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B.A. Economics

(Second Year)

INTERNATIONAL ECONOMICS - II

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INTERNATIONAL ECONOMICS – II

Unit I: Exchange Rate

Meaning – Types – Determination of Foreign Exchange Rate – Methods of Foreign exchange rate.

(15L)

Unit II: Tariffs and Quotas

Tariffs: Meaning - Types– Effects of Tariffs. Quotas: Meaning - Types – Effects of Quotas – Dumping and Anti – Dumping Measures.

(15L)

Unit III: International Financial Institutions

IMF: Objectives – Functions – Structure. World Bank: Objectives – Functions – structure - Special Drawing Rights [SDRs].

(10L)

Unit IV: Trade Agreements

International Trade Agreements – GATT: Objectives and Functions – WTO: Objectives and Functions – TRIMS – TRIPS – GATS.

(10L)

Unit V: Foreign Trade

Features– Volume and Composition of Foreign Trade – Measures for Promoting India's Foreign Trade - Recent Trends in India's Foreign Trade.

(10L)

(Total: 60L)

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UNIT - I

EXCHANGE RATE

1.1. Concept of Foreign Exchange Rate:

Foreign exchange rate is the price at which one currency can be converted into another. It represents the rate at which a firm may exchange one currency for another. Thus, the exchange rate is simply the amount of a nation's currency that can be bought at a given time for a specified amount of the currency of another country. The actual amount received in conversion or the effective exchange rate, usually differs from the stated rate because it takes into account all taxes, commissions and other costs that the public must pay to complete the transaction and actually receive the foreign funds. The exchange rate will be maintained in the world foreign exchange market by arbitrage. Arbitrage refers to the purchase of a foreign currency in a market where its price is low and sell it in some other market where its price is high. The effect of arbitrage is to remove differences in the foreign exchange rate of currencies so that there is a single exchange rate in the world foreign exchange market.

1.2 Types of Foreign Exchange Rate:

There are two important exchange rate systems the fixed (or pegged) exchange rate and the flexible (or fluctuating or floating) exchange rate. These two exchange rates have been tried and tested in the past. Fixed exchange rate system had been tried by the IMF during 1947- 1971 when this system was abandoned. After 1971, the world's exchange rate became a flexible one or a floating one. Truly speaking, the exchange rate that is being followed by the IMF now is known as 'managed floating system, or 'managed flexibility'.

1. Fixed and Floating Rates:

When Government of a country fixes the rate of exchange for its own currency, it is termed as 'Fixed Exchange Rate'. This is also known as official rate of exchange. Fixed exchange rates are fixed by the respective Governments from time to time for the betterment of their economy. In contrast exchange rates move, as in any other market place, depending on the demand and supply pressure and are further influenced by the market

forces and economic conditions of the respective countries. Floating exchange rate may be free floating or a managed floating. A currency is freely floating if there does not exist a system of fixed exchange rates and if the Central Bank of the country in question does not attempt to influence the value of the currency. However, in reality this kind of situation does not exist.

In most of the countries Governments attempt to influence movements of exchange rate either through direct intervention in the exchange market or through a mix of fiscal and monetary policies. Under such circumstances, floating is called as 'managed' or 'dirty float'. A number of countries use a pegged float as a system of exchange rates. The value of one currency is pegged to the value of another currency that itself floats. In a joint float, currencies in a particular group have a fixed exchange value in terms of each other, but the group of currencies floats in relation to other currencies outside the group. The fixed exchange rate system has inbuilt ad-vantage of simplifying exchange transactions. It imbibes self-discipline for economic policies by participating countries. In India the exchange rate regime of rupee has evolved over a period of time moving in the direction of less exchange controls and current account accountability. The RBI manages the exchange rate of the rupee. In recent few years the RBI has been very actively intervening in the market to hold the rupee-dollar rates within tight bounds while rupee rates in relation to other currencies fluctuate in correspondence with the fluctuation of this US dollar against them. In addition, the RBI took several measures to relax exchange control and liberalize foreign trade.

2. Spot and Forward Rates:

Spot rates refer to those rates which are applicable on the day of transaction in which physical delivery is made within two working days after the date of transaction the spot exchange between two currencies should be the same across the various banks engaged in rendering foreign exchange services. In case of large discrepancy customers or other banks would buy large amounts of a currency from whatever banks quoting relatively low price and sell the same immediately to a bank quoting a relatively high price. This will cause adjustments in the exchange rate quotations that would offset the existing discrepancy.

In Forward rates, exchange rates are fixed in advance for a transaction which matures at some specified future date. The exchange at the date in future will be at the price agreed upon now. Foreign exchange rates are function of forward demand and forward supply of various currencies. A foreign currency is said to be at a forward premium if its future value exceeds its present value in terms of domestic currency and it is said to be at discount if the reverse is true. For example spot rate between rupees and dollar is S (Rs/$) = Rs. 45.50 and three months forward is F3 (Rs. /$) = Rs. 46.70/$; these rates signify that dollar is at a premium and rupee is at discount in the forward. Forward exchange rates are quoted on most major currencies for different maturities. Standard maturities quoted by banks are of 1, 3, 6, 9 and 12 months. Maturities beyond one year are now becoming more common. Maturity extending to 5 and beyond 5 years is also possible for good bank customers.

1.3. Determination of Exchange Rate:

There are two methods of foreign exchange rate determination. One method falls under the classical gold standard mechanism and another method falls under the classical paper currency system. Today, gold standard mechanism does not operate since no standard monetary unit is now exchanged for gold. All countries now have paper currencies not convertible to gold. Under inconvertible paper currency system, there are two methods of exchange rate determination. The first is known as the purchasing power parity theory and the second is known as the demand-supply theory or the balance of payments theory. Since today there is no believer of purchasing power parity theory, we consider only demand-supply approach to foreign exchange rate determination.

Demand-Supply Approach of Foreign Exchange:

Since the foreign exchange rate is a price, economists apply supply-demand conditions of price theory in the foreign exchange market. A simple explanation is that the rate of foreign exchange equals its supply. For simplicity, we assume that there are two countries: India and the USA. Let the domestic currency be rupee.

The US dollar stands for foreign exchange and the value of rupee in terms of dollars (or conversely, the value of dollars in terms of rupee) stands for foreign exchange rate. Now the value of one currency in terms of another currency depends upon the demand for and the supply of foreign exchange.

