6) Write Short notes on :

(i) Agreement on anti-dumping

(ii) Agreement on import licensing procedures

(iii) Agreement on rules of origin.

UNIT 11 REGIONAL ECONOMIC GROUPINGS

Structure

11.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the developments that have resulted in the formation of regional groupings
- describe the different forms that regional groupings have taken
- discuss the rationale behind formation of regional groupings
- evaluate, to what extent, formation of regional groupings contradict the principles of free trade and result in replacement of free trade by restricted trade
- evaluate the impact of regionalism on third countries
- suggest, in the light of the above, some strategies to promote exports

11.1 INTRODUCTION

In the earlier units, you have learnt about the influence of environment on international business as also about the role played by international organisations and national governments in the orderly growth of global trade. Unit 9 exposed you to the trends in and structure of world trade with particular emphasis on the problems faced by developing countries in promoting exports, while Unit 10 dealt, in detail, with the multilateral trading system and the role of GATT and WTO. This Unit deals with an important phenomenon in global trade i.e. regional groupings. The origin and growth of this phenomenon is traced and the factors that have brought about the development are enumerated. The question of regionalism versus multilateralism is also addressed. The possible impact of regional groupings on third countries, as far as export promotion is concerned, is also dealt with. The Unit concludes with some suggestions for third countries to make best use of the conditions.

11.2 OVERVIEW

One of the significant developments that has taken place in the world economic scenario since the second half of the fifties has been the emergence of regional economic groupings. No region in the world appears to be free from regional groupings and most of the countries irrespective of the stage of their economic development, seem to be interested to become full members of or in forging some sort of alliance with one grouping or the other. There is, in fact, a growing feeling among many that, in future, external trade and economic relations may take place and issues pertaining to them may be tackled more among groupings than among nations. Though a large variety of groupings of different types have emerged confining their scope either to the limited objective of achieving exchange of commodities with mutual preferences or enlarging it far beyond, and move towards total economic integration, **the main aim is to accelerate the development process and improve the quality of life of the residents of the region by providing them with greater choice both as producers and as consumers.** In short, in a regional grouping, the economic significance of national political boundaries is completely lost.

11.3 HISTORY

Two distinct waves of regional groupings appear to have swept the world since the end of the second world war. The first one surfaced during the 1950s with the formation of European Common Market (ECM) by the then West Germany, France, Italy, Belgium, Luxemburg and the Netherlands on 1st January 1958. The formation of ECM was only one of a number of steps initiated by West European nations to create a "United States of Europe" or "One Europe from Urals to Atlantic" as a means to revive the war torn European economy and, more significantly, to avoid future wars among European nations. ECM was preceded by the European Coal & Steel Community (ECSC) during August, 1952 by the same six West European countries. In fact, much before formation of ECSC and ECM an economic union between Belgium and Luxemburg was in operation since 1922 and, with the addition of the Netherlands to the two countries, a customs union, Benelux came into existence during 1948.

Cooperation among European nations after the Second World War saw a beginning with the establishment of the Organisation for European Economic Cooperation (OEEC) by 16 West European countries during April 1948. Subsequently, an European Payments Union (EPU) was also instituted within OEEC. OEEC was later expanded to include more members including non European nations and converted into the Organisation for Economic Cooperation and Development (OECD) on 1st October, 1961.

The year 1955 witnessed the establishment of the Western European Union (WEU) with the six ECM countries and the UK as members with the objective of coordination of the defence policies of the member nations and cooperation in their political, social, legal and cultural affairs. Encouraged by the success of Benelux — in one year customs duties on intra-trade were totally abolished and a common tariff on trade with third countries was established and, during the next year, quota restrictions in intra-trade were completely removed — and the progress made in moving towards greater cooperation and integration among the European nations as evidenced by the establishment of OEEC, WEU and ECSC, attempts were made to establish the European Defence Community (EDC) and the European Political Community (absorbing ECSC and EDC) during the 1950s. The attempts, however, did not succeed.

The failure of attempts at political and military integration on the one hand, and, the success, on the contrary, of the functioning of a customs union in the region in the form of Benelux and other institutions such as OEEC, ECSC and WEU had a lesson to the European statesmen. It meant that the path to creation of a "United States of Europe" was through economic integration. Hence, following the report of a committee which formulated proposals for an economic union and an atomic energy pool in the region, the "Rome Treaty" was signed during 1957 which saw the birth of the European Common Market (ECM) on 1st January 1958. Along with ECM, the European Atomic Energy Community (EURATOM) was also established.

