

Regional Trade Agreements

- Multilateral integration of economies - GATT/WTO
- Regional groupings, an alternative route to integration.
e.g. European Union, NAFTA, 150+ others.
- Why? 2007 very important year for trade policy.
 - WTO talk deadlocked
 - 2-3 potential PTAs/FTAs coming up for vote
 - Fast-track authority expired in June, not renewed

Levels of Integration

Preferential trade agreement

– most common, sometimes start with specific goods

Free trade Area

– very low internal barriers. Ex: NAFTA

Customs Union

– FTA but with common external tariffs and joint position in world negotiations

Common Market

– FTA + free movement of factors. Ex: Early stages of EU

Economic Union

– Common market + efforts to reduce frictions and costs of trade. Ex: coordination of legal standards, financial regulation, railway timetables, macro policy

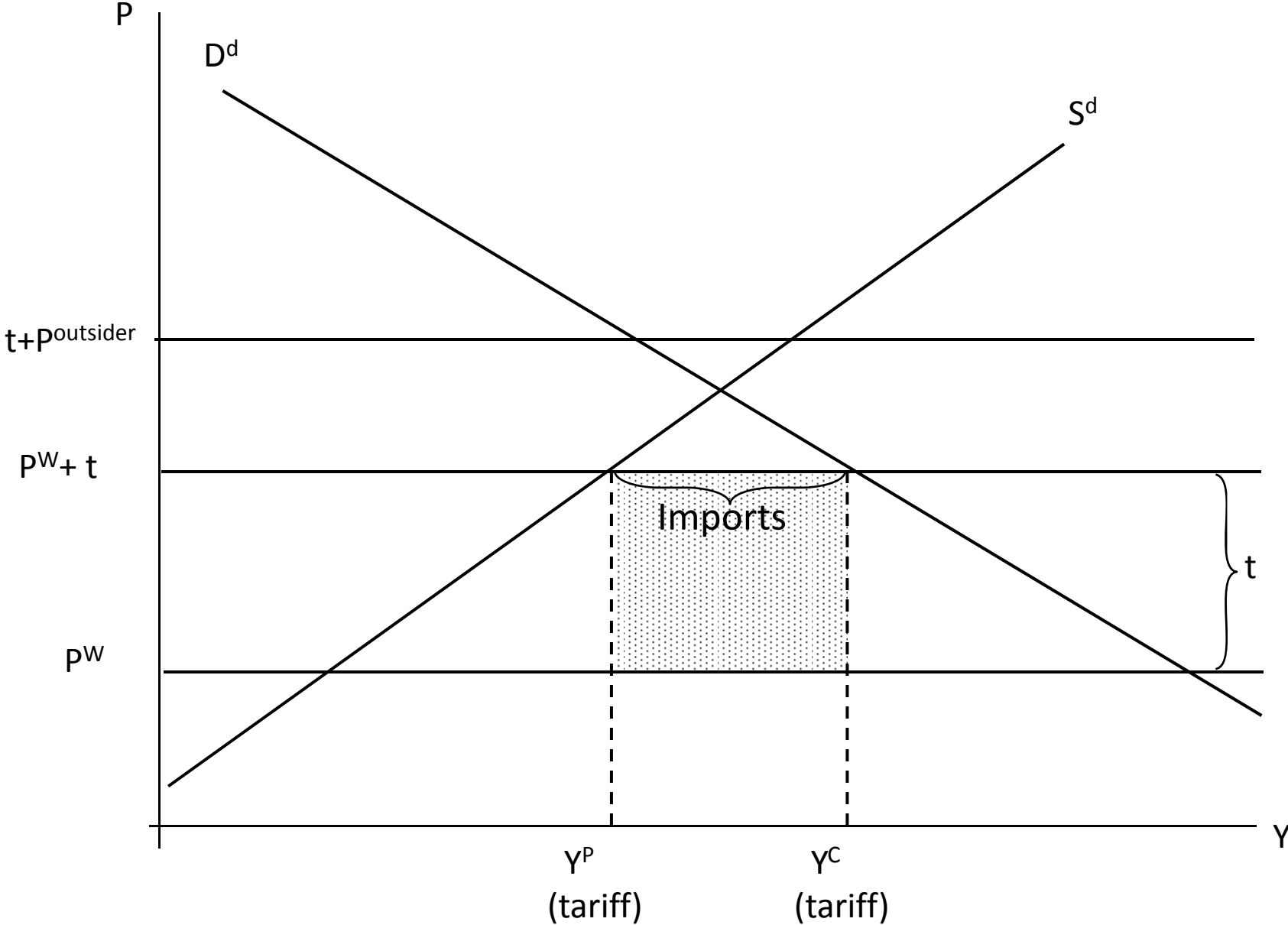
Federal System

– Economic Union + Supra state authority. Ex: States within the US have Federal regulations on them in some areas which they can not veto

