Titanic FTAs: Is this time to establish Pan-Asian FTA?

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I. Context and Objective

It is fast becoming an important question as to what role can potential Pan-Asian Free Trade Agreement (PAFTA) play in the era of titanic regionalism with the new-incarnation regional dinosauric blocs, namely the Enlarged European Union (EEU) and the Free Trade Area of the Americas (FTAA) already in place. Would the Dinosauric Blocalisation help or thwart the multilateral values cherished in the WTO?

Further, why should one need to worry about if the multilateralism is being, somehow, simultaneously kept partly alive through the vehicle of the World Trade Organisation (WTO)?

Finally, why should there be any argument on issues relating to the regionalism versus multilateralism when the former is permitted under Article XXIV of the GATT?

It is in this context that we would like put forward an unpretentious hypothesis to be tested in the present paper: *South Asian Free Trade Agreement (SAFTA) can matter in the overall scenario of international trade relations simmering through diverse diction and camouflages in the name of the regional trading arrangements (RTAs)*. The only condition we put is that *the SAFTA should, at a declared later date, graduate into open or autonomous trade liberalisation through accepting the two basic pillars of the WTO, namely the most-favoured nation (MFN) clause and the national treatment (NT) for trade with non-members of SAFTA.*

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Let us make our stand clear. We shall not argue against or in favour of the *multilateralists* or the *regionalists* and would let them make and break each other's arguments as well as ours. We shall talk about evolution of a Pan-Asian Free Trade Agreement (PAFTA). The PAFTA in our discussion is an *open* response to the ongoing *Dinosauric Blocalisation* by the EU and the Americas. In the present paper, we are deliberating about the likely evolution of the third *Dinosauric Bloc* whose constellation would be *openly benign* in its trade relations with the two other *Dinosauric Blocs* as well with other humbler RTAs and even to the countries not belonging to any of the RTAs.

The establishment of the SAFTA can make the beginning. We assume that these blocs would eventually become multilateralism-friendly and adhere to the MFN and NT within the GATT and the WTO.[1]

In the year 2000, the three regions encompassing EEU, FTAA and PAFTA accounted for more than 90 per cent of the income generated in the world, more than 85 per cent of world exports of goods and services, and more than 75 per cent of the world population.[2] While the FTAA countries accounted for about 40 per cent of the income generated in the world, the corresponding figure was 26 per cent each for the EEU countries as well as for the PAFTA countries. However, it was mainly the PAFTA countries, which carried the burden of population with about 55 per cent of the world population residing in these countries. The corresponding share was 13.4 for the FTAA and 7.4 for the EEU countries. The shares of world exports of

[1] The hypothetical PAFTA would include 23 Asian countries from South and East Asia including China, Japan, Australia and New Zealand.

[2] The source for the figures quoted in this paragraph is the *World Development Indicators (WDI) 2002*, the World Bank.

goods and services were relatively evenly distributed with 38 per cent contribution from the EEU countries, 25 per cent from the PAFTA and 23 per cent from the FTAA countries.

The income distribution in the year 2000 was highly skewed across regions of the world. The average per capita income in the EEU countries was $18,003 in 2000 and $15,253 in the FTAA countries. The corresponding figure was $2,421 in the PAFTA countries. While about 93 per cent of the people in the PAFTA were below the per capita income of $9266, more than 98 per cent of the people in the EEU countries and more than 82 per cent of the people in the FTAA were above it.[3] About 50 per cent people in the PAFTA countries were in the low-income category. The corresponding figure was below 2 per cent in the FTAA countries and zero in the EEU countries.

The main objective of this paper is to analyse the impact South Asia forming a free trading agreement, and eventually, of undertaking autonomous trade liberalisation. It also attempts to analyse hypothetical welfare impacts when more and more countries of South Asia gradually join the Asian FTA. The analysis would be conducted both under preferential PAFTA as well as under PAFTA that embraces autonomous or open trade liberlisation at a later date.

II. Multilateralism versus Regionalism[4]

Like the *chicken and the egg* inquest, the debate on multilateralism versus regionalism seems to be endlessly assiduous. It is generally though not universally accepted that that the

[3] High income: US$ 9266 and above; Upper middle income: US$ 2996-9265; Lower middle income: US$ 756-2995; Low income: less than or equal to US$ 755 (see WDI 2002, the World Bank).

[4] We found no logic for writing the debate title either as *'regionalism versus multilateralism'* or *'multilateralism versus regionalism'*. We have, therefore, adopted the superiority of *alphabeticism*.

multilateralism is the *first best*. It is the *weak functioning* of this system that has lead to the *growing regionalism* around the world. Yet there seems to be no conclusive note on strengthening multilateralism except for the lip service generally paid by the WTO members during its meetings only to go back and get increasingly involved in their respective regional pursuits.

The debate on regionalism versus multilateralism, which started vigorously during the early 1990s, continues to be topical. Concerns have been expressed whether preferential trade agreements (PTAs) improve the welfare of member countries and the world as a whole.[5] There appears to be no common agreement on whether the proliferation of PTAs will accelerate or retard the process of global trade liberalisation. Bhagwati (1993) and Krueger (1993), among others, argue that the spread of PTAs poses a threat to the world trading system through their adverse welfare effects on certain member countries as well as through slowing down of trade liberalisation. Others like Summers (1991) and Krugman (1991) tend to believe that the FTAs are likely to improve welfare and serve as `building blocs' for global trade liberalisation.[6] Some interesting literature has evolved during the 1990s on the issues involved on the question of regionalism.[7] Though multilateralism has been agreed upon as being the 'first best', there is yet no conclusive answer to the issues of regionalism versus multilateralism.

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[5] We use RTAs, PTAs and FTAs as synonyms in this paper. A generic name can be regional integration agreements (RIAs). See Panagariya (1999).

[6] Yang, Yongzheng, Ron Duncan and Tony Wilson (1998) Chap 7 in Drysdale and Vines (eds), Europe, East Asia and APEC, Cambridge University Press.

[7] See Panagariya (1999) and Krueger (1999) for a discussion and overview of this literature. ((page 12, IIE, New RTAs by Scollay and Gilbert(2001)).