Demand for Foreign Exchange:

When Indian people and business firms want to make payments to the US nationals for using US goods and services or to make gifts to the US citizens or to buy assets there, the demand for foreign exchange (here dollar) is generated. In other words, Indians demand or buy dollars by paying rupee in the foreign exchange market. A country releases its foreign currency for buying imports. Thus what appears in the debit side of the BOP account are the sources of demand for foreign exchange. Larger the volume of imports, greater is the demand for foreign exchange. The demand curve for foreign exchange is negative sloping. A fall in the price of foreign exchange or a fall in the price of dollar in terms of rupee (i.e., dollar depreciates) means that foreign goods are now cheaper. Thus, an Indian could buy more American goods at a low price. Consequently, imports from the USA would increase—resulting in an increase in the demand for foreign exchange, i.e., dollar.

Conversely, if the price of foreign exchange or the price of dollar rises (i.e., dollar appreciates) foreign goods will now be expensive leading to a fall in import demand and, hence, fall in the demand for foreign exchange. Since price of foreign exchange and demand for foreign exchange move in opposite directions, the importing country's demand curve for foreign exchange is downward sloping from left to right. In Fig. 1.1, DD_1 is the demand curve for foreign exchange. In this figure, we measure exchange rate expressed in terms of domestic currency that costs 1 unit of foreign currency (i.e., dollar per rupee) on the vertical axis. This makes the demand curve for foreign exchange negative sloping. If the exchange rate is expressed in terms of foreign currency that could be purchased with a 1 unit of domestic currency (i.e., dollar per rupee), the demand curve would exhibit positive slope. Here we have chosen the former one.

Supply of Foreign Exchange:

In a similar fashion, we can determine the supply of foreign exchange. Supply of foreign currency comes from receipts for its exports. If the foreign nationals and firms intend to purchase Indian goods or buy Indian assets or give grants to the Government of India, the supply of foreign exchange is generated. In other words, what the Indian exports (both goods and invisibles) to the rest of the world is the source of foreign exchange. To be more specific, all the transactions that appear on the credit side of the balance of payment account are the sources of supply of foreign exchange.

A rise in the rupee-per-dollar exchange rate means that Indian goods are cheaper to foreigners in terms of dollars. This will induce India to export more. Foreigners will also find that investment is now more profitable. Thus, a high price or exchange rate ensures larger supply of foreign exchange. Conversely, a low exchange rate causes exchange rate to fall. Thus, the supply curve of foreign exchange, SS_1, is positive sloping. Now we can bring both the demand and supply curves together to determine foreign exchange rate. The equilibrium exchange rate is determined at that point where the demand for foreign exchange equals the supply of foreign exchange.

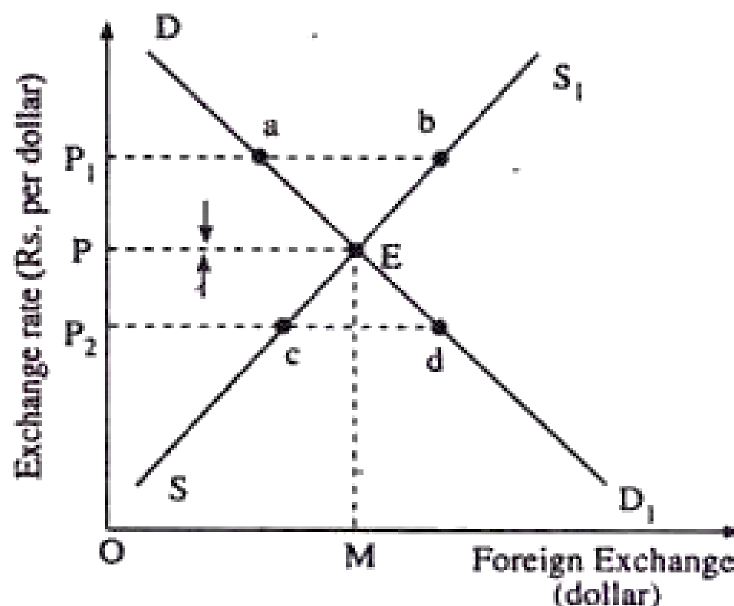

Fig.1.1. Determination of equilibrium of exchange rate

In Fig. 1.1, DD_1 and SS, curves intersect at point E. The foreign exchange rate thus determined is OP. At this rate, quantities of foreign exchange demanded (OM) equals quantity supplied (OM). The market is cleared and there is no incentive on the part of the players to change the rate determined. Note that at the rate OP, (say, Rs. 50 = $1) demand for foreign exchange is matched by the supply of foreign exchange. If the current exchange rate OP, (suppose, pc 55 = $ 1) exceeds the equilibrium rate of exchange (OP), there occurs an excess supply of dollar by the amount 'ab'. Now the bank and other institutions dealing with foreign exchange, wishing to make money by exchanging currency, would lower the exchange rate to reduce excess supply. Thus, exchange rate will tend to fall until OP is reached. Similarly, an excess demand for foreign exchange by the amount 'cd' arises if the exchange rate falls below OP, i.e., OP. Banks would then experience a shortage of dollars to meet the demand. The rate of foreign exchange will rise till demand equals supply. The exchange rate that we have determined is called a floating or 'flexible exchange' rate. (Under this exchange rate system, the government does not intervene in the foreign exchange market.) A floating exchange rate, by definition, results in an equilibrium rate of exchange that will move up and down according to a change in demand and supply forces. The process by which currencies float up and down following a change in demand or a change in supply forces is thus illustrated in Fig. 1.2.

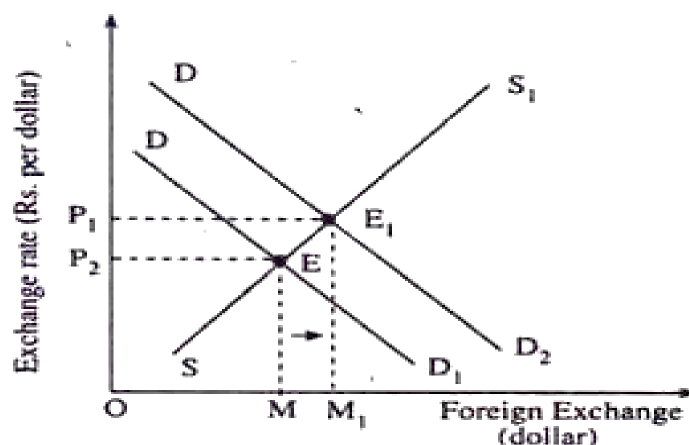

Fig.1.2. change in equilibrium exchange rate following a change in demand

Let us assume that national income rises. This results in an increase in demand for imports of goods and services and, hence, demand for dollar rises. This results in a shift in the demand curve from DD_1 to DD_2. Consequently, exchange rate rises as determined by the intersection of the new demand curve and supply curve. Note that dollar appreciates while rupee depreciates. Similarly, if the supply curve shifts from SS_1 to SS_2 as shown in Fig. 1.3, the new exchange rate thus determined would be OP_2. If Indian goods are exported more following an increase in national income of the USA, the supply curve would then shift rightward. Consequently, dollar depreciates and rupee appreciates. New exchange rate is settled at that point where the new supply curve SS_2 intersects the demand curve at E_2.

