Trade Liberalisation & Consumer Welfare in South Asia

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Background

- Intra regional trade in South Asia is least as compared to other economic blocs in the world

- Intra regional trade has stagnated at under 5% of total trade as against 27.06% for ASAEN

- SAFTA suffers from shortcomings such as:
  - Large Sensitive Lists retained by Members
  - Minimal provisions on non tariff measures
  - Strict value-addition requirements

Background

- Though positive effects of export promotion on economic growth is well acknowledged, trade policy regimes in South Asia are still highly influenced by the notion of import-substitution

- Impact of trade liberalisation on producer welfare is given thrust, while positive effects on consumer welfare is ignored

- Deeper economic cooperation among the South Asian countries could avoid high costs to consumers

Theoretical Basis

- Classical trade theory and its modern derivations treat consumer welfare effects of trade as inseparable from producer welfare. Empirical literature consider them differently because of distinct incidence on importing and exporting country respectively.

- Given that reciprocity is a basic element for the functioning of trade treaties, demands for tariff concessions in sectors with maximum export induced producer welfare should be accompanied by offers of tariff concessions in sectors with maximum import induced consumer welfare.

Inferences from Meta-Analysis

❑ Beginning of import substitution and protectionism in the post independence era worked asymmetrically against regional trading partners for all SA countries

❑ Empirical evidences exist for minimal impact of trade diversion

❑ The political economy of selection of sensitive lists indicates weak possibility of trade diversion

❑ Argument of need for resistance to regionalism in other parts of the world through SAFTA. It may quicken multilateral freeing of tariff barriers

Inferences from Meta-Analysis

❑ Rejection of significance of SAFTA based on "natural trading block" hypothesis based on geographical proximity (trade intensity index), degree of complementarity (complementarity index – matching export profiles and import demands) Ignores Post-liberalisation trade diversification effects

❑ Existence of huge informal trade in the region could not be explained

Inferences from Meta-Analysis

❑ Wide variation in quantitative predictions on impacts depending on assumptions used

❑ Reliance on past trends and ex-post analysis

❑ Ignores positive influence of RTAs in changing the traditional rent-seeking behavior

❑ Ignores positive externalities of development of trade infrastructure and related trade reforms for trade costs

❑ Excludes effects of changes in transaction costs due to trade facilitation measures

Inferences from Meta-Analysis

- Omission of spillover effects of comprehensive economic integration including simplification of banking facilities for import financing, transit facilities for the landlocked countries, removal of barriers to intra-SAARC investments, policy consultations, rules for fair competition and promotion of venture capital, development of communication systems and transportation infrastructure, easing foreign exchange controls on repatriation of profits, simplification of procedures for business visas, etc

- Dearth of studies on consumer welfare effects – only passing references to consumer welfare gains in general equilibrium modeling exercises

Assessment of Consumer Welfare under SAFTA

- Country wise assessment of potential consumer welfare gains due to subjecting items in the sensitive lists to Trade Liberalisation Programme of SAFTA

- Calculates figures of minimum gains for product categories with maximum potential effects on consumer welfare and minimal distortions to domestic industries.

- Country wise trade data for the analysis is accessed from UNCOMTRADE database and data on import and export prices and quantity is accessed from Trade Maps, International Trade Centre

Assessment of Consumer Welfare under SAFTA (Methodology)

STAGE 1- Selection of products from sensitive lists (HS07 6-Digit level) of each country by sequentially applying the following three criteria:

☐ Products in sensitive lists of a SAFTA member country (m) with high shares in the total exports of partner countries (p) to rest of the world (RoW), reflecting the export potential of partner countries in such products

☐ A list thus selected is further filtered by selecting products which prominently feature in member county's import basket.

☐ Third level filtering by selecting products in which exports of partner countries to the member country is minimal

Assessment of Consumer Welfare under SAFTA (Methodology)

STAGE 2 – Consumer welfare gains for a member is calculated as:

$\sum CW^{mi} = \sum (p^{mi}q^{mi} - p^{pi}q^{mi})$ where,

CW^{mi} – Consumer Welfare due to change in import price of country M in product i

p^{mi} – Import price of member country M in product i from ROW

p^{pi} – Export price of SAFTA partner country p in product i to ROW

q^{mi} – Import Quantity of member country (m) in product i from ROW

Summary Results

Table 2.1				
Summary of Results on Aggregate Consumer Welfare Gains				
Country	Product Lines in Sensitive Lists	Consumer Welfare Gains (in US $ million)	Current Value Imports of Country from ROW (in US $ million)	Percentage of Consumer Welfare Gains in Imports
Bangladesh	50	398.56	2781.33	14.33
India	161	597.29	1095.45	54.52
Nepal	73	457.50	1068.27	42.83
Pakistan	44	206.18	349.24	59.04
Sri Lanka	27	288.61	918.54	31.42
Total	**355**	**1948.15**	**6212.83**	**31.36**

From Minimum to Maximum Estimates of Consumer Welfare Gains

- These estimates only show the effects of change in import price with fixed quantity of imports. The following three effects should be taken into account to arrive at revised figures:

  - ❑ Effects of domestic price reduction due to import competition by using data for total quantity consumed in the importing country, instead of import quantity

  - ❑ Effects of trade creation due to increase in import demand by using estimates of potential trade creation

  - ❑ Effects of reduction in trade costs within the SAARC region following trade facilitation measures

Usefulness of the Estimates

- The estimation method helps to identify products with maximum potential consumer welfare gains for each country and therefore, qualifies for removal from their respective sensitive list

- The estimates form the basis for more detailed studies on the effects of reduction in transportation costs and other trade facilitation measures on consumer welfare

- The estimates will facilitate comparison with other trade costs and relative merits of tariff liberalisation in each product category can be assessed

Perception Survey: Observations

- ☐ Opinion about SAFTA as an effective instrument for enhancing regional trade is regardless of opinion on the importance of regional trade integration.

- ☐ Opinion disfavouring SAFTA is not observed to based on lack of economic merits, but fundamentally on pessimism about its political feasibility

- ☐ SAFTA's future critically depends on the extent to which non-trade issues are disentangled from trade negotiations.

- ☐ Awareness on consumer welfare gains from intra-regional trade is lacking

Perception Survey: Observations

- Awareness generation on consumer welfare impacts of regional trade can make regional trade discourse more participatory and balanced

- Consideration of consumer welfare gains in trade discourse change the incentive for political utilisation of SAFTA, as consumers as a stakeholder group forms the largest constituency

Thank You