Chapter-VI

Summary, Conclusions and Recommendations

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6.1: Short Summary

Mercantilism, the famous idea, that prevailed in Europe during 1500-1800 lay stress on promoting foreign-trade sector for nation-building through the achievement and maintenance of favourable balance of trade i.e. a surplus of exports over imports. But the mercantilists were severely attacked due to their static view of world resources i.e. a country's gain from trade would only come at the expense of the other country participated in the international trade. The first assault on mercantilism came from David Hume's (1752) famous price-specie-flow mechanism which stated that mercantilists polices could at best only provide short-run economic advantages. Naturally, mercantilists, according to Hume, failed to provide a comprehensive economic analysis of nation building in the long- run perspective. Second attack on mercantilism came from Adam Smith (1776). Mercantilists' idea about world's economic pie was challenged by him who categorically stated that world's economic pie is not a fixed quantity. According to his theory of absolute advantage international trade permits countries involved in trade to take advantage of division of labour and specialization. Adam Smith's dynamic view of trade suggests that all the trading countries could simultaneously achieve higher levels of production and consumption with the absence of trade restriction. Many other economists had also made valuable contributions to the theory of international trade; notable among them were Robert Torrens (1808), David Ricardo (1819) and John Stuart Mill (1844). David Ricardo was indeed able to make essential contributions to the pure theory of international trade who stressed on the role of comparative advantage in explaining structure of foreign trade. According to David Ricardo, countries often develop comparative advantages resulting from natural advantages and acquired advantages.

Adam Smith's main contribution to international trade theory can be found, as mentioned earlier, in his dynamic approach to extent of the market. Smith combines, as Aykut Kibritcioglu explained, the concept of learning by doing with economies of scale through the idea of division of labour, which in turn can only be improved by extending the market. In the early 20th century Eli F.Heckscher and Bertil Ohlin (1919, 1933) gave an explanation of comparative advantage arguing that a country would be able to produce

at lower cost those products whose production required relatively large amounts of the factors of production with which that country was relatively well endowed. All the modern trade theories developed especially since 1960s onwards are based on economies of scale and imperfect competition. Relaxing the assumptions of constant returns to scale and perfect competition can lead to new trade theory. Almost half of the trade in manufactured goods among advanced industrialized countries is based on product differentiation and economies of scale. It is not easy to explain this phenomenon of trade with the help of comparative advantage and Heckscher-Ohlin model. Many new trade theories were developed during 1960s, 1970s and even during 1980s to clearly understand and explain world trade pattern. The trade theories which can vividly describe the current pattern of commodity trade, among others, are imitation lag hypothesis (Michael V. Posner, 1961), theory of overlapping demands (Staffan Linder, 1961) and product cycle theory (Raymond Vernon, 1966). The study of intra-industry trade (Verdoorn, 1960; Kojima, 1964; Grubel, 1967; Balassa, 1966) is looked upon as the continuation of the concern with the pattern of trade where products in the same industrial category are both imported and exported.

The characterization of intra-industry trade is simultaneous imports and exports of essentially the same kind of goods. The most frequent intra-industry trade takes place in the developed part of the world, between countries that have a similar economic and social structure. The theories of comparative advantage developed until then, based on Ricardian technology differences or Heckscher-Ohlin factor abundance, cannot explain this type of trade. During the 1980s, new trade theory models were developed to explain high level of intra-industry trade (IIT) and the large proportion of world trade between very similar countries. Intra-industry trade (IIT) is also dubbed "two-way trade". IIT is prevalent in regions and industries where increasing returns to scale in production, monopolistic competition and product differentiation play an important role, although endowments do not differ significantly between them. Theories of trade specialization can be divided into two schools: neo-classical theory and new trade theory. The economic literature identifies six techniques to measure the inter-industry specialization. These techniques are:(i) Hine and Greenaway Method (ii) Sapir Method, (iii) Aquino-Balassa Index, (iv) Gini Index. (v) Normalized Balance and (vi) Donges and Riedel Index.

