European Economic Integration II

Lecture 4

14 October 2024

Aims of Lecture

1. Explaining the acquis communautaire and its role in EU integration
2. Examining bilateral trade agreements and the shift from autarky to trade cooperation
3. Analyzing government role in import restrictions and tariffs
4. Exploring custom unions, focusing on trade creation and diversion within the EU

Acquis Communautaire

The acquis communautaire is a fundamental concept in the EU, representing the total body of EU law and obligations that member states must adhere to. Here are the key reasons why it is important:

- A. All member states operate under a common legal framework, promoting uniformity and coherence within the Union
- B. The acquis supports the functioning of the EU's internal market by ensuring free movement of goods, services, capital, and people.
- C. This integration fosters economic cooperation among member states and enhances competitiveness on a global scale

Benefits of Acquis Communautaire

1. The acquis communautaire enabled member states to engage in more comprehensive economic activities, including labor and capital exchanges without nationality restrictions.

2. Trade hasn't been limited to just coal and steel, or manufactured goods, or agricultural, goods. It allowed for a broader range of trade in goods and services.

3. It contributes to economic growth by creating a unified legal and regulatory framework that enhances trade, investment, and competition among member states.

4. It facilitates market integration, attracts foreign investment, and fosters innovation, driving economic development across the EU.

Bilateral Trade Agreement

- The challenge of moving out of autarky was met gradually by finding trading partners that were willing to accept some means of payment other than dollars or gold.
- The first step in this direction was to arrange **bilateral trade agreements**
- *Barter trades*: one country agreeing to import a specified quantity of a good from a trading partner, which in turn agreed to import a specified quantity of some other good from the first country

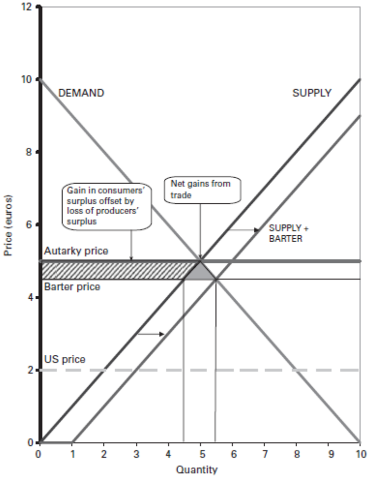


Figure: Bilateral Trade Agreement

- The Demand curve slopes downward, showing that as the price decreases, consumers demand more of the product.
- The Supply curve slopes upward, showing that as the price increases, suppliers are willing to produce more.
- **Autarky price**: The price at which the quantity demanded equals the quantity supplied in a closed economy (without trade).

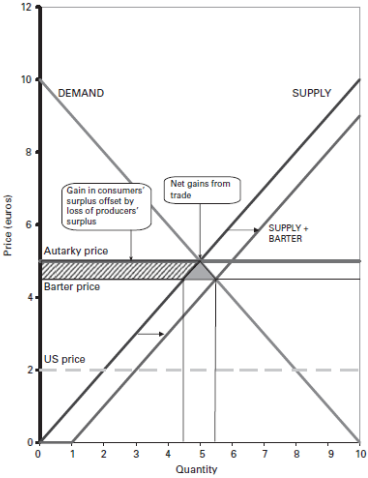


Figure: Bilateral Trade Agreement

- **US price**: Represents the world price (or the price in the US). Lower than the autarky price, showing that the good is cheaper internationally.
- **Barter price**: An intermediate price between the autarky and US prices, likely representing a negotiated price.
- **Consumer Surplus**: Gains due to trading at the lower US price, allowing consumers to buy cheaper.

