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Book Review

Economic Integration in South Asia: An Exploratory Study. By Ayubur Rahman Bhuyan. Dacca: The University of Dacca. 1979. Appendix; Bibliography; Index. xi + 224 pp. US $ 12.00 or Bangladesh Taka 125.00.

In the book under review, Dr. Ayubur Rahman Bhuyan has made a commendable effort to analyse some of the economic effects of a "possible" customs union among the South Asian countries: India, Pakistan, Bangladesh and Sri Lanka. While an attempt has been made to quantify the static effects of integration, the rest of the analysis is mostly qualitative. In spite of the limitations imposed by the paucity of data, Dr. Bhuyan's scholarly discussion goes a long way to bring the relevant issues to light.

Before going into empirical estimation of the gains and losses of a customs union among the South Asian countries, the author provides a rationale for economic integration among developing countries in terms of the theory of customs unions. He bases his case for economic integration on the need for industrialization. In line with the argument advanced by Johnson[1] as well as by Cooper and Massell,[2] he considers industrial production to be a "public good" which yields to the community satisfaction over and above that obtained through private consumption of industrial products. Industrialization of an underdeveloped country is believed to be virtually impossible in the face of an open competition with developed countries. Hence the need for protection. However, protection has a cost to the economy. Integration is likely to reduce this cost by making available benefits of economies of scale and external economies, thereby bringing about an improvement in productive efficiency.

After having established the case for industrialization, the author considers the question of selecting a suitable strategy for industrialization. He argues that the poor export performance of the LDCs in the past and the gloomy prospects for the export of manufactured goods from these countries leave import substitution policy as the most effective policy for industrialization. However, import substitution has its own problems. The author points out some of these problems in the framework of narrow national markets and concludes, as Sydney Dell did, that the problems

[1]H. G. Johnson. "An Economic Theory of Protectionism, Tariff Bargaining and the Formation of Customs Unions". *Journal of Political Economy*. June 1965.

[2]C. A. Cooper and B. F. Massell. "A New Look of Customs Union Theory". *Economic Journal*. December, 1965.

inherent in the process of import-substituting industrialization are so immense that "concerted action with their neighbours seems indispensable for many of these countries, especially smaller and weaker ones".[3]

To set the stage for the subsequent analysis, he then undertakes an extensive analysis of the economic structure, patterns of production, and trends and composition of foreign trade of the South Asian countries. The nature and extent of competitiveness and complementarity among different countries in South Asia are clearly brought out. In this regard he notes that in the past a highly competitive structure of production had evolved in India, Pakistan and Bangladesh. The author, however, believes that there is still a wide range of activities in which there is actual or potential complementarity in the region which can provide a basis for gains from a customs union in South Asia. In the field of agriculture, he thinks large gains can be derived if there is an expansion in the acreage of food crops in India, jute in Bangladesh, cotton in Pakistan and natural rubber in Sri Lanka. We are, however, not so optimistic about the gains to be derived from such a reallocation for two reasons. Firstly, the present pattern of agricultural production in these countries is more or less on the lines of their respective comparative advantage. In the case of Pakistan, for example, perhaps the only gain for Pakistan could be a reduction in sugarcane production if India could supply sugar cheaper. Secondly, and more importantly, a further specialization in agricultural commodities will increase the already high level of concentration of production and trade in these countries. The area is already a net exporter of all the products (except some food crops). The individual countries will have to sell their additional production on world markets which will further expose their economies to the vicissitudes of international demand. The variation and, perhaps, relative decline in the prices of their exports may cause much more harm than the limited benefits expected from the reallocation of resources.

Even the industrial production of these countries does not seem to have deviated too much from their "known" comparative advantage. The benefits to be derived from a reallocation of resources on the basis of "static" comparative advantage are thus limited. This is not to say that there have not been distortions or that the industrialization experience of these countries has been a resounding success; nor does it imply that the most efficient use has been made of the resources invested in industry. All it suggests is that after discounting for the costs involved in the reallocation of resources, the net benefits to be derived from such a reallocation would not be large enough to justify a customs union. The real potential gains from a customs union lie in new investment. One can argue that the traditional industries have been pushed too far, as the "incremental" comparative advantage might lie in other lines of production: or, in the context of import-substituting strategy, even if a country does not have comparative advantage in some particular industry at a particular stage of industrialization, it might develop one at a later stage. The doctrine of comparative advantage is more useful in explaining where a country has been than in indicating where it might go. Once this is accepted, Dr. Bhuyan's emphasis on the market-size expansion as being a necessary prerequisite for industrialization becomes totally justified since the success of import substitution critically depends on the market size and the economies of scale. The author is, therefore, right in his claim that substantial benefits will accrue from economies of scale due to a larger market. Problem arises when it comes to selecting industries for import-substituting strategy. None of the countries will be prepared to sacrifice its national interests to let other countries avail themselves of the economies of scale and the gains from specialization. Specifically, it is difficult to perceive these countries agreeing to a scheme whereby India specializes in iron and steel, defence and transport industries, Bangladesh in tobacco and jute, and Pakistan in textiles and mineral industries. We believe that nationalistic considerations will prevail, thus limiting the benefits to be derived from specialization.