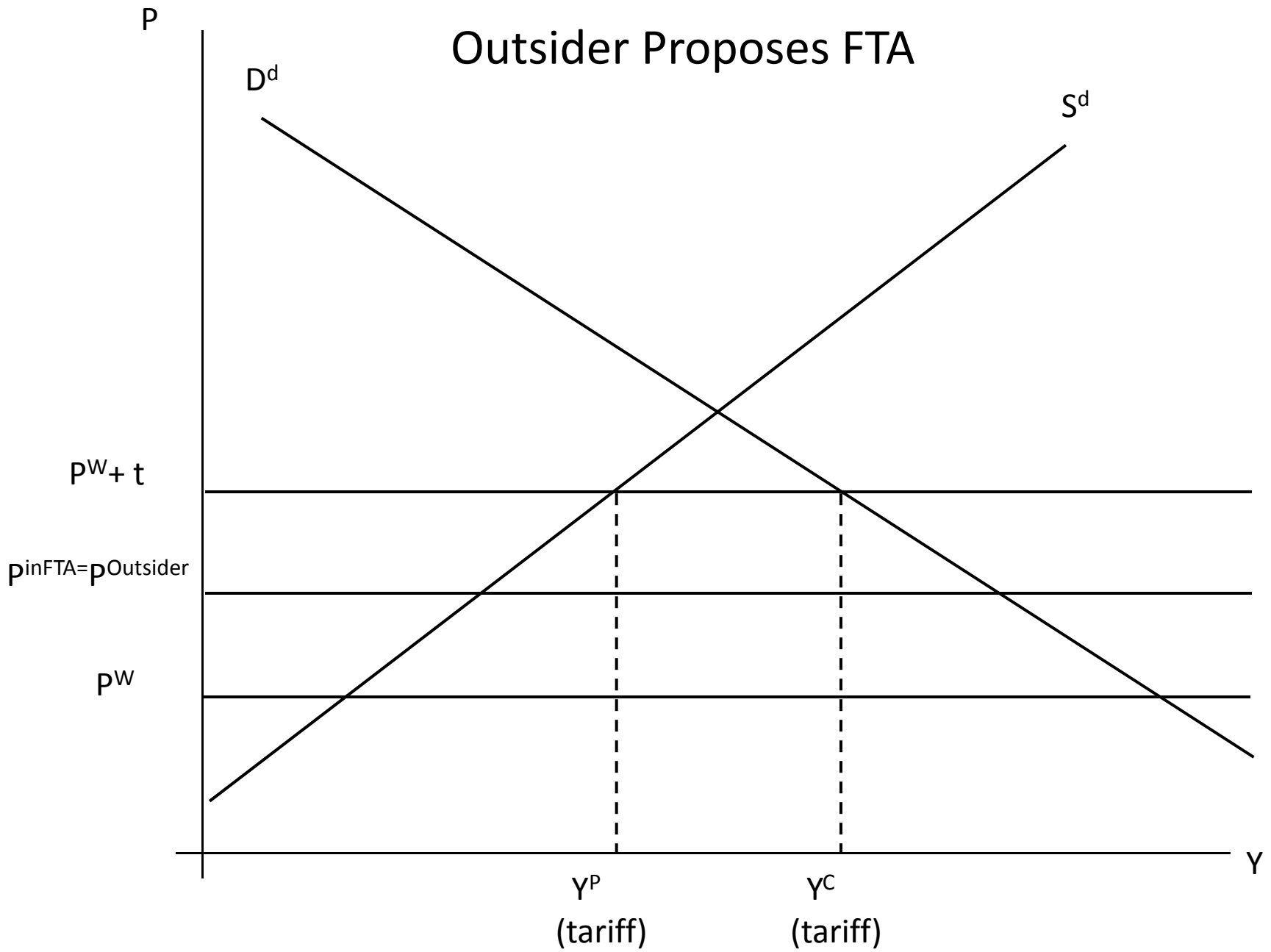
Views on Regional Trade Agreements

For	Against
<ul style="list-style-type: none">• Benefits from Free trade• Easier to negotiate and manage than multilateral agreements• Politics by economic means (Ex: EU)	<ul style="list-style-type: none">• Political economy of trade policy – some groups will lobby against free trade• Loss of national identity/ sovereignty• Slippery slope argument: where will integration stop?• Could distract from multilateral agreements• Trade Creation versus Trade Diversion