Following the formation of ECM, 14 other countries in West Europe led by the UK, formed the European Free Trade Association (EFTA) in 1960. Inspired, perhaps, by the above developments in West Europe and to some extent atleast, by the substantial growth in intra-ECM trade during the sixties, regionalism spread through Africa and South America and, to some extent, Asia during the sixties. Thus the developing world witnessed the establishment of Central American Common Market, Andean Common Market, Latin American Integration Association, Arab Common Market, West African Customs Union, Southern African Customs Union and the Association of South East Asian Nations (ASEAN).

When all this was going on in the other parts of the world, North America remained passive to the idea of formation of regional groupings. The first wave of regionalism can be said to have come to a halt by the end of 1960s or, the latest, by the first half of 1970s.

The second wave surfaced during the mid 1980s with the United States of America (USA) as a significant player. Thus, the Canada-US Free Trade Agreement was negotiated in 1989 and later, the North American Free Trade Area (NAFTA), with USA, Canada and Mexico as members, came into existence during 1992.

The above developments triggered more initiative and activities among many countries. Thus, in South America, MERCOSUR, the Southern Cone Common Market, has been formed; in the Pacific, there is ANZCERT, the Australia-New Zealand Closer Economic Relations Trade Agreement; in Africa, the Preferential Trade Area for Eastern and South African States (PAT) exists, besides the Economic Community of Central African States and, in the Arab world, five countries have formed the Arab-Maghreb Union (AMU).

Attempts are continuing towards greater integration and increased cooperation among a number of countries. The ECM, which has evolved into the European Union (EU) with 15 countries as members (many member nations of EFTA, led by the UK, had subsequently left EFTA and joined the ECM and most of the remaining members are also seeking membership of EU), is moving towards not only expanding the size of the Union by admitting more nations as full members but also towards achieving integration in monetary, defence and foreign policies a greater European Economic Area (EEA) has come into existence between the European Free Trade Association (EFTA) and the EU; NAFTA is preparing to enlarge its membership; moves are afoot to establish Asia Pacific Economic Cooperation (APEC) and an Indian Ocean Rim Initiative; the original five nation member ASEAN is doubling its membership; the South Asian Association for Regional Cooperation (SAARC) member nations are intending to move towards a South Asia Free Trade Area (SAFTA) by 2000 AD.

11.4 FORMS

Regional Groupings can be classified, conceptually, into five major types:

Preferential Trading Arrangement, where the member countries lower barriers to imports of identified products from one another;

Free Trade Area, where barriers to trade in respect of all items among member countries are completely eliminated while each member country follows its own policy in regard to trade with non-member countries;

Customs Union, where, apart from elimination of all barriers to trade among themselves, the member countries follow a common policy in regard to their trade with non-members;

Common Market, where the region becomes a common market for all factors of production including labour, services and capital; and

Economic Community, where the member countries follow common policies in respect of all economic matters;

The regional groupings that exist today fall in one or more of the above categories or are variations/combinations of some form/forms, the Bangkok Agreement among Bangladesh, India, Laos, South Korea and Sri Lanka is a specimen of a preferential trading arrangement: EFTA and NAFTA are free trade areas: there are a number of examples of customs union and common market: they include Central American Common Market, Caribbean

Common Market, ANDEAN Common Market and Arab Common Market while the European Union is, perhaps, the best example of evolution of a regional grouping through the stages of customs union to common market to economic community.

11.5 PRESENT POSITION

No comprehensive compilation is available, as on date, on the number of regional groupings in the world. A Study (Norman S. Fieleke — "one Trading World or Many : The Issue of Regional Trading Blocs" : *New England Economic Review*, May-June, 1992, pp.3-19) carried out sometime back listed 23 such arrangements in 119 countries accounting for about 82 per cent of global trade in commodities. In an address (GATT Press Communique No. GATT/1596 of 16th September 1993) at a Seminar organised by the EC/Rio Group on Regional Integration (CEFIR), Mr. Peter Sutherland, the then Director General of GATT mentioned that there were, in all, 85 regional arrangements in the world, of which 28 had been notified to GATT since 1992. These arrangements include Economic Communities, Common Markets, Customs Unions, Free Trade Areas and Trade Preference Associations. Countries which are not members of such arrangements seek to link themselves to regional groupings in some way or the other as is evidenced by the arrangements between 70 ACP countries (countries in Africa, the Carribean and the Pacific), East European Countries, Gulf Countries and Israel with the European Union. Look at Table 11.1 which lists some of the better known groupings that are in operation today.

