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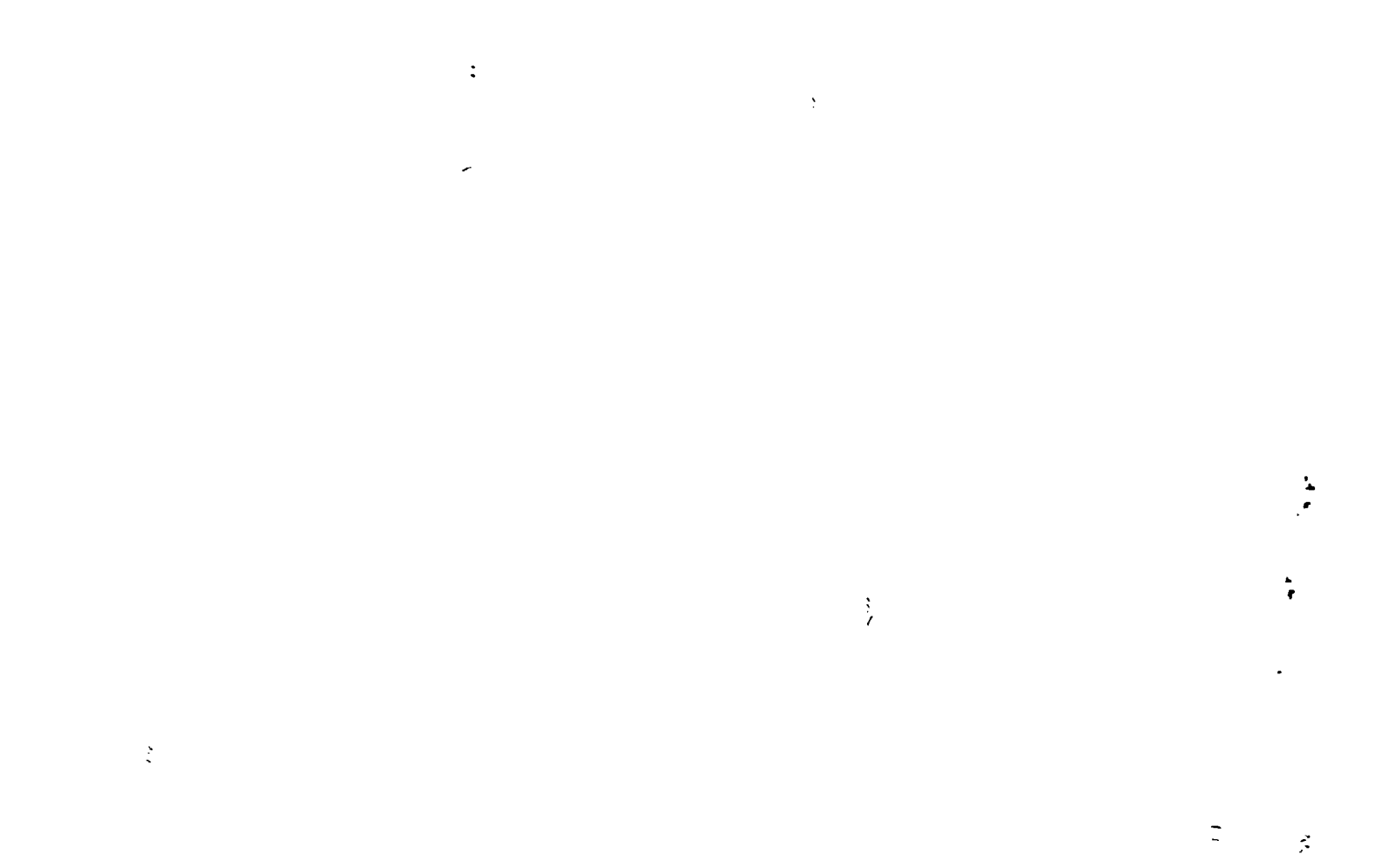
Economics Series No. 5

**FOREIGN TRADE
AND
ECONOMIC DEVELOPMENT**

V. L. D'SOUZA

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KARNATAK UNIVERSITY

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AND
ECONOMIC DEVELOPMENT

V. L. D'SOUZA

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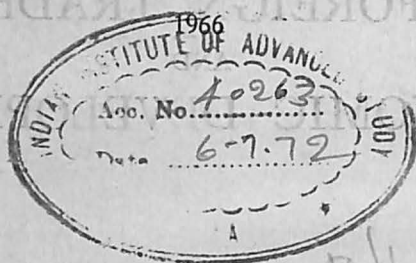


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INTRODUCTION TO THE SERIES

This publication contains three lectures delivered by Professor V. L. D'Souza at the Department of Economics in February 1966.

The balance of payments barrier arising from the sluggish export performance of developing countries has become a major limiting factor in their economic development. There seem to be two main explanations for such a situation. At one extreme, it is argued that stagnation in export earnings is due to stagnant world demand for exports of developing countries. At the other, it is stated that the past behaviour in exports is due to the defective policies of the concerned governments or agencies combined with internal demand and supply factors within the developing countries. With such different views found in enormous literature on this subject, it is rewarding to know the fresh and practical outlook that Professor D'Souza has brought to bear on the topic of foreign trade and economic development within a small framework of three lectures.

Lecture I deals with the changes in the body of international trade theory and the nature and content of economic policy in respect of trade. Lecture II discusses measures, both general and specific, and their efficacy in negotiating the balance of payments barrier. In Lecture III ingredients of a practical policy for a developing country facing a declining export ratio are outlined and the need for an integrated long-term programme for exports and imports is emphasised.

We are grateful to Professor V. L. D'Souza for delivering these lectures and also for agreeing to their publication.

Department of Economics
August 1966

D. M. NANJUNDAPPA

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LECTURE I

CHANGING PATTERNS IN THE STRUCTURE OF WORLD TRADE

I. Theory of International Trade Reconsidered

Recasting of the pure theory of international trade has been the outcome of recent developments in economic science. Advances made in the theory of employment, demand, interest and money and in the theory of economic growth have had their repercussions on the classical doctrines of international trade.

The countries of the world are being classified into developed and developing countries, countries which have fully utilised the resources of the Industrial Revolution and those which are late comers in the race for economic progress and planning. In such a context both the theory of international trade and the patterns and processes of international exchange call for a certain measure of rethinking and readaptation to suit a fast changing world economy.

The new theoretical structure is concerned with the relation of the new dynamic theory to international trade theory and the bearing of this relation to economic policy making. Today all our economists and traders are beginning to ask: how much may be gained if nations come together and see economic development not in terms of isolated units, each seeking its own profit, but as a pattern of active growth in which all could be participants. The self-interest of each country, apart from considerations of altruism, requires that its policy should be well aligned with the rest. As Harrod says, 'Gone is the time when it should be considered sufficient for national economic policy-makers to regard their duties on the external side as bounded by the precepts that they must keep their balances of payments in good order. Import policy, for instance, should be assessed not only by what a given country needs for its own purposes, but in relation to balanced growth in the world as a whole'.

We are concerned not only with the recent findings within the static theory of international trade but also with the slow invasion of this orthodox domain by dynamic theory. In fact the present stage of static theory is in striking contrast to the traditional teachings of Adam Smith, Marshall, Taussig, above all Haberler and Ohlin, the foremost exponents of classical theory. The new school is represented by Professor H. G. Johnson, Professor Roy Harrod and Professor Morgan. The starting point for an analysis of foreign trade theory has always been to take the case of two commodities and two factors of production. It is a simple model, and the addition of more factors and more commodities do not normally alter the basic relations revealed by that simple model.

In these days of growth theory protection has lost favour as a prime instrument for stimulating development. It is now coming to be recognised that from the point of view of developing economies the ratio of capital to labour endowment is undoubtedly important for productivity and the standard of living but it has relatively small effect on the pattern of foreign trade. What is important is the natural resources of the country and its human resources in the shape of skill, enterprise, pioneering ability and the inventive capacity of the people. For example, Britain still continues to be a large exporter of wool because certain kinds of sheep are reared easily only in Britain. Or again the big shift in world's textile trade is caused by the demand of people for quality, design and colouring and not merely a covering against the weather.

Relative factor endowments enter into the equation of international trade. It is not merely a question of capital and labour; it is also a question of what natural resources, technological sophistication and managerial ability can contribute towards the making of internationally traded goods. It is usually assumed that the U.S. industry prospered because it was capital-intensive. The truth is that capital in terms of interest rate was not at all cheap in that country, but it was cheap relatively to labour which was altogether a scarce factor. The more intensive use of capital was caused by the expensiveness of labour which had to be equipped by more and more efficient tools. When Western nations advise under-developed countries to concentrate on industries which used little capital and much labour they seek to

condemn them to a lower level of productivity and simpler manufactures that will turn out only low-grade consumers' goods. There are several capital-intensive industries which these countries should develop, if necessary, in the initial stages with borrowed capital and foreign know-how, as these items go to form the infrastructure. It is worthwhile investing in capital assets with high productivity, even if it involves denial of capital to the rest of the industry in the short run. Free trade, restricted trade, no trade: these are the various points in the trade spectrum that each country selects and mixes in certain proportions suited to its particular phase of development.

One ought to be careful when using the two-factor models on which much of trade theory rested. In the two-factor representation, only capital and labour figured. If one considered a model, using, say, land and labour one would come nearer to a proper explanation of the trade facts. After all land with its natural resources has much to do with the pattern of trade. We have also to allow for various costs of highly skilled labour and many different production functions just as we must consider economies of scale, the size of markets, monopolies and transport costs.

International trade theory suffers from the attempts made at excessive simplification. There is, for example, the tacit or explicit assumption that the whole of a good was produced in one country. Several countries export processed raw materials just as several other countries export semi-manufactured goods. Moreover the efficiency of capital is not the same in every country. It depends on the number of shifts e.g., a machine used for 8 hours in France might be used for 24 hours in U.S.A. Or the same machine might be used faster in a given period of time in the two countries. Such factors as the tempo and rhythm of work ought to find a place in international comparisons. Just as nobody today presented a single simple theory of business cycles so also we should combine several models i.e., several factor proportions. Production functions differed between countries just as factor intensities changed at various factor proportions.

Economists were now stressing the role of intangible input factors. Sometimes these seem to be even more important than quantity of capital and of labour. For example, the steel industry of Belgium which accounted for 25 per cent of her exports is

obviously the outcome of the comparative advantage she enjoyed. Belgium has a high proportion of savings to income, she also has technicians and entrepreneurs with skills developed to produce and export steel. A recent study made in the U.S.A. revealed that between one-eighth and one-half of increased output resulted from increases in physical factors of production while the remainder was due to intangible factors such as productivity, managerial ability and technological skill. With an ever increasing rate of innovation and invention the non-physical inputs tend to become progressively more important than factors like capital, labour and raw materials. The consumers are today demanding products that seemed to be novel, elegant, fashionable and that are neatly packed and presented. The same bias exists when governments in under-developed countries choose their productive equipment and techniques from foreign countries.

Professor Ohlin has stated that the theory of international trade was only a part of a general theory of the localization of economic activity. The British trade in the nineteenth century moved from her factories which were localized and concentrated in definite regions in the country to all parts of the world bearing heavy transportation costs. But trade between contiguous countries is also international trade but with transportation costs falling almost to zero e.g., the trade within the European Common Market. In solving such problems we have to seek the aid of a location theory as well as a trade theory of the classical type. Following the same line of thought we could raise the question whether there is intrinsic difference between labour and capital as factors of production. Several grades of labour embodied a certain amount of capital in the focus of time, effort and training even as capital may be considered as embodied or concealed labour. Transport costs cease to be meaningful when, for example, motor cars can be transported quite cheaply over the border from France to Germany and *vice versa*. Before the War, both Japan and Germany were asking for their place in the sun so as to make up their lack of natural resources, now they fall back upon invention, new techniques and innovation and make appropriate adjustments through trade and technology. Japan produces industrial salt from her sea water and synthetic fibres from her limestone. The factor proportions theorem was relevant for trade, but could not explain the existing trade patterns between

industrial nations on the basis of differing factor endowments, because there were no such marked differences in the endowments of U.K., Germany, France and so forth. The products which developed countries sold to under-developed countries were largely the result of particular countries being accustomed to employing their factors in a particular way. We should, however, note that a considerable measure of flexibility is imparted to the texture of foreign trade by the fact that capital goods and specialized labour can be obtained from abroad for the starting of new lines of development.

What may be described as the technological revolution of the past few decades has an all-pervading effect. It brings about changes in the wealth of nations and in the distribution of income. It is the main cause of economic progress. It bestows affluence wherever its techniques are developed or adopted.

The effects of technical change are clearly perceived in the existing pattern and composition of international trade. They have a direct bearing on comparative cost, on terms of trade and on the gains from international specialization. The problems created by technical change in the theory of international trade relate to the new pattern of comparative cost conditions—the adjustment of costs between the country in which the change occurs and the countries that are the trading partners. A continual series of technical changes keep international trade in a state of flux. There are also monetary disturbances and movements in the economic welfare of the trading countries to be considered.

J. S. Mill and Edgeworth did attempt an analysis of the effects of technical change on trade, and made a study of the influence of improvements in the method of production both on the exporting and importing countries, pointing out how the benefit of cost reduction brought on by technical change was divided between domestic and foreign consumers. They, however, worked out their theory when the technical revolution had hardly begun. The developments in this branch of theory had to wait till the full force of new techniques and new man-made commodities, synthetics and plastics began to be felt. Hicks, Singer, Meade and Harrod have gone into this fertile field of speculation and given a shape to the modern theory, taking it up from where Mill and Edgeworth left it.

Technical change, desirable in itself, may either promote or inhibit international trade. All technical change in the crucial area of transport and communication will certainly increase trade between countries. Transport costs like commercial policy act as a break on the smooth flow of trade. Reductions in such costs tend to increase the range of commodities entering into the main stream of international trade. However, one cannot exclude the possibility that improvements in methods of transport can also have a trade—inhibiting effect in the sense that it will promote domestic trade at the expense of external trade. Some industries might acquire the habit of continual technical progress and might even set up a permanent organisation for it; in these circumstances, these industries would ultimately become exporters and the whole economy tends to become export—oriented or export-biased.

In a world developing by means of technical progress and capital accumulation the meaning of 'comparative advantage' would undergo a change. In a rapidly moving technical environment, comparative advantage would arise from the possession of (1) particular natural resources or (2) economics of scale through specialisation in particular lines of production or (3) technology derived from highly sophisticated scientific and engineering knowledge. In the long run no country is likely to enjoy increasing gains from trade at the expense of its trading fellows, since such gains may be spread over a large surface by the sharing of technical know-how. It is also possible that technological innovations may act as a substitute for natural advantages which may mean that international trade will eventually cease to be an important contributor to national income. Prof. H. G. Johnson says, 'Instead of being firmly grounded in static and enduring characteristics of national economies—inherent cost difference as in the Ricardian model or differences in factor-endowments as in the Heckscher—Ohlin model—comparative advantage is the evolving consequence of the dynamics of technical progress, capital accumulation and population increase, and their diffusion through the world economy'.

