theory of customs unions in 1950, concentrated on the production effect of trade creation and ignored the consumption effect;**
- ◆ **Meade extended the theory of customs unions in 1955 and was the first consider the consumption effect;**
- ◆ **Johnson added the two triangles to obtain the total welfare gain of a customs union.**

## ■ Conclusion



- **A trade-creating customs union can increase the national welfare—the trade creation: production welfare and consumption welfare from the comparative advantages**
- **A trade-creating customs union also increases the welfare of non-members because some of the increase in its real income spills over into increased imports from the rest of world**

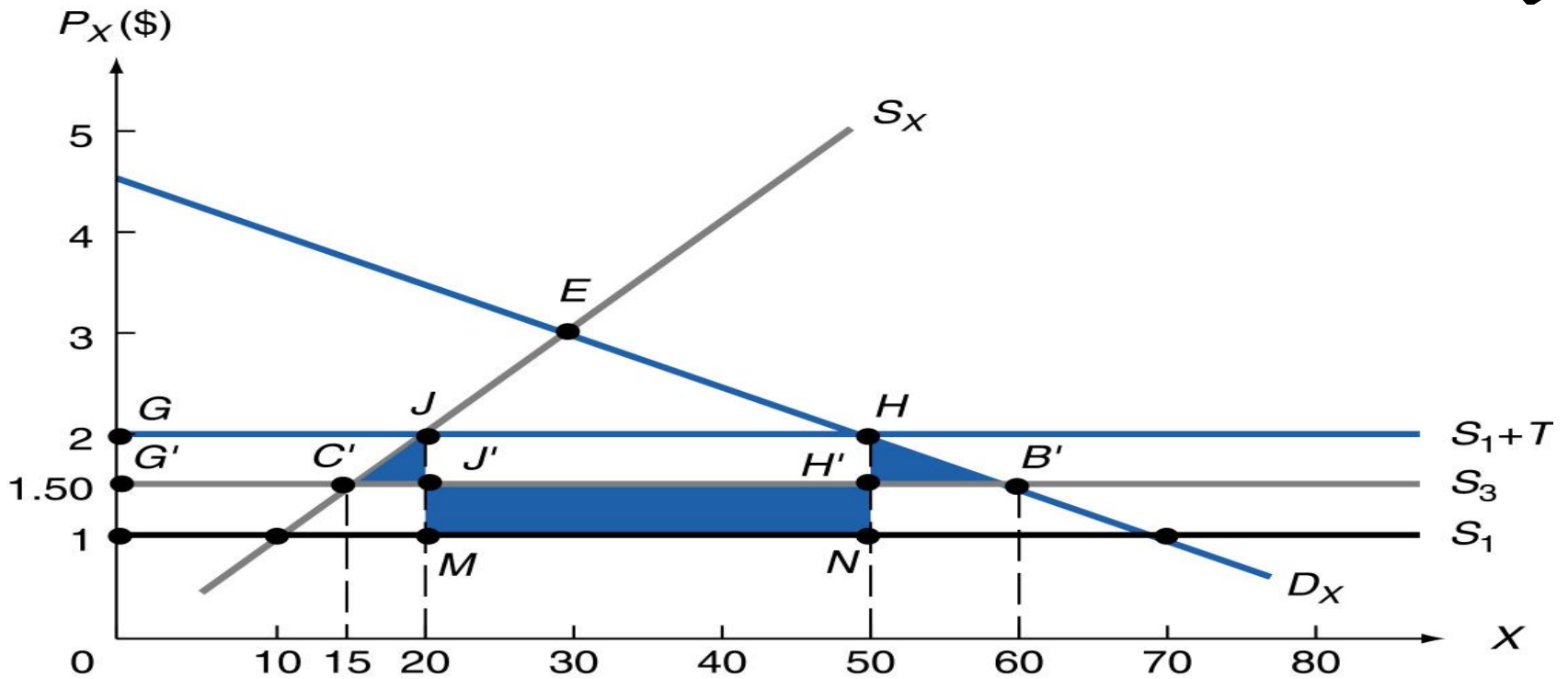


- **The Effects of a Trade-diverting Customs Union**
- ◆ **In the end, a trade-diverting customs union results in *both trade creation and trade diversion***
- **Conclusion**
- ◆ **Whether a trade-diverting customs union can increase or reduce the welfare of union members, depending on the relative strength of these two opposing forces**
- ◆ **While the non-members can be expected to decline because their economic resources can only be utilized less efficiently than before trade was diverted away from them**

# ■ Illustration of a Trade-Diverting Customs Union



• **Figure 2**



**FIGURE 2** A Trade-Diverting Customs Union.

## ■ Conclusion



- **A trade-creating customs union leads only to trade creation and un-equivocably increases the welfare of members and non-members**
- **A trade-diverting customs union leads to both trade creation and trade diversion, and can increase or reduce the welfare of members (and will reduce the welfare of the rest of the world)**

## ■ Conditions More Likely to Lead to Increased Welfare



- **Conditions**
- ◆ **The higher of the pre-union trade barriers of member countries, it is more probable that the greater trade creation rather than trade diversion**
- ◆ **The lower of the customs union's barriers on trade with the rest of world, the less likely to costly trade diversion**
- ◆ **The more competitive rather than complementary are the economies of member nations, the greater opportunities for specialization in production and trade creation**
- ◆ **The closer geographically are the members of the customs union, less transportation costs barriers to trade creation among members**
- ◆ **The greater of pre-union trade economic relationship , the greater opportunities for significant gains**

## ■ Other Static Welfare Effects of Customs Unions



- **Administrative Savings**

It means the elimination of customs officials, border patrols.

