

Class 19

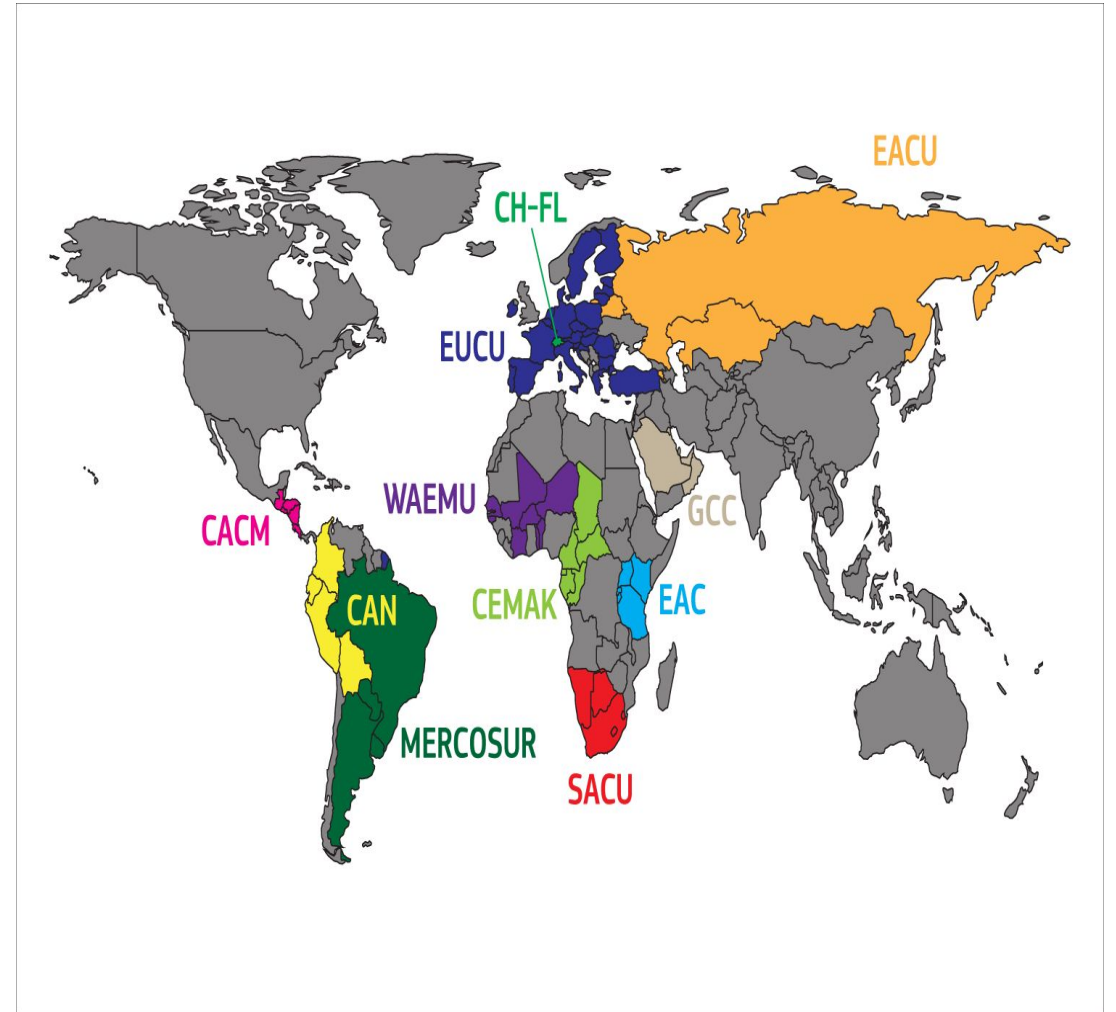
- TRADE CREATION AND
TRADE DIVERSION

Trade creation and Trade diversion

- They are important direct effects of the formation of a customs union.
- They are two concepts in international trade theory that describe the impact of economic integration on trade patterns.

Lets know: What are Customs unions?

- Customs unions are groups of countries that apply one common system of procedures, rules and tariffs for all or almost all their imports, exports and transiting goods.
- Usually, countries participating in customs unions share common trade and competition policies.



What are the customs unions in the world?

- Andean Community (CAN)
- Caribbean Community (CARICOM)
- Central American Common Market (CACM)
- East African Community (EAC)
- Economic and Monetary Community of Central Africa (CEMAC)
- Eurasian Customs Union (EACU)
- European Union Customs Union (EUCU)
- EU-Andorra Customs Union
- EU-San Marino Customs Union
- EU-Türkiye Customs Union
- Gulf Cooperation Council (GCC)
- Israel-Palestinian Authority
- Southern Common Market (MERCOSUR)
- Southern African Customs Union (SACU)
- Switzerland-Liechtenstein (CH-FL)
- West African Economic and Monetary Union (WAEMU)

