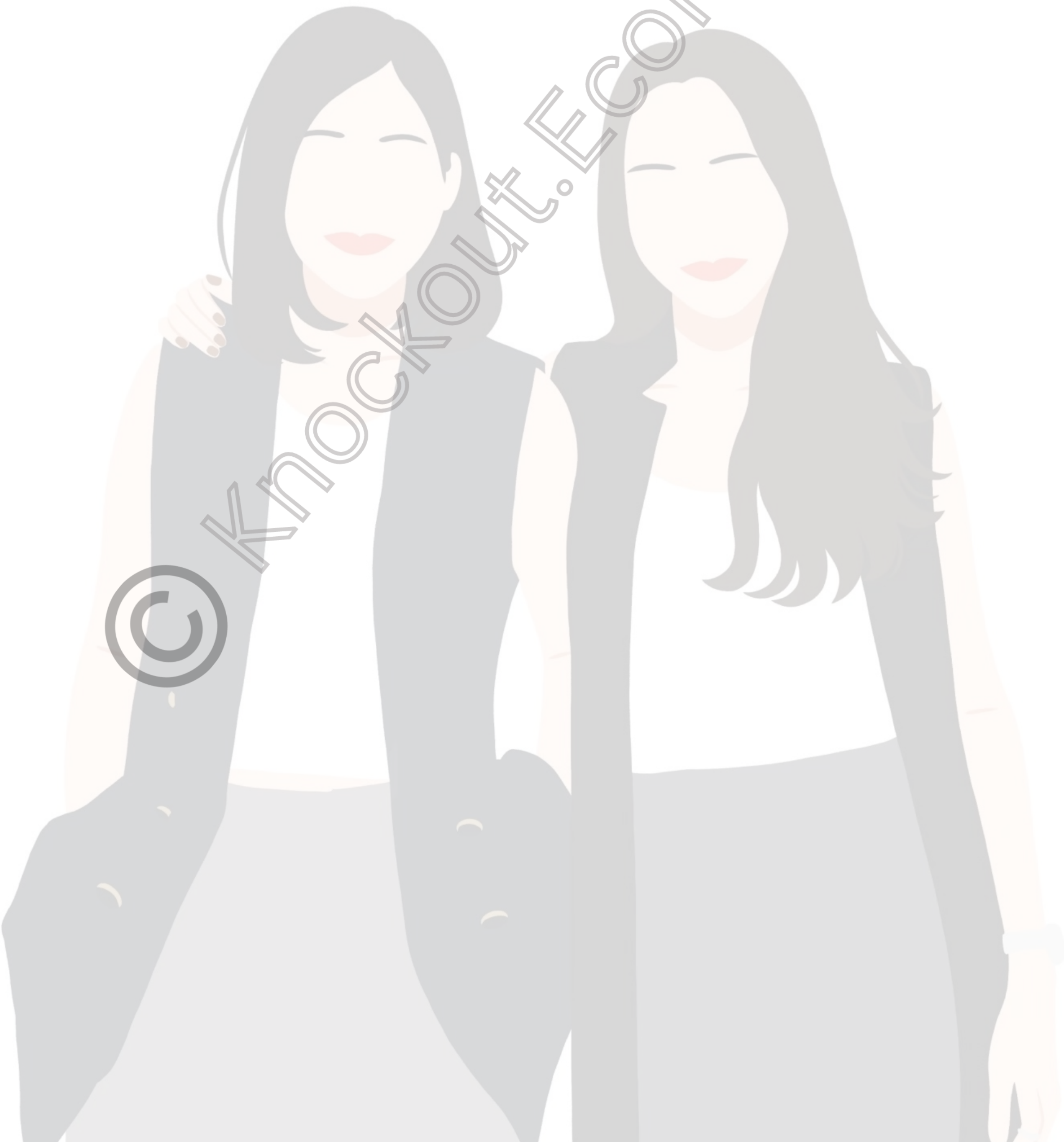
Chapter 26

Trade liberalisation and trading blocs

Key terms

1. Trade liberalization: the move towards greater free trade through the removal of protectionist barriers to trade
2. Bilateral trade agreement: an agreement between two countries, or between a country and a trading bloc, which gives favorable trade arrangements; it reduces some barrier of trade between the two
3. Multilateral or plurilateral trade agreement: a regional trade agreement between 3 or more counties or trading blocs
4. Common external tariff: a common tariff set by a group of countries imposed on imported goods from non member countries
5. Common market: a group of countries between which there is free trade in products and factors of production, and which imposes a common external tariff on imported goods from outside the market; product standards and laws concerning free movement of goods and services are common between countries
6. Custom union: a group of counties between which there is free trade in products and which imposes a common external tariff on imported goods fro, outside the market
7. Economic union: a group of countries where the economies of member countries are as fully integrated economically as different regions within a single country; for example, a single market will be combined with a fiscal and monetary union
8. Fiscal union: a group of countries where a central body has some powers over government borrowing, government spending and setting uniform rates of taxation in member countries
9. Free trade area: group of countries between which there is free trade ingots and services but where member countries are allowed to set their own level of tariff against non member countries
10. Monetary union or currency union: a group of countries which share a common currency such as euro

11. Regional trade agreement: an agreement between at least 2 countries to reduce or eliminate tariffs, quotas and other protectionist barriers between themselves
12. Tariff: tax on imported goods
13. Trade creation: the switch from purchasing products from high cost producers to lower cost producers
14. Trade diversion: the switch from purchasing products from low cost producers to high cost producer
15. Trading bloc: a group of countries that have signed an agreement to reduce or eliminate tariffs, quota and other protectionist barriers between themselves



1. World trade organisation (WTO)

2 main aims of WTO

- To reduce restrictions on free trade
- To make sure member countries follow the trading rules

2. Trading blocs