During the inter-war period and subsequently, the theory of international trade underwent rapid and striking changes. The changes were partly a result and reflection of the changes in the general structure of economic science. Keynes led the revolution

which is often referred to by his name. He gave a jolt to the traditional ways of thinking on employment and economic growth. These innovations were followed up in the theory of production, value and prices. It is now common knowledge how the concept of measurable utility was given up, and the theory of demand was reshaped by Hicks and Allen who introduced the new tool of indifference curves. These developments and refinements in the theory of employment and equilibrium of income, interest, prices and value came to be applied to the special problems of international economics which seemed but one step removed from domestic or national economics. Most of these theories overflowed, as it were, into international economics and reshaped the theory of international trade. The automatic adjustment of the balance of payments, a pillar of classical thought, underwent substantial alterations and got itself closely linked to the circular flow of income, to the international spread of business cycles and to the solution of the conflict between domestic stability and international equilibrium.

The theory of employment made its impact on international economics principally on the monetary side; developments in price theory affected the 'pure' theory of international trade on that side which deals with the Law of Comparative advantage and with the distribution of gain from trade between countries. The precise formulations of Ricardo and Mill came down almost to our own day in all their rigidity but were finally assailed by the new theories of economic growth and of the place which foreign trade should occupy in planned economies. The highly unstable trade and international economic policies since the First World War have called for a constant explanation in terms of well-understood theory, and where such explanation failed to satisfy, the economists were hard put to reshape the theory to suit the new conditions and the ever changing situation in the foreign trade of countries.

It is worthwhile considering the most important factors that actively influence the course of international trade and international economic policy in the post-war era. The first in importance appears to be the technological factor. There have been fundamental changes in the technique of production and transportation which have altered the meaning of international trade for many countries. These have learned to do without

certain things they used to get from abroad, because they have learnt to produce them at home as they have discovered substitutes for them. Industrially backward countries, especially those that have recently attained their independence have made great strides towards a diversified industrial structure. The distance between the leading industrial nations and the raw material-producing countries is not so great as before. To take a few examples, the modern development of the chemical industry has reduced the scope for profitable international division of labour. As Prof. Robertson points it, 'It is now possible to produce out of local dusts and dirt all sorts of things which formerly had to be imported.' The exhaustion of scarce natural resources in certain countries is offset by alternative man-made sources of supply. The advance in the synthetic industries has enabled each country to produce certain of its requirements for which formerly it had recourse to international trade. In the words of Haberler, 'The standard of living which should be maintained with no trade or little trade is higher to day than it was thirty years ago.' Of course, the tremendous progress in the field of transportation, the improved methods of mass production and the insatiable demand from a fast growing population have contributed to keeping the world trade at a high level.

Secondly, the volume of international trade rises and falls with the rise and fall in national income and output. In recent years, the upward trend in production the world over is reflected in a rising trend in the volume of world trade. The new demand, exerted by the fast developing economies and the steadying controls exercised on cyclical ups and downs contribute to a high level of international exchange of goods and services. The rise in national income which has become a characteristic feature of the post-war era, in fact, the perpetuation of boom conditions in the forward countries, create demand for foreign raw materials and foreign finished foods.

The third important factor that affects the progress of international trade is the comprehensive commercial policy followed by the trading countries. Commercial policy is no longer confined to tariff but has a formidable array of weapons at its disposal such as quotas, licenses, exchange control, currency devaluation and government import monopolies. Almost with the conclusion of World War II there came economic planning and state inter-

ference in economic life and process. In a greater or smaller degree the regime of central control of economic life has spread everywhere. It is clear that national planning involves government direction of production and prices which in its turn, requires regulation of international trade in the national interest. The change in economic thinking away from free trade and liberation towards planning and protection has been marked even in Great Britain and the United States. The practical issue has been whether the time honoured device of protection alone will suffice to safeguard the national interest or should it be supplemented strongly by quotas, exchange control, clearing and payment agreements, bulk purchases and discriminatory duties. The free trader of today is not such a die-hard. He has moved to the position that tariff protection may be given though sparingly, that duties should be fairly stable, that they should be governed by the most favoured nation principle and that they should be non-discriminatory.

Among these devices, the attitude of many countries towards exchange depreciation has undergone a remarkable change since the days of World War II. The gold standard with its fixed exchange rates gave way to exchange depreciation in the thirties to meet the impact of the Great Depression. Under the influence of Keynes people came to regard exchange depreciation as an easy way out of a situation where imports increased and exports diminished. The currency depreciation was abused and it was found that it does not work if many countries join in the race. Moreover countries now have more powerful and less dangerous weapons of control at their disposal. They have realized that exchange depreciation leads to competition among the trading partners, that it often moves beyond the point necessary to bring about equilibrium in the balance of payments and that it gives rise to speculative capital movements in anticipation of expected changes in the exchange rate.

II. Terms of Trade as they affect developed and developing countries

There are several concepts of the terms of trade. They may be taken as the ratio between the prices of two commodities that may be exchanged against each other—'commodity terms of trade'.

Or they may be taken as the index of the price for exports divided by the index of the price for imports, showing the imports obtainable in exchange for the exports already sent out—'income terms of trade'. Or again they may be taken as the ratio of real values of exports to real values of imports—Taussig's 'gross barter terms of trade'. Economists in the main have held fast to the notion of the commodity terms of trade.

In 1912, Keynes estimated the extent to which Britain was worse off (£ 37 million) because of falling terms of trade between 1900 and 1911. In recent years a U.N. Committee on Commodity Trade and Economic Development have stressed the policy implications of changes in terms-of-trade. They have worried over the deteriorating terms of trade of under-developed areas. In their opinion, a comparatively small fall in commodity prices is equivalent in its effect to a cut of billions of dollars in aid to under-developed countries. Kindleberger, Myrdal and Bernstein have borne testimony to the falling terms of trade of under-developed countries due to a chronic surplus of primary products, to a fall in raw material content of industrial output and also to the wages in their export industries being fixed at the level of peasant earnings.

World experience in the movements in terms of trade has now been reduced to acceptable generalisations. In a long-run view the prices of primary products have been falling relatively to prices of manufactures. Despite wide fluctuations now and then the trend downward for the prices of primary products seems well-established. In the words of Kindleberger, the terms of trade tend to 'favour the developed and run against the under-developed'. In any such generalization we have to take into consideration qualitative improvements in manufacturing products which understate the relatively good price position of primary producers; we have also to note that the transportation costs have been falling over the past century conferring a certain advantage on primary producers; we must provide for the fact that the British data in which these terms of trade conclusions are usually based do not admit of application to all regions of the world. T. Morgan says, 'The over-all impression is that of a wide variety of experience of different nations. Several countries show extreme fluctuations and various changes of trend. India, for example, shows amidst its fluctuations a rising relative price trend for primary products

up to 1900-10, an irregular fall to the 1930's and a rise since'.

Morgan has made a study of recent trends in terms of trade as between developed countries and under-developed countries for the period 1953 to 1960. He presents a frequency distribution for these two groups of countries in accordance with the changes in their terms of trade. Out of 18 developed countries as many as 12 showed improved terms of trade ranging from 1 to 20 per cent. Out of 29 under-developed countries 9 countries showed an improvement in terms of trade ranging from 1 to about 20 per cent while 20 countries showed a worsened situation ranging from 1 to about 20 per cent. The developed countries have exhibited greater stability in their terms of trade than the under-developed countries. A few more contrasts were drawn. The developed countries seem to be bent on diversifying their exports, particularly since 1950 but the under-developed countries are still depending mainly on the exports of their primary products. Moreover where the leading primary export of a country as a ratio of world export of that commodity is concerned Morgan finds that the developed countries have moved on from 49 per cent in 1950 to 60 per cent in 1957 while the under-developed countries have moved on from 30 to 38 per cent. The developed countries as a group have a sort of oligopolistic power to influence price in their favour. In prices of food exports the under-developed countries have fared badly but not in raw materials and in minerals. Price variations in individual commodities are sought to be controlled by commodity trade agreements and by price stabilization schemes as for tobacco and cotton in the U.S.A.

The discussion on terms of trade which was started by J. M. Keynes tried to establish that there was a steady deterioration in the U.K. terms of trade, that a given unit of manufactured product purchases year by year a diminishing quantity of raw product and that the comparative advantage moved against industrial countries. Arguing in the same strain D. H. Robertson spoke of a normal tendency for the ratio of exchange to alter against the manufacturing and in favour of the agricultural countries. Kindleberger thinks that favourable terms of trade are correlated with the capacity of a country to shift resources to suit the changing patterns of comparative advantage. Malenbaum and Stolper writing in 1960 ascribed the stunning growth of West Germany

and China as compared with the slow progress of East Germany and India not to ideology as to methods and aims of production but to their flexibility in selecting economically productive courses of action. Jacob Viner has shown that prices during a period of capital borrowing rise in the borrowing country and fall in the lending country, that is, the terms of exchange shift in favour of the borrowing country and against the lending country. The borrowing country obtains more foreign product in exchange for each unit of its exports than it did prior to the borrowing.

There appears to be a chronic surplus of primary products, partly because of the growth of agricultural population in primary producing countries and partly because of the improvement in the technology of food and raw materials production. As *per capita* incomes rise the proportion spent on food declines, the decline being greatest in the case of cereals, sugar, fats and edible oils. There has also been a decline in the raw material content of industrial production due to the development of synthetic materials and the substitution of less highly sophisticated for more highly sophisticated raw materials. So also the raw material content of goods, in so far as there is a shifting from non-durable articles such as textiles to durable goods such as radios, transistors and kitchen equipment, has greatly diminished causing some times a glut in the market for raw materials.

Terms of trade are 'derived' from statistics, that is from index numbers of the average prices of exports and imports. Indices obtained from different sources often give divergent results which for that reason, are not reliable. There are also large gaps in the export prices of several countries. Difficulties also arise because of changes in quality. All these factors add up to the scepticism expressed by T. Morgan as to whether there was any long-run trend either in favour of or against primary products and under-developed areas. There, however, appears a long-run stability of the terms of trade between manufactures and primary products. This stability is the result of there being a large number of products in these two major categories with many influences working on each of the individual products. The differences tend to cancel out and lead to stability in the ratio between the two sets of indices.

Though export and import price indices and resulting calculations of the terms of trade were in the nature of statistical manipulations, not fully to be trusted, several economists are inclined

to the view that changes in terms of trade do not appear to be large. Over ten years a change of 1 per cent may be considered big. Yet an error of 10 per cent in the figure for the terms of trade is quite possible. The errors are there because, for example, the prices of engineering goods are hard to measure and these goods are growing most rapidly while services, an important item, are not at all included in the index.

Turning to policy implications of the theory of terms of trade, it is suggested that countries should readjust their pattern of trade so as to allow the under-developed countries to export more and more. The thorny problem is how to increase flexibility in the economies of under-developed countries. When the under-developed countries set out to expand their export markets for manufactured goods they are faced with the charge that they compete with goods made by cheap labour and assisted by subsidies. The developing countries only ask for relief if man-made barriers are raised against their exports. Thus what the developing countries wanted in their best interest was trade and not aid. In fact there has been an increase of 53 per cent in the tropical produce sent to temperate countries as against an increase of only 15 per cent in the primary products trade between temperate countries. The movement of tropical produce had not suffered greatly from the mere fact of industrialization in the developed countries.

That trade amongst primary producers has not expanded as much as trade among the industrial countries is a problem to be tackled. Trade is the chief requisite for their progress. Their important requirements as developing countries would increase as they go ahead with their plans. They have to increase their exports even in the short run and for this, in the initial stage at least, they have to try and increase their export of traditional commodities along traditional lines. These exports almost under compulsion, as it were, would lead to a worsening of their terms of trade. The backward countries should be given every facility to diversify their economies, and thus be in a position to export a wide variety of goods and thereby stop further deterioration in their terms of trade.

Sooner or later the primary and under-developed countries must take to manufacturing. Thereby the trade patterns of different countries would become somewhat similar and the disparities in costs that now given rise to problems of terms of

trade would be evened out. Both primary products and manufactures would figure in the imports and exports of most countries in these days of technology. The big differences between the primary and the industrial or between the developed and under-developed countries unequally distributing the gains of trade will tend to vanish. There is a case for industrializing backward countries just as there is a case for strengthening the agrarian economies of the economically forward.

The terms of trade concept is a deceptively simple measure. When economists in industrialized countries discussed their terms of trade, it was on the assumption that those terms would deteriorate and were deteriorating. The economists in under-developed countries argue in the same way in respect to their own situation. The case for the terms of trade moving against manufacturing countries cannot be established, because the ratio of their expenditure on food, especially that produced in under-developed countries, to total expenditure would fall as income rose. Grain has a low income-elasticity of demand but the loss here would be offset by meat and fruit which have high income-elasticities. So also the demand for industrial raw materials in general would go down with the increasing use of technological substitutes affecting the import content of output on the whole, but there are some raw materials still in demand and in short supply. There will be a high income-elasticity of demand in these compensating the loss on the replaceable industrial raw materials.

One has to distinguish between primary products from tropical countries and those from temperate countries. Unfortunately the tropical countries produced only a narrow range of foods and raw materials which may be faced with a shortage of demand unlike the diversified primary products of the temperate regions which may be faced with an excess of demand. A flexibility is required in the range of production of tropical countries. Britain's terms of trade are affected by changes in the prices of imported raw materials which subsequently emerge as British manufactures which are exported. Moreover Britain is also interested in exporting the processes of manufacture rather than the goods themselves and these like services rendered by British shipping, insurance and banking are not normally reckoned as constituents of the terms of trade. The unsatisfactory nature of calculations of the aggregate terms of trade may be rectified, as is suggested by Dr Myint, by

making a distinction between consumer goods and capital goods in the imports of under-developed countries, and between food and raw materials in their exports.

Terms of trade, if they could be accurately or reasonably accurately measured, would have important implications for policy. The economic systems of individual countries should have a built-in flexibility to cut down production and losses if the fluctuation is adverse; or to expand and gain if the fluctuation is favourable. There are too many predictions in the field giving contradictory advice and one does not know on whom to rely—poor terms of trade, rising terms of trade, falling terms of trade or the simple agnosticism of the 1953 U.N. experts. Economists will go on forecasting the terms of trade according to their light and they will influence industrial and primary production accordingly. In the words of T. Morgan, 'The moral is plain, that the prudent policy-maker will hedge on even the most careful predictions, and that he should have as a main goal the attaining of a high degree of flexibility in his economy'.

