
Why do Countries Form Regional Trade Agreements – Insights From the Literature

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Abstract

The world trading system witnessed rapid rise in the formation of Regional Trade Agreements (RTAs) particularly in the post WTO period. Despite large number of studies conducted on this area by the trade economists, there are divergent views on the outcome of RTAs on world trade as well as there is no unanimity on the desirable mechanism of trade liberalization. The paper looks in to various theoretical arguments and empirical explanations that supports or opposes RTAs. Careful review of the studies identified the underlying conditions that are required for the successful functioning of the RTAs. Even though regionalism is discriminatory in nature, it enjoys as a preferred method of trade liberalisation among nations as it provides immediate results to the trade policy initiatives. The paper concludes that for the successful functioning of the RTAs it should be carefully calibrated by identifying trade creating partners and accommodating the interests of the local stakeholders. Also successful regional cooperation agreements should stimulate multilateral initiatives.

Key Words: Regionalism, Free Trade Agreements, Multilateralism, WTO

Introduction

Regional Trade Agreements (RTAs) have a long history and along with Multilateralism it occupied the centre place in the discourse of trade theory and commercial Policy for a long time. There is a serious debate about Regional Trading Agreements as 'building block' versus 'stumbling block' to world trade. Even after numerous theoretical and empirical studies on this debate the issue remains unsettled as the results are divided and diverse expiations are espoused for this difference. Preferential Trade Agreements (PTAs) are diverse from shallow integration to deep integration agreements which necessitated designing appropriate methodologies and model building techniques for measuring the static and dynamic effects of trade liberalization. Complicating this phenomenon is the proliferation of large number of bilateral Trade Agreements between members of the RTAs creating a 'noodle bowl' effect on trade. In this backdrop the paper systematically reviewed the studies undertaken on this debate and brought some policy implications for the future roadmap of countries with regard to trade liberalization. The paper is divided in to four parts. The introduction is followed by the review of theoretical studies which followed by the systematic review of empirical studies. The paper concludes with the challenges to trade liberalization and the approaches to be followed by countries on this vexed issue.

The Regionalism versus Multilateralism debate

The regionalism versus multilateralism debate has a long history and claims and counter claims appear in the literature even today. While some argue regionalism is stumbling block (Bhagwati and others; 1993, 1996) others see it as a building block (Frankel, 1997, Summers, 1991 et.al.).

Multilateralists believe widespread regionalism may lead to a break-up of the World economy in to hostile blocks that divert political energies from multilateral initiatives. PTAs make it more difficult to negotiate at the multilateral level because agreements about positions need to be achieved within blocks before and during negotiations. PTAs are by definition discriminating, and large PTA blocks may exert market power to improve the terms-of-trade of its members. Closed membership clauses may block additional members in order to preserve trade gains, while open membership clause seduce members in to protectionist regional initiatives and diverts political energies from multilateral initiatives. Protectionism of countries not involved in PTAs may increase as regionalism spreads. Use of non-tariff barriers, such as antidumping and countervailing duty actions, against non-member countries increase as weaker industries struggle to survive regional free trade. Deeper integration of policies and institutions may create or strengthen interest groups that benefit from trade diversion and have incentives to lobby against free trade. Deeper integration may introduce protection in previously unprotected markets through the adoption of common, distorting internal policies.

Contrary to the above view those who favour regionalism argue that PTAs encourage others to come to the multilateral negotiating table, ie. the prospect of 'fortresses' may help motivate greater efforts to achieve successful multilateral negotiations. It may be easier to negotiate multilaterally between fewer and larger PTA- based blocks than large number of individual countries. Deeper integration within PTAs can help avoid destructive trade wars. Regionalists also believe that expansion of membership based on open membership clauses will eventually lead to global free trade. Adoption of 'open regionalism' is a slow and definite step that can eventually lead to global free trade. PTA-induced growth can induce increased demand for extra-PTA imports thereby benefiting non-members. PTAs may be able to tackle issues too deep or complex for multilateral negotiations, and may even serve as blueprints for such issues before coming to the global level. Deeper integration of policies and institutions may help lock-in complementary market oriented policies (competitive liberalism ie. increasing regionalism creates competition for reform and for membership of PTAs). Deeper integration among PTA members (Ex. Harmonisation of technical standards to international norms) may also promote trade both within the PTA and with third countries.