Trading bloc: a group of countries that have signed an agreement to reduce or eliminate tariffs, quota and other protectionist barriers between themselves

- **Forms of trading bloc**

2.1 Free-trade areas

Free trade area: group of countries between which there is free trade ingots and services but where member countries are allowed to set their own level of tariff against non member countries

2.2 Customs Unions

Custom union: a group of counties between which there is free trade in products and which imposes a common external tariff on imported goods fro, outside the market

2.3 Common markers

Common market: a group of countries between which there is free trade in products and factors of production, and which imposes a common external tariff on imported goods from outside the market; product standards and laws concerning free movement of goods and services are common between countries

2.4 Economic and monetary unions

Economic union: a group of countries where the economies of member countries are as fully integrated economically as different regions within a single country; for example, a single market will be combined with a fiscal and monetary union

Monetary union or currency union: a group of countries which share a common currency such as euro

Summary of types of trading blocs

	Tariffs on trade between countries in the agreement	Common tariffs on imports from outside the agreement area	Free factor mobility within the area	Harmonisation of economic policies
Free trade agreement	Eliminated	No	No	No
Customs union	Eliminated	Yes	No	Possible
Common market	Eliminated	Yes	Yes	Desirable
Economic union	Eliminated	Yes	Yes	Yes

▲ **Table 1 Summary of types of trading blocs**

<u>3. Costs and benefits of membership of a trading bloc</u>

1. Trade creation between members

- Trade creation: the switch from purchasing products from high cost producers to lower cost producers
- However, trading blocs can cause trade diversion as a country moves from buying goods from a low cost country outside to trading blocs to a higher cost producers inside trading blocs, in order to avoid trade barriers.

2. Competitions, costs and prices

- A trading bloc reduces trade barriers. It increases competition in the market so firms have to improve efficiency in order to be able to compete with foreign firms.
- Without tariff and other trade barriers, price of imported goods will decrease.
- Monopoly may raises in the long run and it can increase price of goods and services.

3. Economies of scales

- Firms can take advantages of economies of scale from expanding market share in member countries.

