Advantages and disadvantages of free trade to trading blocs

Economics, Trade

Trading blocs are agreements between governments of countries where they agree to reduce or abolish tariffs and taxes on inter-country trading. While this might seem like a good idea on the surface, there are some significant disadvantages for countries joining trading blocs, which are also sometimes known as Free Trade Agreements.

It's been long believed by economists and some scholars that the disadvantages of trading blocs outweigh the advantages.

Perhaps the main disadvantage of a trading bloc is that it can actually harm economic welfare.

Here is a simplified example of one disadvantage of a trading bloc: If a country is able to manufacture and produce goods at a price that is far cheaper than your local regional manufacturers can create the same goods and the government sets up a trading bloc with that country, then it becomes cheaper for retailers to import those goods from overseas.

While this might seem like a great idea on the surface, the disadvantages include economic difficulties for the local manufacturers and producers. This can increase the pressure on local suppliers and can also affect unemployment rates negatively.

The old saying buy local seems to have some merit in this example, even if the product may be a little more expensive.

Perhaps another disadvantage is when countries form free trade agreements among themselves and exclude various other countries that might not offer similar benefits for intra-industry trade.

Regional businesses that rely on exporting to other countries to secure their profits may also be disadvantaged if their own local government has not secured a free trade agreement with the governments of other countries. This is because the tariffs and taxes on exporting their goods can be higher, which increases the prices. The importing country then feels compelled to import from other suppliers.

This kind of disadvantage with trading blocs has been seen recently with the agreement set in place between Europe, Australia and New Zealand. Once a large importer and exporter of some American cars (GM being the most notable), Australia now has agreements in place to import and export to Europe at a much lower cost. Australia also exports grain, sheep, beef and wool to Europe at a reduced tariff cost.

An agreement such as this excludes other countries outside the trading bloc, which can damage the economic vitality and efficiency of local exporters attempting to enter those regions.

However, it's not just exporting manufacturers of goods that are disadvantaged in trading blocs. Countries frequently buy and sell foreign currencies in order to business with the governments of other countries. An example of this is Britain exchanging Pounds Sterling with Europe for Euros. The trade agreement between European countries actually strengthened the value of the Euro, but it has a disadvantage on countries outside that agreement.

As an example, the primary disadvantage with a strengthening foreign currency would mean deflating the value of the American dollar by comparison, which can create higher inflation levels in the long run.