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Regionalism and the Drive Toward Liberalizing Trade

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Abstract

In this paper, I ask the question if Preferential Trade Agreements are hindering the multilateral process or not. Analyzing data on how India and Brazil exhibit trade complementary or trade substituting behaviour and comparing it to trade volumes indicates that regionalism does not substitute away from multilateral trade. A case study of the two countries and an analysis of the nuances in trade strategy reveal reasons for each country's trade preference.

Introduction

The proliferation of Preferential Trade Agreements (PTAs) is endemic to international trade. According to World Trade Organization (WTO) statistics, over two hundred bilateral and plurilateral agreements have come into force since 1948, and many more are awaiting WTO approval. The 153 members negotiate agreements to reduce international trade barriers between each other and integrate their economies multilaterally. It is the ultimate goal of all entrants to the WTO since multilateralism grants a country access to the largest available market – the world. PTAs, on the other hand, are special agreements in which pairs or groups of countries are a permitted (by the WTO) to remove trade barriers between themselves, while maintaining trade barriers for countries not party to the agreement.[1] This encourages growth in regional trade, which potentially comes at a cost to international trade. Pascal Lamy, Director General of the WTO has expressed concern that "many countries [are] ready to accept rules and disciplines at the bilateral level that they are not prepared to accept at the multilateral level" thus hindering efficiency in multilateral trade (2007). However, Kamal Saggi and Halis Murat Yildiz perform a study that shows that PTAs improve trade in areas that countries find difficulty negotiating multilaterally.

Before diving into the argument, I will give a brief explanation of the economic theory, which suggests that the welfare effects of a Free Trade Area (FTA) are ambiguous (Viner, 1950). Removing trade barriers results in trade creation as the domestic market expands into a bigger region and inefficient domestic producers are replaced by efficient regional producers. However, trade amongst members within the barrier comes at a cost of reduced or eliminated trade with third countries that might otherwise be more efficient producers. Moreover, PTA members lose rents that they would have otherwise levied on imports from third countries. There is no

consensus whether the economic effects of a PTA are welfare promoting or welfare reducing. Scholars generally agree (Bhagwati et. al., 1998; Zahrnt, 2005) that multilateral trade is the surest way to promote trade growth and welfare. It opens the market for the most efficient producer and brings the price down to true international prices for optimal competition. However, PTA proliferation continues unabated (the success of European regional integration has proved tempting for others to emulate) since countries are only too eager to accept terms at the regional level, which they turn down at the multilateral table.

Article XXIV of the GATT (General Agreement on Tariffs and Trade) sets out the rules countries must consult with before engaging in a PTA. The rules are condensed as follows: 1) The contracting members must notify the WTO and its members before the agreement is inked; 2) there must be a definite plan to reduce all tariff and non-tariff barriers between contracting parties and within a reasonable amount of time to 0; 3) Contracting members do not raise barriers upon non-members country over and above the barriers that are already in place. This is to ensure that non-members are not in a worse position than they were in before the countries are not worse off.

Since Article XXIV of the GATT is only enforceable upon developed countries, developing countries follow a slightly modified set of rules laid out under the Enabling Clause. As per the Enabling Clause, developing countries must notify members of the WTO before engaging in PTAs and they must not increase barriers on goods from third countries. However, contracting parties do not need to reduce all tariff rates to 0. By virtue of their status as developing countries, they are allowed to keep tariff barriers on certain products. The preferential rates can be lower than the non-preferential rates, but they do not need to be 0.

I choose Brazil and India for my study because they are similar on many counts. They are both liberalizing countries having followed models of Import Substitution Industrialization (ISI), which drove those countries to bankruptcy and ultimately developed into deregulated export-oriented markets. They are both members of the G20, which speaks of their economic might in the international trade arena. They are both democracies, which means that international firms find them reliable market environments in which to operate. India and Brazil are competitors in the agriculture as well as the manufacturing and service sectors. Agriculture generates 17 percent of India's GDP (2009 est.) and 6 percent of Brazil's. Manufacturing is over 15 percent of both India's and Brazil's GDP. According to the "2010 Global Manufacturing Competitiveness Index", by Deloitte Touche Tohmatsu and the US Council on Competitiveness, India is ranked second and Brazil fifth in terms of global competitiveness of the manufacturing sector. Both countries would benefit from joining a bigger market to sell their products in. These similarities control for other differences that exist within the two markets.

Regional versus Multilateral Trade

PTAs contradict the non-discrimination policy of the WTO – the very cornerstone of the Organization, yet article XXIV sanctions them with relative ease. When PTAs are signed and subsequently sanctioned, it raises the question of whether member nations would have agreed to cut MFN rates prior to the formation of the PTA (Lamy, 2007, Levy, 1997, and Limao, 2007). Therefore numerous studies have been conducted to discover if trade blocs substitute away from and hinder multilateral trade, or truly enhance it through complementing trade strategies. This is the biggest criticism in the classic 'building block versus stumbling block' logic that has been hotly debated since the early years of the GATT (General Agreement on Tariffs and Trade). The large market of PTAs gives members leverage at the Multilateral Trade Negotiation (MTN) table

and reduces the risk of failed MTNs or biased multilateral liberalization.[2] However, the risk that each member of a PTA signs onto when it joins one is that if the PTA favours regionalism to multilateralism, short-term gains achieved in the PTA could potentially become lost in the long run. Conversely, if a PTA is seen as a stepping stone for further multilateral trade liberalization, then the potential of long-term gains will encourage countries to liberalize trade regionally even in the likelihood of short-term losses. Economic models created on the subject suggest that cutting tariffs preferentially has, at best, an ambiguous effect on member welfare (Viner, 1950), and at worst, causes a deterioration in international trade if too many PTAs form (Bhagwati et al., 1998). Bhagwati designs a model called the Dynamic Time-Path model, which suggests that the final outcome of expanding PTAs is multilateral trade. Countries that form PTAs with the intention of trading multilaterally eventually create a multilateral regime through the expansion of those PTAs.[3]

However, the intermediate step of PTA expansion into the multilateral regime is not purely governed by economics. When PTAs are signed, it isn't certain whether member nations will agree to MFN rate tariff cuts later. The desire to liberalize trade beyond regional agreements is something Bhagwati et al. Dynamic Time-Path Model does not consider, and yet ascertaining this plays a vital role in determining how negotiations progress at the multilateral table (Bhagwati et al. 1998). The model says that given enough time, all regional agreements will converge to multilateralism. However, a definite timeline for multilateral integration following regional integration becomes important for confidence in the multilateral system. With little short-term incentive for smaller countries to integrate multilaterally, they are more prone to becoming comfortable with regional trade, and hence risk diluting domestic support for multilateral integration.