4. Transaction costs

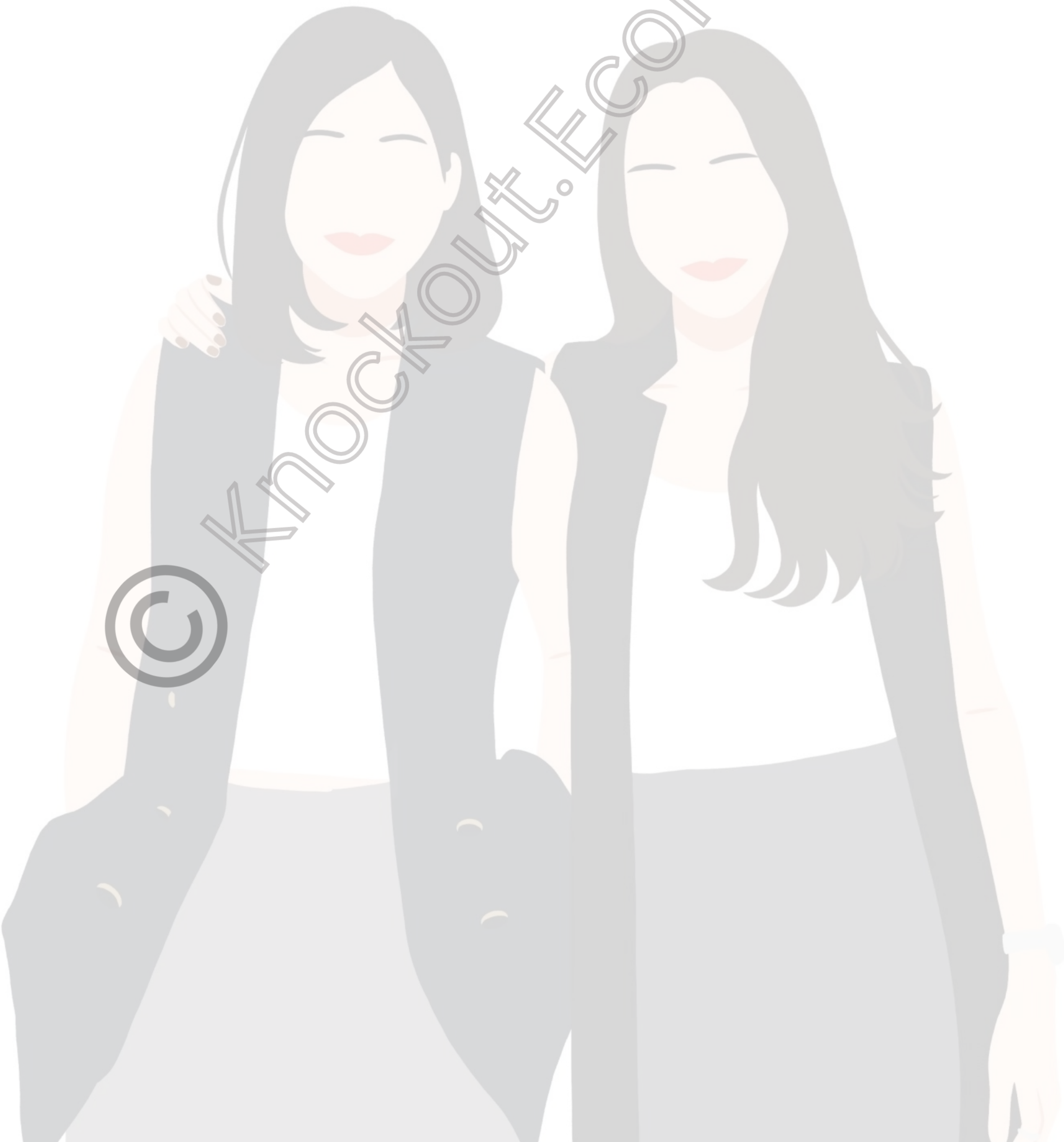
- In monetary union, members use the same currency, it reduces transaction cost.

5. Movement of factors of production

- In common market or economic union, there is free movement of factor of production such as about and capital.

4. Possible conflicts between trading blocs and the WTO

- Trading blocs increase trading between member within trading blocs rather than world free trade.
- WTO aims for free trade between all its member.



Exercise

Trade liberalisation and trading blocs

1. Between 2000 and 2013, Bangladesh's terms of trade worsened by around 43% while Norway's terms of trade improved by around 60%.

(A) Assess the factors that can cause a change in a country's terms of trade. (15 marks)

(B) Evaluate the effects of a worsening of a country's terms of trade on a government's macroeconomic objectives. (25 marks)