Strategic Trade and protectionism - Theories and Empirics
Prof. Pratap Chandra Mohanty
Department of Humanities and Social Sciences
Indian Institute of Technology, Roorkee

Lecture – 36
Economic Integration: Blocs and Blocks

Welcome friends, once again to the MOOC Co model module of NPTEL on Strategic Trade and Protectionism. We are at the verge of the very last week of our contents of our discussion where we have been trying to understand the Economic Integration, how the integrating policies are actually creating trade as well as you know diverting trade. And these are also the latest trends of strategies by which countries can able to divert the trade of another country.

So, forming union, forming groups are some of the strategies made by different countries over the time. Now if the classic example of formation of union which could able to divert many forms of trade or restrict many proper trade is none other than the OPEC formation in the early 70s. Where the OPEC countries largely actually you know, diverted trade of many participating countries who have been actually used to get their oil prices at a very cheaper cost at for the market prices.

Once the OPEC was formed, many you know Organization of Petroleum Exporting Countries decided to you know, restrict their flow with a higher price. So, when they decide a price range to be much higher which has actually created lots of panic in the production function and thereby caused production to fall at the time. So therefore, this has restricted hugely.

Now there are similarly, famous examples like you know, like ASEAN nations ASEAN, Association of South East Asian Nations, you know NAFTA, European Union, you know, even you know with the Indian continent or Indian you know country India which is attached with some other unions like you know SAARC countries G20 nations, BRICS nations, there are various forms of you know trading cooperation or trading integration which is resulted some forms of restrictions within the countries and or other than the member countries.

So therefore, the last week is on purely understanding economic integration. Some of the theories on customs union will also verify in our next lecture. Plus this lecture on its 36 episode, we are trying to explain some Blocs versus Blocks. One is blocing to strategize trade, another blocking B-L-O-C-K is to restricting trade. And largely, we have seen so far as blocks are concerned, we have seen tariffs non-tariff measures are actually you know creating lots of blocks B-L-O-C-K to the trade you know flows.

Now therefore, now this is quite important and we must explore in detail. Now so far as trading blocks are concerned, I mean, look at the you know the way by which blocks are made large those are though economic weapons, but politically you know oriented or motivated. So, basically these are the steps which undermines the flow of goods.

What type of blocks we have since over the time? They are either in the forms of embargo or boycotts, we have already seen with one diagram earlier and sanctions or trade war or not-trade war. Sanctions like you know if we talk about general terms of restriction of some search like ban on textile products, sneakers, balls or soccer balls made with child labor content these are you know technical barriers to trade type of restrictions.

And similarly, tariffs, retaliation further retaliations or import quota are some of the other forms of trade blocks we have already verified in the last week lecture. Last week as well as last to week lecture in detail.

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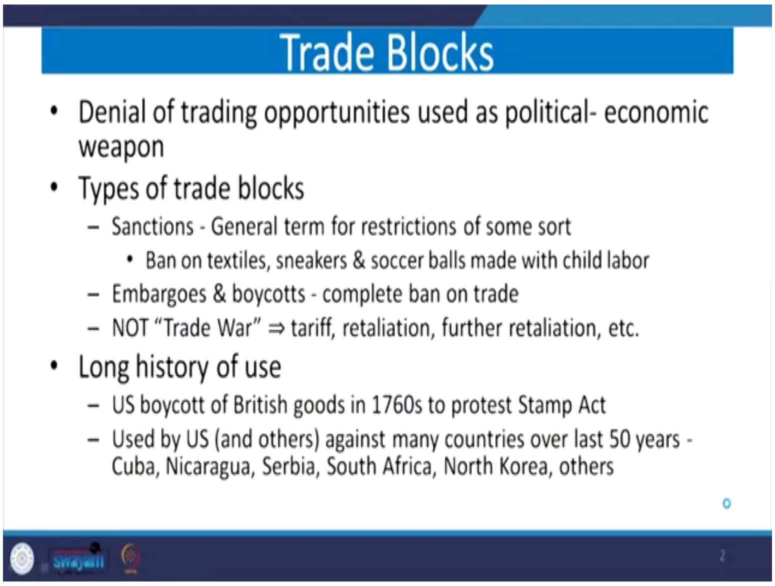

And so far, if you count the history behind the trading blocks, US boycott one such famous example here presented before you. US boycott British goods in 19 1760 to protest a Stamp Act. Stamp Act was actually very famous which are related to you know boycotting the products of British by the US.