Bilateral Trade Agreement (continued)

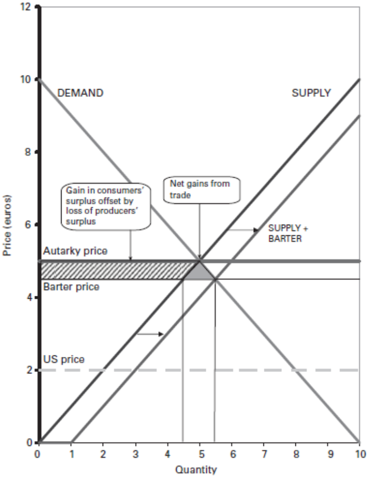


Figure: Bilateral Trade Agreement

- **Producer Surplus**: Losses for domestic producers who must now sell at the lower international price.
- The shaded area shows "Gain in consumers' surplus offset by loss of producers' surplus."
- The "Net gains from trade" area represents the total welfare gained, showing an overall economic benefit from trade.

Import Quantity Restriction

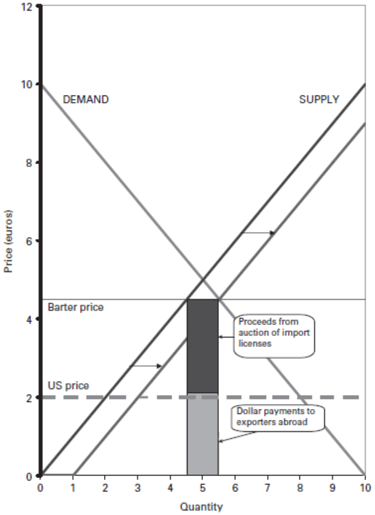


Figure: Import Quantity Restriction

- The intersection of demand and supply curve shows the barter price (around 4 euros).
- Below the barter price, a US price represents the cost of the good from the most efficient exporter, the US.

The Role of Government

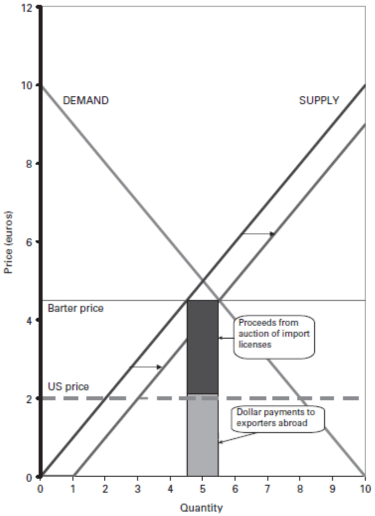


Figure: Import Quantity Restriction

- The government sets a quantity restriction in the form of an import quota, represented by the vertical line at quantity 5.
- To allocate these restricted imports efficiently, the government auctions off import licenses.

Implications of Auctioning Licenses

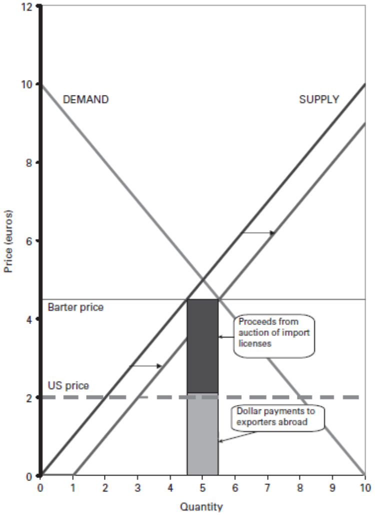
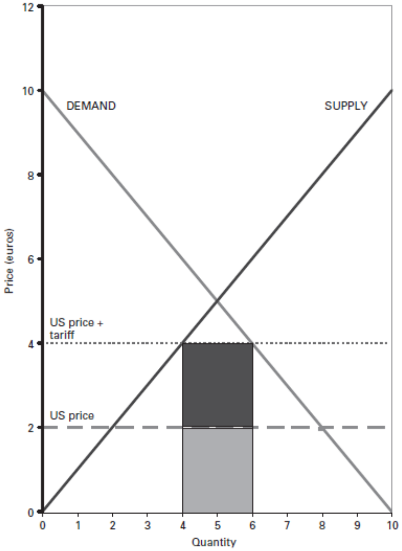


