5.3 Economic integration

Name: _____ Class: _____ Date: _____ **Total: 21 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

exercises.lol exercises.com.cn

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.

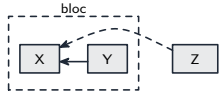
Answer shapes: identify the type of bloc → explain the mechanism (creation or diversion) → evaluate for members and non-members.

2 Practice

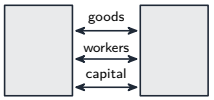
2.1 Distinguish between a free trade area and a customs union. [2]



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



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



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

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]



exercises.lol exercises.com.cn