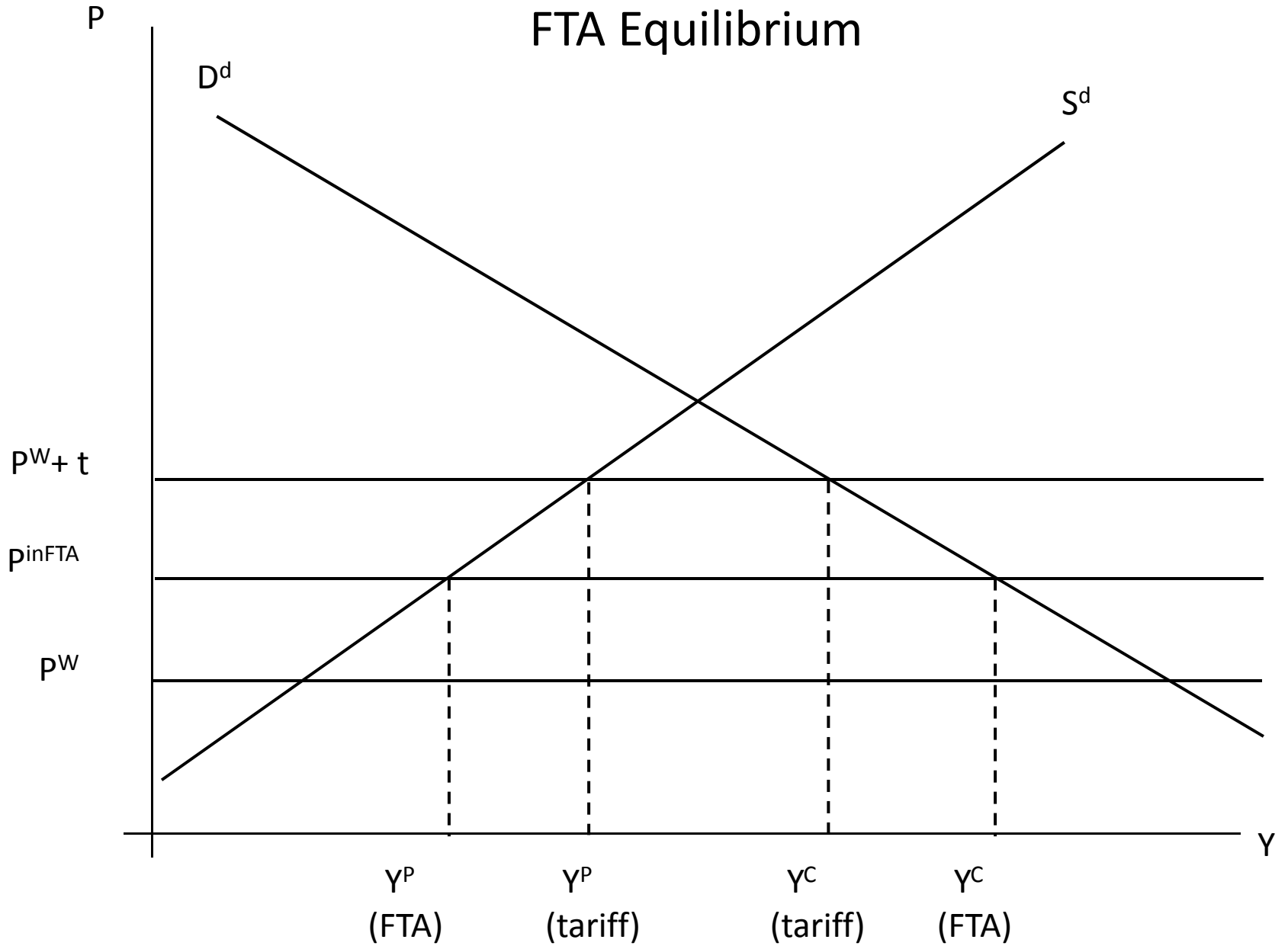
Initial situation, before establishment of FTA