Two criteria are generally used for assessing whether RTAs qualify as `building blocs' or `stumbling blocs' for a more open international trading system.[8] Firstly, the formation of a RTA should enhance economic welfare of its members as well as global economic welfare, while avoiding negative effects on the welfare of non-member countries. Secondly, RTAs should leave open scope for the negotiation of further arrangements satisfying the first criterion as well as for further progress toward global free trade via multilateral liberalisation. However, it appears to be a complicated and accident-prone route to achieving the `first best'. It is difficult to forecast `conjectural reactions' of the non-member countries as well as other FTAs to the formation of a new one. The likely casualties might lead to divergence from rather than convergence to the scenario of multilateral liberalisation.

Certain exceptions to the MFN principle are permitted under Article XXIV of the GATT Agreement. Countries may enter bilateral or regional agreements if they eliminate "duties and other regulations of commerce" on "substantially all trade" among themselves. A free trade agreement is likely to be negotiated between governments as a response to political pressures from industry-specific interests and also with some attention paid to the plight of a general voter. The phrase "substantially all trade" under Article XXIV has been interpreted to allow some latitude in the formation of a FTA. Regional and bilateral trade agreements typically exclude some politically sensitive sectors and specify prolonged phase-in periods for some others. Each government would attempt to exclude certain sectors whose inclusion would impose relatively high political costs. "Thus the conditions that enhance the viability of a potential agreement also raise the likelihood that the agreement would reduce aggregate social welfare."[9] However,

[8] See Scollay and Gilbert, New RTAs in the Asia-Pacific? IIE, pp15-16.

[9] Grossman and Helpman, 2002, Interest Groups and Trade Policy, Princeton University Press, pp202.

because the enthusiasm for regional arrangements is still strong, it is important to make an attempt to minimise the adverse effects of FTA formation. A good alternative is to ensure that a FTA has well-defined deadline when the mutual concessions within a FTA would be made available to all other WTO trading partners on MFN basis.[10]

International economic and trade scenario appears to have reached the crossroads of chaos and confusion with regard to issues relating to regionalism versus multilateralism. While the advocates of regional arrangements view them as stepping stones towards freer trade, believers of multilateral discipline argue that such arrangements detract from the liberalisation and fragment the global trading system. A new wave of regionalism started showing up since the mid-1980s with the United States, disappointed with the progress of multilateral discipline, converting from a multilateral approach to a dual multilateral-regional combine. However, with the Uruguay Round having been successfully concluded, the rationale of the United States to simultaneously promote preferential regional agreements has now disappeared (Panagariya, 1999).

The final goal of trade policy should be to minimise restrictions on the flow of trade across all countries. Reduction in trade restrictions leads to gains in efficiency. However, the experience during the last five decades has been varied. Though the rules of multilateral trade were written in the original GATT, the paradox, however, lies in its self-defeating Article XXIV, which promotes regional trading arrangements. Some critics find the idea of adherence to most-favoured nation (MFN) principle to be incompatible even with open regionalism. Thus, Srinivasan (1997) comments, “if regionalisation is to be extended on the same time table ‘in

[10] Panagariya and Srinivasan (pp2235-37) in Bhagwati and Hirsch: *The UR and Beyond*, Dunkel Honour, 1998.

practice and in law' to non-member countries on an MFN basis, it would be multilateral and not regional. If that is the case, why would any group initiate it on regional basis in the first place?"

We also have another school of thought arguing that bilateral and multilateral strategies are mutually exclusive. "The very instruments of the GATT/WTO's progress – its growing membership, active dispute settlement, and frequent trade negotiations – encourage states to seek bilateral options to secure the greatest possible benefits from the multilateral regime" (Mansfield and Reinhardt, 2002).

On June 16, 2003, less than three months before the Cancun Ministerial, the Director General of the WTO spoke in the opening session of a Symposium on the "Challenges Ahead on the Road to Cancun". He pointed out to the growing global uncertainty and profound challenges to multilateralism. The Doha negotiations offer governments an opportunity to demonstrate renewed commitment to multilateral cooperation and shared responsibility for addressing problems such as poverty and unemployment. These problems are closely linked up with the issues of international security and stability. Though, the Director General felt encouraged with positive hopes for successful culmination of the DDA yet he warned that the Round could face gridlock unless focused political energy was applied to avert it. He pointed out that the missed deadlines on TRIPS and health, special and differential treatment, implementation-related issues, agriculture, and market-access in non-agricultural products were serious issues. He had some words of praise for positive response in the negotiation process being observed through increasing interest from senior officials and trade ministers of the members.

The competitive regionalism and bilateral deals are rapidly putting the most-favoured nation (MFN) principle on the back burner. The newly created constituencies may resist further multilateral liberalisation (Curtis and Ciuriak, 2003). There is an increased activity on the regional and bilateral fronts. As of May 5, 2003 a total of 184 RTAs were in force under notification to GATT/WTO. These included 136 RTAs notified to the GATT/WTO on and after January 1, 1995.[11] These included 19 RTAs under the "enabling clause", 26 under the "GATS Article V" and 139 under the "Article XXIV". While 6 out of the 19 RTAs under the "enabling clause" were notified on or after January 1, 1995, the corresponding numbers for the RTAs formed under the "Article XXIV" were 103 out of 139. All 26 RTAs under GATS were obviously notified on or after January 1, 1995 since the birth of GATS coincides with that of the WTO. It really surprising to note that there have been 26 RTAs already signed under the GATS Article V while very little liberalisation has actually been achieved under the multilateral negotiations.

The befuddlingly complex series of overlapping deals, each with its own pattern of preferences, schedules and exclusions, undoubtedly adds to the political and technical difficulties of negotiating a multilateral WTO deal. It makes it less likely that governments will even try. The leaders around the world must stop, think and then react to save the DDA, which still may be a possibility even though remote.