Table 11.1: Major Existing Regional Trade Arrangements

S. No.	Name of the Arrangement	Year Launched	Member Countries	Type of Arrangement
1	Association of South East Asian Nations (ASEAN)	1967	Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand, Vietnam	Free Trading Bloc
2	Bangkok Agreement	1976	Bangladesh, India, Laos, South Korea, Sri Lanka	Trade Preferential Arrangement
3	European Union	1958	Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxemburg, Portugal, Spain, Netherlands, United Kingdom, Austria, Finland, Sweden	Common Market
4	European Free Trade Association (EFTA)	1960	Finland, Iceland, Liechtenstein, Norway, Sweden, Switzerland	Free Trading Bloc
5	EU and EFTA	1972		Industrial Free Trading
6	Central American Common Market (CACM)	1960	Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua	Customs Union
7	Andean Common Market (Andean Group)	1969	Bolivia, Colombia, Ecuador, Peru, Venezuela	Common Market
8	Caribbean Common Market (CARICOM)	1973	Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts-Nevis, St. Lucia, St. Vincent and Grenadines, British Virgin Islands	Common Market
9	Organization of Eastern Caribbean States (OECS)	1981	Antigua and Barbuda, Dominica, Grenada, Montserrat, St.Kitts-Nevis, St. Lucia, St.Vincent and Grenadines, British Virgin Islands	Customs Union
10	Latin American Integration Association (LAIA)	1980	Argentina, Brazil, Chile, Mexico, Paraguay, Uruguay and Andean Countries	Trade Preferential Arrangement
11	Southern Cone Common Market (MERCOSUR)	1991	Argentina, Brazil, Paraguay, Uruguay	Common Market
12	Arab Common Market (ACM)	1964	Egypt, Iraq, Jordan, Lebanon, Libya, Mauritania, Syria	Common Market
13	Gulf Cooperation Council (GCC)	1981	Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates	Common Market
14	North American Free Trade Agreement (NAFTA)	1991	Canada, Mexico, United States	Free Trading Bloc
15	Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERT)	1983	Australia, New Zealand	Free Trading Bloc
16	Economic Community of West African States (ECOWAS)	1975	Benin, Burkina Faso, Cape Verde, Cote d' Ivoire, The Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, Niger, Senegal, Sierra Leone, Togo	Common Market
17	Southern African Customs Union (SACU)	1969	Botswana, Lesotho, Namibia, South Africa, Swaziland, four South African 'homelands'	Customs Union
18	West African Customs Union (CEAO)	1959	Benin, Burkina Faso, Cote d'Ivoire, Mali, Mauritania, Niger, Senegal	Custon. Union
19	Preferential Trade Area for Eastern and South African States (PAT)	1981	Burundi, Comoros, Djibouti, Ethiopia, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Rwanda, Somalia, Swaziland, Tanzania, Uganda, Zambia, Zimbabwe	Trade Preferential Arrangement
20	Economic Community for Ground Lakes Countries (CEPFL)	1978	Rwanda, Zaire, Brunei	Trade Preferential Arrangement
21	Customs and Economic Union of Central Africa (UDEAC)	1978	Cameroon, Chad, Congo, Equatorial, Guinea, Gabon, Central African Republic	Trade Preferential Arrangement

S. No.	Name of the Arrangement	Year Launched	Member Countries	Type of Arrangemen
22	Economic Community of Central African States	1981	Burundi, Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea, Gabon, Rwanda, Sao Tome and Principe, Zaire	Common Market
23	Arab Maghreb Union (AMU)	1989	Algeria, Libya, Mauritania, Morocco, Tunisia	Common Market
24	Mano River Union (MRU)	1973	Guinea, Liberia, Sierra Leone	Customs Union
25	South Asian Preferential Trade Arrangement (SAPTA)	1995	Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka	Trade Preferential Arrangement

Source: Norman S. Fieleke, "One Trading World or Many — The Issue of Regional Trading Blocs", *New England Economic Review*, May-June, 1992.

