6.3 Economic integration

Name: _____ Class: _____ Date: _____ **Total: 30 marks**

KEY WORDS free trade area • customs union • common market • monetary union • trade creation • trade diversion

Objective

Build the skills to answer exam questions on **economic integration** : trade agreements, trading blocs, **trade creation** and **trade diversion**, and monetary union.

You must be able to:

- distinguish bilateral, regional and multilateral trade agreements
- compare free trade areas, customs unions, common markets and economic and monetary unions
- explain trade creation and trade diversion
- evaluate trading blocs and monetary union

1 Key knowledge and worked examples

■ Economic integration

Preferential trade agreements give some countries easier access to a market. They can be **bilateral** (two countries), **regional** (a group), or **multilateral** (many countries, through the WTO).

level of integration	features	example
free trade area (FTA)	no tariffs between members; each keeps its own tariffs on non-members	USMCA, ASEAN Free Trade Area
customs union	free trade inside plus a **common external tariff**	Southern African Customs Union
common market	customs union plus free movement of **labour and capital**	the EU single market
economic and monetary union	common market plus a **single currency** and one central bank	the eurozone

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Trade creation: joining a bloc lets a country switch from a **higher-cost domestic producer** to a **lower-cost partner** producer: more efficient. **Trade diversion:** a country switches from a **low-cost producer outside** the bloc to a **higher-cost member** because of the common external tariff: less efficient.

Advantages of trading blocs: larger markets and economies of scale; more competition; more foreign investment; trade creation; stronger negotiating power; political cooperation.

Disadvantages: trade diversion; loss of national control over trade policy; harm to non-members; complex rules of origin in FTAs.

Monetary union: benefits: no exchange-rate costs or risks between members; price transparency; more trade and investment. **Costs**: one interest rate and exchange rate for all, even when members are in different situations; no own monetary policy or exchange rate to respond to shocks; fiscal rules may limit governments.

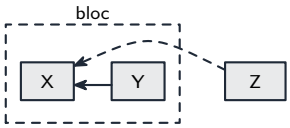
Answer shapes: identify the type of bloc → explain the mechanism (creation or diversion) → evaluate for members and non-members.

2 Practice

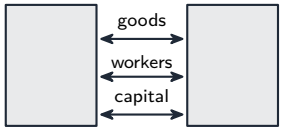
2.1 Distinguish between a free trade area and a customs union. [2]



2.2 Define **trade diversion**. [2]



2.3 Explain **two** benefits for firms of joining a common market. [4]

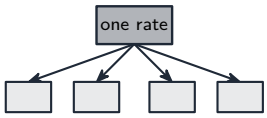


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2.4 Before joining a customs union, country X imported TVs from country Z (outside) at \$200 plus a 10% tariff. After joining, X faces a 30% common external tariff on Z, and buys from member Y at \$240 with no tariff. Explain whether this is trade creation or trade diversion. [3]

	before	after
from Z	\$220	\$260
from Y	—	\$240

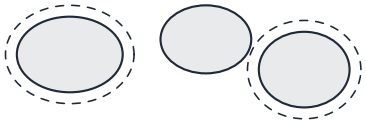
2.5 Explain how a country that joins a monetary union loses **two** tools for dealing with a recession. [3]



3 Exam-style questions

3.1 Many countries belong to regional trading blocs.

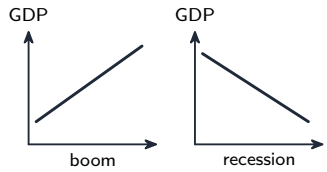
Explain why a country may benefit from joining a trading bloc, and why non-members may lose. [10]



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3.2 Some economists argue that the eurozone's single interest rate caused problems when member economies were in different situations.

Evaluate monetary union for its members. [6]



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Solutions

Marking: **M1** a correct method, **A1** the correct answer, **B1** an independent mark.

Each answer shows the steps, then the **result**.

2.1

free trade area: members remove tariffs between themselves but each sets its own tariffs on non-members; customs union: members also set a common external tariff on non-members

2.2

when joining a trading bloc causes imports to switch from a lower-cost producer outside the bloc; to a higher-cost producer inside the bloc, because of the common external tariff

2.3

any two, explained: access to a much larger market without tariffs, so sales and economies of scale rise; free movement of labour lets firms hire skilled workers from other members; free movement of capital makes it easier to invest and raise funds across borders; common rules lower the cost of selling in many countries

2.4

before: Z's TV cost \$220 in X; after: \$260 from Z vs \$240 from Y; X switches to Y, a higher-cost producer (\$240 > \$200 before tariffs); so it is trade diversion: less efficient, and consumers pay more than before

2.5

it can no longer set its own interest rate: the common central bank sets one rate for all members; it cannot let its currency depreciate to make exports cheaper; so it must rely on fiscal policy, which may be limited by debt rules

3.1

award up to [10]: larger market without tariffs: more exports and economies of scale; trade creation: buying from lower-cost partners instead of high-cost domestic firms, so prices fall and efficiency rises; more competition and foreign investment; stronger bargaining power in world trade talks; non-members: their exports to the bloc face the external tariff, so they lose sales; trade diversion moves purchases away from efficient non-member producers; developing countries outside blocs may find it harder to diversify; clear explanation with examples

3.2

benefits: no exchange-rate costs or risks within the union, encouraging trade and investment; price transparency increases competition; costs: one interest rate cannot suit a boom and a recession at the same time; members lose the exchange rate to regain competitiveness, so adjustment comes through slow wage cuts and unemployment; fiscal rules may restrict spending in a recession; judgement: works best when economies are similar, labour is mobile, and there is shared fiscal support