III. Main Trends in World Trade

There have been some major trends in the structure of international trade over the past decade. The trading relationships between the industrial countries and the primary-producing countries are not the same as before. The distinction between these two groups, however, is not clearly marked, for the industrial countries may also be exporters of primary products while the primary producing countries may also export manufactures.

The primary-producing areas are also the primary-exporting countries. In the post-war world their difficulties arise from the fact that their exports do not keep pace either with the expanding world trade or with the increasing activity in the industrial areas. The poor export performance of the primary-producing areas has been a depressing feature of world trade over the past decade. This is in marked contrast to the unusually rapid expansion in trade among the industrial countries.

1. *Imports of industrial countries from primary-producing areas*

A break-up of these imports into certain well-recognised categories will give a true picture of the changes in the volume and

relative importance of different items in the import trade of the industrial countries. We are seeking to gauge their demand for these goods item by item.

Taking first 'Food', we find that in the post-war years there has been a fall in the import content of national consumption in industrial countries. The fall is due in part to a shift in the pattern of demand and in part to substitution of home produce for the imported articles. Thus with the general rise in *per capita* income the demand has shifted to better qualities and superior varieties of the different foods and these are being produced more and more within the industrial countries themselves e.g., cheese and butter. There have been import substitution of beet for cane sugar, of synthetic detergents for soap made from tallow or vegetable oils, and of the soya bean produced on an immense scale under subsidy from U.S.A. for the oilseeds produced by small cultivators from the primary-producing countries. The expansion in wheat production in the EEC countries has meant a sharp decline in their imports from the traditional markets. Moreover government policies in the industrial countries rather dim the export prospects of the primary-producing countries. Their policies may be briefly summed up thus: import tariff, quantitative restrictions on imports and subsidy for home production. Their collective effect is to reduce the demand for 'food, beverages and tobacco' coming from the primary-producing countries.

Secondly so far as 'industrial materials' are concerned there is a repetition of the same pattern of change as between primary-producing countries and the industrial countries. Apart from protection and fiscal policies, changes are brought about chiefly by technical development in the industrial countries. New industries such as engineering and chemicals have forged ahead while their textile industry has shown but small increase. The import content of engineering and chemical production is rather small while that of textiles has always been relatively large. About two-thirds of the net imports of raw materials from the primary-producers consists of cotton, wool, jute and rubber. The consumption of these in the industrial countries has risen only slightly. So also the case with the traditional non-ferrous metals usually derived from primary producers. Steel production expanded by one-third but with only minor imports of iron ore;

aluminium production also went up sharply but with only a small increase in bauxite imports from the primary-producing countries.

Another factor responsible for the change in the traditional pattern of trade is the substitution of materials produced in the industrial country itself for imported materials e.g., aluminium for copper and steel, man-made fibres such as rayon and nylon for cotton and wool, synthetic rubber for natural rubber, and plastics for a wide range of traditional materials such as textiles, paper, wood and metals. In the United States during the last decade there was a 20 per cent growth in manufacturing production and yet her consumption of 'natural' materials imported from abroad did not increase at all. It has to be observed however that in the 1950's the import content of consumption of raw materials in Japan and EEC countries was rather high while in the U.S.A. it was quite low. But once West Germany and Japan achieved their economic reconstruction and recovery after the World War II they also tended to fall into line with the U.S.A. The broad conclusion can be drawn that the marginal propensity of the industrial countries to import raw materials will be reduced still further. The trend to substitute 'processed' for 'natural' materials so marked in U.S.A. is spreading to all industrial countries. The pattern of manufacturing production is likely to go on changing in favour of engineering and chemical output which makes only a sparing use of raw materials.

These tendencies which have been observed since 1950 indicate that the primary-producing countries cannot expect a considerable increase in demand for their raw materials.

Thirdly, changes in the demand as between different kinds of 'fuel' have been affecting favourably the fortunes of the primary-producing countries. In absolute terms the total consumption of energy rose by 18 per cent in the 1950's in the industrial countries. The total has increased but there have been some drastic changes in pattern. Consumption of solid fuel such as coal fell by 3 per cent in the last decade while petroleum and hydro-electricity rose by one-third and one-half respectively. There has been a growing dependence of the industrial areas on imports for their petroleum supplies which come largely from primary-producing countries. The future trend is even more strongly towards oil and away from coal. The 'newer' forms of energy such as hydro-power, natural gas and nuclear energy are likely to grow but even so a substantial

part of the energy requirements of the industrial countries will be met by imports of oil, very largely from the primary-producing countries. Even for the United States the prospects are for a continuous increase in oil imports, assisted by the much lower production cost of imported oil.

Fourthly, 'manufactures' do not figure prominently in the exports of primary-producing countries. By far the most important item in the manufactures exported to industrial countries are cotton goods and jute manufactures. In the fifties there was a relatively small increase compared with total world trade in manufactures, the reasons for the slow growth being, first, textiles have a much lower income elasticity of demand than manufactures as a whole and second, industrial countries protect their domestic industries from the competition of such 'cheap' imports. However as these agricultural countries develop industrially there are possibilities for the growth of a wide range of manufactures available for export such as electrical appliances, certain types of mechanical equipment, lightly processed metals and engineering goods. Any substantial increase in these imports from the primary-producing areas will call for compensating adjustments in the economy of the industrial countries, safeguarding their employment and their resources.

2. Exports from industrial countries to primary-producing countries

The flow of trade from industrial to primary-producing countries consists chiefly of manufactured goods but their exports of primary produce is also substantial. These exports are of the value of about \$ 5 billion, the greater part consisting of foodstuffs. The United States which before the war accounted for one quarter of the exports of primary products to the primary-producing countries now accounts for nearly one-half of the total.

The shipments of surplus commodities like, rice, wheat and cotton from the United States under Public Law 480 and similar aid programmes have been a marked feature in the economy of developing countries like India bent on industrializing themselves. Such commodity aid to needy countries has the effect of safeguarding their currency reserves so that they could get on with their development plans unhampered by the recurring need to find foreign funds for food imports. Of course, the facility

with which the under-developed countries could draw on American surpluses is not without its drawbacks. First, the fact that large-scale commodity imports are available induces a sort of soporific effect against urgently needed measures to increase production in the agricultural sector and to reduce reproduction in the population sphere. Secondly, the commodity aid from U.S.A. and the new rich countries adversely affects the economy of several primary-producing countries who have to make a living by exporting their agricultural output at remunerative prices. Finally these flows of commodities at concession rates and at a sacrifice create a vested interest in a needlessly high farm output and in price support policies in the exporting country. Both U.S.A. and the beneficiary countries are now beginning to realize that the most effective aid to under-developed countries is through the export of farm machinery, equipment and fertilizers which will solve their long-range problem of hungry mouths and un-productive agriculture.

Exports of manufactures from the industrial to the primary-producing countries though still large in volume have been subject to two sets of influences. First, there has been a considerable substitution of locally produced goods for imports in the industrializing countries. Over the years there has been a constant pressure on the backward countries to work towards industrial self-sufficiency. Under the stimulus supplied by the economic crisis of the 1930's, by the adverse movement of the terms of trade against agricultural countries and by frequent cuts in the flow of foreign capital determined efforts were made towards fostering domestic industry. Thus the dependence of primary countries on imports for their supplies of manufactures was reduced from 60 per cent in 1913 to 30 per cent at the outbreak of World War II. The import proportion is being steadily reduced still further. Even so, the increase in their demand for manufactures has more than offset what has been gained by import substitution.

Secondly the development of the oil industry in certain primary-producing areas has been a major influence in their external trade. The oil industry necessitated imports of various kinds from the industrial countries. The past decade has shown a substantial increase in imports of capital and manufactured goods in these areas.

The primary-producing countries have been importing manufactured articles to an increasing extent. According to GATT estimates, between 1953-58 their total imports rose by \$5.6 billion while their total exports rose by \$2.7 billion. The gap was filled by net borrowings from the industrial countries. We might say that the economic growth of the primary-producing areas over the past decade has been dependent on increased borrowing rather than on increased exports. It is a challenge for them to expand their exports appreciably in the coming decade; if not, the growing burden of debt and debt-repayment will come in the way of capital imports for development purpose.

Trade between the Soviet States and the primary-producing countries is still small; it is likely to remain small because of the nature of Soviet economy and because in the Soviet group itself there are countries which produce raw materials and fuels. Finished manufactures represent only a small fraction of the total imports into the Soviet countries while their exports to the under-developed areas consist mainly of manufactures and capital goods. The Soviet lands, also, like their Western neighbours have been making increasing use of plastics and synthetic stuffs in place of raw materials imported from foreign countries. Russia also is planning increased production of tea, rice, sugar, oils and oilseeds. The Soviet countries have been granting long-term credits at low levels of interest.

3. Trade of the Industrial countries among themselves

A major trend in world trade in the post-war period has been the rapid expansion in the trade between industrial countries. From 1950-60 the total volume of intra-trade among the industrial countries rose by about 100 per cent as compared with only a 50 per cent increase for the rest of the world trade. Among the industrial countries, the increase for manufactures was more than twice as great as that for primary products. The high rate of growth in trade among the industrial countries has been kept up for several decades in spite of the set-back it has received on the way by the economic depression of the 1930's, the trade and currency restrictions of the inter-war period and the autarkic policy of countries like Germany. Between 1950 and 1960 many of the trade restrictions were given up; there was liberalization of trade; there was the ready availability of the dollar and dollar credits as

international currency; there was the 'miracle' of the recovery of Germany and her neighbours.

Trade in manufactures among the industrial countries has expanded in recent years partly as a result of the liberalization measures and partly as the outcome of fast economic growth that has taken place in Europe, Japan and in several of the Commonwealth countries. The intra-trade in manufactures may not grow in the coming decade as fast as before, for the industrial countries have reached a stage of full employment and buoyant economic activity. A new factor however which has resulted in increasing the rate of growth has been the establishment of free or freer trading groups such as the EEC and EFTA within Western Europe.

Recent changes in the volume, direction and commodity content of world trade almost amount to a revolution. There is an increasing cleavage between the industrial countries and the primary-producing countries, each group, particularly the former, tending chiefly to trade with one another in the same group. There have been radical changes in the complexion of demand in the industrial countries, changes brought on by developments in technology, by the use of synthetic in place of natural materials in industry, by fiscal and protectionist policies affecting foodstuffs and textile manufactures which limit the export of these goods from the primary-producing countries. In the past decade there is a slowing down in the export earnings of the primary-producing countries just at a time when they need them for financing the subsequent imports of capital goods and development aids. The position would have become quite serious but for an increasing flow of loans and grants from the developed countries and the various international agencies such as the World Bank and the Monetary Fund. The flow of financial assistance, large as it is, is barely sufficient to offset the incommensurate growth in exports. The development of the primary-producing areas cannot proceed undisturbed if the recent trends showing stagnation or a diminishing rate in the growth of their exports were to continue.

Changes in demand patterns and in industrial technology are stubborn facts that take no account of the difficulties of the backward countries. But help can come from a readjustment of the fiscal, protectionist and financial policies of the industrial countries which will increase the scope for imports from the developing

areas. What is required is not so much the reduction of trade barriers and restrictions between the industrial countries *inter se* as between the industrial countries and the rest of the world now bent on development.

It is unlikely that an expansion in the exports of developing countries would be sufficient to pay for their expanding imports. While developed countries should encourage imports of primary products it would also be necessary for the developing countries to increase the exports of their own manufactured goods to fill the gap. It should be possible to achieve this result, since wages are lower in under-developed countries and their productivity in at least some industries, as in the case with India, is not short of that in Europe. The developed countries, in their own interest, should embark on *import drives* for goods from under-developed countries while the latter should launch *exports drives*, offering export subsidies and other aids on new types of manufactures. Exports subsidies would turn the terms of trade against the country imposing them, but in the short run it is a price worth paying.

In the existing conditions, if one wanted to export manufactured goods from a primary-producing country, the industrial countries will not provide a ready market. For this purpose, one has to explore the prospects in primary-producing countries themselves of which there are several. For example, U.K. and U.S.A. took a surprisingly low percentage of Indian export of textiles but the bulk of these went to the primary countries. There is a strong case for the under-developed countries to enter into regional arrangements for the expansion of their trade in manufactured goods. The market for primary products was not rising as fast as the need of the developing countries to import high-grade capital goods and engineering equipment. The primary-producing countries should trade with each other much more than they have done so far and thus conserve their foreign exchange to finance the necessary imports from the Western countries.

One notices that the current industrialization pattern of under-developed countries proceeds on similar lines. They are all busy introducing the same industries at the same time, and then protecting these industries against competition from each other, a process which will hinder the development of trade between the under-developed countries.

IV. The Future of International Trade

The question frequently asked is—What is the future of international trade and will it ever play again the same dominant part as it played when the industrial, agricultural and transport revolutions were enlarging and enriching the economic life of the world? The answer is, the prospects of foreign trade are as bright as ever, though there are frequent changes in composition, direction, structure and terms of trade. For a period covering the Great Depression and the World Wars there was a shrinkage in the ratio of foreign trade to total production which naturally led to the speculation as to whether forces have been at work to reduce the importance of specialization in production on which much of international trade was raised. Such a specialization had worked as a means of increasing national income and national welfare. German economists even talked of a 'law of the diminishing importance of foreign trade', pointing out as evidence that for several countries and for the World at large the ratio of foreign trade to total production was declining. The fact was total production itself was increasing by leaps and bounds. The shrinkage in trade was largely due to a deliberate policy of restrictionism and national self-sufficiency. It was demonstrated that the potential capacity of international specialization and exchange to yield economic benefit suffered any serious damage.

Apart from autarchy a rational explanation of the downward trend in the ratio of foreign trade to total production is that the fast moving and the fast spreading scientific and technological progress has narrowed the range of comparative differences in costs of production and has lessened the need for international specialization on the scale that it existed before. Technical skill and technological knowledge are now available to all the developing countries and technical collaboration between the experts is the agency by which newer types of manufacture and newer processes of industry are made available even to backward areas of the world. Mechanization, automation, mass-production and production of chemical substitutes have constituted a new revolution with the result that several types of goods can be produced anywhere almost with equal efficiency. The most convincing example is the universal spread of textile manufacture in which the whole world may be said to be specializing.

Labour inputs, fuel inputs and capital inputs per unit of output for manufactures or for agricultural commodities take on a pattern of efficiency closely adjusted to the circumstances of each country, whatever they are. The differences in 'efficiency' at least in particular lines of production are tending to be small. The substitution of electricity for steam-power and of petroleum for coal have enabled a wider distribution of industries just as the invention of synthetics have lessened the importance of natural minerals and materials.

