天津外国语大学(天外)
Tianjin Foreign Studies University (TFSU)

Geoeconomics & Regional Development

Online class starts at 08:00

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Regional Trading Arrangements

Since World War II, advanced nations have significantly lowered their trade restrictions. This trade liberalization has stemmed from two approaches. The first is a reciprocal reduction of trade barriers on a nondiscriminatory basis. Under the General Agreement on Tariffs and Trade (GATT) and its successor, the World Trade Organization (WTO), member nations acknowledge that tariff reductions agreed on by any two nations would be extended to all other members. Such an international approach encourages a gradual relaxation of tariffs throughout the world.

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A second approach to trade liberalization occurs when a small group of nations, typically on a regional basis, form a regional trading arrangement. Under this system, member nations agree to impose lower barriers to trade within the group than to trade with nonmember nations. Each member nation continues to determine its domestic policies, but the trade policy of each includes preferential treatment for group members. Regional trading arrangements (free trade areas and customs unions) have been an exception to the principle of nondiscrimination embodied in the WTO. This chapter investigates the operation and effects of two regional trading arrangements, **the European Union** and the **North American Free Trade Agreement.**

Regional Integration versus Multilateralism

a major purpose of the WTO is to promote trade liberalization through worldwide agreements. However, getting a large number of countries to agree on reforms can be extremely difficult. By the early 2000s, the WTO was stumbling in its attempt to achieve a global trade agreement, and countries increasingly looked to narrow, regional agreements as an alternative. The number of regional trading agreements has risen from around 70 in 1990 to more than 300 today and they cover more than half of international trade. Are regional trading agreements building blocks or stumbling blocks to a multilateral trading system?

Regional trading arrangement

Two other factors suggest that the members of a regional trading arrangement may not be greatly interested in worldwide liberalization. First, trade bloc members may not realize additional economies of scale from global trade liberalization that often provides only modest openings to foreign markets. Regional trade blocs that often provide more extensive trade liberalization may allow domestic firms sufficient production runs to exhaust scale economies. Second, trade bloc members may want to invest their time and energy in establishing strong regional linkages rather than investing them in global negotiations.

Regional trading arrangement

On the other hand, when structured according to principles of openness and inclusiveness, regional blocs can be building blocks rather than stumbling blocks to global free trade and investment. Regional blocs can foster global market openings in several ways. First, regional agreements may achieve deeper economic interdependence among members than do multilateral accords, because of the greater commonality of interests and the simpler negotiating processes. Second, a self-reinforcing process is set in place by the establishment of a regional free trade area: As the market encompassed by a free trade area enlarges, it becomes increasingly attractive for nonmembers to join to receive the same trade preferences as member nations.

Let us next consider the various types of regional trading blocs and their economic effects.

Types of Regional Trading Arrangements

U.S. Free Trade Agreements

Agreement	Date of Implementation	Agreement	Date of Implementation
Israel	1985	Morocco	2006
Canada	1989	CAFTA, DR**	2006
NAFTA*	1994	Oman	2009
Jordan	2001	Peru	2009
Chile	2004	South Korea	2012
Singapore	2004	Colombia	2012
Australia	2005	Panama	2012
Bahrain	2006		

*Members of the North American Free Trade Agreement (NAFTA) include Canada, Mexico, and the United States.
**Members of the Central American Free Trade Agreement (CAFTA) include Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the United States. DR stands for Dominican Republic.

Source: U.S. Census Bureau, *Foreign Trade Statistics*, and World Trade Organization, *Regional Trade Agreements Information System*.

Since the mid-1950s, the term **economic integration** has become part of the vocabulary of economists. Economic integration is a process of eliminating restrictions on international trade, payments, and factor mobility. Economic integration results in the uniting of two or more national economies in a regional trading arrangement. Before proceeding, let us distinguish the types of regional trading arrangements.

A **free trade area** is an association of trading nations in which members agree to remove all tariff and nontariff barriers among themselves. Each member maintains its own set of trade restrictions against outsiders. An example of this stage of integration is the North American Free Trade Agreement (NAFTA), which consists of Canada, Mexico, and the United States. Beyond NAFTA, t

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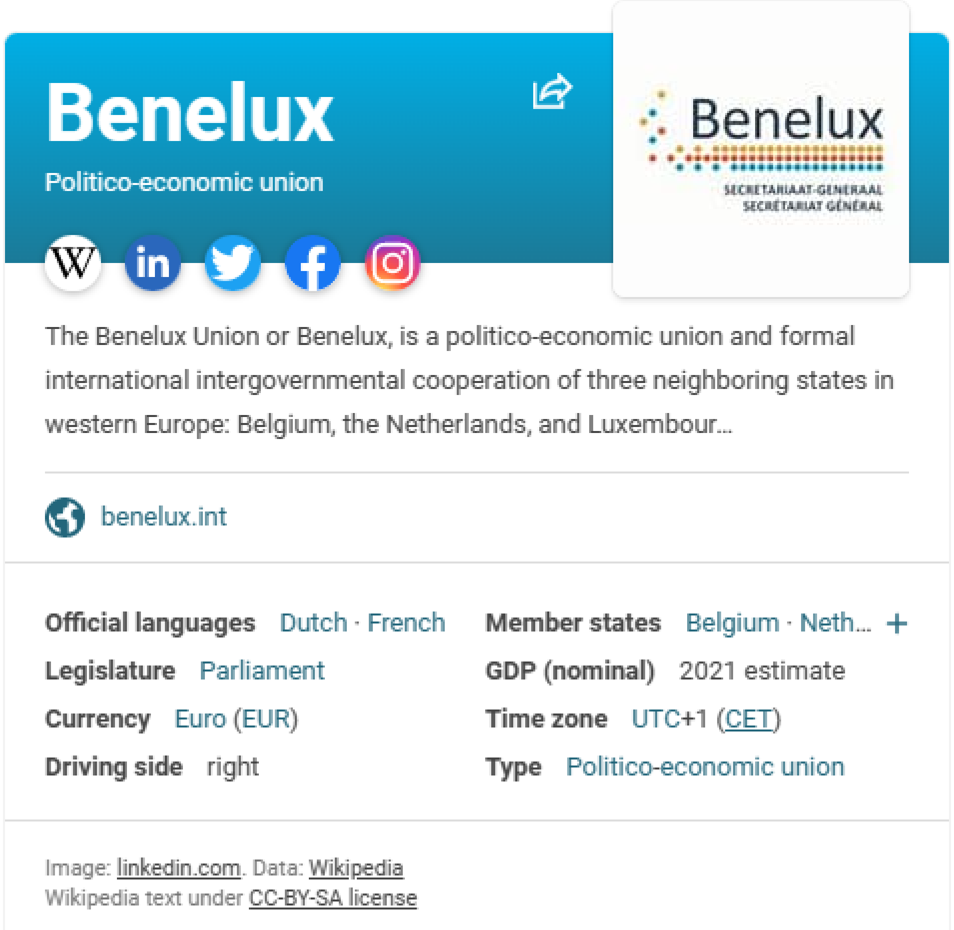
Customs union

Like a free trade association, **a customs union** is an agreement among two or more trading partners to remove all tariff and nontariff trade barriers between themselves. In addition, each member nation imposes identical trade restrictions against nonparticipants. The effect of the common external trade policy is to permit free trade within the customs union, whereas all trade restrictions imposed against outsiders are equalized. A well-known example is **Benelux** (Belgium, the Netherlands, and Luxembourg), which was formed in 1948.



Common market

A **common market** is a group of trading nations that permits

(1) the free movement of goods and services among member nations,

(2) the initiation of common external trade restrictions against nonmembers, and

(3) the free movement of factors of production across national borders within the economic bloc.

The common market thus represents a more complete stage of integration than a free trade area or a customs union. The **European Union (EU)** achieved the status of a common market in 1992.

Note.
Founded in 1957, the European Community was a collective name for three organizations: the European Economic Community, the European Coal and Steel Community, and the European Atomic Energy Commission. In 1994, the European Community was replaced by the European Union following ratification of the Maastricht Treaty by the 12 member countries of the European Community. For simplicity, the name European Union is used throughout this chapter in discussing events that occurred before and after 1994.

Economic Union and Monetary Union

Beyond these stages, economic integration could evolve to the stage of **economic union**, in which national, social, taxation, and fiscal policies are harmonized and administered by a supranational institution. Belgium and Luxembourg formed an economic union during the 1920s. The task of creating an economic union is much more ambitious than achieving the other forms of integration. This is because a free trade area, customs union, or common market results primarily from the abolition of existing trade barriers; an economic union requires an agreement to transfer economic sovereignty to a supranational authority. The ultimate degree of economic union would be the unification of national monetary policies and the acceptance of a common currency administered by a supranational monetary authority. The economic union would thus include the dimension of a **monetary union.**

Created with AI by prompt " Belgium and Luxembourg forms an economic union ".

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Impetus for Regionalism

Regional trading arrangements are pursued for a variety of reasons. A motivation of virtually every regional trading arrangement has been the prospect of enhanced economic growth. An expanded regional market can allow economies of large-scale production, foster specialization, enhance learning-by-doing, and attract foreign investment. Regional initiatives can also foster a variety of noneconomic objectives such as managing immigration flows and promoting regional security. Regionalism may enhance and solidify domestic economic reforms. East European nations have viewed their regional initiatives with the European Union as a means of locking in their domestic policy shifts toward privatization and market-oriented reform.

Impetus for Regionalism

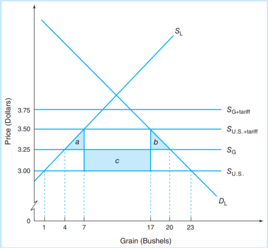
As new regional trading arrangements are formed or existing ones are expanded or deepened, the opportunity cost of remaining outside an arrangement increases. Nonmember exporters could realize costly decreases in market share if their sales are diverted to companies of the member nations. This prospect may be sufficient to tip the political balance in favor of becoming a member of a regional trading arrangement, as exporting interests of a nonmember nation outweigh its import-competing interests. The negotiations between the United States and Mexico to form a free trade area appear to have strongly influenced Canada’s decision to join NAFTA, and not be left behind in the movement toward free trade in North America.

Effects of a Regional Trading Arrangement

What are the possible welfare implications of **regional trading arrangements**? We can delineate the theoretical benefits and costs of such devices from two perspectives. First are the **static effects of economic integration** on productive efficiency and consumer welfare. Second are the **dynamic effects of economic integration** that relate to member nations' long-run rates of growth. Because a small change in the growth rate can lead to a substantial cumulative effect on national output, the dynamic effects of trade policy changes can yield substantially larger magnitudes than those based on static models. Combined, these static and dynamic effects determine the overall welfare gains or losses associated with the formation of a regional trading arrangement.