However, governments continue to laud the benefits of PTAs and assert that all PTAs are formed with the intent of ultimately liberalizing multilaterally. PTAs essentially act as laboratories for multilateral agreements (Zahrnt, 2005). Unfortunately, regional agreements have the potential of obscuring the potential gains from multilateral liberalization and result in a loss of political support for the same (Levy, 1997). Countries engage in deep integration regionally and become very comfortable with the cozy market that gets created. The power asymmetries of large and small country PTAs allows the larger countries to actually create higher non-tariff barriers for non-members (Limao, 2007), and gain better control of the regional market. Despite the fact that multilateral trade improves the status quo on prices, and consequently reduces volatility (Mansfield and Reinhardt, 2005), members do not want to forgo the short-term benefits of PTAs that they have become accustomed to.

On the flipside, much of the literature suggests that PTAs are predominantly trade creating. Most countries form PTAs to eventually liberalize their markets multilaterally (Krueger, 1999), which is in concurrence with the Dynamic Time-Path model. Paul-Henri Spaak, the Director-General of the newly formed WTO was of the opinion that Regional Trade Agreements, "are becoming more and more important in terms of trade rules, and for the political weight they represent in international negotiations" (1995). Ethier (1998) views preferential trade as a result of liberalization achieved in MTNs. He argues that it is easier to reach a consensus with fewer members. Liberalization achieved at the multilateral table benefits smaller countries when they enter trade agreements with larger countries. Either finds that developing countries actually compete with one another to gain the favour of large economies so that they can enter a trade agreement with them and reap the benefits of the agreements reached at the multilateral table. Competition by nature improves welfare and it is the main goal of multilateral trade from the

outset. From this perspective, PTAs are a result of the success of the open multilateral system and are thus compatible with further multilateral liberalization.

PTAs increase in regional trade volumes, which ultimately leads to an increase in total trade volumes as demand rises (Steinberg, 2002).

Saggi and Yildiz design a model that analyzes scenarios in which FTAs are permitted to form in conjunction with global trade against scenarios in which FTAs are not allowed to form, leaving global trade as the only option. They find that pursuing FTAs along with multilateral trade reduces the likelihood of reaching full free global trade. Accordingly, there is a conflict between Article XXIV and the main goal of the GATT of achieving global free trade. However, they also find that FTAs lead to welfare improving trade liberalization when global free trade cannot be achieved. According to this, it is better to have some PTAs than to have none at all when global free trade is infeasible. Their model takes into consideration the potential asymmetries in market size and power that is endemic to international trade. As a result, FTAs are better able to favour low cost producers relative to high cost producers. (Saggi and Yildiz, n.d.)

Method and Argument

In this study, I analyze ad valorem tariff rates and intra-regional trade volumes to see if there is trade creation or trade diversion. I examine the relationship between preferential and Most Favoured Nation (MFN) ad valorem tariffs on goods being imported into India and Brazil. The analysis follows the Baldwin and Seghezza study (2007) for tariff rates exhibiting trade complementing behaviour versus trade substituting behaviour. I hypothesize that trade substituting behaviour will reflect in the data on trends in intra-regional trade and show that it

grows in relation to extra-regional trade. In trade complementing behaviour, intra-regional trade volumes will either shrink or remain the same in relation to extra-regional trade volume.

Tariff barriers are the first line of protectionism that countries use to substitute away from multilateral trade. The goal of the WTO is to harmonize international tariff barriers between countries, or eliminate them altogether. Harmonizing tariffs allows fair competition in the international market and shifts supply to the most efficient producer in the market. Eliminating tariffs altogether, allows international goods to compete with domestic products, and provides the most level playing field for products sold on the international market. Analyzing the relationship between preferential and non-preferential ad valorem tariff rates on goods imported allows for a quantification of how open or protectionist a market is. Each data point is a product that has a preferred tariff rate as well as an MFN rate. Using this we can compare the added cost of the product in the world market in comparison to the preferential trade market. Using data for products that have both these rates controls for products on which a consensus at the WTO has not been reached.

Tariff rates inherently carry little information on whether preferential trade agreements lean away from multilateral trade or not. In the case of Mercosur, where 15 percent of the products still have domestic tariff rates, it is important to know what those products are and what quantities are traded on the international market. It also becomes important to know the other 85 percent of products on which preferential tariff rates are zero and whether those products are disputed at the WTO or not. Therefore, tariff rates are only a first indicator to evaluate if a country is substituting away from multilateralism, or complementing it.

When negotiating at the multilateral table, it becomes important for non-members to know if it is worthwhile to pursue multilateral liberalization. Large negotiation costs can be

avoided if it can be made clear whether PTAs are willing to reduce barriers or not. As I mention above, economic models fail to explain when regional trade agreements will reduce barriers for the rest of the world. One signal that countries can give the international trade community of their intent to liberalize multilaterally is to reduce their trade barriers over time to Most Favoured Nation Rates (MFN rates). Comparing MFN rates to the tariffs offered to regional partners on the same products indicates whether those countries see regionalism as a substitute for multilateral trade or as a complement. I gather data on tariff barriers over a specified number of years to see how tariff barriers perform.

I then look at intra-regional and extra-regional trade volumes in absolute terms and relative terms within SAARC and Mercosur to India. A comparison between total trade volumes in absolute terms and the volume of imports as a percentage of GDP will constitute a first glance into whether imports are mostly coming from countries within the regional agreement or not. I then look at the data on ad valorem tariff barriers. The goal is to see if preferential tariff rates are significantly lower than world tariff rates or not. If there is considerable discrepancy, then the countries are substituting away from international trade. However, if the difference in tariff rates is low, then multilateral trade and regional trade are complements of each other. The latter is what I hope to obtain as it will be an optimistic outlook for MTNs. However, if the converse is true, where preferential trade is a substitute for multilateral trade, then there is a strong chance that the presence of the PTA is not only detrimental to non-members, but to members of the PTA as well.

