HL IB Economics

Your notes

4.4 Economic Integration

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4.4.1 Understanding Economic Integration

Your notes

Economic Integration

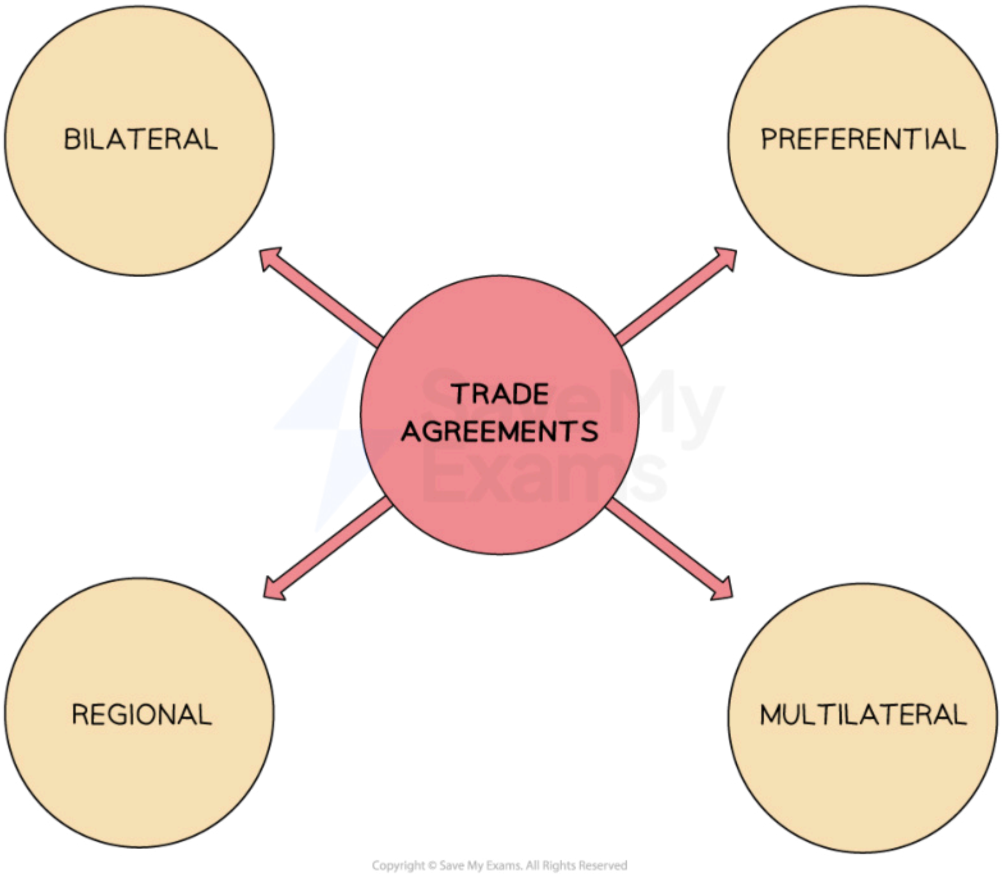
- **Economic integration** occurs as countries reduce trading barriers between themselves and become more interdependent

- There are several ways in which **economic integration can deepen**

1. Through the development of trade agreements
2. Through the creation of trading blocs
3. Through the formation of a monetary union

1. Trade agreements

Your notes



There are 4 common types of trade agreements

- **A preferential trade agreement (PTA)** is an agreement between two or more countries providing preferential (better) terms and conditions of trade to member countries
  - **E.g. Vietnam** has preferential tariff rates with Australia
- **A bilateral trade agreement** is a preferential trade agreement between two countries and aims to reduce or eliminate barriers to trade
  - **E.g. Vietnam** signed a bilateral trade agreement with Korea in 2015

- **A regional trade agreement (RTA)** is a preferential trade agreement usually between more than two countries in the same geographical region
  - **E.g. Armenia** created an agreement with the EU in 2019 to create the EU-Armenia RTA

- **A multilateral trade agreement** is a legally binding preferential trade agreement between more than two countries or trading blocs and is usually negotiated and overseen by the World Trade Organisation (WTO)
  - **E.g. The East African Community** was created in 2005 between seven African countries

2. Trading Blocs

- There are generally three types of trading blocs - Free Trade Areas (FTAs), Customs Unions, and Common Markets
  - Each successive bloc has a higher level of integration