Static Effects

Static Welfare Effects of a Customs Union

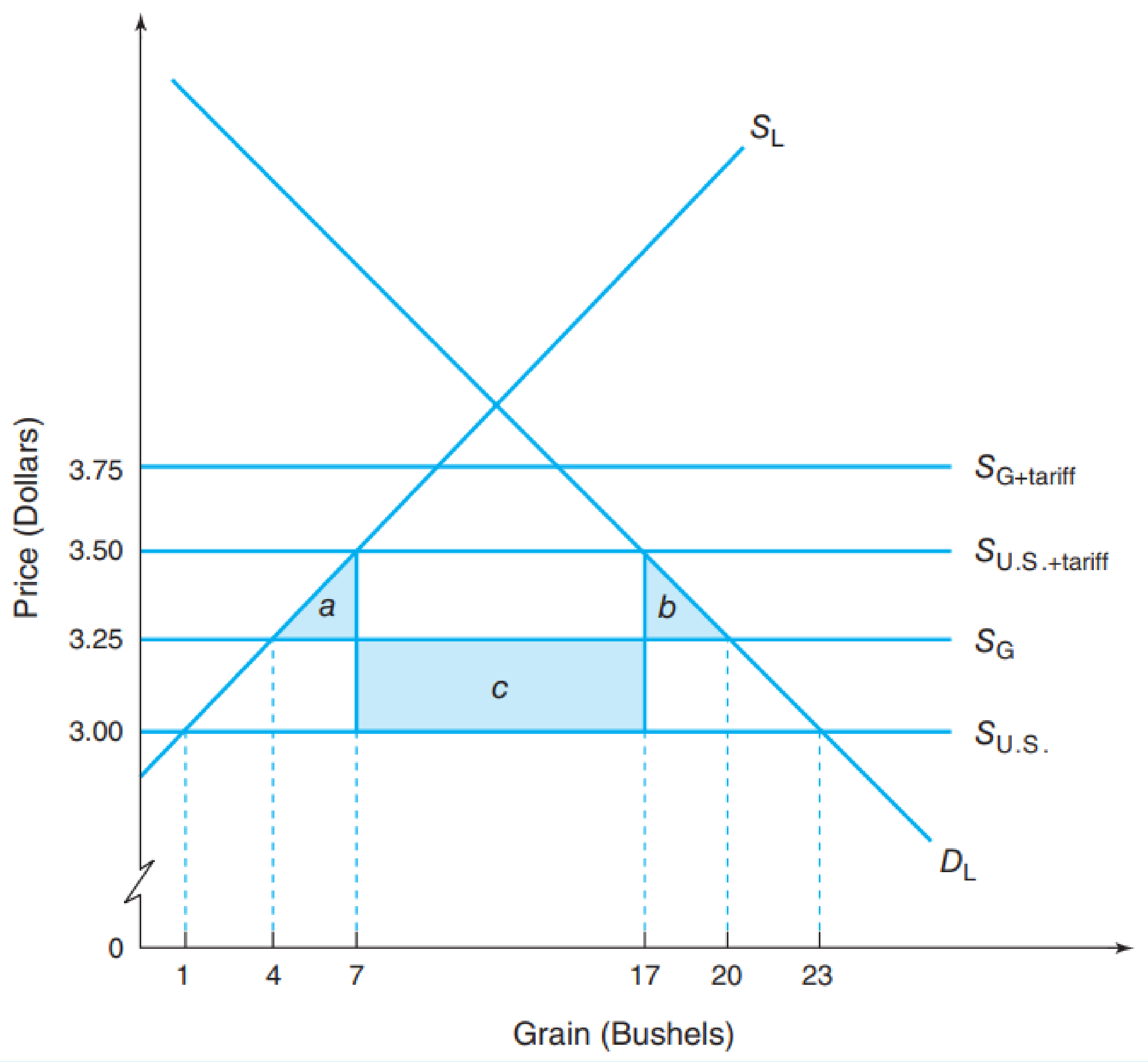


The formation of a customs union leads to a welfare-increasing trade creation effect and a welfare-decreasing trade diversion effect. The overall effect of the customs union on the welfare of its members, as well as on the world as a whole, depends on the relative strength of these two opposing forces.

The static welfare effects of lowering tariff barriers among members of a trade bloc are illustrated in the following example. Assume a world composed of three countries: Luxembourg, Germany, and the United States. Consider Luxembourg and Germany decide to form a customs union, and the United States is a nonmember. The decision to form a customs union requires that Luxembourg and Germany abolish all tariff restrictions between themselves while maintaining a common tariff policy against the United States.

Figure 1

Static Welfare Effects of a Customs Union



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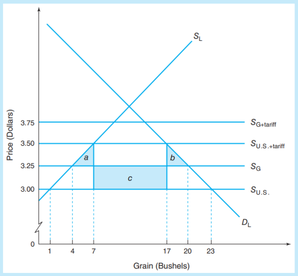
Results of the analysis

This analysis illustrates that the success of a customs union depends on the factors contributing to trade creation and diversion. Several factors that bear on the relative size of these effects can be identified. One factor is the kinds of nations that tend to benefit from a customs union. Nations whose pre-union economies are quite competitive are likely to benefit from trade creation because the formation of the union offers greater opportunity for specialization in production.

Static Welfare Effects of a Customs Union



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Dynamic Effects

Not all welfare consequences of a regional trading arrangement are static in nature. There may also be dynamic gains that influence member nation growth rates over the long run. These dynamic gains stem from the creation of larger markets by the movement to freer trade under customs unions. The benefits associated with a customs union's dynamic gains may more than offset any unfavorable static effects. Dynamic gains include economies of scale, greater competition, and a stimulus of investment.

Example

The European refrigerator industry provides an example of the dynamic effects of integration. Prior to the formation of the EU, each of the major European nations that produced refrigerators (Germany, Italy, and France) supported a small number of manufacturers that produced primarily for the domestic market. These manufacturers had production runs of fewer than 100,000 units per year, a level too low to permit the adoption of automated equipment. Short production runs translated into a high per-unit cost. The EU's formation resulted in the opening of European markets and paved the way for the adoption of large-scale production methods, including automated press lines and spot welding. By the late 1960s, the typical Italian refrigerator plant manufactured 850,000 refrigerators annually. This volume was more than sufficient to meet the minimum efficient scale of operation, estimated to be 800,000 units per year. The late 1960s also saw German and French manufacturers averaging 570,000 units and 290,000 units per year, respectively.

Summary

Broader markets may also promote greater competition among producers within a customs union. It is often felt that trade restrictions promote monopoly power, whereby a small number of companies dominate a domestic market. Such companies may prefer to lead a quiet life, forming agreements not to compete on the basis of price. With the movement to more open markets under a customs union, the potential for successful collusion is lessened as the number of competitors expands. With freer trade, domestic producers must compete or face the possibility of financial bankruptcy. To survive in expanded and more competitive markets, producers must cut waste, keep prices down, improve quality, and raise productivity. Competitive pressure can also be an effective check against the use of monopoly power and in general a benefit to the nation’s consumers

The European Union

In the years immediately after World War II, Western European countries suffered balanceof-payments deficits in response to reconstruction efforts. To shield their firms and workers from external competitive pressures, they initiated an elaborate network of tariff and exchange restrictions, quantitative controls, and state trading. However, in the 1950s, these trade barriers were generally viewed as counterproductive. Therefore, Western Europe began to dismantle its trade barriers in response to successful tariff negotiations under the auspices of GATT. The hope was that by binding European nations together economically and financially, it would not be in their interest to go to war.

The European Union

It was against this background of trade liberalization that the European Union, then known as the European Community, was created by the Treaty of Rome in 1957. The EU initially consisted of six nations: Belgium, France, Italy, Luxembourg, the Netherlands, and West Germany. By 1973, the United Kingdom, Ireland, and Denmark had joined the trade bloc. Greece joined the trade bloc in 1981, followed by Spain and Portugal in 1987. In 1995, Austria, Finland, and Sweden were admitted into the EU. In 2004, ten other Central and Eastern European countries joined the EU: Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia. In 2007, Bulgaria and Romania joined the EU, and in 2013, Croatia also joined, bringing the membership to 28 countries. **Now there 27 EU members**. The EU views this enlargement process as an opportunity to promote stability in Europe and further the integration of the continent by peaceful means.

The European Union (EU) is a political and economic union of 27 member states that are signatories to the founding treaties of the union and thereby share in the privileges and obligations of mem... +

Wikipedia

Category Member state

Location European Union

Created 1952/1958/1993

Number 27 (as of 2022)

See more

The European Union is a group of **27 countries** throughout Europe that have combined to form a union based on political and economical compatibility and fusion.

A European Union member state is any one of the twenty-seven countries that have joined the European Union (EU) since it was found in 1958 as the European Economic Community (EEC).

Finally, in 1993, the European Union, or EU, received its official name. The membership reached 15 nations, including **Austria, Finland**, and Sweden.

Pursuing Economic Integration

According to the Treaty of Rome, the EU agreed in principle to follow the path of economic integration and eventually become an economic union. In pursuing this goal, EU members first dismantled tariffs and established a free trade area in 1968. This liberalization of trade was accompanied by a fivefold increase in the value of industrial trade—higher than world trade in general. The success of the free trade area inspired the EU to continue its process of economic integration. In 1970, the EU became a full-fledged customs union when it adopted a common external tariff system for its members.

Pursuing Economic Integration

After forming a customs union, the EU made little progress toward becoming a common market until 1985. The hostile economic climate (recession and inflation) of the 1970s led EU members to shield their citizens from external forces rather than dismantle trade and investment restrictions. By the 1980s, EU members were increasingly frustrated with barriers that hindered transactions within the bloc. European officials also feared that the EU’s competitiveness was lagging behind that of Japan and the United States.

Pursuing Economic Integration

While the EU was becoming a common market, its heads of government agreed to pursue much deeper levels of integration. Their goal was to begin a process of replacing their central banks with a European Central Bank and replacing their national currencies with a single European currency. The **Maastricht Treaty,** signed in 1991, set 2002 as the date this process would be complete. In 2002, a European Monetary Union (EMU) emerged with a single currency, known as the euro.

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Convergence criteria

This effort, called convergence, has led to a high degree of uniformity in terms of price inflation, money supply growth, and other key economic factors. The specific convergence criteria as mandated by the Maastricht Treaty are as follows:

- Price stability. Inflation in each prospective member is supposed to be no more than 1.5 percent above the average of the inflation rates in the three countries with the lowest inflation rates.
- Low long-term interest rates. Long-term interest rates are to be no more than 2 percent above the average interest rate in those countries.
- Stable exchange rates. The exchange rate is supposed to have been kept within the target bands of the monetary union with no devaluations for at least two years prior to joining the monetary union.
- Sound public finances. One fiscal criterion is that the annual budget deficit in a prospective member should be at most 3 percent of gross domestic product (GDP); the other is that the cumulative amount of government debt should be no more than 60 percent of a year's GDP.

Euro

The euro is the official currency of 19 of the 27 member states of the European Union. These states, known collectively as the eurozone, are Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain. Notably, the United Kingdom, Denmark, and Sweden have thus far decided not to convert to the euro. The euro is also used in another six European countries and is consequently used daily by some 330 million Europeans. Over 175 million people worldwide use currencies that are pegged to the euro, including more than 150 million people in Africa.

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Agricultural Policy

Besides providing free trade in industrial goods among its members, the EU has abolished restrictions on agricultural products traded internally. A **common agricultural policy** has replaced the agricultural stabilization policies of individual member nations that differed widely before the formation of the EU. A substantial element of the common agricultural policy has been the support of prices received by farmers for their produce. Schemes involving deficiency payments, output controls, and direct income payments have been used for this purpose. In addition, the common agricultural policy has supported EU farm prices through a system of **variable levies** that applies tariffs to agricultural imports entering the EU. Exports of any surplus quantities of EU produce have been assured through the adoption of **export subsidies**

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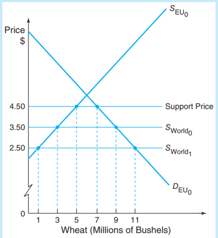
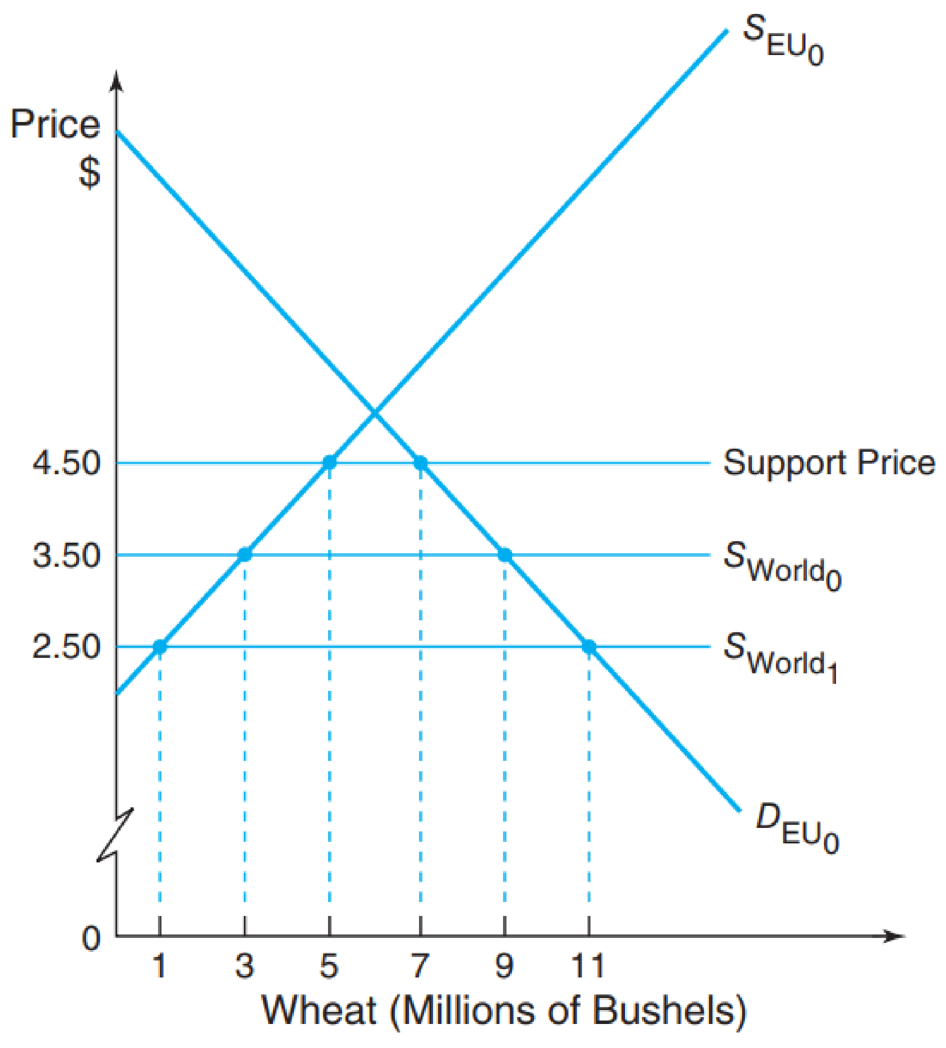
Variable Levies

Variable Levies



The common agricultural policy of the EU has used variable levies to protect EU farmers from low-cost foreign competition. During periods of falling world prices, the sliding scale nature of the variable levy results in automatic increases in the EU's import tariff.