The data I have collected includes *ad valorem* tariffs on a range of products that Brazil and India import both multilaterally as well as preferentially. They are coded as advalorem1 and advalorem2 respectively. The variables are operationalized as a value added tax or a percentage

of the cost of the product levied on the final price in the market. This effectively makes the imported products more expensive for domestic consumers and consequently less desirable in the face of domestic or regional substitutes. I analyze data from 2001 to 2009 for India (barring a few years in the middle due to unavailability of data) and from 2004 and 2009 for Brazil. I check to see the ratio of preferential *advalorem2* rates and non-preferential *advalorem1* rates to confirm trade diversion or trade promotion. I analyze data over a series of years to see if a trend emerges.

To see if there is an improving trend in tariff rates, the time series study will look at the mean tariff rate for advalorem1 and advalorem2 and the standard deviation for both to check for convergence to 0. If there is convergence between world tariffs and preferential tariffs then there is no need for rates to drop to zero. However, if there is significant difference between the two, then analyzing the trend for the mean value as well as the standard deviation over time becomes important in discovering insights into each country's respective trade practices.

The study of ad valorem tariff barriers is insufficient to indicate whether a country is leaning toward multilateral liberalization or not. This becomes especially pertinent in light of the study performed by Saggi and Yildiz, which suggests that preferential trade might actually help in areas that cannot be reached multilaterally. If keeping high tariff barriers actually helps multilateral trade, then a third dimension requires analysis.

Results

The summary statistics for each country over the specified time series reveal that while India has been steadily reducing both its SAARC as well as MFN Tariff Rates (MFN rates), Brazil has kept its MFN rates steady throughout the time range. The mean advalorem1 rate for India has reduced from about 38.6 percent to 20 percent from 2001 to 2009. India has fluctuated

the number of products it sells on both the international as well as SAARC market, but that may have to do with India engaging a strategy of specialization and comparative advantage since it opened its economy in the 90s. Brazil on the other hand has a mean tariff of approximately 11 percent to 12 percent on the products it imports from the world, as opposed to Mercosur countries to which it offers a 0 percent *ad valorem* tariff rate. The results are displayed in tables 1, 2 and 3. Figure 3 gives a graphical indication of international tariff rates across a variety of products that Brazil imports both internationally and preferentially. The MFN rates have largely remained steady since 2004 with tariff rates changing for a marginal number of products. The mean tariff rate remains locked between 11.39 and 12.38 and the standard deviation also remains steady between 5.98 and 7.83. Figure 3 does not show any indication of MFN rates converging to Preferential Tariff Rates; Brazil is not budging.

India is exhibiting trade-complementing behaviour. Figure 4 is an amalgamation of India's Preferential and MFN Tariff Rates from 2001 to 2009. The data in the scatterplots fits Baldwin and Seghazza's model for complementary behavior. The years 2008 and 2009 show reveal that a number of products have low Preferential Trade Rates and high MFN rates, but for the most part, the data follows the 1:1 line showing a proportional relationship between Preferential Trade Rates and MFN rates, which signals a trade policy favouring complementary trade tariff rates. The mean advalorem1 value for India in Table 1 drops from 38.59 to 20.17 (it drops to 18.35 in 2005 only to rise in 2008, but the change is small compared to the overall change, and it also has to do with the fact that more products – more than 600 – have been added to India's import portfolio between those years). The standard deviation also falls from 35.24 to 18.33 showing that there is lesser fluctuation in tariffs on products between Preferential Tariff Rates for SAARC countries and MFN rates for the rest of the world. The advalorem2 import

rates for SAARC countries trading with India also exhibit a similar optimistic convergence of rates as the mean value drops from 18.68 to 12.87 after jumping to 30.07 in 2004. The standard deviation also reduces from 7.82 to 6.55, which isn't a big difference, but it sends a signal to its PTA members as well as to other WTO members that India is steadfast on keeping import tariffs low on many products, and high rates only for a few in comparison. Figures 1 and 2 give a better visual understanding of how the data for advalorem1 and advalorem2 is distributed for India. The number of observations increases more than doubles from 2004 to 2009. India has begun trading more and more products both preferentially, as well as multilaterally. The mean value for both variables fluctuates, but the trend is that of reduction. The trend is also simultaneous for both preferred rates and MFN rates which shows complementary behavior in the data and bodes well for MTNs.

Trade volumes for countries in SAARC show that imports from India as a percentage of total world imports are either increasing, or remaining steady for other SAARC members. In absolute terms, import volumes are growing for each country, and as the import volume grows, so does the amount it imports from within the PTA. This is true for all members of SAARC apart from India who is leaning more toward trade from outside the region than preferential trade. This trade practice seems almost self-diversionary on the part of the smaller members since they could be trading multilaterally, but they are availing of the small advantages in preferential tariffs that they receive from India.

In the case of Mercosur, imports from Brazil as a percentage of total world imports decrease for Paraguay and Uruguay. Imports from other Mercosur countries as a percentage of total world imports also reduce for Brazil. However, Argentina is the only country for whom imports from Brazil grow. In three out of the four cases, as absolute import volumes increase, the

import volumes from Brazil (for Paraguay and Uruguay) as a percentage of total world import volumes and import volumes from other Mercosur countries (for Brazil) as a percentage of total imports from the world both decrease. This indicates that, even with the tariff barriers in place, Mercosur countries are importing more and more from countries outside the regional agreement.

Analysis

Brazil is showing a much stronger preference for preferential trade over multilateralism. The fact that the MFN rates have not changed in the last six years could signal that the regional market is becoming comfortable with the regional policies. India, on the other hand, is simultaneously opening up trade for products both preferentially as well as multilaterally. SAARC uses a commodity-by-commodity approach to trade integration. This is done to meet domestic policy objectives, which are extremely different in each of the member countries of SAARC. However, this makes negotiations notoriously long and, at times, politically fruitless.