Figure: Import Quantity Restriction

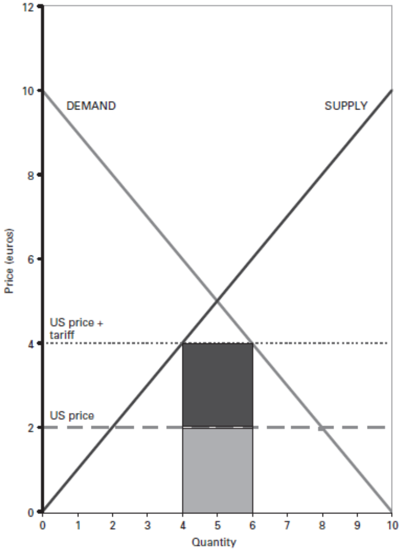
- The government earns revenue from auctions, shown by the dark grey area labeled Proceeds from auction of import licenses.
- The light grey area labeled "Dollar payments to exporters abroad" shows the amount importers pay to US exporters in foreign currency (dollars).
- This approach helps balance trade expansion with economic sovereignty.

Fixed Tariff on Imports



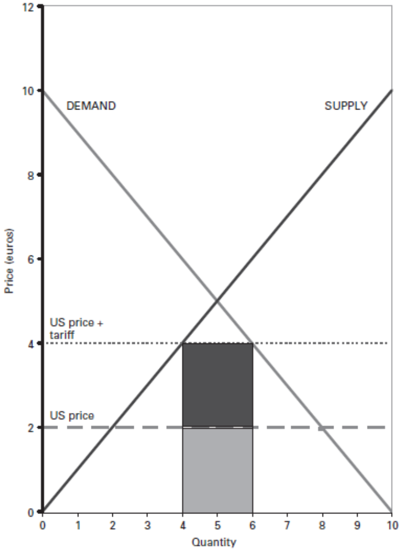
- French consumers can import goods at a lower cost from the most efficient supplier (US price).
- The US price line represents the cost of the good when imported from the most efficient supplier.
- The "US price + tariff" line shows the price with a fixed tariff added, which the French government collects as customs revenue.

Consumer and Government Gains

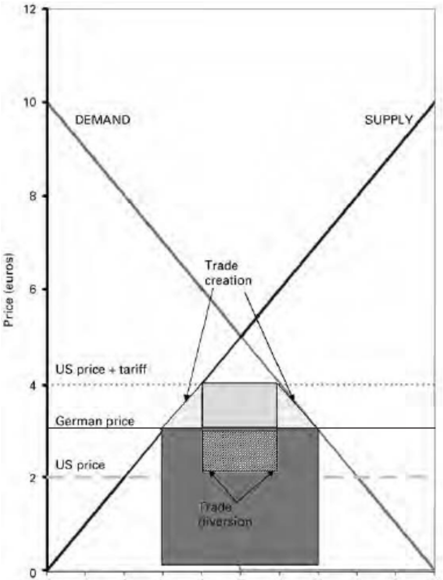


- The light grey area represents consumer gains from accessing the good at a lower price (US price) than the domestic price.
- The dark grey area indicates tariff revenue collected by the government.
- This system reduces costs by eliminating the need for bilateral agreements and import licenses.

The Role of Government in Trade Liberalization



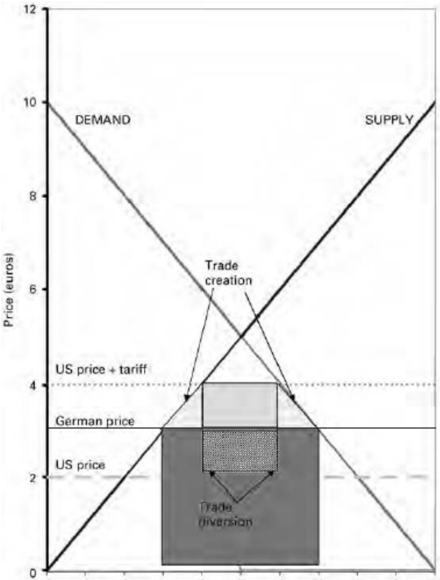
- By imposing a fixed tariff, the government gains customs revenue, aligning with multilateral trade policies.
- Simplifies trade for France, enabling imports from efficient suppliers and reducing paperwork and administrative costs.
- Although less efficient French producers may lose market share, the overall gains for consumers and the government



- This figure shows the economic effects of a customs union, where France maintains a tariff on US imports but removes it for imports from Germany.