India's share in global exports had declined steadily from 2.4 percent in 1948 to 0.7 percent in 1980 and again to 0.4 percent in 1996 and was hovering at around 0.6

percent in 2002-2003. During the post independence period India has gradually transformed from a predominantly primary product exporting country to an exporter of manufactured products. Before liberalization, the share of agriculture and allied products was 27.70 percent in 1985-86. This went down to 19.41 percent of its share during post liberalization period. At present, India's exports by major commodity groups are: manufactures which include engineering goods, chemicals and allied products, cotton yarn, fabric etc., jute manufactures, leather and its manufactures, readymade garments, gems and jewellery. In 1990-91, agricultural and allied goods exported were valued at Rs. 6317 crore but there was a tremendous fall in their share to 19.40 percent. As compared to 1960-61, it can be stated that during a span of 30 years, share of agricultural and allied goods exported by India suffered a major setback. From a large share of 44.24 per cent in 1960-61, its share came down to only 19.40 percent. On the import front largest partners of India from which India imports a larger amount in value terms are EU, OPEC, some Asian developing countries and North America. The exports grew at an average annual rate of 61.10 percent during post-reformed period whereas imports grew at an average rate of 46.59 percent. The performance of Indian exports can be seen from another angle by measuring the contribution of foreign trade to the gross domestic product (GDP) during the reformed period. Both exports and imports have increased during the pre and post liberalization periods. The rate of growth in imports as compared to exports during the post-liberalization period remained higher which led to higher trade deficit during the post-reform period. The annual average of India's share in world's export during 1980s was 0.49 percent whereas during 1990s the share of India's exports to world exports was 0.58 percent.

Since the formation of SAARC India has become the major player in trade in the SAARC member countries. India controls the trade of the whole region along with Sri Lanka and Pakistan. Among the SAARC countries India and Bangladesh are the two major countries having historical, cultural and social commonness. In terms of trade India is the second largest partner of Bangladesh, just after the USA (2003).India's position is at the top in terms of its total imports from the world (IMF, 2004). The trade share of both counties was 56.23 percent of the intra-SAARC trade in 1990.Bangladesh's import intensity indices with India are quite high than export intensity indices. India's share in Bangladesh's global import increased to 15.5 percent in 2003 from 4.7 percent in 1990. India's contribution to Bangladesh's export to SAARC countries increased to 53.5

percent in 2003 from 36.6 percent in 1990. India alone provided 94.1 percent of Bangladesh's imports from SAARC countries in 2003. India's share to Bangladesh's total trade with the SAARC countries was 91.7 percent, and Bangladesh's share to India's total trade with the SAARC countries was 40.91 percent in 2003. Therefore India's largest export market is Bangladesh in the whole SAARC region.

Economic liberalization was started in India in the mid-1980s and got intensified in the early 1990s. India's overall merchandise trade with East Asia more than doubled from about US $ 13 billion in 1997-98 to about US $ 17 billion in 2003-04 registering a compound annual growth rate of 13 percent. India's merchandise exports merchandise exports to ASEAN have more than tripled from about US $ 1.0 billion in 1991-92 (3.7 percent of its exports) to US $ 3.4 billion in 2001-02 (7.7 percent of its world exports). East Asia's share (except that of Japan) in India's exports has been increasing particularly since 2000-2001, with that of India's import also exhibiting similar trends. In particular, China's share in India's exports and imports expanded from 19 percent and 3.4 percent to 4.7 percent and 6.4 percent respectively, which that of ASEAN-6 increased from 6.4 percent and 7.7 percent to 9 percent respectively for both flows. The India-ASEAN Free Trade Agreement is going to be operational very soon with an "Early Harvest" scheme involving 105 products. This is likely to be expanded to include other areas in due course. Concomitantly, the Comprehensive Economic Cooperative Agreement (CECA) pact between India and Singapore is reportedly progressing towards the concluding stage.

India is traditionally the exporter of textiles, agricultural and marine products, gems and jewellery, leather and engineering and electronic products. Sectors like chemicals, carpets, granites and electronics have exhibited the fastest growth in the last five years. Indian exports from Europe on the other hand, comprise mainly gems and jewellery, engineering goods, chemicals and minerals. . The intra-industry index was 0.99 and the percentage in the IIT level was 3.13 percent with respect to previous year 1997. Indian exports are mainly dominated by textiles and clothing (32.5 percent), agricultural and marine products (8.57 percent), gems and jewelry (12.24 percent) and leather and leather goods (10.03 percent) which together account for more than 60 percent of total exports. India's exports to EU comprised textiles and clothing (30.87 percent), gems and jewellery (12.01 percent), leather and leather goods (11.67 percent), engineering goods (10.93 percent), chemical and allied product (8.74 percent) and agricultural and allied products (7.38 percent). The annual compound growth rate of intra-industry trade of India

with world (calculated at 2-digit level) is around 3.4 percent and the annual average growth rate is approximately 4 percent.

USA is world's third largest country by size after Russia and Canada and by population after China and India. The USA is a very important and strategic market for India because about ¼ the of India's total export that India is an insignificant trade partner for USA. India contributes only 0.6 percent of total import of USA in the year 1991. Indo-US trade is mostly intra-industry oriented.