Advantages and Disadvantages of Trading Blocs

Advantages	Disadvantages
▪ Greater access to markets offer the potential for **economies of scale** ▪ With freedom of labour, there are **greater employment opportunities** ▪ Membership in a trading bloc may allow for stronger **bargaining power** in new multilateral negotiations ▪ **Greater political stability** and cooperation between the countries within the bloc due to the increased interdependence ▪ **Trade Creation** Trade creation occurs when a regional trade agreement (RTA) leads to the expansion of trade between member countries. By eliminating or reducing trade barriers, such as tariffs or quotas, within the agreement, member countries can	▪ **Loss of sovereignty** as nations increasingly give up their autonomy, perhaps most visible when joining a monetary union (nations lose the ability to set their own monetary policy) ▪ **Multilateral trading negotiations** become more challenging as countries within a trading bloc have to maintain the existing bloc rules when dealing with third-party countries ▪ **Trade Diversion** Trade diversion occurs when a regional trade agreement redirects trade away from **more efficient external suppliers** towards less efficient internal suppliers It can sometimes lead to higher costs and reduced efficiency due to the **loss of access to lower-cost suppliers outside the agreement**

access new markets and increase their trade volumes.	

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3. Monetary Unions

- Monetary Unions often develop once there is integration at a Common Market level
- Nations in the Common Market may desire the creation of a common **central bank** and convergence of **monetary policy**

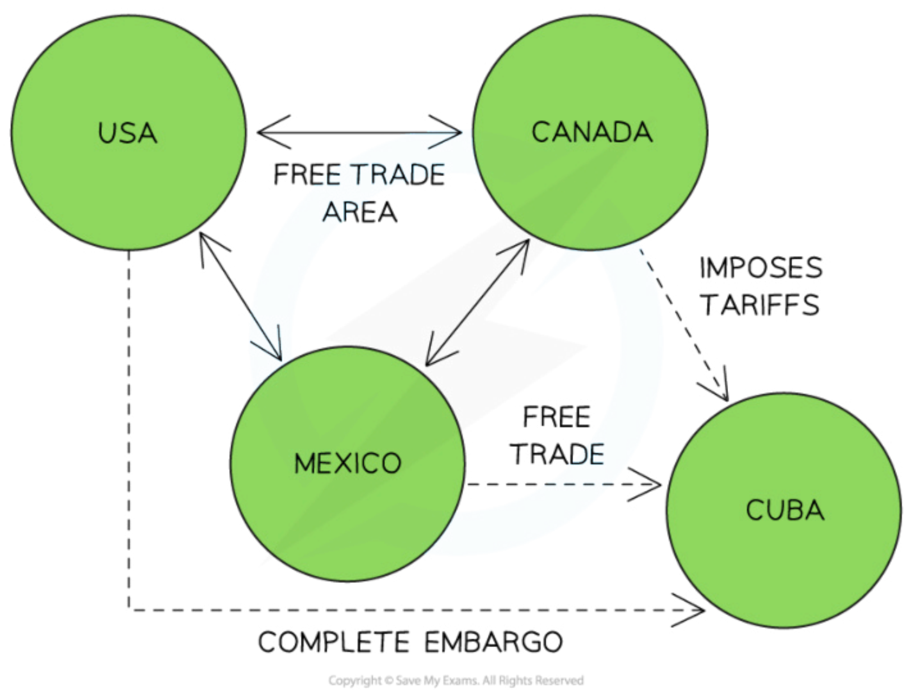
Your notes

4.4.2 Types of Trading Blocs

1. Free Trade Areas (FTAs)

- A **trading bloc** is a group of countries who come together and **agree to reduce or eliminate any barriers to trade** that exist between them
- There are different levels of **economic integration** ranging from relatively low integration in a **bilateral agreement** to high integration in a **monetary union** e.g. the Eurozone
- Globally, there were more than 420 regional trade agreements in effect in 2022
- Each subsequent type of trading bloc has **increased levels** of economic integration

- A **free trade area** is a bloc in which countries agree to **abolish trade restrictions between themselves** but maintain their **own restrictions** with other countries e.g Canada-United States-Mexico Agreement (CUSMA)