- **The Improvement in Collective Terms of Trade**

- **Much More Bargaining Power**

Several countries act as a single unit in international trade negotiations. It is more powerful than a single country

---

# Dynamic Benefits from



- **Increased Competition**
- **Economies of Scale**
- **Stimulus to Investment**
- **Better Utilization of Economic Resources**

## ■ Increased Competition



- **In the absence of a customs union**  
Producers are likely (especially those in monopolistic and oligopolistic market ) to sluggish and complacent behind trade barriers
- **With the customs union**
  - ◆ Producers in each nation must become more efficient to meet the competition of other producers within the union, merge, or go out of business, reducing the cost of production to the benefit of consumers
  - ◆ The increased level of competition is also likely to stimulate the development and utilization of new technology, reducing the cost of production to the benefit of consumers



- **The Enlarged Market**

The formation of a customs union leads to the enlarged market . It is likely to benefit from the economies of scale.

Such as EU, before the formation of the customs union, some of several small countries have obtained the economies of scale through the scale production for domestic consumption and exports, after the formation EU achieved significant economies of scale.

## ■ Stimulus to Investment



- **The stimulus to investment to take the advantage of the enlarged market and to meet the increased competition**
- **The formation is likely to spur outsiders to set up production facilities within the customs union to avoid trade barriers imposed on non-union products (*called as tariff factories*)**
- **Examples for U.S. Investment in EU after 1955 and after 1986**

# History of Attempts at Economic Integration



- **The European Union**
- **The European Free Trade Association**
- **U.S. Free Trade Agreements and the North American Free Trade**
- **Attempts at Economic Integration among Developing Countries**
- **Economic Integration in Central and Eastern Europe and in the Former Soviet Republics**

## ■ The European Union ( European Community)



### ◆ Economic Community

***Single European Act (86)* provided for the removal of all remaining barriers to the free flow of goods, services, and resources among members (by 1992) and, in fact, became a single unified market at the beginning of 1993.**



- **Main Provisions**

- ◆ **Common Commercial Policy**

the EU constitute one single market with a Common Commercial Policy which includes the uniform EU-wide application of [Trade Policy Instruments](#) (dispute settlement, trade barriers regulation, anti-dumping, anti-subsidy, safeguard, injurious pricing instrument, trade defense instruments-enlargement, trade defense instruments-small & medium-sized enterprises (SMEs), monitoring of third country commercial defense actions) with a **Common value-added tax system**;

.



## ◆ **Common Agricultural Policy (CAP)**

It was formed in 1968. EU determines common farm prices, and then it imposes tariffs so as always to make the imported agricultural products equal to the high established EU prices. There are two measures to reach the purpose.

1. **Variable Import levies**
2. **Deficiency Payments**

Negative effect: huge agricultural surplus, high storage costs and subsidized exports

## ■ The European Free Trade Association



- **EFTA**
- ◆ It was formed in 1960 by UK, Austria, Denmark, Norway, Portugal, Sweden, and Switzerland, Finland becoming an associate member in 1961(full member in 1986). EFTA achieved free trade in industrial goods in 1967, but only a few special provisions were made to reduce barriers on trade in agricultural products
- ◆ On January 1, 1994, the EFTA joined the EU to form the European Economic Areas (EEA)



## ■ U.S. Free Trade Agreements and the North American Free Trade



- **In September 1985, US negotiated a free trade agreement with Israel. It was the first bilateral trade agreement signed by US**
- **In 1988 a free trade reached with Canada**
- **In 1993, North American Free trade Agreement (NAFTA) agreed among US, Canada and Mexico, which took effect on January 1, 1994**

## ■ Attempts at Economic Integration among Developing Countries



- **Economic Integration in Developing Countries**
  - ◆ **Central American Common Market**
  - ◆ **Latin American Free Trade Association**
  - ◆ **Southern Common Market ( Mercosur)**
  - ◆ **Free Trade Area of Americas (FTAA)**
  - ◆ **Caribbean Free Trade Association**
  - ◆ **East African Economic Community**
  - ◆ **West African Economic Community**
  - ◆ **19-member Preferential Trade Area of Eastern and Southern Africa**
  - ◆ **Association of Southeast Asian Nations (ASEAN)**



## ■ Economic Integration in Central and Eastern Europe and in the Former Soviet Republics



- **Council of Mutual Economic Assistance (CMEA or COMECON)**

It was formed in 1949 in Soviet Union with the communist bloc nations in eastern Europe (Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, and Romania) plus Mongolia (Cuba, North Korea, and Vietnam jointed later).

- **Main Purpose**

It was to divert trade from Western nations and achieve a greater degree of self-sufficiency among communist nations

---

# ■ Economic Integration in Central and Eastern Europe and in the Former Soviet Republics



- **Commercial Policy**

- ◆ Among the member countries, the state decided and controlled all International transactions through a number of state trading companies
- ◆ Trade among the member countries conducted on the basis of bilateral agreements (**barter trade and counter trade in which one good was exchanged for another**) and bulk purchasing (**the agreement of a state trading company to purchase a specified quantity of a commodity of a year or for number of years from a state trading company of another nation** )

- **The End of CMEA**

After the end of 1989, it collapsed all over due to the political changes