Tariff barriers divert trade away from the world and to the region. Trade diversion is something the multilateral trade regime wants to minimize or eliminate altogether. The fact that Mercosur has steady trade barriers means that the region is substituting away from multilateral trade (as per the Baldwin and Seghezza model). However, the WTO allows PTAs to form under the condition that while they may reduce trade barriers internally, they must not raise the external trade barrier (more than their original level) so as not to leave third countries worse off. But how does all of this enhance multilateral trade? This is a heavily nuanced subject and there is no easy answer. Data obtained from UNCTAD on imports to Brazil from other Mercosur members as a percentage of total world imports is steadily reducing (from 13.9 percent in 2000 to 8.9 percent in 2008). Despite the common external tariff, imports from the world are finding there way into Mercosur. The multilateral regime is being enhanced by the regional market as it is allowing

more trade from outside to enter. The question is: what are the factors promoting international trade?

One theory is that regional trade agreements sufficiently enlarge the market so that domestic goods first compete with regional goods. The most efficient good gains footing regionally and then when regional goods are strong enough to compete with extra-regional imports the market is slowly opened for international products. So here is an answer to the question: how does regionalism enhance multilateralism? A basic answer would be that regionalism holds multilateral trade at bay while the regional market grows. During this time, third countries are not any worse off. When the regional market is ready, extra-regional imports are allowed to enter, which makes third countries better off. The case of Mercosur seems to suggest this.

It is commonly understood that the fewer participants there are in a negotiation, the higher the chances of reaching agreements. Moreover, the fewer the number of participants in the agreement, the greater the scope of issues upon which agreements can be made i.e. deeper integration can be achieved. (Either, 1998; Reich, 2010) This is the basic rationale for why PTAs are permitted by the WTO: the multilateral regime must not inhibit agreements that could potentially be made at the regional level. The Saggi and Yildiz model predicts the success of a strategy to allow preferential trade agreements to form on areas that the multilateral trade regime fails.

The next section seeks to address the nuances in Preferential and Multilateral Trade patterns exhibited by India. I will perform a historical case study to see how each country's trade strategy evolved over time. I hypothesize that an increase in competitiveness in areas where Brazil and India have comparative advantage under PTAs has allowed the two countries to

engage in trade creation. Competitiveness is achieved by offering the highest quality of products and services for the lowest price. Industries are able to become competitive in an environment where they face low costs of production and are able to sell large enough volumes in the market to make profits for further investments.

Regionalism is an increase in the market size, and so an ability to trade in larger volumes. Members become favoured insiders in protected markets, which gives them more economic and political gains than through multilateralism. For developing countries, engaging in regionalism, allows them to improve their imports and gain competitiveness, which is seen as a gateway to global trade. The protection tariff barriers offer allows firms to grow without having to face competition from more efficient producers in third countries. As a result, countries can export within a market that slowly makes brings them to the level of competitiveness they need to reach before their exports can compete with third countries outside the regional agreement. Competitiveness of exports is essential for improving employment and striking a healthy Balance of Payment account. The latter gives countries flexibility in the amount they import without worrying about losing foreign exchange reserves. Both employment levels and foreign exchange reserves are important factors for the macroeconomic stability of a country. Regionalism gives protection to sectors in which a country sees maximum potential for employment. This is the basic tenet that guides a country's impetus to liberalize trade regionally before integrating multilaterally.

The Case of India

Before 1991, India followed a model of Import Substitution Industrialization (ISI). It implemented a model of a planned economy in which capitalism was combined with government

intervention. Created by Jawaharlal Nehru, an elaborate system of licensing, infamously called the "License Raj" was set up. All aspects of the economy were controlled by the government and private firms had to go through extensive measures of red tape before they could procure an official license to carry out business and even then the amount companies produced was determined by the license instead of market forces. The fixed quotas on production reduced export competitiveness and imports were determined through more bureaucratic red tape and not market forces. As a result, exports essentially became what the local economy could not consume domestically and not a result of international demand (Nath, 2008: 121).

The consequences of India's ISI strategy were deleterious to its balance of trade. Non-competitiveness of domestic firms caused imports to far outstrip exports despite the significant protectionism in place by way of licensing. The restrictiveness of the Indian market caused multinational corporations (MNCs) to reduce or altogether eliminate investment. As Kamal Nath, India's Minister of Commerce put it, "if businesspeople, industrial barons, and foreign investors are hanging around some government office instead of being in the market, assessing investment decisions and doing deals, then there is something wrong somewhere" (2008). The government was closing the economy to the outside world, which was costing India. Coupled with low growth rates caused by a loss-making public sector the Indian government was going bankrupt.

In 1991 India obtained a loan from the IMF, and began implementing measures to liberalize the economy. Government licensing was significantly reduced and a process of industrial deregulation and privatizing the public sector was initiated. Regulations on imports were also removed and India opened its borders to international trade. India's approach toward private capital, trade policy, and foreign investment was redefined. Competitiveness was needed

to drive India's growth but India's market still needed to develop before it could match the competitiveness of the international trading arena. A popular method of promoting bilateral trade took a hold of India, as it gave India the ability to expand into markets on terms that it found conducive to slowly improve competitiveness. As a developing country and a producer of primary goods it saw bilateral and plurilateral trade as a way of improving and exploiting its comparative advantage (Acharya, 2009).

In its search for regional trade partners, India has made plurilateral agreements with developing countries such as Nepal, Bhutan, Bangladesh, Afghanistan, Pakistan and Sri Lanka in SAARC, as well as bilateral relations with the US, the EU and China. For India, developing a regional agreement with SAARC members was a strategic move to expand trade in a market where it has a comparative advantage in almost every sector (Dash, 1996). Exports to SAARC countries have remained steady between 4.2 percent and 6.4 percent of its total world exports over the last 10 years. Bhutan, Maldives and Nepal rely heavily on trading with India, which constitutes a loyal market for Indian exports.