Theoretical Developments in Regionalism

There have been intense theoretical expositions by trade theorists on the likely impact of regionalism on the international trade flows of commodities. The two issues primarily addressed by them are how the formation of Regional Trading Blocs impacts the welfare of the members and world at large and whether regionalism help or hinder the process of multilateral trade liberalization.

Viner (1950)one of the earliest in the debate demonstrated that preferential trade need not necessary improve the welfare of the members and there is a possibility that reduces it by diverting trade from low cost country to high cost country. Using two concepts namely 'trade creation' and 'trade diversion' Viner explained PTAs on the one hand 'create' new trade between union members while on the other, they 'divert' trade from low –cost outside suppliers to high cost within union suppliers. The 'trade creation' is beneficial as the union partner replacing home country's less efficient industry and the consumers can avail the same commodity at a lower price. The 'trade diversion' effect arises from a union member displacing a more efficient outside supplier by taking advantage of the tariff preference it enjoys in a partner country and

this is harmful. Meade (1955) outlined the modern static theory of regional integration which is an improvement over Viner's in many ways. Meade's analytical framework made refinements to Viner model and these refinements admit the possibility of not only spillover effects of regional integration agreements on non-member countries but also feedback effects of international adjustments to the formation of regional integration arrangements on member countries. Meade focused his analysis on the economic welfare of the world economy, not simply the countries forming a regional integration arrangement.

Lipsy (1960) looked in to the welfare effect of customs union rather than merely looking the trade creation and trade diversion aspects and said welfare effects of customs union depend on the combination of its effect on the locationnamely world production and consumption. Lipsy in his model showed an increase in welfare may follow from the formation of a customs union which results solely in the diversion of trade from lower – to higher- cost sources of supply.

Ohyama (1972), Kemp and Wan (1976) and Vanek (1965) looked in to the role of intra-regional and extra-regional trade on international prices of traded goods its welfare implications on both member countries and non-member countries. Taking the external trade vector as a constraint, the joint welfare of A and B is maximized by equating the marginal rate of transformation (MRT) and marginal rate of substitution (MRS) for each pair of goods across all agents in the union. This is accomplished by eliminating all intra-union trade barriers and setting the common external tariff (CET) vector at a level just right to hold the extra - union trade vector at the pre-union level. In addition to trade creation and trade diversion effects there are *terms-of-trade effects* due to Preferential Trade Agreements (PTAs). Increased trade within the PTA may lead to a decline in the availability of goods to non-members, thereby raising the price of nonmember imports from the PTA (and may force the non-member to produce such goods themselves). So even if a PTA member loses tariff revenue in connection with a diversion of trade from non-members to members, these losses may be outweighed by improved terms-of-trade vis à vis non-members.

The Domino theory of regionalism developed by Baldwin (1993) points out that idiosyncratic shocks such as deeper integration of an existing regional block can trigger membership requests from countries that were previously happy to be non-members. Since closer integration reduces the profits of non-member firms, the exporters in the non-member country initiate greater pro-regional political activity. As the block enlarges, the cost to the non-members increases and this will bring more pro-regional political activity in non-members countries resulting in further enlargement of the bloc.

The Juggernaut theory of Baldwin (2005) suggests that once the liberalisation process sets in, it is difficult or impossible to stop it and will have sweeping changes on trade. Multilateral trade negotiations based on reciprocity make exporters lobby for domestic tariff cut to gain access to foreign markets and this tariff liberalization alters the economic landscape and this generates a sort of political economy momentum and eventually liberalise the sector which is included in the tariff-cutting talks. Baldwin contended that interaction between the domino theory and juggernaut theory suggests that regional trade blocs are building blocks toward free trade – at least in most cases. But there is a need to focus from the high theory of shallow integration to a more policy-relevant issue and professional thinking on how the liberalisation in RTAs can be made to be more supportive of multilateral liberalization.