This is the balance of payments theory of exchange rate determination. Wherever government does not intervene in the market, a floating or a flexible exchange rate prevails. Such a system may not necessarily be ideal since frequent changes in demand and supply forces cause frequent as well as violent changes in the exchange rate. Consequently, an air of uncertainty in trade and business would prevail. Such uncertainty may be damaging for the smooth flow of trade. To prevent this awkward situation, government intervenes in the foreign exchange rate. It may keep the exchange rate fixed. This exchange rate is called a 'fixed exchange' rate system where both the demand and supply forces are manipulated or calibrated by the central bank

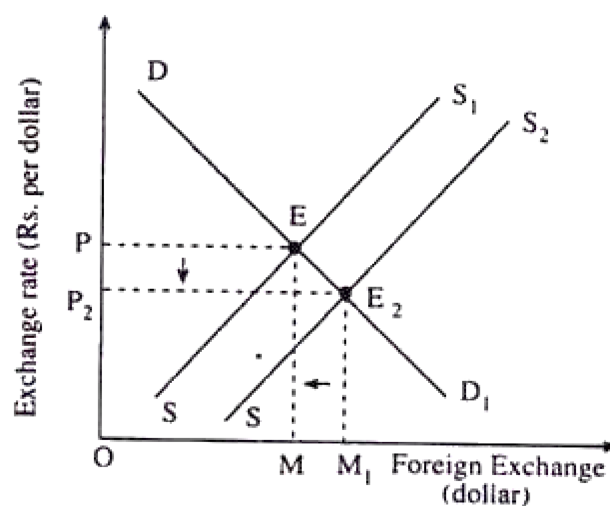

Fig.1.3: change in equilibrium exchange rate following a change in supply

in such a way that the exchange rate is kept pegged at the old level. Often 'managed exchange rate' is suggested. Under this system, exchange rate as usual is determined by the demand for and the supply of foreign exchange. But the central bank intervenes in the foreign exchange market when the situation demands to stabilise or influence the rate of foreign exchange. If rupee depreciates in terms of dollar, the RBI would then sell dollars and buy rupee in order to reduce the downward pressure in the exchange rate. There are two methods of foreign exchange rate determination. One method falls under the classical gold standard mechanism and another method falls under the classical paper currency system. Today, gold standard mechanism does not operate since no standard monetary unit is now exchanged for gold. All countries now have paper currencies not convertible to gold. Under inconvertible paper currency system, there are two methods of exchange rate determination. The first is known as the purchasing power parity theory and the second is known as the demand-supply theory or the balance of payments theory. Since today there is no believer of purchasing power parity theory, we consider only demand-supply approach to foreign exchange rate determination.

1.4. Methods of exchange rate:

Advantages of Fixed Exchange Rate:

(i) Elimination of Uncertainty and Risk:

The necessary condition for an orderly and steady growth of trade demands stability in exchange rate. Any undue fluctuations in exchange rate cause problems to the plans and programmes of both exporters and imports. In other words, incomes of export-earners and the cost of imports of the importers tend to become uncertain if the exchange rate fluctuates. This uncertainty can be removed by a fixed exchange rate method. Further, the risks associated with international trade and investment get minimised largely if exchange rates are not allowed to vary.

(ii) Speculation Deterred:

As exchange rate remains unchanged for a fairly long period of time, people expect that such rate would not change in the immediate future. This then eliminates speculation in the foreign exchange market. Further,

as stability in the exchange rate over longish period eliminates the threat of speculation, it discourages the flight of capital. In a world of free fluctuating exchange rate, the danger of the flight of capital is rather high as this kind of exchange rate induces people to speculate. As exchange rates remain fixed, traders have a sense of confidence that international payments can be made safely without the danger of losses.

(iii) Prevention of Depreciation of Currency:

In poor developing countries, one experiences BOP difficulties of a permanent type. Under the circumstances, any frequent changes in exchange rate will tend to aggravate the BOP crisis, like continuous depreciation of home currency in terms of currencies of other countries. In other words, unstable exchange rates result in depreciation of currencies. This can be prevented by the stable exchange rate.

(iv) Adoption of Responsible Macroeconomic Policies:

Stable exchange rate system prevents government from adopting irresponsible macro- economic policies like devaluation of currencies. Above all, under the fixed exchange rate system, deflationary policies can even be pursued to tide over the BOP deficit, even without bringing any change in domestic policies.

(v) Attraction of Foreign Investment:

Exchange rate stability may encourage foreigners to perk their investible funds in a country. If the exchange rate changes rather frequently, it will deter them to invest in a country. Of course, such foreign investment having multiplier effect leads to higher economic growth.

(vi) Anti-inflationary:

Fixed exchange rate system is anti-inflationary in character. If exchange rate is allowed to decline, import goods tend to become dearer. High cost import goods then fuels inflation. Such a situation can be prevented by making the exchange rate fixed.

Disadvantages of Fixed Exchange Rate:

(i) Speculation Encouraged:

In fact, uncertainty and, hence, speculative activities, tend to get a boost even under the fixed exchange rate system. Under a fixed rate

system, if a country faces huge BOP deficit then the possibility of speculation gets brightened. If the speculators can guess that such BOP deficit will persist in the days ahead and the authority may go for a cut in foreign exchange rate then these people will be more enthusiastic to sell domestic currencies in the foreign exchange market.

If such sale of home currencies continues for a longer period, the central bank will then be forced to reduce exchange rate, instead of keeping it at the old fixed rate. Under the circumstance, speculators go on buying home currencies where exchange rates have been reduced. This will make these people to earn profit. The Bretton Woods System of the IMF collapsed in 1971 because of such speculation made with the US dollars.

(ii) Adequacy of Foreign Exchange Reserves:

For the effectiveness of a stable exchange rate, the necessary condition is the adequacy of holding, foreign exchange reserves. Poor developing countries find it difficult to maintain an adequate volume of foreign exchange reserves. Speculators then anticipate currency devaluation in advances if BOP needs to be corrected. Before 1970, fixed exchange rate, in fact, prevailed because of low volume of global trade and, hence, low volume of foreign exchange reserves.

(iii) Internal Objectives of Growth and Full Employment Sacrificed:

When countries experience large and persistent deficits or 'fundamental disequilibrium' in BOP, they are down with the foreign exchange reserves. Countries then opt for devaluation of their currencies and take some internal measures to reduce their deficits. These harsh internal measures tend to contract economies. But the fallouts of these measures are rising prices and rising unemployment. These then reduce economic growth. Thus, fixed exchange rate—in the ultimate analysis—go for currency depreciation that results in lower economic growth and higher unemployment coupled with high inflation—the two most undesirable and unpleasant macro- economic variables not liked by anyone.