Similarly, used by US against many countries over last 50 years like Cuba, Nicaragua South Africa, North Korea and others. Now, let us understand what are the success and failure related to blocks? B-L-O-C-K, blocks.

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One is through size large countries imposed sanctions on small countries. I think we have already discussed the debates on small versus large countries in this particular regard. Now small country while imposing you know restriction, or a block blocks may not derive the better advantage in terms of terms of trade and only because of the fact that the small country does not have huge capture on the elasticity of demand and supply of their products and cannot able to tap the market as a whole.

Therefore, their attempts to correct the terms of trade and to derive benefits out of the international trade may not be feasible. Now small country can be heavily you know, trade-dependent because of low elasticity patterns. Whereas, the reverse is true the relative cost and the I mean related to the cost, I mean low for large country and high on small country.

So, large country retains trade with non-sanctioned countries. Therefore, large country being like in India by its structure because of huge demand sensitivities of variety of products, you know, different product as well as differentiated products; you know, we have you know largest here in the international basket of commodities. Therefore, India used to minimize the relative cost in the international you know transactions.

So, far as scope is concerned, sanctions on more goods whose larger cost on small country again, so, we have already discussed this opens up the window for the small country to have an exposure to the larger segment of products. So far as friends and you know connections are concerned, it is more effective when large country enlist others to cooperate.

So, less effective if target maintains trade with others. And regarding timing, as the success and failure explanation for trade blocks you know, it is extreme certain sanctions more effective, more time allows more time to adjust, because you know any kind of blocks we create you know it hinders the flow because of certain time component on it. And there are lots of politics again you know, like dictatorship may retain power even when economic cost are very high.

So, so, I mean largely it is political in nature they want to have their dictatorship by protecting certain you know the products or the flows. So therefore, this is again restricting huge cost on the international flows of goods.

Now, regarding the comparison between bloc, B-L-O-C-S, blocs basically, building you know groups and B-L-O-C-K blocks basically, hindering or restricting the flows through various instruments. What is very important here is to look at a trade blocks that remove trade barriers among countries, the member countries particularly. So therefore, trade blocks encouraging you know, I mean, trade blocks actually is responsible for encouraging trade which may be good, but with cost as well as benefits.

That basically we will discuss in the next class related to you know, creating trade basically, trade marriage partners. It is a due to trade or due to blocks we create trade we also divert some of the possible trades. We will discuss in detail of these examples in the next class. That is purely meant for understanding trade creation versus trade diversion arguments.

Now, certain policy concerns are there regarding regional trade blocks are RTA, regional trading agreements as per the you know norms of WTO member countries may form you know, regional groups for their better trade flows.

So the policy concerns are like you know, it promote you know, costly trade divert trade diversion like you know, so, it actually you know, reduces the costly trade and it diverts those costly trade aspects and may also reduce the tariffs between the blocks.

However, regional cooperation often you know easier than multilateral because of because of the fact that there are small groups and slow small groups have higher you know, magnitude of similarities and higher overlapping of production function which could able to minimize the cost of production better. And the strategizing among the smaller group is much easier than in the larger groups.

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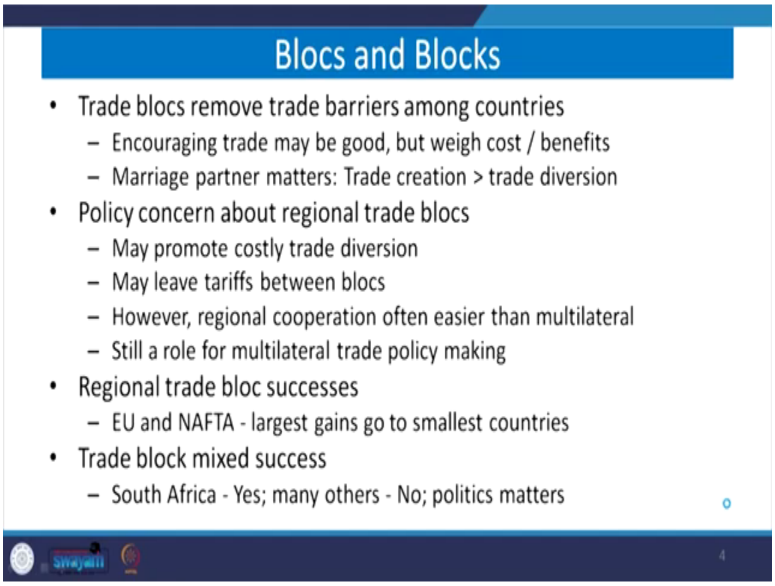

Now, still a role for multilateral trade policy is I mean in the policy making is very needed only because of the fact that you know, in the I mean basically, these fosters for flow of goods across the boundaries in the globe and this causes you know minimization of restriction further across the globe.

