

# International Economics: Lecture 13

## Theory & Practice of Economic Integration

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## Free Trade Agreements of Armenia

Countries with which Armenia has FTA	Year Entry Into Force
EEC (customs union)	2015
Georgia	1998
Kazakhstan	2001
Kyrgyz Rep.	1995
Moldova	1995
Russia	1993
Turkmenistan	1996
Ukraine	1996
CIS (only Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Ukraine, Uzbekistan)	2012

# Multilateralism

- WTO is based on multilateralism: i.e. **no discrimination**.
  - **Most Favored Nation** (MFN) – (1<sup>st</sup> article of GATT)  
No discrimination among trading partners.
    - Any advantage granted to any product originating from any country shall be accorded immediately and unconditionally to the like product originating of all other countries.
  - **National Treatment** (MFN) – (3<sup>rd</sup> article of GATT)  
Imported & domestic products should be treated equally.  
No discrimination between imported and domestic products.
    - Internal taxes & regulations should not be applied to imported or domestic products so as to afford protection to domestic production.

# Regionalism

- Regional Trade Agreements are based on **discrimination**.

Favors are granted to RTA partners in expense of non-partners.

## Degrees of economic integration

Preferential trade area	Mutual trade restrictions are reduced but not eliminated.
Free trade area (NAFTA)	All mutual trade restrictions are eliminated. Free movement of goods & services
Customs union	Common external tariff
Common market	Free movement of labor & capital
Economic union (EEC)	Harmonization of economic policies, both monetary and fiscal.
Monetary union (EU)	Common currency

## Customs Union Theory

- Trade creation  
The replacement of domestic production by cheaper imports from CU member country.
- Trade diversion  
The replacement of cheaper imports from lower cost non-CU country to not-so-cheap imports from less efficient CU member country.

## Trade diversion

countries A, B, C

T-shirt price  
(A's autarky price is \$10)

	Imported from B	Imported from C
Price in A under free trade	7.5	8.5
Price in A after \$2 non-discriminatory tariff	9.5	10.5
Price in A after A+C customs union	9.5	8.5

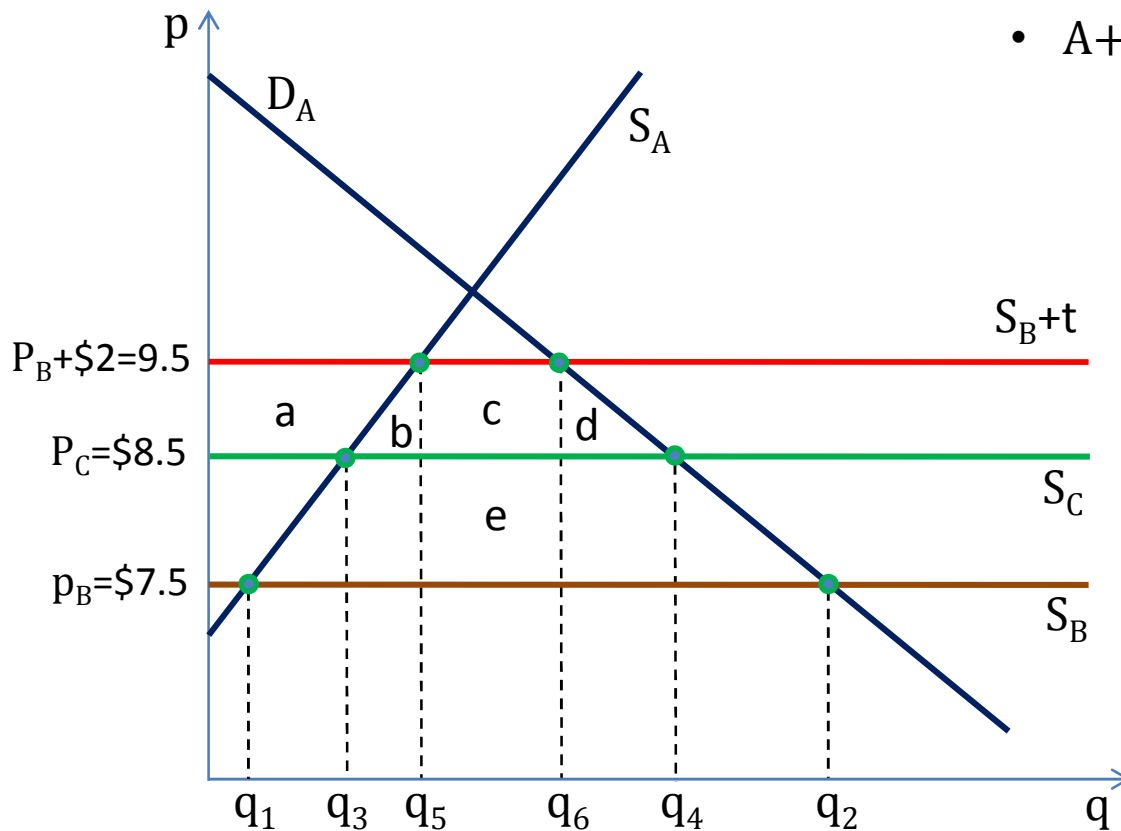
- Under free trade B will be the only foreign supplier in the A's market.
- Under \$2 tariff B will still be the only foreign supplier in the A's market.
- Under A+C customs union trade will divert from B to C.