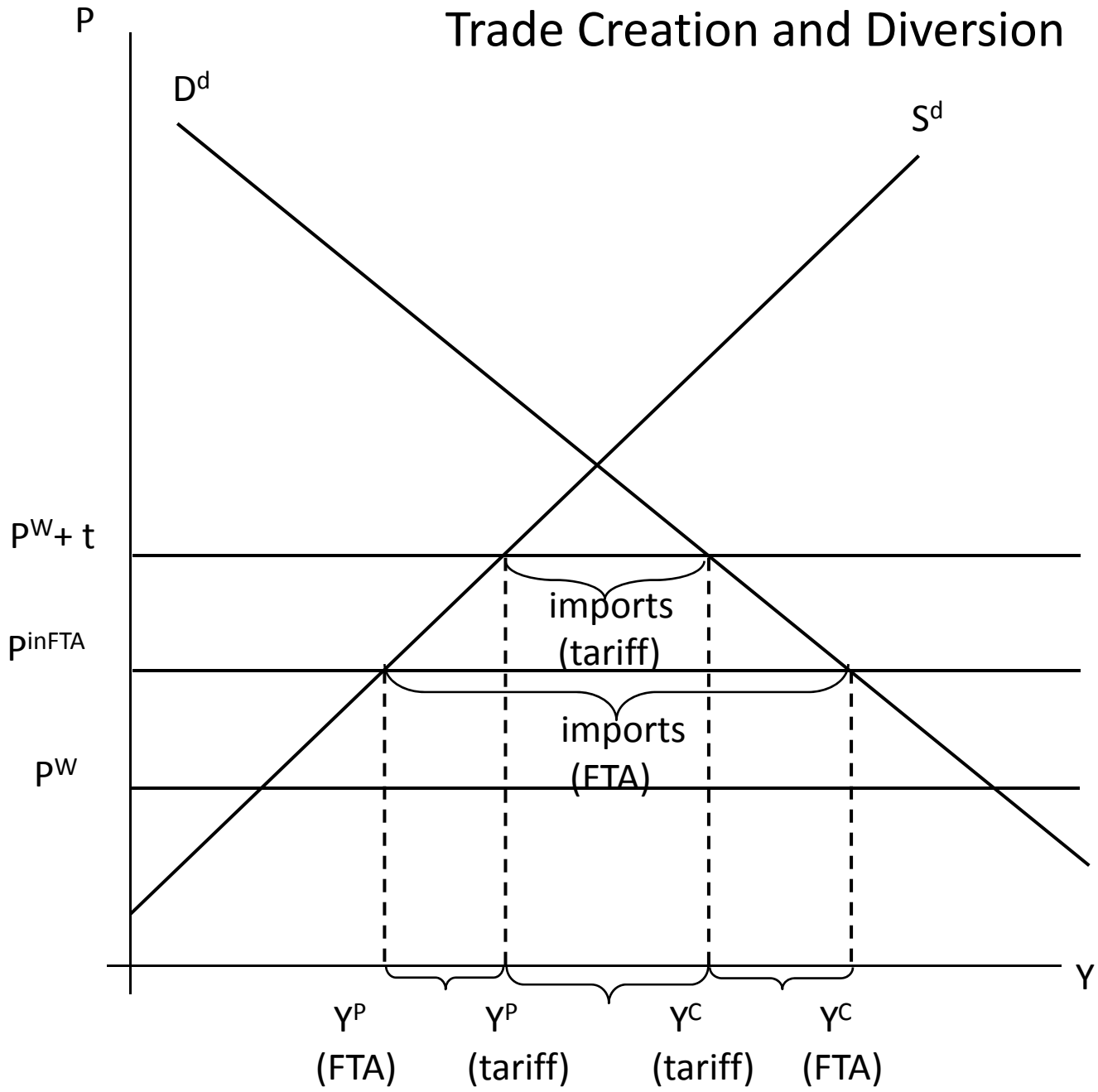
Outsider Proposes FTA



FTA Equilibrium



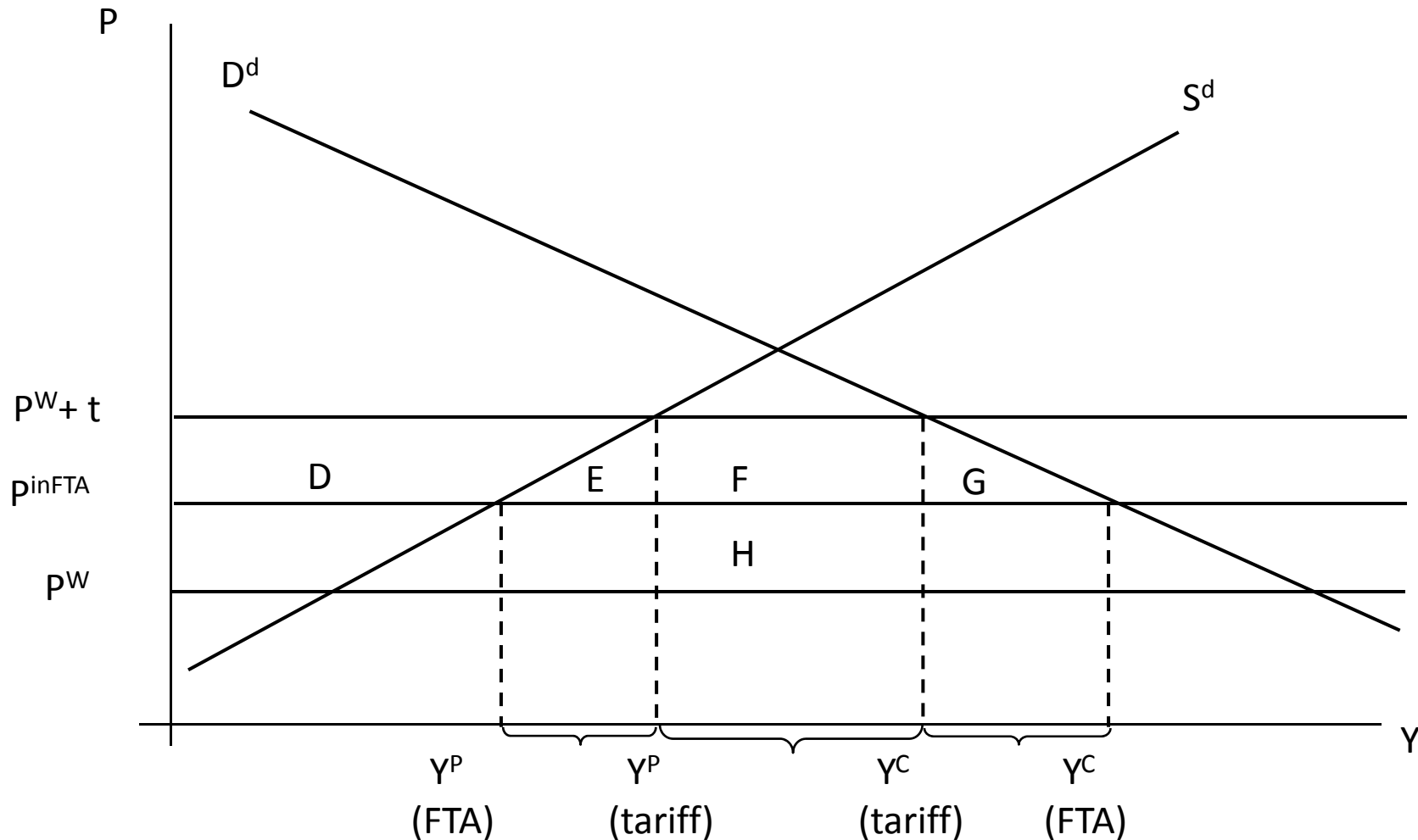
Trade Creation and Diversion



Trade Diversion = $Y^C(\text{tariff}) - Y^P(\text{tariff}) =$
Imports that were diverted from cheapest producer in the world to partner country

Trade Creation = $Y^P(\text{FTA}) - Y^P(\text{tariff}) + Y^C(\text{FTA}) - Y^C(\text{tariff}) =$ Imports that were created (over and above already existing levels) due to FTA

Trade creation makes E+G. Trade diversion destroys H.



Gain in consumer surplus = $D + E + F + G$

Loss in producer surplus = D

Loss in tax revenues = $F + H$

Net gain from FTA = $E + G - H$