The growth in technical knowledge has made possible the substitution of one raw material for another, and in so far as it is produced locally it lessens the quantum of world trade. Countries can thrive today even if imports are cut-off to a much greater extent than, say, a few generations ago. We have rayon and nylon today where formerly we were restricted to cotton, wool and hemp; we substitute copra, cottonseed and groundnut for animal fats; we use glass, wood, stone and iron as building materials. All these will not reduce the quantum of trade in a world that is fast developing industrially and that is demanding more and more, rather better and better goods for its fast growing population. There can never be an exact equality in efficiency. There will always be differences in comparative advantage which will make trade between countries worthwhile. There will be scope for gainful exchange between manufactured products and primary products, between all products and the products from mines such as metals and petroleum, between atomic or nuclear substances and highly sophisticated chemicals and drugs, between the products of temperate and tropical zones, between highly specialised goods and simple manufactures. As *per capita* wealth and income rise, housing, personal service, social amenities become important in consumers' expenditures but these are not available for international exchange in the sense that tangible commodities are. Thus the growth of *per capita* wealth tends to lessen the relative importance of foreign trade but it operates to increase its absolute importance. As transportation costs tend to be smaller for quality goods than for low-income staples, there is a stimulus for such trade between countries. Above all there is the insatiable hunger of the less developed countries for machinery, machine tools and similar capital goods of all kinds that enter into international trade.

Governments all over the world are taking upon themselves the responsibility of maintaining full-employment. They are much concerned over the uncertainties and irregularities of foreign trade in connection with their development plans. Their natural instinct is to cut down their imports to bare essentials and conserve their foreign assets only for the purchase of their 'sinews of economic war' in favour of their programmes and priorities of planning. Even so the quantum of world trade goes on increasing.

LECTURE II

TRADE POLICY FOR ECONOMIC GROWTH

The need for a trade policy

The under-developed countries no longer wish to remain in a stationary state or in a state of stagnation. They have caught the fever of progress and the infection from the affluent societies. They are determined to call in the aid of modern science and technology and apply all the methods by which the developed countries have attained their high levels of production and high standards of living. Economic growth, they have discovered, does not take place by itself. It has to be inspired, stimulated and consciously directed to pre-determined ends. They have picked up the strategy of development and they are in a great hurry to make up for lost time by adopting the plans and programmes of the Western countries and by accelerating the tempo of production in all spheres.

An appropriate trade policy is an important instrument in a plan of economic development. It is a policy which takes the nation outside seeking foreign aid and international co-operation. Of course, the problems and prospects of different developing countries would not be the same. There will be differences in accent and emphasis in the various sectors as well as in the whole of the economy. A plan is a coherent, integrated unit. Therefore the plan of one country both in parts and as a whole is bound to differ from the plan of another country depending on ideology, natural endowment, the skill and aptitude of the people, its industrial organisation and its social stability. In such a setting the trade policy for a developing economy has to be framed and given effect to.

To build up an economy from a state of stagnation or arrested development, the country should initiate a progressive movement of these growth factors, viz., increasing productivity, adequate savings, and external viability. These, acting and interacting on one another will achieve and keep going a desired rate of growth in national and *per capita* incomes. Productivity is really a func-

tion of efficiency, that is, a set of technological, managerial, educational and biological attributes which create and sustain efficiency. Economic progress requires a continuing increase in such productive efficiency. Productivity needs a capital base made up of the rising savings which are the outcome of increasing capacity to produce. The savings have to be adequate for each stage of growth. In the initial stages of development, however, there is likely to be a deficiency in productivity and savings which can be overcome by external viability. Foreign capital and foreign collaboration will come to the rescue of a country in the early stages of planned growth. But sooner or later the country should reach a level of saving and a stage of efficiency which would permit a satisfactory rate of growth without vast quantities of external aid. External viability should thus be a passing phase, a crutch to be thrown away at the earliest opportunity or to be used sparingly as circumstances demand.

In the planning of the development of backward nations external viability becomes an important objective. Economic growth requires a diversified economic structure to meet its diverse needs. In the initial stages such a structure has to be created and to create it, capital goods and industrial raw materials, not to speak of technical know-how, have to be imported. An export sector confined to a few traditional goods, the demand for which is rather inelastic, is not able to balance these imports. Even to convert such internal resources as they have into machines and materials they need foreign capital equipment. Thus a 'balance of payments barrier' springs up which can be negotiated only by external assistance. These balance of payment difficulties are to be distinguished from difficulties which arise from inadequate savings or inflationary fiscal and monetary policies. There are a few under-developed countries fortunate enough to have one or two valuable assets like petroleum, coffee, tin or gold that can earn enough foreign exchange to finance their development plans. But in general the under-developed countries have only a limited degree of resources and are confronted with real balance of payments difficulties. The deficit in their international accounts may be measured by the difference between the level of investment and the domestic savings.

In fully developed countries with a wide variety of industries real resources are easily inter-changeable, rather manoeuvrable.

But in a developing country, if resources are not properly deployed, there are bound to be bottlenecks and lop-sided activities inhibiting ordered growth. To secure a better balance of payments position there should be on the one side an attempt to mobilise the available savings potential and on the other a resource allocation so as to remove brakes on further progress. In the fixing of an investment pattern on the lines suggested it is not all the intention to sacrifice the productivity criterion for achieving a better balance of payments. Developing countries have constantly to contend against the constraints imposed by the avoidance of trade deficits and thus they are justified in taking stern measures to meet the situation though such a course may involve them into accepting a smaller increase in production in the short run.

Development and Import Regulation

Import policy should be adjusted and adjusted carefully to the requirement of the economy that is sought to be developed. No country is fully self-sufficient for development purposes. There are deficiencies which should be made up by drawing on foreign resources. The process of development entails a demand for certain imports to a greater or smaller extent. There cannot be development without an increasing demand for machinery and machine goods, raw materials and durable manufactures. The demand can only be satisfied, at least in the initial stages, by foreign imports which must be paid for by domestic exports and external assistance. The potential demand for exports will be reduced by the fast development of local industries which will have to be protected from foreign competition until they reach the necessary level of efficiency.

The infant industry argument has won wide acceptance. In these days of perspective planning and stimulated growth the argument has received a liberal interpretation. If a country is to develop fast, its first consideration should be to do all that is necessary to reduce her dependence on foreign countries and to set up its own basic industries and create its own industrial infrastructure. Foreign trade is not ruled out but it should become an instrument of growth for the developing country and not an instrument that constantly threatens the external viability and the internal stability of the country. In planning a country's progress it is just

as important to focus attention on potential domestic supply to meet a potential domestic demand in the growing economy, e.g., fertilizers, oil, plastics or special steels. We go beyond the familiar protection of infant industries by means of tariffs and think in terms of priority in investment and the dynamics of development. Infant industry argument by itself cannot sustain the entire burden of development making for a take-off stage of growth. It is no longer a simple weighing up of the infants to be protected in the country's interest, their number, the timing of their infancy and the sequence in which they have to be fostered.

A large developing country like India may have too many infants demanding protection, and protection, it must be noted, represents real cost to the country till the infants grow up, if they grow up at all, as fast as they were expected to. Economic growth involves a whole set of considerations regarding the alternative uses of limited resources over space and over time. Industries have to be developed also from the point of view of 'import-saving' or 'import-substitution'. Of course, in a developing economy all production is, in a sense, import-saving but in the context of economic growth it means the satisfaction of domestic demand by domestic production according to plan. Thus the strain on balance of payments, foreign resources and external viability will be eased off. Instead of matching exports by imports, at each stage, which is a difficult feat under growth conditions the developing country should work towards a balance in its favour.

What needs to be emphasized is the restriction of imports over time. What needs to be remembered is that import-substituting industries themselves would set up their own demands for the immediate import of investment goods, raw materials, components and spare parts. Paradoxical as it may seem, the process of import-saving will lead to the swelling of imports in the short run but as years go by it may prove the most import-saving. The development of basic industries which should come early rather than late will exert a heavy pressure on foreign exchange but there is a bright prospect of saving in imports in the long run.

Import-saving should go along with export promotion. They each exert opposite pressure on the balance of payments, one taking away from and the other adding to the foreign assets of the country. The superiority or otherwise of import substitution

over export promotion can only be decided on the circumstances accompanying economic growth, and on considerations of comparative advantage.

The 'infant industries' argument can be further reinforced by two considerations, namely first, a developing country has to increase investment in essential goods for which purpose it should drastically curtail, the import of all luxury goods, secondly the developing country should produce what is called 'demonstration effect' by cutting down the production of all luxuries, which needlessly creates new demands and reduces the saving—potential. It should be noted that the consumption of imported goods comes to acquire an unusual social prestige in societies. By reducing the imports of cars, transistors, watches, television sets we are supported to produce the additional savings required to finance additional investment. Austerity itself becomes an agent of economic progress in so far as it releases savings for development. Conspicuous consumption and status-conscious expenditure should be done away with. These stern measures will operate only for the period necessary, otherwise the pent-up demand will burst its barriers seeking satisfaction in luxury goods and prestige expenditure.

Import restrictions are recognised as an important means for economic development. They have even received international sanction. Import restrictions to safeguard the balance of payments position are permitted by GATT. Also their advocacy applied with special force to developing countries.

While the idea of import restrictions is widely recommended, the question is how best to secure the end sought for: is it by tariffs and fiscal measures such as subsidies or by direct import quotas? Tariffs may have to be preferred to quotas, for quotas involve administrative complications and corrupt practices and also the benefit of quotas in the shape of higher prices and profits goes to a few quota holders. The proper approach would be a combination of tariffs and quotas. In tariff the difficulty arises from the legislature having to make frequent changes to suit the changing circumstances whereas the ease with which quotas can be varied has itself been the source of speculation and instability.

It has to be observed that often the domestic production of goods formerly imported is undertaken by the foreign suppliers

now turned into local manufactures. Private foreign investment encouraged by assistance from foreign governments may amount to a wasteful diversion of resources nullifying all the import-saving that was originally intended. The domestic production of the former luxury imports may turn out to be manufacture only in name as the bulk of the components are imported and the high profits made in a protected market constitute ultimately a drain on the country and a burden on the balance of payments. What is wanted is not the employment of these domestic savings in luxury goods but their diversion into worthwhile investment which will also mean an improvement in employment.

A developing country making use of the policy of import restrictions against luxury imports has to reckon with the repercussions and reactions of the countries affected by it. The richer countries exporting motor cars, refrigerators, electric appliances, air-conditioners and television sets may be forced to retaliate but it is a fair presumption that, in view of a small market for these goods in the developing country and in the interest of general economic development everywhere they may not retaliate. A real difficulty crops up when we deal with trade in luxury articles among the under-developed countries themselves. They have to respect the principle of non-discrimination and refrain from imposing restrictions which will injure the trade of their neighbours. They also realize that maintaining restrictions against each other's imports would be to the detriment of all. In such a difficult situation the developing countries can enter into bilateral agreements and practise only marginal discrimination with some amount of reciprocity such as for Iraqi dates, Burmese timber and Indian carpets. In the application of these principles there are complicated considerations and what will finally emerge is an arrangement based on give-and-take.

Regional grouping among the developing nations may offer a way out of the difficulty but there would still remain the question of trade relations between one group and another. The developing countries could try a liberal import policy towards one another in the interest of the general good and thus avoid the necessity for entering into a series of bilateral arrangements which are intricate and difficult to work so far as their imports are concerned. The richer countries may even adopt a '*double standard*' as Myrdal advocates, a stricter trade and tariff policy towards the developed

nations and a more liberal and accommodating policy towards the weaker nations.

Development and Export Promotion

With all the attempts at import-saving, development goes on as a continuing process making heavier and heavier demand on foreign goods and capital. The total import bill goes on rising. The developing countries from the very commencement of the planning era should increase their exports substantially. In India the vigorous development of the last ten years has pushed up India's imports from Rs 750 crores a year to 1,250 crores. During the same period exports have increased but nominally and are moving around Rs 700 crores per year. The imports will go on increasing at least for some years more and may conceivably reach the high figure of Rs 1,400 crores. It calls for a vigorous export drive, nearly doubling the present amount. India cannot for long rely upon external assistance to fill up the gap. The gap must be filled by export promotion. The very emphasis on exports would itself involve a larger import of sophisticated goods like components, materials and machinery.

In the allocation of investment and scarce resources sufficient attention should be paid to the development of export industries. An exploration of all the avenues for export—old markets or new markets and primary, secondary or tertiary production must be made and fullest advantage taken of all opportunities to push sales abroad. Investment in export industries should go hand in hand with a policy of restraint and self-denial in domestic consumption and of insistence on the maintenance of quality in the goods to be exported. There should also be an effort to avoid inflation which introduces all kinds of distortion in prices.

Export markets do not lie ready to hand. They have to be fostered. There is no better way of fostering them than by the offer of incentives to export industries, at least, in the initial stages. The case for export incentives is on all fours with that for 'infant industries' protection though it has not found wide acceptance even among economists. Export incentives get branded as 'dumping' and are looked upon as something shady and unscrupulous. The truth is that just as there is one legitimate weapon to promote 'infant industries' in the face of foreign competition,

there is an equally legitimate and economically sound weapon to encourage exports to foreign markets which are competitive. There are however, certain forms of export aids which do harm both to the giver and the receiver. It only means that there are rational methods of export promotion as there are traditionally justifiable methods of protecting infant industries.

Bilateral arrangements for export promotion have come into vogue since the setting up of 'State-trading economies' in the countries of Eastern Europe, the Soviet Union and China. A new world of trade possibilities has sprung up, as it were, to redress the balance of the old. Both developed countries and developing countries have been entering into bilateral agreements with them and thus cornering—sizeable share of the new trade for themselves. Especially where the traditional markets are getting saturated, new outlet for these exports can be found in the vast new world slowly waking up with new demands and new opportunities. India has shown an unusual sense of realism in being among the first to open out its doors to trade with what has come to be called the communist countries. To this new market Ghana can export its surplus cocoa, Ceylon rubber, India tea, Burma rice and Pakistan jute.

Bilateral trade is open to the objection that it might distort trade patterns, that one partner may have sold more than he was able to buy from the other partner or that the net gain to exports may be offset by higher prices for imports. These fears though with some basis can be dispelled by the vigilance of trading partners combined with the desire to enter into mutually profitable trading relations. India cannot give up bilateral trading with the Soviet group of countries but she can hope that they will fall in line with the rest of the world on a general, multi-lateral basis.

