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Subject: INTERNATIONAL TRADE AND AGREEMENTS
Topic: Week 8: Regional Trade Agreements
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Introduction:

Regional trading agreements refer to a treaty that is signed by two or more countries to encourage the free movement of goods and services across the borders of its members. The agreement comes with internal rules that member countries follow among themselves. When dealing with non-member countries, there are external rules in place that the members adhere to.

Regional trade agreements (RTAs) can be a useful tool in promoting growth.1 RTAs structure trade in a way that can increase domestic productive capacity, promote upward harmonization of standards, improve institutions, introduce technical know-how into the domestic market and increase preferential access to desirable markets. These are outcomes that could benefit developing economies in general and particularly the least developed countries (LDCs) and other low-income countries. However, most studies of regional integration agreements show that, on average, low-income countries benefit less (see for example Ariyasajjakorn et al., 2009; Feenstra, 1996).

Despite the relatively low benefits for LDCs, every country in the LDC category is a member of at least one RTA. The agreements range from partial scope agreements to economic integration agreements targeting political union. Most RTAs involving LDCs are South–South agreements (figure 1), which are generally poorly implemented and not known to be particularly beneficial for the industrialization of partner countries. There is also an increasing, albeit small, number of agreements in which LDCs are part of North–South agreements (for example the European Union-Caribbean Forum (CARIFORUM) Economic Partnership Agreement). The expected impact of LDC participation in North–South agreements is larger, but few studies have sought to quantify the impact.

Benefits of Regional Trading Agreements

1. **Boost Economic Growth**
   Member countries benefit from trade agreements, particularly in the form of generation of more job opportunities, lower unemployment rates, and market expansions. Also, since trade agreements usually come with investment guarantees, investors who want to invest in developing countries are protected against political risk.

2. **Volume of Trade**
   Businesses in member countries enjoy greater incentives to trade in new markets, thanks to attractive trading conditions due to the policies included in the agreements.

3. **Quality and Variety of Good**
   Trade agreements open a lot of doors for businesses. As they gain access to new markets, the competition becomes more intense. The increased competition compels businesses to produce higher-quality products. It also leads to more variety for consumers. When there is a wide variety of high-quality products, businesses can improve customer satisfaction.

Types of Regional Trade Agreements: FTAs, Customs Unions, Common Markets, Economic Unions

1. **Free Trade Agreements**

A free trade agreement is an agreement between two or more nations to reduce barriers to imports and exports among them. Under a free trade policy, goods and services can be bought and sold across international borders with little or no government tariffs, quotas, subsidies, or prohibitions to inhibit their exchange.

How a Free Trade Agreement (FTA) Works?

In the modern world, free trade policy is often implemented by means of a formal and mutual agreement of the nations involved. However, a free-trade policy may simply be the absence of any trade restrictions.

A government doesn't need to take specific action to promote free trade. This hands-off stance is referred to as “laissez-faire trade” or trade liberalization.

Laissez-faire is an economic theory dating back to the 18th century that opposes any government intervention in business affairs. The driving principle behind laissez-faire economics is that the less the government is involved in the economy, the better off business, and society as a whole, will be.

Governments with free-trade policies or agreements in place do not necessarily abandon all control of imports and exports or eliminate all protectionist policies. In modern international trade, few free trade agreements (FTAs) result in completely free trade.

For example, a nation might allow free trade with another nation, with exceptions that forbid the import of specific drugs not approved by its regulators, animals that have not been vaccinated, or processed foods that do not meet its standards.

It might also have policies in place that exempt specific products from tariff-free status in order to protect home producers from foreign competition in their industries.

Free Trade Pros and Cons

Pros

- Allows consumers to access the cheapest goods on the world market.
- Allows countries with relatively cheap labor or resources to benefit from foreign exports.
- Under Ricardo's theory, countries can produce more goods collectively by trading on their respective advantages.

Cons

- Competition with foreign exports may cause local unemployment and business failures.
- Industries may relocate to jurisdictions with lax regulations, causing environmental damage or abusive labor practices.
- Countries may become reliant on the global market for key goods, leaving them at a strategic disadvantage in times of crisis.