Variable Levies



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Variable Levies

The variable import levy tends to be more restrictive than a fixed tariff. It discourages foreign producers from absorbing part of the tariff and cutting prices to maintain export sales. Cutting prices only triggers higher variable levies. For the same reason, variable levies discourage foreign producers from subsidizing their exports in order to penetrate domestic markets.

The completion of the Uruguay Round of trade negotiations in 1994 brought rules to bear on the use of variable levies. It required that all nontariff barriers, including variable levies, be converted to equivalent tariffs. The method of conversion used by the EU essentially maintained the variable levy system except for one difference. The actual tariff applied on agricultural imports can vary like the previous variable levy, depending on world prices. Now there is an upper limit applied to how high the tariff can rise.

Export Subsidies

The EU has also used a system of export subsidies to ensure that any surplus agricultural output will be sold overseas. The high price supports of the common agricultural policy have given EU farmers the incentive to increase production, often in surplus quantities. But the world price of agricultural commodities has generally been below the EU price. The EU pays its producers export subsidies so they can sell surplus produce abroad at the low price but still receive the higher, international support price. By encouraging exports, the government will reduce the domestic supply and eliminate the need for the government to purchase the excess.

Subsidies for the agricultural products

Government Support for Agriculture, 2015

Country	Producer-Subsidy Equivalents* as a Percentage of Farm Prices
Switzerland	58
Norway	58
South Korea	52
Japan	48
Iceland	47
European Union	18
Mexico	14
Canada	11
United States	11
Australia	4
New Zealand	1

*The producer-subsidy equivalent represents the total assistance to farmers in the form of market price support, direct payments, and transfers that indirectly benefit farmers.

Source: From Organization of Economic Cooperation and Development (OECD), *Agricultural Policy Monitoring and Evaluation*, 2016. See also World Trade Organization, *Annual Report*, various issues.

Virtually every industrial country subsidizes its agricultural products. As seen in Table 2, government programs accounted for 18 percent of the value of agricultural products in the EU in 2015. This amount is even higher in certain countries such as Switzerland and Japan, but it is much lower in others, including the United States, Australia, and New Zealand. Countries with relatively low agricultural subsidies have criticized the high subsidy countries as being too protectionist.

Is the European Union Really a Common Market?

For decades, members of the EU have tried to build a common market with uniform policies on product regulation, trade, and movement of factors of production. But are the policies of these countries really that common?

Consider the case of Kellogg Co., the American producer of breakfast cereals. For years Kellogg has petitioned members of the EU to let it market identical vitamin fortified cereals throughout Europe. The firm's requests have run into numerous roadblocks. Government regulators in Denmark do not want vitamins added, dreading that cereal consumers who already take multivitamins might surpass recommended daily doses that could jeopardize health. The Netherlands' regulators don't think that either folic acid or vitamin D is beneficial, so they don't want them included. However, Finland prefers more vitamin D than other nations to help Finns compensate for lack of sun. Kellogg has to produce four different varieties of cornflakes and other cereals at its plants in the United Kingdom.

Kellogg's

American food company

The Kellogg Company, doing business as Kellogg's, is an American multinational food manufacturing company headquartered in Battle Creek, Michigan, United States. Kellogg's produces cereal and convenie...

kelloggs.com

Traded as NYSE: K · S&P 500 component

Founded February 19, 1906 (as Battle Creek Toasted Corn Flake Com... +

Founder Will Keith Kellogg

Headquarters Battle Creek, Michigan · U.S.

See more

One of the largest names when it comes to breakfast is **Kelloggs cereals**. They are so famous that they are being used for breakfast across many countries and people just love these cereals.

Kellogg's is a **major player** in the **breakfast food market sector** and is one of the most sophisticated operators within the fast-moving consumer goods industry.

Kellogg's is a **popular brand** in many households, named for its quality cereals. Trusted by many mothers across the world, Kellogg's cereals are the best way to start your day.

Is the European Union Really a Common Market?

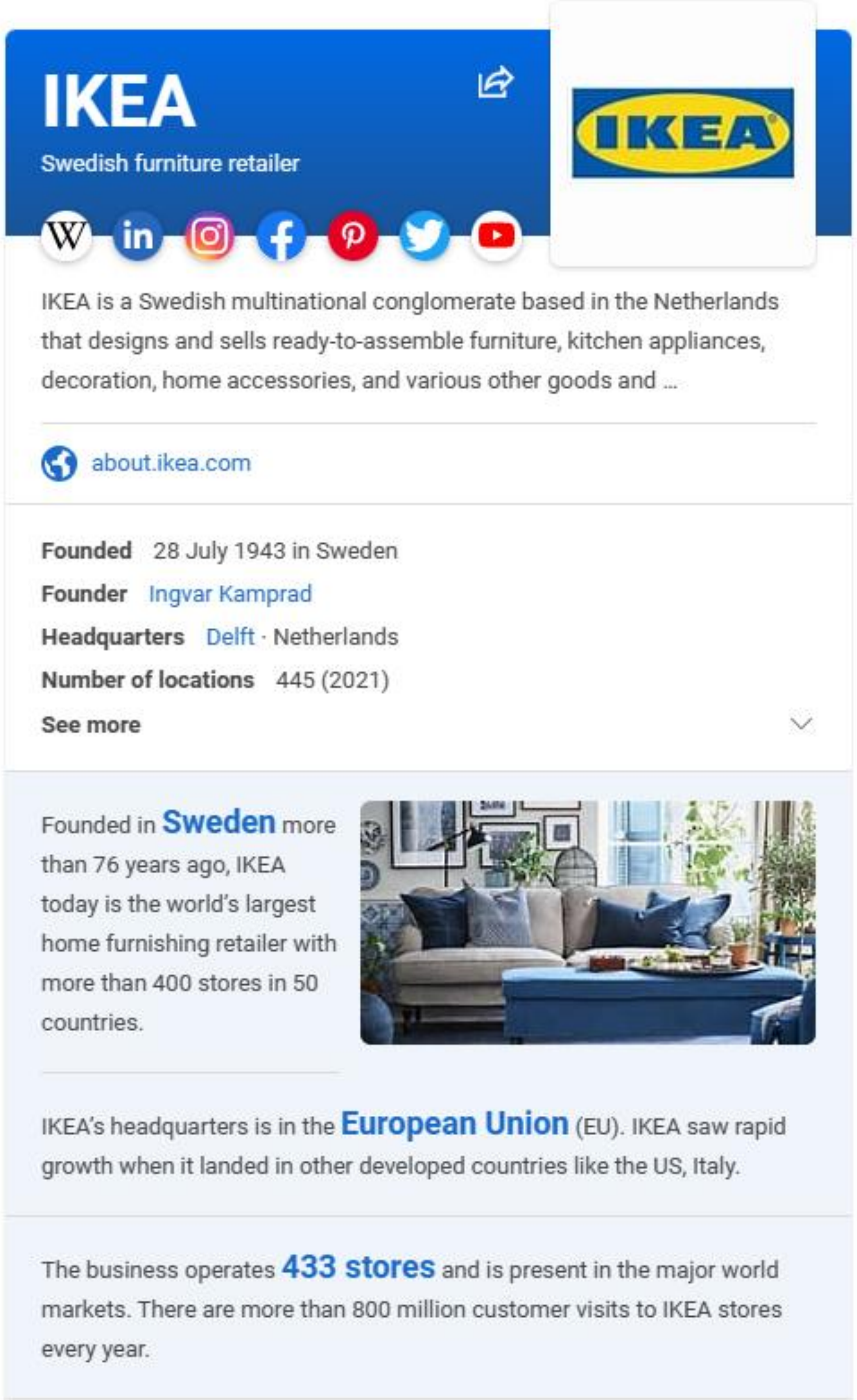
The original concept of the EU was a common market based on uniform regulations. By producing for a single market throughout Europe, firms could attain production runs large enough to realize substantial economies of scale. Instead, persistent national differences have burdened firms with extra costs that stifle plant expansion and job creation.

This lack of consistency extends well beyond the domain of breakfast cereals. Caterpillar Inc. sells tractors throughout Europe. In Germany, its vehicles must include a louder backup horn and lights that are installed in different locations. The yield signs and license plate holders on the backs of tractors and other earth-moving vehicles must differ, sometimes by just centimeters, from nation to nation. Officials at Caterpillar contend that there is no sound justification for such regulatory discrepancies. Discrepancies only make it hard to mass produce in an efficient manner.

IKEA Group

Persistent regulatory differences between markets have adversely affected business expansion plans throughout Europe. IKEA Group, the Swedish furniture retailer, must pay for studies to prove that its entry into markets will not displace local businesses. According to IKEA, each study costs approximately $25,000 and takes about a year before a decision is made. Moreover, only 33 to 50 percent of IKEA's petitions result in approval.

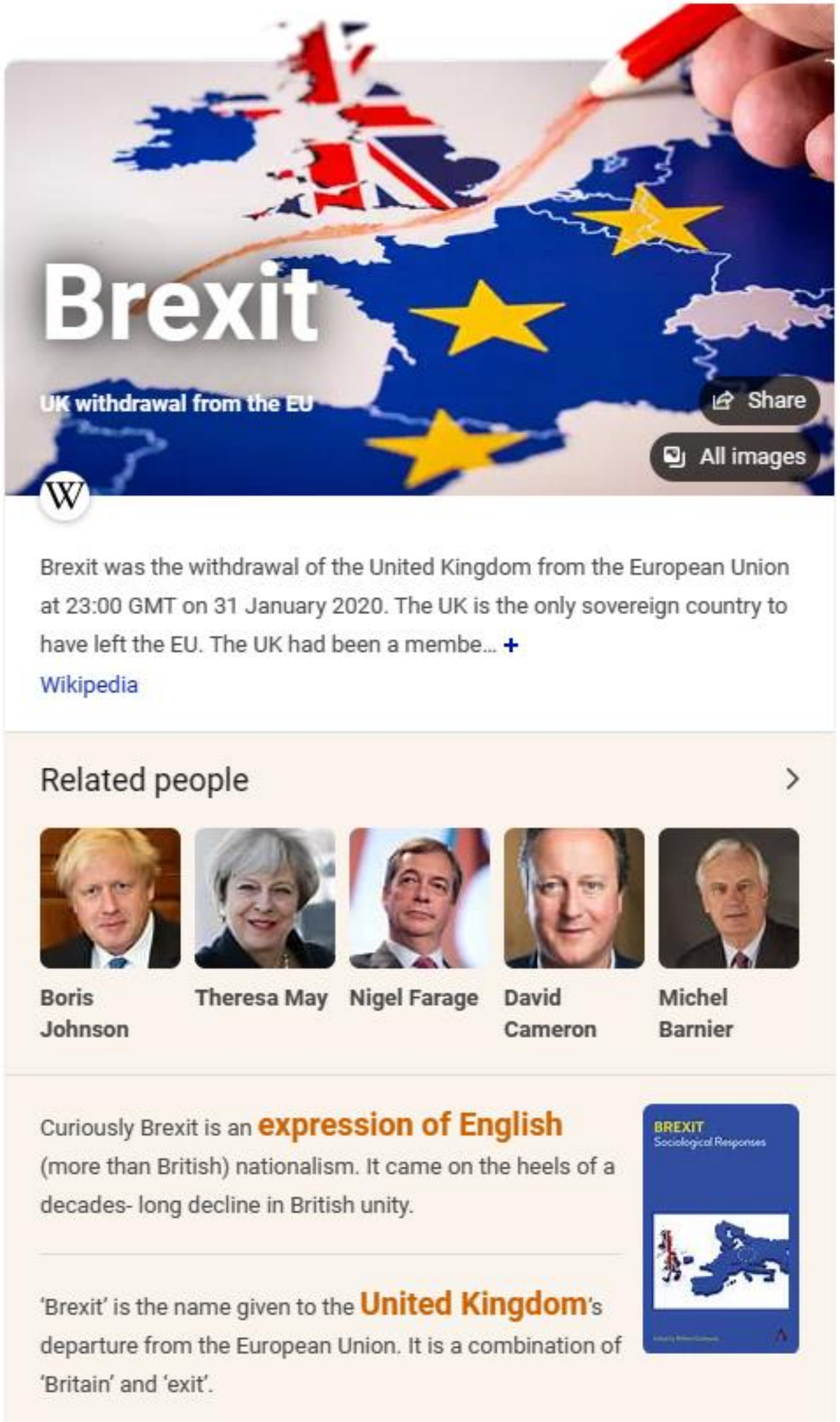
Although members of the EU have advanced to higher levels of economic unification in the past 50 years, regulatory differences remain that have created barriers to trade and investment that stifle economic growth. These barriers have resulted in numerous legal battles between producers and national regulators, as well as between the European Commission and individual governments. Europe's common market remains uncommon.