The success of the regional integration efforts in creating additional trade depends on numerous factors. Some of the factors which received attention in the literature include complementarities in trading Nations, level of initial protection, domestic trade liberalization measures, size of the economy and rule of origin. The greater complementarity in import demands between PTA members, the greater the potential gains from a PTA. The higher the initial level of protection, the greater the benefits from the PTAs. Similarly inclusion of a highly protected sector in trade agreements brings out substantial gains for the members. The economic size of the participating countries in a regional trade agreement can influence the trade flow and economic welfare. But this depends on the extent to which the world price and thereby the terms-of-trade of the countries involved will be affected due to integration efforts.

There were some excellent review papers emerged in the literature on regionalism (Panagaria, 2000; DeRosa, 1998; Lloyd and Maclaren, 2004; Piermartini and Teh, 2005). Panagaria (2000) based on systematic economic analysis argued strongly in favour of multilateral trade liberalization than regional agreements as PTAs can divert trade and lower welfare for the participating nations. DeRosa (1998) extensively reviewed the static theory of regional integration arrangements and considers the economic impact of such arrangements, based on recent quantitative studies of customs unions and free trade areas. Lloyd and Maclaren (2004) surveyed the theoretical and empirical aspects of regional integration and shown how member and nonmember countries gains and losses due to trade liberalization in goods by forging free trade area or a customs union. Piermartini and Teh (2005) provided a non-technical explanation to two important trade policy models namely CGE and gravity models and explained theoretical underpinning, model requirements and computational procedures required for these models. De Groot, Liners, Rictveld and Subramanian(2004) explicitly investigated the effect of institutions and found that institutional quality has a significant positive and substantial impact on bilateral trade flows. There is a possibility that Countries with similar levels of institutional quality may be familiar with each other's business practices and trade more.

The hypothesis of 'natural – trading partners' enunciated by (Wonnacott and Lutz (1989) and espoused by Summers (1991) and Krugman (1993)] envisage that the more two countries trade with each other relative to the outside world, the less likely that a union between them will be harmful. It has been suggested that neighbouring countries or countries whose relative resource endowments are highly complementary in both cases, giving rise to appreciable initial levels of trade should be expected to expand their trade (Devos). Bhagavati and Panagaria (1996) and Shiff (1996) argues that under this case the tariff revenue loss will be substantial and the economic gains from forming a trade block are likely to be smaller.

Wonnacott and Wonnacot (1981, 1992) used the concepts of foreign trade barriers and transport costs to explain the formation of regional trade agreements. Foreign trade barriers and transport costs drive a wedge between the price that consumers in importing countries pay and price producers in exporting countries receive for the same traded goods. This wedge might be sufficiently large to offer neighboring countries for expanding their mutual trade on a preferential basis. The home country and the partner country exchange trade preferences (giving up tariff revenues from one another) in order to capture the greater savings from the high costs of protection or transport of goods associated with the home country's exports to the non-member country. But Panagaria (1997) criticizes this argument by saying that transport costs are no different than any other costs and as such deserve no special attention in considering PTAs.

Bhagavati and Panagaria (1996) argued that the proposition which makes a PTA between proximate partners superior to distant partners is false by citing examples of India-Pakistan versus India-U.S. relationship). The regionalism debate offers another explanation of non-traditional gains to the small partners. These non-traditional gains include, guaranteed access to the large market, shield the developing country from administered protection of the rich country and credibility to their reform process (lock-in effects). Panagaria (1995 and 1996) reject these arguments taking the case of NAFTA.