For India, trading with each SAARC member sets a unique set of opportunities and challenges. Nepal and Bhutan have a reciprocal relation with India of completely open borders for trade. However, being least developed countries (LDCs), the markets in Nepal and Bhutan are not big enough to sufficiently boost India's exports. The security concerns with Pakistan are the biggest impediment to regional trade in SAARC. India accords MFN status to Pakistan, but the policy is not reciprocated. As a result, trade with Pakistan emerges from a need to maintain regional security instead of trade competition. As a result of these security issues, reaching plurilateral agreements at SAARC summits takes longer than regional agreements generally take in concluding.[4]

Despite difficult relations, India has the ability to produce cheaper goods for the region (otherwise available at high rates) and help members conserve their foreign-exchange reserves. Unfortunately, this runs the risk of appearing as though other members are dependent on India. Economic interdependence, and not dependence is what is needed to offset the threat of India's trade hegemony. However, the territorial disputes and security concerns within the region make interdependence politically difficult. Along with the bilateral disputes, the spillover effects of ethnic and religious conflict make regional cooperation difficult.

In the last two decades, India has made significant advances in the service, manufacturing, and agricultural sectors and has steadily increased its trade surplus reaching $8.5 billion in 2008 (Reserve Bank of India). Although the manufacturing sector in India is small compared with China and OECD countries and is not the main driving force behind India's growth, it ranks as the second most competitive in the world.[5] It is the service sector in which India has significant comparative advantage that fuels India's exports to developed countries. The positive relationship between exports and employment is an important factor in fuelling India's growth.

India has significant interest in increasing its exports to be able to import high-technology goods from its larger trading partners such as the US and the EU. Trading bilaterally with the US and EU requires a highly competitive export sector to match the competitiveness of firms in those markets. India's comparative advantage in the service sector has given it the edge it needs in negotiating bilateral agreements with the US and EU. Both the US and EU rely on India's service sector to improve entrepreneurial activity in their private sectors. As India becomes an important trade ally, its firms are able to expand exports to a market where they can profit from the most. As a result India is successfully able to acquire high technology imports that improve competitiveness in the agricultural sector, which is still heavily protected. Moreover, India has

been able to ink deals with the US in areas of military technology, which it requires to exert military influence in a region plagued with security issues in the form of Indo-Pak and Sino-Indian relationships. India's space program also gains significant advancement from the same range of technological imports India receives for military purposes.

The Case of Brazil

Brazil too followed a model of ISI that lasted several decades before it led to hyperinflation, stagnation and crises. The public sector was inefficient and making heavy losses. Regulations for investing in the domestic market were not boosting growth. Imports were curtailed to artificially bring about a balance of trade surplus. But domestic growth was insufficient. Brazil continued to borrow from international financial institutions, to boost growth amidst inflationary pressure. As a result, Brazil spiralled into foreign as well as domestic debt in the late 1980s. With no other option remaining Brazil too began a process of liberalizing the market in 1990, privatizing the previously regulated public sector. This was done to boost competition and efficiency to tackle inflation and bring Brazil out of debt.

However, the developmental policies that the nation followed previously "were adapted without dismantling the web of interests installed in the Brazilian State" (Lengyel and Ventura-Diaz, 2004). As market regulations were reduced, so were tariff barriers on imports into Brazil. They fell from well above 32 percent in the early 1990s to about 13 percent by the end of 1993. The Brazilian government simultaneously promoted the conversion of a bilateral trade agreement with Argentina into a Free Trade Area that included Uruguay and Paraguay as well. Mercosur was created which was to eventually become a Customs Union. Latin American politicians hoped that creating a regional trade bloc would be a stepping stone for negotiating larger trade

agreements multilaterally, and despite what critics said about the ambiguous nature of PTA welfare, politicians in the respective countries hoped that the positive effects would outweigh the negative effects (Angrisani, 2005).

"The aim of regionalization" in Latin America, as Angrisani puts it "is to unite countries in Latin America into small groups prior to their integration into a larger, hemisphere-wide trade bloc" (2005: 129). This strategy concurs with Zahrnt's logic of PTAs being laboratories for integration strategies before multilateral liberalization can be considered viable (2005). Mercosur's coordinated macroeconomic policies are geared toward attracting investment, and this is visible as the economies, and injection of FDI in member countries grows rapidly. By the early 2000s (expedited greatly by the Argentinean financial crisis) Brazil reduced tariff rates on nearly 85 percent of the goods traded within Mercosur to 0 percent. There was a mean tariff of about 12 percent on goods coming from outside Mercosur. This is relatively high when compared with average tariffs between 4 and 6 percent levied on imports by OECD countries.

The legacy of pre-1990 protectionism from larger industrial nations still remains amongst the technocrats of Brazil, so the domestic lobby of industrial elites prefers intra-regional trade to protect its import-competing sector from larger industrialized nations (Veiga, 2009: 115). Since 1996, Brazil has implemented a policy of controlling imports while increasing and diversifying exports. Today, Brazil manufactures both heavy industrial goods (cement, iron and steel, heavy chemicals), and tertiary goods (automobiles) for the global market. Mercosur's GDP (ranked 5th according to the World Bank) creates a sizeable market for Brazilian goods with comfortable trade barriers in place.

Despite high trade barriers for goods form outside Mercosur, Brazil still imports considerably from outside Mercosur. Brazil ranks 5th on the Global Competitiveness in

Manufacturing Index, which draws imports from outside Mercosur.[6] In 2006, Brazil's imports from the US totalled $19.2 billion. Computer parts and peripherals topped the list, followed by civilian aircraft parts, oil drilling machinery, plastics, and organic chemicals such as fertilizers. In the same year, US imported a total of $26.4 billion from Brazil. This list consisted of a range of heavy industrial (chemicals, crude oil, civilian aircraft, semi finished steel goods) as well as raw goods (stone, cement, fuel oil) (Workman, 2007).