The developing countries trade chiefly with the flourishing industrialized countries of the West. It is to these countries they must export on a large scale if they are going to pay for what they import and if they are to cease to rely on foreign loans and grants. The developing countries run a heavy deficit with the West, making it necessary for a transfer of capital from the richer to the poorer year after year. The industrialized nations discourage imports from the developing countries instead of following the opposite policy of encouraging their exports. The whole

armoury of import restrictions—tariffs, quotas, administrative protection, high internal excises—is brought into action against the developing countries. It is feared that the position may even degenerate with the formation of regional units, with unashamed use of the ‘cheap labour’ argument, with the spread of ‘tied loans’ even with the strict regulation of the trade, in articles like textiles on which the developing countries rely so much for their foreign exchange. These obstacles have to be removed and a positive policy of assisting the export drive from the poorer countries should be accepted.

The developing countries need not look mainly to the advanced countries as markets for their exports. They can develop export surpluses with countries at their own level of development and these may be utilised to meet their deficits with advanced countries. Such triangular exchange plays an important part in international trade. There is no likelihood of a decline in the imports of the developing countries. The advanced countries should reciprocate by devising ways and means for absorbing more and more products of the developing countries.

Exchange Rate Policy for under-developed countries

A developing country is often forced on the one side to improve import duties on all goods in general and on the other to grant export subsidies. The question has been raised if the same results of discouraging imports and stimulating exports cannot be achieved by a devaluation of the exchange rate. Devaluation, however, sets up all sorts of reactions, psychological as well as economic. There may even be frequent upward revision in exchange rates which are not as convenient or handy as variations in import duties and export subsidies. Moreover while devaluation affects all and sundry the method of import duties and export subsidies can be discriminatory and made to vary according to the nature of imports and exports. The idea is not to impose a uniform rate of duty or of subsidy. In the case of devaluation, sooner or later, many countries will enter the field in a competitive spirit and each hard-pressed country will be driven to adopt beggar-my-neighbour policies. In the last analysis it will be the developed countries that will stand to gain by improved terms of trade.

External Assistance and External viability

No country can rise from a state of stagnation without foreign aid rendered in the form of capital goods, technical know-how, loans and grants. Both external government aid and private foreign capital are important agencies for the growth process. They have a direct bearing on trade and development problems. One particular aspect of foreign capital needs to be stressed namely 'Tied assistance' the use of which is confined to definite projects and the utilisation of which is restricted to the grantor country.

On the assumption that developed countries accept some responsibility for aid to the backward areas, the problem is how to accept it irrespective of the form in which it is given. The case for tied assistance rests on payments difficulties and on the state of the aid-giving country which may be temporarily in deficit and thus cannot afford to permit utilisation of her aid in other countries. A certain amount of waste is implicit in tied aid but beggars cannot be choosers. They may, however, point out the loss involved in restricting the use of the aid funds to certain kinds of compulsory purchases, mostly machinery and materials, in the aid-giving country. Sometimes the importation of capital goods under the tied aid programme has led to the creation of additional capacity when existing capacity itself stood idle for want of raw materials and components. One begins to wonder if the object of tied aid is to boost foreign production and find a ready market for it.

The developing countries should work towards the elimination of their helpless dependance on external aid. It is not intended that they should cease to import free and untied capital when it is to their advantage to do so. Private capital and international capital mobilized through agencies such as the World Bank and its associates and affiliates on terms of mutual profit will always be needed and will always be welcome.

Dr I. G. Patel has discussed the trade problems of a developing economy. He says, 'The balance of payments position of the developing countries acts as a special and distinct constraint on the continuing growth of their economies. The policy implications of this phenomenon and the truly gigantic nature of the task of overcoming this bottleneck within a reasonable period are not generally appreciated. Many of the concrete measures required

in this connection run counter to accepted norms of international trade and payments behaviour. Some would appear as establishing a double standard of morality among nations. But the double standard is more apparent than real. Problems of international trade in the world as we find it cannot, after all, be approached in terms of some abstract model which seeks to maximize some abstract concept of world welfare in which each nation has an equal claim to share. There exists already a will to co-operate in the development of the less developed countries'.

Assessment of the various Trade Policy Measures

No country seems immune from balance of payments difficulties for long. They are however, more frequent, almost chronic, in the case of under-developed countries. A highly industrialised country normally shows a substantial surplus though telling examples of deficiency can be quoted from the current history of even affluent societies like U.K. and U.S.A. Under-developed countries have to impose controls on trade to a much greater extent than their advanced trading partners.

In the absence of a sufficient volume of foreign aid and again in the absence of sufficient gold and foreign exchange reserves, every country should find the means to adjust its deficit on trade and services. A number of measures are available which the under-developed countries are not slow to adopt. These measures have been classified under the headings of 'import policy', 'export policy', 'exchange rate policy', 'external assistance policy'. It now remains to make a comparative assessment of these measures from the point of view of their effectiveness taken either singly or in combination of one another.

The easiest and most popular method of dealing with deficits in a country's balance of payments is 'import policy', that is, restriction of imports. Tariffs and quotas will relieve the pressure on the country's external balance to a considerable extent. Tariffs and quotas can also be used for 'infant industry protection' and for improving the terms of trade. It must however, be realized that 'protection' through tariffs as such benefited certain selected commodities facing competition while import restrictions needed to buttress the trade balance usually affected the whole range of luxury goods which the country should, in difficult circum-

tances, do without. Of course the government imposing such restrictions should see to it that luxuries prohibited from entry are themselves not produced within the country. In a developing country what is saved on luxuries should be utilised to strengthen the industrial structure of the country. The alternative of a stiff duty on all goods classed as luxuries whether imported or produced internally may also be considered, depending on the circumstances of the country. Moreover trade restrictions for balance of payment purposes as distinguished from the need to protect infant industries involve a large measure of quantitative control. Quotas create artificial scarcity rents which invariably go into the pockets of the lucky quota holders. They should, therefore, be used with care.

The development of backward countries require a determined and sustained effort on a broad front which would include the creation of diverse facilities such as social overheads, capital goods, technical know-how and state assistance to private as well as public enterprise. Protective tariffs are also among these measures of development policy but we cannot lay too great a reliance on them considering that there have been several countries which attained a high degree of industrial prosperity, some in spite of tariffs as U.S.A. and some without tariffs as U.K. and Japan.

The reasons why under-developed countries rush to tariffs and trade restrictions is that their currencies tend to be over-valued and consequently their imports receive an artificial stimulus. They rightly feel that so long as their exchange rates are not re-adjusted, some measure of import restriction is required to keep the tipping balance under control. Economic liberals advocate exchange rate adjustment as a better method than an import tariff, for which they plead that devaluation would be like a uniform rate of duty and subsidy on all imports and exports striking all goods in the same way. It should be noted that one measure of devaluation leads to another and these small and frequent changes in the foreign exchange rate are not convenient instruments of trade adjustment. Past experience does not encourage the belief that variations in exchange rates will succeed in keeping the imbalance within reasonable dimensions.

Discontinuous variations in exchange rates, that is, frequent devaluation of currencies only led to disruption in trade, capital movements and prices. Modern Governments have more or less

kept away from this dangerously easy expedient. The authorities are hard put to work the 'system of the adjustable peg', a system devised at Bretton Woods for pegging exchange rates. That devaluation is by no means a sovereign remedy for countries with balance of payment difficulties is illustrated by the spectacular recovery and quick growth of West Germany and Japan, they carried on with undervalued currencies during the 1950's saving themselves the trouble of trade restrictions. On the contrary economic growth in many countries with such restrictions was disappointing.

Stability of exchange rates has a great deal to do with the direction and size of capital movements. Currency over-valuation simply drives private capital away from the country. Maintenance of equilibrium in the exchange rates is a primary condition for the inflow of a big volume of capital. It is these capital inflows that feed the development programmes. The pegging of exchange rates has very little to recommend it. The balance of payments question was not important for developing countries and one has to make a difficult decision between directing investment towards raising productivity on the one hand and directing it towards improving the balance of payments on the other, that is, between investment on infra-structure and on investment for tradeable goods. The decision depends largely upon the state of the economy of the country. If one compared countries having a combination of exchange controls and high import duties like Argentina, Brazil and Chile with countries in a reverse situation like Mexico and Peru it is found that with all their controls and duties they had not been able to increase their exports in the past fifteen years.

International trade is not an end in itself; its role is to help in achieving the maximisation of national income and of the rate of economic growth in the country. There may be conflicts between trade policy and economic development. Therefore, we should have a proper perception as to how measures to reduce balance of payments deficits affected growth in the economy. Under a fixed exchange rate, a balance of payments deficit can be met by reducing growth, that is, by reducing the imports of the means of growth. U.K. did it by cutting down her investment in infra-structure and by putting up her interest rates. One has to work out the consequences for the balance of payments deficit

of a reduction of, say, 5 per cent in foreign trade and see, if by doing so, the country would be much better off with smaller international trade but faster economic growth in the long run.

Following the lead of Professor Robinson one could pursue the question as to what made the ratio between foreign trade and national income what it was in a given country at a particular moment and further as to how this ratio changed over time and if trade policies had much to do with the changes. In the first place the quantum of a country's trade was partly determined by the size of the country itself. In countries with population of about 200 million (U.S.A.) or about 450 million (India) trade represented 5 to 7 per cent of national income. In countries of 50 million like the U.K. it ranged from 15 to 20 per cent. There are smaller countries showing 25 to 30 per cent. Secondly apart from the size of the country there is the question of factor endowment which also keeps on changing. For example, a country which exported minerals might find these exhausted, as nitrate in Chile. Thirdly there were also changes in the composition of foreign trade and in the relative importance of products through technical progress. For example, oil as a source of energy has modified the position of coal in several coal-producing countries. Similarly synthetic rubber has affected the factor endowments of countries producing natural rubber as for example, Malaya and Indonesia.

According to Rostow, countries which had taken off into sustained growth had gone through a period in which the exports expanded greatly and the rate of growth increased pretty fast. In the U.K. exports rose from 10 per cent of national income in 1740 to 16 per cent in 1880. In Japan the ratio rose from 3 per cent in 1868 to 11 per cent in 1900. The U.S. ratio in her take off period was 7 to 8 per cent. In the case of under-developed countries at present there is an attempt to stimulate growth rates in circumstances where they are dependent on exports of primary products and in consequence thereof they have a falling ratio of exports to national income. Most of them would want to increase their imports, especially of capital goods and components but their foreign trade position does not allow of it. What will satisfy them is not a series of temporary adjustments in their balance of payments but a reversal of the long run trend in which their exports have kept on falling relatively to national income.

The usual pattern of trade for the take-off countries is that both exports and imports rise. In the U.K. increasing exports of manufactured goods, which was a result of increased specialization in industries with a comparative advantage went to pay for larger and larger imports of foodstuffs and raw materials. The under-developed countries are today attempting to reach a take-off stage with a falling ratio of exports to national income. Unlike the rich countries they cannot rely on their exports to bring in imports. They are also faced with bottlenecks caused by shortages that cannot be easily met through imports.

It is imperative for developing countries to achieve a correct balance when they plan for their development. India is constantly wrestling with shortage of exports and of foreign exchange. As a result of adverse trade balance there was a gap of about Rs 500 crores per year. India has been practising frugality in imports but it has not done enough to step up its exports of manufactured goods, to pool available gold in the country and to go in for import substitution on a massive scale. 60 per cent of India's export trade comes from her agricultural produce. The output had declined, so also the prices, thanks to foreign competition. Sugar which fetched in one year Rs 1,400 per ton in the international market fell precipitously to Rs 200 per ton in the following year. There is little hope of a sufficient increase of India's traditional exports such as tea, jute goods, cotton cloth, skins, oilseeds and tobacco. There is not much hope that her new exports consisting of manufactures, engineering goods, edible oils and petroleum products would make a strong impression on her export income ratio. The import-saving industries by and by should be turned over to exporting. India like most under-developed countries should move away from a situation where the ratio of imports to income is high and devaluation is, therefore, likely to be inflationary. We might take special steps towards the production of exportables and importables but we have to look beyond the immediate profitability of various investments to the structure of the economy itself.

The modern world situation in terms of international trade was worse than in previous times for two reasons: first there was the long-run tendency for prices of primary producers to fall; second, there were cyclical movements in these prices. Together they created the difficulties for economic planners and developers.

The U.S.S.R. had started an industrialization in the 1920's and 1930's. She had to increase import of capital goods for her industrial base at a time when her primary-produce prices were low and she had nothing else to export. The Russian example illustrates the necessity for long-term loans at low rates of interest on a purely commercial basis. Again, the under-developed countries should learn to pay their debts not only in foreign exchange but also by exporting the goods which they could produce most easily or at a comparative advantage.

Measures to correct balance of payments in developing countries should be part of a long term strategy for constructing the basic structure of the economy in all its strength. These measures may be of several kinds such as devaluation, foreign aid, import restrictions and export subsidies. The developing countries should adopt a pattern of investment which strengthened the balance of payments in the long run. One however, could conceive of circumstances where long-term growth would be slowed down and the short-term balance of payments corrected, even though this could be done at an immediate cost in terms of over-all productivity.

Since exports pay for imports and since imports of certain categories of goods such as machines, materials and fuels in ever increasing quantities are required to build up the industrial apparatus of a developing economy, the planners of growth have to bestow much care on the volume, diversification and direction of their external trade. Our export performance during the three Plan periods has not at all been encouraging. In one word it can be summed up as stagnation. The following table shows the position of our merchandise exports and imports year by year.

<i>Years</i>	<i>Exports (Rs crores)</i>	<i>Imports (Rs crores)</i>	<i>P.C. of Imports financed by exports</i>
1951-52	730	962	76
1955-56	640	773	83
1960-61	630	1,105	57
1964-65	802	1,396	58

Over the period from 1951-52 to 1964-65 the improvement in the export figures from Rs 730 crores to Rs 802 crores has been slight. Not only is there no buoyancy in our exports there is also an ever widening gap between exports and imports. In 1964-65

the proportion of imports financed by exports was represented by 58 per cent as compared with 76 per cent in 1951-52. Exports have dismally failed to keep pace with imports.

In the world setting, Indian exports have shown little or no progress. Over the decade 1951-65 the total export trade of the world doubled, but India's share in it declined from 2.1 per cent to 1.1 per cent. India despite her ambitious planning makes a poor showing in the face of the growth of several countries both in the east and in the west. The following table shows the relative position of India regarding export growth in terms of millions of U.S. dollars:

<i>Countries</i>	<i>1961</i>	<i>1964</i>	<i>P.C. growth</i>
India	1,386	1,749	24.2
France	7,222	8,995	24.6
West Germany	12,690	16,221	28.0
Italy	4,183	5,956	42.4
U.K.	10,752	12,341	14.8
U.S.A.	21,000	26,582	26.6
Japan	4,236	6,675	57.6
Philippines	500	737	47.4
Taiwan	196	418	113.3

An appraisal of Indian exports can also be made in terms of Gross National Product. To achieve the objectives of planning one would have expected that a greater and greater slice of production would be exported to finance our development imports and maintenance imports. The figures speak otherwise. In 1952-54 India exported 5.1 per cent of her GNP and in 1959-61 the per cent declined to 4.0. At the same time the imports as percentage of GNP rose from 5.6 to 6.5.