The new theory of international trade considers a variety of effects such as imperfect competition, scale effects and increasing returns to scale on the preferential trade agreements. Moreover, some analysts argue that the efficiency gains estimated using techniques based on old trade theory seem small relative to national income and to explain the rapid economic growth that accompanied trade expansion (Burfisher et al. 2003). The new trade theory tools include analysis of rent seeking behaviour, game theory, industrial organisation theory, and new growth theory.

If scale economies are achieved, it can offer greater international competitiveness to individual firms. In addition to achieving cost reduction effects related to increasing returns to scale, regional integration arrangements might successfully erode market power of dominant firms in member countries through encouraging market entry of competing firms from other member countries. This “pro-competitive” effect is widely cited in popular discussions of regionalism. Increased competitive conditions within the trading bloc could increase welfare substantially according to Smith and Venables (1988) through cost reduction effects and rationalisation of production location, increased sales by domestic firms in domestic markets and exit by some if not a substantial number of firms. The geographic coverage and pattern of RTAs fundamentally changed recently. Wonnacott (1996) introduced the terminology of hubs and spokes. A hub exists where one country (customs territory) is a member of two distinct RTAs. Single country hubs arise in several ways. Hubs may arise when one country is a member of one pre-existing RTA and then forms a new bilateral RTA with another single country outside the origin RTA. Or hubs may arise when one country almost simultaneously negotiates bilaterals with a number of countries or becomes a member of two multi-member RTAs.

Empirical Studies on Regionalism: An Overview

Empirical studies on regionalism addressed the theoretical debate with actual trade data using appropriate methodologies and simulation of various using sophisticated econometric models. Quantitative studies of regional integration arrangements may be classified as mainly empirical or analytical. Empirical studies are based on extensive contemporary or historical data, and parameters derived from these data through econometric estimation and hypothesis testing. Analytical studies, on the other hand, assume a theoretical structure and then rely predominantly on *a priori* estimates of key parameters compiled from empirical studies that are not necessarily related to issues raised by customs unions and free trade areas. There are large number of studies which looked in to changes in economic variables due to the implementation of trade policies are also studied in a static, comparative static and dynamic economic framework. Similarly there are large number of empirical studies which used a partial or general equilibrium framework to study the effect of RTAs.

The relationship between trade and economic growth particularly regional integration and economic growth is subjected to lot of empirical investigations. Thirlwall (2000), Wacziarg and

Welch (2003), and Frankel and Romer (1999) showed a positive relationship between trade liberalization and growth. There are skeptics like Rodriguez and Rodrik (1999) and Cruz (2008) on the role of trade or openness per se in stimulating growth. Lei and Netz (2001) extensively surveyed and empirically investigated the relationship between different forms of international integration and economic growth came to a conclusion that general openness, membership into a trade block and foreign direct investment into a country do lead to increased growth.

There are number of studies that focused the reason behind rapid increase in bilateral and regional trade agreements in the arena of international trade. Whalley (2006) identified factors like customized bilateral agreements to suit the requirement of partners, coverage of non-trade issues, limited yet dilatory success of multilateral process, demonstration effect of large players towards RTAs and use of RTAs by politicians and negotiators to advance their personal gains. Fiorentino Verdeja and Toqueboeuf (2006) argued that the proliferation of RTAs is a challenge as well as opportunities for WTO members and RTAs should be designed and implemented to address this dichotomy so as to ensure RTAs complement the multilateral process. Sager (1997) explored the effect of the proliferation of regional trading agreements on the multilateral trading system and said there is widespread disagreement regarding the effect of regional trade agreements on the multilateral trading system. While questioning the growth and importance of RTAs in the world trading system, Pomfret (2007) argued that the large number of RTAs are misleading as there is double counting of RTAs and inclusion of defunct and inconsequential RTAs and their trade share overstated. The author believed the design of the RTAs has inherent bias towards trade diversion and vehemently argued for multilateral trade liberalization for enhanced welfare.

