

European Economic Integration II

Lecture 4

14 October 2024

Aims of Lecture

- 1 Explaining the *acquis communautaire* and its role in EU integration
- 2 Examining bilateral trade agreements and the shift from autarky to trade cooperation
- 3 Analyzing government role in import restrictions and tariffs
- 4 Exploring custom unions, focusing on trade creation and diversion within the EU

The *acquis communautaire* is a fundamental concept in the EU, representing the total body of EU law and obligations that member states must adhere to. Here are the key reasons why it is important:

- Ⓐ All member states operate under a common legal framework, promoting uniformity and coherence within the Union
- Ⓑ The *acquis* supports the functioning of the EU's internal market by ensuring free movement of goods, services, capital, and people.
- Ⓒ This integration fosters economic cooperation among member states and enhances competitiveness on a global scale

Benefits of Acquis Communautaire

- 1 The acquis communautaire enabled member states to engage in more comprehensive economic activities, including labor and capital exchanges without nationality restrictions.
- 2 Trade hasn't been limited to just coal and steel, or manufactured goods, or agricultural, goods. It allowed for a broader range of trade in goods and services.
- 3 It contributes to economic growth by creating a unified legal and regulatory framework that enhances trade, investment, and competition among member states.
- 4 It facilitates market integration, attracts foreign investment, and fosters innovation, driving economic development across the EU.

Bilateral Trade Agreement

- The challenge of moving out of autarky was met gradually by finding trading partners that were willing to accept some means of payment other than dollars or gold.
- The first step in this direction was to arrange **bilateral trade agreements**
- *Barter trades*: one country agreeing to import a specified quantity of a good from a trading partner, which in turn agreed to import a specified quantity of some other good from the first country

Bilateral Trade Agreement (continued)

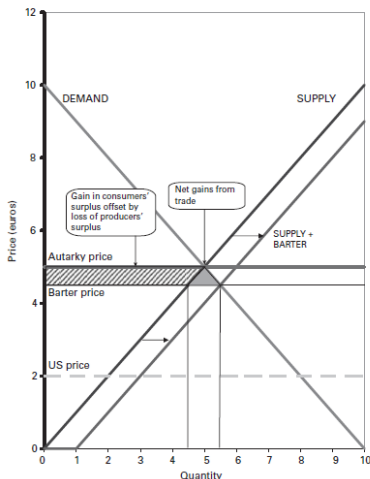
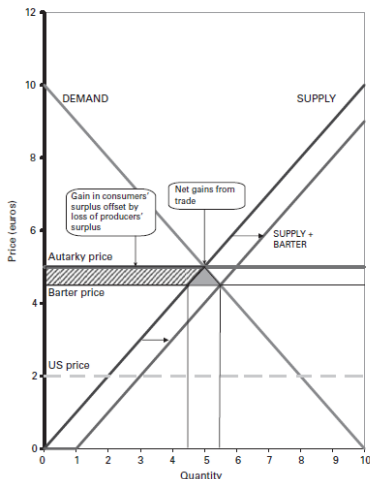


Figure: Bilateral Trade Agreement

- **US price:** Represents the world price (or the price in the US). Lower than the autarky price, showing that the good is cheaper internationally.
- **Barter price:** An intermediate price between the autarky and US prices, likely representing a negotiated price.
- **Consumer Surplus:** Gains due to trading at the lower US price, allowing consumers to buy cheaper.

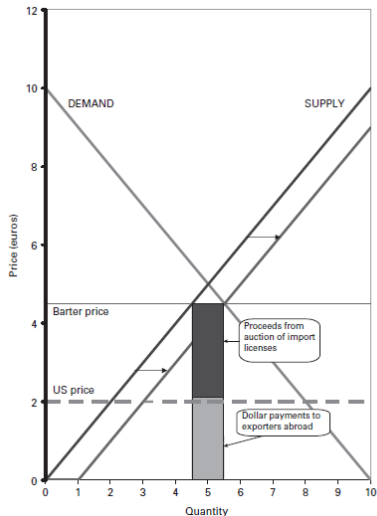
Bilateral Trade Agreement (continued)



- **Producer Surplus:** Losses for domestic producers who must now sell at the lower international price.
- The shaded area shows "Gain in consumers' surplus offset by loss of producers' surplus."
- The "Net gains from trade" area represents the total welfare gained, showing an overall economic benefit from trade.

Figure: Bilateral Trade Agreement

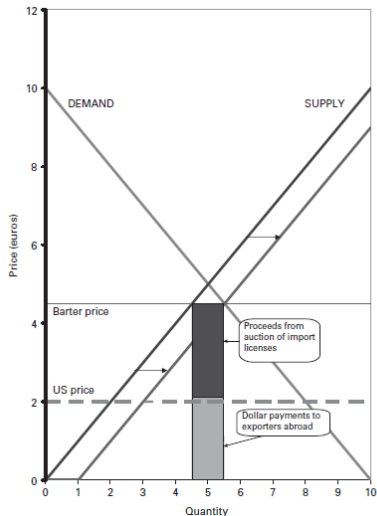
Import Quantity Restriction



- The intersection of demand and supply curve shows the barter price (around 4 euros).
- Below the barter price, a US price represents the cost of the good from the most efficient exporter, the US.

