

Chapter 10

Regional Economic Agreements E136

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Regional Economic Agreements - Baby Steps

- Regional Trade Agreements - agreements to reduce trade barriers within a specific region (WTO agreements cover everyone)
- Many levels
 - Preferential Trade Agreement
 - Free Trade Area
 - Customs Union
 - Common Market
 - Economic Union

Free-trade area - FTA

- Countries agree to eliminate tariffs and other non-tariff barriers between them
- Again must cover “substantially all” trade
 - May just cover non-agricultural products
 - May cover all merchandise trade
 - May cover all trade in goods/services, foreign direct/portfolio investment

Customs Union

- Agreement between countries to maintain a free-trade area and a common external tariff
- Common external tariff – each country replaces national tariff schedule with common tariff schedule applicable to all member countries
 - U.S. exporting to EU faces one tariff schedule

Common Market

- Capital and labor are free to move within member countries
- More efficient allocation of capital
- More efficient allocation of human capital
- Large wage differentials may induce large amount of migration – noticeable effect on national wage rates
- Problems with common regulations

Economic Union

- Common external tariff
- Free mobility of capital and labor
- Some degree of unification in government policies and monetary policies
- Requires common currency
 - Common Central Bank

Economic Union

- Each national government must align national policies with other member countries
 - Tax rates
 - Antitrust law
 - Labor regulations
 - Environmental regulations, etc.

US Trade Agreements

U.S. REGIONAL TRADE AGREEMENTS		
Country	Status of the Agreement	Date of Implementation
Israel	Implemented	1985
Canada	Implemented	1989, 1994
Mexico	Implemented	1994
Jordan	Implemented	2001
Chile	Signed	
Morocco	Under negotiation	
Singapore	Signed	
Australia	Signed	
Bahrain		
Central America FTA Dominican Republic, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua	Under negotiation	
Panama	Under negotiation	
Southern African Customs Union Botswana, Lesotho, Namibia, South Africa, Swaziland	Under negotiation	
Andean Pact Colombia, Peru, Ecuador, Bolivia	Under negotiation	

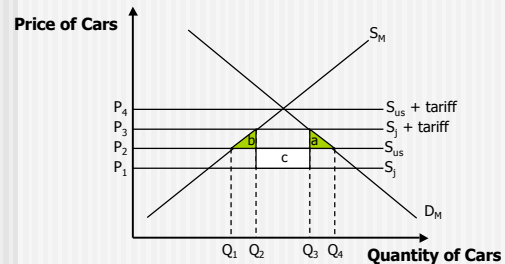
Source: U.S. Trade Representative, wwwustr.gov.

Trade Creation vs. Trade Diversion

- Trade Creation (TC)
 - Increase in trade between two countries from mutual elimination of tariffs
 - If Mexico and US eliminate tariffs to each other, US will import more from Mexico and vice versa.
- Trade Diversion (TD)
 - Export losses to other countries
 - US will import from Mexico instead of from other countries.

Example: US, Japan and Mexico

Figure 9.4: Static Welfare Effects of a Customs Union



European Union

- Association of European countries agreeing to free-trade area and a common external tariff
- Developed in 1951 when European Coal and Steel Community (ECSC) was formed
 - Elimination of tariffs and quotas for coal and steel industries

European Union

- 1985 EU commission determined necessary steps to barrier free internal market in EU
- Maastricht Treaty of 1992 laid plans for new European currency (the Euro).
- Euro replaced all separate country currencies in January 2002.

NAFTA

- North American Free Trade Agreement
 - Sets up free trade area between US, Canada, and Mexico
 - Straight forward trade agreement
 - Economic effects relatively small
 - Signed in 1989

NAFTA Benefits

- Gives Canada unrestricted access to larger market
- Long run appeal to US and Canada
 - Mexican economy growing much faster than US or Canada
 - Mexican tariffs were much higher before trade agreement.

NAFTA Benefits

- Benefits for Mexico
 - Access to world's two largest markets
 - Help advance export-led growth
 - Attract investment capital country needed
 - Make Mexico's economic reform process since 1980's permanent

Empirical Results of NAFTA

- Total trade among the three NAFTA countries has more than doubled, passing from US\$297 billion in 1993 to almost US\$883 billion in 2006. (198% growth)
- During NAFTA's first thirteen years, GDP growth has been significant:
 - United States: 50% growth
 - Canada: 54% growth
 - Mexico: 46% growth

Empirical Results of NAFTA

- What about Unemployment?
 - 1993 6.9%
 - 1994 6.1%
 - 2000 4.0%
 - 2002 5.8% (recession year in US)
- Manufacturing Jobs in US?
 - 1994 17 million
 - 1998 17.56 million
- Wages?
 - Real hourly wages have risen steadily since 1994

Summary

- Reductions of trade barriers between countries can be nondiscriminatory through GATT/WTO or discriminatory through regional trade agreements.
- Economic integration refers to the elimination of restrictions on international trade in goods and services, the flows of capital and labor, and the harmonization of laws among countries that would distort trade.

Summary

- The different types of economic integration are a free-trade area, a customs union, a common market and an economic union.
- RTAs have two conflicting effects: trade creation and trade diversion.
- Rules of origin reduce the amount of trade deflection that may occur with an RTA.
 - Such rules also can be used as nontariff barriers to trade.