# Trade diversion & Trade creation

countries A, B, C

Consumption in A under

- free trade:  $q_2$
- non-discriminatory tariff:  $q_6$
- A+C customs union:  $q_4$



Welfare effects of customs union relative to tariff

Consumer surplus	$(a+b+c+d)$
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Producer surplus	$-a$
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Government revenue	$-(c+e)$
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National welfare	$b+d-e$
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Trade creation	$b+d$
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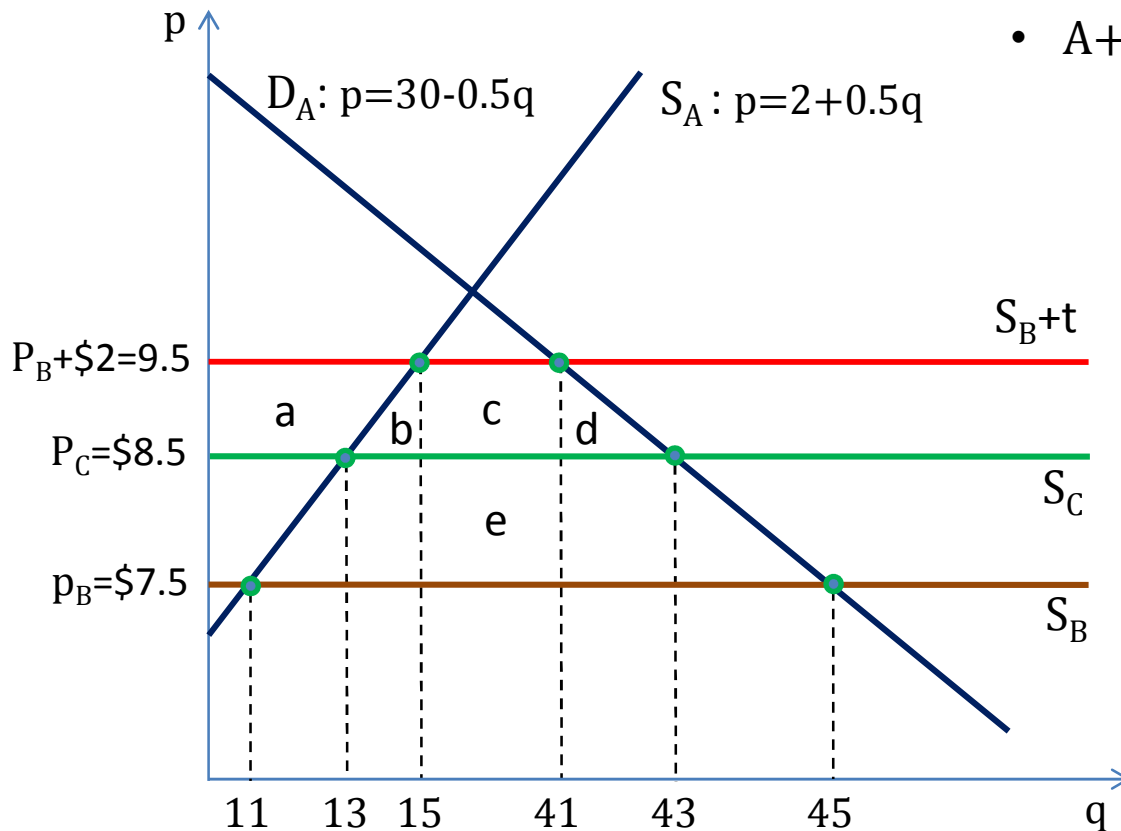
Trade diversion	$e$
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# Trade diversion & Trade creation

countries A, B, C

Consumption in A under

- free trade: 45
- non-discriminatory tariff: 41
- A+C customs union: 43



Welfare effects of customs union relative to non-discriminatory tariff

Consumer surplus	$(a+b+c+d)=42$
Producer surplus	$-a=-14$
Government revenue	$-(c+e)=-52$
National welfare	$b+d-e=-24$
Trade creation	$b+d=2$
Trade diversion	$e=26$



Thank you and good luck,

but remember

Educating the mind without  
educating the heart is no  
education at all.

Aristotle