

(H. 12) TRADE BLOCS

- COUNTRIES THAT AGREE TO LOWER TRADE BARRIERS AMONG BLOC COUNTRIES

- **TARIFFS**
- **QUOTAS**
- **STANDARDIZE PACKAGING**
- **LEGAL AGREEMENT**

FREE TRADE AREAS

① LOWERED TARIFFS + QUOTAS BETWEEN BLOC COUNTRIES

- AUTONOMOUS TRADE POLICY W/ NON-BLOC COUNTRIES

- NAFTA, CFTA, JORDAN, ISRAEL
CHILE, SINGAPORE, AUSTRALIA

CUSTOMS UNION

① + ② COMMON TRADE POLICY FOR
ALL NON-BLOC COUNTRIES

- MERCUSOR (BRAZIL, URUGUAY,
PARAGUAY, ARGENTINA)

COMMON MARKET

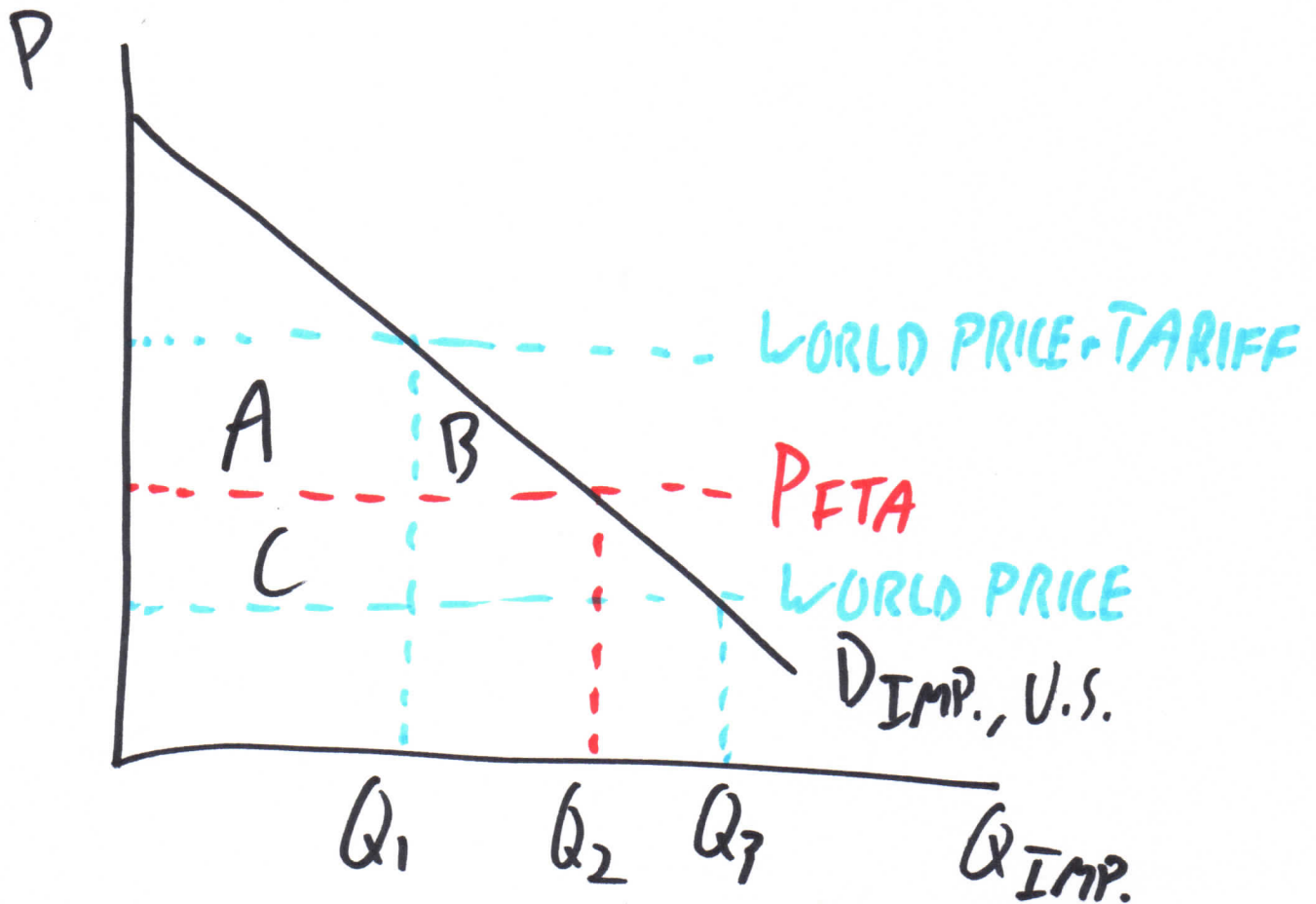
① + ② + ③ FREER FORMS OF
LABOR MOBILITY + FINANCIAL
CAPITAL MOBILITY

- EUROPEAN UNION

ECONOMIC UNION

① + ② + ③ + ④ UNIFIED FISCAL +
MONETARY POLICY
- UNITED STATES

TRADE BLOCS + WELFARE



TARIFF + NO FTA $\rightarrow Q_1$
 FTA $\rightarrow Q_2$
 NO TARIFFS $\rightarrow Q_3$

SIGN FTA?
 CS $\uparrow$ BY $A+B$
 TARIFF REV. FALLS BY $A+L$
 TO $\emptyset$

$$\boxed{\text{FTA GAINS} = B - C}$$

AREA B - TRADE CREATION EFFECT

MORE WELFARE DUE TO GREATER
TRADE ($Q_1 \rightarrow Q_2$)