Figure: Import Quantity Restriction

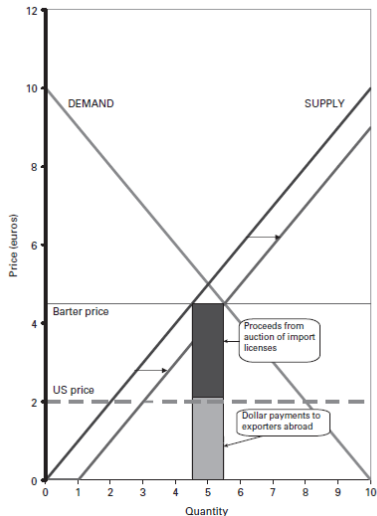
The Role of Government



- The government sets a quantity restriction in the form of an import quota, represented by the vertical line at quantity 5.
- To allocate these restricted imports efficiently, the government auctions off import licenses.

Figure: Import Quantity Restriction

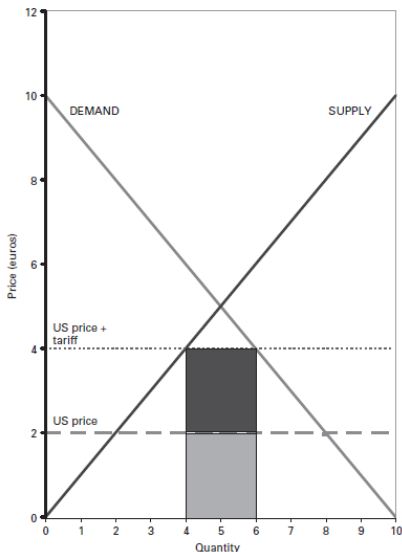
Implications of Auctioning Licenses



- The government earns revenue from auctions, shown by the dark grey area labeled Proceeds from auction of import licenses.
- The light grey area labeled "Dollar payments to exporters abroad" shows the amount importers pay to US exporters in foreign currency (dollars).
- This approach helps balance trade expansion with economic sovereignty.

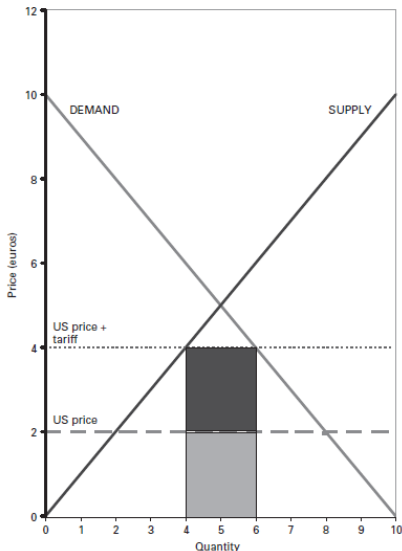
Figure: Import Quantity Restriction

Fixed Tariff on Imports



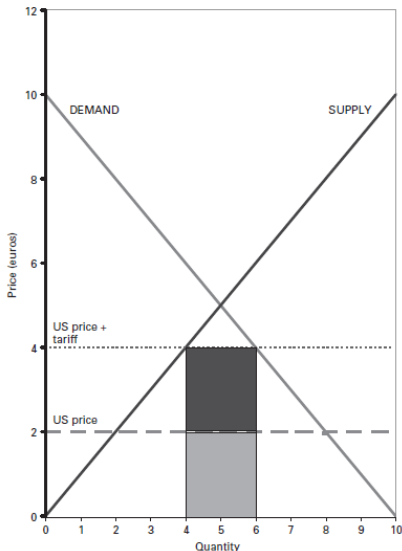
- French consumers can import goods at a lower cost from the most efficient supplier (US price).
- The US price line represents the cost of the good when imported from the most efficient supplier.
- The "US price + tariff" line shows the price with a fixed tariff added, which the French government collects as customs revenue.

Consumer and Government Gains



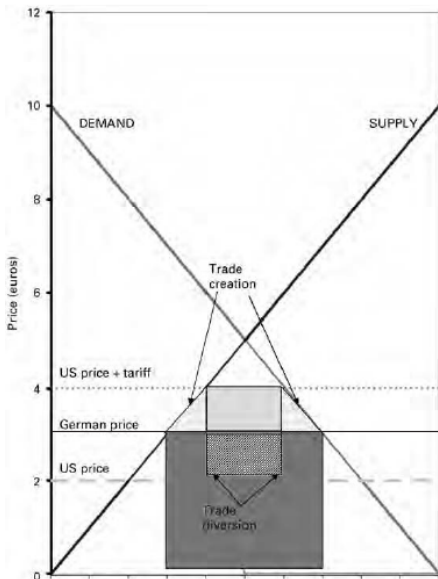
- The light grey area represents consumer gains from accessing the good at a lower price (US price) than the domestic price.
- The dark grey area indicates tariff revenue collected by the government.
- This system reduces costs by eliminating the need for bilateral agreements and import licenses.