One cannot emphasize too much the significance of exports for a developing economy. The country has already to face immense defence as well as development expenditure and she is vainly facing it with a lower growth of output and of export earnings. Hence there are intense pressures on the price level and on the foreign exchange reserves and also on the country's capacity to finance the plan expenditure which is fixed to meet the needs of the economy. For a developing country like India particularly export expansion should go along with economic

growth. A high tempo of development calls for an uninterrupted import of materials, machines and technical know-how. Any reduction in export earnings or capital inflows will be automatically reflected in the capacity to import.

The impact of export shortfalls on the economy is far reaching. First they upset current programmes of investment and production. Secondly they increase the need for foreign assistance which in effect mortgages the country's future exports for debt service. It is estimated that during the Fourth Plan (1966-67 to 1970-71) the servicing of past debts alone will absorb as much as 25 per cent of our export earnings.

Defence, development and debt servicing all demand a high level of exports in the coming years. At first the country's planners did not seem to realise the value of export programming and export promotion. It did not figure as an integral part of the country's development efforts. In an outlay of Rs 2,069 crores for the First Plan they bestowed no thought on export surpluses. The Second Plan also did not provide for augmentation of export earnings. There was a strong reliance on the sterling balances, though rapidly depleting and a great faith in the export staples of tea, jute and cotton. The Third Plan showed conscious awareness of the link between export earnings and the import of capital goods and industrial raw materials. A broad approach to the export problem was adopted with measures to curtail home consumption and to release the produce for exports, to encourage cost reduction and quality control, to organise market research and intelligence. Plans were laid and targets were fixed but there was hardly anything in the nature of a vigorous export drive.

The Fourth Plan has boldly accepted export strategy as of the essence of development. The overall export target has been placed at Rs 5,100 crores as compared with Rs 3,850 crores for the Third Plan. The items in the export strategy are cost reduction, quality improvement, product designing, pre-shipment inspection, attractive packaging, financial facilities, export credits and bilateral trade agreements. Also a large number of institutions have been set up for export promotion. To mention a few of these: The Board of Trade, the Indian Institute of Foreign Trade, the Directorate of Export Promotion, Export-Import Advisory Council, Export Credit and Guarantee Corporation. Above all, care is being taken to promote the acceptability of Indian products

abroad. These products are apt to be dislodged from foreign markets partly because they are priced out and partly because their quality is sub-standard. Germany has complained of 37.3 per cent of sand in the tapioca supplied to them while Russia has complained of shoes and leather-ware not coming up to sample. In 1963 complaints against Indian exports numbered 421 of which 113 were for poor quality or wrong specification.

The ECAFE has summed up the trade position and prospects in India's development plans as follows:

- (a) Existing and Planned exports: Tea, cotton and jute manufactures, sugar, spices, cashenuts, vegetable oil, oilcakes, raw cotton and waste, yarns, coir manufactures, manganese ore, iron and steel, tobacco, leather manufactures, electrical and light engineering goods, transport equipment.
- (b) Required imports: Raw materials, non-ferrous metals, mineral oil and fuels, specialized equipment, chemicals and other capital goods.
- (c) Import substitution or self-sufficiency drives: mild steel, aluminium, drugs, chemicals, transport equipment, machinery, paper board, rayon, synthetic rubber.

Prime importance should be attached to the development of a flexible attitude in our trading patterns and policies. We have to trade with old capitalistic countries and new communist countries, with countries that believe in free or freer trade and those that are deeply committed to tariff protection and trade regulation, finally those that are developed countries and those that are less developed. We have to trade with all those for their benefit as well as ours. A flexible approach will enable us to gain the utmost from the processes of international trade.

LECTURE III

PLANNING THE FOREIGN TRADE OF A DEVELOPING ECONOMY

I. Pattern of Foreign Trade in Under-developed countries

It has often been asserted that economic development has a leaning towards autarky and that in its uncritical enthusiasm for national progress the planning authority is apt to neglect, if not sacrifice, the advantages of international division of labour. There is apparently a conflict between free trade and economic planning. The choice between the two is nowadays not so rigid as in the past. Jacob Viner has shown that there is no inherent or inevitable association between the planning principle and reduction in trade volume. Planning is after all resource allocation in the most productive combinations and if a further increase in trade is required in given circumstances the planning arrangements should provide for it in the measure desired. Where there is conflict between foreign trade and economic development, emphasis should generally be laid on the latter. The problem briefly is this: given a desirable rate of economic growth how to make international trade and international division of labour service its purpose.

In a typical situation of under-development, government intervention should be directed so as to secure maximum gains from foreign trade. A developing country cannot afford to leave her foreign trade to the capricious play of market forces. The contribution that foreign trade can make to economic development is set forth by Kitamura. He says that the capacity to create wealth is the capacity to attain self-sustained growth. Under-development indicates a lack of the instruments for growth. What is wanted is not wealth itself but a capacity to produce wealth, a capacity to grow in terms of a continuous process of cumulative expansion. The production of income depends on the input capacity of economic resources, that is to say, input co-efficients showing the efficiency with which income can be created out of the given plant and equipment. Real income or welfare is raised

by internal division of labour but the capacity to create income may remain unaffected. The internationally traded goods are either consumption goods or producer goods or both. The producer goods serve future production while the equipment and raw materials that are involved in a trade flow add to the producing capacity of the importing countries. Moreover with capital goods there is the transmission of superior technical knowledge and know-how and highly sophisticated industrial arts. Though non-tradeable and intangible these are important input items.

From the standpoint of the pace of development true gains from external trade must be reckoned in terms of the increase in the supply of goods of high growth potential. The under-developed countries severely handicapped by shortage of capital are trying their best to increase the quantum of intermediate goods and producer goods in their import structure, for these are indicators of the growth potential that can come from foreign trade.

Savings create capital and capital creates investment. But savings on the scale required for growth may not be had within the country itself. There should be an increased supply of capital and capital goods obtained through the trade flow. The under-developed countries have reversed the traditional sequence from consumer goods industry to producer goods industry and now make a start with heavy industry and with production of the means of production. Once an industrial base is established and there is a brisk flow of producer goods capital accumulation will take place of its own accord. But such a quick transformation from backward economy to modern industrial dynamics is not possible for the smaller under-developed countries. Certain specialized types of basic equipment will have to be imported from their 'Capital goods basis' located in developed countries. Apart from domestic savings, capital formation may be facilitated by the composition of imports.

The industries that supply exports may yield increasing returns and external economies and these in their turn will raise the productivity level. A part of the productivity gain in the export sector will be transferred abroad along with the goods but the rest will assist the process of capital formation at home. Whenever the price structure fails to reflect real costs as in the case of regimented economies there is a case for selective control of foreign trade and Viner has admitted that even the strict

theory of *laissez faire* would permit it. With so many controls on free exchanges the principle of comparative advantage, as Ragnar Nurkse puts it, ceases to be a matter of market mechanism, surrenders any claim to explain the existing trade pattern and becomes in effect merely an expedient of economic planning.

Under the planning regime the concept of infant industry protection has been greatly broadened. State interference with foreign trade now goes far beyond what the familiar infant-industry argument would allow. We are no longer thinking in terms of a measure of protection—just so much and for just so long a time as to suit the particular infant. Under the infant-industry plea we now bring in a broad range of government measures of control, sustained over a long period and creating the required productivity basis for the economy on a broad front. It is not the old autarky—inspired protection. It does not run counter to the principle of international specialisation. It does not sacrifice the object of balanced development and increased productivity. The criteria are not just the cost of production or the competitive viability of a single infant but contribution of differentiated industries to the development potential of the economy as a whole. The principle of planning is linked to productivity in resource allocation and investment decisions. It demands, in theory at any rate, a high degree of economic calculus and discipline. There is need to distinguish between goods with greater and those with lesser growth potential and then draw up a system of import priorities according to their growth potentiality. The import structure should be geared to the need for technical progress and capital accumulation.

Nowadays even economists of the orthodox variety are prepared to concede the special claim of under-developed countries for government interference. They, however, prefer a uniform import tariff or export subsidy causing the least dislocation of the market forces. They are prepared to stretch the argument for an infant industry to an infant economy as a whole. These principles are incorporated in the tariff systems of under-developed countries distinguishing them from the protective schemes of advanced countries. As Raul Prebisch has pointed out, to demand reciprocity in respect of tariff concessions made by the well-to-do nations is to introduce a detrimental element on the economic development of those less-favoured. Here lies also the economic

justification for Professor Myrdal's 'double-standard morality in international trade' as between the forward and backward nations.

Though the planning approach to foreign trade is productivity-oriented it must be conceded that the efficient use of domestic resources is the real basis for economic growth. When all is said and done the contribution that foreign trade can make to development is more or less marginal. Historically the countries which interfered purposefully with their foreign trade showed a more rapid growth rate, but in these countries the domestic economy was expanding with technical progress and investment opportunities. As Gottfried Haberler says, 'The main job has to be done inside each country, and the protectionist trade policy can make only a marginal contribution'.

International exchange of goods has a growth potential in it. Home market is of a limited size but beyond the home market we have the wider world with its insatiable demands. Export sector is thus capable of almost indefinite expansion. In fact the export sector can be made to play a leading role in economic development. Historically several countries went in for trade-oriented development. Given modern conditions, under-developed countries have to face severe competition in the export markets. Hence they are committed to the principle of directed or planned development. A popular estimate of the need to expand their production puts it at 6.3 per cent a year which entails an annual growth rate of exports at 15 per cent a year. In the early stage of industrialisation, the marginal propensity to import rises at a rate higher than the growth rate of national output. In the later stage where the economy gets diversified the marginal propensity to import tends to fall and so also the ratio of imports to national income. Finally the two rates will become stabilized at a level optimal to the country in question.

The foreign trade of a developing country is strongly influenced by the import needs of capital goods and of raw materials. The growth of imports tends to be more rapid than that of the national output. Exports are needed to pay for these increasing imports. An under-developed country's exports consist mainly of primary products which have a low income elasticity of demand, which have to face a substitution of synthetic products and which, due to technological changes, have to reckon with a considerable saving of raw materials per unit of manufactured goods.

There is a widening discrepancy in income levels between advanced and backward countries. To bridge the gap, the rate of growth has to be high, even higher than the rate of growth of the developed countries. Unlike the typical development of the days of the Industrial Revolution when the leading countries devised their own technologies and techniques, the backward countries of the present time undergo the more easy process, called 'derived development' which is based on inventions and innovations made elsewhere. The move towards developing an economy is facilitated by the imitative nature of modern technology which is available for all and which may flow into any country via her imports. From these propositions there arise a series of consequences: the rate of growth of a developing country can be higher and needs to be higher than that of the ripe, mature economies; the rate of increase in import expansion consisting as it does of investment goods and raw materials is likely to be higher than the rate of growth in national output; exports of a developing country tend to grow more slowly than the income growth in developed countries; the need of imports in a developing country outruns her capacity to import which is primarily determined by her exports.

The ECAFE secretariat has compiled an index showing how the import capacity of the primary producing countries in Asia has fallen far short of their import needs. With 1928 as the basis, production in 1955-57 stood at 145, imports at 163, exports at only 122. So also in India there is considerable leeway between export prospects and economic growth. According to the perspective plan of the Planning Commission, between 1956 and 1976 real income is estimated to increase by 150 per cent and the value of investment by 500 per cent but the volume of exports (the capacity to import) by only 33-50 per cent. In view of these trends it is difficult for a country like India to maintain its external stability without domestic inflation. Foreign trade has, therefore, to be carefully planned so as to foster the quantum of exports and make the most of the capacity to import which results from it. In the nineteenth century when conditions were different exports which were plentiful and in great demand were a leading factor in growth. Today there are import needs but there is not sufficient import capacity which is the obverse of export earnings. The countries

which suffer most are those like India with high population pressure.

In planned economic growth there is a tendency for the trade balance to deteriorate. To relieve the pressure on it, we may call into play certain dynamic factors with a slant for quick growth. Technical aids and technological skills which will raise the level of productivity may be applied to the export sector or the import-substitution sector whichever gives the better results. The export-bias production will reduce the gap in the balance of payments while the import-bias production will have the same effect while improving the terms of trade.

It is generally recognised that the population pressure has become a national problem in most backward countries. As the labour force increases, the marginal productivity of labour tends to decline. Development based on capital-saving techniques or what comes to the same thing labour-intensive production is justified. The problem of employment and the problem of productivity are to be taken as parts of a development policy. Even labour-intensive techniques should be judged from the standpoint of their effect on output. The comparative advantage of a country with a high population density rests with labour-intensive production. Under scientific cultivation even the major export crops show a capital intensity which is higher than manufacturing industry.

In allocating resources for the future, two considerations should weigh with the planners, viz., first, factors making for elasticities of cost reduction, secondly factors making for growth elasticity of demand for products, in other words, the state of demand for the products and the rate at which it will rise as the economy grows. The ECAFE studies show that export crops of backward countries are not sufficiently growth-elastic, that the demand for primary products of the Asian region is not likely to be brisk, that in a period of twenty years their export earnings are likely to move up to only 50 per cent or less. This rate of growth is slow when considered in the context of fast growing populations, and in so far as export earnings are an important element in their national product there is bound to be a decline in real income *per capita*. The force of these dismal prospects is particularly felt in plantation economies as those of Ceylon which are heavily export-oriented. Realising the need for recasting the structure of exports and of

production, the planners of the Asiatic economies are inclined to sacrifice the principle of comparative advantage, as for example, in respect of their plantation crops and give every encouragement to diversify their production and their export patterns on a long run calculus of both direct and indirect benefits for their economies. At present productivity in the plantation sector is higher than in the non-plantation sector, but in their economic projections they reckon upon the investment of a given unit of resources giving a relatively higher productivity in the home sector than in the export sector.

