Preferential trade agreements

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Overview (/study/ap 186- cid- 754025/c

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Source: "Cumbre de líderes del G20 (https://commons.wikimedia.org/wiki/File:Cumbre_de_l%C3%ADderes_del_G20_(45252535475).jpg)" by Presidencia de la República Mexicana is licensed under CC BY 2.0 (https://creativecommons.org/licenses/by/2.0/deed.en)

RTAs are becoming ever more significant and complex in world trade today. There were less than thirty trade agreements in force in 1990. By 2019 there were more than 300 in force. Negotiations for trade agreements today go beyond tariffs and may also include intellectual property rights, human rights, environmental policies and more. This new complexity helps countries to redefine the rules of economic cooperation. The direct benefits include improvements in social welfare, increased international cooperation, foreign direct investments (FDIs) and economic growth. Look at the growing number of complex RTAs in **Figure 2**.

Student view

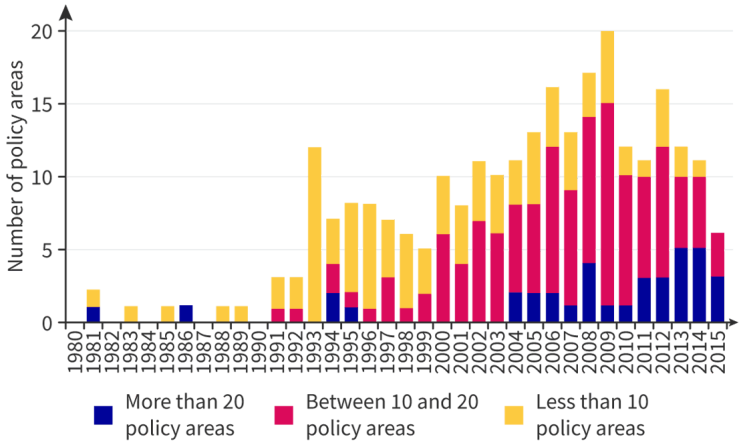

Figure 2. Increasing complexity of RTAs.

Source: "World Bank (https://datacatalog.worldbank.org/dataset/content-deep-trade-agreements)"

More information for figure 2

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Overview (/study/ap 186- cid- 754025/c

- From 1986 onward, there is a noticeable increase in the number of agreements covering more than 10 policy areas, especially between 1990 and 2000.
- The trend of increasing complexity continues steadily, reaching its peak around 2010, where the number of RTAs with over 10 policy areas (represented by the pink and blue bars) rises significantly.
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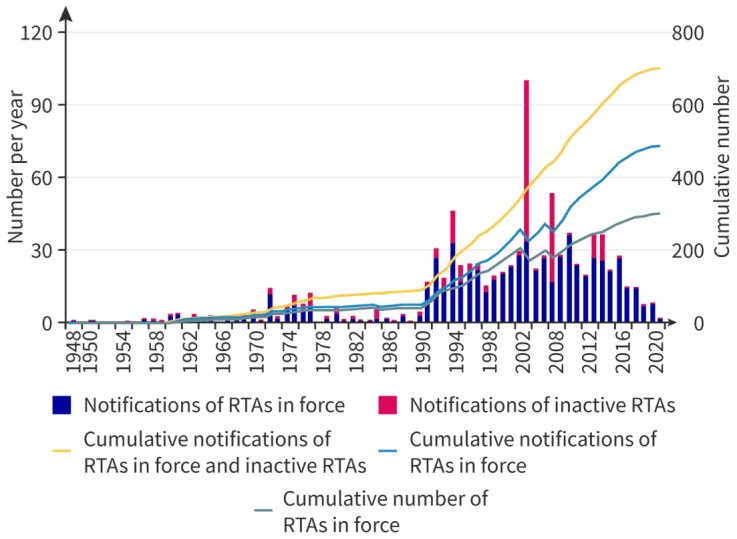
[Generated by AI]

Notifications of regional trade agreements (RTAs)

All members of the World Trade Organization (WTO) must notify the WTO of any RTAs which they participate in. This includes the addition of new countries to already existing trade agreements, such as when Croatia entered the European Union customs union in 2013. You can see the evolution of RTAs in the world in **Figure 3**:



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Overview (/study/ap 186- cid- 754025/c

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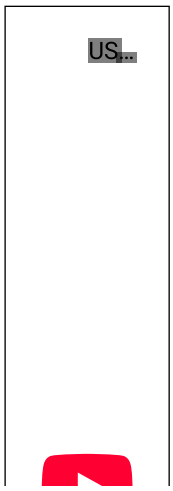

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Complete section with 3 questions

Start questions

Overview (/study/ap 186- cid- 754025/c

Previous section(/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30657/)

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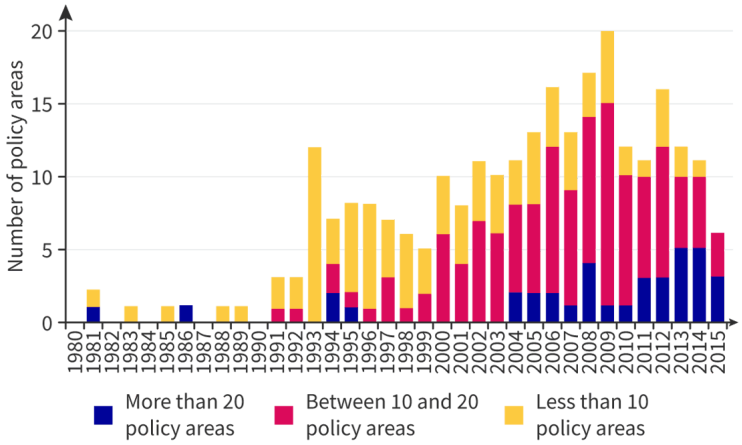

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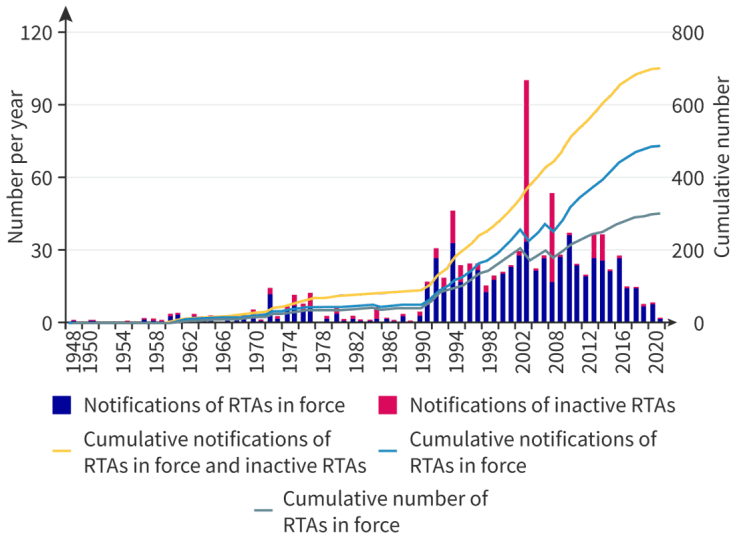

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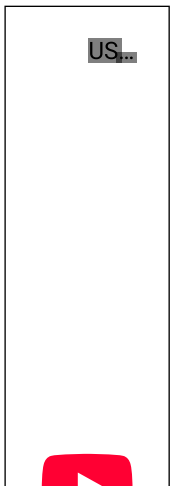

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Complete section with 3 questions

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Overview (/study/ap 186- cid- 754025/c

Previous section(/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30657/)

Next section (/study/app/pp/sid-186-cid-754025/book/tradi

Student view

Trading blocs

A trading bloc is a closer level of economic integration than the PTAs we discussed in the previous section (https://app.kognity.com/study/app/economics-hl-2013/international-economics/economic-integration/preferential-trade-agreements). There are four types of trading blocs:

- Free trade areas
- Customs unions
- Common markets
- Monetary unions (these will be discussed in section 4.4.5 (/study/app/pp/sid-186-cid-754025/book/monetary-unions-id-30660/))

We will discuss the first three here, but spend a little longer on monetary unions in section 4.4.5 (/study/app/pp/sid-186-cid-754025/book/monetary-unions-id-30660/).

Free trade areas/agreements

Free trade areas (FTAs) are formed by a trading bloc of countries signing trade agreements to remove most or all barriers to trade with the other countries involved in the agreement. Countries are free to set their own external policy towards non-member countries. This is the most common type of trading bloc.

In **Table 1** below, you can find some examples of free trade agreements around the world, starting with some of the newest to some of the oldest still in force today:

Table 1. Free trade agreements around the world.

Name of the FTA	Type	Countries & Regions	Scope	Date
Australia—Hong Kong	FTA — Bilateral	Australia; Hong Kong	Goods & Services	17-Jan-2020
Israel—Panama	FTA — Bilateral	Israel; Panama	Goods & Services	01-Jan-2020
Turkey—Kosovo	FTA — Bilateral	Turkey; Kosovo	Goods & Services	11-Jun-2019
ASEAN—Hong Kong	FTA — Multilateral & Regional	Brunei Darussalam; Cambodia; Hong Kong; Indonesia; Laos; Malaysia; Myanmar; Philippines; Singapore; Thailand; Vietnam	Goods & Services	11-Jun-2019
Alianza del Pacifico	FTA — Multilateral & Regional	Chile; Colombia; Mexico; Perú	Goods & Services	01-May-2016

Overview (/study/ap 186-cid-754025/c

Name of the FTA	Type	Countries & Regions	Scope	Date
Egypt—Sudan	FTA — Bilateral	Egypt; Sudan	Goods	20-Jan-1965
Greenland—Norway	FTA — Bilateral	Greenland; Norway	Goods	03-May-1960

Here you can find a full list of trade agreements (https://findrulesoforigin.org/home/agreements)around the world (you can search by specific countries if you would like).

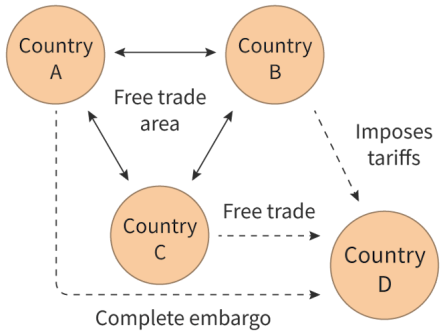

Figure 1. A free trade area.

More information for figure 1

This diagram illustrates a free trade area involving Country A, Country B, and Country C. These three countries engage in free trade with each other, depicted by arrows labeled 'Free trade area' connecting them. Country D is not a member of the free trade agreement. Country A imposes a complete embargo on Country D, while Country B imposes tariffs on Country D, shown by arrows with labels that specify these actions. Country C has a dashed arrow labeled 'Free trade' pointing toward Country D, indicating a free trade relationship between them.

[Generated by AI]

Student view

Figure 1 shows an illustration of a free trade area (FTA). Countries A, B and C engage in free trade with each other, but country D is not a member of the agreement. The FTA countries each have different trade policies towards country D, with A imposing a complete embargo.

You might think that country D can simply import from country C if it wanted to avoid the embargo imposed by country A or the tariff restrictions imposed by country B. This is called re-exportation. To avoid this happening, the original origin of the good or service must be declared before it is allowed into the country. (You can check the tag on your clothes to see where they came from.)

Overview (/study/ap 186- cid- 754025/

Figure 2. Tags on clothes allow you to check the origin of the product.

Credit: Getty Images Perry Mastrovito

Customs unions

A customs union is another form of economic integration. It is very similar to an FTA but has one important difference. The countries participating in the agreement set a common external policy towards non-members, while still engaging in free trade among themselves.

On the one hand, members of a customs union may enjoy greater efficiency, an increased variety of goods and services, and possibly lower prices and higher employment within the economies of the customs union.

On the other hand, all members of a customs union must apply the same trade barriers to non-member nations. This might 'divert' trade from more efficient countries which are not part of the customs union but which could produce goods cheaper and more efficiently. HL students can learn more about trade diversion in section 4.4.4 (/study/app/pp/sid-186-cid-754025/book/trade-creation-and-trade-diversion-id-30661/).

Student view

Figure 3 shows an illustration of a customs union. Here, countries A, B and C engage in free trade with each other but share the same external policy towards country D. They set exactly the same tariffs, quotas and/or subsidies together.

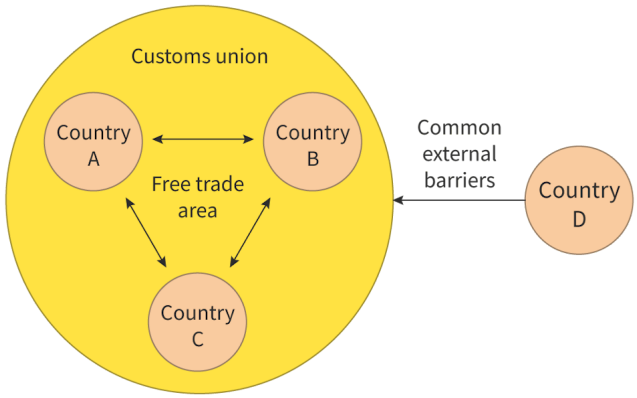

Figure 3. A customs union.

More information for figure 3

The diagram depicts a customs union involving three countries: A, B, and C. These countries are encircled within a yellow area labeled "Customs union," indicating they participate in free trade with each other. Arrows point bidirectionally between Countries A, B, and C, signifying free trade among them. Below the label "Free trade area," these arrows form a triangular path connecting the three countries.

Outside this customs union, there is Country D, isolated on the right side of the diagram. A horizontal arrow labeled "Common external barriers" points from the customs union to Country D, illustrating that Countries A, B, and C have a shared external trade policy towards Country D, including synchronized tariffs, quotas, and subsidies.

The design emphasizes the concept of free internal trade among the union members and uniformity in external trade policies against non-union members.

[Generated by AI]

In **Table 2** and **Figure 4**, you can find some of the customs unions around the world:

Table 2. Customs unions around the world.

Name of the customs union	Countries	Scope	Date
Gulf Cooperation Council (GCC)	Bahrain; Kuwait; Oman; Qatar; Saudi Arabia; United Arab Emirates	Goods	01-Jan-2020
Eurasian Economic Union (EACU)	Armenia; Belarus; Kazakhstan; Kyrgyzstan; Russian Federation	Goods & Services	01-Jan-2015
EUCU	Austria; Belgium; Bulgaria; Croatia; Cyprus; Czech Republic; Denmark; Estonia; Finland; France; Germany; Greece; Hungary; Ireland; Italy; Latvia; Lithuania; Luxembourg; Malta; Netherlands; Poland; Portugal; Romania; Slovak Republic; Slovenia; Spain; Sweden; Turkey	Goods & Services	01-Jul-2013
East African Community (EAC)	Burundi; Kenya; Rwanda; Tanzania; Uganda	Goods	01-Jul-2007
Southern Common Market (MERCOSUR)	Argentina; Brazil; Paraguay; Uruguay	Goods & Services	07-Dec-2005

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Southern African Customs Union (SACU)	Botswana; Eswatini; Lesotho; Namibia; South Africa	Goods	15-Jul-2004
Caribbean Community and Common Market (CARICOM)	Antigua and Barbuda; Bahamas; Barbados; Belize; Dominica; Grenada; Guyana; Haiti; Jamaica; Montserrat; Saint Kitts and Nevis; Saint Lucia; Saint Vincent and the Grenadines; Suriname; Trinidad and Tobago	Goods & Services	04-Jul-2002
West African Economic and Monetary Union (WAEMU)	Benin; Burkina Faso; Côte d'Ivoire; Mali; Niger; Senegal; Togo	Goods	01-Jan-2000
Economic and Monetary Community of Central Africa (CEMAC)	Cameroon; Central African Republic; Chad; Congo; Equatorial Guinea; Gabon	Goods	24-Jun-1999
Andean Community (CAN)	Bolivia; Colombia; Ecuador; Perú; Venezuela	Goods	25-May-1988
Central American Common Market (CACM)	Costa Rica; El Salvador; Guatemala; Honduras; Nicaragua; Panama	Goods	04-Jun-1961
Switzerland—Liechtenstein (CH-FL)	Switzerland; Liechtenstein	Goods	10-Jan-1924

You can use this link to find a list of all customs unions (https://rtais.wto.org/UI/PublicAllRTAListAccession.aspx)in force around the world today. (Organise the table by 'type' and sort by 'CU').