2. Customs Union

A customs union is an agreement between two or more neighboring countries to remove trade barriers, reduce or abolish customs duty, and eliminate quotas. Such unions were defined by the General Agreement on Tariffs and Trade (GATT) and are the third stage of economic integration.

Unlike in free trade agreements, a common external tariff is imposed on non-members of the union. When countries outside the union trade with countries in the customs union, they need to make a single payment (duty fee) for the goods that have crossed the border. Once inside the union, they can trade freely with no added tariffs.

Purpose of Customs Unions

The purpose of a customs union is to make it easier for member countries to trade freely with each other. The union reduces the administrative and financial burden of barrier trading and fosters economic cooperation among nations. However, member countries are not given the freedom to form their own trade deals. The countries in the customs union usually restructure their domestic economy and economic policies in order to maximize their gain from membership in the union. The European Union is the largest customs union in the world in terms of the economic output of its members. A customs union generates trade creation and diversion that helps with economic integration. Below are the advantages and disadvantages of customs unions.

Advantages of Custom Unions

- **Increase in trade flows and economic integration**

  The main effect of a free-trade agreement is that it increases trade between member countries. It helps improve the allocation of scarce resources that satisfy the wants and needs of consumers and boosts foreign direct investment (FDI). Customs unions lead to better economic integration and political cooperation between nations and the creation of a common market, monetary union, and fiscal union.

- **Trade creation and trade diversion**

  The effectiveness of a customs union is measured in terms of trade creation and trade diversion. Trade creation occurs when the more efficient members of the union sell to less efficient members, leading to a better allocation of resources. Trade diversion occurs when efficient non-member countries sell fewer goods to member countries because of external tariffs. It gives less efficient countries in the union the opportunity to capitalize on their position and sell more goods within the union. If the gains from trade creation exceed the losses from trade diversion, that leads to increased economic welfare among member countries.

- **Reduces trade deflection**

  One of the main reasons a customs union is favored over a free trade agreement is because the former solves the problem of trade deflection. This occurs when a non-member country sells its goods to a low-tariff FTA (free trade agreement) country, which then resells to a high-tariff FTA country, leading to trade distortions. The presence of a common external tariff in customs unions helps avoid problems that arise from tariff differentials.

Disadvantages of Customs Unions

Along with the advantages, customs unions also come with a few drawbacks:

- **Loss of economic sovereignty**

  Members of a customs union are required to negotiate with non-member countries and organizations such as the WTO. This is necessary to maintain a customs union; however, it also means that individual member countries are not free to negotiate their own deals. If a country wants to protect an infant industry in its market, it is unable to do so by imposing tariffs or other protective barriers due to the liberal trading policies. Similarly, if a country wants to liberalize its trade outside the union, it is unable to do this due to the common external tariff.

- **Distribution of tariff revenues**

  Some countries in the union do not receive a fair share of tariff revenues. This is common among countries like the UK that trade relatively more with countries outside the union. Around 20%-25% of the tariff revenue is retained by the member who collects the revenue. It is estimated that the cost of collecting this revenue exceeds the actual revenue collected.

- **Complexity of setting the tariff rate**

  A common problem faced by customs unions is the complexity of setting the applicable tariff rate. The process is very costly and time-consuming. Member countries often find it hard to forgo the trade of certain goods or services because another country in the union is producing it more efficiently.

3. **Common Market**

A common market is a formal agreement where a group is formed amongst several countries that adopt a common external tariff. In a common market, countries also allow free trade and free movement of labor and capital among the members of the group. The trade arrangement is aimed at providing improved economic benefits to all the members of the common market.

The most famous example of a common market is the European Common Market, which aims to provide the free movement of goods, capital, services, and labor within the European Union.

Conditions Required to be Defined as a Common Market

To be defined as a common market, the following conditions must be satisfied:

1. Tariffs, quotas, and all barriers regarding importing and exporting goods and services among members of the common market are eliminated.
2. Common trade restrictions such as tariffs on countries outside the group are adopted by all members.
3. Production factors such as labor and capital are able to move freely without restriction among member countries.