So, there are certain policy concerns on it regarding regional trade blocks of shares as an example, European Union, NAFTA: North American Free Trade Agreement. So, then against to go to smallest countries let us again to go to smallest countries basically, you know they wanted to attach the trade with a smallest countries because, they have already harnessed the benefits among those small countries as well.

Now regarding, you know trade block mixed success, South Africa, I mean blocks B B-L-O-C-K we are referring to here, South Africa, yes there are you know, by blocking also there are success stories attached. Many other countries as per the literature suggests no actually blocks does not give success; rather, you know it creates lots of politics in between the transactions.

Now, regarding the you know types of blocks we are now discussing B-L-O-C-K as blocks types. Last we are going to discuss 5 broad categories of you know, trading blocs or trading groups. First one is called preferential trading agreements, PTA, where it lowers for specific countries. Basically, like you know I tell regional trading agreements, RTA, can be formed. It actually reduces the tariff among the specific countries.

One such example is British Commonwealth; we will discuss this in the next slide, in detail. Now, another component or type of you know type of trading blocs or free-trade area.

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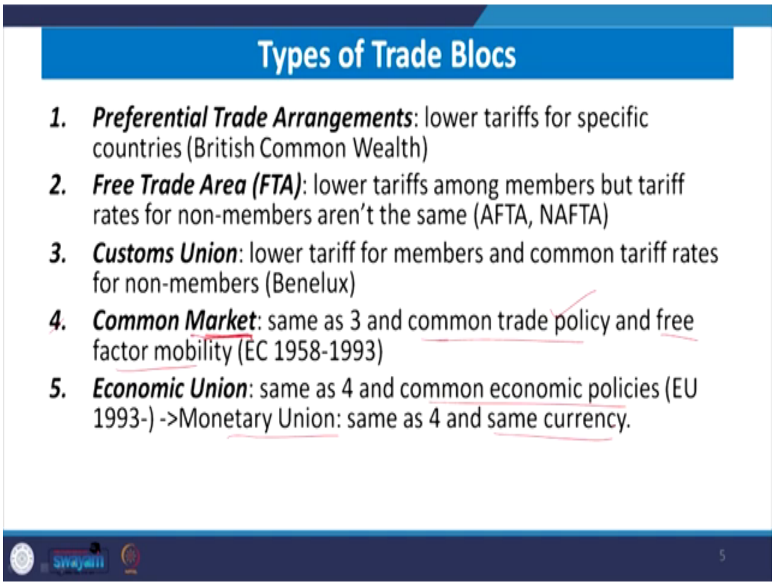

The area are to be defined as first one is called arrangements, just to arrange certain preferences for trade here on the next you know, type we are discussing free-trade area. The area has to be you know freer basically, this refers to much lower tariffs among the members, but tariff rates for non-members are not the same.

So, like famous example ASEAN free-trade agreement. So, NAFTA North American Free Trade Agreement, those agreement actually defines in areas where you know, among the member countries, the rates are much lower and thus the contracts is practiced against the non-member countries.

Now regarding the third type is called Customs Union Customs Union where, as we know the famous customs restrictions. So, whosever have signed the Customs Union or part of the Customs Union actually lower the tariff among the members and also, they are part of common tariff rates for non-members that is be different than that of free trade area is not completely free you know, in the sense that in the free-trade area we say that lower the tariff among the members and not lower or very much higher among the non-member.

Now here it says that and among the non-member you have the leverage of charging different rates to different countries. But here, once you are part of the Customs Union like Benelux Belgium, Luxembourg and nether and Netherland Belgium, Netherland and Luxembourg this they are part of these Customs Union, they have you know been agreed to have much lower among themselves and also which are almost equal rate to other countries.

Why are the countries? Because, other countries are equally you know, affecting the strategies of those member countries. If you have differentiated rates to other non-member countries, probably it is also difficult for a union to exist.

Now, regarding the fourth component called common market. Now the word is market here, market means what? Demand, we refer to the demand and supply and how demand and supply is actually attached to trade policies. This would have common trade policies. Other are right, I mean so far customs is I mean, common market are also called Customs Union, in addition to that, they have certain extra feature called their policies must be also equal.