Overview (/study/ap 186- cid- 754025/

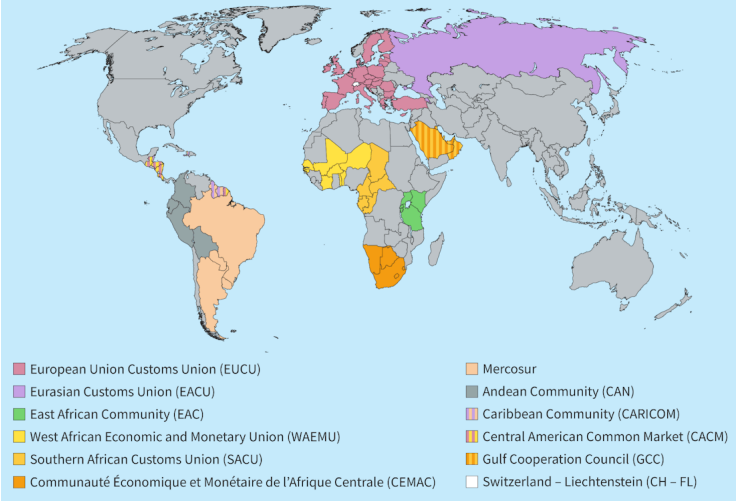


Figure 4. A selection of customs unions in the world.

Source: "WTO (https://www.wto.org/english/tratop_e/region_e/rta_plurilateral_map_e.htm)"

More information for figure 4

This world map illustrates the geographic distribution of various customs unions. Each union is represented with distinct colors, and the map's legend lists these unions with their corresponding colors. The European Union Customs Union (EUCU) is marked in pink, Eurasian Customs Union (EACU) in purple, East African Community (EAC) in green, West African Economic and Monetary Union (WAEMU) in light yellow, Southern African Customs Union (SACU) in orange, Communauté Économique et Monétaire de l'Afrique Centrale (CEMAC) in yellow, Mercosur in light brown, Andean Community (CAN) in grey, Caribbean Community (CARICOM) in striped purple, Central American Common Market (CACM) in striped orange, Gulf Cooperation Council (GCC) in yellow, and Switzerland — Liechtenstein (CH — FL) in green. The map highlights areas with distinct color patterns to indicate the presence of these unions within various regions globally, depicting their influence in the respective countries.

[Generated by AI]

Common markets

Student view

A common market is another form of economic integration and is the first major step towards creating a single market or economy. In a common market there must also be a customs union that allows the free movement of **factors of production** such as land, labour, entrepreneurial talent and capital resources.

The most famous example of a common market is the European Union. If you have a European passport, you will know that you do not need a visa to visit, live, study or work in any other European country.

Another example is the Southern Common Market or Mercosur, which was formed in 1991 in South America. Just like EU citizens in Europe, within the borders of the Mercosur countries, the citizens of Argentina, Brazil, Paraguay and Uruguay can travel across borders with only a driving licence.

The physical, technical and fiscal barriers between countries need to be removed as much as possible for a common market to work properly. First, people need to be able to move freely across borders between countries. Driving from one EU country to another does not require you to queue to show passports. Some countries have opted out of this feature of common markets – such as the United Kingdom, which opted out of the Schengen area – as those countries prefer to maintain some control over who comes and goes. The United Kingdom voted to leave the EU altogether on 23 June 2016 and finally left in January 2020.

Overview (/study/ap 186- cid- 754025/c

Second, standards should be synchronised between countries to allow capital and labour to move freely across borders. For example, teachers and doctors should be able (language permitting, of course) to practise their profession in any country belonging to a common market, as long as they can prove their core competencies. Production regulations should also be standardised so that goods can be sold anywhere within the common market, and companies applying for patents should not have to do so in all the countries within this type of trading bloc.

You can explore other examples of other common markets around the world in the following link (https://www.wto.org/english/tratop_e/region_e/rta_plurilateral_map_e.htm) .

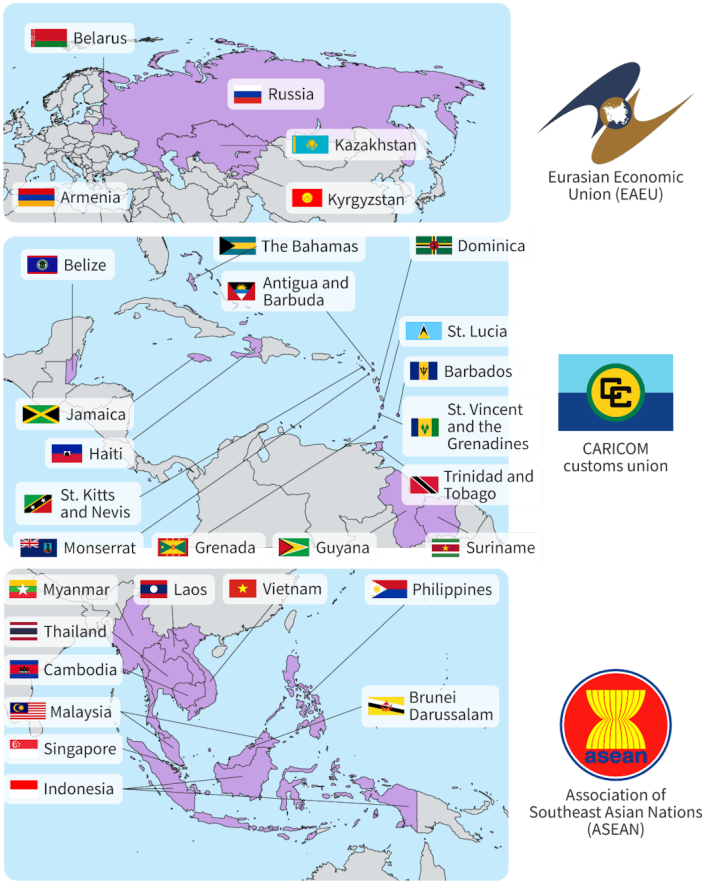


Figure 5. Examples of common markets .

More information for figure 5

This image depicts a world map with highlighted countries and organizations. The countries are divided into three groups, each associated with a different economic union or association.

1. **Eurasian Economic Union (EAEU):** This group includes countries in Eastern Europe and Central Asia. The countries part of the EAEU in the map are Russia, Belarus, Armenia, Kyrgyzstan, and Kazakhstan. These countries are highlighted with a purple overlay, and the EAEU logo is present near them.

2. **CARICOM (Caribbean Community):** This includes countries from the Caribbean region. Countries shown are Belize, Jamaica, Haiti, St. Kitts and Nevis, Antigua and Barbuda, The Bahamas, Dominica, St. Lucia, Barbados, St. Vincent and the Grenadines, Trinidad and Tobago, Monserrat, Grenada, Guyana, and Suriname. The CARICOM logo is placed near the Caribbean region in the map.

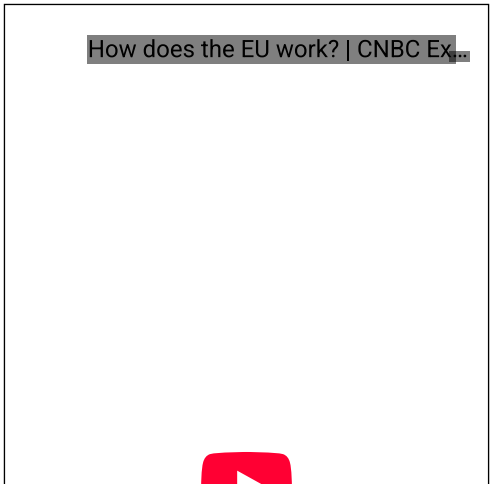
3. **ASEAN (Association of Southeast Asian Nations):** This group features Southeast Asian countries such as Myanmar, Laos, Vietnam, Thailand, Cambodia, the Philippines, Malaysia, Singapore, Indonesia, and Brunei Darussalam. These countries have a purple overlay, and the ASEAN logo is shown alongside.

Student view

Overview (/study/ap 186- cid- 754025/c

The countries are labeled with their flags above or beside them, providing a visual association of each flag with its corresponding country and union.

[Generated by AI]



Could Africa follow the path of the European Union? Check this web page (https://www.visualcapitalist.com/africa-free-trade/)to learn more about the prospects of the African Continental Free Trade Area (AfCFTA) becoming the world's largest free-movement and single-currency union.

Activity

Explore a complex grid of trade agreements.

In a group of three, identify all of Vietnam's trade agreements (https://www.cekindo.vn/blog/guide-to-vietnams-most-important-free-trade-agreements/) (in place in August 2023) and organise them by their level of integration. You could add the definition for each one if you desire.

You could also look up some of the trade agreements listed above, as well as many others, by using this tool (https://www.wto.org/english/tratop_e/region_e/rta_plurilateral_map_e.htm)from the World Trade Organization (WTO).

Student view

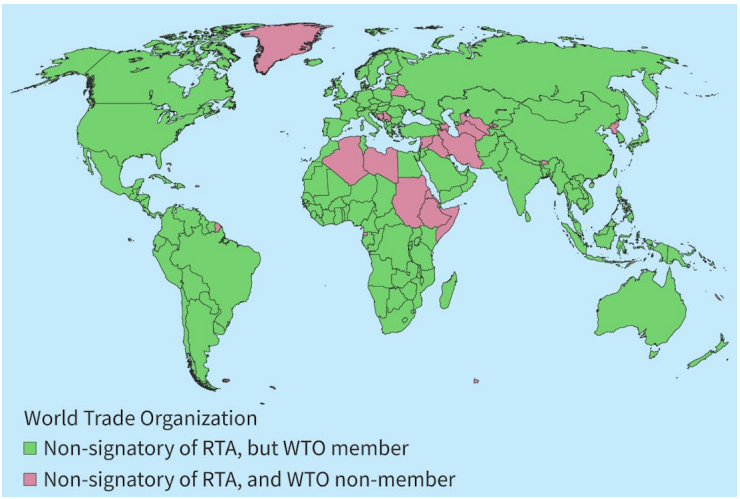


Figure 6. Membership of plurilateral Regional Trade Agreements around the world.
Source: "WTO (https://www.wto.org/english/tratop_e/region_e/rta_plurilateral_map_e.htm)"

More information for figure 6

The image is a world map displaying countries in two colors: green and pink. The map represents the membership status of countries in terms of the World Trade Organization (WTO) and Regional Trade Agreements (RTA). Countries in green are non-signatories of RTAs but are members of the WTO. Countries in pink are non-signatories of RTAs and non-members of the WTO. The map covers all continents including North and South America, Europe, Africa, Asia, and Australia, providing a global perspective on the membership distribution.

[Generated by AI]

Case study

Why did the UK want to leave the EU?

Figure 7. The European Union common market lost a member.

So far, you have studied the numerous benefits of being part of a common market, such as greater efficiency, lower prices, greater mobility of factors of production and more. So, why did the UK decide to leave?

Could you find a possible answer by analysing the information below?

How do Germany and the Netherlands compare to the UK?

What will the impact be on the EU budget with the UK no longer part of the bloc?

Overview (/study/ap 186- cid- 754025/c

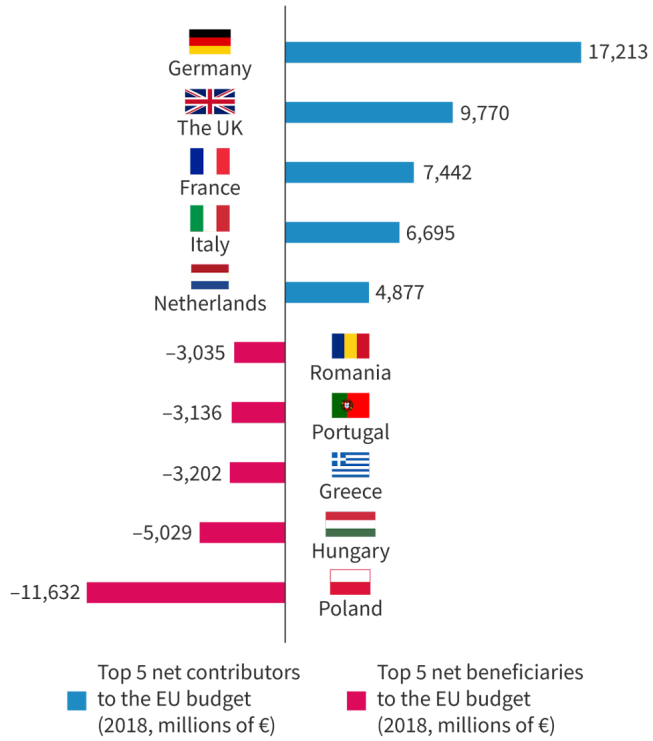


Figure 8. EU budget contributions in 2018.
Source: "European Comission (https://ec.europa.eu/info/strategy/eu-budget_en)"

More information for figure 8

The image is a horizontal bar chart illustrating the EU budget net contributors and beneficiaries for 2018. The X-axis represents the financial figures in millions of Euros while countries are listed along the Y-axis. In blue are the net contributors, with Germany at the top contributing 17,213 million Euros, followed by the UK with 9,770 million, France with 7,442 million, Italy with 6,695 million, and the Netherlands with 4,877 million.

In pink are the net beneficiaries starting with Poland receiving 11,632 million Euros, Hungary with 5,029 million, Greece with 3,202 million, Portugal with 3,136 million, and Romania with 3,035 million. This chart highlights the significant financial contributions and distributions among EU member states in 2018.

[Generated by AI]

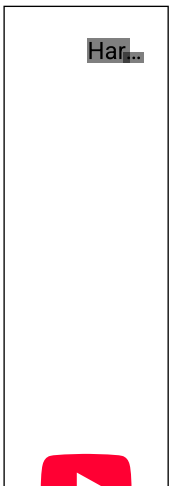
Student view

By the end of 2020, if no additional trade agreement is reached, the UK will lose all the benefits of being part of the EU. That means that tariffs and all other trade restrictions would be applied to it just like any other non-member of the EU. Besides trade restrictions, there are other complex issues to consider. Read Brexit: All you need to know about the UK leaving the EU (https://www.bbc.com/news/uk-politics-32810887)to understand the basics of Brexit and think about the following issues:

- Access to fishing waters
- Aviation standards and safety
- Law enforcement, data sharing and security
- Licensing and regulation of medicines
- Migration
- The border between Northern Ireland and Great Britain and between Northern Ireland and the Republic of Ireland
- Supplies of electricity and gas

Now watch the video below to consider the pros and cons of Brexit. On the one hand, the UK will be free to negotiate its own trade deals with all the countries in the world, including the US and China. On the other hand, the UK will lose the massive economic and political force of the EU with 27 countries standing together.

Overview (/study/ap 186- cid- 754025/



Theory of Knowledge

Economic integration has been successfully implemented in the European Union over the last several decades. However, this integration has come under scrutiny as Britain leaves the European Union. Brexit is the name given to the formal referendum held in the United Kingdom which saw a majority vote to leave the European Union. It spawned two very distinct perspectives in the lead up to the vote — the 'leave' side and the 'remain' side. Both sides used the power of language to incite populist and emotional responses in their respective supporters, and the success of the 'leave' campaign showed how effectively language can be used to stir emotions.