Britain Announces Withdrawal from the European Union (Brexit)

During the past 60 years, the movement toward increasing economic integration has been remarkably durable. Since the founding of the EU in 1957, 28 countries have joined and none have left (other than Greenland, a Danish territory, and Algeria, which stopped being part of the EU upon independence from France). This is mainly because government officials have accepted the economic rationale for integration: It increases the size of the market, exposes domestic producers to more competition, and accelerates the dissemination of new ideas via foreign investment and immigration. As another example of economic integration, since the World Trade Organization's beginnings in 1948 (as the General Agreement on Tariffs and Trade), 164 countries have joined and none have left.

Yet on June 23, 2016, the United Kingdom (UK) settled a question that remained at the center of attention for a generation: Should the country remain within the EU, or leave the organization and go it alone? Voters of the UK addressed this question in a referendum on the country's membership. The result of the referendum was a vote of 52 percent to 48 percent to exit the EU. The British exit from the EU became known as Brexit—a combination of "Britain" and "exit." How did Brexit come about and what does it mean?



The Brexit Referendum of 2016

The notion of the UK’s leaving the EU has been debated for decades, but it gained renewed momentum in the midst of a tough reelection campaign in 2013. Facing strong anti-EU feelings within his own party, Prime Minister David Cameron pledged to call a referendum on EU membership if the Conservatives won the election in 2015. After they won in a landslide, the Brexit referendum was scheduled for June 23, 2016.

Brexit turned out to be a classic example of the law of unintended consequences. Cameron sought a vote to remain in the EU in order to end, once and for all, domestic disputes about Europe in a minority of the Conservative Party and among fringe populist groups. However, his strategy failed when UK voters unexpectedly decided to leave the EU.

Pros and Cons Regarding Brexit

Supporters of Brexit maintain that the UK would be better off politically and economically by reclaiming sovereignty and being free from EU regulations that hinder the UK’s competitiveness. They also contend that the UK’s contributions to the EU budget are too expensive. For example, in 2015 the UK paid 13 billion pounds to the EU, but it received only 4.5 billion pounds worth of spending from the EU, so the UK’s net contribution was 8.5 billion pounds. Moreover, Brexit supporters fear that high levels of immigration to the UK from other EU countries will mean fewer jobs and lower wages for UK citizens.

However, those in favor of continued membership in the EU warn of potentially dire economic consequences of a vote to leave. They maintain that the UK’s trade and investment ties with the EU are so deep and extensive that Brexit could lead to weaker economic growth, higher inflation, and a depreciation of the pound. They also argue that EU membership helps to attract foreign affiliates and foreign direct investment to the UK and gives the UK more influence in global politics.

Created with AI by prompt "EU and British are hugging".

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Negotiating a Withdrawal from the EU

According to the regulations of the EU, a member state that wants to exit the bloc needs to first formally notify the other 27 governments, initiating a complex process set out in Article 50 of the treaty. Doing so would open a two-year window—and possibly a longer period—to work out myriad issues, from singlemarket access for UK companies, to Britain’s sharing of EU security databases in the fight against terrorism. Many European politicians indicated that they wanted the UK out as soon as possible to discourage other countries from taking a similar tack in an effort to get a better deal. The UK government started the withdrawal process in March 2017, putting the UK on course to leave by April 2019.

Economic Costs and Benefits of a Common Currency: The European Monetary Union

As we learned, the formation of the EMU (also known as the eurozone) in 1999 resulted in the creation of a single currency (the euro) and a European Central Bank. Switching to a new currency is extremely difficult.

The European Central Bank is located in Frankfurt, Germany, and is responsible for the monetary policy and exchange rate policies of the EMU. The European Central Bank alone controls the supply of euros, sets the short-term euro interest rate, and maintains permanently fixed exchange rates for the member countries. With a common central bank, the central bank of each participating nation performs operations similar to those of the 12 regional Federal Reserve Banks in the United States.

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Advantages and Disadvantages of Adopting a Common Currency

Advantages	Disadvantages
The risks associated with exchange fluctuations are eliminated within a common currency area.	Absence of individual domestic monetary policy to counter macroeconomic shocks
Costs of currency conversion are lessened.	Inability of an individual country to use inflation to reduce public debt in real terms
The economies are insulated from monetary disturbances and speculation.	The transition from individual currencies to a single currency could lead to speculative attacks.
Political pressures for trade protection are reduced.	

Optimal Currency Area

Much analysis of the benefits and costs of a common currency is based on the theory of optimal currency areas. An **Optimal currency area** is a region in which it is economically preferable to have a single official currency rather than multiple official currencies. The United States can be considered an optimal currency area. It is inconceivable that the current volume of commerce among the 50 states would occur as efficiently in a monetary environment of 50 different currencies. Table 3 highlights some of the advantages and disadvantages of forming a common currency area.

Advantages and Disadvantages of Adopting a Common Currency

Advantages	Disadvantages
The risks associated with exchange fluctuations are eliminated within a common currency area.	Absence of individual domestic monetary policy to counter macroeconomic shocks
Costs of currency conversion are lessened.	Inability of an individual country to use inflation to reduce public debt in real terms
The economies are insulated from monetary disturbances and speculation.	The transition from individual currencies to a single currency could lead to speculative attacks.
Political pressures for trade protection are reduced.	

Common Currency

However, a single policy can also entail costs, especially if interest rate changes affect different economies in different ways. The broader benefits of a single currency must be compared against the loss of two policy instruments: an independent monetary policy and the option of changing the exchange rate. Losing these is particularly acute if a country or region is likely to suffer from economic disturbances (recession) that affect it differently from the rest of the single currency area, because it will no longer be able to respond by adopting a more expansionary monetary policy or adjusting its currency.

Common Currency

The theory of optimal currency areas concludes that for a currency area to have the best chance of success, countries involved should have similar business cycles and economic structures. The single monetary policy should affect all the participating countries in the same manner. There should be no legal, cultural, or linguistic barriers to labor mobility across borders, there should be wage flexibility, and there should be some system of stabilizing transfers.

INTERNATIONAL TRADE APPLICATION

European Monetary "Disunion"

A main goal of the European Monetary Union is to promote economic and political unification throughout Europe. Two world wars fought in Europe, plus the Depression of the 1930s that was fueled by protectionist trade policies, made a compelling case to dismantle the political and economic borders of post–World War II Europe. The United States encouraged closer economic ties to promote European reconstruction in view of expanding Soviet communism. Supporters maintained that monetary union would foster European peace and also restore European geopolitical power, with a currency on par with the U.S. dollar.

As Europe proceeded toward the euro and monetary union, concerns about the lack of fiscal union to support it were swept aside. Some economists predicted that a monetary union without a political mechanism to supervise fiscal policy (rein in budget deficits) would eventually make the monetary union impossible to maintain. They also contended that a uniform monetary policy geared to the low inflation of Germany (the largest member) might result in an interest rate that was too low for smaller, high-inflation countries like Greece, leading to trade deficits fueled by easy credit. These economists were often ridiculed by the European media for their alarmist views.

When the eurozone was being formed, the government of Germany insisted that Italy, as the fourth-largest European economy, be a founding member even though it did not fulfill the condition of sound government finances. Once debt-ridden Italy was included, there was no argument for excluding high-spending countries such as Greece, Ireland, and Portugal, which became members of the eurozone. The eurozone consisted of the fiscally healthier countries such as Germany and the fiscally weak countries like Greece. As the global debt crisis emerged during the Great Recession of 2007–2009, it became increasingly apparent that although the eurozone has a single currency, the member countries are not identical.

Skeptics note that the euro was a bold venture that placed the cart before many horses. The basic problem is that the eurozone is not a single country. Initially 11, and now 19, sovereign countries signed up for a currency union without first homogenizing their budget policies, tax systems, and bank regulations—that is, they did not form an economic union as discussed at the beginning of this chapter. They did so without creating a central government strong enough to enact cross-border fiscal discipline or finance cross-country transfers. Disunity within the eurozone mounted as some countries pursued sound fiscal policies while others pursued unsound policies. Fears have spread that the weak nations of the eurozone could default on their debt and might have to pull out of the eurozone.

To lessen such fears, the eurozone countries met in 2011 and pledged that each member would enact a constitutional rule to balance its budget and face penalties if its actual deficit exceeds 3 percent of its GDP. The fines could cost billions of euros. Critics maintain that there is no enforcement mechanism for this pledge and it could easily be violated and watered down to be completely ineffective. At the writing of this text, the determination of the eurozone members to achieve fiscal integrity remains unclear.

What do you think? Do you think that the eurozone countries will ever achieve fiscal union?

天津外国语大学（天外）

Tianjin Foreign Studies University (TFSU)

Geoeconomics & Regional Development

Online class starts at 08:00

(Beijing Time, GMT+8)

Ivan Monich, PhD

May 29, 2023

Source: https://pixabay.com/photos/tianjin-sunset-city-aerial-view-2185510/

We stopped here 22-05-2023
Eurozone's Problems and Challenges

Although the EMU has resulted in some economic efficiencies for its members, it has also suffered from several problems. Recall that to be included in the EMU, countries were supposed to fulfill certain economic criteria, such as small budget deficits, low inflation, and interest rates close to the eurozone's average. However, some countries (such as Greece) did not appear to fulfill these standards when they were accepted into the monetary union. These standards were sometimes ignored once countries became members of the monetary union. This put the eurozone on weak financial footing from its beginnings.

Eurozone’s Problems and Challenges

Therefore, without the normal adjustment mechanisms to keep economic imbalances from destroying the eurozone, some analysts have pushed for the concept of fiscal union. This would result in the integration of the fiscal policies of the eurozone countries, including taxation and government spending programs. The idea would be to impose budget discipline on the laggard, deficit countries. Control over fiscal policy has been regarded as essential to national sovereignty, and eurozone members have not been willing to give up their fiscal independence. The eurozone has a monetary union, but it does not have a fiscal union.

Eurozone’s Problems and Challenges

An important monetary policy challenge for the EMU is the ability of the European Central Bank to focus on price stability over the long term. Some are concerned that over time, monetary policy may become too expansionary given the large number of countries voting on monetary policy and the fact that strong anti-inflationary actions are not well ingrained in countries like Greece, Portugal, Spain, Italy, and Cyprus.

Eurozone’s Problems and Challenges

Analysts note that structural reforms are necessary for several reasons. First, they would lower the EU’s persistently high structural unemployment rate. Second, firms would provide needed flexibility in adjusting to recessions, especially those that affected one or a few countries in the eurozone. If prices and wages were flexible downward, a decline in demand would be followed by lower prices, tending to raise demand. Increased labor mobility would be particularly useful in adjusting to recessions.

Greece and the Eurozone

The experience of Greece illustrates some of the challenges of the eurozone. As a result of the global financial crisis that began in 2007–2008, the eurozone entered its first official recession. The severity of this downturn came close to breaking up the eurozone as financially weak members such as Greece, Portugal, Cyprus, and Spain teetered on the verge of bankruptcy.

In 2008, Greece was in deep recession, its economy was uncompetitive with northern eurozone members like Germany, and its debt was more than three times as large as previously estimated. With debt piling up, investors feared that Greece could not pay its international obligations. To shore up Greece's financial position, other eurozone countries, in conjunction with the International Monetary Fund (IMF), agreed on a package that gave Greece 110 billion euros in loans.