There is a new trend emerging in the area of regionalism namely 'cross-border regionalism' where countries who are part of an existing RTA or from different geographical areas form bilateral agreements resulting in complex Rule of Origins (RoOs) and multiple enforcement norms. Baldwin (2006) while analyzing the global free trade observed regionalism and the 'Spaghtti Bowl' type of numerous trade agreements will regulate the world trade and a multilateralisation of the world's existing and emerging regionalism is required. Tovias (2008) observed that cross regionalism reduces overall economic welfare eventhough individual partner may gain independently from it. Lee, Park and Shin (2004) showed that RTAs on average increase global trade by raising intra-bloc trade without damaging extra-bloc trade. It is also shown that net trade creation effects of RTAs are substantially lower for countries participating in overlapping RTAs and there is less likely that the currently proliferating RTAs will completely merge and lead to global free trade. Freund (2000) observed free trade is the unique Nash equilibrium in which a country is always better off forming a bilateral trade agreement with every other country, irrespective of previous agreements. This suggests that each new preferential free trade agreement may be a step towards multilateral free trade.

There are number of studies that looked in to the determinants affecting the RTAs. Baier and Bergstrand (2005) found closeness of partners, remoteness, larger and similar economies, difference in capital-labour endowment ratios are important factors affecting RTAs. Holmes (2005) found countries from same continent have higher chances of signing an RTA irrespective of their importance in each other's trade. Magee (2003) showed neighbouring countries are more likely to enter the PTAs but this cannot be attributed to 'natural trading hypothesis' since these agreements do not lead to more trade creation or less trade diversion. Harmsen and Leidy (1995)

observed coverage of all sectors, shorter transition periods, transparent rules of origin, liberal rules of accession, no anti-dumping laws among members of PTAs and MFN liberalisation should either precede or accompany new PTAs are conditions that will lead to gains from an RTA. Venables (1999) while examining the way benefits and costs are distributed among the RTAs found that developing countries are likely to be better served by 'north south' than by 'south-south' free trade agreements.

There are studies that looked into the age of RTA and their economic outcome. Coulibalya (2004) found that for 'younger' developing RTAs first years of participation are rewarded by a positive trade and welfare effects while the 'older' ones depicted a more volatile trade and welfare profiles as the number of years of participation of the members keep increasing. Fratianni and Oh (2007) tested the relationship between the size of regional trade agreements (RTA) and openness and found that regional trade bias declines with the size of the club. Freund and McLaren (1999) studied the dynamics of trade reorientation experienced when a country joins a regional trade bloc and stated that the joining country's trade orientation toward bloc countries typically rises along an 'S'-shaped path.

Vamvakidis (1999) studied regionalism versus broad liberalization in the context of member countries growth and showed that economies grew faster after broad liberalization, in both the short and the long run, but slower after participation in an RTA. Venables (2000) found that the effects of RIAs on the world trading system are not clear-cut. There is little evidence that regionalism has retarded multilateral liberalization, but neither is there support for the view that continuing expansion of regional agreements will obviate the need for multilateral liberalization efforts. Brown, Deardorff and Stern (2000) said welfare gains from multilateral trade liberalization are therefore considerably greater than the gains from preferential trading arrangements and more uniformly positive for all countries. Madani (2001) studied industrial growth of three Andean pact counties and showed that unilateral liberalization had a more positive impact on output growth, through the channel of greater imports of intermediate inputs than regional integration arrangements.

Estevadeordal, Freund and Ornelas (2005) in their study found that regionalism helps the multilateral process and concern about a negative effect of regionalism on multilateralism in developing countries is overblown. It is also shown that greater the tariff preference that a country gives to its partners in a given product, the more the country tends to reduce its multilateral (MFN) tariff in that product. Nitsch and Sturm (2005) showed that RTA membership has, on average, no measurable effect on a country's trade policy. Lee and Shin (2005) identified factors such as geographical distance, land borders, common language, and area, have significant impacts on trade creation and trade diversion and East Asian RTAs are more trade creating than trade diverting.