Capital is a prime requisite in the process of achieving higher productivity. Capital is drawn both from home saving and foreign trade in so far as capital goods are imported from abroad. In fact Joan Robinson equates exports with a capital goods industry, because exports are payments for acquiring capital goods through imports. An important object of planning is to transfer the export sector from consumer goods to higher manufactures, from food production to processed goods, from simple articles to sophisticated goods. Lamartine Yates in his survey of forty years of foreign trade says that in 1913 out of 30 countries, 25 took more than half of their imports in consumer goods, but in 1953 only 9 countries did so. The most spectacular progress is shown by the countries of Latin America while the countries of Africa and Asia (except Japan and latterly India) have been content with their export of primary produce and raw materials. A practical remedy being tried successfully by India is to cut out all unnecessary imports and to set about replacing imported goods by domestic production. The process of import substitution can be assisted by tariffs and by exchange and trade control measures. These may be supplemented by domestic policy measures such as tax reliefs. The limits of state intervention have now gone far beyond the safeguarding of infant industries. It is the safeguarding of the economy itself.

In the early stages of industrialisation, the under-developed countries cannot hope to export their manufactured goods to advanced countries but they can export to one another according to their comparative advantages. At present almost all under-developed countries try to economize foreign exchange by producing the same kind of goods. But a more reasonable thing to do is to exchange with one another goods produced according to

regional specialisation and comparative advantage. Following the example of Free Trade Areas and Common Markets, the Asiatic countries also can enter into arrangements whereby they can sell to one another the simple sorts of manufactured articles and engineering goods. As Kitamura says, 'It would be easy to establish a special case for close collaboration among under-developed countries in general, in preference to the often illusory world-wide multilateralism. There are several special reasons why intra-regional co-operation in development and trade policy among expanding countries in Asia seems particularly desirable today'.

II. Trade and the Course of Economic Growth

International trade and the problems of international payments that go along with it affect the process of development in two rather diametrically opposite ways: first, it may speed up the rate of development through the introduction of specialisation, new techniques and capital accumulation. Secondly, it may encourage the propensity to import so as to exceed the power to export, producing balance of payment difficulties and forcing the country into the patterns of development which tend to diminish rather than to increase productivity. The country may be forced to protect its currency reserves by raising interest rate which will diminish the volume of imports unnecessarily and interfere with the development plans.

The normal measure of the size of the foreign trade of a country is the ratio of its exports to national income. The ratio reflects both the size of the country and the range of its factor endowments. Thus a large country like U.S.A., or India has more internal and less external trade than the small countries of Europe. There is nothing permanent in the pattern of international trade. It is a changing pattern, the changes dictated by wider dispersal of skills which make for comparative advantage or by the exhaustion of natural resources, or again by the substitution of, say, man-made fibres and synthetic rubber for natural products. The pattern will change from time to time in a country's development.

The relation of exports to national income is significant, for it is the foreign earnings that determine the expenditure on imports. In most advanced countries like U.K. and Japan the

standard pattern seems to be one of acceleration in the rate of development accompanied by ratio of exports to national income. Exports appear to be a motive force in British progress. In the nineteenth century labour was continually transferred from less productive agriculture to more productive manufactures which permitted higher profits and greater exports. There was both a more efficient utilisation of capital and a higher ratio of capital formation to total national income. In Japan also there was a definite relation between the growth of exports and economic development. During the period of her rapid growth there was a rising export ratio. The initial stimulus, the capital instruments the new techniques that created the Industrial Revolution in Japan, all came from abroad, all through the operations of foreign trade. There was a steady rise in wealth and productivity with the result that both imports and exports grew and helped each other.

It is clear that in very many countries there is an association between the export ratio and the rate of economic growth. It is however, conceivable that there can be development without foreign trade playing a major role as for example in U.S.S.R. or in U.S.A. where during the period of the take-off the economy was stable, in other words neutral rather than positive.

In normal circumstances foreign trade does act as an agent of expansion and development. In the first place foreign trade leads to a concentration in those industries where productivity is likely to be very high, thus raising the rate of growth in national income and capital. Secondly economies of scale, both internal and external can be realised which would not be possible within the narrow confines of a small home market. Switzerland is the classic example of a small country but with considerable foreign trade and high productivity and *per capita* income. Thirdly foreign trade may arise out of a few nuclei or enclaves scattered over those areas of high productivity and natural resources but in course of time these industries may spread over a larger and larger area, making both for accelerated growth and diffusion of benefits. In India these foci of development were found first in the region around the coal and iron belt in Bengal and Bihar and in the cotton belt in the city and environs of Bombay. But today the benefits of Industrial Revolution are distributed over a wider surface, practically in several parts of the country. The intensive development of the leading sectors according to local advantages can

become the means ultimately of a wide geographical complex of industries. India provides an example of the way in which the difficulties of foreign trade and of the balance of payments may obstruct development and hold up the progress of the country's plans.

In India the volume of exports has declined substantially since 1929. In the post-war years it has persistently remained some 15 per cent below the 1929 level. The tendency for a falling ratio of exports to national income has been strong. Even now about 95 per cent of exports consist of the traditional items such as tea, jute goods, cottons, tobacco, vegetable oils; about 5 per cent are the new items such as the simpler manufactures. The traditional or conventional exports are more or less stagnant and the demand for them is of low elasticity. The new items are expanding though slowly and are not likely to arrest the declining ratio of exports to national income. The export ratio was 6 per cent in 1955-56, and may go down perceptibly if strong measures are not taken to boost the exports, especially of the newer kind.

An easy way out of the difficulty is the stimulation and expansion of exports. If the currency is over-valued, they say, devalue it and encourage exports. If a diversification of the export is required, they say, push forward the rapid growth of the new exports by lower prices. These are remedies of doubtful potency. As Austin Robinson says, 'India suffers temporarily from the same disability as a number of other countries, which developed their foreign trade on the pattern of exchanging now vanishing surpluses of primary products for manufactured imports. Its one substantial export—cotton textiles—is a declining rather than an increasing export. Despite cheap labour, India has no long-established traditional skills applicable to local materials and offering ready-made comparative advantages. They need to be created and developed afresh in terms of new skills and new commodities'.

An increasing tempo of development against the background of a declining export ratio seems to be highly improbable. As it is, nearly half of India's capital investment is imported from abroad, that is, roughly half the estimated imports are made up of capital goods. The share of capital goods in the import list may rise still further but attempts are made strenuously to reduce the

import-content of investment. The expedient of resorting to foreign borrowing, necessary at it is atleast in the initial stages, will create its own obligations to service the external debt. India cannot contemplate with equanimity a continuing series of deficits.

Countries which depend on exports of primary products have to contend with two drawbacks: first, international trade in these products lags behind the growth of world output, secondly consumption of primary products does not rise so fast as consumption of manufactured articles. The primary countries have to reckon with the low income elasticity of food demand and the decline in raw material content of manufactured articles. The world trade in primary produce lags far behind the world trade in industrial production. There has been an increase of 112 per cent in manufacturing trade while the increase in primary trade has been only 30 per cent. Some big manufacturing countries which export their goods use their own home-produced supplies of raw materials e.g., U.S.A. Moreover in modern times engineering goods form a large part of international trade and it is the characteristic of these goods to combine the use of indigenous materials with a low raw material content in output. There is also the question of synthetics which diminish the use of primary products and to that extent reduce the quantum of international trade. The increased flow of manufactured goods into the under-developed countries can be sustained only by financing arrangements with industrial countries.

A practical policy for developing countries facing a declining export ratio would be to promote import-saving investment and lift the pressure on the balance of payments. As Austin Robinson says, 'Regarded as ideological doctrine, the principle of beginning development with heavy industry, moving on to the capital goods and only coming finally to consumer goods is nonsense. But regarded as a pragmatic policy of breaking through the limitations of a declining export ratio it may very possibly prove to contain an element of practical sense. Such a policy will lead to a progressive reduction in the import-content of investment.' The developing country will have to forego some of the advantages of international trade but ultimately the domestic manufacture will replace the imports and start a new cycle of a substantial increase of exports and foreign assets.

When a country launches on a course of economic development there is always the possibility that the balance of payments with a declining export ratio and a rising import ratio will prove a limiting factor. Hence it is of the highest importance that a forecast should be made of the long-term trend of exports and imports and integrate it with a long-term development policy. An acceleration of the rate of economic growth demands a high and rising ratio of imports as well as exports to national income, all the time exports paying for the imports of capital equipment, raw materials, components and spare parts. With respect to each country it should be possible to devise a strategy of development which will simultaneously be import-saving and investment-oriented.

The planning systems do not always succeed in achieving the results they set out to get. Situations develop which the planners have not foreseen. Indian Planning has sought to achieve a socialistic pattern of society. The accent is on socialism but in actual practice there has been concentration of wealth, income and economic power. The difference between rich and poor has got accentuated while monopolies and restrictive practices have made the richer, richer. In the words of the Monopolies Enquiry Commission, 'The planned economy which the Government decided to accept for the country as the quickest way to achieve industrialization on right lines has proved to be a potent factor for further concentration'. In the last fifteen years since independence three Five Year Plans have been implemented. These have set on motion dynamic forces making for a high tempo of economic activity. But the end result is far from equality.

There is a wide variety of product-wise concentration. There is complete monopoly of production in the case of infant milk goods, medicines, footwear, time pieces, cars, jeeps and scooters. The Tatas and Birlas between them are responsible for a great degree of monopolisation in the country. Tatas with 53 companies in their group accounted for assets of Rs 418 crores with turnover amounting to Rs 325 crores. Birlas with 151 companies had assets of Rs 293 crores and a turnover of Rs 290 crores. A further indication of the prevalence of private sector monopolies is shown by the fact that 650 accounts constituted roughly two-thirds of the total advances of the banking system.

Concentration of economic power though anti-social in some respects is a necessary evil in the economic interest of the country. It may be relied upon to make important contribution to industrial development in the years to come. In the interest of capital formation it may not be wise to cripple the industrially rich at the cost of slowing down the pace of industrial development.

The allocation of resources and the settlement of priorities which planning necessarily involves have necessitated a system of licensing for the start of new industries or for expanding the old established units or for introducing new units in existing industries. Capital issues too are controlled in the interest of ordered growth for the country.

The need for obtaining capital goods, machinery, raw materials and essential components from foreign countries has required a close watch on the foreign exchange position and consequently on import policy. Unfortunately for India, to meet scarcity conditions, her government was forced to expend large amounts of foreign exchange in securing foodgrains from U.S.A. and elsewhere. For these reasons her balance of payments position has become precarious. It has become imperative to prohibit imports in respect of consumer goods and regulate them strictly in respect of producer goods. Even when import is permitted it has to cross generally a high customs frontier erected for protecting Indian industries.

III. The role of Foreign Trade in India's Economic Growth

India has believed in planned development. There can be no successful planning which does not take account of the state of the country's foreign trade, both imports and exports, and adapt them to the needs of a growing economy. In the last eighteen years India has had the right and the opportunity to frame her own foreign trade policies. Development largely depends on the quantity and quality of factor supplies, on improvements in technology and on the character and composition of the country's external trade. Our trade traditions have been largely liberal and *laissez faire*. Multilateral trade with a fixed exchange rate seems to have been the only policy which we could operate under Britain's lead. Recent years have seen several shifts in trade policy which is like groping towards an ideal pattern by the method of trial and error.

Right through the British rule in India there was an unseemly controversy on the value of protection through import duties. The issue was between *laissez faire*, a theory which prevailed during the period of British industrial growth and which suited Britain and *protectionism*, a theory which India, impoverished by the decline of her arts and handicrafts and the increasing ruralisation of the country, considered as the only solution for her industrial regeneration and progress. England was master and dictated her Indian policy from Whitehall in London. She was fortified in her stand by the prevailing theory of international trade, based on comparative advantage and the gains that accrue to the trading parties and to the world as a whole. To fight such a formidable array of arguments India could only put forward the infant-industry approach for selected industries. It did not occur to her to generalise the approach and ask for protection for all the industries and for the whole country to enable it to pass from an agrarian stage to a stage of full-fledged industrial development. The industry may be an infant but in a real sense the whole country industrially speaking may also be an infant among the advanced countries fully benefiting by the Industrial Revolution.

India first tried 'discriminating protection'. Not satisfied with the progress towards industrialization she, on the departure of the British, made a bold bid for what is called 'Developmental Protection'. It is the kind of State intervention that seeks to transform the economic environment, create industrial and social overheads, give wide scope for state and private enterprise, innovation and pioneering skill. The cry was no longer for the protection of isolated and unrelated industries but for the creation of a complex of industries, aiding one another and all profiting by internal and external economies. As the Fiscal Commission puts it, 'Our general view is that the decision whether protection should be given to basic industries should rest rather on considerations of national economics than on the economics of a particular industry'. India has come full circle beginning from halting and timid protection of selected infant industries, often balancing import duties with countervailing duties on home-produced goods, to a full-blooded state interventionism making use of several stimuli for fast industrial development, among which a protective import duty is but one. The Fiscal Commission realizing the need for a developmental approach rather than an

infant industry and isolated industry approach stated, 'The protection of industries should be related to an overall plan of economic development; otherwise there may be unequal distribution of burdens and an unco-ordinated growth of industries'.

In securing its objects the Fiscal Commission thought mainly of the method of protective duties and only incidentally of the method of quantitative restriction. It conceived of protective duties as making up the gap between the indigenous cost of production and the landed cost of similar imported product. It thus sought to keep the burden on the consumers at the minimum and to encourage the producers to reduce their costs and improve their quality. When subsequently India adopted planning as a national policy, the question of the kind of industries to protect and the quantum of protection was decided outside the Fiscal and Tariff Commissions and on considerations beyond the narrow range of carefully selected industries and carefully adjusted tariff duties just to meet an existing trade situation.

The planners raised the comprehensive question of what should be the proper attitude towards the composition and quantity of imports. The course of economic development that was envisaged demanded that certain types of imports, in the interest of exchange-saving, should be replaced by domestic production and that certain other types of imports should be encouraged in the interest of industrialising the country. As foreign exchange crisis raised its head the country changed its outlook. The factors in the situation were the fast disappearing sterling balances, the need for foreign capital to finance the vast scale of heavy industries, the urge to cut down imports of consumer goods to the bare minimum and finally the necessity to adopt an import-substitution pattern of development in the face of scarce foreign resources.

The trend in the changes in imports in the 'developing' ECAFE countries for the years 1958-60 as compared with the base years 1951-53 = is shown below:

	<i>ECAFE countries</i>	<i>India</i>
Food	98	82
Other consumption goods	77	76
Materials chiefly for consumption goods	104	93
Materials chiefly for capital goods	145	186
Capital goods	165	213
Total	111	126

The imports of capital goods and raw materials for capital goods have increased in quantity; the imports of materials for consumption goods have remained more or less stationary; imports of other consumption goods have declined sharply; and imports of food have shown some diminution. The changing pattern of imports both in India and in the rest of the ECAFE region amounts almost to a radical transformation of their economies with an accent, marked in India, towards their industrialization. In India the pace of industrialization has been much faster and the rate of import substitution much greater but these substantial steps forward have been neutralized since 1961-62 by heavy imports of food and agricultural products. India has also increased its import dependence in respect of producer goods and intermediate goods.

