wall of trade barriers.[16] The exploitation of economies of scale is also made more possible within a union, if the markets of the member countries are individually too small to allow optimum firm size to be achieved. Although these economies could have been achieved by export before the union was formed, the reduction in intra-regional import protection makes this easier. Also, direct investment in other member countries allows economies of experience to be realized in subsidiaries and facilitates technological spillovers. Non-member countries may wish to invest within the union, either to circumvent tariffs or to take advantage of the newly expanded market and increasing returns as welfare increases within the union. The free flow of capital and labour within a union also leads to greater efficiency in the allocation of resources and smooths the difficulties of structural adjustment.

Globalization, led by increased foreign direct investment, might also have implications for the trade diversion effects of RTAs. Trade creation within the union could benefit third-country firms with production facilities in the region and trade diversion could harm member country firms with production facilities in third countries which are exporting to the region.[17] Therefore, globalization can complicate the welfare implications of RTAs. Also, the measurement of trade diversion and creation becomes more difficult in the presence of decreasing costs as trade liberalization causes changes in the production of all affected countries.

Today, it is generally believed that trade diversion and trade creation are simply examples of types of broader terms of trade and volume of trade effects which can be brought about by RTAs. The traditional concept of trade diversion focused exclusively on the importing member country and missed potential welfare gains to other members and third countries. Some of the positive effects that might outweigh trade diversion include changes in the volume of production and income, changes in the terms of trade with the rest of the world and changes in the volume of trade with members and non-members.[18] For example, the value of imports from a non-member country to a member country of an RTA might not fall even if trade diversion predominates, because increased income within the member countries can lead to an increased demand for imports, some of which could be supplied by non-member countries.

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[16]One potential problem is that oligopolies or monopolies could form within the union just as they did within the member countries, allowing similar non-competitive practices and excessive profits.

[17]Lloyd, *op. cit.*, p. 24,

[18]*Ibid.*, p.24.