If one of the conditions is not satisfied, the resulting market is not a common market. For example, if production factors such as labor and capital are not able to move freely without restriction among member countries, then the arrangement would instead be defined as a customs union.

Benefits of a Common Market

- **Free movement of people, goods, services, and capital**

In addition to the removal of tariffs among member countries, the key benefits of a common market include the free movement of people, goods, services, and capital. Therefore, a common market is often regarded as a “single market” as it allows the free movement of production factors without the obstruction created by national borders.

- **Efficiency in production**

For an economy, a common market facilitates efficiency among members – factors of production become more efficiently allocated, resulting in stronger economic growth. As the market becomes more efficient, inefficient companies eventually shut down due to intense competition.

Companies that remain typically benefit from economies of scale and increased profitability, and innovate more to compete in a more intensely competitive landscape.

Costs of a Common Market

- **Less competitive countries may suffer**

The transition to a common market comes with a few drawbacks. For one, companies that have previously been protected and subsidized by the government may struggle to remain afloat in a more competitive landscape. The migration of production factors to other countries may hinder the economic growth of the country and lead to increased unemployment.

- **Trade diversion**

Trade diversion occurs when efficient non-members are crowded out of the common market. Furthermore, a country may exhibit depressed wages if it faces an influx of migration of production factors where supply exceeds demand.

4. **Economic Union**

An economic union is one of the different types of trade blocs. It refers to an agreement between countries that allows products, services, and workers to cross borders freely. The union is aimed at eliminating internal trade barriers between the member countries, with the goal of economically benefitting all the member countries.

Economic Union vs. Customs Union

An economic union is different from a customs union since, in the latter, member countries are allowed to move goods across borders, but they do not share a currency. They are also not allowed to move workers across borders freely.

An economic union is the last step in the process of economic integration, after free trade area, customs union, and common market.

North American Free Trade Agreement (NAFTA) / United States-Mexico-Canada Agreement (USMCA)

The North American Free Trade Agreement (NAFTA) was implemented to promote trade between the U.S., Canada, and Mexico. The agreement, which eliminated most tariffs on trade between the three countries, went into effect on Jan. 1, 1994. Numerous tariffs, particularly those related to agricultural products, textiles, and automobiles, were gradually phased out through Jan. 1, 2008. NAFTA was terminated and replaced by the United States-Mexico-Canada Agreement (USMCA) in 2020.

The USMCA is a free trade agreement between the United States, Mexico, and Canada. The deal, which was proposed by the Trump administration and signed on Nov. 30, 2018, went into effect on July 1, 2020. It replaced NAFTA, which was also a free trade agreement between the three nations. It is meant to be "mutually beneficial for North American workers, farmers, ranchers, and businesses."

There are 34 chapters to the USMCA as well as a dozen side letters. The majority of NAFTA's chapters remain, with certain exceptions. As part of the deal, the three nations also agreed to changes to the original text. These amendments included revisions to the following:

- Protection for intellectual property rights
- Labor and environmental concerns
- Dispute settlement
- Rules of origin for the automotive industry

The agreement has a life span of 16 years. All three countries must review the USMCA in July 2026 to decide whether they plan on renewing it for another 16-year term.

USMCA vs. NAFTA

	NAFTA	USMCA
Automotive	62.5% of vehicle parts must be made in U.S., Mexico, or Canada	75% of vehicle parts must be made in U.S., Mexico, or Canada
Dairy	No tariffs on most goods	Keeps no tariff provision but also opens up Canadian and U.S. dairy markets
Environment	Environmental requirements difficult to enforce	Provision to apply $600 million to tackle environmental problems
Labor	Lower wages sent jobs to Mexico	Enhancements to U.S. labor laws to make them more competitive
Technology	No provisions for digital trade	U.S. companies are no longer required to store data on domestic servers

The USMCA is built upon and aims to improve provisions that were written into NAFTA. Some of the major changes that were ushered in with the USMCA include open trade between the U.S. and Canadian dairy markets, enhancements to labor laws (when lower wages helped push jobs to Mexico under NAFTA), and increasing the percentage of motor vehicle parts required to be produced in the region.