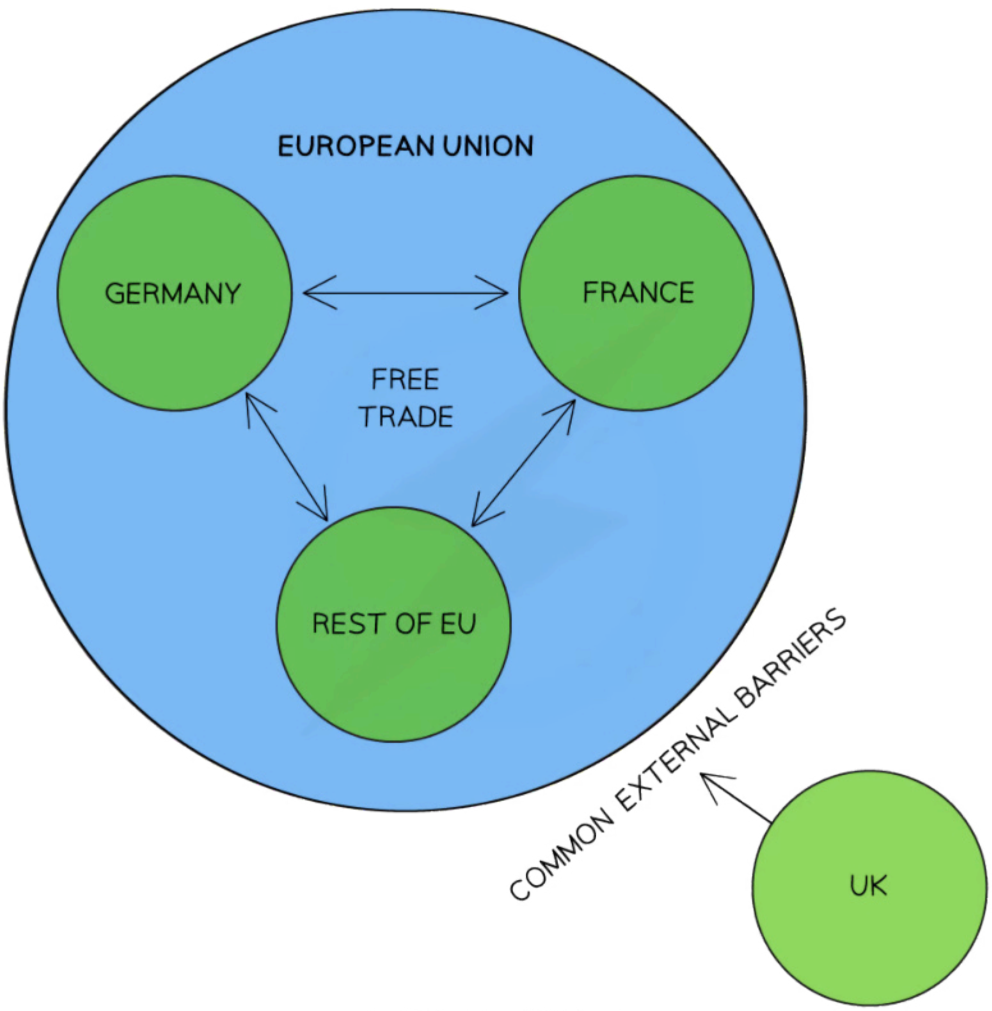
Mexico, Canada and the USA have a free trade agreement but can deal individually with Cuba as they see fit

Your notes

- In the diagram above, Mexico, Canada and the USA have **reduced/eliminated many trade restrictions** between themselves
  - The USA **refuses to trade** with Cuba and has placed a complete ban on all exports/imports to Cuba
  - Canada trades with Cuba but imposes **tariffs on all imports**
  - Mexico **trades freely** with Cuba

2. Customs Unions

- A **customs union** is an agreement between countries in which all goods/services produced by members are **traded tariff free**. Additionally, countries agree on **common tariff rates on imports** from all external (third-party) countries



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Countries within the European Union trade freely between themselves and have common barriers with all third-party countries e.g. UK

- In the diagram above, countries in the **European Union** have **eliminated all tariff barriers** between themselves but impose **common tariff barriers** on third party countries such as the UK or China

3. Common Markets

- Similarly, to a customs union, goods/services are traded tariff-free in **common markets**
- Additionally, the four **factors of production** flow freely between member countries
  - The goal is to improve the **allocation of resources** between the common market members and lower the costs of production
  - The **European Union** is a customs union and a common market