11.6 RATIONALE

While the basic objective of all the groupings, irrespective of the form that each of them might have taken, appears to be the same, viz improving the welfare of people within the region through creation of a larger production base and increased market size for producers and greater choice to both producers and consumers, a number of factors seem to have contributed to regional groupings gaining momentum in recent years. Let us discuss them briefly:

Political Objective: The basic motive behind formation of the European Union was political, i.e., to avoid future conflicts among European nations after the two world wars. The West European countries, who had paid a very heavy price during the first and the second world wars had, after considerable deliberations, decided to seek political unity through economic route. With the support provided by USA under the Marshall Plan, they decided to form the United Community by surrendering their individual national sovereignties to a regional body on trade and economic matters. This gave birth to the European Common Market, to start with, and now the countries are moving towards political and economic union.

Response to Slow Progress of Global Liberalisation: One of the factors that has contributed to formation of economic groups with emphasis on removal of mutual trade barriers can perhaps be traced to the dissatisfaction, at the relatively slow progress, at international level, of attempts at liberalisation of international trade. The Uruguay Round of Trade Negotiations, which commenced as far back as 1986 could, after all, be concluded during December 1993 only and still there are a number of issues such as labour standards on which agreement is yet to be reached. It is, therefore, no wonder if some countries had felt that, probably, it was better to begin the trade liberalisation agenda by knocking down barriers among limited number of like minded countries in the region, while at the same time continue working towards barrier removal at global level.

Regional Initiatives: One of the reasons for emergence of regional groupings can be traced to a feeling, among countries belonging to a region, that it was far more easier and made better economic sense to trade more with the countries in the region rather than with countries outside the region. The objective was to fully exploit the advantages offered by regional initiatives. This logic was behind the philosophy of South-South trade and the trade groupings becoming region oriented. The poor countries in particular, given the small size of their markets, looked at regional grouping as a better means to achieve their objective of import substituting industrialisation since it gave them the benefit of an enlarged market.

Demonstration Effect: Another reason for the countries belonging to a particular region flocking together, probably, was to improve their bargaining power when they noticed that developments towards formation of groupings were taking place in other regions. This was more in the form of demonstration effect or self defence mechanism mainly undertaken to avoid the likely problems of isolation from the general trend.

Whatever were the reasons that have prompted a number of countries to form regional groupings of some sort or the other, the groupings have proved one thing, that it has been found more easy for producers, rather than consumers, to get together.

Check Your Progress A

1) List four major categories of regional groupings?

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2) Enumerate three issues that influence formation of regional groupings.

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3) Distinguish between custom union and common market.

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4) Are the following statements **True** or **False**?

i) There was no regional grouping at all before the end of the Second World War.

ii) The United Kingdom is one of the founder members of the European Common Market.

iii) The European Defence Community and the European Political Community were established during the 1950s.

iv) The Asian continent is free from the trend to form regional groupings.

v) The dissatisfaction at the relative slow progress of trade liberalisation at global level has, perhaps, contributed to formation of regional groupings.

11.7 REGIONALISM V/S MULTILATERALISM

Does regionalism mean that free exchange of goods and services among nations is sought to be replaced by discriminatory trade?

Does establishment of regional trade blocs contradict the principles of free trade enshrined in the articles of WTO (the former GATT)? Has global trade got transformed substantially as a result of emergence of regional groupings? Are these groupings "stumbling blocs" or "building blocs" to international trade?

Since in the multilateral trading arrangement, trade is based on the non discriminatory Most Favoured Nation (MFN) principle, according to which each contracting party (to GATT) must grant to every other contracting party treatment as favourable as it grants to any other country while, in a regional grouping, member countries enjoy trade preferences over non member countries, emergence of regional groupings has provoked concern that the arrangements might violate the legal obligations assumed by WTO (former GATT) member countries.

The first paragraph of the first article of GATT lays down a broad prohibition against the use of preferential tariff rates which is given expression in MFN principle. However, the second paragraph of the same first article permits an exception to this principle, the exception being given for continued application of such preferential tariff rates as were in effect at the time GATT was adopted. In addition, Article XXIV of GATT which deals with customs unions and free trade areas, permits such preferential trading arrangements subject to the conditions that (a) trade barriers are eliminated on substantially all trade among members; (b) the trade barriers remaining against non-members are not higher or more restrictive than those previously in effect (in the case of a customs union, not, on the whole, higher or more restrictive); and (c) interim arrangements leading to the free trade area or customs union are employed for only a reasonable length of time.