The Role of Government in Trade Liberalization



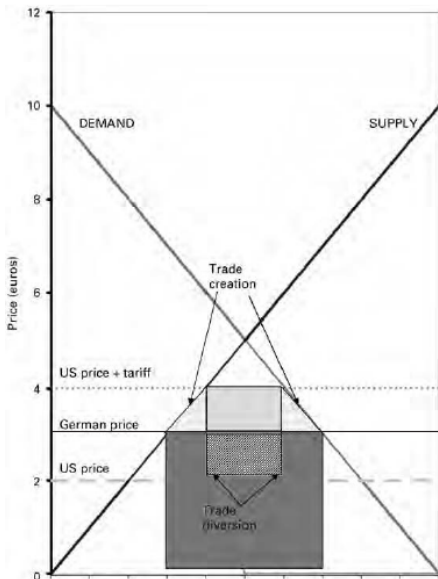
- By imposing a fixed tariff, the government gains customs revenue, aligning with multilateral trade policies.
- Simplifies trade for France, enabling imports from efficient suppliers and reducing paperwork and administrative costs.
- Although less efficient French producers may lose market share, the overall gains for consumers and the government.

Introduction to Custom Union



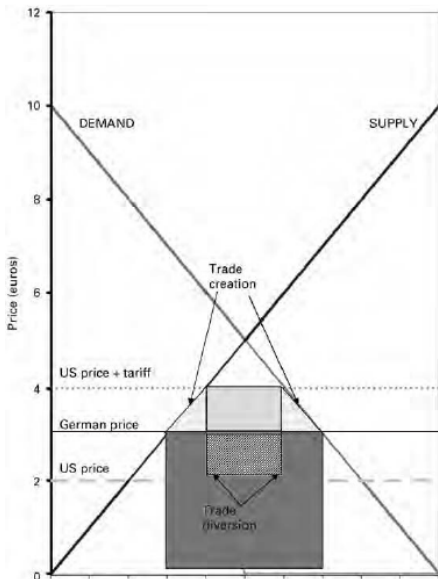
- This figure shows the economic effects of a customs union, where France maintains a tariff on US imports but removes it for imports from Germany.
- Demand and Supply Curves: The demand and supply curves intersect at the domestic equilibrium without trade, showing the price that would prevail if there were no imports.

US Price and Tariff Effects



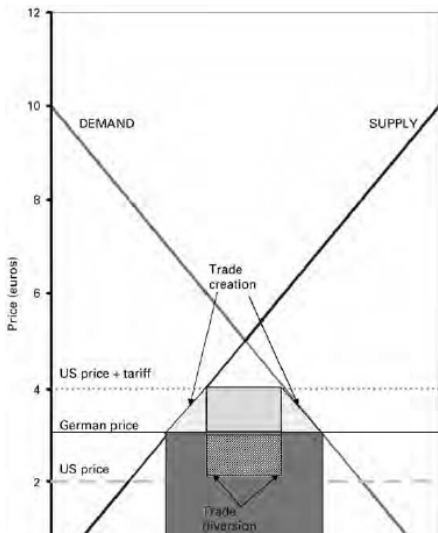
- US Price and US Price + Tariff: The US price represents the cost of the good if imported from the US without any tariff.
- The US price + tariff (dotted line) shows the effective price French consumers would pay if a tariff were applied to imports from the US. This tariff remains in place for US imports.

German Price and Trade Creation



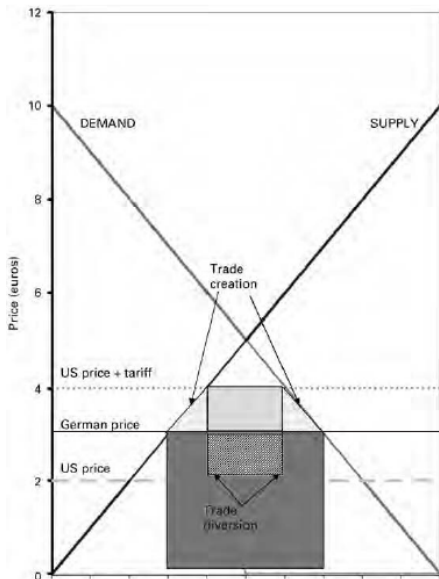
- German Price: The horizontal line labeled "German price" indicates the cost of the good when imported from Germany, which is cheaper than the domestic price but slightly higher than the US price.
- With the customs union, the tariff is removed for German imports, making Germany the preferred source for imports.

Gains from Trade Creation and Losses from Trade Diversion



- Gains from Trade Creation: The light grey triangles on either side of the former tariff revenue area (above the German price) represent gains from trade creation
- The right triangle shows gains from increased consumption, while the left triangle shows gains from reduced inefficient French production.

Net Effect of Custom Union



- Net Effect: The net effect of moving to a customs union is the sum of gains from trade creation (two light grey triangles) minus the loss from trade diversion (patterned rectangle).
- If demand and supply are elastic, gains from consumption and production shifts are larger, enhancing union benefit.