Classes_1_Economic integration

1. definition (by Business Dictionary)
Economic integration is an agreement among countries in a geographic region to reduce and ultimately remove, tariff and non tariff barriers to the free flow of goods or services and factors of production among each others; any type of arrangement in which countries agree to coordinate their trade, fiscal, and/or monetary policies are referred to as economic integration. Obviously, there are many different stages of integration.

a. integration as an outcome – integration as something static; integration can be achived when certain criteria are fulfilled
b. integration as a process – integration as a dynamic process; represented by stages of integration going form FTA to political integration

2. objective
An increase of welfare has been recognized as a main objective of economic integration. The increase of trade between member states of economic unions is meant to lead to the increase of the GDP of its members, and hence, to better welfare.

3. Stages of economic integration
The degree of economic integration can be categorized into five stages:
1. Free trade area
2. Customs union
3. Single market
4. Economic and monetary union
5. Complete integration (political union)

These differ in the <u>degree of unification of economic policies</u>, with the highest one being the political union.

A free trade area (FTA) is formed when at least two states partially or fully abolish custom tariffs on their inner border. Free trade area is a type of trade bloc, a designated group of countries that have agreed to eliminate tariffs, quotas on most (if not all) goods traded between them.
To exclude regional exploitation of zero tariffs within the FTA there is a rule of certificate of origin for the goods originating from the territory of a member state of an FTA. Unlike a customs union, members of a free trade area do not have a common external tariff (with respect to non-members), meaning different quotas and customs. To avoid evasion (through re-exportation) the countries use the system of certification of origin most commonly called <u>rules of origin</u>, where there is a requirement for the minimum extent of local material inputs and local transformations adding value to the goods. Goods that don't cover these minimum requirements are not entitled for the special treatment envisioned in the free trade area provisions.
Examples of FTA:
Central European Free Trade Agreement (CEFTA)
North American Free Trade Agreement (NAFTA)

A customs union introduces unified tariffs on the exterior borders of the union (common external tariffs). A customs union is a type of <u>trade bloc</u> which is composed of a free trade area with a common external tariff. The participant countries set up common external trade policy.

A common market adds the unification of economic policies (tax, social welware benefits etc.). A common market is a type of trade bloc which is composed of a customs union with common policies on product regulation, and freedom of movement of the factors of production (capital and labour) and of enterprise. The goal is that the movement of capital, labour, goods, and services between the members is as easy as within them. A single market has many benefits. With full freedom of movement for all the factors of production between the member countries, the factors of production become more efficiently allocated, further increasing productivity. For both business within the market and consumers, a single market is a very competitive environment, making the existence of monopolies more difficult. This means that inefficient companies will suffer a loss of market share and may have to close down. However, efficient firms can benefit from economies of scale, increased competitiveness and lower costs, as well as expect profitability to be a result. Consumers are benefited by the single market in the sense that the competitive environment brings them cheaper products, more efficient providers of products and also increased choice of products. What is more, businesses in competition will innovate to create new products; another benefit for consumers.

An economic and monetary union is a type of trade bloc which is composed of a single market with a common currency.

Example: Economic and Monetary Union of the European Union

Complete economic integration is the final stage of economic integration. After complete economic integration, the integrated units have no or negligible control of economic policy, including full monetary union and complete or near-complete fiscal policy harmonisation.

Stage of economic integration	Deminishing trade barriers	Setting up common external tariffs	Freedom of movement of the factors of production	Common currency. Common economic policy	Integration in non- economic areas (like common foreign affairs policy or internal affairs)
A free trade area	X				
A customs union	X	X			
A common market	X	X	X		
An economic and monetary union	X	X	X	X	
Complete economic integration	X	X	X	X	X

The basics of the theory were summarized by the Hungarian economist Béla Balassa in the 1960s. <u>As economic integration increases, the barriers of trade between markets diminish.</u>