However, when it comes to a vote with serious economic and political consequences, how valid is emotion as a way of knowing and as a framework for making a decision? Have the 'remainers' valued their emotional and instinctive desire for the status quo (being a member of the European Union) over the possibility of the unknown? Consider the ideas in this article here. (https://www.businessinsider.com/brexit-poll-most-british-people-want-to-rejoin-eu-2020-6?r=US&IR=T)

How does language shape the perceptions of one side against another? For example, does calling the 'remain' side 'vicious' influence the reader's views on the issue?

Outside the United Kingdom, perceptions differed as the emotional proximity to the issue was more distant. Does this distance create a more reasoned perspective on the matter? Consider this article here (https://www.brookings.edu/blog/order-from-chaos/2020/07/23/what-a-shift-in-the-uks-foreign-policy-means-for-the-us/).

To what extent does emotional proximity impact perception? What about the question of authenticity? Does emotional proximity encourage a more authentic perspective?

Knowledge question : Do we need to know the knower's perspective, as seen through their personal knowledge, to fully understand events such as the Brexit vote?

Student view

Complete section with 3 questions

Start questions

Previous section(/study/app/pp/sid-186-cid-754025/book/preferential-trade-agreements-id-30658/) Next section (/study/app/pp/sid-186-cid-754

Advantages and disadvantages of trading blocs

In this section, we will discuss some of the factors that have contributed to globalisation since the 1980s. We will also learn about some of the advantages and disadvantages of a country deciding to enter a trading bloc.

For the **advantages** we will discuss:

- Greater access to markets and the potential benefit from economies of scale
- Greater employment opportunities with labour mobility
- Stronger bargaining power in multilateral negotiations
- Greater political stability and cooperation

For the **disadvantages** we will discuss:

- Loss of sovereignty
- The difficulties of engaging in multilateral trade negotiations

The extent to which it is beneficial for a country to join a trading bloc will depend on the nature of the goods and services it needs to import and export and the trade relations it already has in place.

Free trade will always increase competition between producers from different countries, and should improve efficiency in global and domestic markets. However, it may be that competition from strong foreign economies or individual industries will be too overbearing for some weaker countries or local industries to handle. It may be the case that many firms end up being out-competed and have to close down.

The globalisation process increases international trade, improves mobility of workers and supports the free movement of investment flows. Advocates of globalisation would argue that this leads to increases in the standard of living for all of the countries within a trading bloc.

The basic principle behind globalisation is the free market and Adam Smith's invisible hand. If people choose what serves their own self-interest, the result is that society as a whole prospers – and this principle is the same on a global scale.

Factors that contribute to globalisation

The rise of free-market economics

Since the 1980s, the benefits of the free market have been increasingly recognised and have become the dominant view. The incentives provided by the price mechanism will enhance economic growth as individuals are encouraged to work harder and resources are used in the most efficient way.

Overview (/study/ap 186- cid- 754025/c

However, critics would argue that the basis of the free market is greed, which encourages exploitation, and not all problems can be resolved by the price mechanism. Where markets fail on a global level, such as environmental issues or the dominance of large MNCs in world trade, the principle that the free market provides the same benefits for all may not be accurate.

Exam tip

In order to achieve the higher bands of the criteria on your exams, you must use real-life examples by integrating them with your arguments and claims within your essays.

Complete the activity box below to add a few examples to your toolbox. These could be especially helpful while writing policy recommendations on HL paper 3.

Activity

Choose a partner and divide the work: each of you will choose one of the investigative reports below (China or the Democratic Republic of the Congo).

You and your partner should each create a simple mind map with the main concepts that you have learned in the report by linking them to globalisation and international trade.

Then, share your mind map with your partner and try to find similarities and differences by considering the pros and cons of globalisation.

Student view

Figure 1. Example of a mind map.

More information for figure 1

This image is a colorful mind map depicting various tips for creating effective mind maps. At the center, a box labeled "How to mind map" serves as the starting point. Branching out from the center are various categories:

1. **Equipment**: Includes items such as highlighters, fine-tip pens, and pencils, indicating tools used for creating mind maps.
2. **Central Image**: Suggests using a simple image, noting that color and an image that first comes to mind can be helpful.

3. **Use Color**: Describes how color can be used to make the mind map fun and to separate out ideas, highlighting that different colors can indicate similar ideas.
4. **Draw Pictures**: Indicates that exaggerated, crazy images work best, and suggests that mind maps don't need to be artistic.
5. **Computer vs Hand Drawn**: Compares benefits of paper (freedom, easier to follow) with computer downsides (slows creative process), and suggests considering paper type (lined vs small sheets) and orientation (landscape vs portrait).
6. **Curve Your Branches**: Advises curving branches, suggesting it's more interesting for the brain than straight lines.

Overall, the mind map emphasizes creativity, the use of color, and flexibility in the approach to creating mind maps.

[Generated by AI]

1. Learn about the production process for cobalt (an essential mineral for lithium-ion batteries) and how unintended consequences can be so close to our phones and computers, but so far from our minds. Take the time to go through this investigative report (https://www.washingtonpost.com/graphics/business/batteries/congo-cobalt-mining-for-lithium-ion-battery/) from the Washington Post on the Democratic Republic of the Congo and identify the benefits and costs of our globalised economies.

2. Learn about the supply chain for graphite (an essential mineral for lithium-ion batteries) and consider the same issues as above.

Reduced trade barriers, increased trade and competition

The WTO is responsible for promoting world trade by encouraging reductions in trade barriers, although it has been accused of being dominated by the rich, industrialised countries.

Critics would argue that it is fair trade and not free trade that many developing countries need. Removing trade barriers increases imports to a country. Usually, those imports would be higher quality and have lower prices in comparison to domestic production.

On the one hand, if the industries within a country are not ready to compete with those foreign products, there is a possibility of those domestic companies shutting down.

On the other hand, if domestic industries are able to compete, the imported products would push companies to improve their production efficiency and move the industry forward. This healthy level of competition would benefit consumers by providing them with higher-quality and more varied products at lower prices.

Multinational corporations (MNCs)

There has been significant growth of multinational corporations. MNCs are companies that have production facilities in more than one country. Investment by MNCs around the world has enabled them to exploit the cheapest resources and produce on a large scale to reduce average costs. The jobs created have provided a boost to the domestic economy and the resulting trade has further enhanced the dynamic benefits of these organisations.

However, critics would argue that MNCs are powerful enough to exploit the country where production is happening, profits are repatriated, the jobs created are low-paid, and there is little respect for the environment.

Overview (/study/ap 186- cid- 754025/

Company name	Revenues (millions of $)
1. Walmart	514,405
2. Sinopec Group	414,649
3. Royal Dutch Shell	396,556
4. China National Petroleum	392,976
5. State Grid	387,056
6. Saudi Aramco	355,905
7. BP	303,738
8. Exxon Mobil	290,212
9. Volkswagen	278,341
10. Toyota Motor	272,612

Source: "Fortune Global 500 (https://fortune.com/global500/)"

Figure 2. According to the Fortune 500, of the top 10 highest revenue earners in 2019, only two companies were not MNCs (China National Petroleum and State Grid).

More information for figure 2

The image is a table listing the top 10 companies in 2019 ranked by revenue in millions of dollars. The table has two columns: 'Company name' and 'Revenues (millions of $)'.

1. Walmart - 514,405
2. Sinopec Group - 414,649
3. Royal Dutch Shell - 396,556
4. China National Petroleum - 392,976
5. State Grid - 387,056
6. Saudi Aramco - 355,905
7. BP - 303,738
8. Exxon Mobil - 290,212
9. Volkswagen - 278,341
10. Toyota Motor - 272,612

Walmart tops the list with the highest revenue, surpassing 500,000 million dollars, while Toyota Motor closes the list with over 270,000 million dollars.

[Generated by AI]

Student view

New technology

New technology is making international trade and communication much easier. The internet allows information to be shared and firms to operate on a global scale even if they are relatively small.

Another significant technological improvement that is important for international trade is the size of container ships. Bigger ships can carry more cargo and reduce the cost of transportation. This can help a firm to achieve economies of scale. There has been a dramatic increase in the size of those ships. Today, the biggest ship can carry almost 24 000 containers. See the infographic on the evolution of container ships here (https://transportgeography.org/?page_id=2232) and **Table 1** showing the sizes of the largest ships.

Table 1. Fifteen largest container ship classes, listed by TEU capacity.

Overview (/study/ap 186- cid- 754025/c

Built	Name	Class size	Maximum TEU
2020	HMM Algeciras	7	23964
2020	HMM Oslo	5	23820
2019	MSC Gulsun	6	23756
2019	MSC Mina	5	23656
2017	OOCL Hong Kong	6	24413
2018	COMSO Shipping Universe	6	21237
2018	CMA CGM Antoine de Saint Exupery	3	20954
2017	Madrid Maersk	11	20568
2018	Ever Golden	7	20388
2017	MOL Truth	2	20182
2017	MOL Triumph	4	20170
2019	Ever Glory	4	20160
2018	COSCO Shipping Taurus	5	20119
2015	Barzan	6	19870
2016	MSC Diana	6	19462

In **Figure 3** you can see the growing number of containers moved through the international ports of the world. If you would like to have an interesting and perhaps even jaw-dropping visual perspective, visit this page (https://www.visualcapitalist.com/global-shipping-container-traffic/).

Student view

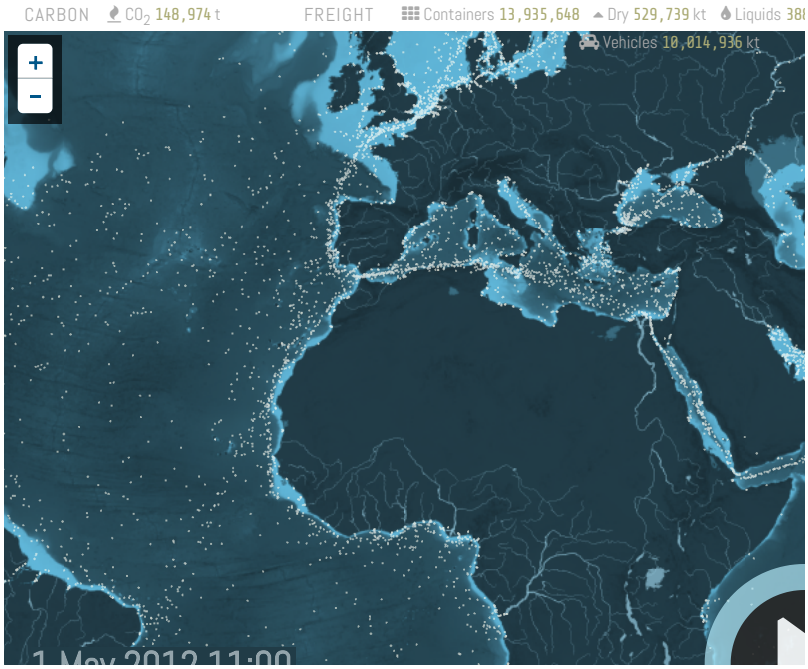
Container port traffic (TEU: 20 foot equivalent units)

Figure 3. The number of containers moving around the world.

More information for figure 3

Overview (/study/ap 186- cid- 754025/c

This video includes a brilliant animation of the position of cargo ships across the oceans in 2012. It provides a glimpse of the beauty and complexity of our integrated world.



Video 1. Position of Cargo Ships Across the Oceans in 2012.

More information for video 1

Student view

1

00:00:00,167 --> 00:00:01,000

[soft music plays]

2

00:00:01,100 --> 00:00:02,133

narrator: At any given moment,

3

00:00:02,200 --> 00:00:05,500

tens of thousands of giant cargo ships

are moving around the world's oceans.

4

00:00:06,067 --> 00:00:09,100

These ships, some of which are more than

a quarter of a mile long

5

00:00:09,167 --> 00:00:11,367

are the heavy lifters

of the global economy,

6

00:00:11,533 --> 00:00:13,067

shifting everything from metal ores

7

00:00:13,133 --> 00:00:16,133

and compressed gas

to fresh fruit and plastic toys.

Overview (/study/ap 186- cid- 754025/c

Student view

8

00:00:16,667 --> 00:00:17,967

This interactive map

9

00:00:18,033 --> 00:00:21,300

shows the movements of the world's

commercial shipping fleet in 2012,

10

00:00:21,567 --> 00:00:24,633

based on hundreds of millions

of individually recorded positions.

11

00:00:25,600 --> 00:00:28,767

Plotting all the raw positions

at once shows the extraordinary extent

12

00:00:28,833 --> 00:00:30,133

of modern shipping's reach.

13

00:00:30,667 --> 00:00:32,067

Even without a background map,

14

00:00:32,133 --> 00:00:34,067

the world's coastlines

are clearly defined,

15

00:00:34,367 --> 00:00:36,400

albeit with plenty of variation

16

00:00:36,633 --> 00:00:39,200

from the buzz

of activity in the East China Sea,

17

00:00:39,267 --> 00:00:42,733

to the relative quiet

of Somalia's piracy afflicted waters.

18

00:00:44,133 --> 00:00:46,700

While ships can move freely

through the open ocean,

19

00:00:46,767 --> 00:00:48,600

routes are predetermined closer to land

20

00:00:48,800 --> 00:00:50,367

and especially in tight straits,

21

00:00:50,433 --> 00:00:53,033

such as the dual carriage way

Overview (/study/ap 186- cid- 754025/c

Student view

of the English Channel.

22

00:00:54,133 --> 00:00:56,700

The most crucial shipping thoroughfares

of all though are

23

00:00:56,767 --> 00:00:59,200

the manmade canals linking

different bodies of water,

24

00:00:59,467 --> 00:01:02,200

such as the Panama Canal opened

a century ago

25

00:01:02,267 --> 00:01:04,100

to connect the Atlantic and Pacific oceans

26

00:01:04,467 --> 00:01:06,733

and the even older and busier Suez canal,

27

00:01:07,033 --> 00:01:10,100

which saw 17,000 transits in 2012 alone.

28

00:01:11,200 --> 00:01:14,100

In some places, ships penetrate

deep into continents

29

00:01:14,167 --> 00:01:16,900

via rivers and lakes,

such as the massive Paraguay

30

00:01:16,967 --> 00:01:18,767

and Amazon rivers in South America

31

00:01:19,500 --> 00:01:21,467

or the Great Lakes in North America

32

00:01:21,533 --> 00:01:24,367

whose ports include Chicago,

Milwaukee and Toronto.

33

00:01:25,700 --> 00:01:27,367

Coloring the ships by category

34

00:01:27,433 --> 00:01:30,033

shows the flows of the global economy

in more detail

35

00:01:31,300 --> 00:01:32,633

Overview (/study/ap 186- cid- 754025/c

Student view

the red dots of the tankers,

36

00:01:32,700 --> 00:01:35,133

which shun oil from massive

terminals in the Middle East

37

00:01:35,233 --> 00:01:37,667

or from offshore rigs

in West Africa and elsewhere,

38

00:01:38,000 --> 00:01:40,533

while the blue dots

are so-called dry bulk ships,

39

00:01:40,600 --> 00:01:42,333

which move aggregates, ores and coal

40

00:01:42,400 --> 00:01:46,233

from mines and quarries many of them found

in Australia and Latin America.

41

00:01:47,400 --> 00:01:49,200

Many of these raw materials are shipped

42

00:01:49,267 --> 00:01:51,667

to manufacturing regions

to make finished goods

43

00:01:51,733 --> 00:01:54,900

that are themselves then moved back across

the ocean in container ships

44

00:01:55,000 --> 00:01:56,200

shown here in yellow.

45

00:01:56,900 --> 00:01:59,367

China is the center

of the shipping container world.

46

00:01:59,700 --> 00:02:03,300

Shanghai alone moved

33 million units in 2012.