(iv) International Competitive Environment Bypassed:

The continuous changes in international competitive environment do not get reflected under the fixed exchange rate system. Thus, to make the

home product more competitive in the foreign market, what is required is the change in domestic economic policies so that the country's export products get larger foothold in the foreign market. In other words, the fixed exchange rate system fails to gloss over the international competitive environment.

Floating Exchange Rates:

Advantage of Floating Exchange Rates:

Floating exchange rates have the following advantages:

1. Automatic Stabilisation:

Any disequilibrium in the balance of payments would be automatically corrected by a change in the exchange rate. For example, if a country suffers from a deficit in the balance of payments then, other things being equal, the country's currency should depreciate. This would make the country's exports cheaper, thus increasing demand, while at the same time making imports expensive and decreasing demand. The balance of payments equilibrium would therefore be restored. On the contrary, a balance of payments surplus would be automatically eliminated through a change in the exchange rate.

2. Freeing Internal Policy:

Under the floating exchange rate system the balance of payments deficit of a country can be rectified by changing the external price of the currency. On the country if a fixed exchange rate policy is adopted, then reducing a deficit could involve a general deflationary policy for the whole economy, resulting in unpleasant consequences such as unemployment and idle capacity. Thus, a floating exchange rate allows a government to pursue internal policy objectives such as full employment growth in the absence of demand-pull inflation without external constraints (such as debt burden or shortage of foreign exchange).

3. Absence of Crisis:

The periods of fixed exchange rates were frequently characterised by crisis as too much pressure was put on central bank to devalue or revalue the country's currency. However, the central bank that devalued a currency by giving out too much of it would soon either stop or run out of

it. Similarly the central banks that revalued a currency by giving out too little of it in exchange for other currencies would soon be flooded with that currency as it would get relatively large amounts of other currencies. Under floating exchange rate system such changes occur automatically. Thus, the possibility of international monetary crisis originating from exchange rate changes is automatically eliminated.

4. Management:

J. E. Meade has pointed out that under the floating exchange rates system national governments enjoy considerable discretion. To be more specific, governments are free to manipulate the external value of their currency to their own advantage.

5. Flexibility:

Changes in world trade since the first oil crisis of 1973 have caused great changes in the values of currencies. How these could have been dealt with under a system of fixed exchange rate is not yet clear.

6. Avoiding Inflation:

John Beardshaw has argued that, "A floating exchange rate helps to insulate a country from inflation elsewhere. In the first place, if a country were on a fixed exchange rate then it would 'import' inflation by way of higher import prices. Secondly, a country with a payments surplus and a fixed exchange rate would tend to 'import' inflation from deficit countries."

7. Lower Reserves:

Finally, floating exchange rates should mean that three is hardly any need to maintain large reserves to develop the economy. These reserves can therefore be fruitfully used to import capital goods and other items in order to promote faster economic growth.

Disadvantages of Floating Exchange Rates:

Floating exchange rates have the following disadvantages:

1. Uncertainty:

The very fact that currencies change in value from day to day introduces a large element of uncertainty into trade. A seller may not be quite sure of how much money he will receive when he sells goods abroad.

Some of this uncertainty may be reduced by companies buying currency ahead in forward exchange contracts.

2. Lack of Investment:

The uncertainty introduced by floating exchange rates may discourage direct foreign investment (i.e., investment by multinational companies).

3. Speculation:

The day-to-day fluctuations in exchange rates may encourage speculative movements of 'hot money' from country to country, thereby because more and mooring exchange rate fluctuations.

4. Lack of Discipline:

The need to maintain an exchange rate imposes a discipline upon the national economy. It is quite possible that with a floating exchange rate such short-run problems as domestic inflation may be ignored until they have created crisis situations.

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UNIT - II
TARIFFS AND QUOTAS

2.1. INTRODUCTION

Most countries are limited by their natural resources and ability to produce certain goods and services. They trade with other countries to get what their population needs and demands. However, trade isn't always conducted in an amenable manner between trading partners. Policies, geopolitics, competition, and many other factors can make trading partners unhappy. One of the ways governments deal with trading partners they disagree with is through tariffs. A tariff is a tax imposed by one country on the goods and services imported from another country to influence it, raise revenues, or protect competitive advantages.

2.2. MEANING OF TARIFFS:

A tariff is a duty or tax imposed by the government of a country upon the traded commodity as it crosses the national boundaries. Tariff can be levied both upon exports and imports. The tariff or duties imposed upon the goods originating in the home country and scheduled for abroad are called as the export duties. Countries, interested in maximising their exports generally avoid the use of export duties. Tariffs have, therefore, become synonymous with import duties.

The import duties or import tariffs are levied upon the goods originating from abroad and scheduled for the home country. Sometimes a country may also resort to what is called as a transit duty. It is imposed upon the goods originating in the foreign country and scheduled for a third country crossing the borders of the home country. For instance, if India imposes tariffs on goods that Bangladesh exports to Nepal through the Indian Territory, these will be called as transit duties. Such duties are usually a matter of much concern for the land-locked countries. The imposition of import tariff results in the relative changes in prices of products and factors. That brings about a significant change in the structure of international trade. High tariffs certainly have the effect of restricting the volume of international trade. A negative tariff or subsidy is often supposed to expand foreign trade over and above its volume in the absence of subsidy.

2.3. TYPES OF TARIFFS:

Tariffs are of several types and these can be classified into different groups or sub-groups as below:

(1) Classification on the Basis of Criterion for Imposition:

On the basis of the criterion for imposition of tariffs.

These can be of such types as:

(a) Specific tariff,

(b) Ad Valorem tariff,

(c) Compound tariff and

(d) Sliding scale tariff.

(a) Specific Tariff:

Specific tariff is the fixed amount of money per physical unit or according to the weight or measurement of the commodity imported or exported. Such duties can be levied on goods like wheat, rice, fertilisers, cement, sugar, cloth etc. Specific duties are quite easy to administer, as they do not involve the evaluation of the goods. The determination of the value of the traded goods may be difficult as there are several variants of price such as demand price, supply price, market price, contract price, invoice price, f.o.b, (free on board) price, c.i.f (cost, insurance, freight) price etc. The resort to specific duties enables the government to keep out of complexities of prices. However, the specific duties cannot be levied on high valued goods such as diamonds, jewellery, watches, T.V. sets, motor cars, works of arts like paintings etc. These articles can be taxed either on the basis of weight, surface area covered or the number of articles.