Countries across the globe are competing with one another to enter into one or the other bilateral and/or regional trade agreement. The benefit-cost analysis of expenditure incurred on such negotiations is regressive with the smaller countries losing relatively bigger chunk out of the total pie of government expenditure. The industrialised countries can well afford the luxury of maintaining a galaxy of experts dealing with issues of respective national interests both at the regional as well as the multilateral platforms. On the contrary, the developing and even the underdeveloped countries are easy targets for being lured into the gamut of playing regional

[11] Source: WTO website accessed on June 27, 2003: http://www.wto.org/english/trat_e/regions_e/provision_e.xls

games. In fact, they can ill afford to undertake any meaningful work on its pros and cons. Moreover, most of these countries also have to afford their embassies in Geneva for participating in the multilateral agreements. There is every possibility that these countries might not actually get any significant benefits, matching with the costs incurred, through their participation in the dual games of international trade. On the contrary, the rich countries armed with results of plenty of homework done may well afford their costs due to much larger potential gains to be reaped in this dual game. Thus, the developing countries might end up sharing the R&D expenditure being incurred by the developed countries. Nor should one get mesmerised by the aid given by the developed countries to the developing ones in the name of "capacity-building". Many a time such aid may actually be investment by the donors to trap the receiving countries into what the developed countries believe as being good for the developing countries.

III. Emerging Tripolar World: The Issue of Leadership

Quandary appears to be the order of today's world trade scenario. Hence there arises an important question. What are the necessary ingredients of the world trading order? A short but hardly enlightening answer is *leadership*. The world trading system appears to be in dire need of *leadership*. The stakes are high with the very sustainability of the rule-based multilateral system is apparently in danger (Ostry 2002). The WTO needs an urgent reform but only if its members are willing. Are they? Who is the *leader*?

With the United States and the EU being engrossed in their respective *dinosauric regional* efforts, the hopes that the DDA would lead to successful multilateral trade liberalisation have gradually been fading away. Such pessimism has further been reinforced by the missed deadlines within the WTO agreements. Other countries and the regions of the world are also displaying their *regional* wits to the best of their capabilities. These include Asian countries of China, Japan, Singapore, Thailand, India, Sri Lanka, the ASEAN and many other countries. We make a modest, novel, and may be even astounding proposition in this paper. *Let us, the peoples of South Asia take this lead.*

Though this may appear to be a remote possibility, we would attempt to convince the people in Asian region about the positive aspects of formation of the SAFTA and then *PAFTA*. We are ready for the brickbats on account of such a seemingly controversial proposition. However, this does not reverse our disposition since we view it as a corrective measure to resolve the bizarre developments in the world trade scenario ever since the conception and birth of the WTO.

The possibility of the world trade environment turning into a tripolar system is fast becoming certain. The recent developments under the FTAA and the EU enlargement are expected to lead to an East Asian or even an Asian bloc. It is difficult to assess implications of tripolar trading world on the multilateral values. Each of the three *dinosauric blocs* may have strong incentives to aggressively pursue the enhancement of its own welfare at the expense of the other two blocs. Further, any two blocs may collude to defeat the ambitions of the third. On the contrary, it is also conceivable that the existence of three large blocs may accentuate multilateralism through an expectation that each of the three blocs would have interest in maintaining the effectiveness of the WTO (Scollay 2002). This would at least ensure a lot more work for economists, politicians and bureaucrats.

Let us now turn our attention to the three *dinosauric blocs* currently in making. As mentioned earlier, these include the FTAA, EU Enlargement and East Asia Trade Bloc. South Asia has been playing its own little regional game SAFTA. The emerging *dinosauric aspirations* within the

Asian region have also been discussed. Two of the recent events have contributed further to this debate. The first refers to the “Expert Group Meeting on the Regional Agreements in Asia and the Pacific” held in Bangkok in January 2003 under the auspices of the *Economic and Social Council for Asia and the Pacific* (ESACP). The second refers to the International Conference on “Building New Asia: Towards an Asian Economic Community” held in New Delhi in March 2003 under the auspices of the *Research and Information System for the Non Aligned Countries* (RIS), India. Other collaborating institutes were the Malaysian Institute for Economic Research (MIER), Malaysia, the Centre for Strategic and International Studies (CSIS), Indonesia and the Sasakawa Peace Foundation (SPF), Japan.

The ESCAP 2003 Meeting discussed the possibility of the regional cooperation among the *ASEAN+3* (China, Japan and South Korea). It was suggested that though inconceivable, the *ASEAN+ 3+ SAARC+ESCAP* could provide leadership to the Asian regionalism, which is both necessary and desirable to augment and complement multilateralism. It has been stated that the role of big states, namely India, China and Japan in Asian regionalism is a natural presumption. A cautionary note was also added: “But too much self-serving, politically motivated regionalism would be harmful to multilateralism, not that unifying ESCAP-SAARC-ASEAN+3 is any mean or even manageable feat. Any integration should be economic and market-driven as it is neither desirable nor conceivable for the kind of political economy and deep integration witnessed in the EU” (Low, 2003).

The International Conference organised by the RIS rightly observed that the trading blocs in Europe and North America have led to substantial diversion of trade and investment and have become an important factor in shaping the patterns of location of production and comparative advantage. It also observed that the Asian countries had been pursuing multilateralism in their trade and investment, except for the ASEAN and the SAARC. However, it is time now for Asia to recognise the importance of regional economic integration (Kumar, 2003). The Conference deliberated on the likely formation of a novel RTA named the **JACIK** (Japan, ASEAN, China, India and Korea).[12] Exploitation of such RTA may help in exploitation of the mutual complementary advantages and that the experience of the APEC has not been good due to the lack of enthusiasm by the member countries to liberalise without any reciprocity.

Using a CGE-based analysis, it has been concluded that the JACIK FTA "may be welfare enhancing for all countries in the region" (Kumar et al, 2003). Though it concludes that such "regional economic liberalisation also enhances global welfare" but is silent on whether this increase is due increased welfare of the JACIK countries. What happens to the welfare of the countries/regions, which are not the members of a newly proposed JACIK FTA?

IV. Let South Asia Openly Take A Global Leap Forward: Catalyse Creation of PAFTA

What happens to the fate of the small countries within the **FTAA, EEU**, **JACIK and ASEAN+3+SAARC+ESCAP**? Do they really know whether to join the process of such *dinosauric blocalisation* or not? Do they actually understand enigmatic issues relating to the forthcoming *Grand Agreements* along with issues relating to their existing liberalisation commitments within the WTO? Can they afford the pecuniary costs involved? Do they have the requisite resources? Are the bilateral donors not going to maneuver the "capacity building exercise" in their own interest or else not build the capacity? Would the regional initiatives, both

[12] Other SAARC member countries, except India, have not even been considered to join the proposed **JACIK** FTA even though the RIS has earlier championed for the cause of an active SAARC and SAFTA.

bilateral and plurilateral, not put pressure on whatever little intellectual capacity the small countries have away from multilateralism?