4. Monetary Union

- A **monetary union** takes integration a step further. Members enjoy all of the benefits of a customs union and common market, but then also establish a **common central bank** which issues a **common currency** and controls the monetary policy of member countries
  - Prior to Brexit, the UK was a member of the **European Customs Union** and common market **but never joined the Eurozone**
  - At the start of 2023, 20 of the 27 countries in the EU are also members of the Eurozone

Advantages and Disadvantages of Monetary Unions

Advantages	Disadvantages
Price Stability - The common currency eliminates exchange rate fluctuations, reducing transaction costs and increasing price stability within the union **Increased Trade and Market Access** - A single currency makes it easier for businesses to engage in cross-border trade within the union leading to increased trade and economic growth	**Limited Monetary Policy Flexibility** - Member countries relinquish control over their monetary policy decisions to a supranational authority, such as the European Central Bank in the case of the Eurozone - This restricts a country's ability to **independently adjust interest rates** or implement policies tailored to its specific economic conditions, potentially hindering its ability to address domestic economic challenges **Loss of Exchange Rate Control**

Enhanced Monetary Policy Credibility ▪ Having a credible and independent central bank that follows a transparent monetary policy **promotes investor confidence in all countries** within the union (even weaker ones)	▪ Countries in a monetary union lose the ability to adjust their exchange rates to maintain competitiveness ▪ They cannot rely on currency devaluation or revaluation to **restore competitiveness or rebalance** their economies **Fiscal Constraints and Policy Coordination** ▪ Countries must adhere to **strict budgetary rules**, deficit and debt limits, and coordinated fiscal policies ▪ This constraint **limits a country's fiscal policy** autonomy and can create challenges during **economic downturns (recession)**

4.4.3 The World Trade Organisation (WTO)

Your notes

The role of the WTO

- The World Trade Organisation (WTO) was established in 1995 to **promote free trade**
  - They believe free trade is the best way to raise living standards, create jobs and improve people's lives
- **Trade liberalisation** is the process of rolling back the barriers to free trade e.g. removing tariffs
- The WTO has two main roles in liberalising trade

1. It brings countries together at conferences and encourages them to reduce or eliminate **protectionist trade barriers** between themselves e.g. The Doha Round conferences
2. It acts as an **adjudicating body** in trade disputes. Member countries can file a complaint if they believe a trading partner has violated a trade agreement. The WTO will then run a hearing and make a judgement

The Objectives and Functions of the WTO

Objectives of the WTO	Functions of the WTO
▪ Improving people's lives ▪ Promotion of fair competition ▪ Protecting the environment	▪ Trade negotiations ▪ Implementation and monitoring of trade agreements ▪ Dispute settlement ▪ Building trade capacity between nations ▪ Outreach to governments and influential organisations on behalf of member countries

EXAMINER TIP

WTO judgements are **not legally binding.** Members voluntarily submit to them (or not). A judgement in favour of a trade dispute does allow the aggrieved nation to put protectionist measures in place with the WTO's approval. The hope is that these measures will then force the nation committing the violation to back down and resolve the trade issue.

> When evaluating the effectiveness of trade agreements, it is worth noting that larger economies tend to selectively choose which rulings of the WTO to abide by. Smaller (usually developing) economies tend not to have that luxury.

Your notes

Factors Affecting the Influence of the WTO

- In March 2022 there were 320 **regional trade agreements** globally
- While these are **beneficial to the members** in the agreement (as they strengthen ties and create more trade between them), they also create **conflicts** with the stated aim of the WTO - to liberalise trade
  - Regional agreements often **shift trade** from a non-member who is more efficient in producing certain goods/services, to a member country who is less efficient (trade diversion)
  - Regional trade members then often institute common **trade barriers** on non-members which is the opposite of trade liberalisation (protectionism)

Two key Factors Which Continue to Undermine the Influence of the WTO

Difficulties in reaching agreement on services and primary products	Unequal bargaining power of members
▪ **MEDCs continue to subsidise** many firms producing primary products which allows them to dominate global markets ▪ LEDCs do not have the tax revenue to do the same for their firms and so they are unable to compete ▪ Firms from **LEDCs are frequently blocked** from offering services (which generate higher profit and income) in MEDCs ▪ This prevents free trade in services	▪ Firms and individuals from MEDCs tend to be **better networked** and will unashamedly work their connections so as to gain better trading conditions ▪ Larger, wealthier countries will also **pressurise WTO negotiations** in order to secure the outcome they want ▪ It is much harder for LEDCs to gain preferential terms in trade negotiations due to this **power imbalance**