Policy related to I mean, trade policies as well as free factor mobility; factors to be mobile freely within the common market. Now, look at the Schengen area, European countries where European countries between 1958 to 1993 you know, famously referred to as common market because the market can be accessed anywhere from any country within that regions and there is no restriction to the mobility of the factors.

So also, they have similarities with customs union that they have a very low you know tariff rate within their member countries, and also they treat equally though the rates are higher different, but the rates imposed by the individual member countries to the non-member countries should be equal. All member countries should follow is equal rate to all non-member countries. That is the most important features of Customs Union.

In addition to that, you have added common trade policy plus free trade free factor mobility.

Last one to be discussed as part of types of trade blocks are is last one is, economic union. This is economic union; that means all kind of economic strategies, economic policies, economic perspectives, economic directions must be equal. European Union from 93 onwards refer to age you know, economic union. All your till 93, I mean there are lots of restriction till

93, they did not have common economic policies. But now, after 93 they also have common economic policies like fiscal policies you know measures, monetary policy, fiscal policy are also same.

So, this is basically economy same as the four point and in addition to that they have economic policy like common same currency. I think European in the standard example to that and they have you know similar you know similar currency as well. So, that is Euro is similar in all the countries. Now British as you all know, British is not following the similar currency they are not part of the economy economic union.

So, they are not part of the Brexit, is famously you know known to everyone and Britain actually you know removed or decided to remove from the Union to go out of the Union. So, no longer British is part of the economic union.

Now, let us explore bit by bit to understand these you know, preferential trade I mean, these different types of arrangements systematically. Now prepare let us start with preferential trade arrangements. What do we mean by these preferential trade arrangements? As we already said, it is among the member countries to have you know, lower rate. And lower tariff rate this provide lower barrier barriers to the to trade among the participating nations there on the trade with non-member nations.

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And the loosest form of Economic integration we have already discussed here, lower tariffs for specific countries are called very I mean arrangements. Whereas, in free-trade area we have already said that it is lower within the member countries and differentiated rates among non-member countries, ok.

So, there are certain arrangements which lowers the rates among those countries but there is no restrictions whether they go for it you know, FTA, Free Trade Area or not. Now such examples are, British Commonwealth Preference Scheme, we have already mentioned which was established in 1932 between UK and the British Empire.

And one famous example here is also referred as I mean, aspect is referred as MFN principle, Most Favored Nation principle a trade concession which is granted to any foreign nation must be granted to all foreign nations with MFN status. Once MFN like you know, India granted you know reference status to its Pakistan.

Now, though in the present government, very recently, due to certain you know problems at Balakot strike as you all know, Indian government decided to actually you know withdraw their reference status to Pakistan. Now MFN principle says that if you have granted MFN status to a particular country; that means, you have to treat all other foreign nations with MFN status. So, if trade concession granted to any foreign nation must be granted to all foreign nations.

So, this you know is actually one of the biggest flaws of them if you I mean problem of MFN's MFN principle, so, though now India has actually withdrawn this. Now there are you know, I mean basically, so far as preferential trade arrangements are concerned, in it encourages non-discrimination among the P PTH. So and GATT has granted dozens of except exceptions for European Union and NAFTA.

So therefore, there are various for grants are made in those 2 groups are different than any other groups. Now, what are the principles of I mean, let us understand a bit on MFN, Most Favored Nation you know, status. So, what are the principles of multilateral trading systems is as is mentioned or embodied in WTO agreements? So trade basically, it if the principle is based on non-discrimination and that is due to two reasons. One is called Most Favored Nation's treatment and another is National Treatment.

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So, far as Most Favored Nation treatment is concerned, this is this requires every WTO members to treat all its trading partners equally, without any prejudice or discrimination. And if a member countries grant some special favor, to, of to any another country in terms of certain concessions or concessions that has to be extended to all other WTO members.

The essence of MFN's principle is basically on equality of treatment. That is That is has one of the essence of MFN which can be summed up as Favor one, favor all. This is the key phrase which is very important while we discuss MFN status.

So, article one of GATT which contained the MFN principle which governs trade-in goods or trade-in services and article 4 of the agreement actually contains Trade Related Intellectual Property you know Rights discussions.

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Now, are they there are any exceptions to the MFN principle? Yes, there are a number of exceptions majorly, 3 types one is formation of common markets or free-trade agreements instead of PTA or Regional Trading Agreements; RTA. If these are formed then, then certainly there are you know, number of exceptions one can enjoy while they go for you know, MFN status.

