CHAPTER 7

MAIN FINDINGS, POLICY CONSIDERATIONS AND CONCLUSIONS

7.1 Introduction

The revival of regional trade arrangements in the world has generated many interpretations. After analysing these interpretations in a global perspective, this thesis attempts to analyze the implications for Indian trade policy. The evolution of regional trade arrangements throughout history suggests that growth of regionalism has not been spontaneous. These are incentive driven and there had been several factors behind the establishment of regional arrangements. These factors are, however, not the same for all the arrangements. The range of objectives behind the formation of regional trade arrangements vary from pure gains from trade to strategic considerations and were discussed in Chapter 3.

Regionalism today, in the post-Cold War regime, has become an important issue because in spite of having a multilateral organization, the WTO, to decide upon the rules governing international trade, these have been on an increase. The establishment of the GATT has been, partially if not fully a response both to the events of the 1930s and World War II. It was realized by every nation that beggar-thy-neighbour policies that successively raised trade barriers in Europe, and the US were partly responsible for plunging the world into global economic recession and could not be the way to prosperity. The way forward was thus co-operation rather than retaliation and hence the birth of the GATT was to ensure a trade regime that could restrain trade retaliatory practices in the post war period.

In the post-War period, regional trade integration in Europe, in the 1950s, was mainly a
strategic concern of avoiding a further European war by using trade integration as a way of securing co-operation among European nations. The idea was that mutual economic interest among the major European nations would override possible military objectives. There were two other considerations in early European integrations. One was to strengthen the European alliance against Communism, the idea being a strong anti-communist alliance would have the underpinnings of a trade agreement. The other was strengthening European bargaining power in trade negotiations under the GATT. The Treaty of Rome, in fact, put forward a cohesive bargaining unit which played a very important role in the series of GATT negotiations. Whatever be the early motivation for the formation of the EEC, gains from European integration in the sixties have been very impressive which in fact has strengthened the process of integration in Europe in later period.

Unlike European integration which progressed through a process of 40 years starting from European Coal and Steel Community to Treaty of Rome in 1957, Taxe Unique System, Common Market 1992 programme and Maastricht Treaty, integration in North America is in a very primitive stage and without a road map. Integration in North America could be regarded as market driven.

Regionalism in Asia is far more younger to North America. Regionalism in Asia has been in partial response to the formation of NAFTA and the deeper integration in Western Europe. The growing surge for regional trade arrangements in Asia, Europe and America has drawn the attention of many nations including India. This thesis in the main, is an attempt to understand the implications of regionalism for India and others in general. In doing so the thesis has used both econometric techniques as well as a general equilibrium framework for analysing
various aspects of regional trade arrangements. In the following section we discuss the main findings of the study, make some policy recommendations and some concluding remarks.

7.2 Main Findings, Policy Recommendations and Concluding Remarks

Chapter 1 highlights that since July 1991 Indian economic policies have been comprehensively reformed but Indian policy makers are worried about the proliferation of regional trade arrangements on the globe given the fact that India does not belong to any large trading bloc. A major concern for India is about her competitive position in a trading regime dominated by preferential trading arrangements. Then what is an appropriate strategy response in this situation? Should India also try to establish regional trading arrangements and if so with whom?

Chapter 2 analyses the theoretical underpinnings of the regional trading arrangements. The literature on the theory of regional trade arrangements has concentrated under the narrow heading of customs union. The simultaneous existence of the forces both for regionalism and multilateralism in the Eighties and Nineties has revived the debate whether the formation of a customs union could be superior to unilateral trade liberalization and thus whether a CU or FTA is a move on the right direction i.e., global free trade. There are two opposite views in the existing literature; on the one hand it is argued that in the absence of economies of scale and changes in the terms of trade unilateral liberalization is necessarily superior, and one the other, there is a strong case for customs union (Kemp and Wan 1976 for example). This chapter concludes that in fact there is no contradiction. The reason behind this contradictory result are the underlying assumptions. The differences in emphasis.

Chapter 3 analyzes regional trade arrangements both in the historical and the present
context and then draws the implications for the future. Regionalism today could be classified into two broad categories - open regionalism and competitive regionalism. Regionalism in Asia, APEC in particular, falls under the broad category of open regionalism. Under open regionalism any party can join the FTA subject to fulfilling the rules. The regional trade arrangements in Europe and America fall under competitive regionalism. Under competitive regionalism, the motivation for forming a coalition is to harness their competitive edge over the rest of the world. A country could be allowed to join only if existing members agree. This is also pro-competitive but the road map is different. The idea is that bloc formation is required to strengthen its competitive edge for the final bargain where all blocs will compete with each other.

It is argued in this context that while the possibility of the trading system becoming more protectionist with more barriers to trade and that retaliation can not be ruled out, such chances are limited by the severity of domestic problems in larger countries. But the trend toward regionalism will continue as regional trading arrangements act as an effective mechanism for solving regional problems regionally expeditiously rather than through the time consuming GATT process. The trend towards regionalism would continue also because regionalism has become an instrument for regional-multilateral interplay i.e., using regional trade agreements for multilateral objectives and vice versa.