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Greece and the Eurozone

By 2015, it became apparent that the previous bailout wasn't doing the trick as Greece's economy continued to crumble. Its gross domestic product declined by a quarter over five years, unemployment was over 25 percent, and youth unemployment was over 50 percent. Partly to blame was the austerity program demanded by the creditors. Critics maintained that it attempted to reduce Greece's budget deficit too fast, thus intensifying the country's economic downturn.

Events intensified when Greece announced that it could not fulfill its debt payments to the IMF. To minimize the financial panic of a bankrupt Greece, the government imposed capital controls that prevented the movement of euros out of Greece and temporarily closed domestic banks to prevent depositors from rushing to withdraw euros from their accounts. After much wrangling with creditor nations, Greece agreed to another bailout program in which 94 billion euros were lent to Greece in exchange for additional austerity measures. Indeed, the people of Greece felt that they were losing their sovereignty to creditors including the European Central Bank and the IMF. Yet the people of northern Europe, who were lenders to Greece, were becoming increasingly dissatisfied about Greece's lackluster economic performance

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Greece and the Eurozone

Although the 2015 bailout provided temporary relief to Greece, it did not eliminate the underlying economic problems. Greece needs to escape its existing depression, reduce its debt burden, and restore its competitiveness. This requires a change of mind-set to address the country’s structural impediments to economic growth: rampant clientelism, hopeless public administration, bad governmental regulations, a lethargic and unreliable justice system, nationalized assets and oligopolies, and inflexible markets for goods and services and labor.

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Deflation and the Eurozone

In 2016, the world economy was not in good health. Although the performance of the U.S. and British economies was reasonably positive, China's growth rate was declining. Also, Japan's economy was struggling, as were the economies of continental Europe (the eurozone). Not only were prices falling throughout Europe, but the overall inflation rate was slipping to under 0.5 percent. The question was whether Europe would fall into deflation, as Japan did in the late 1990s and the United States did during the Great Depression.

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Deflation and the Eurozone

With the rate of inflation well below the European Central Bank’s (ECB) target rate of 2 percent in 2015, policymakers feared that the eurozone could slip into deflation. This resulted in the ECB’s implementation of an expansionary monetary policy to steer inflation back to its target. By 2017, the deflationary pressures were subsiding, although the financial position of the eurozone remained weak.

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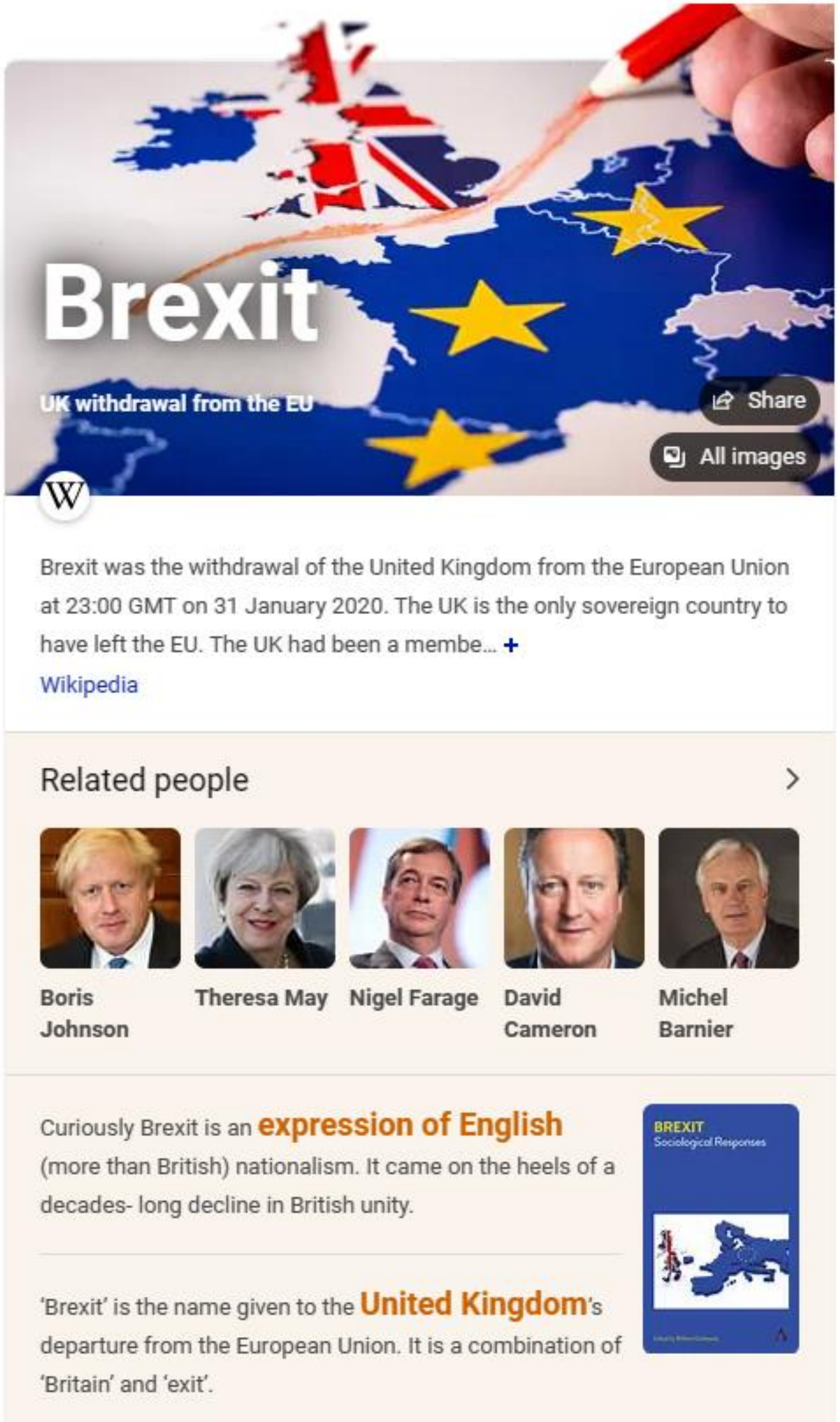
Q&A session

Author an essay on the topic of the pros and cons of Brexit.



Q&A session

210710 wenye guo

Brexit naturally has its own reasons. From an economic perspective, the UK believes that its interests have been compromised because it has entered a developed financial and service industry, while the EU focuses on manufacturing. From a societal perspective, the UK believes that joining the EU will increase domestic spending and bring greater social problems. Because some underdeveloped countries in the EU region prefer to make a living in developed EU countries, the influx of these immigrants into the UK has led to a continuous increase in social problems such as crime. Meanwhile, the UK is not a eurozone country and has always maintained its currency, the pound sterling.

Pros: After Brexit, the UK does not have to pay EU membership fees at all, and will use these fees for people's livelihood construction and welfare.

Secondly, an independent and free trading system plays a role, and after exiting the EU, the UK no longer needs to be constrained by the EU.

Thirdly, there is no refugee problem. After the UK withdrew from the EU, there is no need for the UK to address the refugee issues in EU countries.

Fourthly, leverage the role of Commonwealth member states and have greater say in the economic and trade system.

Fifth, reduce production costs. After Brexit, the UK can break free from the constraints of the 100 EU production standards and regulatory regulations, further reducing production costs, bringing opportunities for the development of small and medium-sized enterprises, and increasing employment rates.

Cons: Firstly, after the UK left the EU, although it had an independent and independent economic development model, it also needed to respond independently to crises.

Secondly, after Brexit, the UK lost its previous influence on EU countries.

Thirdly, the EU is an alliance of developed countries in the world, and its technology is second to none in the world. Within the EU, many resources, whether in research and development or application technology, are shared among countries. If the UK leaves the EU, it will lose this shared treatment.

Zhixuan Gong

The benefits of Brexit. 1. Monetary autonomy of sterling can be established. 2. It does not bear the responsibility of EU members to reduce the gap. 3. The annual EU expenditure is removed and the task of receiving refugees is reduced

Bad. 1. Influence international reputation. 3. Many scientific research projects in the UK will not be able to receive funding from the EU. Previously, the UK was the second largest recipient of funding in the EU (after Germany).

here： 2. With some restrictive conditions, trade will become less free than before.

'Brexit' is the name given to the United Kingdom's departure from the European Union. It is a combination of 'Britain' and 'exit'.

Chenyang Wu
The pros:
1. have more sovereignty than before and can work out own tacks more freely.
2. Retain more human capitals. Exiting the EU will lead to more red tapes of the immigration and more labors will be kept.
3. Help to save budget and doesn't have to contribute much to the EU

Cons: 1. Potential economic fluctuations without being under the cohesion with other EU member countries.
2. myriad red tapes during the Brexit, time-consuming and lead to inefficiencies.

210709梁琼文 Liang Qiongwen
Brexit will have the following advantages and disadvantages for the UK:
pros:
First, it can have an independent free foreign trade policy. After Brexit, Britain will be free from the constraints of the EU and can sign free trade agreements with countries outside the EU and set independent industrial policies.

Second, the annual payment of EU funds is removed, and the task of receiving refugees is reduced
Before Brexit, Britain was required to pay a hefty annual contribution to the EU, but received nothing in return. The UK pays around 163 million pounds a week to the EU, about 130 pounds per person per year for the average Briton. After Brexit, there will be no need to pay this huge amount of membership fee, which reduces the economic burden of the country and is more conducive to the economic development of the country.

Third, It strengthens Britain's independence in handling international affairs and helps build a "global empire"
Eu laws are too restrictive. The huge EU control system, which restricts the free trade agreements between Britain and other countries such as China, India and the United States, has affected the development of many industries in Britain. Post-brexit Britain could be freed from these rules and better prepared for its long-term economic benefits.

cons:
First, the UK would not be able to trade freely with the rest of the EU, thus potentially losing the EU market of more than 500 million people.

Second, after losing the support of the EU, the UK needs to independently obtain the right to make rules and speak in the world, and its international influence will be reduced.

Third, the UK financial sector has been greatly affected. After Brexit, the UK will become less attractive to global investment.

Q&A session

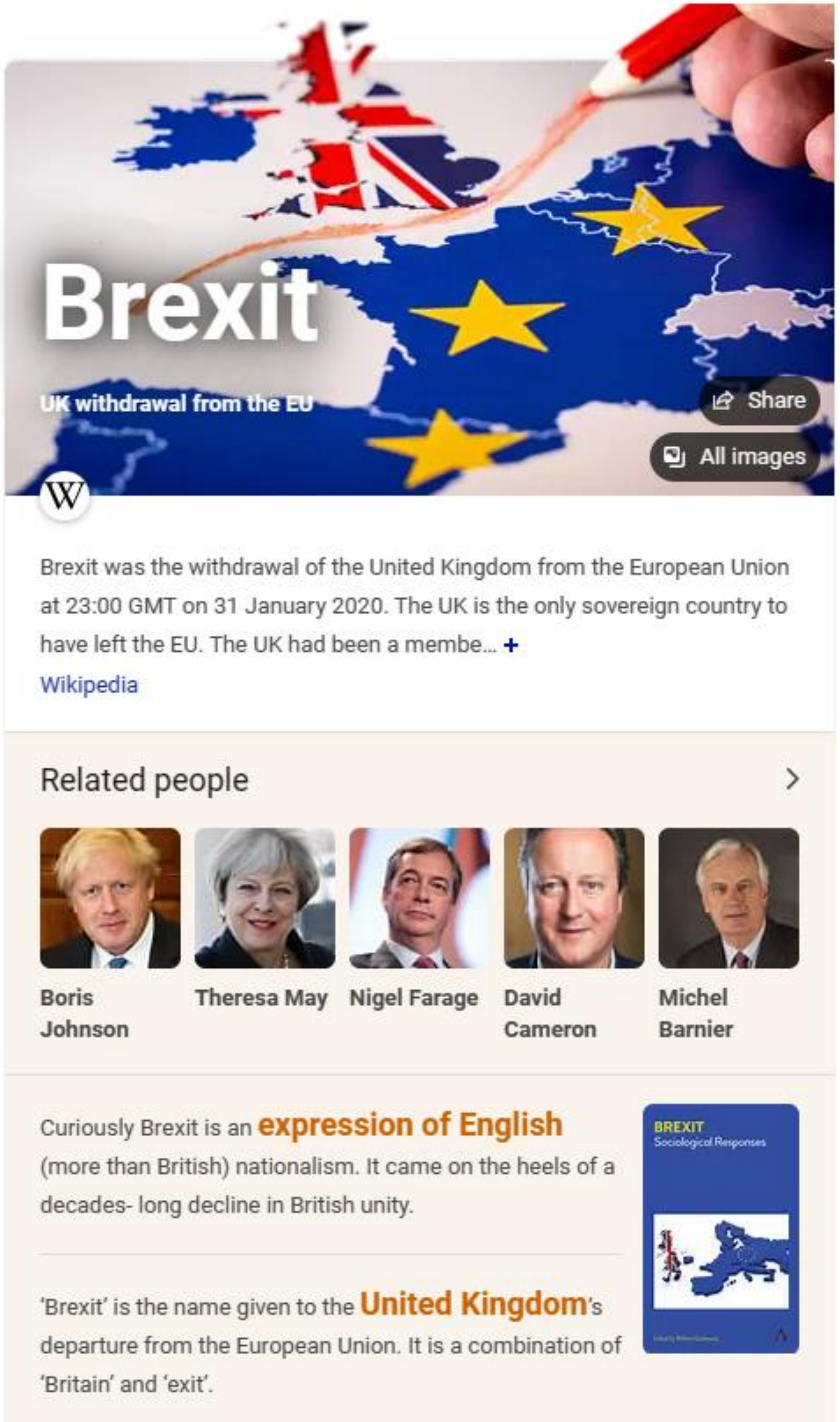
Brexit, or Britain's exit from the European Union, is a historic decision that has profound implications for the country and its relations with the rest of the world. The referendum that took place on June 23, 2016, resulted in a narrow majority of 52% voting in favor of leaving the EU, while 48% voted to remain. Since then, the process of negotiating and implementing the terms of the withdrawal has been fraught with challenges and uncertainties. In this essay, I will examine some of the main arguments for and against Brexit, as well as some of the alternative arrangements that could shape Britain's future trade with the EU.