We are worried on account of the questions posed in the preceding paragraph. However, we believe that the relatively small sub-region of South Asia can provide a lead to resolve the ever-continuing conundrum of "multilateralism versus regionalism".

V. Computational Analysis of the PAFTA

As discussed in Section I, we are deliberating about the likely evolution of the third *Dinosauric Bloc*. The constellation of this bloc would eventually become *openly benign* in its trade relations with the two other *Dinosauric Blocs* as well with other humbler RTAs and even to the countries not belonging to any of the RTA. We include 23 countries of Asia in our conceptual exercise.

The establishment of the SAFTA can make the beginning. We then keep adding more Asian countries / regions to make the bloc wider. We assume that these blocs commence in a preferential manner, but, at a later date would become multilateralism-friendly thus adopting open or autonomous trade liberalisation and would adhere to the MFN and NT within the GATT and the WTO.[13]

In this section we analyse the impact of the likely formation of the PAFTA for trade in goods. We will use computable general equilibrium (CGE) model-based simulation analysis to assess the potential economic effects arising from the FTA formation. The computational experiments

[13] In our exercise, the hypothetical PAFTA would include 23 Asian countries from South and East Asia including Bangladesh, India, Pakistan, Sri Lanka, Nepal, Bhutan, Maldives, China, Brunei, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Thailand, Vietnam, South Korea, Hong Kong, Japan, Australia, and New Zealand. We can add more countries if needed in future exercise.

consist of simulating the economic effects of reduction of tariff barriers on trade across the member countries.

The Michigan BDS-CGE Model

The distinguishing feature of the Michigan Model is that it incorporates some aspects of the New Trade Theory, including increasing returns to scale, monopolistic competition, and product heterogeneity.[14]

The main data source is "The GTAP-6 Database" of the Purdue University Centre for Global Trade Analysis Project. The reference year for this database is 2001. It has 87 countries/regions and 57 sectors of production including 14 in agriculture, 4 in minerals and metals, 24 in manufacturing and 15 in services. We have concorded these into 12 sectors. The 14 sectors of agriculture have been aggregated into one agricultural sector, the 4 sectors of mineral products have been aggregated into one sector, the 24 sectors of manufacturing have been aggregated into 9 sectors, and the 15 sectors of services have been clubbed into one service sector. Thus we have one agricultural, one mineral and one service sector each. The nine sectors of manufacturing include food beverages and tobacco; textiles; wearing apparel; leather, wood and paper products; petroleum and products; non-metallic minerals; metal and metal products; motor vehicles and transport equipment; and other manufactures.

23 countries of Asia have been distributed among nine countries/regions. While India, Bangladesh, Sri Lanka, Pakistan, China and Japan have been taken as separate countries, the other 14 countries have been aggregated into three regions, namely ASEAN, NIEs and the grouping of Australia and

[14] For details refer to Lawrence and Chadha (2004). A complete description of the formal structure and equations of the model can be found on line at www.Fordschool.umich.edu/rsie/model/. Also see Brown, Deardorff and Stern (2001).

New Zealand (ANZ). Apart from Asia, other regions considered in our exercise include NAFTA, European Union, South America and all the remaining countries of the world included in "others".[15] Thus the 13 countries/regions included in our model exercise are Bangladesh, India, Pakistan, Sri Lanka, China, ASEAN, NIEs, Japan, ANZ, NAFTA, European Union, South America and "others".

Agriculture and service sectors are modelled as perfectly competitive and all the manufacturing sectors as monopolistically competitive with free entry and exit of firms.

The model is solved using General Equilibrium Modeling Package (GEMPACK), Version 8.0 (Harrison and Pearson, 2002). When policy changes are introduced in to the model the method of solution yields percentage changes in key variables of interest.

Salient Features of the BDS-CGE Model[16]

It is useful first to review the features of the model that serve to identify the various economic effects that are being captured in the different scenarios. This would help us explain and interpret the results of this exercise. Although the model includes the aforementioned features of the New Trade Theory, it remains the case that markets respond to trade liberalisation in much the same way that they would with perfect competition. That is, when tariffs or other trade barriers are reduced in a sector, domestic buyers (both final and intermediate) substitute toward imports and the domestic competing industry contracts production while foreign exporters expand. With multilateral liberalisation reducing tariffs and other trade barriers simultaneously in most sectors

[15] Pakistan data is not available separately in the GTAP database release 6. We have used the rest-of-South Asia as a proxy for Pakistan. The data for Bangladesh, India and Sri Lanka are available country-wise.

[16] See Brown, Deardorff and Stern (2001) for details.

and countries, each country's industries share in both of these effects, expanding or contracting depending primarily on whether their protection is reduced more or less than in other sectors and countries. At the same time, countries with larger average tariff reductions than their trading partners tend to experience a real depreciation of their currencies in order to maintain a constant trade balance, so that all countries therefore experience mixtures of both expanding and contracting sectors.

The effects on the welfare of countries arise from a mixture of these terms-of-trade effects, together with the standard efficiency gains from trade and also from additional benefits due to elements of the New Trade Theory. Thus, we expect on average that the member countries would gain from mutual liberalisation, as resources are reallocated to those sectors in each country where there is a comparative advantage. In the absence of terms-of-trade effects, these efficiency gains should raise national welfare measured by the equivalent variation for every country, although some factor owners within a country may lose, as will be noted below. However, it is possible for a particular country whose net imports are concentrated in sectors with the greatest liberalisation to lose overall, if the worsening of its terms of trade swamps these efficiency gains.

On the other hand, although the New Trade Theory is perhaps best known for introducing new reasons why countries may lose from trade, in fact its greatest contribution is to expand the list of reasons for gains from trade. It is these that are the dominant contribution of the New Trade Theory in our model. That is, trade liberalisation permits all countries to expand their export sectors at the same time that all sectors compete more closely with a larger number of competing varieties from abroad. As a result, countries as a whole gain from lower costs due to increasing returns to scale, lower monopoly distortions due to greater competition, and reduced costs and/or increased utility due to greater product variety. All of these effects make it more likely that countries will gain from liberalisation in ways that are shared across the entire population.