Chapter 4 attempts to understand the historical pattern of Indian trade. By using an extended version of the gravity model this chapter finds that there has been a certain degree of regionalization in Indian trade towards ASEAN, SAARC, US, Japan and EU. Use of dummies for continents give significantly negative coefficient for continents. This implies that Indian trade has been concentrated in specific areas even within continents. For example in North America
it is concentrated in the US and in Europe it is concentrated in Western Europe. The model did not consider any other barriers (e.g., tariffs and NTBs) except natural factors like distance. The model therefore, cannot be used to forecast the effect of a regional trade agreement that reduces tariff and nontariff barriers. On the question of choosing partners for trade agreement this chapter suggests that any regional bloc that includes either or all of EU, US and Japan would be a better option for India as it sets the evidence that India's trade has a positive bias with regard to these regions.

Chapter 5 analyses the implications of NAFTA for India and member countries within NAFTA. In doing so this chapter first examines the nature of India-NAFTA trade by computing the export similarity index (ESI) and export-import similarity index (EISI) due to Finger and Kreinin (1979) and Allen (1957) respectively. These suggest that there is very little similarity in the pattern of exports to NAFTA by India and by other members of NAFTA including Mexico. This suggests that there is very little scope for diversion of trade from India to Mexico or to other NAFTA members due to exchange of preferential arrangements within NAFTA members. On the other hand the export-import similarity indices indicate reasons for optimism for expansion of Indo-NAFTA trade subject to reduction of barriers to trade between India and NAFTA.

This chapter highlights some potential areas of concerns due to NAFTA from the perspective of a third country. It also makes a comparison between the concessions agreed in the Uruguay Round of negotiations and the concessions agreed within NAFTA. First, tariff reductions under the NAFTA are more straightforward and transparent, particularly with regard to textiles and apparel which is a major concern for the developing countries. The growth to
growth approach agreed in the Uruguay round would affect discriminately. Countries with higher export growth would be getting the maximum advantage. The phasing out of the quota regime by bringing more and more items under coverage could be manipulated as it is difficult to monitor in the absence of any standard rule followed in product classification under the MFA. Each country is free to choose the products to be integrated at each stage, the only constraint being that there must be some products from each of a specified list of categories. Given the transitional safeguard arrangements, it is believed that most of the phasing out of quotas by the importing countries would be done at the end of the 10th year. An examination of India’s textile exports to the US reveals that India had been exporting in 1200 textile categories (as per H.S. 8 digit) since 1987 on a regular basis. The tariff schedule offered by the US to India after the round reflects that only in 10 per cent of these categories were tariff concessions achieved. As against these incidents the NAFTA rules are far more transparent and benefits to the member countries are more assured.

This chapter developed a India NAFTA CGE model. The results from the model simulations indicate that India loses very marginally due to NAFTA while Canada and Mexico are the main gainers, Mexico being the biggest. Model simulations suggest that India along with Canada and Mexico would benefit if tariff liberalization takes place as between the NAFTA members and India. This suggests that an India-NAFTA free trade agreement could be a good option for India. A unilateral tariff liberalization vis-a-vis NAFTA makes India worse as compared to a reciprocal tariff liberalization which could be the way forward for India. India gains substantially from global free trade. The welfare of the rest of the world also improves substantially. In fact, India could also become the proponent of global free trade. May be India
could follow the path of open regionalism.

These analyses, however, indicate very small welfare changes in terms of absolute number as well as in terms of GNP. The small changes in welfare are mainly because the tariff rates are already low in NAFTA countries and this model did not incorporate NTBs due to lack of available estimates of tariff equivalents of NTBs. It is believed that NTBs are significantly high. But this study gives the direction of welfare changes.

Incorporation of NTBs could bring in larger welfare changes compared to this but not enough to explain the major concern of the smaller countries like India. In a study that uses NTB equivalents, Ghosh and Whalley (1997) argued that the major concern of the smaller countries from the proliferation of regional trade arrangements is the threat of retaliation. This requires an entirely different approach that captures the aspects of optimal tariff and retaliation. In Chapter 6 we consider this issue by computing a tariff game non-cooperative Nash equilibria. We also compute the comparative static competitive equilibria under which tariff rates are exogenously decided. These two results indicate sharp differences in model solutions. The welfare changes under a tariff game non-cooperative Nash equilibria are of a significantly larger magnitude to the extent of 5 to 6 per cent of GNP.

Model simulations indicate that moving towards regionalism in the form of a customs union is not good for the global trading system if retaliation were to occur. Under such a situation countries within the customs union would be better off and countries outside the union would be the worst sufferers. Movement towards FTAs are rather better compared to both constrained and customs union Nash trade war if global retaliation were to occur. A comparison of various probable and hypothetical bilateral FTA and CUs by India and other regions indicate
that India could be better off being within a regional trading arrangements, the best option being a FTA with Europe or NAFTA or both. An FTA arrangement between India and Europe or NAFTA or both eliminates the threat of retaliation by the big parties in the trading system.