47

00:02:04,367 --> 00:02:07,600

While all of this shipping

makes modern life as we know it possible,

48

00:02:07,667 --> 00:02:09,033

there is a downside

Overview (/study/ap 186- cid- 754025/c

49
00:02:09,100 --> 00:02:11,300
moving billions of tons of ships and cargo
50
00:02:11,367 --> 00:02:13,967
relies on burning massive
quantities of bunker fuel.
51
00:02:14,233 --> 00:02:16,367
The result is a huge
amount of carbon dioxide
52
00:02:16,433 --> 00:02:19,367
or CO2 the main driver of global warming.
53
00:02:19,433 --> 00:02:23,067
Commercial ships produce more
than a million tons of CO2 every day,
54
00:02:23,133 --> 00:02:26,833
more than the whole of the UK
or Canada or Brazil.
55
00:02:27,800 --> 00:02:30,400
Click around the map
to explore the data for yourself
56
00:02:30,467 --> 00:02:31,800
or click the info sign
57
00:02:31,867 --> 00:02:34,000
for more information about
how it was made.
58
00:02:38,100 --> 00:02:40,733
[music fades out]

Student view

Created by London-based data visualisation studio Kiln (https://www.kiln.digital/) and the UCL Energy Institute (http://www.bartlett.ucl.ac.uk/energy)

The International Monetary Fund (IMF) and the World Bank

The IMF and the World Bank actively promote globalisation, and they are an important influence on the economic direction that world economies take, particularly in the developing world.

On the one hand they provide financial assistance and advice to countries, but on the other, in order to receive that assistance, countries are often forced to liberalise their markets. The consequences of a more free-market approach have been mixed. More details on this topic can be found in subtopic 4.10 (/study/app/pp/sid-186-cid-754025/book/the-big-

Overview (/study/ap 186- cid- 754025/

picture-id-30433/).

Source: "IMF Logo (https://en.wikipedia.org/wiki/File:International_Monetary_Fund_logo.svg)" & The World Bank logo (https://commons.wikimedia.org/wiki/File:The_World_Bank_logo.svg)"

Figure 4. The logos of the International Monetary Fund (IMF) and the World Bank.

Advantages of trading blocs

Access to markets and the benefits of economies of scale

A country that joins an economic bloc would have access to the markets of the whole bloc. This would increase the number of consumers for its domestic companies. This increase in demand could push national companies to increase exports and could promote economic growth. By producing more, those companies would have to hire more workers and invest in all sorts of productive capital.

Student view

On 17 July 2018, Japan and the EU signed an FTA covering goods and services. The EU, with a nominal GDP around USD 18.8 trillion in 2018, represented around 20% of the world's economy. The FTA gave Japanese companies an excellent opportunity to access one of the biggest markets in the world.

Figure 5. European Council President Donald Tusk, European Commission President Jean-Claude Juncker and Japan's Prime Minister Shinzo Abe, signing an FTA for goods and services between Japan and the EU, at a ceremony in Tokyo on 17 July 2018.

Source: "EU-Japan EPA Signing (https://commons.wikimedia.org/wiki/File:EU-Japan_EPA_Signing_(9).jpg)" by kantei.go.jp is licensed under CC BY 4.0 (https://creativecommons.org/licenses/by/4.0/deed.en)

Overview (/study/ap 186-cid-754025/

If the market is big enough, firms may also be able to take advantage of economies of scale, which is one of the most significant benefits of a trading bloc. Economies of scale decrease the average cost of production.

We covered this in subtopic 4.1 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30650/). Gaining access to new markets and new production opportunities will allow firms to benefit from economies of scale. This is when a firm can lower average total costs in the long run with expansion. With at least one factor of production fixed in the short run (a firm's market can only be so big if limited to one country), at some point it may start to experience diminishing marginal returns.

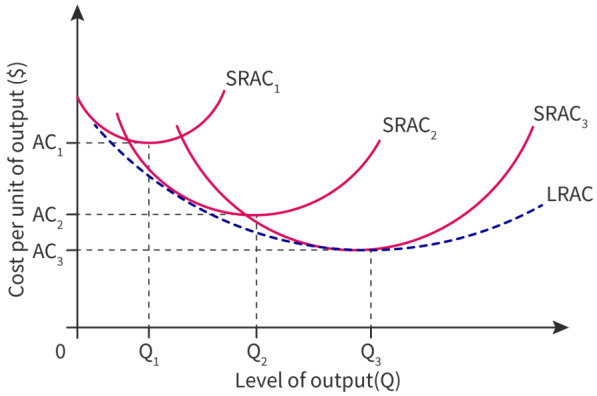


Figure 6. Falling long-run average costs.

More information for figure 6

The image is a graph illustrating the concepts of short-run and long-run average costs (LRAC) in economics. The X-axis represents the level of output (Q) while the Y-axis represents the cost per unit of output in dollars. The graph features three short-run average cost curves (SRAC1, SRAC2, and SRAC3) that are U-shaped. Each SRAC curve intersects with the downward-sloping long-run average cost curve (LRAC), which is depicted as a dotted line. At different levels of output (Q1, Q2, Q3), the firm may move from one SRAC curve to another as it expands, aiming to reach a lower average cost possible through economies of scale. Key points Q1, Q2, and Q3 indicate increasing levels of output with corresponding lower average costs AC1, AC2, and AC3 respectively.

[Generated by AI]

Student view

But as soon as a firm starts operating in another country, its factors of production will have increased, with more capital, labour and land available for use. This allows the firm to change from operating at $SRAC_1$ to $SRAC_2$ and if the firm continues growing, it could reach $SRAC_3$ (in **Figure 6**) as it increases output and lowers its average cost.

For example, when Japanese firms start planning and preparing to supply goods and services to the EU, those firms may invest in better machines to produce more efficiently. They may also start buying raw materials in bulk quantities, and that would allow for discounted prices. The Japanese firms could also reduce the costs of transportation by increasing the size of the shipments (remember the container ship sizes we discussed earlier). So as the market expands, firms could produce at lower average costs (economies of scale), offering lower prices for higher quantities of exports.

Making connections

HL students have already studied economies of scale in subtopic 2.11 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-29858/), so you can apply the learning from that section to this topic.

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SL students learned about economies of scale in subtopic 4.1 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30650/).

It is important to apply the knowledge learned in previous topics as much as you can, so that you can create more robust arguments by interlacing topics and concepts from different sections to make sense of the real world.

Greater employment opportunities and labour mobility

Within trade blocs such as a common market, factors of production are free to move around without restrictions or barriers. That includes labour. So, in practical terms, workers could work and live in any country within the common market. This free movement allows nations to become more efficient because workers and companies have many more options to find the best fit for their skills and preferences. If one country has higher rates of unemployment, such as Greece (16% in Feb of 2020), workers can migrate to other countries in the EU, where there might be more opportunities for employment. You can see the number of EU citizens living in other countries in this map.

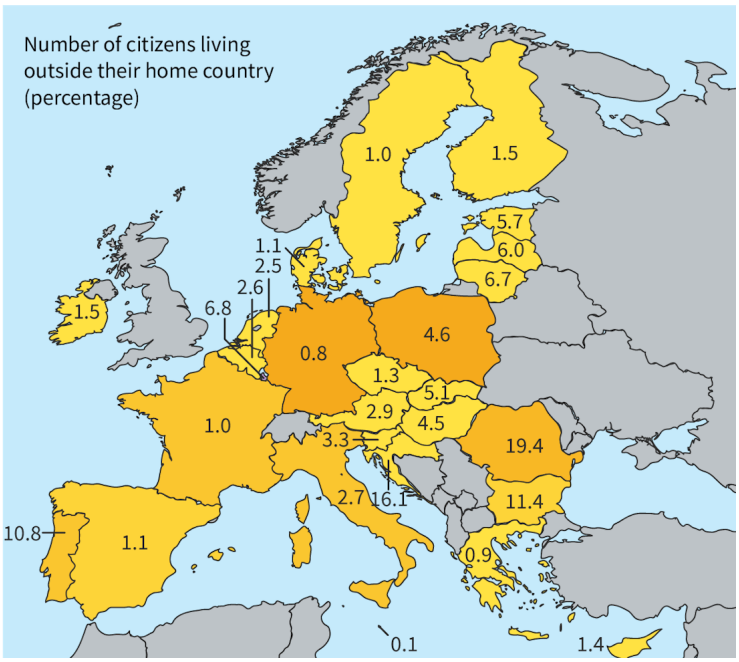


Figure 7. The percentage of EU nationals living in another EU member nation (data from 2016).

Source: "Eurostat (https://ec.europa.eu/eurostat/statistics-explained/index.php/EU_citizens_living_in_another_Member_State_-_statistical_overview#Who_are_the_most_mobile_EU_citizens.3F)"

More information for figure 7

This map illustrates the percentage of EU citizens living in another EU member country as of 2016. Each country is marked with a percentage indicating how many of its citizens reside outside their home nation. For example, Ireland has 16.1%, Luxembourg 19.4%, and the UK 1.5%. Other notable figures include Spain at 10.8%, Germany at 4.5%, and Italy at 10.8%. The map uses colors to differentiate between countries, with yellow indicating countries for which this data applies. Gray indicates countries not part of the data set. The map provides an overview of intra-European movement, highlighting countries with high expatriation rates such as Luxembourg and Ireland, as well as those with lower percentages like Poland (0.8%) and Denmark (1.1%).

[Generated by AI]

Student view

Overview (/study/app/pp/sid-186-cid-754025/c

Stronger bargaining power in multilateral negotiations

When countries integrate through trade agreements, they become stronger together. Let us take the example of the integration of Colombia as an associate member of Mercosur. A PTA was signed at the end of 2017 between Colombia and the countries from Mercosur (Argentina, Brazil, Paraguay and Uruguay).

Colombia and South Korea signed an FTA in 2013. In 2013, South Korea (USD 1 305 billion) had an economy more than three times bigger than the economy of Colombia (USD 381 billion).

Before 2017, South Korea had a much bigger economy than Colombia, so you can imagine that South Korea would have the upper hand in its negotiations with Colombia.

After 2017, when Colombia representatives reached an agreement with the representatives of Mercosur with its massive combined GDP (USD 2 807 billion), Colombia would now have a bargaining power with a total economy that is almost twice as big as the economy of South Korea (USD 1 530 billion).

Greater political stability and cooperation

When countries bond together through trade agreements, they share a mutual interest in the growth and prosperity of the whole bloc. In that sense, the improvement of one country promotes the improvement of its partners. There is a common goal that drives actions and policies towards helping each other.

Common markets such as the EU collaborate in other areas beyond international trade. In education, for example, they have the ERASMUS programme (https://www.erasmusprogramme.com/)(student exchange programme), European Higher Education Area (EHEA) (http://www.ehea.info/)(integration of different educational systems), and many multinational collaborative research institutions.

In the area of health, they have the European Health Insurance Card (EHIC) (https://ec.europa.eu/social/main.jsp?catId=559)(medical treatment outside your country for free or at reduced costs) and Smart Open Services for European Patients (epSOS) (https://cordis.europa.eu/project/id/224991)(integration of medical data for patients across Europe).

Student view

We could also mention defence systems through the North Atlantic Treaty Organization (NATO) (https://www.nato.int/), human rights through the Charter of Fundamental Rights of the European Union (CFR) (https://ec.europa.eu/info/aid-development-cooperation-fundamental-rights/your-rights-eu/eu-charter-fundamental-rights_en), and much more.

Disadvantages of trading blocs

Loss of sovereignty

In highly integrated trading blocs such as monetary unions (you will study these in more detail in the next subtopic 4.4.5 (/study/app/pp/sid-186-cid-754025/book/monetary-unions-id-30660/)), countries lose their ability to control their own monetary policies. In a monetary union, countries forgo their autonomy to control interest rates and their own currencies.

The Eurozone is an example of a monetary union. It consists of countries within the EU who chose to adopt the euro as their official currency. The European Central Bank is the entity that controls monetary policy for all 19 states within the Eurozone.

Overview (/study/ap 186- cid- 754025/

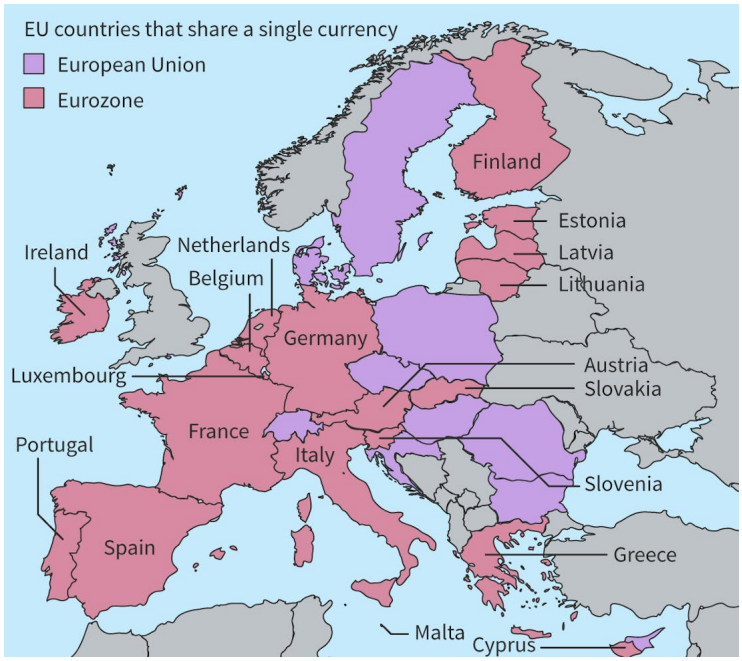


Figure 8. The Eurozone with its 19 members using the euro. (The UK will be leaving the EU effectively by the end of 2020.)

More information for figure 8

The image is a map highlighting countries in the European Union and distinguishing those that are part of the Eurozone. Two colors are used in the map: a shade of purple to denote the European Union countries and a shade of red to represent the Eurozone countries, which use the euro as their currency. Specific countries identified in the Eurozone include Ireland, Portugal, Spain, France, Belgium, Luxembourg, Germany, Netherlands, Finland, Estonia, Latvia, Lithuania, Austria, Slovakia, Italy, Slovenia, Greece, Cyprus, and Malta. The map provides a visual representation of the Eurozone's geographic spread across Europe and its distinction from the broader EU membership.

[Generated by AI]

Student view

Individual countries within the Eurozone lose not only the ability to adjust their economy through monetary policies, but also the ability to manipulate the value of their own currency, as you will learn in the next subtopic, 4.5 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30663/). A country may also lose a sense of identity by forgoing its national currency, with all the history and culture that it represents. See the sample list below of currencies replaced by the euro:

Overview (/study/ap 186- cid- 754025/c

Figure 9. Sample list of currencies replaced by the euro.

Source: "Austrian_schilling (https://commons.wikimedia.org/wiki/File:1000_Schilling_Karl_Landsteiner_obverse.jpg)"; "Slovak koruna (https://commons.wikimedia.org/wiki/File:200_korunova_bankovka_Slovenska_republika.jpg)"; "Lithuanian litas (https://commons.wikimedia.org/wiki/File:500_litai_(2000).jpg)"; "Italian lira (https://commons.wikimedia.org/wiki/File:Lire_100000_(Caravaggio).JPG)"; "Greek drachma (https://en.wikipedia.org/wiki/Greek_drachma)"; "Finnish markka (https://commons.wikimedia.org/wiki/File:FIN-1000m-anv.jpg)"; "Deutsche Mark (https://commons.wikimedia.org/wiki/File:200_Mark_(Obverse).jpg)"; "Cypriot pound (https://commons.wikimedia.org/wiki/File:CYP-10l-anv.jpg)"

The difficulties of engaging in multilateral trade negotiations

Due to the differences among countries, it may be difficult to find common ground when attempting to close trade deals. Think of how widely political, social, cultural, historical and economic characteristics might vary between countries in a trading bloc.