In perfectly competitive trade models such as the Heckscher-Ohlin Model, one expects countries as a whole to gain from trade, but the owners of one factor – the “scarce factor” – to lose through the mechanism first explored by Stolper and Samuelson (1941). The additional sources of gain from trade due to increasing returns to scale, competition, and product variety, however, are shared across factors, and we routinely find in our CGE modelling that both labour and capital gain from liberalisation. That is often the case here.

In the real world, all of these effects occur over time, some of them occur quicker than do others. This model is however static, based upon a single set of equilibrium conditions rather than relationships that vary over time. Our results therefore refer to a time horizon that is somewhat uncertain, depending on the assumptions that have been made about which variables do and do not adjust to changing market conditions, and on the short- or long-run nature of these adjustments. Because our elasticities of supply and demand reflect relatively long-run adjustments and because we assume that markets for both labour and capital clear within countries, our results are appropriate for a relatively long time horizon of several years – two or three at a minimum.

On the other hand, this model does not allow for the very long-run adjustments that could occur through capital accumulation, population growth and technological change. Our results should therefore be thought of as being superimposed upon longer-run growth paths of the economies involved. To the extent that these growth paths themselves may be influenced by trade liberalisation, therefore, our model does not capture that.

As a result of trade liberalisation, there are changes in member and non-member countries' terms of trade that can be positive or negative. Those countries that are net exporters of goods with the greatest degree of liberalisation will experience increases in their terms of trade, as the world prices of their export rise relative to their imports. The reverse occurs for net exporters in industries where liberalisation is slight - perhaps because it already happened in previous trade rounds.

Computational Scenarios

The database under use provides us with an approximate picture of what the world looked like in 2001.[17] The impact of open preferential trade arrangement within the South Asia and between the South Asia and other Asian regions would be analysed through the use of CGE model by simulating the possible elimination of import tariffs. For the sake of brevity, we would not enter into the impact of Uruguay Round Agreement though we have discussed the same elsewhere.[18]

We undertake six alternative simulation scenarios for the formation of the Asian dinosauric bloc, namely SIM_1 through SIM_6. Each experiment is run on preferential as well MFN basis. We explain our simulation scenarios as given below.

SIM_1: The four major South Asian countries, namely Bangladesh, India, Pakistan and Sri Lanka, mutually eliminate their import tariff barriers with one another while maintain the existing ones on imports from all other countries/regions (SAFTA). This is preferential SAFTA trade liberalisation. An alternative simulation is then run assuming that each of the four major SAFTA countries eliminates its import tariff barriers unilaterally for imports from other SAFTA

[17] Global Trade Analysis Package (GTAP), Release 6.
[18] See Chadha et al (2003).

countries as well as from all other countries/regions of the world. This is open or autonomous SAFTA trade liberalisation based on the MFN principle.

SIM_2: Both the experiments under SIM_1 are now run with China as the fifth country /region of the expanded SAFTA-China bloc.

SIM_3: Both the experiments under SIM_2 are now run with ASEAN as the sixth country /region of the expanded SAFTA-China-ASEAN bloc.

SIM_4: Both the experiments under SIM_3 are now run with NIEs as the seventh country /region of the expanded SAFTA-China-ASEAN-NIEs bloc.

SIM_5: Both the experiments under SIM_4 are now run with Japan as the eighth country /region of the expanded SAFTA-China-ASEAN-NIEs-Japan bloc.

SIM_6: Both the experiments under SIM_5 are now run with ANZ as the ninth country /region of the expanded SAFTA-China-ASEAN-NIEs-Japan-ANZ bloc. This expanded hypothetical bloc is referred to as PAFTA in the present study.

VI. Computational Results

Tables 1 to 12 report various economy-wide changes for each of the countries / regions of the model under the six simulation scenarios. These tables report changes in welfare, imports exports and welfare in millions of dollars, and changes in terms of trade, welfare, real wage rate and real return to capital in percentages. The terms-of-trade is the world price of a country’s exports relative to its imports. The equivalent variation is the amount of money that, if given to the country’s consumers at initial prices, would be equivalent in terms of their level of welfare to the effects of the assumed liberalisation. In general, as discussed above, a worsening (fall) in a country's terms of trade has an adverse effect on its consumers' welfare. But this can be outweighed by the other gains from trade due to increased economic efficiency and the other benefits modelled by the New Trade theory.

The sectoral results are reported in **Tables 13 to 28**. We provide sectoral results only for **Simulation 1** *(SAFTA)* and **Simulation 6** *(PAFTA)***.**

Table 1 provides percent changes in welfare on all the countries/regions under preferential regionalism. The corresponding changes under autonomous trade liberalisation are given in **Table 2**. The corresponding dollar value terms are given in **Tables 3 and 4**. The absolute changes in imports are provided in **Tables 5 and 6** and exports are in **Tables 7 and 8**. The percent changes in real returns to labour are provided in **Tables 9 and 10** and to capital in **Tables 11 and 12**. While **Tables 1, 3, 5, 7, 9 and 11** refer to preferential trade liberalisation scenarios. **Tables 2, 4, 6, 8, 10 and 12** refer to autonomous trade liberalisation scenarios.

Simulation 1 sectoral results are provided in **Tables 13 to 20**. These Tables provide sectoral changes for the four South Asian countries (India, Bangladesh, Sri Lanka and Pakistan) under preferential regionalism **(Tables 13 to 16)** and autonomous trade liberalisation **(Tables 17 to 20)**.

Simulation 6 sectoral results are provided in **Tables 21 to 28**. These Tables provide sectoral changes for the four South Asian countries (India, Bangladesh, Sri Lanka and Pakistan) under preferential regionalism **(Tables 21 to 24)** and autonomous trade liberalisation **(Tables 25 to 28)**.

Results of Simulation 1: Preferential versus Open SAFTA

The preferential liberalisation through the removal of import tariff barriers among the South Asian countries results in benefits to all four countries of south Asia under study. The equivalent variation (welfare) increases by 0.5 per cent for Bangladesh, 0.4 for India, 1.2 for Pakistan and 1.6 per cent for Sri Lanka.[19] The corresponding dollar value changes in welfare are given in Table 3. While the South Asian countries gain about $3.2 billion in terms of increased welfare under preferential liberalisation, the world's gains are about $2.7 billion since the welfare of non-members of SAFTA declines. In the case of autonomous trade liberalisation, South Asia gains five times, i.e. by $16.5 billion and the global gains are nearly 21 times at $56.4 billion. Clearly it is a win-win game for all.