AREA A - WAS TARIFF REVENUE
BEFORE FTA, NOW CS

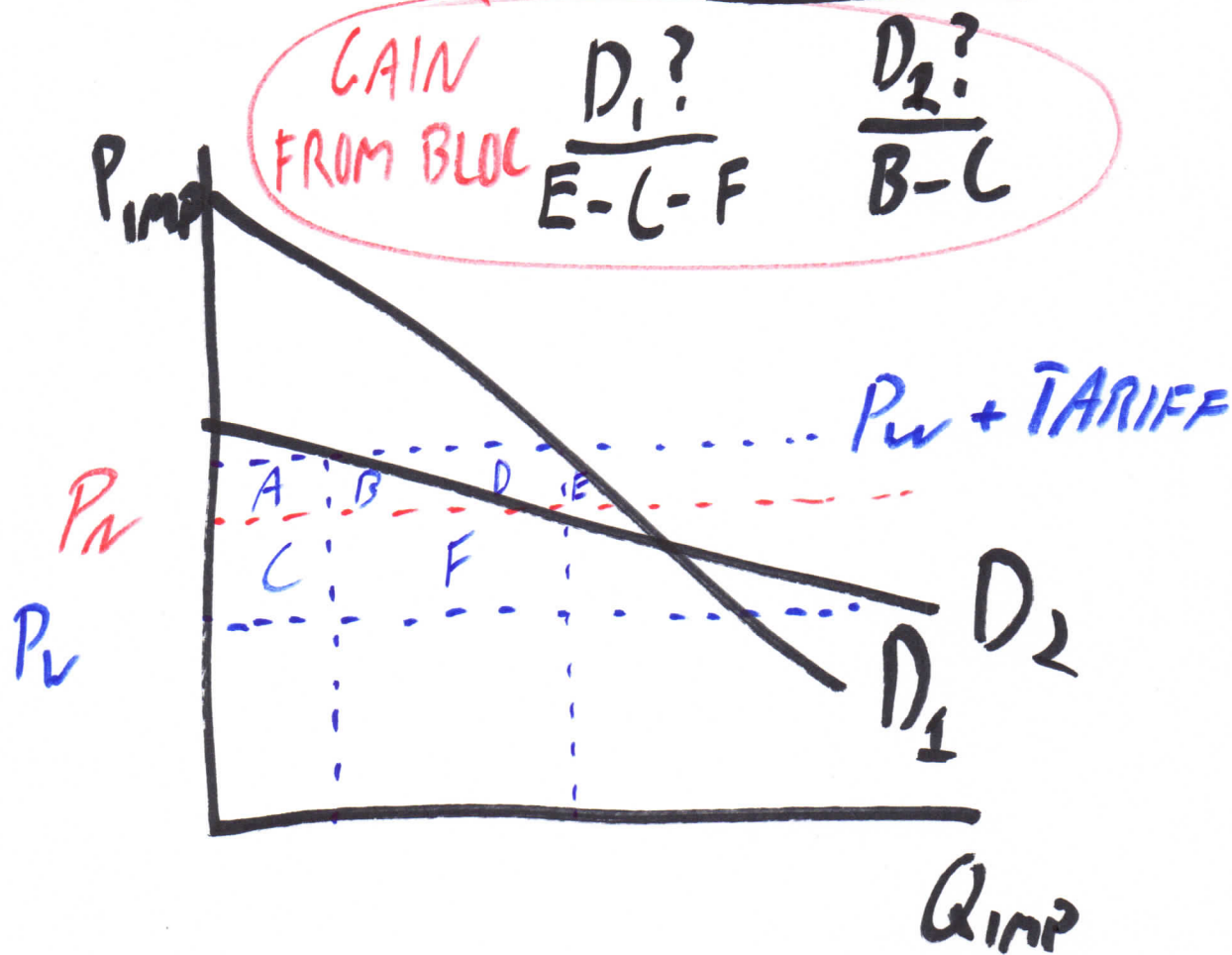
AREA C - WAS TARIFF REVENUE
BEFORE FTA, NOW ~~X~~

(=) TRADE DIVERSION EFFECT

IMPORTING FROM LESS COST
EFFICIENT PRODUCERS - DIVERTING
TRADE TO WORSE PRODUCERS

TRADE BLOCS ARE WELFARE
ENHANCING WHEN... $B > C$

- ① PARTNER OR BLOC COSTS ARE SIMILAR TO ROL COSTS
(LESS TRADE DIVERSION, MORE TRADE CREATION)
- ② IMPORT ~~DEMAND~~ DEMAND ELASTICITY IS HIGH