Student view

On the one hand, those differences may be a key driver to move the trade deal forward. Consider the relationship between Mexico and the US. They are quite different, but they are complementary partners. The US imports vegetables and fruit from Mexico, and Mexico imports meat, oilseeds and grains from the US.

Mexico is the US's biggest trading partner. In 2019, it was responsible for 14.8% of all the US's trade transactions (US census bureau (https://www.census.gov/foreign-trade/statistics/highlights/top/top1912yr.html)). Similarly, the US is Mexico's biggest trading partner; in 2018 it provided 76% of Mexico's trade transactions (WITS (https://wits.worldbank.org/countrysnapshot/en/MEX)).

On the other hand, those differences can be an obstacle to closing the deal. Turkey has been negotiating full membership of the EU since 2005 and those negotiations stalled in 2016. The issues for not achieving a deal were:

- Different perspectives on human rights
- Turkey’s close import partnership with Russia
- Fears that the large young population of Turkey could tilt the balance of the European parliament
- Turkey's sensitive foreign relations with Cyprus and Greece

Overview (/study/ap 186- cid- 754025/c

The gains from joining a trade bloc can be very different for each of its members. Those differences can be a source of disputes, especially as there are also likely to be various stakeholders within each country, who would be impacted in different ways based on the outcomes of trade deals.

Trade blocs can also be a threat to global trade liberalisation. Different trade blocs may try to defend the best interest of their members, while at the same time imposing barriers on non-member countries. Disputes between major trading blocs could also potentially undermine the efforts of the WTO.

Complete section with 3 questions

Start questions

Previous section(/study/app/pp/sid-186-cid-754025/book/trading-blocs-id-30659/) Next section (/study/app/pp/sid-186-cid-754025/book/trade-

Student view

Trade creation and trade diversion (HL)

There are two consequences of trading blocs that you need to be able to explain as a Higher level student. These are:

- Trade creation
- Trade diversion

The hope is that trade increases opportunities for importing and exporting new goods and services. This is known as trade creation. There will be a greater choice for consumers and there are likely to be lower prices.

However, sometimes becoming part of a customs union might mean that a country has to erect barriers to trade with countries that it used to trade freely with, meaning that importing goods and services could become more expensive. This is known as trade diversion. Economists often debate the extent to which trade blocs improve free trade, especially as globalisation became much more significant throughout the 1990s.

Exam tip

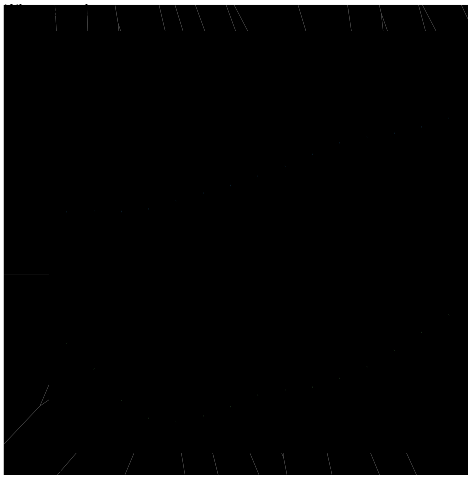
Students often forget to use the definitions of trade creation and trade diversion when answering exam questions.

Use these definitions to support the development of consistent arguments when discussing the advantages and disadvantages of joining a trade bloc.

Trade creation

According to the World Bank (https://data.worldbank.org/indicator/NY.GDP.PCAP.PP.KD?end=2018&locations=EU-LT&start=2004), Lithuania's GDP per capita adjusted for purchasing power parity (PPP) was 82% of the EU average in 2018, a large increase from 52% in 2004 (the year of Lithuania's accession to the European Union). Arguably, this is the result of the new opportunities for trade that Lithuania now has as part of the EU.

GDP per capita, PPP (constant 2021 international $)



Overview (/study/ap 186- cid- 754025/c

Figure 1. GDP per capita, PPP (constant 2011 international $), European Union and Lithuania (2004—2018).

Source: "World Bank Data (https://data.worldbank.org/indicator/NY.GDP.PCAP.PP.KD?end=2018&locations=EU-LT&start=1990&view=chart)"

More information for figure 1

The graph compares Gross Domestic Product (GDP) per capita, PPP (Purchasing Power Parity), constant 2021 International dollars for Lithuania and the European Union over time. The x-axis represents the years from 1990 to 2018, while the y-axis displays GDP per capita in thousands of international dollars. The data, sourced from the World Bank, highlights Lithuania's initial economic challenges, with GDP per capita starting below the European Union (EU) average and declining before steadily increasing, reflecting its developmental progress. The EU shows consistent growth, indicating economic stability. The data points marked on the graph are as follows.

Year	European Union GDP per capita.	Lithuania GDP per capita.
1990	33,396	20, 568
1991	33,557	19,367
1992	33,656	15,267
1993	33,355	12,850
1994	34,172	11,676
1995	35,086	12,153
1996	35,746	12,862
1997	36,610	14,032
1998	37,633	15,189
1999	38,658	15,130
2000	40,131	15,757
2001	40,979	16,918
2002	41,396	18,200
2003	41,708	20,285
2004	42,710	21,848
2005	43,466	23,923
2006	44,940	26,106
2007	46,274	29,344
2008	46,530	30,418
2009	44,447	26,194
2010	45,277	26,863

Student view

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Year	European Union GDP per capita.	Lithuania GDP per capita.
2011	46,244	29,214
2012	45,829	32,907
2013	45,688	32,484
2014	46,353	34,001
2015	47,377	35,295
2016	48,224	36,701
2017	49,574	38,935
2018	50,607	41,241

Learners will gain insights into the economic trajectories of Lithuania and the EU, observing how GDP per capita (PPP) has evolved over time.

When countries join trade blocs, there is the possibility of **trade creation**. When Lithuania acceded to the EU in 2004, trade barriers were lifted. The removal of tariffs offered the opportunity to replace higher-cost goods (domestically produced or imported) with lower-cost imports from members of the trade bloc.

⚠ Be aware

There is no requirement in the syllabus to use diagrams for the concepts of trade creation and trade diversion.

For the sake of an effective explanation, diagrams will be used below, and you are free to use them on your examinations if you would like to do so.

Student view

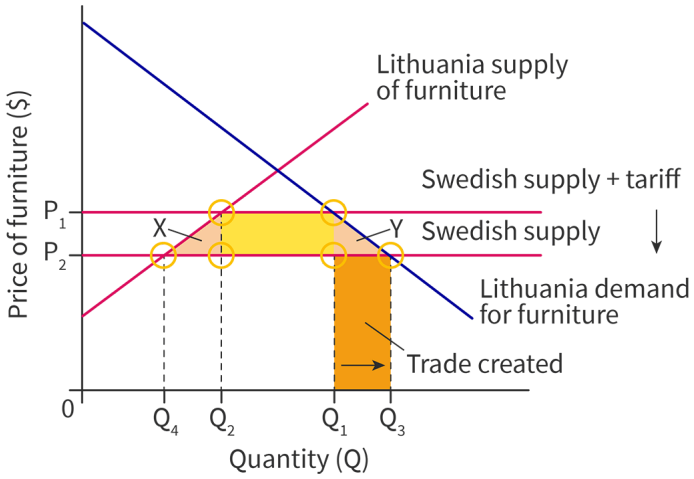

Figure 2. Trade creation when joining a customs union.

More information for figure 2

Overview (/study/ap 186- cid- 754025/c

The diagram illustrates trade creation when joining a customs union. It features multiple regions and color-coded sections representing different economic zones. There are arrows indicating the flow of trade between these regions, and numerical notations marking points of economic interaction. The areas are divided into sections showing economic activities such as import and export, with labels describing changes in trade dynamics post-formation of the customs union. The Lithuanian market for furniture is highlighted, with a focus on changes in trade barriers and alterations in import dynamics.

[Generated by AI]

Let us assume that the Lithuanian market for furniture used to import Q_1 furniture from Sweden, as there were tariff barriers imposed in Lithuania for protectionist reasons.

When Lithuania joined the European Union in 2004, it agreed to remove all tariff barriers to European products. As such, the world supply shifted downwards from Swedish supply + tariff to Swedish supply, and trade was created when total consumption in the market increased from Q_1 to Q_3 (see **Figure 2**).

The net welfare gain for Lithuania is given by the areas X + Y. Area X is a gain due to Lithuanian consumers now being able to buy furniture from a more efficient producer (Sweden rather than Lithuanian domestic producers), and area Y is a gain because of the extra trade created.

Trade diversion

In our discussions about trade so far, we have mostly concluded that a reduction in trade barriers will always increase the allocation of resources and global efficiency.

However, this may not always be the case, as making agreements with certain countries may just result in new barriers being erected between other countries. This is known as **trade diversion**, and if this takes place there will not be any overall improvement in the allocation of resources.

Student view

Trade diversion occurs when a lower-cost import must be substituted with a higher-cost import due to a country joining a trading bloc such as a customs union. That occurs because all countries within a customs union must impose the same trade restrictions on non-members. If a trade diversion happens, there will be a decrease in welfare.

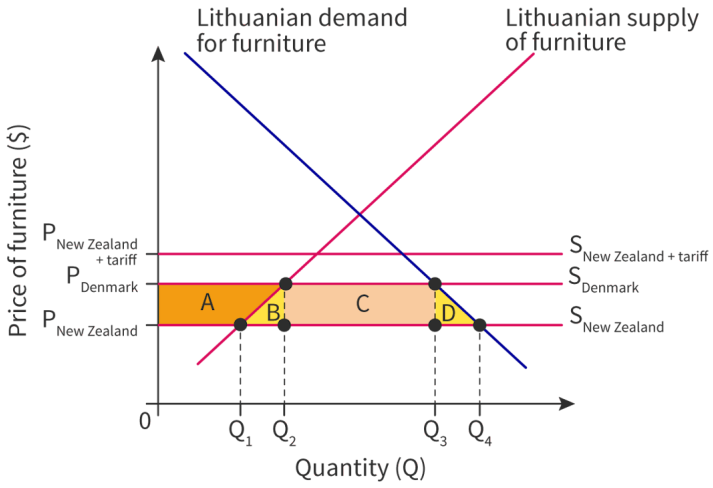

Figure 3. Trade diversion when joining a customs union.

More information for figure 3

Overview (/study/ap 186- cid- 754025/

The graph represents the trade diversion effect on Lithuania's furniture market upon joining a customs union. It features supply and demand curves, labeled as "Lithuanian supply of furniture" and "Lithuanian demand for furniture." The X-axis represents quantity (Q), marked from Q1 to Q4, and the Y-axis represents the price of furniture in dollars (P).

There are several horizontal lines indicating different price levels: "P New Zealand + tariff," "P Denmark," and "P New Zealand," showing the price differences when importing from different countries, including tariffs. Four vertical lines on the demand curve correspond to quantities Q1 to Q4.

Shaded areas within the curves are labeled: A, B, C, and D, indicating changes in consumer and producer surplus due to the shift in sourcing furniture from different suppliers, illustrating welfare impacts. The graph visually explains how joining a customs union increases prices and changes welfare distribution in the context of trade diversion.

[Generated by AI]

Figure 3 illustrates the situation where a country joins a customs union and, because of trade diversion, ends up with a lower level of welfare than before it joined.

The domestic country is Lithuania, and before joining the customs union, it had a choice between trading with New Zealand or Denmark to buy furniture. Lithuania had the autonomy to impose its own trade barriers and it did not levy tariffs on either country. As New Zealand was the lower-cost producing country, Lithuania would purchase Q_4 units at a price of $P_{\text{New Zealand}}$, of which $Q_4 - Q_1$ was imported, and Q_1 was produced domestically.

Lithuania then joined the European Union, which has a common external tariff on New Zealand. Lithuania now opts to buy from Denmark at a price of P_{Denmark} because Denmark's price is now lower than New Zealand's (due to the additional tariff imposed by the customs union). Lithuania now consumes at quantity Q_3, of which $Q_3 - Q_2$ would be imported and Q_2 produced domestically.

Consumer surplus decreases by the areas A + B + C + D. Area A is just transferred to Lithuanian domestic producers but areas B + C + D are lost completely and represent the trade diversion effect of joining the customs union. There is a benefit because domestic production, and therefore employment, increases, but consumers do end up paying a higher price and consuming less of the product.

Student view

Complete section with 2 questions

Start questions

Previous section(/study/app/pp/sid-186-cid-754025/book/advantages-and-disadvantages-of-trading-blocs-id-30662/) Next section (/study/app/p

Monetary unions

A monetary union (also called a currency union) is created when countries form a trading bloc in which there is free trade, a common external policy, free movement of factors of production and a **shared currency**. A monetary union in operation today is the Eurozone or European Monetary Union, consisting of 20 countries who are all members of the 27-nation European Union (Croatia adopted the Euro on January 1st, 2023). Its shared currency is the euro. **Figure 1** shows the Eurozone and the countries that use the euro.

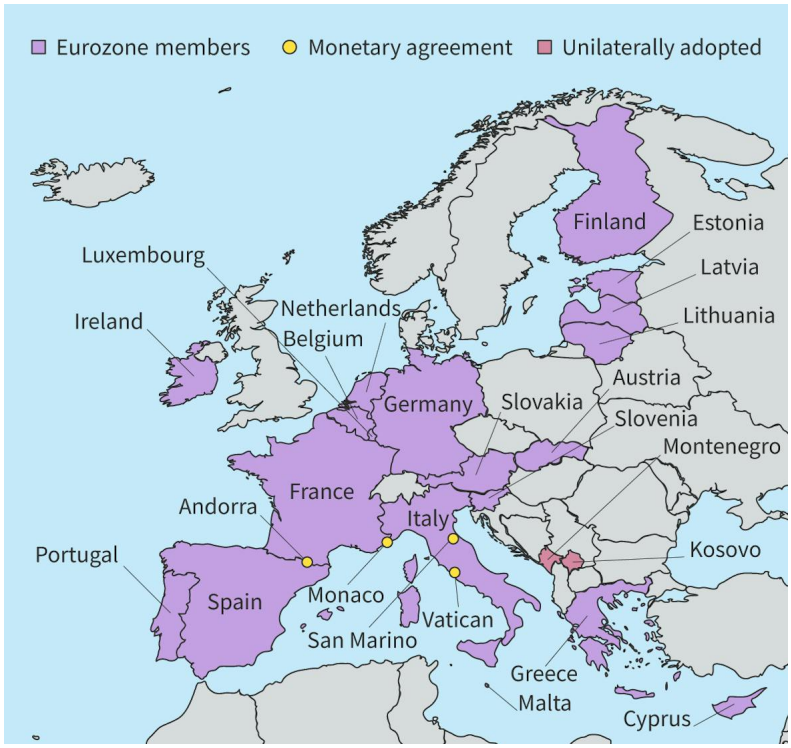

Figure 1. Countries using the euro in Europe (2022).

Croatia also adopted it on January 1st, 2023

Source: "European Union (https://europa.eu/european-union/about-eu/euro/which-countries-use-euro_en)"

More information for figure 1

The image is a map of Europe illustrating the countries that use the euro. Eurozone members are highlighted in purple, including countries like France, Spain, Germany, Italy, and others. Countries with a monetary agreement using the euro are marked with yellow circles, such as Vatican City and Monaco. A single country that has unilaterally adopted the euro, Kosovo, is highlighted in light pink. The map clearly labels each country and shows its position relative to others, offering a geographical overview of currency adoption in Europe.

[Generated by AI]

Discussion of the possibility of a monetary union in Europe started as early as the 1960s, and from 1979 to the early 1990s European countries attempted to stabilise their currencies using the Exchange Rate Mechanism (ERM) in order to prepare for the single currency.