While real returns to labour increase for all the four countries of SAFTA (Tables 9 and 10), real returns to capital take a dip for Bangladesh in the case of autonomous liberalisation (Tables 11 and 12). Nevertheless, as already observed, welfare gains are positive for all the four countries including Bangladesh.

It may be observed from Table 1 that the welfare of countries/regions other than South Asia is affected adversely due to preferential liberalisation across the South Asian countries. The changes in welfare of all the countries/regions under study under open or autonomous trade liberalisation agreement among the South Asian countries leads not only to larger welfare gains within the South Asian countries but also across all other regions. This is shown in per cent change values in Table 2 and absolute dollar value changes in Table 4. Thus the adoption of autonomous trade liberalisation by the four South Asian countries is a superior choice over preferential liberalisation. Similar results may be observed in Tables 5 through 12.

Results of Simulations 2 to 6:

It may be observed from Table 1 that all the five countries mentioned under Simulation 2 gain under preferential liberalisation. However, all the five countries in this expanded arrangement gain higher welfare along with positive gains for all other regions when these countries undertake autonomous trade liberalisation.

The process of gains clearly increases with each additional region joining in the expanded Asian club provided all the participants practice autonomous trade liberalisation. The scenario in Simulation 6 termed as PAFTA is by far the best scenario.[20] The South Asian countries gain about $10.4 billion in terms of welfare under preferential PAFTA liberalisation (Table 3) but $17.8 billion under open or autonomous PAFTA trade liberalisation (Table 4). The global gains are high. These touch about $89 billion under preferential PAFTA liberalisation (Table 3) and about $205 billion under open PAFTA liberalisation (Table 4). Autonomous or open PAFTA trade liberalisation is accompanied by increased own as well as others' welfare. Clearly, this is a case of global charity.

While real returns to labour increase in all simulation scenarios 2 to 6, for all the participating Asian countries (Tables 9 and 10), real returns to capital take a dip for Bangladesh (Tables 11 and 12). Nevertheless, as already observed, welfare gains are positive for all the participating countries including Bangladesh.

VII. Conclusions and Policy Implications

It is clear from results of the six simulation scenarios that the gains to the participating members of the proposed SAFTA to PAFTA undergo an upward change when more regions of Asia join

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[19] Refer to Column SIM 1 of Table 1.

this Agreement. The gains are larger under the autonomous regionalism as compared to the preferential regionalism.

However, it may be noted that our computational analysis has been confined to the removal of tariffs on agriculture and manufactures. We have not been able to quantify other features of the preferential trade arrangements, such as the negotiation of explicit rules and development of new institutional and co-operative arrangements that could be beneficial to the countries involved. We have also not made allowance for rules of origin that may be negotiated as part of individual bilateral or plurilateral trade agreements.

While our focus has been on the member and potential member countries of the proposed PAFTA, we have also provided results for other major trading regions of the world. The major conclusion that emerges from this paper is that autonomous or open trade liberalisation has positive and often sizeable impacts on the economic welfare and real returns to labour and capital in both the industrialised and developing countries / regions of the world.

The second conclusion of our analysis is that the preferential trade arrangements may be welfare enhancing for the member countries involved but these welfare gains are considerably smaller than the ones resulting from multilateral trade liberalisation. Moreover, these arrangements often involve elements of trade diversion and are therefore may be detrimental to some non-member countries / regions. Open or autonomous trade liberalisation is a win-win game for members as well as non-members of PAFTA.

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[20] Refer to Column SIM 6 of Table 2.

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Table 1: Per cent Change in Welfare – Preferential Regionalism							
COUNTRY/REGION	**CODE**	**SIM 1**	**SIM 2**	**SIM 3**	**SIM 4**	**SIM 5**	**SIM 6**
India	IND	0.4	0.7	1.2	1.3	1.4	1.5
Bangladesh	BGD	0.5	0.5	0.8	0.1	0.1	0.4
Sri Lanka	LKA	1.6	1.9	2.6	2.9	2.9	3.3
Pakistan	XSA	1.2	1.6	2.5	2.7	2.7	2.9
China	CHN	-0.0	0.2	0.4	0.0	0.0	0.3
ASEAN	ASN	-0.0	0.0	1.7	2.0	1.9	2.1
NIEs	NIE	-0.0	0.0	-0.1	2.1	2.0	2.1
Japan	JPN	-0.0	0.0	-0.0	-0.1	1.1	1.3
Australia & New Zealand	ANZ	-0.0	0.0	-0.0	-0.0	0.0	1.0
NAFTA	NFT	-0.0	0.0	0.0	-0.0	-0.0	-0.0
European Union	EUN	-0.0	0.0	-0.0	-0.1	-0.2	-0.2
South America	SAM	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0
Others	OTH	-0.0	0.0	0.0	-0.0	0.0	-0.0
World		--	--	--	--	--	--

Table 2: Per cent Change in Welfare – Open Regionalism							
COUNTRY/REGION	**CODE**	**SIM 1**	**SIM 2**	**SIM 3**	**SIM 4**	**SIM 5**	**SIM 6**
India	IND	2.4	2.4	2.5	2.5	2.5	2.6
Bangladesh	BGD	2.2	2.1	2.1	2.1	2.1	2.2
Sri Lanka	LKA	4.9	5.1	5.3	5.6	5.6	5.7
Pakistan	XSA	4.1	4.2	4.2	4.3	4.3	4.4
China	CHN	0.2	2.4	2.5	2.3	2.4	2.4
ASEAN	ASN	0.4	0.9	3.9	4.0	3.8	4.0
NIEs	NIE	0.3	1.1	1.3	2.8	2.8	2.9
Japan	JPN	0.1	0.5	0.6	0.8	1.7	1.8
Australia & New Zealand	ANZ	0.2	0.5	0.6	0.7	1.0	0.8
NAFTA	NFT	0.1	0.1	0.1	0.1	0.0	0.0
European Union	EUN	0.7	1.2	1.3	1.5	1.4	1.5
South America	SAM	0.1	0.1	0.1	0.1	0.1	0.1
Others	OTH	0.2	0.3	0.3	0.4	0.4	0.4
World		--	--	--	--	--	--