Brazil's agricultural sector competes with distorting trade practices because of the US Farm Bill (Cason, 2011). No amount of good will on the part of the US can compensate the losses Brazil accrues due to the trade distortion of US agricultural subsidies. Brazil has a natural comparative advantage in the agricultural sector and is the world's largest exporter of oranges and sugar (Encyclopedia of Nations). Brazil must keep barriers on US agricultural products or risk losing the market to them. Because of the trade distorting practices of the US and hence sees the WTO as the most relevant forum for fairer trade. Brazil favours regionalism because it has increased market power at the multilateral negotiation table to counterbalance the hegemonic capacity of the United States. That has always been its primary tenet, and the driving force behind the political rhetoric in the region to favour regional trade within Mercosur. In fact, despite long-standing average tariff barriers of on goods imported from outside Mercosur, Brazil has a competitive trade environment and attracts a larger share of its imports from outside Mercosur as a percentage of its total imports year after year.

As India and Brazil's economic strength improves, they have the ability to negotiate at the WTO on behalf of developing countries in terms of reforms in the agricultural sector. A highly protected and highly distorted sector on the multilateral level, reforms are required to promote fair multilateral trade in agriculture, and this requires countries, which have not only a

vested interest in undistorted trade, but and are able to exert leverage as well. Leverage comes in the form of interdependence with third countries on trade with Brazil and India, and an interest in sectors in which third countries want access through reduced barriers.

Conclusions and Notes for Further Study

I ask the question: do PTAs enhance multilateral trade? Scholars agree on both sides and the two paradigms I present seem to create trade. While it may seem as though Brazil is substituting away from multilateral trade more than India but the data on recent import and export trends from Mercosur and SAARC countries shows that extra-regional imports are growing more than intra-regional trade. Both India and Brazil are reformers. They have taken great measures in liberalizing their economies in the 90's and see the benefits in extending this ideology and strategy amongst its Trading partners. Tariff rates are not the best way to see if countries are trade creating or trade diverting extra-regional trade volumes.

The emphasis of the world-trading regime has shifted from pure multilateralism to one in which multilateralism and preferential agreements coexist. Does this follow the Dynamic Time-Path model to eventual multilateralism, or will countries be satisfied in bearing the heavy costs of forging individual agreements? Do PTAs stimulate support for further multilateral liberalization or do partners become "satisfied with projected trade patterns" (2010: 638), thereby diluting the political incentive for multilateral trade. Ascertaining the extent to which proliferation of PTAs is compatible with further strengthening and liberalization of the open multilateral trading system is imperative for better trade.

Regionalism has helped India and Brazil become more competitive and exploited their comparative advantage to boost exports, and this is what has given them the ability to engage in more global trade. They have successfully kept trade surpluses, and even rank highly on the

Global Manufacturing Competitiveness Index in 2nd and 5th place. Both countries are able to exploit this advantage on the global scale and thereby attract imports from countries beyond their regional agreements despite high tariffs.

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Data Sources:

UNCTAD
DOTS
WITS

Table1. Country: India
Variable: advalorem1

Year	Obs	Mean	Std. Dev.	Min	Max
2001	2272	38.58952	35.24844	0	587
2004	618	44.32183	26.70688	15	105
2005	1024	18.34961	9.738057	5	105
2008	1675	19.25688	16.11723	2	100
2009	1624	20.16687	18.32922	2	150

Table2. Country: Brazil
Variable: advalorem1

Year	Obs	Mean	Std. Dev.	Min	Max
2004	9587	11.75029	6.576855	0	55
2005	8942	11.45667	6.068795	2	55
2006	8870	11.44831	5.988588	2	35
2007	8889	11.39211	6.009683	2	35
2008	8836	12.11402	7.472192	2	35
2009	8894	12.37936	7.827099	2	55

Table 3. Country: India
Variable: advalorem2

Year	Obs	Mean	Std. Dev.	Min	Max
2001	2272	18.68239	7.820173	0	103.5
2004	618	30.06733	22.20392	15	95
2005	1024	15.74365	6.531072	3.75	94.5
2008	1675	12.773	6.542191	1.5	29.11
2009	1624	12.87346	6.557449	1.5	27

Table 4. Summary Statistics Trade Volumes

country	year	imports from world	imports from SAARC (percent of world imports)
India	2000	50336.4	0.941614816
India	2001	59153.1	1.112949279
India	2002	58912.5	0.92523658
India	2003	74078.1	0.89714774
India	2004	99838.1	0.890902371
India	2005	139888	0.935950904
India	2006	176669	0.839897209
India	2007	235025	0.834117647
India	2008	281467	0.664866574

country	year	imports from world	imports from MERCOSUR (percent of world imports)
Brazil	2000	61875	13.85978343
Brazil	2001	61463.4	12.54567922
Brazil	2002	51955.7	11.88811815
Brazil	2003	53302.1	11.73402924
Brazil	2004	69154.1	10.16916423
Brazil	2005	80928.6	9.584653633
Brazil	2006	101175	9.753103039
Brazil	2007	132669	9.642995726
Brazil	2008	229877	8.905214963

scale: millions
Source: UNCTADSTAT
URL:
http://unctadstat.unctad.org/TableViewer/tableView.aspx