Thus member nations of WTO (former GATT) can form regional groupings without violating their legal obligations to WTO provided they satisfy the above three conditions. It is not easy to establish that a regional grouping has not eliminated trade barriers on "substantially all trade" among members or, the trade barriers against non-members are "on the whole higher or more restrictive" than those previously in effect or "reasonable length of time" has not been allowed for interim arrangements before a customs union or free trade area is formed. Besides, non members of WTO need not abide by any such conditions as indicated above.

It should also be noted that regional grouping is not the only mode of discrimination in international trade. Schemes such as Generalised System of Preferences (GSP) and voluntary export restraint (VER) arrangements are other forms of discrimination. It is not easy to categorically maintain that the trade blocs promote trade among member countries at the expense of trade with the rest of the world. The fact that intra-trade has grown significantly in respect of some regional groupings does not necessarily mean that, in the absence of the grouping, there would have been more extra-trade. For one thing, in most cases, the member countries of the regional groupings are geographically close to one another and, other things being equal, the geographical proximity itself would lead to more trade among them than with the outside world. Moreover, if the member countries enjoy more rapid economic growth, trade among them would grow more rapidly than with the rest of the world.

11.8 IMPACT

What is the impact/likely impact of regional groupings on exports of non-member countries, particularly the developing countries? What are the strategies, at the national and corporate levels, that one can think of to promote exports when regional groupings have not only become a fact of life but also appear to be growing in number? Let us learn the impact of regional economic groupings.

Trade Diversion: It is established that, increased intra-regional trade being the main objective of regional groupings, formation of groupings leads to "trade diversion" away from countries outside the grouping to countries within the grouping. In the case of the European Union, probably the most successful grouping of today, intra-trade accounts for

more than 60 per cent of the total trade as compared to about 30 per cent during the 50s. In the case of some groupings in Africa and South America, in particular LAIA, Andean Pact countries, CARICOM, ECOWAS and MERCOSUR, intra-trade has grown faster than trade with the outside world. Even in the case of the recently formed NAFTA, intra-trade has grown quite fast. However in the case of ASEAN and EFTA, the share of intra-trade in total trade has, in fact, declined or at best remained stationary over the last more than two decades. It is, perhaps, an indication of the success of the policies of some groupings, in particular the European Union, vis-a-vis other groupings in achieving their objectives. Table 11.2 below gives the share of intra-trade in the total trade of major regional groupings for selected years.

Table 11.2: Share of Intra-trade in the Total Trade of Major Regional Groupings for Selected Years during 1970-96

	1970	1980	1990	1993	1995	1996
EU (15)	59.5	61.0	66.0	61.2	62.0	60.4
EFTA (6)	18.1	14.7	13.5	11.4	11.5	11.5
NAFTA	36.0	33.6	41.4	45.4	46.2	47.3
CACM	26.0	24.4	15.3	14.2	14.1	15.3
LAIA	9.9	13.7	10.6	15.9	15.8	15.5
Andean Common Market	1.8	3.8	3.8	9.2	11.8	10.7
CARICOM	4.5	4.4	7.6	8.5	3.9	4.1
ASEAN	23.1	17.0	18.6	20.0	23.5	21.6
ECOWAS	3.0	10.2	7.9	8.6	11.4	11.0
MERCOSUR	9.4	11.6	8.9	17.5	18.3	19.6

Source: UN *Handbook of International Trade and Development Statistics,* 1997.