Overview (/study/ap 186- cid- 754025/c

The signing of the Maastricht Treaty in 1992 moved Europe closer towards the Economic and Monetary Union and the euro was formally launched on 1 January 1999 with it properly coming into circulation on 1 January 2001. Control of the currency and monetary policy was given to the European Central Bank (ECB), located in Frankfurt, Germany.

In order to be part of the Eurozone, countries have to meet certain conditions (convergence criteria) related to levels of budget deficits, national debt, interest rates, exchange rates and inflation. In addition, countries would have to forgo their own ability to control national monetary policies. The ECB is responsible for the monetary policy decisions for all members, including the money supply and interest rates. You can find out more about the history of the euro in the video below.

The euro is not just used by the 20 official members of the Eurozone. In **Figure 1**, you can see that Andorra, Monaco, San Marino and Vatican City are not members of the Eurozone. They have made monetary agreements to be allowed to use the euro as their national currency and as part of the agreement they can even issue their own euro coins within the agreed limits.

Kosovo and Montenegro are not members of the Eurozone, but in 2002 they unilaterally adopted the euro as their national currency. The use of the euro is not legally agreed on, but the population of those two countries use it as a legal tender.

Student view

The euro is also used outside of Europe. Look at **Figure 2** and explore this website (https://www.ecb.europa.eu/explainers/show-me/html/euro_outside_europe.en.html)to learn more about the places around the world where the euro is used as the national currency.

Overview (/study/ap 186- cid- 754025/c

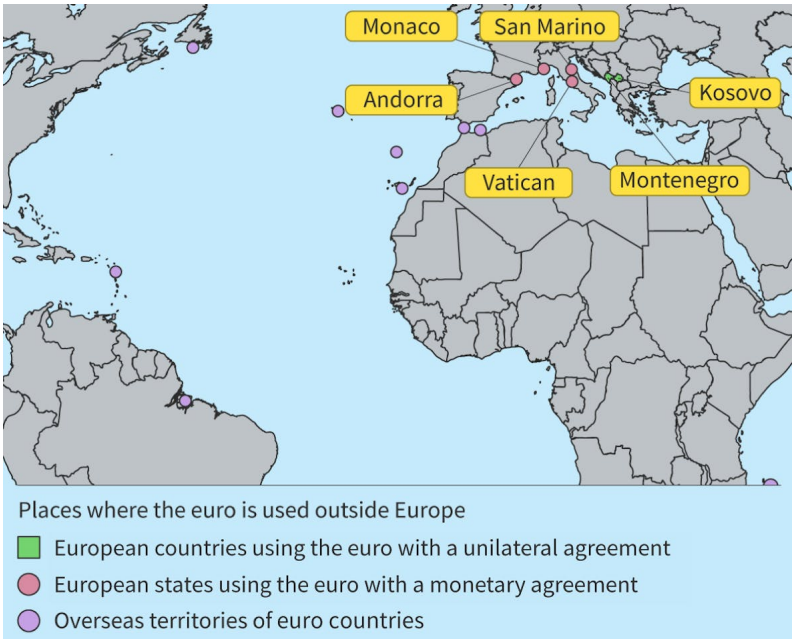

Figure 2. Places where the euro is used outside Europe.

Source: "European Central Bank (https://www.ecb.europa.eu/explainers/show-me/html/euro_outside_europe.en.html)"

More information for figure 2

The image is a world map highlighting regions where the euro is used outside of Europe. Several areas are marked and labeled: Monaco, San Marino, Kosovo, Andorra, the Vatican, and Montenegro, indicating European countries using the euro with a unilateral or monetary agreement. Additionally, overseas territories are marked in different colors, in line with the legend which states: "European countries using the euro with a unilateral agreement" marked in green, "European states using the euro with a monetary agreement" marked in purple, and "Overseas territories of euro countries" marked in blue. The map distinguishes these regions using color-coded labels and dots and situates them against the geographical backdrop of each continent.

[Generated by AI]

Student view

Be aware

The European Union and the Eurozone are not the same thing. The European Union is a common market (free trade, common external policy and free movement of labour and capital) consisting of 27 countries. Of these, 20 countries share a currency — these 20 countries make up the European Monetary Union, also called the Eurozone.

Activity

This chart shows the ratio of the exports of all Western European countries divided by their combined GDP. Your task is to look for patterns in the data, and to consider how major historical events might have affected Western Europe's exports.

Think about the EU and its history, and identify important dates. Then you can think about how these events might have affected the level of European exports to different regions of the world.

Here is a sample list of events you might find useful:

- World wars
- Establishment of the EU

Overview (/study/ap 186- cid- 754025/

- Economic crises
- Oil supply shock of 1979
- Implementation of the euro

Choose a partner or be part of a small group of students and share what you see.

Figure 3. Western European exports by region of destination.

More information for figure 3

This interactive stacked area chart displays India's merchandise exports by continent from 1949 to 2014, measured as a share of GDP. It categorizes exports by destination, including Asia, Western Europe, North America, South America, Africa, Eastern Europe, and Oceania. The chart uses stacked areas to show the relative contribution of each continent over time, helping users identify trends in India's export relationships.

The interactive features allow users to toggle between different years using a slider, compare export trends across different regions, and customize the dataset by selecting or deselecting specific countries or continents. The table view provides an alternative numerical representation of the data, while the chart visually highlights patterns over time.

The data shows significant fluctuations in export levels. From 1949 to the 1970s, India's exports remained relatively low, with a slight dip in the 1960s. The 1990s marked a turning point, coinciding with India's economic liberalization, which led to a sharp rise in exports. The early 2000s witnessed further expansion, with exports reaching a peak around 2008, likely impacted by the global financial crisis. Asia remains India's dominant export destination, occupying the largest share throughout the timeline. Western Europe and North America also account for a significant portion, with trade increasing notably after the 1990s. Africa, South America, and Oceania have a relatively smaller but growing share.

Users can analyze how global events, such as India's economic reforms in 1991, oil price shocks, and financial crises, influenced export patterns. The ability to filter regions and track changes over time makes it a valuable tool for economic and historical analysis.

Student view

Complete section with 3 questions

Start questions

Previous section(/study/app/pp/sid-186-cid-754025/book/trade-creation-and-trade-diversion-id-30661/) Next section (/study/app/pp/sid-186-cid

Monetary unions

A monetary union (also called a currency union) is created when countries form a trading bloc in which there is free trade, a common external policy, free movement of factors of production and a **shared currency**. A monetary union in operation today is the Eurozone or European Monetary Union, consisting of 20 countries who are all members of the 27-nation European Union (Croatia adopted the Euro on January 1st, 2023). Its shared currency is the euro. **Figure 1** shows the Eurozone and the countries that use the euro.

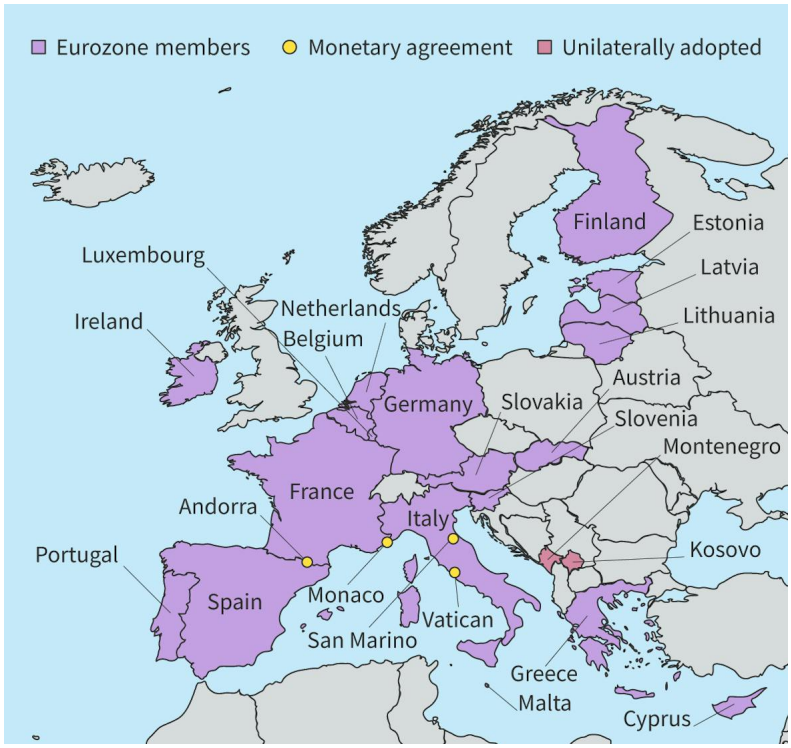

Figure 1. Countries using the euro in Europe (2022).

Croatia also adopted it on January 1st, 2023

Source: "European Union (https://europa.eu/european-union/about-eu/euro/which-countries-use-euro_en)"

More information for figure 1

The image is a map of Europe illustrating the countries that use the euro. Eurozone members are highlighted in purple, including countries like France, Spain, Germany, Italy, and others. Countries with a monetary agreement using the euro are marked with yellow circles, such as Vatican City and Monaco. A single country that has unilaterally adopted the euro, Kosovo, is highlighted in light pink. The map clearly labels each country and shows its position relative to others, offering a geographical overview of currency adoption in Europe.

[Generated by AI]

Discussion of the possibility of a monetary union in Europe started as early as the 1960s, and from 1979 to the early 1990s European countries attempted to stabilise their currencies using the Exchange Rate Mechanism (ERM) in order to prepare for the single currency.

Overview (/study/ap 186- cid- 754025/c

The signing of the Maastricht Treaty in 1992 moved Europe closer towards the Economic and Monetary Union and the euro was formally launched on 1 January 1999 with it properly coming into circulation on 1 January 2001. Control of the currency and monetary policy was given to the European Central Bank (ECB), located in Frankfurt, Germany.

In order to be part of the Eurozone, countries have to meet certain conditions (convergence criteria) related to levels of budget deficits, national debt, interest rates, exchange rates and inflation. In addition, countries would have to forgo their own ability to control national monetary policies. The ECB is responsible for the monetary policy decisions for all members, including the money supply and interest rates. You can find out more about the history of the euro in the video below.

The euro is not just used by the 20 official members of the Eurozone. In **Figure 1**, you can see that Andorra, Monaco, San Marino and Vatican City are not members of the Eurozone. They have made monetary agreements to be allowed to use the euro as their national currency and as part of the agreement they can even issue their own euro coins within the agreed limits.

Kosovo and Montenegro are not members of the Eurozone, but in 2002 they unilaterally adopted the euro as their national currency. The use of the euro is not legally agreed on, but the population of those two countries use it as a legal tender.

Student view

The euro is also used outside of Europe. Look at **Figure 2** and explore this website (https://www.ecb.europa.eu/explainers/show-me/html/euro_outside_europe.en.html)to learn more about the places around the world where the euro is used as the national currency.

Overview (/study/ap 186- cid- 754025/c

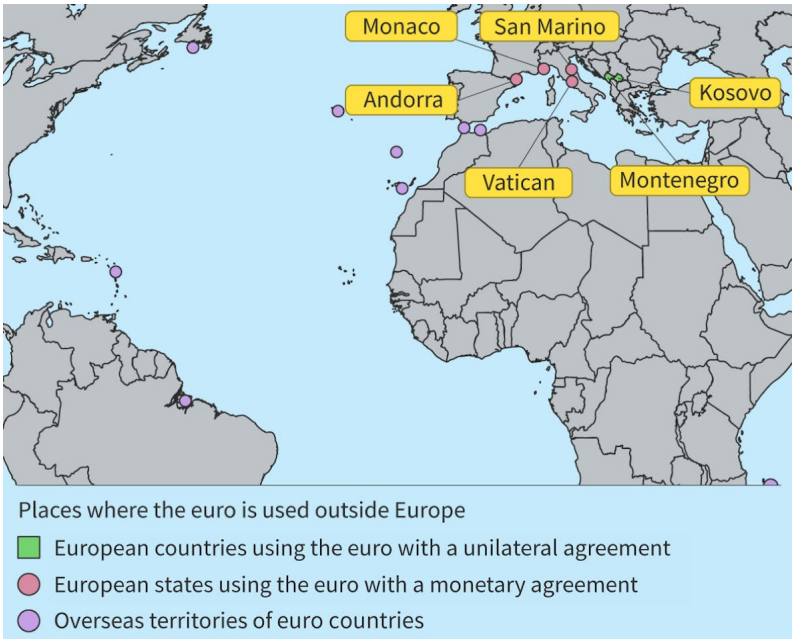

Figure 2. Places where the euro is used outside Europe.

Source: "European Central Bank (https://www.ecb.europa.eu/explainers/show-me/html/euro_outside_europe.en.html)"

More information for figure 2

The image is a world map highlighting regions where the euro is used outside of Europe. Several areas are marked and labeled: Monaco, San Marino, Kosovo, Andorra, the Vatican, and Montenegro, indicating European countries using the euro with a unilateral or monetary agreement. Additionally, overseas territories are marked in different colors, in line with the legend which states: "European countries using the euro with a unilateral agreement" marked in green, "European states using the euro with a monetary agreement" marked in purple, and "Overseas territories of euro countries" marked in blue. The map distinguishes these regions using color-coded labels and dots and situates them against the geographical backdrop of each continent.

[Generated by AI]

Student view

Be aware

The European Union and the Eurozone are not the same thing. The European Union is a common market (free trade, common external policy and free movement of labour and capital) consisting of 27 countries. Of these, 20 countries share a currency — these 20 countries make up the European Monetary Union, also called the Eurozone.

Activity

This chart shows the ratio of the exports of all Western European countries divided by their combined GDP. Your task is to look for patterns in the data, and to consider how major historical events might have affected Western Europe's exports.

Think about the EU and its history, and identify important dates. Then you can think about how these events might have affected the level of European exports to different regions of the world.

Here is a sample list of events you might find useful:

- World wars
- Establishment of the EU

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- Economic crises
- Oil supply shock of 1979
- Implementation of the euro

Choose a partner or be part of a small group of students and share what you see.

Figure 3. Western European exports by region of destination.

More information for figure 3

This interactive stacked area chart displays India's merchandise exports by continent from 1949 to 2014, measured as a share of GDP. It categorizes exports by destination, including Asia, Western Europe, North America, South America, Africa, Eastern Europe, and Oceania. The chart uses stacked areas to show the relative contribution of each continent over time, helping users identify trends in India's export relationships.

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Student view

Complete section with 3 questions

Start questions

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Advantages and disadvantages of monetary unions (HL)

We explored what a monetary union is in section 4.4.5 (/study/app/pp/sid-186-cid-754025/book/monetary-unions-id-30660/). Now you will learn about what the advantages and disadvantages of it are.

The advantages may be summarised as:

- Price stability
- Reduction of uncertainties
- More competitive business environment
- Stronger relations between countries
- Stronger position in global trade

The disadvantages are may be summarised as:

- Political difficulties
- Loss of control over monetary policy
- Restrictions on the use of fiscal policy
- Large initial outlay to change currency

Advantages of forming a monetary union

There is a lot to be gained when countries choose to foster closer links with each other, and the Eurozone has proved to be a formidable economic force. It is the world's third biggest economy. The advantages of forming a monetary union include price stability, reduction of uncertainties, a more competitive business environment, stronger relations between countries and a stronger position in global trade.

Price stability

This is a key benefit that is gained from the process of joining together in a single currency, and the need for economic consistency amongst the member countries once the currency has been launched. Prior to the formation of the Eurozone, the countries who wanted to participate had to abide by 'convergence criteria' in managing their economies. These included:

- Keeping inflation at no more than 1.5% above the average of the three lowest rates among EU members
- Maintaining exchange rate stability within the Exchange Rate Mechanism (ERM) bands for two years prior to joining
- Ensuring that the government budget deficit was no greater than 3% of GDP and that the national debt was no more than 60% of GDP
- Maintaining interest rates no more than 2% above the average rate of the three EU member countries with the lowest rates

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Looking at **Figure 1**, we see significant variations in inflation across the 11 original users of the euro during the 1980s. This would have been in part due to the high oil prices during the 1970s. By the late 1990s, however, we see inflation rates beginning to mirror each other (the euro was introduced by the 11 original countries in 1999).