OTHER REASONS TO LIKE BLOCs

① INCREASED COMPETITION

→ KEEPS PRICES LOW

→ LOW INFLATION

② COMPETITION INDUCES INNOVATION

→ PRODUCTIVITY

→ QUALITY

③ MORE EFFICIENT SCALES OF PRODUCTION

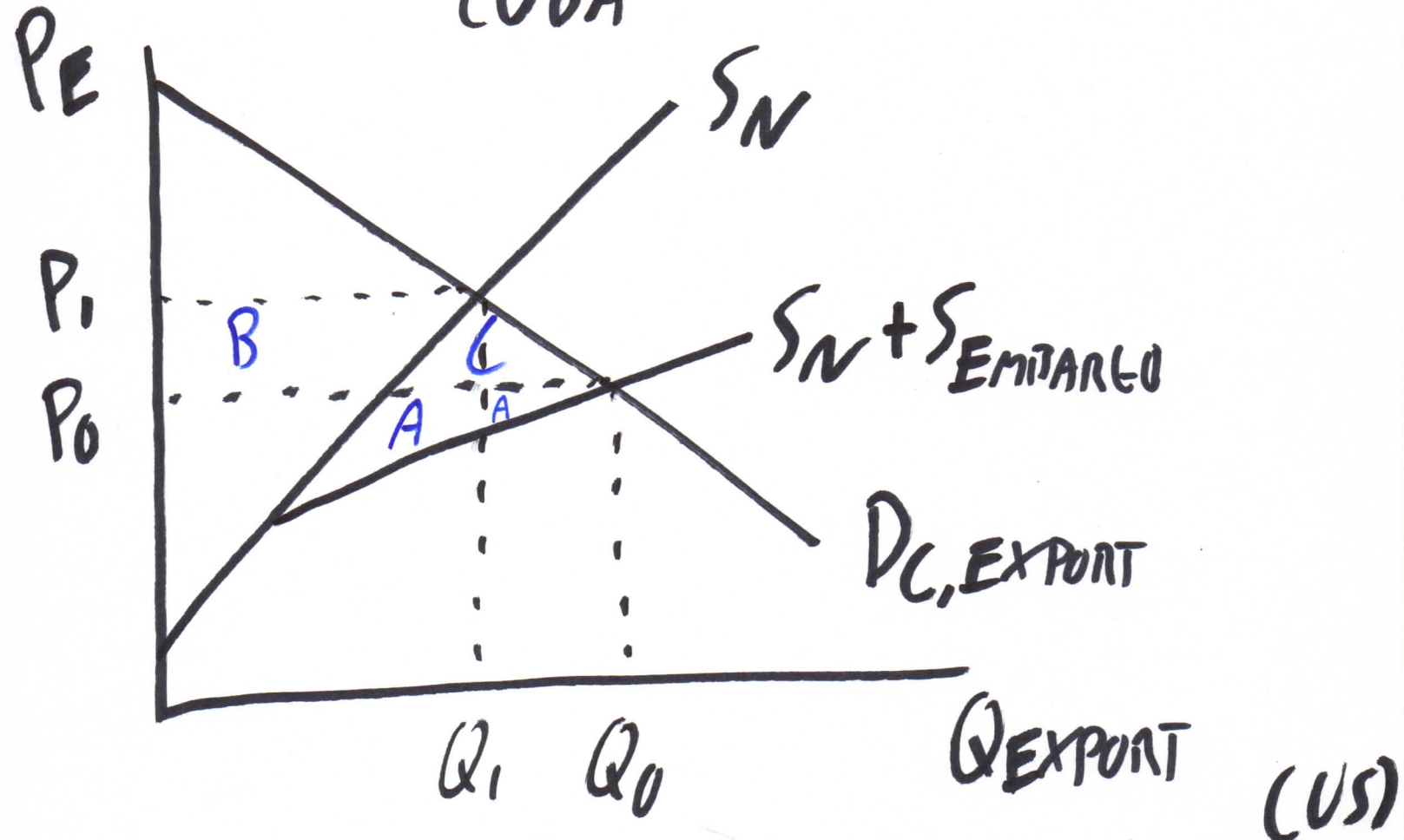
④ INCREASED INVESTMENT OPPORTUNITY

⑤ TRADE=PEACE?

EMBARCO

- CUT OFF TRADE WITH TARGET COUNTRY (CUBA, N. KOREA, IRAN)

CUBA



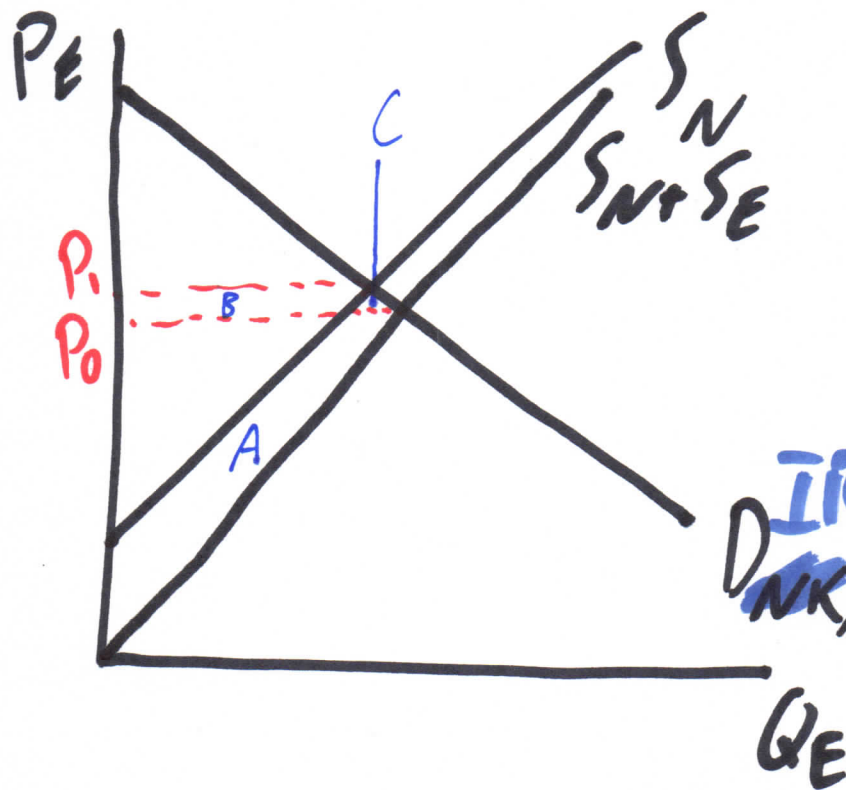
TARGET (CUBA)