Trade Creation: Conceding that intra-trade has grown faster than extra-trade in the case of some major regional groupings, the question is whether there has been at least reasonable growth in the imports of these regional groupings from outside world. The European Union, perhaps, is again a good example in this context. While there is, no doubt, that, between 1958 and 1996, the share of intra-trade in the total trade of the Union has grown from about 30 per cent to more than 60 per cent, it is also a fact that extra-EU imports have grown substantially during the same period, from ECU 24 billion to ECU 579 billion, i.e. more than 20 times in a period of slightly less than four decades. Hence one can conclude that the benefits of the "trade creation" effects of the regional grouping have flowed to non member countries. However, it is noticed that, as far as most of the developing countries are concerned, the benefits have not very much influenced the composition of their export basket because the share of the developing countries in the extra-EU imports of manufactures is not significant. For instance, inspite of substantial imports of engineering goods by the European Union, India's share in the total EU imports of this group of items is not even 1 per cent. Thus, though the "trade creation" effects of the regional grouping, in the case of European Union, is probably apparent, it is confined, by and large, to primary products at least in the case of developing countries and value added items have not benefited much. Considering the problems of primary goods exporters and the attempts being made by almost all the developing countries to promote exports of manufactured items as much as possible, growing imports of primary goods by a regional grouping may, after all, not be of much benefit to the developing countries.

Terms of Trade Effect: The demand growth, if it comes about as a result of trade creation effect, might mean better prices for the products exported by third countries leading to beneficial effect on the terms of trade of those countries. This, however, depends on the relative position of a third country is respect of a particular product in the regional grouping — whether it is a monopoly supplier or one amongst many or one amongst a few suppliers — the price and income elasticities of import demand, the price elasticity of export supply and the relative unit value of the products imported by the exporting country

Economies of Scale and Ease of Entry: One of the apparent implications of a regional grouping is increase in market size. Instead of a third country exporter dealing separately with each country with limited population or limited number of countries, he can deal with the entire grouping that is many times bigger than the country/countries he was earlier dealing with. This has two implications. One is that the size of the export order is likely to be considerably large with the attendant benefits of increased sales and scale of economies. Secondly, if he is able to enter one country in the region on the basis of one approval of one set of documents by one set of authorities, it can safely be assumed that he will be able to reach his products to other countries in the grouping with practically no restriction after the first point, of entry. However, it is also true that if his products are rejected at the first entry point he will not be able to enter any other country in the grouping through any other entry point. But more than this, the greatest limitation that will probably be faced by many developing countries relates to supply constraints. Having used to catering to small sized markets, many exporters from developing countries may not find it very easy to execute large sized orders emanating from the regional markets, due to supply constraints, particularly within a limited period.

Mergers & Acquisitions: Flowing from the above is the fact that the bargaining power of the exporter from a developing country may be somewhat weakened since he may have to deal with a more powerful importer who now controls more markets than in the past. This problem becomes more acute when one considers the corporate mergers and acquisitions taking place/likely to take place in the regional groupings to take advantage of the regional market as against the former country-wide market. It is a documented fact that in the European Union, cross border merger and acquisition deals have grown in recent years and are growing.(Between 1986 and 1995, the number of mergers and acquisitions between European Union firms has increased from 720 to 2296 in industry and from 783 to 2602 in services — EC, *Panorama of EU Industry, 1997*, Vol.I). These mergers and acquisitions mean that, while on the one hand, there is no certainty of the exporter from a third country bagging the order because this may largely be determined by the relative strengths of the parties to the merger, it may also affect the bargaining power of the exporter, to a considerable extent, on the other, because he will find himself dealing with a stronger party in terms of size of operation. This problem assumes greater significance when one considers the supply constraints faced, generally, by many developing countries when they are called upon to execute large orders.

Increased Competition: Regional groupings definitely mean more competition both from within and outside the region. From within the region, companies will have the benefit of larger size orders leading to reduced unit cost and, from outside the region, the sheer enlargement of the size of the market is incentive enough for companies to intensify their efforts to penetrate the regional market. In this, the present and former linkages of a third country with one or more of the countries in the region will play a significant role.

Reduction in Marketing Costs: Perhaps one of the positive developments of regional groupings is reduction in marketing costs as far as homogeneous/standardised products are concerned. However, in personalised items such as garments and shoes, this advantage will not be available.