One of the main arguments of the pro-Brexit camp is that leaving the EU would restore Britain's sovereignty and democratic control over its own laws, policies, and borders. The EU is often criticized as a bureaucratic and undemocratic institution that imposes excessive regulations and costs on its member states, without sufficient accountability or transparency. By leaving the EU, Britain would be able to regain its independence and pursue its own national interests, without being constrained by the rules and obligations of the EU membership. For example, Britain would be able to control its own immigration policy and decide who can enter and work in the country, instead of having to accept the free movement of people from other EU countries. Moreover, Britain would be able to negotiate its own trade deals with other countries around the world, instead of being part of the EU's common trade policy and customs union.

Another argument in favor of Brexit is that it would benefit Britain's economy and public finances in the long run. The proponents of Brexit claim that the EU membership imposes a net financial burden on Britain, as it contributes more to the EU budget than it receives back in spending. According to official figures, in 2016, Britain paid £13.1 billion to the EU budget, while receiving £4.5 billion back in spending, resulting in a net contribution of £8.6 billion [1]. By leaving the EU, Britain would be able to save this money and spend it on its own priorities, such as health care, education, or infrastructure. Furthermore, Brexit supporters argue that leaving the EU would unleash Britain's economic potential and competitiveness, as it would be free from the EU's excessive regulations and red tape that stifle innovation and growth. They also contend that Brexit would open up new opportunities for trade with emerging markets and fast-growing economies, such as India, China, or Australia.

On the other hand, one of the main arguments against Brexit is that it would damage Britain's economy and trade with its largest and closest partner, the EU. The opponents of Brexit warn that leaving the EU would create significant barriers and costs for trade between Britain and the EU, as they would no longer enjoy the benefits of free trade and seamless integration within the single market and customs union. The single market allows for free movement of goods, services, capital, and people across the EU, while eliminating tariffs, quotas, and non-tariff barriers. The customs union ensures a common external tariff and trade policy for all EU members. By leaving these arrangements, Britain would face new tariffs, checks, and regulations when trading with the EU, which could disrupt supply chains, increase prices, reduce competitiveness, and lower output and employment. According to a study by the London School of Economics (LSE), Brexit could reduce UK GDP by between 1.3% and 2.6% in 2020-2029 [2].

Another argument against Brexit is that it would weaken Britain's influence and security in the world. The detractors of Brexit argue that being part of…



Brexit is one of the most controversial and divisive issues in modern European history. It refers to the decision of the United Kingdom (UK) to leave the European Union (EU) after a referendum held in June 2016. The UK officially left the EU on 31 January 2020, but remained in a transition period until 31 December 2020, during which it followed EU rules and regulations. Since then, the UK and the EU have been negotiating their future relationship on trade, security, immigration and other areas.

There are many arguments for and against Brexit, and both sides have their supporters and opponents. In this essay, I will examine some of the main pros and cons of Brexit from different perspectives.

One of the main arguments in favour of Brexit is that it allows the UK to regain its sovereignty and independence from the EU. The proponents of Brexit claim that the EU is an undemocratic and bureaucratic institution that imposes its laws and policies on the UK without its consent or representation. By leaving the EU, the UK can make its own decisions on matters such as trade, immigration, agriculture, fisheries, environment and human rights. The UK can also pursue its own interests and values in the global arena, without being constrained by the EU's rules or influenced by its partners.

Another argument in favour of Brexit is that it frees the UK from the financial burden of being a member of the EU. The supporters of Brexit argue that the UK pays more to the EU than it receives back in benefits or subsidies. By leaving the EU, the UK can save billions of pounds per year that can be spent on domestic priorities such as health, education, infrastructure and defence. The UK can also negotiate its own trade deals with other countries and regions, such as the United States, China, India and Africa, that can boost its economy and create more jobs and opportunities.

However, there are also many arguments against Brexit, and they are equally compelling. One of the main arguments against Brexit is that it damages the UK's economy and trade with its largest and closest partner, the EU. The opponents of Brexit claim that leaving the EU means losing access to its single market and customs union, which facilitate free movement of goods, services, capital and people across 27 countries. By leaving the EU, the UK faces tariffs, quotas, regulations and non-tariff barriers that increase costs and reduce competitiveness for its businesses and consumers. The UK also risks losing its attractiveness as a destination for investment, innovation and talent from Europe and beyond.

Another argument against Brexit is that it weakens the UK's security and influence in Europe and the world. The critics of Brexit argue that leaving the EU means losing cooperation and coordination with its allies on issues such as terrorism, crime, cyberattacks, migration, climate change and human rights. By leaving the EU, the UK reduces its voice and leverage in shaping international norms and standards that affect its interests and values. The UK also risks alienating its friends and partners in Europe, who may see it as an unreliable and unpredictable actor.

In conclusion, Brexit is a complex and multifaceted phenomenon that has advantages and disadvantages for both sides. It is not possible to say definitively whether Brexit is good or bad for the UK or for Europe as a whole. It depends on how one weighs the costs and benefits of being in or out of the EU, as well as on how one envisions the future relationship between them. Ultimately, Brexit is a political choice that reflects different visions of identity, sovereignty, democracy and prosperity.

North American Free Trade Agreement

The success of Europe in forming the European Union inspired the United States to launch several regional free trade agreements. During the 1980s, the United States entered into discussions for a free trade agreement with Canada that became effective in 1989. This paved the way for Mexico, Canada, and the United States to form the North American Free Trade Agreement (NAFTA) that went into effect in 1994.

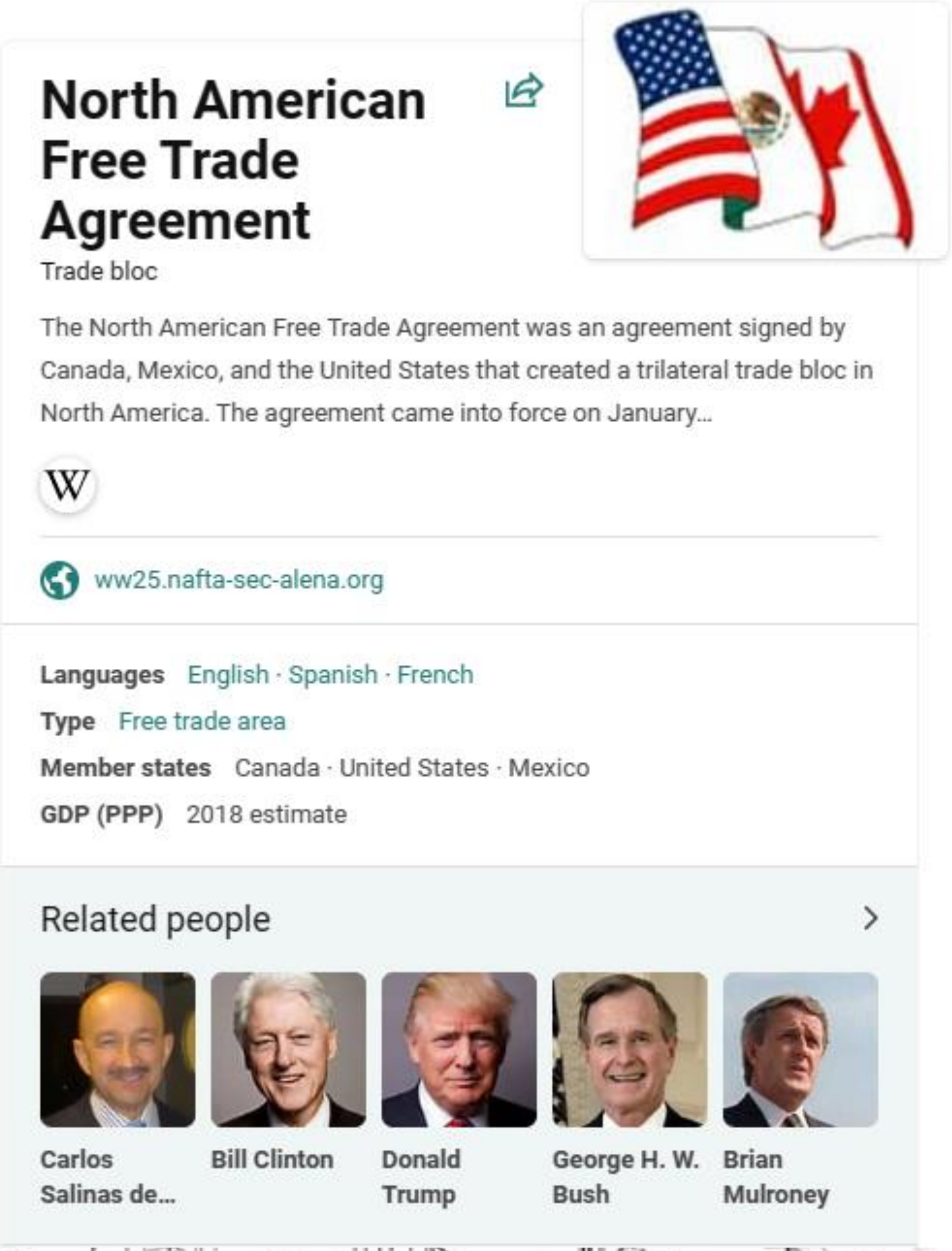
The establishment of NAFTA was expected to provide each member nation better access to the others’ markets, technology, labor, and expertise. In many respects, there were remarkable fits between the nations: The United States would benefit from Mexico’s pool of cheap and increasingly skilled labor, while Mexico would benefit from U.S. investment and expertise.

NAFTA

Winners and Losers in the United States under Free Trade with Mexico

U.S. Winners	U.S. Losers
Higher-skill, higher-tech businesses and their workers benefit from free trade.	Labor-intensive, lower-wage, import-competing businesses lose from reduced tariffs on competing imports.
Labor-intensive businesses that relocate to Mexico benefit by reducing production costs.	Workers in import-competing businesses lose if their businesses close or relocate.
Domestic businesses that use imports as components in the production process save on production costs.	
Consumers in the United States benefit from less expensive products because of increased competition with free trade.	

Negotiating the free trade agreement was difficult because it required meshing two large advanced industrial economies (the United States and Canada) with that of a sizable developing nation (Mexico). The huge living standard gap between Mexico, with its lower wage scale, and the United States and Canada was a politically sensitive issue. One of the main concerns about NAFTA was whether Canada and the United States as developed countries had much to gain from trade liberalization with Mexico. Table 4 highlights some of the likely gains and losses of integrating the Mexican and U.S. economies.



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NAFTA’s Benefits and Costs for Mexico and Canada

NAFTA’s benefits to Mexico have been proportionately much greater than for the United States and Canada because these economies are many times larger than Mexico’s. Eliminating trade barriers has led to increases in the production of goods and services for which Mexico has a comparative advantage. Mexico’s gains have come at the expense of other lowwage countries, such as Korea. Generally, Mexico has produced more goods that benefit from a low-wage, low-skilled workforce, such as tomatoes, avocados, fruits, vegetables, processed foods, sugar, tuna, and glass; labor-intensive manufactured exports such as appliances and economy automobiles have also increased. Rising investment spending in Mexico has helped increase wage incomes and employment, national output, and foreign exchange earnings; it also has facilitated the transfer of technology.