Now similarly, positive differential actions such as generalized system of preferences GSS GSP which is giving you know special market access to special country or group countries. And third one is discriminatory actions due to On fair-trade. If On fair-trade is you know noted then there will be distributed actions, so, not necessarily same. So, therefore, it is may be antidumping or a countervailing actions may be taken. if then the MFN principle may be violated.

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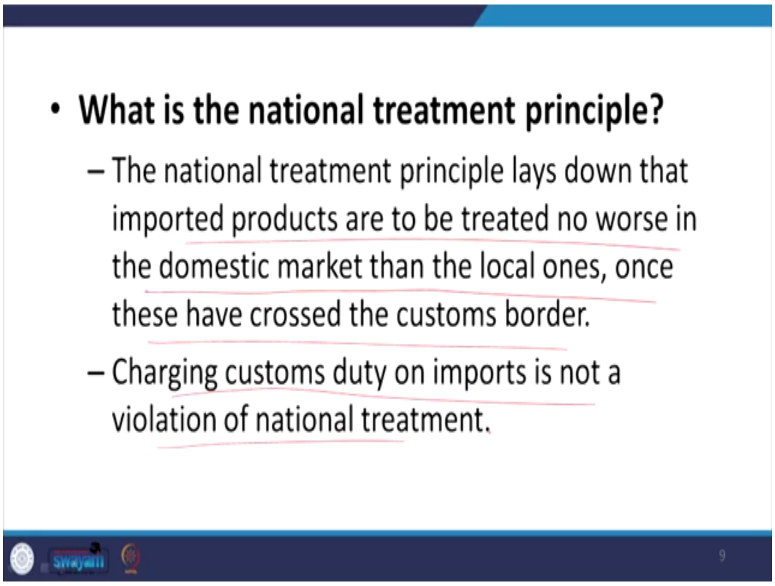

Now, what is the national treatment? We have discussed MFN treatment, now what is national treatment? National treatment principles lays down that imported products are to be treated no worse the domestic product than that of the local ones. Once these have been crossed the customs border. So once, any international product clears the customs requirement those products must have been actually treated like our local ones. So, there should not be any kind of discrimination that is called national treatment.

So, charging customs duty on imports is not a violation of national treatment because, you know customs clearance where we are supposed to have certain you know duties custom duty is not a violation of national treatment, ok.

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Now, we have discussed a MFN related aspect you know, let us also talk about some other types of you know trade blocks. Like, first of all we have discussed PTA preferential trade trading arrangements and now we are discussing free-trade areas. Free-trade areas where we said that you know, lowest and equal rates within the member countries, and differentiated rates or little high and higher rates to the non-member countries that is the principle.

So, this removes all barriers among trade member countries, but, each nation retains its own barriers to trade with non-members countries. And free trade within the area, but separate national therefore, this is very important. Within area this is this is you know, completely free, and outside the area I mean if these are the member countries, any kind of movement is possible. But outside, anyone can take I mean differential treatment not necessarily the treatment are equal.

So, therefore, this needs since all the treatments are different outside the area, so, therefore, a customs inspector is required. Customs will you know check the you know the entries of outside of outsiders. Now whereas, in case of you know a customs union this is bit different customs union or inspector custom inspector is not required because we have nullified the customs you know customs restrictions.

Now, famous example for free-trade areas are European Free Trade Association EFTA which was formed in 1960 among I mean countries like UK, Austria, Denmark, Norway, Portugal, Sweden and Switzerland. So, EFTA 1960 is famous example of free-trade area, North American Free Trade Agreements NAFTA, we have already discussed this was found in 1993. This is where this was formed between Canada Mexico and US.

So, and another example famous example for this is LAFTA a Latin American basically Free Trade Area. Again was also formed during the same time 1960. This is caused you know and actually caused lots of lots of you know a removal of restrictions, but actually this is in 1969. Again, ASEAN Association of South East Asian nation also an example of for free-trade area which was formed in 1976.

India has not been a member country yet, have been I mean have been part of number of you know discussions, but not a full member yet. Regarding, customs unions which I said, no need of custom inspector because you have already opened up the union to be to be of you know completely no restrictive outside the union. You know, I mean remove all barriers within the members and harmonize trade this is very important harmonized trade policy.