Sally (2006) argued hub-and-spoke pattern of FTAs that are emerging in Asia will not drive regional economic integration or further integration with the global economy as it lead to regional economic disintegration. Sulamaa and Widgrén (2005) using a computable general equilibrium model showed that global free trade is better for all regions in the investigation and the biggest winners of global free trade are Asian countries, Brasilia and developing countries. Dee (2007) suggested greatest real income gains would come from comprehensive non-discriminatory trade reform as part of a unilateral domestic regulatory reform. The study observed for reform-weary governments PTAs are the best excuse to avoid reforms and for

reform-ready governments it is a distraction from the main game. Schott(2004)in his study concluded regional blocs would provide only a ‘third-best’, and distinctly suboptimal, option for world trade. Plummer (2007) highlighted the difficulties of the multilateral trade negotiations and how efficient regional agreements are used to overcome it. The study has developed best practices of RTAs and verified how the existing RTAs confirm to the best practices of regionalism in Asia.

The political economy dimension of regional trade agreements were subjected to number of empirical studies; Levy (1997) Krishna (1998) Bird and Rajan (2002) Albertin (2008) etc. Levy (1997) demonstrated that bilateral free trade agreements can undermine political support for further multilateral trade liberalization. Krishna (1998) found preferential arrangements that divert trade away from the rest of the world are more likely to be supported politically and preferential arrangements will reduce the incentives for multilateral liberalization. Bird and Rajan (2002) contended that trade-first approach to regional integration is essentially a political outcome as broadening and deepening of RTAs requires very strong political commitment and it is rarely exhibited as most RTAs are protectionist for strategic reasons. Albertin (2008) in his study showed that a country’s decision to enter a regional trade agreement unambiguously undermines the incentives towards multilateral trade liberalization.

Gupta and Schiff (1997) studied the welfare implications for the excluded countries in a Regional Trade Agreements and contended that regional trade agreements among small countries may have negative welfare implications for outside countries. Yeats (1997) in his study demonstrated the potential pitfall of RTAs on members and on third countries as their trade patterns are different from current comparative advantage. Based on new trade theory, Winters (1997) analysed the welfare impacts of an RTA on non-members and argued that it depend on changes in the terms of trade, levels of output, number of firms, existing trade restrictions and induced investment effects. Winters and Chang (2000) studied Spain’s accession to the EU and found that the preferred exporter will raise its pre-tariff price while the non-member will reduce its pre-tariff price. Chang and Winters (2002) analysed Brazil’s entry in to Mercusor and found that non-members’ export prices to Brazil fell relative to their export prices of the same commodities to other markets. Borchert (2008) demonstrated empirically that different degrees of market access offered by European Union to developing countries induces sizable trade diversion to the detriment of relatively less preferred beneficiary countries.

In addition to the trade benefits to regionalism there are studies highlighting the gains from non-traditional areas in pursuing regional trade agreements. Schiff and Winters (1999) content that regionaltrade agreements is part of diplomacy to reduce security tensions between neighbouring countries as trade between them increases trust between them and reduces the likelihood of conflict. Emphasizing the importance of non-traditional gains of RTAs such as commitment, signaling and insurance mechanisms, Fernández (1997), opined RTAs can serve a useful economic purpose above and beyond the direct gains from trade liberalization by reducing such uncertainties and by enhancing credibility. Lobbying and Special interests often play a very important role on the outcome of Regional Trade Agreement. Thebroad framework to explain the role of special interest groups in shaping regionalism is developed by Grossman and Helpman (1995), which explains policy formations as the outcome of lobbying and contribution competition among industries. Kee, Olarreaga and P. Silva (2003) applied Grossman-Helpman

(1994) model and showed very high returns (above 50 percent) to Latin American exporters' political contributions. Desker (2004) in his paper discussed the underlying security rationale for the conclusion of FTAs, highlighting the nexus between security interests and international economic policy in East Asia. Krueger (1993) worried that the establishment of regional FTAs might create beneficiaries (rent -seekers) who would form a political lobby against multilateralism. Krishna and Bhagavati (1997) showed that if two or more countries are pursuing certain non-economic objectives, they can still form a customs union between themselves and be jointly better off.