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NAFTA’s Benefits and Costs for Mexico and Canada

For Canada, initial concerns about NAFTA had less to do with the flight of low-skilled manufacturing jobs, because trade with Mexico was much smaller than it was for the United States. Instead, the main concern was that closer integration with the U.S. economy would threaten Canada’s social welfare model, either by causing certain practices and policies (such as universal health care or a generous minimum wage) to be considered as uncompetitive or by imposing downward pressure on the country’s base of personal and corporate taxes, thus starving government programs of resources. Canada’s social welfare model currently stands intact.

Canada’s benefits from NAFTA have been mostly in the form of safeguards: maintenance of its status in international trade, no loss of its current free trade preferences in the U.S. market, and equal access to Mexico’s market. Canada also desired to become part of any process that would eventually broaden market access to Central and South America. Although Canada hoped to benefit from trade with Mexico over time, most researchers have estimated that there have been relatively small gains because of the small amount of existing Canada–Mexico trade.

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NAFTA's Benefits and Costs for Mexico and Canada

Although it has succeeded in stimulating increased trade and foreign investment, NAFTA alone has not been enough to modernize Mexico or guarantee prosperity. This result has been a disappointment to many Mexicans. Trade and investment can do only so much. Since the beginnings of NAFTA, the government of Mexico has struggled to deal with the problems of corruption, poor education, red tape, crumbling infrastructure, lack of credit, and a tiny tax base. These factors greatly influence a country's economic development. For Mexico to become an economically advanced nation, it needs a better educational system, cheaper electricity, better roads, and investment incentives for generating growth—things that NAFTA cannot provide.

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NAFTA's Benefits and Costs for the United States

NAFTA proponents maintain that the agreement has benefited the U.S. economy overall by expanding trade opportunities, reducing prices, increasing competition, and enhancing the ability of U.S. firms to attain economies of large-scale production. The United States has produced more goods that benefit from large amounts of physical capital and a highly skilled workforce, including chemicals, plastics, cement, sophisticated electronics and communications gear, machine tools, and household appliances. American insurance companies have also benefited from fewer restrictions on foreign insurers operating in Mexico.

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NAFTA’s Benefits and Costs for the United States

Economies of scale represent another benefit of NAFTA. A member of NAFTA can overcome the smallness of its domestic markets and realize economies of scale in production by exporting to other members. NAFTA has allowed U.S. manufacturing giants from General Motors to General Electric to use economies of scale for their production lines. Prior to NAFTA, GM’s assembly plants in Mexico assembled small volumes of many products that resulted in high costs and somewhat inferior quality. Now its plants in Mexico specialize in a few high-volume products, resulting in low costs and higher quality. This result benefits both U.S. and Mexican consumers

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NAFTA’s Benefits and Costs for the United States

Gross Domestic Product (Purchasing Power Parity), Employment, and Labor Productivity, 2015

Country	Gross Domestic Product (trillions)	Employment (millions)*	Labor Productivity**
United States	$18.27	150.2	$121,638
Australia	1.16	11.9	97,479
Germany	3.99	43.2	92,361
Canada	1.66	18.1	91,713
United Kingdom	2.74	31.4	87,261
Japan	4.91	63.7	77,080
Mexico	2.26	51.4	43,969
China	19.95	824.6	24,194

* Employment = (1 − unemployment rate) × labor force.
** Labor productivity = GDP/number of persons employed. Due to rounding, numbers are not precise.

Source: Central Intelligence Agency, *World Fact Book*, http://www.cia.gov. See also World Bank Group, *Data and Statistics*, http://www.worldbank.org/data/; and International Monetary Fund, *International Financial Statistics*.

According to NAFTA critics, there would be a “giant sound” from U.S. companies moving to Mexico to capitalize on Mexico’s cheap labor. After more than a decade, U.S. companies have not relocated to Mexico in the large numbers forecasted. International trade theory tells us why. As seen in Table 5, the productivity of the average American worker (GDP per worker) was $121,638 in 2015, whereas the productivity of the average Mexican worker was $43,969. The U.S. worker was about 2.75 times as productive as the Mexican worker. Employers could pay U.S. workers 2.75 times as much as Mexican workers without any difference in cost per unit of output. Also, companies operating in the United States benefit from a more stable legal system than exists in Mexico.

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NAFTA’s Benefits and Costs for the United States

To date, the effects of NAFTA on the U.S. economy have been relatively small. These effects have included increases in overall U.S. income and increases in U.S. trade with Mexico, but have had little impact on overall levels of unemployment, although with some displacement of workers from sector to sector. For particular industries or products with a greater exposure to intra-NAFTA trade, effects have generally been greater, including displacement effects on individual workers. Overall, studies have indicated that NAFTA has resulted in greater trade creation than trade diversion for the United States, thus improving its welfare

https://www.istockphoto.com/en/photo/3d-rendering-of-north-american-free-trade-agreement-nafta-member-gm518729077-49250850?phrase=nafta

Modernizing NAFTA

Source: https://en.wikipedia.org/wiki/Donald_Trump

Created in 1994, NAFTA was controversial from the start. Critics have characterized NAFTA as being unfair and a jobs destroyer while proponents maintain that the trade agreement has fostered increased trade and investment among Canada, Mexico, and the United States, resulting in economic growth. In 2017 Donald Trump entered into negotiations with the governments of Mexico and Canada to renegotiate the pact. Trump noted that the original NAFTA deal of the early 1990s was ill-fitted for the much changed economic environment of 2017.

Modernizing NAFTA

Many analysts felt that a possible obstacle to a deal to modernize NAFTA was Trump's insistence that an upgraded NAFTA must reduce America's trade deficits with Canada and Mexico. Trump's critics noted that such a demand asks too much from Canada and Mexico which have sustained continuous trade deficits with the rest of the world, much like the United States. Moreover, America's overall balance of trade is ultimately determined by macroeconomic factors including investment and saving. Even if revising NAFTA were to reduce bilateral trade deficits with Mexico and Canada, unless America saves more, deficits with other countries would increase

10-minute break

Here are some of the issues that were being considered by negotiators.

Road from NAFTA to USMCA

- Digital trade
- Energy.
- Dispute settlement

https://www.istockphoto.com/en/photo/nafta-gm1051571858-281157590?phrase=nafta

The U.S.-Mexico-Canada Agreement (USMCA) entered into force on July 1, 2020, replacing the North American Free Trade Agreement (NAFTA).

The North American Free Trade Agreement (NAFTA), which was enacted in 1994 and created a free trade zone for Mexico, Canada, and the United States, is the most important feature in the U.S.-Mexico bilateral commercial relationship. As of January 1, 2008, all tariffs and quotas were eliminated on U.S. exports to Mexico and Canada under the North American Free Trade Agreement (NAFTA).

Mexico is the United States' third largest trading partner and second largest export market for U.S. products. In 2018, Mexico was third-largest trading partner (after Canada and China) and second-largest export market. Two-way trade in goods and services totaled USD 678 billion, and this trade directly and indirectly supports millions of U.S. jobs. The United States sold USD 265 billion of U.S. products to Mexico in 2018 and USD 34 billion in services, for a total of USD 299 billion in U.S. sales to Mexico. Mexico is the first or second-largest export destination for 27 U.S. states.

NAFTA provides coverage to services except for aviation transport, maritime, and basic telecommunications. The agreement also provides intellectual property rights protection in a variety of areas including patent, trademark, and copyrighted material. The government procurement provisions of the NAFTA apply not only to goods but to contracts for services and construction at the federal level. Additionally, U.S. investors are guaranteed equal treatment to domestic investors in Mexico and Canada.

NAFTA allows your company to ship qualifying goods to customers in Canada and Mexico duty free. Goods can qualify in several ways under NAFTA's rules of origin.This might be due to the products being wholly obtained or produced in a NAFTA party or because according to the product's rule of origin there is sufficient amount of work and materials required in a NAFTA party to make the product become what it is when its exported.

USMCA


INTERNATIONAL TRADE ADMINISTRATION
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United States–Mexico–Canada Agreement
USMCA - A 21st century, high standard trade agreement: supporting mutually beneficial trade resulting in freer markets, fairer trade, and robust economic growth in North America.

https://www.trade.gov/usmca

- USMCA Home
- Tariffs, Certification of Origin, and Rules of Origin
- USMCA vs NAFTA
- New Chapters
- USMCA Information Resources
- Automotive Sector Report
- Issue Specific Fact Sheets
- Press Releases
- CBP's Implementing Instructions
- USMCA State Fact Sheets
- USMCA Export Resources

The United States, Mexico, and Canada updated NAFTA to create the new USMCA. USMCA is mutually beneficial for North American workers, farmers, ranchers, and businesses. The new agreement, which entered into force on July 1, 2020, will create a more balanced environment for trade, will support high-paying jobs for Americans, and will grow the North American economy.

Click here to download video
[23MB]

USMCA Uniform Regulations Interpretation, Application, & Administration of Chapters 5 (Origin Procedures), 6 (Textile & Apparel Goods), & 7 (Customs Administration & Trade Facilitation)

GO TO THE UNIFORM REGULATIONS


Exporting with the U.S.-Mexico-Can...
TRADE
Strengthens Commitments
Expands Trade

USMCA vs NAFTA

Major differences between USMCA and NAFTA in key chapters.

INTELLECTUAL PROPERTY RIGHTS	AGRICULTURE	CUSTOMS AND TRADE FACILITATION	FINANCIAL SERVICES	TEXTILES	ADVANCE RULINGS	TARIFFS, CERTIFICATION OF ORIGIN, AND RULES OF ORIGIN

Task 01. Please compare the USMCA and NAFTA by visiting the official websites from the authorities, like this on from the US side:

https://www.trade.gov/usmca-vsnafta

Or you may look for the compartments from the Mexican or Canadian sides.

Author the highlights here in our chat. You may focus on the sectors mentioned on the top: intellectual property rights, agriculture, customs,… and so on.

Canada: https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/cusma-aceum/index.aspx?lang=eng

Chenyang Wu

1. update the provisions of intellectual property and digital trade
2. reduce and prevent non-tariff barrier through more transparency
3. more updated on the rules of origin and will promote the auto industry in the US

The Canada-United States-Mexico Agreement (CUSMA)

Canada, the United States, and Mexico created the largest free trade region in the world, generating economic growth and helping to raise the standard of living for the people of all three member countries.

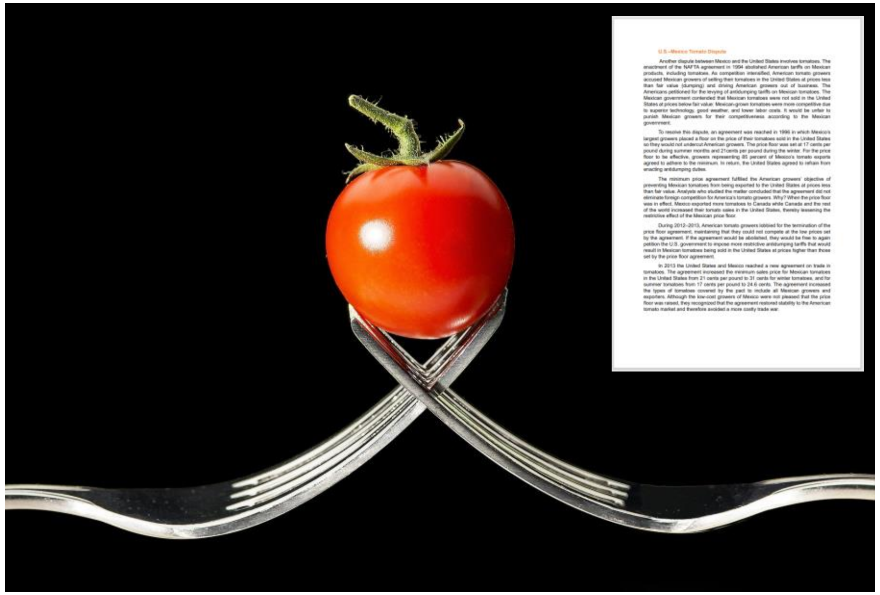
The Canada-United States-Mexico Agreement (CUSMA) will serve to reinforce Canada's strong economic ties with the United States and Mexico.

https://can-mex-usa-sec.org/secretariat/index.aspx?lang=eng

U.S.– Mexico Tomato Dispute NAFTA case-study 01.

Another dispute between Mexico and the United States involves tomatoes. The enactment of the NAFTA agreement in 1994 abolished American tariffs on Mexican products, including tomatoes. As competition intensified, American tomato growers accused Mexican growers of selling their tomatoes in the United States at prices less than fair value (dumping) and driving American growers out of business.