(b) Ad Valorem Tariff:

'Ad Valorem' is the Latin word that means 'on the value.' When the duty is levied as a fixed percentage of the value of the traded commodity, it is called as valorem tariff. Such duties are levied on the products the value of which is disproportionately higher compared to their physical characteristics such as weight or measurement. These duties are more equitable as the costly goods, generally consumed by the rich, bear greater burden of duty, while the cheaper goods bought by the poor, bear lesser burden of tariff. For instance, if the import of watches is subject to 70 percent ad valorem tariff, a watch

valued at Rs. 1000 will be subject to a duty of Rs. 700 and a watch valued at Rs. 1200 will be subject to a tariff amounting to Rs. 840. The ad valorem duties have an additional advantage that the international comparison of tariffs, in their case, can be easily made.

(c) Compound Tariff:

The compound tariff is a combination of specific and ad valorem tariff. The structure of compound tariff includes specific duty on each unit of the commodity plus a percentage of ad valorem duty. The compound tariffs not only impart a greater elasticity to revenues but also assure a more effective protection to the home industries.

(d) Sliding Scale Tariff:

The import duties which vary with the prices of the commodities are termed as sliding scale duties. These may either be on specific or ad valorem basis. In practice, these are generally on a specific basis.

(2) Classification on the Basis of Purpose for Which Tariff is imposed:

On the basis of purpose of levying the tariff.

These can be of two types:

(a) Revenue Tariff and

(b) Protective Tariff.

(a) Revenue Tariff:

The tariff, which is imposed primarily for generating more revenues for the government is called as the revenue tariff. In advanced countries, the introduction and diversification of direct taxes has reduced the importance of tariff as a source of government revenues. But in the less developed countries, there is still much reliance of the governments on this source of revenue. Generally pure revenue tariff is not possible. The imposition of tariff, even for the purpose of securing revenues, does have protective effect when it leads to switch of demand by the domestic consumers from the imported to home-produced goods.

(b) Protective Tariff:

The tariff may be imposed by the government to protect the home industries from the cut-throat competition from the foreign produced goods. The higher the tariff, greater may be the protective effect of tariff. A perfect protective tariff

is likely to prohibit completely the import from abroad. In practice, the perfect protective tariff may not exist. If the domestic demand for import remains strong, there can be the possibility of smuggling imported goods. In addition, such a tariff will not yield any revenue to the government. A high rate of protective tariff can make the domestic producers more lethargic and inefficient and unable to face foreign competition even in the long run.

(3) Classification on the Basis of Discrimination:

If the tariff is influenced by the consideration of discrimination.

There can be two types of tariffs-

(a) Non-discriminatory and

(b) Discriminatory.

(a) Non-Discriminatory Tariff:

If the uniform tariff rates are applicable to all the commodities irrespective of the country of origin, these are known as non-discriminatory tariffs. It is possible that low rates of tariffs on certain commodities exist because of commercial agreements with some countries but the tariff-imposing home country extends the same low tariff rates to the commodities of all the countries.

Such a system of non-discriminatory tariff is called as single column tariff. This system of tariff is easy and simple to administer. There is, however, one deficiency that it is not elastic enough to adjust according to the changing needs of the industries of the home country. From the viewpoint of revenues too, it may not be satisfactory for the tariff-imposing country.

(b) Discriminatory Tariff:

In case of discriminatory tariff, the varying tariff rates exist for different commodities. The products originating from favoured countries are subject to a lower tariff rate than those of other countries. The discriminatory tariffs can be double or multiple column tariffs.

In case of the double column tariff, two different rates of duty exist for all or some commodities. Both the rates are either announced by the government right from the beginning and the two rates come into existence after the country enters into favoured-nation commercial agreement with

some foreign countries. The favoured rates of tariff may either be on a unilateral basis or on a reciprocal basis.

The double column tariff can be further classified as:

(i) General and conventional tariff

(ii) Maximum and minimum tariff

(iii) Multiple Column Tariff.

(i) General and Conventional Tariff:

The general tariff schedule is determined by the state legislature. It also makes provision for the adjustment in tariff rates as and when required to fulfil the obligations of international commercial agreements. The conventional tariff schedule is evolved through the commercial agreements of the home country with other countries. It does not permit changes in tariff rates according to the changes in domestic conditions or requirements.

The changes can be possible only after negotiations and agreements are reached between the concerned countries or after the expiry of the existing agreement. It is clear that there is some rigidity in the conventional tariff schedule. In contrast, the general tariff schedule is more flexible

(ii) Maximum and Minimum Tariff:

Under this system, a country has maximum and minimum tariff rates for every commodity. These tariff rates are fixed by the legislature and the government is authorised to apply specific rates of tariff to the goods imported from the different countries. The minimum tariff rates are applied to the products originating from the countries treated as 'The Most Favoured Nations'. The maximum tariff rates are applied for the purpose of improving the bargaining position of the home country vis-a-vis the foreign countries.

(iii) Multiple Column Tariff:

The multiple column tariff consists of three different rates of tariff – a general rate, an international rate and a preferential rate. The general and international tariff rates can be considered equivalent to the maximum and minimum tariff rates discussed above. The preferential tariff is generally applied by a subject country to the products originating from the colonial countries.

The preferential tariff rate is kept lower than the general rate of tariff. For instance, the goods imported by India from Britain before independence were subjected to a lower tariff or duty free on account of Imperial Preferences. On the other hand, the goods imported from other countries such as Japan, Germany and others were subject to higher rates of tariff.

(4) Classification on the Basis of Products:

Whether a product is imported or exported can be the basis of tariff.

On this basis, the tariffs can be of the types of:

(a) Import duties and

(b) Exports duties.

(a) Import Duties:

If the home country imposes tariff upon the products of the foreign countries as they enter its territory, the tariff is known as import tariff or import duty.

(b) Export Duties:

If the products of the home country become subject to tax as they leave its territory to be sold in the foreign market, the tax or duty is called as export tariff or export duty.

The import tariffs have remained the matter of deep interest both for analytical and policy reasons. These are far more wide-spread, and almost every country takes resort to them. In contrast, the export duties are applied to a very limited extent. Some countries like the USA have prohibited export duties by law. Even in those countries, where these are in vogue, the basic purpose is to secure larger revenues.

(5) Classification on the Basis of Retaliation:

On this basis, the tariffs can be of the types of

(a) Retaliatory tariffs and

(b) Countervailing tariffs.

(a) Retaliatory Tariffs:

If a foreign country has imposed tariffs upon the exports from the home country and the latter imposes tariffs against the products of the former, the tariffs resorted to by the home country will be regarded as the retaliatory tariffs. The home country, while adopting this measure does not either has

the object of raising revenues or protecting home industries but of acting in retaliation.