The large number of bilateral free trade agreements that came out recently also subjected to empirical testing. Klausning (2001) found establishment of Canada – US Free Trade Agreement had substantial trade creation effects, with little evidence of trade diversion. Roberts (2004) used the gravity model to study China-ASEAN Free Trade Area (CAFTA) and demonstrated that more developed CAFTA economies have a crucial role to play if integration is to benefit the less-developed economies. Tongzon (2005) looked the likely impact of the establishment of a FTA between China and ASEAN and showed there are economic opportunities for ASEAN from the FTA as China imports a significant portion of its input requirements, particularly raw materials and industrial components and agricultural products from ASEAN. Yihong and Weiwei (2006) applied Export Similarity Index to examine China's export potential to ASEAN market and found China ASEAN FTA had a significant positive effect on bilateral trade volume. Hertel, Walmsley and Itakura (2001) used a modified version of the dynamic GTAP model to evaluate the new age provisions of RTA between Japan and Singapore and found that they have significant impacts on bilateral trade and investment flows, with customs automization playing the most important role in driving increases in merchandise trade.

Bhattacharya (2006) studied the prospects of regional cooperation in trade, investment and finance between BIMSTEC countries and Japan and found that it will increase intraregional trade but Japan gains the most from it. Liu (2004) analysed the desirability of forming a bilateral free trade agreement between China and Australia and showed clear benefits for both Australia and China from a bilateral free trade agreement. Wang (2006) argued that regional economic integration in Asia should first realize sub-regional integration between East Asia and South Asia, among which the most important one should be a China-India FTA. Bhattacharya (2004) used a gravity model and simulation method to show the increase in India-Bangladesh bilateral trade under four hypothetical scenarios of tariff rate cuts. The results showed that in a free trade regime, the increase in India's exports will be more than the increase in its imports from Bangladesh. The trade potential between Brazil and India using Balassa's Revealed Comparative Advantage Index was done by Fonseca, Azevedo and Velloso (2005 for three-year period between 2000 and 2002. The results suggested low complementarity between the supply and demand of the two economies, which is one of the main reasons for low volume of bilateral trade. Pradhan, S.R (2006) used augmented gravity model to estimate the magnitude of India's export potential to the six-member Gulf Cooperation Council (GCC) countries which are currently negotiating a Free Trade Agreement (FTA). The result showed that the magnitude of India's export potential is highest with Oman, followed by Qatar, Bahrain, and Kuwait and there is no export potential with UAE, and Saudi Arabia.

Major Findings

A careful review of the literature showed that the issue of trade creation and trade diversion is not resolved decisively yet. The issue of complementarity and substitutability between regionalism and multilateralism is also complicated. The magnitude of the impact of RTAs is not uniform. Certain methodological issues like nature of analysis, model specifications, and functional forms need further exploration. How regionalism influences multilateral liberalization, collective bargaining and trade negotiations are becoming increasingly important for developing countries. India's experience with regionalism is relatively limited and India cannot ignore the changing realities. The advent of World Trade Organisation and its inability to take quick decision led to emergence of large number of Regional Trade Agreements. The powerful regional groupings succeeded to achieve short term trade objectives at the expense of multilateral trade liberalization. But the structure of regional trade agreements became so complicated with multiple overlapping and enforcement of Rules of Origins became difficult. This leads to the measurement of trade gains and economic welfare difficult from an RTA. The impacts of RTAs on different domestic constituencies are very difficult to delineate. This has led to rethinking in some of the existing regional grouping about breaking away from the groping for national good over collective welfare. The Brexit is an important milestone in this thought process. A calibrated approach taking all dimensions of the domestic economy without seriously hampering the multilateral process is the need of the hour.

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