Free trade allows countries to reduce or eliminate the barriers and tariffs associated with the import-export of goods and services. NAFTA was one of the main agreements in North America. The agreement didn't come without criticism and was replaced by the USMCA. This new agreement used its predecessor as its foundation to include more favorable terms for North American workers, farmers, and businesses. The deal, which went into effect in 2020, is up for review in 2026. If the three nations agree, they can renew the USMCA for another 16 years.

European Union (EU)

The European Union (EU) is a political and economic alliance of 27 countries. It promotes democratic values in its member nations and is one of the world's most powerful trade blocs. Nineteen of the countries share the euro as their official currency. The EU grew out of a desire to strengthen economic and political cooperation throughout the continent of Europe in the wake of World War II. Its gross domestic product (GDP) totaled 14.45 trillion euros in 2021. That's about US $15.49 trillion. The GDP of the U.S. for the same period was about US $23 trillion.

The EU countries are:
Austria, Belgium, Bulgaria, Croatia, Republic of Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain and Sweden.

The European Union was created to bind the nations of Europe closer together for the economic, social, and security welfare of all. It is one of several efforts after World War II to bind together the nations of Europe into a single entity

How Is the European Union Changing in the 21st Century?
The original members of the European Union were the nations of Western Europe. In the 21st century, the EU has expand membership to the Eastern European nations that emerged after the collapse of the Soviet Union. Its current member nations include Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia

Why Was the European Union Created?
The overarching purpose of the European Union, in the years after World War II, was to put an end to the devastating wars that had wracked Europe for centuries. At the same time, it became increasingly clear that a united Europe would have far greater economic and political power than the individual nations in the post-war world.

The EU is a powerful alliance of 27 European countries that promotes democratic values among its members. It serves to faciliate political and economic integration throughout the region. Many, though not all, of its members share the euro as their official currency. Historically, it was made up primarily of the nations of Western Europe; it has since expanded to include member nations that had previously been socialist states prior to the collapse of the USSR. In 2020, the U.K. officially left the EU.

Asia-Pacific Economic Cooperation (APEC)

The Asia-Pacific Economic Cooperation (APEC) is an economic group of 21 members, formed in 1989, with the primary goal of promoting free trade and sustainable development in the Pacific Rim economies.

APEC's principal goal is to ensure that goods, services, capital, and labor can move easily across borders. This includes increasing custom efficiency at borders, encouraging favorable business climates within member economies, and harmonizing regulations and policies across the region.
The creation of APEC was primarily in response to the increasing interdependence of Asia-Pacific economies. The formation of APEC was part of the proliferation of regional economic blocs in the late 20th century, such as the European Union (EU) and the (now-defunct) North American Free Trade Agreement (NAFTA).

Nations Comprising APEC
The founding members of APEC were Australia, Brunei, Canada, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore, Thailand, and the U.S. Since its launch, China, Hong Kong, Taiwan, Mexico, Papua New Guinea, Chile, Peru, Russia, and Vietnam have joined its ranks.

APEC refers to its members as economies rather than as states due to the focus on trade and economic issues rather than the sometimes delicate diplomatic issues of the region, including the status of Taiwan and Hong Kong. The People's Republic of China (PRC) refuses to recognize Taiwan because it claims the island as a province under its constitution. Hong Kong, meanwhile, functions as semi-autonomous regions of China and not a sovereign state.
Official observers of APEC include the Association of Southeast Asian Nations (ASEAN), the Pacific Economic Cooperation Council (PECC), and the Pacific Islands Forum (PIF).

The Asia-Pacific Economic Cooperation's (APEC) Actions and Goals
At a landmark summit meeting in 1994, APEC announced a lofty goal of establishing free trade and investment regimes in the Asia-Pacific region by 2010 for members with developed economies. The group hoped to achieve those same goals for its developing economy members by 2020.