Question: How did the minimum price agreement between Mexico and the United States affect the tomato market in North America and beyond?



https://pixabay.com/photos/tomato-forks-macro-organic-food-1862857/

210710wenye guo

When the minimum price came into effect, Mexico sold more tomatoes to Canada and other countries, while Canada and the rest of the world increased their tomato sales in the United States.

Zhuxuan Gong

Raised the minimum price, which will lead to higher prices for Mexican tomatoes exported to the United States. Reducing the competitive advantage of Mexican tomatoes. Benefits domestic tomato producers.

Chenyang Wu

The foreign competition is not eliminated because Mexico can sell tomatoes at a lower price to the rest of the world and they can then sell them to the US. It is like a shift from the Mexico to other countries, but the competition doesn't disappear.

210710wenye guo

That is to say, Mexico's tomato export prices in the world market are still being pushed down, while American tomato growers can only gain a slight advantage in domestic sales and still cannot gain an export advantage in the international market at low prices.

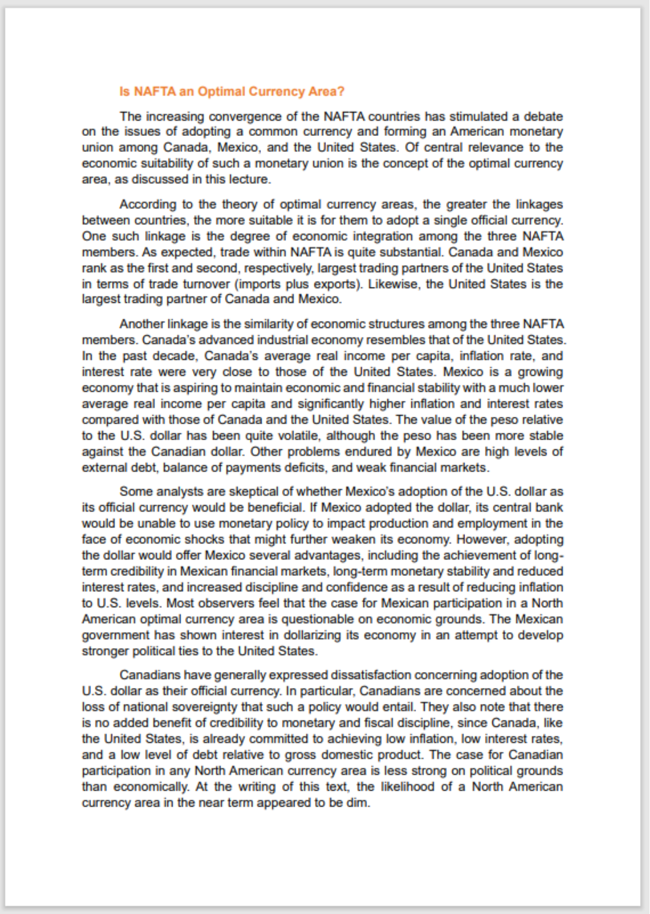
210710wenye guo

Moreover, Canada and other countries around the world are unable to gain export advantages.

Is NAFTA an Optimal Currency Area? NAFTA Case-study 02

The increasing convergence of the NAFTA countries has stimulated a debate on the issues of adopting a common currency and forming an American monetary union among Canada, Mexico, and the United States. Of central relevance to the economic suitability of such a monetary union is the concept of the optimal currency area, as discussed in this lecture.

Question: how does the theory of optimal currency areas apply to the NAFTA countries? Evaluate the costs and benefits of adopting a common currency for Canada, Mexico, and the United States.



Is NAFTA an Optimal Currency Area?

The increasing convergence of the NAFTA countries has stimulated a debate on the issues of adopting a common currency and forming an American monetary union among Canada, Mexico, and the United States. Of central relevance to the economic suitability of such a monetary union is the concept of the optimal currency area, as discussed in this lecture.

According to the theory of optimal currency areas, the greater the linkages between countries, the more suitable it is for them to adopt a single official currency. One such linkage is the degree of economic integration among the three NAFTA members. As expected, trade within NAFTA is quite substantial. Canada and Mexico rank as the first and second, respectively, largest trading partners of the United States in terms of trade turnover (imports plus exports). Likewise, the United States is the largest trading partner of Canada and Mexico.

Another linkage is the similarity of economic structures among the three NAFTA members. Canada's advanced industrial economy resembles that of the United States. In the past decade, Canada's average real income per capita, inflation rate, and interest rate were very close to those of the United States. Mexico is a growing economy that is aspiring to maintain economic and financial stability with a much lower average real income per capita and significantly higher inflation and interest rates compared with those of Canada and the United States. The value of the peso relative to the U.S. dollar has been quite volatile, although the peso has been more stable against the Canadian dollar. Other problems endured by Mexico are high levels of external debt, balance of payments deficits, and weak financial markets.

Some analysts are skeptical of whether Mexico's adoption of the U.S. dollar as its official currency would be beneficial. If Mexico adopted the dollar, its central bank would be unable to use monetary policy to impact production and employment in the face of economic shocks that might further weaken its economy. However, adopting the dollar would offer Mexico several advantages, including the achievement of long-term credibility in Mexican financial markets, long-term monetary stability and reduced interest rates, and increased discipline and confidence as a result of reducing inflation to U.S. levels. Most observers feel that the case for Mexican participation in a North American optimal currency area is questionable on economic grounds. The Mexican government has shown interest in dollarizing its economy in an attempt to develop stronger political ties to the United States.

Canadians have generally expressed dissatisfaction concerning adoption of the U.S. dollar as their official currency. In particular, Canadians are concerned about the loss of national sovereignty that such a policy would entail. They also note that there is no added benefit of credibility to monetary and fiscal discipline, since Canada, like the United States, is already committed to achieving low inflation, low interest rates, and a low level of debt relative to gross domestic product. The case for Canadian participation in any North American currency area is less strong on political grounds than economically. At the writing of this text, the likelihood of a North American currency area in the near term appeared to be dim.

Summary

- The term economic integration refers to the process of eliminating restrictions on international trade, payments, and factor input mobility. The stages of economic integration are (a) free trade area, (b) customs union, (c) common market, (d) economic union, and (e) monetary union.
- The welfare implications of economic integration can be analyzed from two perspectives. First are the static welfare effects, resulting from trade creation and trade diversion. Second are the dynamic welfare effects that stem from greater competition, economies of scale, and the stimulus to investment spending that economic integration makes possible.

Summary (Week 14)

1. Trade liberalization has assumed two main forms. One involves the reciprocal reduction of trade barriers on a nondiscriminatory basis, as seen in the operation of the World Trade Organization. The other approach involves the establishment by a group of nations of regional trading arrangements among themselves. The European Union and the North American Free Trade Agreement are examples of regional trading arrangements.
2. The term economic integration refers to the process of eliminating restrictions on international trade, payments, and factor input mobility. The stages of economic integration are (a) free trade area, (b) customs union, (c) common market, (d) economic union, and (e) monetary union.
3. The welfare implications of economic integration can be analyzed from two perspectives. First are the static welfare effects, resulting from trade creation and trade diversion. Second are the dynamic welfare effects that stem from greater competition, economies of scale, and the stimulus to investment spending that economic integration makes possible.
4. From a static perspective, the formation of a customs union yields net welfare gains if the consumption and production benefits of trade creation more than offset the loss in world efficiency owing to trade diversion.
5. Several factors influence the extent of trade creation and trade diversion: (a) the degree of competitiveness that member nation economies have prior to formation of the customs union, (b) the number and size of its members, and (c) the size of its external tariff against nonmembers.
6. The European Union was originally founded in 1957 by the Treaty of Rome. Today it consists of 27 members. By 1992, the EU had essentially reached the common market stage of integration. Empirical evidence suggests that the EU has realized welfare benefits in trade creation that have outweighed the losses from trade diversion. One of the stumbling blocks confronting the EU has been its common agricultural policy that has required large government subsidies to support European farmers. The Maastricht Treaty of 1991 called for the formation of a monetary union for eligible EU members that was initiated in 1999.
7. The formation of the European Monetary Union in 1999 resulted in the creation of a single currency (the euro) and a European Central Bank. With a common central bank, the central bank of each participating nation performs operations similar to those of the 12 regional Federal Reserve Banks in the United States.
8. Much of the analysis of the benefits and costs of Europe's common currency is based on the theory of optimal currency areas. According to this theory, the gains to be had from sharing a currency across countries' boundaries include more uniform prices, lower transactions costs, increased certainty for investors, and enhanced competition. These gains must be compared against the loss of an independent monetary policy and the option of changing the exchange rate.

Study Questions

1. How can trade liberalization exist on a nondiscriminatory basis versus a discriminatory basis? What are some actual examples of each?
2. What is meant by the term economic integration? What are the various stages that economic integration can take?
3. How do the static welfare effects of trade creation and trade diversion relate to a nation's decision to form a customs union? Of what importance to this decision are the dynamic welfare effects?
4. Why has the so-called common agricultural policy been a controversial issue for the European Union?
5. What are the welfare effects of trade creation and trade diversion for the European Union, as determined by empirical studies?

Key Concepts and Terms

- Benelux
- Brexit
- Common agricultural policy
- Common market
- Convergence criteria
- Customs union
- Dynamic effects of economic integration
- Economic integration

What is Benelux?

Benelux is a term that refers to a politico-economic union of three neighboring countries in Western Europe: **Belgium**, **Netherlands**, and **Luxembourg**. The name is a portmanteau formed from joining the first few letters of each country's name. The union aims to achieve total economic integration by ensuring free movement of people, goods, capital, and services; by coordinating policies in various fields; and by pursuing a common foreign trade policy . Benelux was established in 1944 as a customs union and became a full economic union in 1960. Benelux was also a precursor and an example for the European Union, of which the three countries are founding members. Benelux has a population of about 30 million people and a GDP of about 1.4 trillion euros.

What is common agricultural policy?

The Common Agricultural Policy (CAP) is a set of policies and programmes that aim to support the agricultural sector in the European Union (EU). The CAP was established in 1962 and has undergone several reforms since then. The main objectives of the CAP are to ensure a fair income for farmers, to provide quality food at affordable prices for consumers, to preserve the environment and biodiversity, and to promote rural development and cohesion. The CAP is financed by the EU budget and covers various areas such as direct payments to farmers, market measures, rural development, quality schemes, organic farming, and international trade.

What is common market?

A common market is a type of trade agreement that involves a group of countries that adopt a common external tariff and allow free movement of goods, services, labor, and capital within the group. A common market aims to create a single market that benefits all the members economically and socially. A common market can also increase the efficiency of production and innovation among the members by fostering competition and cooperation. The most well-known example of a common market is the European Union, which consists of 27 member states that share a common market and other policies.

What is convergence criteria?

Convergence criteria are a set of conditions that a country must meet to join a monetary union, such as the eurozone. They aim to ensure that the country's economy is compatible and stable with the other members of the union. The main convergence criteria are:

- Price stability: The country's inflation rate should not exceed by more than 1.5 percentage points the average of the three best performing EU member states in terms of price stability .

- Sound public finances: The country's government deficit should not exceed 3% of its gross domestic product (GDP), and its government debt should not exceed 60% of its GDP .

- Exchange rate stability: The country's currency should participate in the European Exchange Rate Mechanism (ERM II) for at least two years without severe fluctuations or devaluations against the euro .

- Long-term interest rates: The country's nominal long-term interest rate should not be more than 2 percentage points above the average of the three best performing EU member states in terms of price stability .

In addition to these four criteria, the country's legislation and institutions should be compatible with the Economic and Monetary Union (EMU) and its objectives . The convergence criteria are assessed by the European Commission and the European Central Bank at least once every two years, or at the request of a country that wishes to adopt the euro.

What is customs union?

A customs union is a type of trade agreement that involves a group of countries that agree to eliminate trade barriers and tariffs among themselves, while imposing a common set of tariffs on imports from non-member countries. A customs union is defined by the World Trade Organization as a form of economic integration that aims to increase trade flows and efficiency among the member countries. However, a customs union also restricts the ability of member countries to negotiate their own trade deals with non-member countries.

What are Dynamic effects of economic integration?

Dynamic effects of economic integration are the changes in economic performance and structure that result from the removal of trade barriers between countries. Economic integration can lead to dynamic effects such as increased productivity, innovation, competition, and growth. Some of the factors that influence the dynamic effects of economic integration are the size and similarity of the markets, the degree and speed of integration, the institutional and regulatory framework, and the policy coordination and convergence among the countries involved.

Thank you