Import dependence for industrializing the country carries with it the threat of under-utilization of installed capacity. There are several causes for it such as insufficient demand, fuel shortage, lack of credit but the most important cause of all is the non-availability of foreign exchange in the required amount and at the required time for the purchase of raw materials, components and spare parts. Professor Lakdawala gives the following figures to prove excess capacity: Of the 237 industries for which installed capacity figures were available for 1962 a little more than one-half were working at 80 per cent or above capacity and about one-fifth at 60 per cent capacity or less. It is feared that the stringency of foreign exchange which is partly responsible for unused capacity will dog the five-year plans for many years to come.

The grave shortage of foreign exchange, the *enfant terrible* of India's development plans, has created a situation which Professor Lakdawala aptly calls 'pervasive protection'. We no longer think of protection in terms of import duties only; we no longer draw a clear-cut distinction between protected and non-protected industries. The Tariff Commission set up under the 1951 Act finds itself at a loss to know what its functions are coming to. The usual thing to float or expand an industry now is not to seek 'protection' through the Tariff Commission but to apply for an industrial license supplemented by a claim for another license to import the required machinery and raw materials. These licenses are issued not by the Tariff Commission but by the Depart-

ments of Central Government. The last case settled by the Tariff Commission was in 1956 and the last case referred to it for protection was in 1958. The principal activity of the Tariff Commission is now to examine the claims for extension of protection already granted. In any case India's tariff was always low-pitched and the protective tariff was not much higher than the revenue tariff. For example, in 1963 out of the 38 tariff items that were protected, only 11 items had a duty of 50 per cent or more while the remaining items had a duty of 25 per cent or less. Many industries prefer to seek shelter behind the import controls and quota arrangements. Even the protected industries derived additional benefit from the pervading import controls. Import licenses command high premium. The Committee on Prevention of Corruption has reported that import licenses when sold in the market fetch 75 per cent to 500 per cent of their face value depending on the commodity which is a measure of the de facto protection enjoyed by all industries. With all these controls about, import-substitution received a stimulus outside the strict limits of protection. Thus the withdrawal of sugar protection on the ground of no progress in the industry caused no alarm among the producers, because the Government faced with balance of payment difficulties could not afford to permit the import of large quantities of sugar. The number of protected industries has now dwindled to 10.

The main virtues of the Tariff Commission have been, first, the publicity and public scrutiny which surrounds all its inquiries, secondly, its quasi-judicial nature which kept it aloof from sectional interests and political influence, thirdly, its concern to reduce costs and improve the quality and competitive strength of the protection receiving goods. In the new set-up under which the Planning authorities have taken over the promotion and direction of industrial development the Tariff Commission is playing a limited and subordinate role. The functions of the Tariff Commission are being discharged, more and more, by a wing of the Planning Commission. Since excess demand in the home market is the rule the industries that produce the protected commodities are not exposed to any severe pressure to reduce costs, to improve quality and to apply the latest techniques of production. Unlike U.S.S.R. we do not have in our country development councils that will hold enquiries into costs and efficiency. Project and Programme evaluations conducted by the agencies of the

Planning Commission are but poor substitutes for the critical enquiries that were carried out by the Tariff authorities in India.

While over the past decades and particularly since the plans came into operation, India has fashioned an import policy to subserve the needs of development, there has been a corresponding assessment of the export trade of the country and an attempt to raise the level of exports seeking new markets, new products and new customers all over the world. The country has become export-minded. They know that if there are no exports, there will be no imports and if there are no imports of the kind required there will be no planned development. It has not always been so. Foreign trade hardly made any impact on the Indian economy, for it was responsible for a very small proportion of national income. The great staples of her export trade—jute, tea, raw cotton—rose easily to prominence. Thanks to its great size and huge population the Indian economy pursued a policy of self-sufficiency caring only for foreign gold and articles of luxury for the very rich. Her soil produced enough food to maintain her multitudes while Britain saw to it that India remained mainly a raw material exporting country with little or no use for capital goods and intermediate products which would have started an industrial revolution threatening the unchallenged supremacy of England in manufactures and machines.

Until recently India was in the happy position of not bothering about her trade balance, for except for two years, 1921 and 1922, India had no deficit on external account. In fact year after year there were export surpluses which went towards the payment of 'home charges', a sort of tribute to the British rulers and their country. The realization that exports pay for imports, that a developing country should find the wherewithal in the shape of exports to pay for the import of capital equipment, machine goods and industrial materials required for planned development, that instead of imports and exports moving up or down, hither and thither in response to the vagaries of world markets and at the mercy of competitive forces there should be a well-adjusted, co-ordinated trade policy to serve the needs of economic development and the Five-Year Plans has finally dawned on the country. So export targets are fixed, export performances checked from time to time, export duties and export quotas removed or relaxed and vigorous export promotion measures adopted and pursued. Heavy excise

duties have been levied to check domestic consumption of what could be exported. Concession in prices are made to export components. The results are as yet not striking.

The export policy of India started from humble beginnings, and today, under the impact of planning, has developed into a strong instrument whereby the country tries to earn the much needed foreign resources. The policy has evolved itself step by step in response to the exigencies of developmental needs. First came the orthodox methods of export promotion such as the smooth flow of trade through the removal of obstacles and bottlenecks. Not being satisfied with the progress thereof we have adjusted several non-orthodox devices. The first among these is the series of bilateral agreements whereby the two participating countries showed their willingness to exchange products according to a list appended in the agreement. Their primary use, however, was in the establishment of trade contacts and not as a contributor to the correction of disequilibrium in India's international account. After 1958 these bilateral agreements became real trade promotion agencies involving rupee payments and long-term purchases and sales of selected articles. Bilateralism was the most convenient form of trade with the centralized state economies of U.S.S.R. and the East European countries. India exchanged her traditional goods for badly needed capital equipment. The imports from them increased from Rs 11 crores in 1956 to 124 crores in 1964 and exports to them rose from Rs 5.3 crores to 109 crores.

Secondly, imperial preference, rather Commonwealth Preference, which at one time was frowned upon under the belief that India, the exporter of semi-monopolistic commodities gained little while England gained much as her manufactures exported to India now created real interest in India. India's exports to Great Britain were increasingly of manufactured articles such as cotton goods and these gained by the preference they enjoyed in the British market. When Britain attempted to join the European Common Market there was distress in India on the score that she would be losing all the preferential advantages.

Thirdly the establishment of the State Trading Corporation in 1956 meant an additional fillip to export trade. Negotiation and implementation of trade agreements can be expeditiously carried out by large producers' organisations, and where these are not found, by the organised power of the state. STC is most useful for

trade with the communist countries. It enters into several link and barter deals, it engages in export promotion for new commodities and new markets, it is suitable for controlled and planned distribution of imports of scarce commodities, it also ensures that excess profit on supplies accrues to the state. In 1963 the STC handled directly trade of the value of Rs 87 crores and also assisted trade of the value of Rs 55 crores. STC has recently surrendered its dealings in ores to Minerals and Metals Trading Corporation.

Fourthly there is a set of measures devised for export promotion. Most of these relate to the removal of various impediments to exports such as import, excise and sales taxes. There is an appropriate system of reliefs, rebates and refunds. There are also concessions in direct taxation, in special credit facilities, in export guarantee schemes. Taxation of any sort levied on capital goods and intermediate goods which enter into subsequent exports as finished articles is removed. In addition exporters of certain commodities are given special licenses for import entitlement amounting to twice the value of the import content of the goods to be exported. Originally the purpose of these licenses was to obtain the necessary import facilities for the production of goods meant for export but now the right of free transfer is granted and has become a source of profit. Nearly 30 per cent of the exports are entitled to such licenses.

Lastly developing countries like India are asking for some kind of special or preferential treatment from the fully developed countries. The gap between their imports and exports remains wide and there are never enough foreign exchange resources to bridge the gap. Exports and more exports is the only answer. The developed countries should open their doors as far as possible to exports from the developing countries. The developed countries have now been, more or less, integrated into a strong unit. Among themselves they have returned to a freer trade era by the surrender of quantitative restrictions, by the lowering of tariffs, by the adoption of fixed exchange rates, by non-discrimination and multilateral convertibility of foreign exchange. But the special problems of developing countries cannot be solved within the framework of normal international trade. They still make do with quantitative controls, bilateral trade, discrimination in trade, multiple exchange rates, even devaluation of currency.

The governing consideration in the planning of India's foreign trade should be that import requirements are matched by import capacity as determined by her export earnings. Ambitious planning for industrial capacity targets which necessitate maintenance imports and development imports greatly in excess of the country's ability to pay should be avoided. In deciding on a proper ratio between how much of the demand should be satisfied by imports and how much by home production the principle of comparative costs should receive full consideration. With prospects of making great profits in a market where prices are high and inflation moves in a spiral, where no checks on costs, quality, pricing, consumers' interests and industrial productivity operate, where foreign competition is neutralized by every type of domestic control and where inefficiency is not punished by failure and corruption goes undetected and finally the Fiscal Commission is, in practice, deprived of its disciplinary and regulatory functions we should anxiously strive, as far as possible for the restoration, of the salutary principles of comparative cost, free market mechanism and foreign and domestic competition. Prof. Lakdawala says, 'The foreign trade policies and the economic policy of which they are a part, suffer from an insufficient recognition of the problems of planning and development, and inadequate and sometimes conflicting responses to them. We have not yet decided what importance we should attach to the market mechanism both on the national and international fronts, and what substitutes we should have if we want to modify their working'.

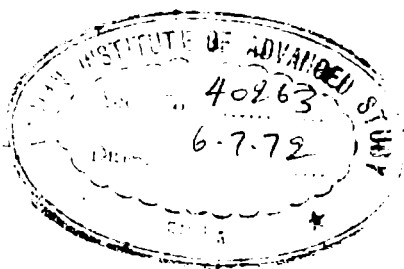
The adverse balance of payments has become a serious obstacle in the way of India's economic development. The continuing shortage of foreign exchange is acting as a brake on the rate of economic growth. It is not only holding up the process of setting up new industries but also prevents the full use of installed capacity though inability to import materials, components, spare parts and replacements. It is estimated that imports of fertilizers would increase the value of agricultural output by a multiple of the foreign exchange cost. What applies to agriculture applies also to industry. Lack of foreign exchange holds up production and hinders the utilisation of the nation's capital and capacity, land and labour. Given foreign aid and an expansion in exports there would be an increase in production several times as great in value which will raise income, increase savings and investment and

through these raise the rate of economic growth. Exports are needed to maintain the present level of imports, to sustain the greatly increased levels of installed capacity and to provide for the heavy repayments of capital and interest on the foreign loans. The service of external debt is put at Rs 200-250 crores per year. In the urgency of the situation investment in import-saving activities should have some preference over investment in production. In the long-run one has to weigh the cost of export subsidy against the cost of import duty until the export infant and the import infant grow up.

While world trade has been expanding very rapidly during the last fifteen years India's exports have been more or less stagnant. Her share in the world market has been falling partly because of the availability of rival sources of supply or substitutes and partly because of her own domestic consumption absorbing much of the local production. She has to reckon with Pakistan jute, Thailand lac, South American manganese ore, Africa's groundnut oil and tea from Ceylon and East-Africa which has invaded the British market at India's expense. India's exports have failed to keep pace with world exports because her traditional staples—tea, jute, manufactures and cotton textiles—belong to a group in which trade is expanding very slowly, if at all. Even so India cannot afford to neglect them. She must strike out new paths in the Soviet block. There could be rapid increase in the exports of iron ore, coffee, vegetables oils, sea-foods. There is also considerable scope in the new manufactures such as light engineering and electrical goods. All told, the prospects of reaching an export figure of the desired size seem to be dim. India is more advanced industrially than her neighbours who should offer a good market for her simpler manufactures.

There is now a general recognition of the need to export if India's economic development is not to come to a standstill. Restraints must be put on the consumption of some goods that can easily be exported e.g., tea, coffee, leather and a wide range of manufactures. Without a massive increase in exports India cannot achieve self-sustaining growth, cannot gain independence of foreign aid and cannot repay the large loans she is receiving from abroad. The advanced nations, realizing India's plight, should make it easy for her to export her goods on a large scale. Says Sir Donald Macdougall, 'The analogy of the Marshall Plan

is relevant. The United States, while giving massive aid to Europe, embarked in effect on an import drive to help sales of European goods in the United States while tolerating severe discriminatory restrictions against her own exports to Europe'. The advanced nations could help by persuading firms with interests in factories in India to waive agreements limiting exports to foreign countries. However successful the export drive, foreign exchange will be the Achilles' heel for many years. There should be greater investment on export industries and on import-saving undertakings and all this at the expense of production that will neither earn nor save foreign exchange. A great expansion of output could be obtained with double or treble shifts worked in industries wherever possible. A combination of measures, already outlined such as drawbacks of customs and excise duties, lower prices for steel used to make exports, additional excises on home sales, remission of taxes on exports' profits and currency retention schemes, has been brought into operation and should be showing good results as days go by. The export drive and the import substitution pursued with vigour will go far to solve the problem of scarce foreign exchange and the balance of payment difficulties.



The first of these is the fact that the United States has
 a large and growing population of Negroes. This population
 is not only large in absolute numbers but also in relative
 numbers. It is the largest of any race in the world and
 is growing rapidly. The Negro population of the United States
 is now over 10 million and is expected to reach 20 million
 by the year 2000. This population is not only large but
 also very poor. The average income of a Negro family is
 only about \$1,000 a year, and many of them are living in
 slums and ghettos. This situation is a result of the
 long history of discrimination against the Negroes in the
 United States. The Negroes have been denied the same
 rights and opportunities as the white population. They have
 been segregated in schools, in public places, and in the
 labor market. They have been denied the right to vote and
 to hold office. This discrimination has led to the
 development of a separate and unequal society for the
 Negroes. The Negroes have been forced to live in
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Professor V. L. D'Souza is one of India's distinguished economists and administrators. He was educated at the Madras University and the London School of Economics and Political Science. He was Professor of Economics in Mysore University; Principal of Maharaja's College, Mysore; and Vice-Chancellor of Mysore University. He was economist member of the All-India Banks Tribunal; President of the Indian Economic Association; economist in the Regional Development and Town Planning Unit at New Delhi, Chairman of the Export Promotion Committee of the Government of India, and member of several All-India Wage Boards.

He has made a number of well-known contributions on theoretical and empirical topics to the Indian Journal of Economics besides his books: 'Financial Problems of the States in Federal India' (Bangalore Press) and 'The Changing Phases of Indian Economy' (Sir William Meyer lectures, University of Madras).