India
Figure 1. World tariff rates on imports to India

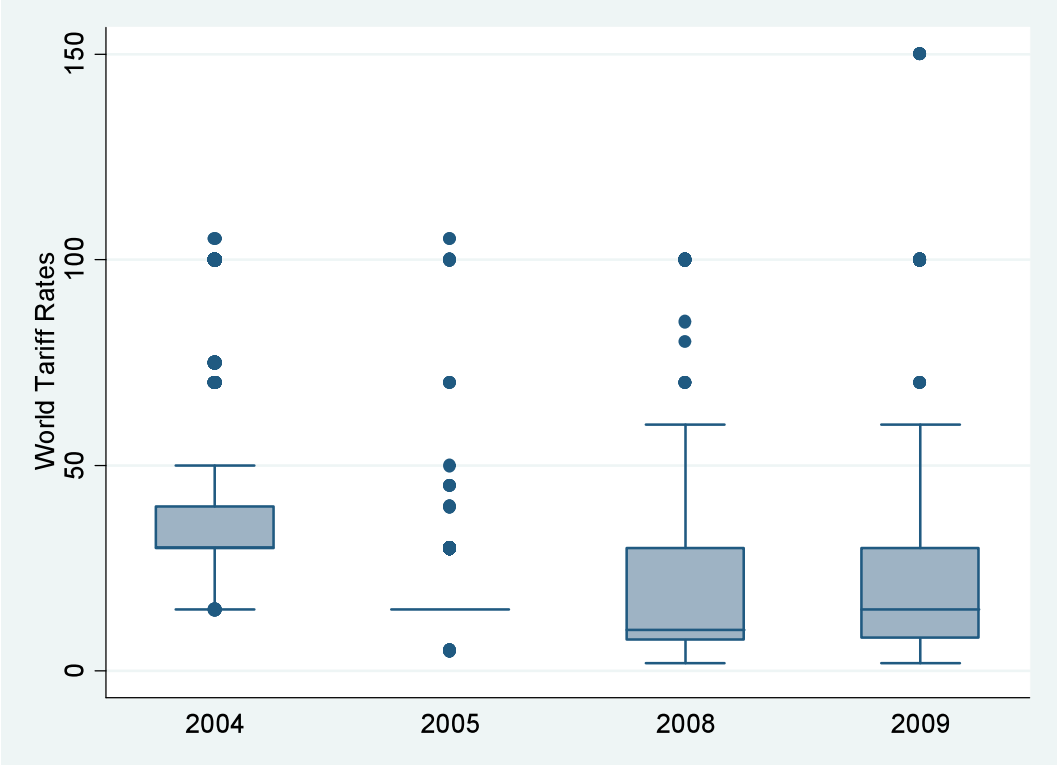


Figure 2. Preferential tariff rates on imports to India.

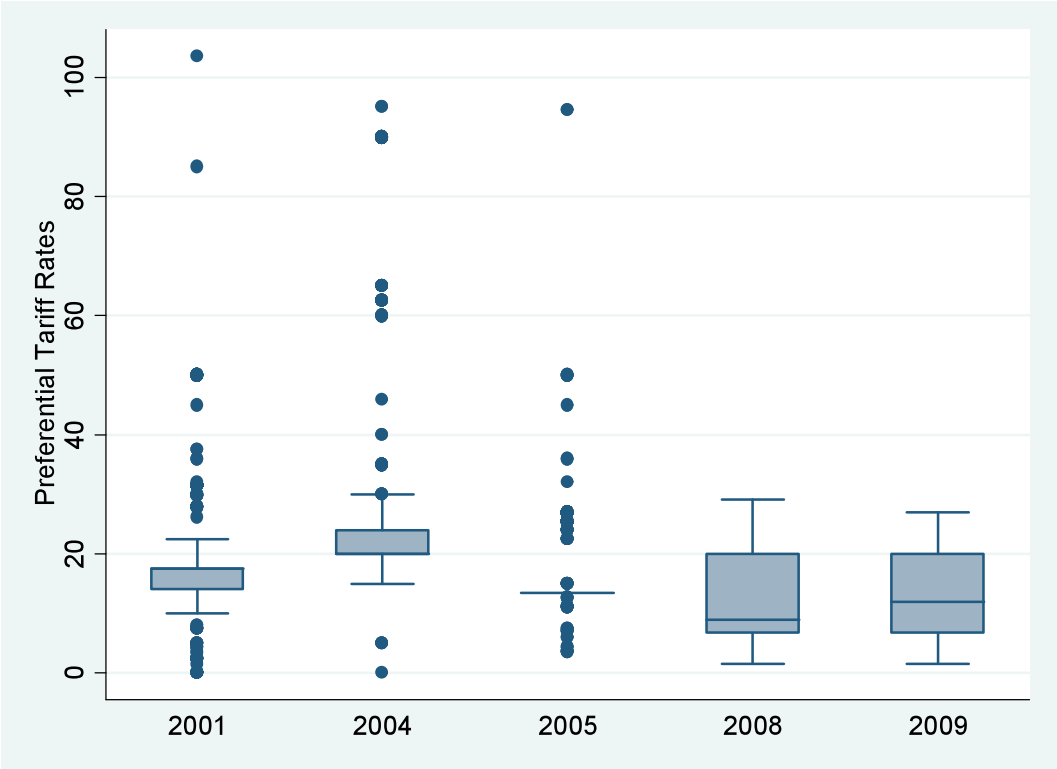


Figure 3. World tariff rates on imports to Brazil.