Impact of FDI Flow: It is generally believed that a regional grouping, to the extent it leads to increased propserity among members of the region, will mean increased foreign direct investment (FDI) outflow. However, while a richer region might mean more funds available for overseas investment, it also means that, because of its prosperity, the region itself becomes an attractive soil for investment not only for local investors but for outsiders also. It is also a fact that in each regional grouping, all countries are not at the same stage of economic development, and there are more developed and less developed countries within each region. Hence there is always a possibility that, while, on the one hand, increased propserity of the region means greater availability of funds for investment, on the other, it

also means that the funds are more likely to be invested in the less developed countries within the region rather than outside the region both by local investors and investors from outside. Thus, for a country outside the grouping, attracting private investment from a regional grouping will depend more on its policies, procedures and climate relating to FDI vis-a-vis the countries in the grouping. Emperical evidence has established that, atleast in the case of the European Union, large funds from within and outside are flowing into the less developed countries in the Union. (EU absorbed 44% of global foreign investment flows in the early 90s, as against 28% in the mid 80s — EC, *Panorama of EU Industry 1997*, Vol I.)

11.9 STRATEGY

Under the above circumstances, what should be the strategy followed by India at the national level and at the corporate sector level ? Not much may be served by voicing concerns about the increasing trend towards formation of regional groupings: it may not be possible to get the trend reversed. Regional groupings appear to have come to stay, atleast for the time being. Hence, India's strategy should aim at taking advantage of the positive aspects of the development and reducing, to the extent possible, the negative impact. In this context, the following are worth consideration:

Product wise strategy: Attempts should be made to derive maximum benefit arising out of the trade creation effects of regional groupings i.e. a clear identification of items that are likely to be continued to be imported from third countries by each grouping should be made and appropriate strategies devised, both at the national and firm levels, for effective marketing of such items. In respect of standardised items with large demand, all constraints on production and marketing of such items should be removed through appropriate policy and procedural adjustments. The corporate sector, on its part, should aim at promotion of standardised items on mass scale through appropriate marketing strategies through collaboration arrangements/strategic alliances, if necessary, with local firms. In the case of personalised items, where the market segment may not be very large, a strategy of niche marketing is likely to yield better results. Simultaneously, efforts should be made to meet the small volume requirements of the region in which local firms may not be very much interested possibly on account of the small size of the order.

Market Segmentation Strategy: The conventional technique of countrywise market segmentation may need to be replaced by regionwise market segmentation, particularly for promoting sales of standardised products and products of mass consumption and appropriate regionwise marketing strategies may have to be developed.

Entry Strategy: Considering the fact that, in a regional grouping, when a product enters one country, it can be reached to other countries in the grouping with practically no restriction after the first point of entry, a successful strategy to step up exports would call for the Indian corporate sector identify relatively easier entry points in respect of each regional grouping and attempt to enter the more difficult markets in the grouping through the first point of entry.

Strategic Alliances: Cross border mergers and acquisitions have grown in regional groupings taking into account the likely increase in market size. The Indian corporate sector should also evolve an effective strategy of strategic alliances with firms in the region to take advantage of the local presence of the latter to promote its products. At the policy level, positive support should be extended to such a strategy.

FDI Strategy: Since the size of the regional grouping and the possible impact of integration on the prosperity of the grouping are likely to attract investment, both from within and outside, to the grouping, particularly to the less developed among the member countries, suitable adjustments in FDI policies and procedures are warranted to make India as attractive as, if not more attractive than, the regional grouping.

Check Your Progress B

1) What do you mean by Most Favoured Nation treatment?

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2) What is trade diversion?

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3) Distinguish between trade diversion & trade creation.

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4) What is terms of trade effect?

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5) Are the following statements **True** or **False**?

i) There is no special article in WTO (former GATT) dealing with customs unions and free trade areas.

ii) Regional grouping is the only known mode of discrimination in international trade.

iii) It is certain that terms of trade of third countries will improve when they export to regional groupings.

iv) The formation of the European Union has encouraged cross border mergers and acquisitions.

v) There is need to adopt a different market segmentation strategy rather than a country wise market segmentation strategy to deal with regional groupings.

11.10 LET US SUM UP

Formation of regional groupings has undoubtedly been one of the significant developments that has taken place in the global economic scenario since the end of the second world war. Regional groupings take several forms ranging from the simple preferential trading arrangement to the most comprehensive economic community; in between fall free trade area, customs union and common market. Whatever may be the form and nomenclature, all the arrangements favour intra-trade. Many factors seemed to have contributed to the formation of regional groupings; thus the political motive of reducing the chances of military conflict among the European nations played an important role in the creation of ECM; dissatisfaction with the progress of the process of trade liberalisation at the global level, eagerness to exploit the advantages of geographical proximity and sheer self defence motivation are some of the factors contributing to emergence of regional groupings in such significant number.