Trade creation

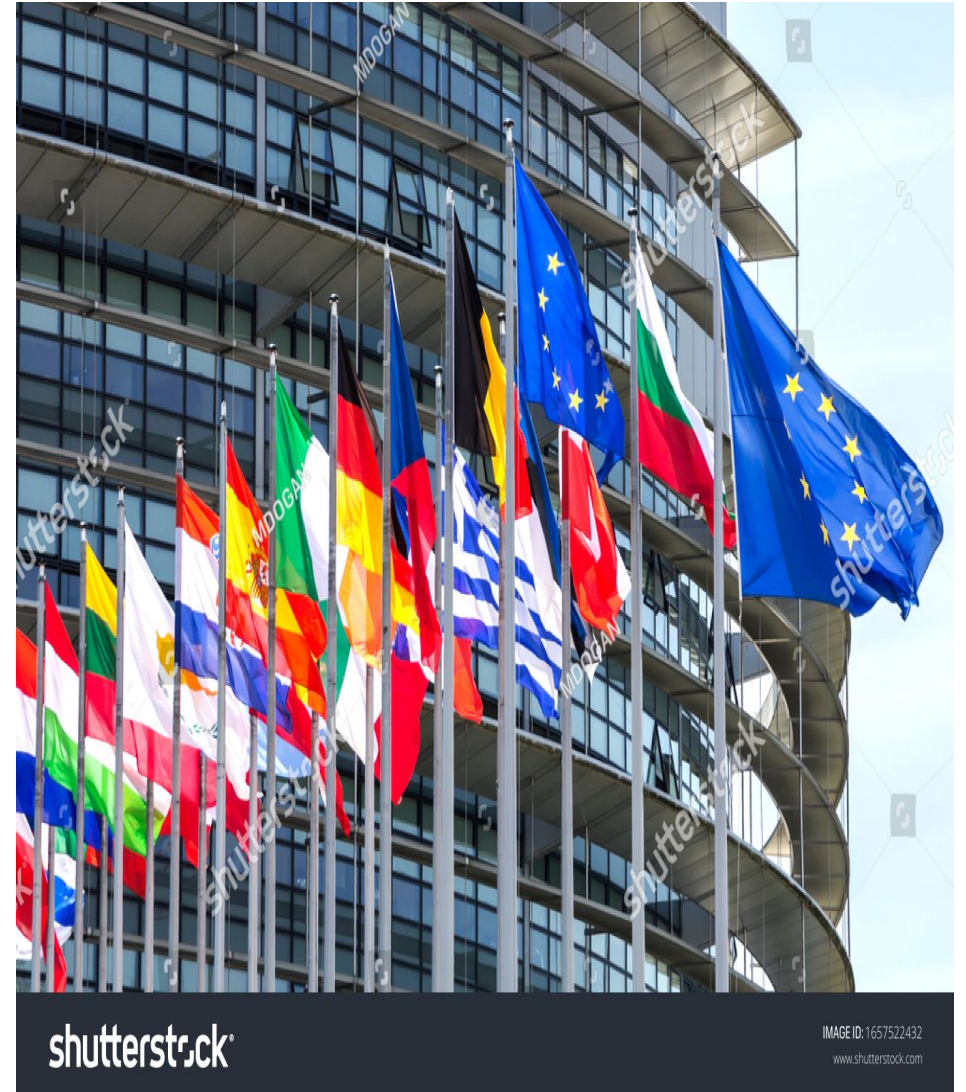
- >> Trade creation is the increased trade that occurs between member countries of trading blocs following the formation or expansion of the trading bloc.
- >> This comes about as the removal of trade barriers allows greater specialisation according to comparative advantage.
- >> This means that prices can fall and trade can thus expand.

Trade creation(contd.)

- >> It thus leads to an increase in trade between member countries, resulting in overall economic benefits for the group.
- >>In other words, trade creation refers to the creation of new trade that would not have existed in the absence of the economic integration.
- >>This can happen when countries specialize in producing goods that they have a comparative advantage in, and trade with each other to obtain goods that they do not produce efficiently.

Real-world example of trade creation >>

- The European Union (EU), which removed trade barriers between member countries and created a single market.
- As a result, trade between member countries increased significantly, leading to overall economic benefits for the group.
- For instance, a German car manufacturer can now sell its cars to customers in other EU countries without facing tariffs or other trade barriers, increasing the company's sales and profits.



shutterstock

IMAGE ID: 1657522432
www.shutterstock.com

Trade diversion

- It thus occurs when the formation of a free trade area or a customs union leads to a shift in trade patterns away from more efficient producers outside the group towards less efficient producers within the group.
- In other words, trade diversion occurs when a country or group replaces more efficient producers from non-member countries with less efficient producers from member countries, resulting in overall economic inefficiencies.

A real-world example of trade diversion

- The creation of the North American Free Trade Agreement (NAFTA), which led to an increase in trade between the United States, Canada, and Mexico.
- However, some critics argue that NAFTA led to trade diversion by allowing less efficient Mexican producers to enter the US market and displace more efficient producers from non-member countries.
- This, in turn, resulted in an overall loss of economic efficiency in the global market.



THANK YOU

- THANK YOU

-

THANK YOU