(b) Countervailing Tariffs:

If the foreign country has been exporting large quantities of its products in the market of the home country on the strength of export subsidies, the home country can neutralise the 'unfair advantage' enjoyed by foreign products through imposing duties upon them as they enter the territory of the home country. The latter has full justification for resorting to these countervailing duties in order that the unfair advantage given by exports subsidies to the foreign products is offset and the competition takes place on equal footing between the foreign and home produced goods.

2.4. EFFECTS OF TARIFFS:

When a small country imposes tariff on import of the product that competes with the product of the small domestic industry, the tariff can neither affect the international prices (as the country is small) nor can it affect the rest of the economy (as the industry is small). In such conditions, the partial equilibrium analysis that concerns the market for a particular product becomes the most appropriate.

Assumptions:

The effects of tariffs under a partial equilibrium system can be analysed on the basis of the following set of assumptions:

- ❖ The demand and supply curves of the given commodity are concerned with home country that imposes import tariff.
- ❖ The given demand and supply curves remain constant.
- ❖ There is no change in consumers' tastes, prices of other commodities and money income of the consumers.
- ❖ There is an absence of technological improvements, externalities and other factors that result in changes in cost conditions.
- ❖ No tariff is imposed by the home country on the import of materials that are required for producing the given commodity.
- ❖ Imported product and home-produced product are perfect substitutes.
- ❖ There is no change in the foreign price of the commodity.
- ❖ There is an absence of transport costs.

- ❖ The foreign supply curve of commodity is perfectly elastic.
- ❖ Domestic production of commodity takes place at increasing costs.

Kindelberger has mentioned eight effects of tariff in a partial equilibrium approach. These include: 1. Protective or Production Effect 2. Consumption Effect 3. Revenue Effect 4. Redistribution Effect 5. Terms of Trade Effect 6. Competitive Effect 7. Income Effect 8. Balance of Payments Effect.

These effects are explained below:

1. Protective or Production Effect:

The imposition of tariff may be intended to protect the home industry from the foreign competition. As tariffs restrict the flow of foreign products, the home producers find an opportunity to increase the domestic production of import substitutes. That is why Ellsworth termed the protective or production effect of tariff as the import-substitution effect. In order to analyse the production and other effects diagrammatically, it is assumed that the world supply of the given commodity is perfectly elastic so that it is available at the constant price and the world supply curve is perfectly elastic. The domestic production of the commodity is possible, it is assumed, at an increasing cost. Therefore, the domestic supply curve is positively sloping. The domestic demand curve of the commodity, as usual, slopes negatively.

In Fig. 2.1, demand and supply are measured along the horizontal scale and price along the vertical scale. D and S are the domestic demand and supply curves of the given commodity respectively. Originally PW is the world supply curve of the commodity and the pre-tariff price is OP. At the price OP, the domestic supply is OQ and demand is OQ_1. The gap QQ_1 between demand and supply is met through import of the commodity from abroad. If PP_1 per unit tariff is imposed on import, the price rises to OP_1 and world supply curve shifts to P_1W_1. At this higher price, the demand is reduced from OQ_1 to OQ_2 whereas the domestic supply expands from OQ to OQ_3. Thus the domestic production of import substitutes rises by the extent of QQ_3. This is the protective, production or import substitution effect. The increased domestic production reduces the demand for foreign product from QQ_1 to Q_2Q_3.

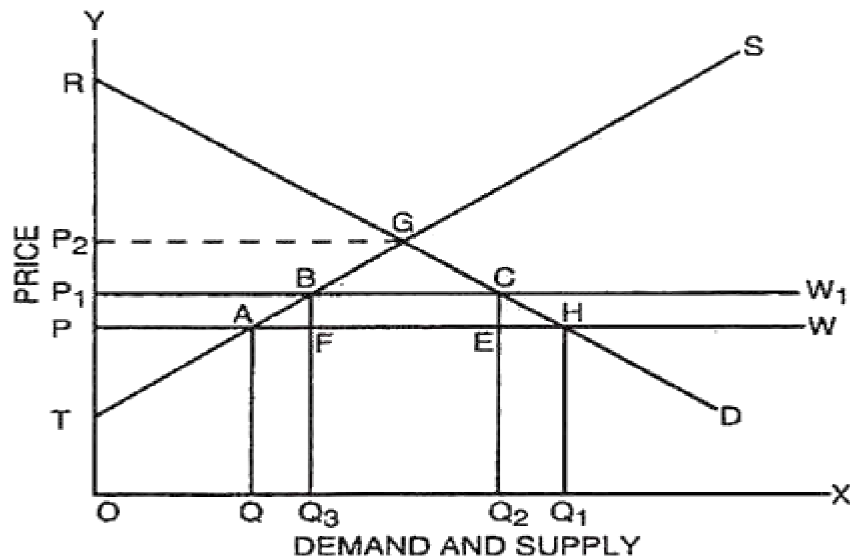

Fig.2.1.Production Effect

In case the per unit tariff were PP_2 causing the price to rise to OP_2, the domestic production would have expanded large enough to meet fully the domestic demand. In such a situation, imports would have been reduced to zero.

2. Consumption Effect:

The imposition of import duty on a particular commodity has the effect of reducing consumption and also the net satisfaction of the consumers. According to Fig. 2.1 at the free trade price OP, the total consumption was OQ_1. It was constituted by OQ as the consumption of home produced good and QQ_1 as the consumption of foreign produced good. After the imposition of tariff, when price rises to OP_1, the consumption is reduced from OQ_1 to OQ_2. Out of it, OQ_3 is the consumption of home-produced good and Q_2Q_3 is the consumption of foreign produced good. Thus there is a reduction in consumption by $OQ_1 – OQ_2 = Q_1Q_2$. There is net loss in consumer satisfaction amounting to the area $PHCP_1$. Kindelberger has called the combined protective and consumption effects as the trade effect. Subsequent to the imposition of tariff, the volume of international trade gets reduced from QQ_1 to Q_2Q_3.

3. Revenue Effect:

The imposition of import duty provides revenues to the government. The revenue receipts due to tariff signify a revenue effect. The original price OP does not include any tariff and no revenue receipts become available to the

government. Subsequently when PP_1 per unit tariff is imposed, the revenue receipts of the government can be determined by multiplying per unit tariff PP_1 (or BF) with the quantity imported Q_3Q_2 or (EF). Thus the revenue receipts due to tariff amount to $PP_1 \times Q_3Q_2 = BF \times EF = BCEF$. This is revenue effect of tariff.

4. Redistribution Effect:

The imposition of tariff, on the one hand, causes a reduction in consumer's satisfaction and, on the other hand, provides a larger producer's surplus or economic rent to domestic producers and revenues to the government. Thus tariff leads to redistributive effect in the tariff-imposing country. The redistributive effect can be shown with the help of Figure.

