## 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