It is not easy to categorically maintain that either regional arrangements violate the legal obligations under WTO or regionalism has replaced free trade by discriminatory trade. Though, MFN principle means non discrimination, exceptions are permitted and it is not easy to prove discrimination. Moreover, there are other modes of discrimination, such as GSP, operating in international trade. As far as the argument that regional groupings have tended to promote more intra-trade at the expense of extra-trade is concerned, it is extremely difficult to establish that in the absence of a regional grouping, the normal trade growth among member countries would not have been as high as that in the intra-trade.

The impact of regional groupings on the export of third countries is likely to be both positive and negative. While the trade diversion effect will mean loss of market, the trade creation and terms of trade effects will mean possible benefits to third countries: similarly enlargement of market size may mean both advantage and disadvantage; the impact on FDI flow also has its positive and negative sides.

Given the situation, the Indian policy makers and the corporate sector should adopt appropriate strategies to take advantage of the positive aspects of regional groupings and try to limit, to the minimum, the harmful effects of the negative aspects. A clear identification of the products in demand in the groupings and formulation of appropriate strategies to market them, market segmentation on a regional basis than on a country basis, gaining entry into the regional market through the softest entry point and entering into strategic alliances with local parties are some of the options available to the Indian corporate sector.

11.11 KEY WORDS

Preferential Trading Arrangement: An arrangement under which the member countries lower barriers to imports of identified products from one another.

Free Trade Area: A trade bloc of countries where barriers to trade in respect of all items among member countries is eliminated, while each member country is permitted to follow its own policy in regard to trade with non member countries.

Customs Union: A trade bloc where member countries, apart from eliminating all restrictions on trade among themsevels, also follow a common policy in regard to trade with non member countries.

Common Market: A regional grouping, which eliminates all barriers to movement of all factors of production between member countries.

Economic Community: A regional grouping, where member countries follow common policies in respect of all economic matters.

Intra-trade: Trade among members of a regional grouping.

Extra-trade: Trade of the regional grouping members with countries which are not members of the grouping.

South-South trade: Trade among developing countries.

Trade Diversion: A situation where, as an outcome of the formation of a regional group-ing, trade with non member countries is diverted to member countries.

Trade Creation: A situation where, the formation of a regional grouping leads to increased prosperity of the member countries and, in turn, it gets reflected in the increased trade with non member countries.

Merger: A situation where two or more firms join together and form a single firm.

Acquisition: A situation where one company takes over one or more other companies.

Market Segmentation: Dividing a market into various homogenous parts on the basis of some common attributes.

11.12 ANSWERS TO CHECK YOUR PROGRESS

A4	i) False	ii) False	iii) False	iv) False	v) True
B5	i) False	ii) False	iii) False	iv) True	v) True

11.13 TERMINAL QUESTIONS

1. Trace the history of various developments since the second world war culminating in the formation of different types of regional groupings.
2. An Indian firm has been exporting leather garments to USA since the 80s. Now that USA has formed the North American Free Trade Area (NAFTA) with Canada and Mexico, what will be the impact of this development on the export prospects of leather garments of the Indian firm? Explain your answer.
3. How could an Indian firm take advantage of the positive aspects of a regional grouping to step up its exports?
4. What is the rationale of Regional Economic Groupings? Do you think that grouping may be beneficial for India.
5. What is multilateralism? Explain the impact of Regional Economic Groupings.

UNIT 12 INTERNATIONAL COMMODITY AGREEMENTS

Structure

12.0 OBJECTIVES

After going through this unit, you should be able to :

- explain the trade in primary commodities
- describe the importance and special problems of commodities specially of those of interest to developing countries in the international market;
- discuss the role and significance of international commodity agreements in coping with special problems of commodities;
- explain the efforts of the United Nations Conference on Trade and Development to solve the problems of commodities; and
- discuss major international commodity agreements.

12.1 INTRODUCTION

Commodities are defined as those products which have undergone either little process or value additon. Thus these commodities remain in the original shape. Hence, they are also known as primary products. These commodities constitute major chunk of exports of developing countries. Thus, developing countries face innumerable problems in the trade of Primary Commodities. This unit explains the features of trade in the primary commodities, the factors affecting the demand for Primary Commodities, role of UNCTAD in solving the problems related to commodities and the major International Commodity Agreements.