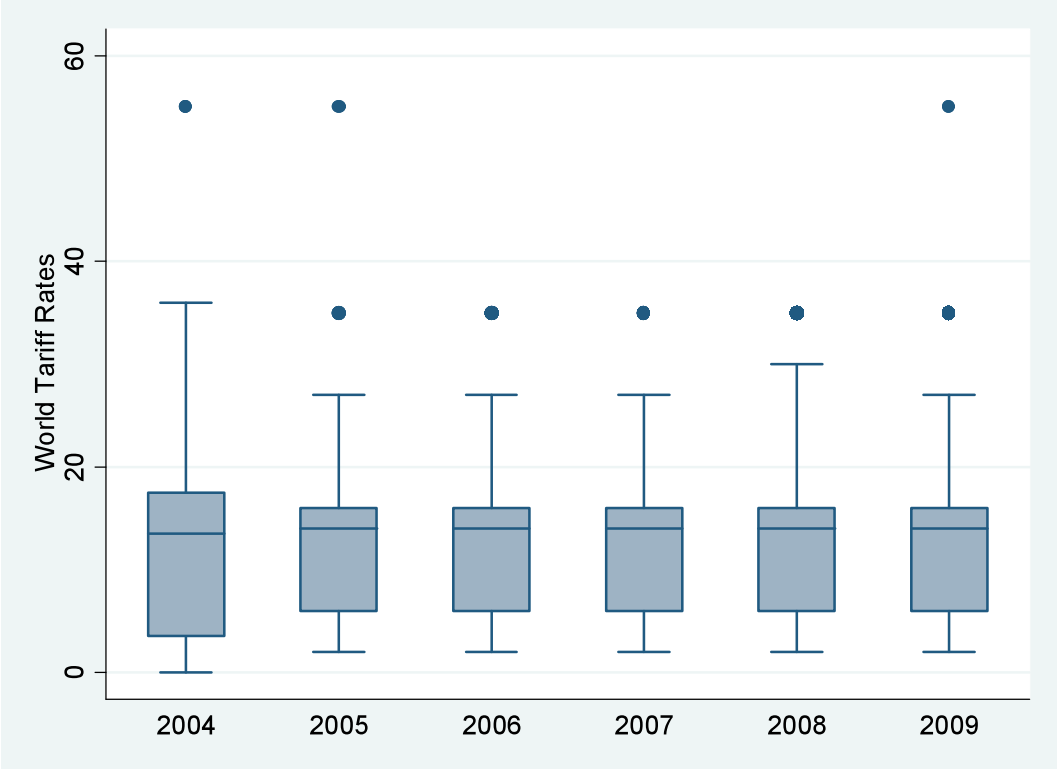
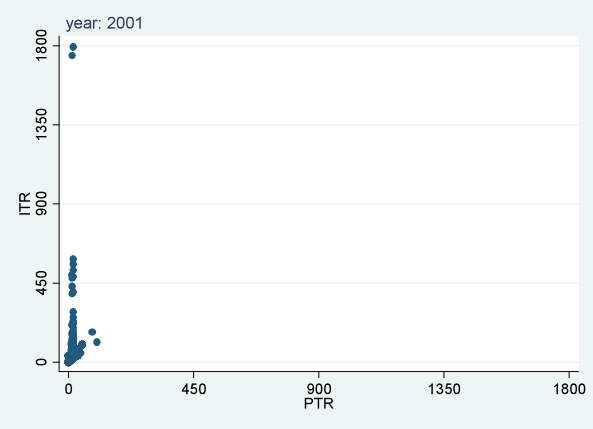
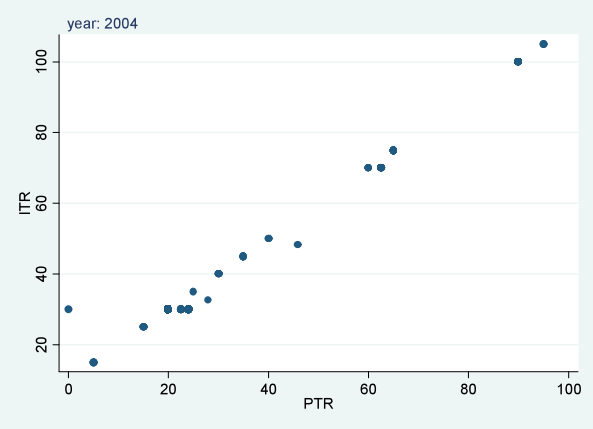
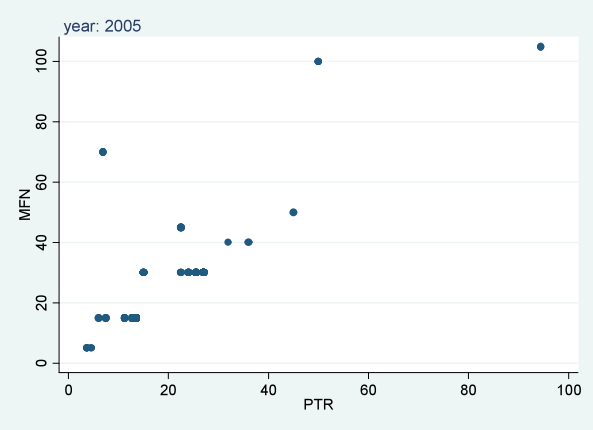
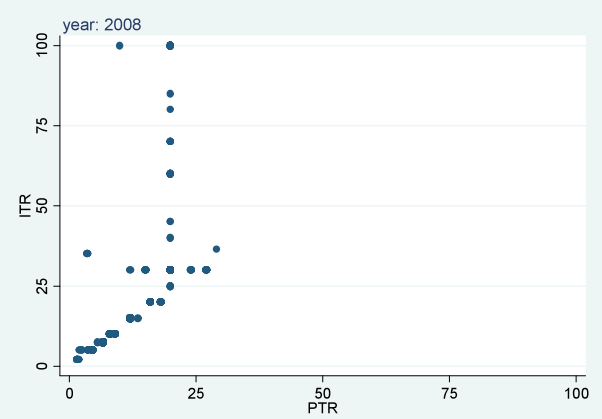


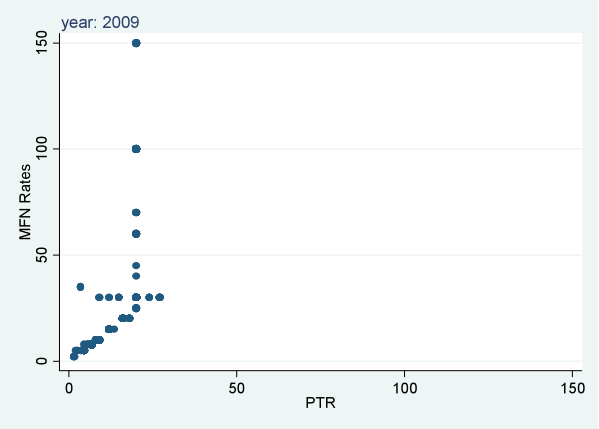
Figure 4. India Time Series PTRs versus MFN rates











Notes

[1] Article XXIV of the GATT permits the formation of PTAs so long as 1) they are notified to the WTO beforehand; 2)that the tariff rates between partners is 0; 3) that there is a definite timetable to achieve the required levels of tariffs; and 4) that contracting parties do not raise barriers upon the rest of the world beyond the barriers that are already in place.

[2] Small countries continually run the risk of being victims of dumping practices on the part of larger economies. This is especially pertinent in the agricultural sector in which most smaller agrarian societies are dependent, but the US and EU continue to overproduce and drive down international prices on food crops.

[3] Bhagwati Dynamic Time-Path model is further explained in Bhagwati et. al. 1998.

[4] Regional agreements are usually phased in over 10-year long processes, but SAARC has been negotiating for the past 25 years without any viable plurilateral solution for lowering preferential tariff rates.

[5] Deloitte, 2010 “Global Manufacturing Competitiveness Index”

[6] Deloitte, 2010 “Global Manufacturing Competitiveness Index”