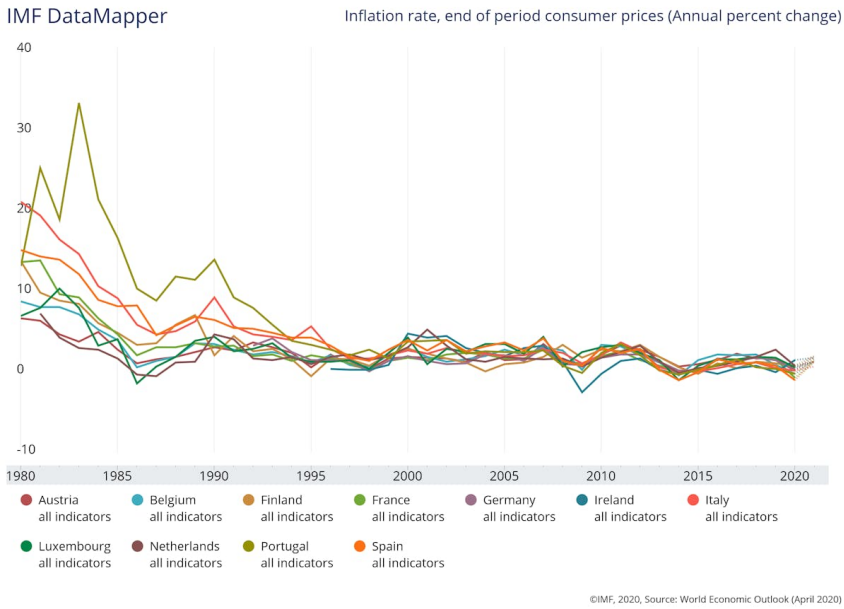

Figure 1. Annual inflation rates since 1980 for the 11 original users of the euro.

Source: "IMF (https://www.imf.org/external/datamapper/PCPIEPCH@WEO/AUT/BEL/FIN/FRA/DEU/IRL/ITA/LUX/NLD/PRT/ESP?year=2021)"

More information for figure 1

The graph shows the annual inflation rates from 1980 to 2020 for 11 original users of the euro. The X-axis represents the years from 1980 to 2020, while the Y-axis represents the inflation rate as a percentage, ranging from -10% to 40%. Different colored lines correspond to each country, including Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal, and Spain.

During the early 1980s, inflation rates were significantly higher and more varied, with some countries reaching upwards of 30%. As the years progressed, the inflation rates for all countries generally decreased, and by the late 1990s, the rates began to converge and stabilize. Post-2000, the inflation rates for the countries remained relatively stable, with minor fluctuations and closer alignment among the countries, illustrating the effects of the euro introduction and subsequent economic policies.

[Generated by AI]

Student view

The Eurozone suffered a major challenge to its stability in 2010. This was largely because countries failed to manage their public debt, which put pressure on the rest of the financial system throughout the Eurozone. For example, Greece (which joined the EU in 2001) had a national debt of over 150% of its GDP by the time the crisis hit.

Reduction of uncertainties

A common currency also eliminates the uncertainties that come with multiple currencies fluctuating in value in relation to other currencies (you will learn more about exchange rates in the next subtopic 4.5 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30663/)).

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Imagine how much easier it is for exporters and importers within the EU, as well as for other non-European countries trading with the Eurozone. A single currency benefits consumers, producers, and investors, giving them all a consistent expectation about the prices of goods and services in just one currency.

A major reason for the currency stability is the European Exchange Rate Mechanism (ERM), which has been updated to ERM II. The ERM II is part of the system responsible for adjusting European currencies and integrating EU members into the Eurozone.

The only currency in the ERM II as of May 2020 is the Danish krone, which the criteria allow to fluctuate ±15% relative to the euro (in reality it only fluctuates around 2%). Every EU member nation is expected to join the Eurozone at some point. The Bulgarian lev and the Croatian kuna may be new additions to the ERM II as these countries adjust to the 'convergence criteria' in order to adopt the euro. Look at the map below to see the status of different countries regarding their adoption of the euro.

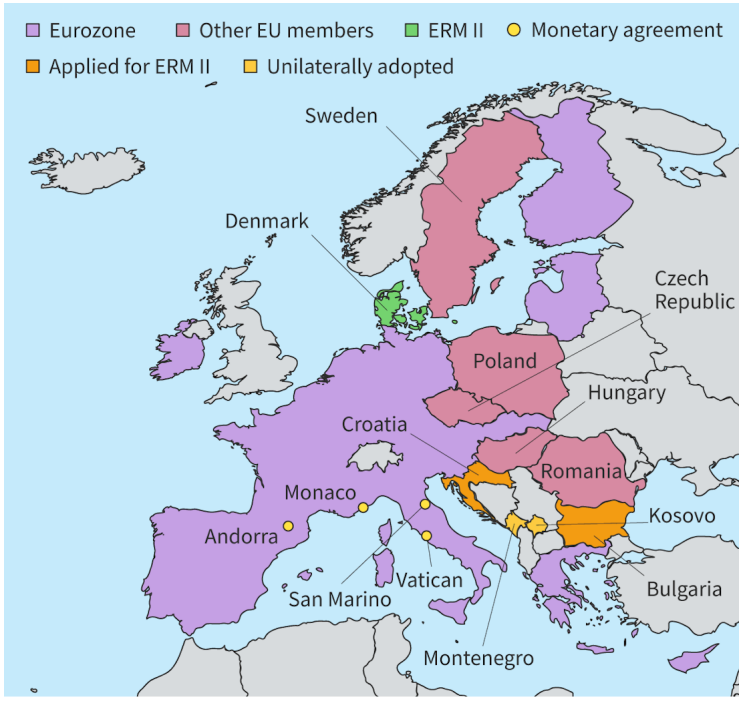

Figure 2. The status of the countries in Europe regarding their adoption of the euro.

Source: "Eurozone map (https://en.wikipedia.org/wiki/European_Exchange_Rate_Mechanism)" by Ssolbergj is licensed under Public Domain (https://commons.wikimedia.org/wiki/Category:PD-self)

More information for figure 2

The map of Europe uses color coding to depict the status of each country's adoption of the euro. Countries in the Eurozone are marked in light purple, including most Western European countries such as France, Germany, Italy, and Spain.

Denmark, colored green, is the only country currently in the ERM II, which allows the Danish krone to fluctuate around the euro.

Countries such as Sweden, Poland, and Hungary are shown in pink, representing other EU members that have not yet adopted the euro.

Bulgaria, highlighted in orange, is listed as having applied for ERM II, indicating the nation is preparing to meet euro adoption criteria.

Several small countries, including Vatican City and San Marino, are marked with yellow dots, signifying they have monetary agreements with the Eurozone but are not EU members.

[Generated by AI]

Student view

A more competitive business environment

One of the main purposes of closer ties between countries – whether in the form of a preferential trade agreement, a free trade area, a customs union or a monetary union – is to develop a more competitive business environment. Some inefficient firms may struggle to cope with the new environment, but many others will thrive, providing an opportunity for them and the wider economy to achieve economic efficiency and growth.

A monetary union provides closer economic ties, which will enable firms to develop trading and investment opportunities as well as achieving greater economies of scale by being able to access a much larger market.

There will be lower transaction costs as firms do not have to pay commission every time currencies are converted and they do not have to reprint their catalogues to convert prices for every country they operate in.

In addition, there will be greater price transparency as everybody is familiar with the same currency. Price comparisons can easily be made and firms will be encouraged to compete more directly with each other, leading to a more efficient production process.

You can see in the chart below that from the early 2000s foreign direct investment (FDI) inflows increased substantially to some of the original countries who adopted the the euro. This is the case especially for Luxembourg, the Netherlands, Ireland, Belgium, and Portugal.

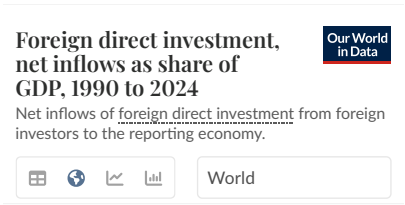

Figure 3. FDI inflows as a percentage of the GDP since 1990 for the 11 original users of the euro.

More information for figure 3

Stronger relations between countries

Having to jointly negotiate issues regularly, and in a formal parliamentary way, will force countries to build closer ties with each other. Even though the political atmosphere may sometimes be difficult, countries taking part in open discussion will always be a good thing for stability, both politically and economically.

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Figure 4. The European Parliament.

A stronger position in global trade

As a single currency area, the Eurozone is the world's third biggest economy, with almost 12 trillion USD worth of nominal GDP in 2019 (Eurostat (https://ec.europa.eu/eurostat/tgm/refreshTableAction.do?tab=table&plugin=1&pcode=tec00001&language=en)). This represents a sizeable contribution to the global economy and is a huge potential market for firms from other countries to operate in.

The current account refers to a part of the balance of payments (which you will learn more about in subtopic 4.6 (/study/app/pp/sid-186-cid-754025/book/the-big-picture-id-30345/)) that consists of the balance of trade, the income balance, and current transfers between a country (or monetary union) and the rest of the world. It is a measure of the international presence of a nation in relation to trade. Below you can see the current account increase for both exports and imports for the Eurozone over the past ten years:

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Figure 5. Current account variations for the Eurozone.

More information for figure 5

Disadvantages of a monetary union

Issues in the news in recent years have highlighted the problems faced by the Eurozone (and to some extent the entire European Union) of sharing a common currency. The first significant difficulties were encountered in 2002, when severe flooding of major European rivers (the Rhine, Danube and Elbe) meant that governments either came close to or actually did break the currency union's fiscal deficit rules. In 2015, Eurostat announced that the Eurozone had deflationary pressures in 2014 (CNN Business (https://money.cnn.com/2015/01/07/news/economy/europe-deflation/index.html)). However, these examples pale into insignificance compared with the ongoing struggle Greece has faced with its public debt levels since the 2009 financial crisis.

Student
view

International Mindedness

Note that currencies carry more than just monetary values. Each paper currency in the world has a motif with significant individuals, places, events, animals and objects that represent national pride, values, culture and even religion.

When a monetary union is formed, some of those elements are lost in exchange for a common motif representing the union of the countries belonging to the monetary union.

Political difficulties

Any kind of joint decision-making is likely to be difficult when there are many different nations involved. In the case of the Eurozone, there are 19 very different countries, with vastly differing economies, trying to jointly manage a currency. Managing the currency is unproblematic if the economic experience of the countries does not vary too much. However, if

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some countries need to loosen monetary policies while others do not, or vice versa, there will be disagreements. In addition, some countries within the Eurozone, such as Germany and France, have more bargaining power than others.

Figure 6. Alexis Tsipras and Angela Merkel, who differ in their political and economic ideology.

Credit: Getty Images Michele Tantussi / Stringer

Governments also differ in ideology, depending on the political parties in charge at any given moment. Angela Merkel, the Chancellor of Germany, who is the leader of a right-wing party, has to negotiate with Greece, represented by Alexis Tsipras, the leader of the left-wing Syriza party.

Finally, there is a big distance between the decision-making process at the top of the organisation and ordinary voters in each member nation. Polling indicates that some people feel decisions are being made that they did not vote for. This is also a problem for the European Union and the running of the EU parliament.

Loss of control over monetary policy

Student view

Decisions that would usually be made by the national central bank are made by the central bank of the monetary union. In the case of the euro, the European Central Bank (ECB) sets monetary policy for all countries in agreement with the national central banks. It is a major task to set a base rate that is appropriate for all countries.

The financial difficulties Greece has faced have led many to question whether it would be safe for countries to give up control of their monetary policy and move towards greater integration.

Figure 7. The European Central Bank in Frankfurt, Germany.

Credit: Getty Images Raimund Linke

Restrictions on the use of fiscal policy

In 1992, when the Maastricht Treaty was signed, countries agreed to limit government deficits to 3% of GDP and public debt levels to 60%. The Stability and Growth Pact (http://ec.europa.eu/economy_finance/economic_governance/sgp/index_en.htm)(SGP), put together a year later, set out the rules for national fiscal policy for both Eurozone and non-Eurozone EU member states. Countries face a fine of 0.2% of GDP if they fail to abide by the rules, or 0.5% of GDP if they break the rules repeatedly. Countries also stand to lose out on other opportunities, such as the European Regional Development Fund.

Figure 8. Maastricht, the Netherlands, where the treaty that led to the creation of the euro was signed.

Credit: Getty Images DutchScenery

Germany faced these fines in the early days of the euro, when severe flooding of the rivers Elbe and Danube threatened to cause significant economic losses to the affected regions.

If a country in the Eurozone enters a recession, it cannot implement independent monetary policies, as the ECB determines monetary policy. Eurozone countries can still enact their expansionary fiscal policies, but if the country is already in debt, it is unlikely that the criteria of the Stability and Growth Pact (SGP) will be met. You can see in the table

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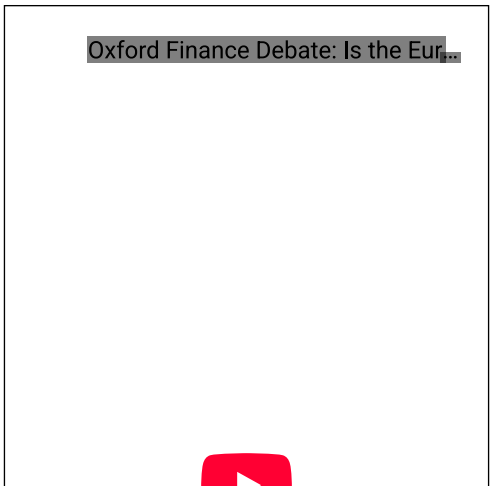
shown here (https://en.wikipedia.org/wiki/Stability_and_Growth_Pact#Member_states_by_SGP_criteria) that nearly every member of the EU has breached the criteria at some point.

Large initial outlay to change currency

It costs time and funds to set up a new currency in a country. All firms need to produce new price lists and convert to the new currency. When the euro was introduced, many people complained (http://www.ijcb.org/journal/ijcb07q4a1.pdf)that prices were rounded up. However, it is not clear from the evidence (http://ec.europa.eu/economy_finance/publications/publication16493_en.pdf)that the introduction of the euro added to existing uncertainty about inflation or whether it directly caused inflationary pressure.

Is the euro a good idea?

Wherever you live in the world, the ongoing struggles of the Eurozone will often feature often in the news. An individual's background, their political views, where they live and many other factors will affect whether that person thinks the euro is a good idea or a bad one. In the video below, two professors from the University of Oxford discuss the main economic advantages and disadvantages of the euro and whether it will ultimately fail.



Student view

Complete section with 3 questions

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The World Trade Organization (WTO)

The main goal of the World Trade Organization (WTO) is to improve and broaden international trade by setting rules and practices to achieve greater balance and transparency in trade negotiations among countries.

The WTO originated from the General Agreement for Tariffs and Trade (GATT) that was set up in 1947 to oversee trade relations between countries. Leaders and ministers were interested in creating a stable global economy after the devastation created by World War II. Some of the causes of the war (http://www.nber.org/papers/w14560.pdf)had been economic in nature, including the hyperinflation in Western Europe, and the success of Hitler's economic policies that led to his menacing rise. During the 1930s, several countries, including many countries in Latin America, also pursued isolationist trade policies.

Figure 1. WTO headquarters in Geneva.