6.2: Conclusions and Recommendations

Most of the world trade today is directed to the rise of intra-industry trade and the emergence of exports of manufactures from the developing to the developed world. The availability of technology and of capital, lower transportation cost and growing speed of communication, unilateral liberalizing measures by developing countries etc. are some of the reasons for the changed circumstances of the direction and pattern of world trade. In India the service sector has been flourishing very fastly mainly because of improvement in the demand for domestic services. There has also been an outstanding expansion of export-oriented IT and BPO sectors due mainly to growing international demand for skilled Indian workers. The industrial sector has also been growing phenomenally maintaining a growth rate of more than 10 percent annually with a strong performance of the manufacturing sector accounting for more than 4/5th of industrial output. Ending of the agreement on Textiles and Clothing provides India the maximum benefit in terms of exports of textiles and clothing to the USA and the European Union (Asian development Outlook, 2006).

It is noticed that trade liberalization has improved static efficiency in production and consumption and it is calculated that total annual gains from all the sources are more than 5 percent of total GDP (Chadha & Others, 1998). Trade liberalization has helped to maintain a sustaining average growth rate of over 7 percent. One important drawbacks is that trade liberalization has in fact failed to improve the status of labour-intensive industries in a substantial degree. What improvement has been made is the growth of exports of industries which are highly capital-intensive in nature. Our agriculture sector is facing several challenges. One important problem that the Indian farmers facing are: (i) stagnation in the production of principal food crops, (ii) stagnation in agricultural education, and (iii) stiff competition in the trade in agricultural commodities. Agricultural practice is becoming technologically challenging and thus trade in agricultural

commodities has become complex. It is in dire need to reorient agricultural education essentially to meet these new challenges. Of late, policy makers have realized that these issues can be addressed through a paradigm shift in human resource development, research, technology generation and dissemination. For this purpose both India and the US have signed a joined declaration in March 2006. The declaration is based on the US-India Knowledge Initiative on Agricultural Education, Research, Service and Commercial Linkages known as Agricultural Knowledge Initiative. The sole objective of this initiative is to revive the two countries' historical ties in agriculture, in the context of contemporary challenges. An important element of this initiative is public-private partnership where private industry can be involved in all spheres of activity from education and research to commercialization of new technologies. This ultimately will help to expand our total exports through more export of agro-based products.

India, along with many developing countries, has been adopting anti-dumping measures (GATT provision) to specify domestic vested interests in favour of protection at the rate akin to those in emerging market economies outside Asia and the major industrially advanced countries. Many studies confirm that too much foreign direct investment may affect IIT intensity of a country. India especially for last 15 years has been inviting FDI which may affect its IIT intensity. A major portion of FDI is destined for manufacturing real-estate development and service-related industries. This type of foreign direct investment not only will affect our inter-industry trade but also our intra-industry trade will be impacted intra-industry trade. It is high time to think over it accordingly our government should invide FDI that will not harm our trade. In this context we must learn lesson from China. China has received a huge amount (largest in the whole of Asia) of FDI since its adoption of new economic policy in 1979. But it is interesting to note that FDI does not affect China's IIT intensity in a significant way.

During the post-reformed period India's foreign trade has been expanding astoundingly. Both exports and imports cover a wide range of items. Exports in rupee terms have shown a remarkable improvement over the last few years. The export items which show rapid expansion in quantity are agriculture and allied products, ores and minerals, gems and jewellery, chemical and allied products, engineering goods and petroleum products and the bulk import goods are fertilizers, cereals, edible oils, newsprint, petroleum products, semi-precious stones for export production and capital goods, raw materials, consumables and intermediates for further production and

technological upgradation. For the promotion of exports India is the first country in the whole of Asia which first recognized the effectiveness of the Export Processing Zones (EPZ) in 1965 with the setting up of its first EPZ in Kandla. In April 2000, the EPZ model was reframed into Special Economic Zone (SEZ). Special Economic Zone Act 2005 has come into effect in 10 February 2006. At present 927 units are operational in the SEZs. These are not only promoting our exports but also are providing huge direct employment to both men and women.

Our SSI sector has been significantly contributing to industrial production, export and GDP. This sector needs to fully exploit the benefits of its product process capabilities on a sustainable manner. In the post-WTO regime it has become clear that to remain in business the SSIs have to be cost competitive and produce high quantity goods. For uplift of the SSIs what we require most are the establishment of branches of commercial banks in rural and semi-urban areas, setting up of regional rural banks as low cost outfits for the welfare of marginal, small, and medium farmers and share croppers, and strengthening of cooperative banks. The growth of this sector is essential for generating employment and eradicating poverty. Apart from small scale industries, artisans, farmers, handloom weavers and cottage industries should be encouraged through more decentralized planning, proper allocation of resources and increasing credit facilities and training.