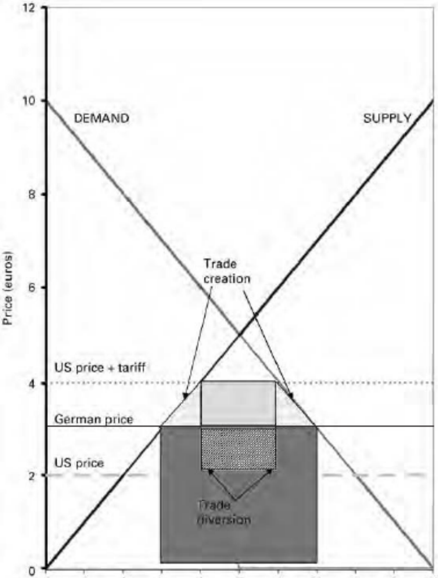
- Demand and Supply Curves: The demand and supply curves intersect at the domestic equilibrium without trade, showing the price that would prevail if there were no imports.

US Price and Tariff Effects



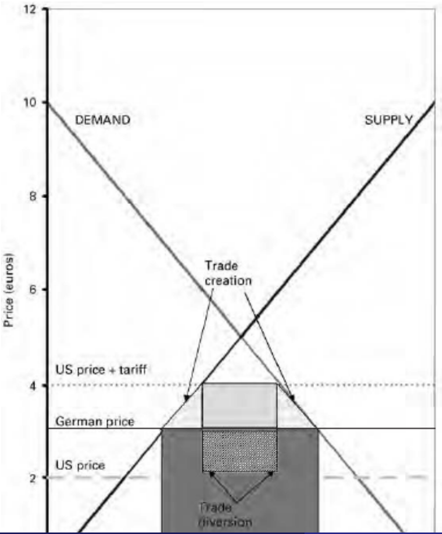
- US Price and US Price + Tariff: The US price represents the cost of the good if imported from the US without any tariff.
- The US price + tariff (dotted line) shows the effective price French consumers would pay if a tariff were applied to imports from the US. This tariff remains in place for US imports.

German Price and Trade Creation



- German Price: The horizontal line labeled "German price" indicates the cost of the good when imported from Germany, which is cheaper than the domestic price but slightly higher than the US price.
- With the customs union, the tariff is removed for German imports, making Germany the preferred source for imports.

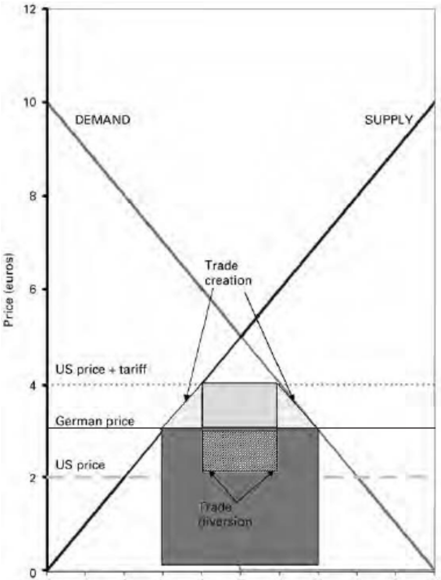
Gains from Trade Creation and Losses from Trade Diversion



- Gains from Trade Creation: The light grey triangles on either side of the former tariff revenue area (above the German price) represent gains from trade creation

- The right triangle shows gains from increased consumption, while the left triangle shows gains from reduced inefficient French production.

Net Effect of Custom Union



- Net Effect: The net effect of moving to a customs union is the sum of gains from trade creation (two light grey triangles) minus the loss from trade diversion (patterned rectangle).
- If demand and supply are elastic, gains from consumption and production shifts are larger, enhancing union benefit.