Table 3: Absolute Change in Welfare (US $ Million) – Preferential Regionalism							
COUNTRY/REGION	**CODE**	**SIM 1**	**SIM 2**	**SIM 3**	**SIM 4**	**SIM 5**	**SIM 6**
India	IND	1722	3196	5590	5947	6449	7296
Bangladesh	BGD	224	250	355	67	35	168
Sri Lanka	LKA	249	302	406	459	465	519
Pakistan	XSA	997	1340	2122	2274	2288	2459
China	CHN	-59	1987	4718	245	247	3731
ASEAN	ASN	-54	11	7048	8365	7837	8796
NIEs	NIE	-59	28	-490	19366	18427	19364
Japan	JPN	-138	73	-592	-2586	43693	52046
Australia & New Zealand	ANZ	-12	5	-13	-11	79	3875
NAFTA	NFT	-32	652	123	-2616	-2241	-4361
European Union	EUN	-71	159	-374	-1599	-2203	-3111
South America	SAM	-56	-23	-291	-1226	-1294	-1798
Others	OTH	-19	67	40	-21	57	-107
World		**2692**	**8047**	**18642**	**28662**	**73839**	**88877**

Table 4: Absolute Change in Welfare (US $ Million) - Open Regionalism							
COUNTRY/REGION	**CODE**	**SIM 1**	**SIM 2**	**SIM 3**	**SIM 4**	**SIM 5**	**SIM 6**
India	IND	11243	11478	11806	11977	11970	12130
Bangladesh	BGD	1028	995	990	991	987	1007
Sri Lanka	LKA	775	814	832	881	880	905
Pakistan	XSA	3412	3500	3527	3603	3639	3716
China	CHN	1815	27731	28376	26971	27228	28054
ASEAN	ASN	1790	3756	15976	16684	15883	16404
NIEs	NIE	2948	10050	12449	26184	25772	26448
Japan	JPN	5485	18845	26047	32919	70089	73370
Australia & New Zealand	ANZ	1007	1880	2331	3041	4166	3402
NAFTA	NFT	11021	11635	12204	9879	1800	3567
European Union	EUN	9691	15975	17769	20776	19824	21280
South America	SAM	4036	7037	7995	10120	10489	10845
Others	OTH	2165	3175	3367	3937	3827	4029
World		**56417**	**116871**	**143668**	**167963**	**196556**	**205156**

Table 5: Absolute Change in Imports (US $ Million) - Preferential Regionalism							
COUNTRY/REGION	**CODE**	**SIM 1**	**SIM 2**	**SIM3**	**SIM4**	**SIM5**	**SIM6**
India	IND	652	1354	2783	3650	4125	4428
Bangladesh	BGD	320	748	1017	1644	1771	1820
Sri Lanka	LKA	132	159	223	350	376	417
Pakistan	XSA	403	649	965	1231	1371	1430
China	CHN	-33	1419	5206	16766	27898	29553
ASEAN	ASN	-26	-1	5657	9362	12931	13698
NIEs	NIE	-39	-86	-764	21620	23820	24819
Japan	JPN	-23	-37	-476	-392	24888	28125
Australia & New Zealand	ANZ	-2	-4	-23	52	130	6750
NAFTA	NFT	52	57	-22	1169	1386	1486
European Union	EUN	-2	45	-403	-728	-1073	-1162
South America	SAM	-5	-26	-86	-169	-208	-184
Others	OTH	-20	-39	-130	-319	-395	-427
World		**1409**	**4238**	**13945**	**54237**	**97021**	**110752**

Table 6: Absolute Change in Imports (US $ Million) - Autonomous trade liberalisation							
COUNTRY/REGION	**CODE**	**SIM 1**	**SIM 2**	**SIM 3**	**SIM 4**	**SIM 5**	**SIM 6**
India	IND	7965	8146	8421	8693	8695	8774
Bangladesh	BGD	2215	2290	2306	2364	2368	2377
Sri Lanka	LKA	510	554	570	630	636	650
Pakistan	XSA	1749	1829	1865	1966	1986	2024
China	CHN	1106	36373	37580	40838	44315	45073
ASEAN	ASN	1007	2741	17513	18511	18670	19064
NIEs	NIE	1689	12542	16224	32125	32927	33478
Japan	JPN	1187	11086	15360	19065	36346	37705
Australia & New Zealand	ANZ	485	1625	2101	2720	4846	7472
NAFTA	NFT	3333	16146	19599	25687	33755	34187
European Union	EUN	7507	17466	20811	25397	27037	28150
South America	SAM	874	3321	3814	5054	5528	5590
Others	OTH	810	1621	1864	2391	2302	2397
World		**30439**	**115740**	**148028**	**185442**	**219411**	**226941**

Table 7: Absolute Change in Exports (US $ Million) - Preferential Regionalism							
COUNTRY/REGION	**CODE**	**SIM 1**	**SIM 2**	**SIM3**	**SIM4**	**SIM5**	**SIM6**
India	IND	570	1484	3518	4820	5579	6032
Bangladesh	BGD	409	967	1306	2132	2288	2354
Sri Lanka	LKA	142	175	256	425	449	502
Pakistan	XSA	345	622	1062	1420	1628	1696
China	CHN	-13	1012	5684	20874	34297	36100
ASEAN	ASN	-12	8	3597	7982	12217	12996
NIEs	NIE	-23	-52	-521	16759	20339	21555
Japan	JPN	-11	-41	-343	-298	20294	24208
Australia & New Zealand	ANZ	-1	-2	-28	21	98	5213
NAFTA	NFT	20	64	6	1221	1450	1716
European Union	EUN	-3	27	-405	-894	-1183	-1251
South America	SAM	-4	-20	-68	-94	-111	-68
Others	OTH	-12	-15	-83	-236	-292	-313
World		**1407**	**4228**	**13983**	**54132**	**97056**	**110741**