[3]Sydney Dell. *Trade Blocs and Common Markets.* London: Constable. 1963.

The analytical core of the book lies in the author's analysis of the static trade effects and some of the dynamic effects of a customs union among the four South Asian countries. He employs an *ex ante* type of model to quantify trade creation and trade diversion effects. He notes some of the limitations of this kind of models, namely the problems of the determination of relative elasticities, the bias due to aggregation of high-elasticity and low-elasticity products into same categories, failure to take account of intra-industry trade, and reasonableness of the assumption that the pre-integration elasticities would remain unchanged.

Some other drawbacks of this technique which the author ignores may be more important for the present study. Firstly, the application of elasticities measured from total trade in any commodity to trade within the region is questionable (especially when the intra-area trade constitutes only a small percentage of their total trade). Due to the huge amount of tied aid, quality differences, colonial links, etc., the trade between developed and developing countries depends on quite different factors as compared to the trade among the less developed countries. Secondly, as Sellekarets[4] has pointed out, estimates from such studies critically depend on the selection of the base period. In this regard, we feel that the selection of 1964-65 is not appropriate since the pattern of trade in the area has undergone tremendous change since then.

Given the data limitations, Dr. Bhuyan's attempt along scientific lines of analysis is, however, praiseworthy. His technique of decomposing total trade effects into trade creation and trade diversion is a contribution to the methods of estimating trade effects of customs union. His findings indicate that trade-creation effect is more than four times the trade-diversion effect, and, as such, on static efficiency

[4]W. Sellekarets. "How Meaningful are Empirical Studies on Trade Creation and Trade Diversion"? *Weltwirtschaftliches Archiv, 109.* 1973.

criterion (and on the author's assumptions) a customs union in South Asia will increase welfare. However, he rightly points out that the Vinerian concepts of 'trade creation' and trade diversion, given their static character, are not entirely applicable to the rapidly changing economies of the developing areas. Economic growth being the ultimate objective, the allocative efficiency becomes only of secondary importance in any scheme of economic integration in under-developed regions. The desirability of a customs union hangs on the long-run dynamic benefits.

The author, therefore, undertakes an analysis of the dynamic effects of a customs union among the four countries. That is an arduous task, and, in an *ex ante* framework with all the data problems, the best that he could do was a simple exercise. His analysis hinges on the existence of economies of scale or of a minimum output below which the production process is inefficient. Using Sargant Florence's criteria to determine the 'representative' efficient size of plants in various industries, he makes a comparison between the market size (measured in terms of the GDP) of the U.K. and those of the four South Asian countries. He finds that certain industries that are characterized by a predominance of large-scale plants may not be economically established in individual markets of the smaller members, but bigger regional market would make them economically feasible.

Besides other limitations that Dr. Bhuyan himself points out, the validity of choosing 'representative' plant sizes on the basis of the U.K. experience is questionable. An efficient plant size depends on the technique of production and, given different factor endowments of the South Asian countries and the U.K., the efficient plant size in South Asian countries may be different from that in the U.K.

While the analysis provided in the book is very revealing, many readers will take exception to the author's conclusion that a customs union among these countries will give rise to substantial benefits. It has been pointed out that the static trade effects and the gains in allocative efficiency will not be sufficient to encourage these countries to participate in the union. As for the dynamic benefits due to a large market, the author's own estimates show that by 1985 the national markets of these countries, with the exception of Sri Lanka, will be large enough to establish all but three industries; and a union before 1985 is impossible anyway.

The free movement of capital and labour, which is an essential component of a customs union, may lead to concentration and domination of some groups which may not be acceptable to some countries. The fear of polarization of industrial activity that the author mentions is even more serious.

Another important prerequisite for a successful customs union is the harmonization of monetary and fiscal policies in the participating countries. It is difficult to perceive how that would be possible with the members of the union pursuing entirely different objectives, e.g. establishment of an Islamic economic

system in Pakistan on the one hand and a socialist type structure in India on the other.

The lack of political harmony is another problem which the author himself recognizes. In an area beset with nationalist struggles, any surrender of economic and political sovereignty, which is inevitable in a scheme of regional integration, seems impossible.

Every study emphasizes some aspects more than the others. It seems that Dr. Bhuyan has not given proper emphasis to the political economy aspects of the study. As far as the analysis goes, it is scientific and professionally sound. He has made an important contribution to the techniques of measuring the static trade effects of customs union. In his own empirical estimation, he has done a very good job. Dr. Bhuyan's book is a valuable addition to the theoretical and empirical literature on economic integration among developing countries.

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