Credit: Getty Images Robert Hradil / Stringer

During the Uruguay Round of talks, which took place between 1986 and 1994, the WTO was developed into its current form. It began operations on 1 January 1995 and has its headquarters in Geneva, Switzerland. As of May 2020, the WTO had 164 nation members.

According to the WTO website (https://www.wto.org/english/thewto_e/whatis_e/what_we_do_e.htm), the functions of the organisation are:

- administering and monitoring the application of WTO trade agreements
- acting as a forum for trade negotiations
- settling trade disputes
- monitoring national trade policies
- providing technical assistance and training for developing countries
- cooperating with other international organisations

The WTO is guided by the following set of principles:

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- Non-discrimination: this principle is applied to higher and lower income countries, but not to trading blocs
- Openness of trade: this should be achieved by lowering all trade barriers among nations
- Predictability and transparency: all stakeholders should trust that negotiations are not led arbitrarily
- Promotion of fair competition: this principle attempts to assess the fairness of trade transactions and guide responses
- Privileging less developed countries: this is aimed at improving equity between more developed countries (MDC) and less developed countries (LDC)
- Protecting the environment: initiatives should have the environment at heart including public health, animal health and plant health

Look at the interactive visuals in **Figure 2** and think about the role of the WTO and the influence that it may have had on increasing the flow of international trade across the world.

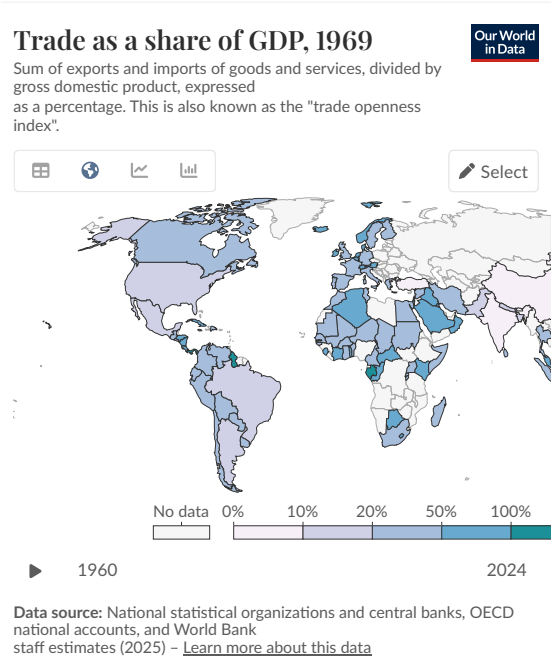

Figure 2. The trade openness index (exports plus imports divided by GDP) across the years.

More information for figure 2

Student view

The interactive visualization represents trade as a share of GDP for the year 1969. It measures the sum of exports and imports of goods and services divided by gross domestic product, expressed as a percentage. This metric is commonly referred to as the "trade openness index." The map uses a color gradient to indicate trade openness, ranging from low percentages in light colors to high percentages in darker shades of blue and green. Countries without data are represented with hatched shading.

Users can switch between table, map, and chart views. The map provides an intuitive way to compare trade openness across different regions. Some countries, particularly in Africa, Asia, and Latin America, show high trade-to-GDP ratios, while others, especially in North America and parts of the Soviet Union, display lower trade shares.

A time slider at the bottom allows users to navigate through different years, from 1960 to 2023, making it possible to analyze historical trends and observe how trade openness has evolved over time. The "Play time-lapse" button animates these changes, providing a dynamic view of globalization trends.

Additional features include options to download the data, share the visualization, or expand it to full screen. Users can also explore the data source, which is credited to the World Bank and OECD. The visualization is hosted by Our World in Data under a Creative Commons license.

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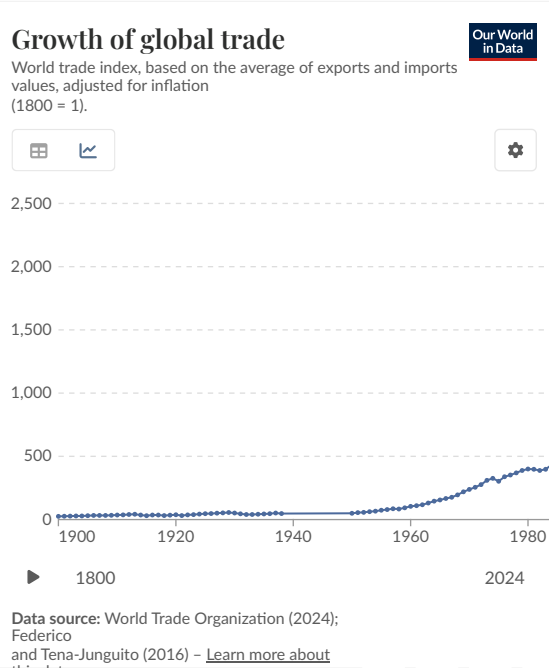

Figure 3. Total value of global exports since 1900.

More information for figure 3

An interactive line chart displays the growth of global exports over time, with total world exports adjusted for inflation and indexed to 1913. The chart represents export volumes as a percentage relative to the base year 1913, illustrating long-term trends in international trade.

Users can toggle between a table and a chart view, with the chart showing a steep upward trend, particularly from the mid-20th century onward. The early 20th century featured relatively stable export levels with minor fluctuations, followed by a decline during major global events such as World War I and the Great Depression. After World War II, exports began to rise steadily, with an accelerated increase from the 1960s onward. The steepest growth occurs from the 1990s into the early 2000s, reflecting the impact of globalization, trade liberalization, and technological advancements. A noticeable dip in the late 2000s corresponds to the global financial crisis, after which exports recover but exhibit fluctuations.

The interactive element includes a time-lapse feature, allowing users to animate the changes over time. A slider at the bottom enables manual selection of specific years for detailed examination. Additionally, users can access data sources, download the visualization, share it, or expand it to full-screen mode.

The data originates from Federico and Tena-Junguito (2016) and is hosted by Our World in Data under a Creative Commons license.

This tool is designed to help users analyze long-term trade patterns, observe the impact of historical events on global exports, and gain insights into economic globalization.

Student view

What affects the influence of the WTO?

You have read about the objectives, functions, and principles of the WTO. In theory, it seems very positive and beneficial to all nations throughout the world. In practice, there is a great deal of debate about the influence of the WTO on international trade.

Trade disagreements

Many of the issues related to trade disagreements are linked to **agricultural subsidies** in the developed world and tariff escalation in developing countries.

On the one hand, more developed countries (MDCs), in general, have higher levels of support for agriculture than less developed countries (LDCs). Look at **Figure 4**, which shows the level of producer support estimates (PSE) measured by the OECD (https://data.oecd.org/agrpolicy/agricultural-support.htm#indicator-chart). This estimate includes subsidies and any other form of financial support to the agricultural industry in various countries around the world. You will see significant differences in the levels of government support in different countries.

Figure 4. Production Support Estimates (PSE) in millions of euros.

More information for figure 4

An interactive line chart visualizes trends in agricultural producer support (PSE) across various countries from 1990 to 2018. It allows users to explore patterns, compare values, and analyze key insights by hovering over data points to view exact values for specific years and nations. The horizontal axis represents the years, illustrating changes over time, while the vertical axis displays PSE values in millions of euros, indicating the level of financial support provided to farmers. Each line represents a different country, showing fluctuations in agricultural subsidies.

China experiences a sharp rise in agricultural support after 2005, peaking at over 206k before declining slightly. The European Union maintains consistently high support levels, fluctuating between 79k and 93.47k. The United States shows moderate but steady growth, reaching around 37.5k by 2018. Argentina and India exhibit negative or minimal producer support, suggesting limited government subsidies for agriculture.

The data underscores significant policy shifts, economic changes, and their impact on global agricultural competitiveness. Developed nations provide higher subsidies, often creating an uneven playing field for farmers in developing countries. This visualization helps users compare international agricultural policies, assess trade dynamics, and understand government intervention in the farming sector.

The MDCs provide high subsidy levels to their farmers, while for most of the LDCs agriculture is their largest economic sector. The subsidies make it difficult for developing countries to compete in the international market.

On the other hand, you can see in **Figure 5** that historically there has been a drastic decline in the level of agricultural export subsidies among the MDC member nations of the WTO. Also, in general MDCs have a lower level of tariffs for all goods in comparison to LDCs. If you would like to learn more about this visit the World Bank Data website (https://tcdata360.worldbank.org/indicators/TM.TAX.MRCH.WM.AR.ZS?country=USA&indicator=1909&countries=BRA&viz=line_chart&years=1988,2018&compareBy=income)and scroll down to the map.

Overview (/study/ap 186- cid- 754025/c

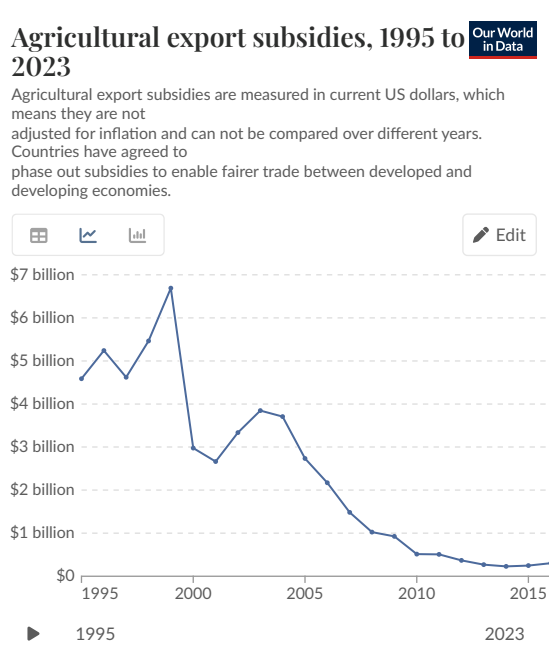

Figure 5. Agricultural export subsidies for WTO member nations from 1995—2016.

More information for figure 5

This interactive line chart presents agricultural export subsidies, allowing users to examine how different countries have provided financial support for agricultural exports over time. Each country is represented by a distinct color-coded line, with the vertical axis displaying values in billions of USD ($1 billion—$7 billion) and the horizontal axis covering the years 1995—2021. The data, sourced from the World Trade Organization, highlights trends in agricultural export subsidies.

Users can hover over data points to view exact values, adjust the timeline slider to focus on specific periods, and toggle between views for deeper analysis. The Country Selection Panel allows for custom comparisons by selecting or deselecting countries of interest. Additionally, a table view is available for structured numerical analysis.

Developed nations, including the European Union and the United States, have historically provided the highest agricultural export subsidies to support their agricultural sectors and maintain competitiveness in global markets. In contrast, many developing countries and free-market economies provide little or no agricultural export subsidies, instead relying on market forces or domestic agricultural policies.

By 2021, agricultural export subsidies had been largely phased out, reflecting a shift toward fairer trade practices. Between 1995 and 2021, a significant decline in subsidies was observed, particularly among More Developed Countries (MDCs) that are members of the WTO. This trend aligns with broader efforts to promote fairer global trade. MDCs also generally maintain lower tariff levels across all goods compared to Less Developed Countries (LDCs), contributing to more open trade policies.

This visualization provides insights into global trade patterns, illustrating how reliance on food exports has varied across countries and over time. By interacting with the data, users can explore economic structures, trade dependencies, and historical shifts, making it a valuable tool for analyzing international trade trends.

At the bottom, sources and credits link to the original research. Additional controls enable users to download the visualization, share it, expand it to full-screen mode, or explore further insights on trade and globalization.

Student view

Tariff escalation is a practice used by developed nations when importing raw materials and semi-processed goods from developing countries. The tariffs become higher the more processed the product is. So raw materials have lower tariffs than semi-processed goods, which in turn have lower tariffs than processed goods.

This scenario creates a situation where the developing countries end up being stuck producing raw materials and semi-processed goods, which usually generate lower levels of revenue. This situation discourages LDCs from improving their industries and receiving higher revenues for their exports.

For example, the EU imposes different import duties on coffee products depending on the processing level of the product:

Product	Tariff level
Coffee husks and skins	0%
Coffee, not roasted (decaffeinated)	8.30%
Coffee, roasted (decaffeinated)	9.00%

You can explore all the different import duties and tariffs imposed by the EU here (https://trade.ec.europa.eu/tradehelp/).

Power imbalances

MDCs usually send large groups of trade specialists and negotiators to work on trade agreements, while LDCs struggle to send any representatives to the rounds of negotiation.

This has led to claims that many trade agreements favour MDCs and that the LDCs' representatives have not even been consulted.

Trade blocs such as the EU have significant power when negotiating trade deals. The sheer size of its combined economy (USD 18.2 trillion in 2019, according to the IMF (https://www.imf.org/external/pubs/ft/weo/2019/02/weodata/weorept.aspx?pr.x=71&pr.y=2&sy=2017&ey=2021&scsm=1&ssd=1&sort=country&ds=.&br=1&c=998&s=NGDP_RPCH%2CNGDPD%2CPPPGI may tilt the balance in any negotiation it has with individual countries.

Activity

Investigate the importance of agricultural products to the total exports of countries around the world. Select one or more countries and try to identify arguments for and against the claim below:

'MDCs with their agricultural subsidies destroy the main export industry of LDCs.'

- Is that the case for all LDCs?
- Investigate South American countries and specifically Colombia. What do you see?
- What is the global trend of the importance for food exports since the 1960s?
- What about the same trend since 2010?
- What is the relevance of agricultural products for the exports of MDCs?

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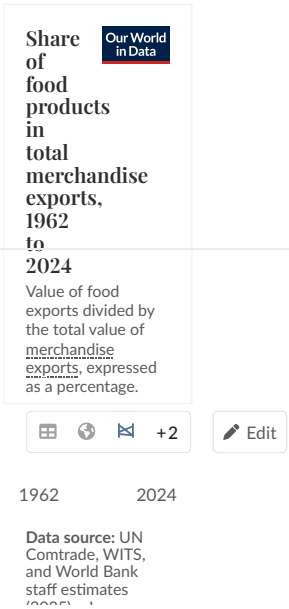
Section

Feedback



- **Figure 6.** Share of food products in total merchandise exports, 1962—2017. ('Food' includes, among other goods, live animals, beverages, tobacco, coffee, oils, and fats.)

More information for figure 6

This interactive line chart shows the share of food products in total merchandise exports from 1962 to 2023. The line chart allows users to track trends over time for different countries, with each country represented by a distinct colored line. Users can add or remove countries from the selection panel on the right, which currently includes Brazil, Cameroon, Colombia, Ecuador, France, Ghana, Malawi, Morocco, the Philippines, and Zimbabwe. The x-axis represents time, starting from 1962, while the y-axis represents the percentage of food exports as a share of total exports. A time-lapse feature allows users to animate the historical changes over the decades.

The data suggests that in many Less Developed Countries (LDCs), food exports initially formed a significant share of total exports. However, this percentage has declined in most countries, likely due to economic diversification, industrialization, and shifting trade policies. The claim that agricultural subsidies from More Developed Countries (MDCs) harm LDCs' export industries is partly supported, as some LDCs show a decreasing reliance on food exports over time. However, this trend is not uniform, with some countries still maintaining high food export shares.

In South America, Colombia shows a fluctuating but overall declining trend in food export importance. This indicates that while agriculture has remained relevant, the country has diversified its economy with other export sectors. The global trend since the 1960s shows a steady decline in food exports' share, reflecting increasing industrialization and service sector growth. Since 2010, the trend remains largely stable for most countries, indicating that food exports have found a relatively fixed share in global trade. For MDCs, agricultural exports generally make up a small percentage of total exports, highlighting their economic diversification. Countries like France show consistently low food export shares, reinforcing this idea.

Student view

Complete section with 3 questions

Start questions

Previous section(/study/app/pp/sid-186-cid-754025/book/advantages-and-disadvantages-of-monetary-unions-hl-id-30664/)

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