LOSES $B+L$ IN CS

EMBARGOING

LOSES A IN PS

ECONOMIC FAILURE (BACKFIRES)



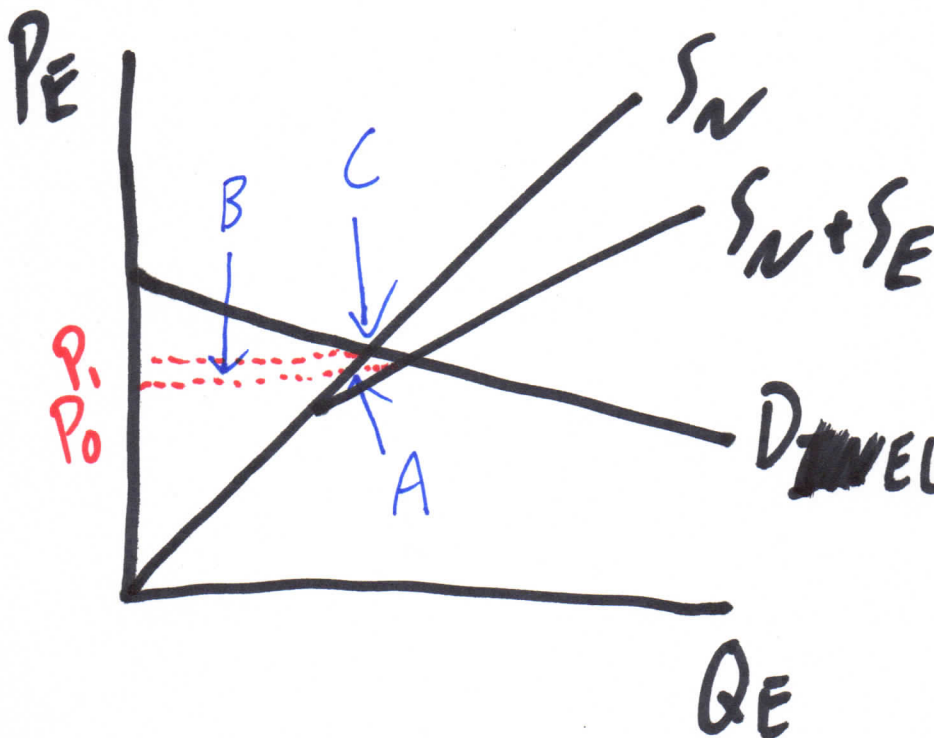
IRAN

~~IRAN~~ LOSES $B+C$ IN CS

E LOSES A IN PS

→ EMBARGO HURTS THE EMBARGOING COUNTRY MORE THAN ~~IRAN~~ IRAN

ECONOMIC FAILURE (IRRELEVANT)



A, B, C ARE TOO SMALL

~~IRAN~~ INELASTIC, E

POLITICAL FAILURE

TARGET COUNTRY TOO STUBBORN