Table 8: Absolute Change in Exports (US $ Million) - Autonomous trade liberalisation							
COUNTRY/REGION	**CODE**	**SIM 1**	**SIM 2**	**SIM 3**	**SIM 4**	**SIM 5**	**SIM 6**
India	IND	12635	12743	12902	13063	13054	13108
Bangladesh	BGD	2810	2868	2874	2918	2924	2931
Sri Lanka	LKA	619	663	674	720	725	736
Pakistan	XSA	2330	2382	2402	2465	2479	2505
China	CHN	228	54199	54989	56557	58429	58922
ASEAN	ASN	-319	287	20860	21305	20667	20964
NIEs	NIE	935	7674	10118	32994	33301	33647
Japan	JPN	495	6756	9852	12169	37267	38162
Australia & New Zealand	ANZ	279	872	1134	1477	2517	6668
NAFTA	NFT	3256	11662	13988	18782	24353	24630
European Union	EUN	5662	12493	14851	18176	18521	19404
South America	SAM	671	2315	2653	3537	3877	3927
Others	OTH	632	1105	1251	1603	1578	1654
World		**30234**	**116019**	**148549**	**185766**	**219693**	**227258**

Table 9: Real Returns to Labour (%) - Preferential Regionalism							
COUNTRY/REGION	**CODE**	**SIM 1**	**SIM 2**	**SIM 3**	**SIM 4**	**SIM 5**	**SIM 6**
India	IND	0.06	0.15	0.30	0.37	0.42	0.47
Bangladesh	BGD	0.18	0.31	0.46	0.72	0.80	0.84
Sri Lanka	LKA	0.65	0.81	1.13	1.62	1.69	1.90
Pakistan	XSA	0.23	0.37	0.55	0.65	0.70	0.74
China	CHN	-0.00	0.06	0.21	0.61	0.98	1.04
ASEAN	ASN	-0.00	-0.01	0.84	1.18	1.79	1.81
NIEs	NIE	-0.00	-0.01	-0.05	1.08	1.20	1.25
Japan	JPN	-0.00	-0.00	-0.01	-0.01	0.39	0.45
Australia & New Zealand	ANZ	-0.00	-0.00	-0.02	0.00	0.00	0.51
NAFTA	NFT	0.00	0.00	-0.00	0.01	0.01	0.01
European Union	EUN	0.00	0.01	0.01	0.09	0.16	0.17
South America	SAM	0.00	-0.00	-0.00	-0.00	-0.00	-0.00
Others	OTH	-0.00	-0.00	-0.01	-0.02	-0.03	-0.03
World		--	--	--	--	--	--

Table 10: Real Returns to Labour (%) - Autonomous trade liberalisation							
COUNTRY/REGION	**CODE**	**SIM 1**	**SIM 2**	**SIM 3**	**SIM 4**	**SIM 5**	**SIM 6**
India	IND	0.98	0.99	1.02	1.04	1.04	1.05
Bangladesh	BGD	1.13	1.18	1.19	1.24	1.24	1.25
Sri Lanka	LKA	2.73	2.92	3.02	3.23	3.21	3.30
Pakistan	XSA	0.95	1.01	1.02	1.06	1.06	1.08
China	CHN	0.05	1.59	1.65	1.72	1.80	1.82
ASEAN	ASN	0.37	0.72	1.48	1.69	2.07	2.11
NIEs	NIE	0.08	0.60	0.85	1.74	1.82	1.86
Japan	JPN	0.02	0.17	0.24	0.30	0.66	0.69
Australia & New Zealand	ANZ	0.05	0.15	0.23	0.30	0.34	0.68
NAFTA	NFT	0.01	0.04	0.05	0.04	0.00	0.01
European Union	EUN	0.21	0.47	0.55	0.65	0.60	0.63
South America	SAM	0.01	-0.01	-0.01	-0.01	-0.01	-0.01
Others	OTH	0.06	0.11	0.12	0.16	0.15	0.16
World		--	--	--	--	--	--

Table 11: Real Returns to Capital (%) - Preferential Regionalism							
COUNTRIES/REGIONS	**CODE**	**SIM 1**	**SIM 2**	**SIM 3**	**SIM 4**	**SIM 5**	**SIM 6**
India	IND	0.05	0.15	0.44	0.48	0.49	0.57
Bangladesh	BGD	0.06	-0.07	-0.08	-0.31	-0.38	-0.33
Sri Lanka	LKA	0.84	1.05	1.47	2.13	2.21	2.42
Pakistan	XSA	0.20	0.24	0.44	0.46	0.47	0.49
China	CHN	-0.00	0.04	0.24	0.42	0.61	0.75
ASEAN	ASN	-0.00	-0.01	0.62	1.01	1.20	1.38
NIEs	NIE	-0.00	-0.00	-0.05	1.29	1.39	1.48
Japan	JPN	-0.00	-0.00	-0.01	-0.01	0.48	0.60
Australia New Zealand	ANZ	-0.00	-0.00	-0.01	0.02	0.05	0.35
NAFTA	NFT	0.00	0.00	0.00	0.01	0.01	0.02
European Union	EUN	0.00	0.01	-0.01	-0.02	0.01	0.01
South America	SAM	0.00	-0.00	-0.00	-0.00	-0.00	-0.00
Others	OTH	0.00	0.01	0.01	0.04	0.06	0.07
World		--	--	--	--	--	--

Table 12: Real Returns to Capital (%) - Autonomous trade liberalisation							
COUNTRIES/REGIONS	**CODE**	**SIM 1**	**SIM 2**	**SIM 3**	**SIM 4**	**SIM 5**	**SIM 6**
India	IND	1.13	1.14	1.13	1.09	1.08	1.08
Bangladesh	BGD	-0.16	-0.16	-0.15	-0.15	-0.16	-0.14
Sri Lanka	LKA	3.39	3.53	3.63	3.89	3.86	3.95
Pakistan	XSA	0.65	0.69	0.67	0.63	0.63	0.64
China	CHN	0.01	2.81	2.80	2.51	2.32	2.33
ASEAN	ASN	0.04	0.28	2.26	2.45	2.36	2.42
NIEs	NIE	0.08	0.59	0.82	2.48	2.50	2.54
Japan	JPN	0.02	0.17	0.25	0.30	1.02	1.05
Australia New Zealand	ANZ	0.07	0.14	0.19	0.25	0.09	0.54
NAFTA	NFT	0.02	0.02	0.02	-0.04	-0.12	-0.12
European Union	EUN	0.36	0.67	0.73	0.86	0.71	0.76
South America	SAM	0.01	-0.02	-0.02	-0.03	-0.03	-0.03
Others	OTH	0.13	0.22	0.23	0.27	0.26	0.27
World		--	--	--	--	--	--