Loss in Consumer's Surplus = $RHP - RCP_1 = PHCP_1$

Gain in Producer's Surplus = $TBP_1 - TAP = PABP_1$

Gain in Revenues to the Government = BCEF

$$\text{Net Loss} = PHCP_1 - (PABP_1 + BCEF)$$

$$= \Delta BAF + ACEH$$

Kindelberger calls this net loss as the "deadweight loss" due to tariff. It signifies the cost of tariff. It is clear that tariff causes a redistribution of income or satisfaction in the given country. Consumers suffer a loss while producers and government make a gain.

5. Terms of Trade Effect:

The traditional theorists believed that tariff led to an improvement in the terms of trade of the tariff-imposing countries. The modern theorists, however, do not hold such a simplistic view. In their opinion, the terms of trade, consequent upon the imposition of tariff, depend upon the elasticity of demand and supply of products of the two trading countries. If the foreign supply of a good is perfectly elastic or if the foreign suppliers are ready to supply the product at a constant price, the imposition of tariff is not likely to improve the terms of trade for the tariff-imposing country. In case the foreign supply of a good is not perfectly elastic, the imposition of tariff can have varying effects upon the terms of trade of the tariff-imposing country depending upon the elasticity of demand and supply in the two trading countries. It has been explained through Fig. 2.2.

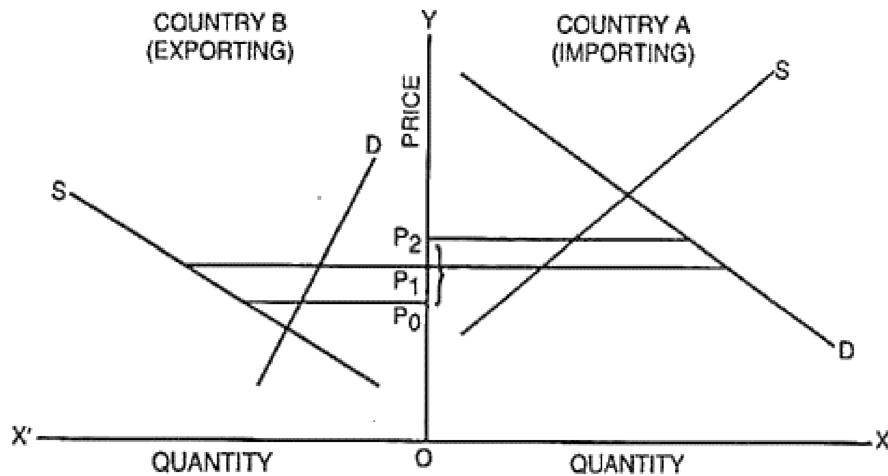

Fig.2.2. Terms of Trade Effect

In Fig. 2.2, country A is an importing and country B is an exporting country. The domestic demand and supply curves of the exporting country B are less elastic. Country B imposes per unit tariff of P_0P_2 amount for reducing import of the commodity. Since the domestic demand is inelastic, the surplus product of country B can be disposed of in the other country A. Therefore, the exporters lower the price of the commodity by P_1P_0. So P_0P_1 part of tariff is borne by exporters and P_1P_2 part of it by the importers.

If the tariff burden borne by importers in country A is less than the burden borne by the exporters i.e., $P_1P_2 < P_1P_0$, the rise in price of the commodity in country A is less than the fall in the export price of the commodity in country B. In such a situation, the terms of trade become favourable to the tariff-imposing country A. In case, P_1P_2 is more than P_1P_0, the rise in price of the commodity in country A being larger than the fall in export price of the commodity in country B, the terms of trade get worsened for country A. It can happen when the elasticities of demand and supply for the commodity in country B are relatively more than in country A.

6. Competitive Effect:

The imposition of tariff, can facilitate the growth of an infant industry which otherwise is not in a position to face the foreign competition. As tariff makes the foreign product relatively more costly, the domestic infant industry finds opportunity to grow behind the protective shield. Thus tariff increases the competitive power of the industries of tariff-imposing country. After the infant industry becomes mature enough to face the foreign competition, tariff may be removed.

The increase in the competitive power of the domestic industries through tariff is called as the competitive effect. The fears are, however, expressed that protection breeds inefficiency and promotes the growth of monopolies.

7. Income Effect:

The imposition of tariff reduces the demand for foreign products. The amount of money not spent on imported goods may either be spent on the home-produced goods or saved. If there is the existence of surplus productive capacity in the home country, switch of expenditure from foreign to home-produced goods will lead to a rise in production, employment and income. Alternatively, if the money not spent on foreign products is saved, that result in greater accumulation of capital. The financing of investment through additional saving can again enlarge the productive capacity and income in the tariff-imposing country. The expansionary effect of reduction in imports upon domestic income can be shown through Fig. 2.3.

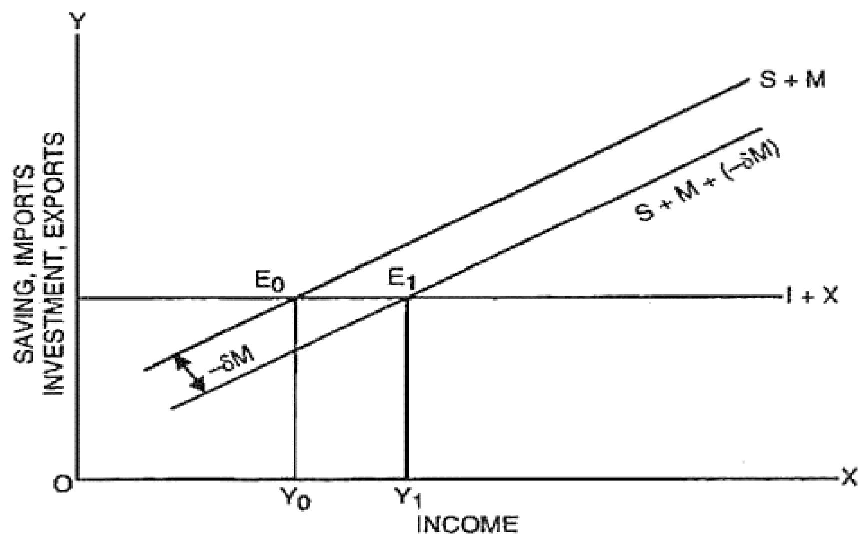

Fig.2.3. Income Effect

In Fig. 2.3, income is measured along the horizontal scale and saving (S), imports (M), investment (I) and exports (X) are measured along the vertical scale. If investment and export are assumed to be autonomous, the investment plus export function (I + X) can be drawn. Assuming saving and import to be positively related with income, saving plus import function (S + M) can be drawn. The intersection between 1+X and S + M results in the original equilibrium at E_0 and the original equilibrium income is Y_0. If tariff causes a reduction in imports by δM, the S+M function shifts down to S+M+(-

δM). The intersection between 1+X and S+M+ (-δM) function at E_1 determines the equilibrium income at a higher level Y_1. The expansion in income Y_0Y_1 is much more than the change in imports measured by the vertical distance between S+M and S+M+(-δM) curves on account of the reverse operation of import multiplier.