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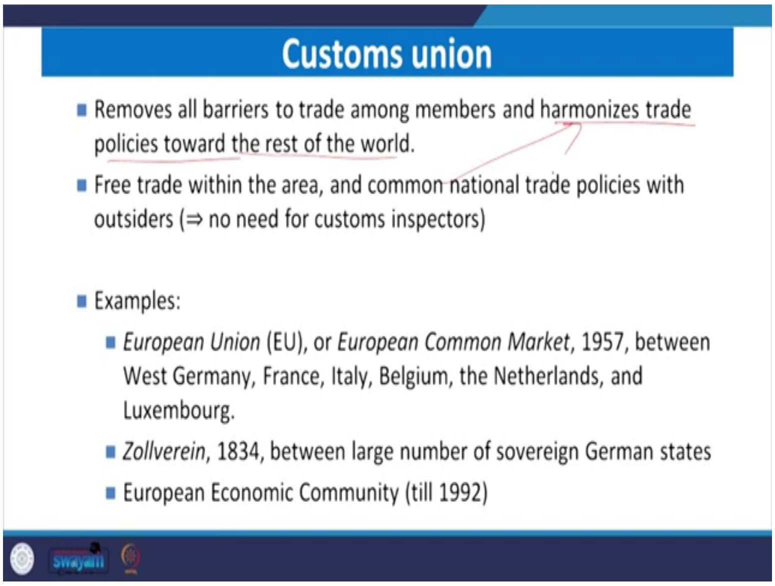

So, therefore, why? If it is harmonized trade policy towards the rest of the world then why should we you know need customs means custom inspector? So, free trade within the area and common national or harmonized trade policies outsiders.

Famous example till was the European Union, the European Common Market is also now part of customs union. Then between West Germany, Belgium, then France, then Netherlands, and Luxembourg and Zollverein1834 between large number of sovereign German states, European Economic Community till 1992 as I mentioned earlier; another example, another type is called common market. We have already said not just harmonize trade out to outsider they also have free movement of labor and capital among member countries.

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So, free movement of factors are very important, European Union they achieve common market status till 1993 after that it is a common union right now because of common economic you know, decisions. So, European Economic Community up to 1992 as a single market decided. So, far as economic union another type of you know integration is concerned.

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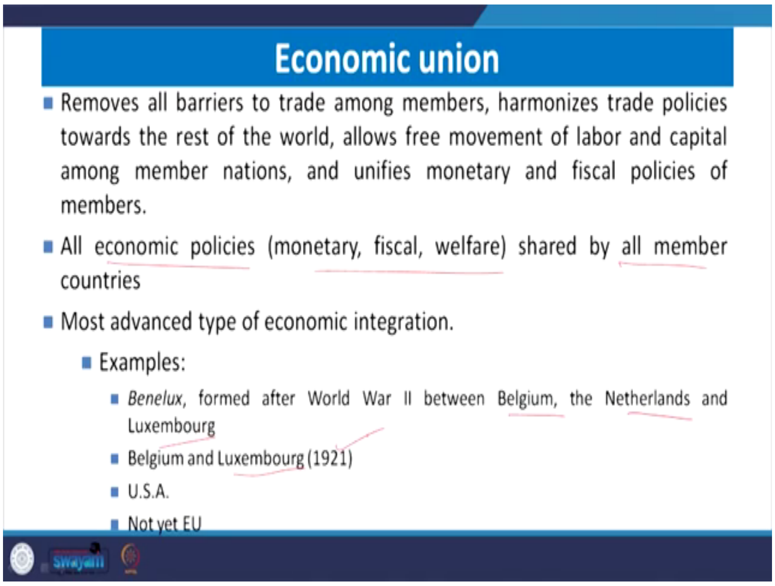

So, it removes all kind of barriers within the countries, harmonized trade also to outside countries under WTO this also you know have given complete flexibility to have you know, free movement of factors in association with that along with that there are common economic strategies like monetary policy and fiscal policy among the member countries.

So, all economy policies are shared by all member countries. So, European Union joint as we told you, from 93 onwards is part of Economic union. Now famous example where like Benelux we discussed Belgium, Netherlands and Luxembourg; Belgium and Luxembourg was also in 1960 21 referred. USA is famous example. Now, it said after 1993 they joined I mean common currency, but somewhere mentioned not yet EU fully, ok. We need to correct it accordingly.

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Now, free another one is called free economic zones areas you know, established to attract foreign investments by allowing raw materials in intermediate products are as duty free. So, we have discussed various types. So, far including EU as common market and also various different union strategies by which member countries can you know, reduce their restriction and you know open up further trade.

Now, in the next class we will talk about how I mean, how customs union are creating trade and diverting trade. I think that that is all for today's class and I mean for a particular class, we will you know you know expect all the details in next class with this I shall stop here.

Thank you.