Topic 25: Economic integration

Economic integration is a process whereby countries coordinate and link their economic policies. As the level of economic integration increases, there will be less trade barriers and fiscal and monetary policies will be more similar.

Trading bloc: defined as a group of countries that join together in some form of agreement in order to increase trade between themselves to gain economic benefits from cooperation

1. Preferential trading area: is a trading bloc that gives preferential access to certain products from certain countries. This is usually carried out by *reducing tariffs*
2. Free trade areas: an agreement made between countries for *free trade between member countries*, but members are able to maintain their *individual external barriers*
3. Customs union: an agreement made between countries where countries agree to trade freely among each other and adopt *common external barriers*
4. Common markets: customs unions with common policies on *product regulation*, and *free movement of goods, services, capital and labour*
5. Economic and monetary union: common market with *common currency and common central bank*
6. Complete economic integration: individual countries have no control of economic policy, full monetary union and full harmonisation of fiscal policy.

Benefits of trading blocs:

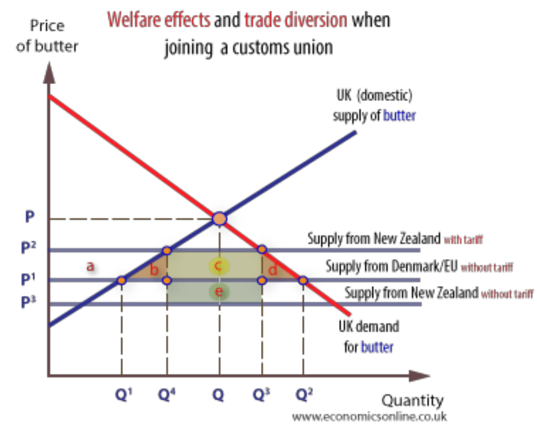
- Greater political stability and cooperation between member countries
- Greater size of market for potential for larger export markets
- Increased competition leading to greater efficiency
    - Lower price for consumers
- More consumer choice

Disadvantages of trading blocs:

- Some domestic producers may not be able to cope with the increased competition
- Enact discriminatory policies against non-members and this can be damaging to the achievements of the WTO
    - This is especially a problem for less developed economies that have little bargaining power

Trade creation: occurs when the entry of a country into a customs union leads to the production of a good or service transferring from a high cost producer to a low cost producer. (adv of greater economic integration)

Trade diversion: occurs when the entry of a customs union leads to the production of a good or service transferring from a low-cost producer to a high-cost producer. (disadv of greater economic integration)



Before the UK joined the EU it had a ***common tariff*** on all **butter** imports, and bought from low cost New Zealand (at price P^2, including the tariff). After it joins the EU it can benefit from tariff free imports from Denmark and other EU producers, at price P^1. It gains consumer surplus of a + b + c + d, and UK dairy farmers lose producer surplus of a; the loss of tariff revenue from imports from New Zealand is c + e. There will be a ***net loss from trade diversion*** in joining the EU if b + d *(the net gain in consumer surplus)* is less than e *(the loss of tariff revenue from New Zealand imports)*. A ***net gain from trade diversion*** would arise if b + d is greater than e.