It is sometimes argued that the income effect due to tariff may not actually take place even under a less than full employment situation for two reasons. Firstly, the imposition of tariff by the home country hits the exports of the foreign country. Such a policy, if raises income, has such an effect at the cost of the foreign country, the exports of which decline resulting in a contraction in its output, employment and income. Joan Robinson and many other economists have called such a trade policy as a 'beggar-my-neighbour' policy. In due course of time, such policies can have adverse repercussion even upon the tariff-imposing country. The reduced exports of a foreign country will lower its income. The foreigners will be able to buy less products from the tariff-imposing country. Thus even the latter will also experience a decline in the demand for its products and consequent decline in its income. Secondly, the foreign countries may adopt retaliatory tariff and other countervailing measures and neutralise any advantage obtained by the home country and the desired income effect may fall to materialise. If the home country is in a state of full employment, the tariff causing a reduction in imports and switch of expenditure to the home-produced goods, will not contribute in raising the output. Consequently, the inflationary pressures alone will be felt. There may be an increase only in money income and the real income, output or employment will remain unaffected.

8. Balance of Payments Effect:

When tariff is imposed by a country upon foreign products, the home-produced goods become relatively cheaper than the imported goods. The price effect caused by tariff, on the one hand, reduces imports from other countries and on the other hand, causes increased production and purchase of home-produced goods. That leads to a reduction in the balance of payments deficit of the home country. It may be illustrated also through Fig. 2.1.

Before the imposition of tariff, the quantity imported was QQ_1. The price being OP or AQ, the value of import or payment for import was $AQ \times QQ_1 = QAHQ_1$. After the imposition of tariff, the price is OP_1 or BQ_3 and quantity imported is reduced to Q_2Q_3. The value of import is Q_3BCQ_2 out of which BFEC is the revenue receipts of the government of the tariff- imposing country so that the net payment to foreigners for import is Q_3FEQ_2, which is less than the payment for imports before tariff. Needless to say that tariff can cause a reduction in the balance of payments deficit of the tariff-imposing country.

In the regard, some doubts are raised that tariff may fail to improve the balance of payments deficit. Firstly, if the demand for imports in the tariff-imposing country is inelastic, tariff may not reduce the volume of imports despite the rise in the prices of imported goods consequent upon the imposition of tariff. Secondly, if the balance of payments disequilibrium is caused by the export surplus, the imposition of tariff will further aggravate rather than adjust the balance of payments disequilibrium. Thirdly, tariff can, at the maximum, bring about some adjustment in temporary disequilibrium of international payments. There is no possibility of adjusting the fundamental disequilibrium in the balance of payments through tariff restrictions.

2.5. QUOTAS:

Quota, in international trade, government-imposed limit on the quantity, or in exceptional cases the value, of the goods or services that may be exported or imported over a specified period of time.

Major types of import quotas are: 1. The Tariff Quota 2. The Unilateral Quota 3. The Bilateral Quota 4. The Mixing Quota 5. Import Licensing.

The system of import quotas may be classified into five major groups:

(1) The tariff or custom quota,

(2) The unilateral quota,

(3) The bilateral quota,

(4) The mixing quota, and

(5) Import licensing.

1. The Tariff Quota:

The tariff or customs quota is a widely acclaimed measure. Under this system, import of a commodity up to a specified quantity is allowed to be imported duty-free or at a special low rate of duty. But imports in excess of this fixed limit are charged a higher rate of duty. The tariff quota thus combines the features of a tariff with those of quota. Flexibility is another advantage of this system.

However, the system has the following drawbacks:

- When imports tend to be more than the fixed limit assigned under low duty rate, the entire gains from the low rate are shared by the exporting country.
- It brings a rush of imports in the beginning of each new tariff quota, which may disturb domestic price levels of the importing country.

2. The Unilateral Quota:

Under this system, a country places an absolute limit on the importation of a commodity during a given period. It is imposed without prior negotiation with foreign governments. The quota so fixed may be either global or allocated. Under global quota, the commodity can be imported from any country up to the full amount of the quota. Under an allocated quota system, however, the total of the quota is distributed among specified supplying countries. The global quota system, however, cannot be treated as a very satisfactory device, as it invariably tends to favour nearby supplier countries as against the distant ones. It also tends to operate against the smaller or less organised supplier countries. It may periodically cause over supply and greater price fluctuations as it provokes a race among importers to fill up the quota.

Further, it does not provide regular protection to domestic producers. The system of allocated quota tries to overcome these defects of global quota. But it has other defects like: (i) it imposes an undesirable rigidity as to source of supply, (ii) it does not consider costs and other aspects of supply conditions abroad, (iii) it gives rise to monopoly-like action among those exporters who are assured of a specific share of the quota, and (iv) it involves large economic and administrative difficulties in allocating quotas.

3. The Bilateral Quota:

Under this system, quotas are set through negotiation between the importing country and the exporting country (or foreign export groups).

It has the following merits:

(i) Quotas are decided by mutual agreement;

(ii) It minimises the suspicion of discrimination;

(iii) It avoids excessive fluctuations in imports;

(iv) It is excludes export monopolies by agreement;

(v) It is less arbitrary, and, therefore, arouses less or no opposition from the exporting countries. Thus, it provokes no retaliation activity.

However, the principal objections raised against the system are:

1. It tends to fall into the clutches of existing international cartels.
2. It also opens the way to corruption on a large scale.
3. It has a tendency to raise prices in the exporting country, so that the importing country may lose.
4. It is a device for an open invitation to monopoly in the exporting country.

4. The Mixing Quota:

It is a type of regulation which requires producers to utilise a certain proportion of domestic raw materials along with imported parts to produce finished goods domestically. It thus sets limits on the proportion of foreign-made raw materials to be imported and used in domestic production. Such mixing regulations have two broad objectives:

(i) To assist domestic producers of raw materials, and

(ii) To save scarce foreign exchange.

Mixing quota system is, however, criticised on the ground that it contributes to a poorer utilisation of the world resources and high domestic prices of low quantity products and as such it inhibits the optimal allocation of resources in terms of comparative advantages.

5. Import Licensing:

The mechanism of import licensing has been evolved as a system devised to administer quota regulations. Under this, prospective importers are required to obtain a licence from the proper authorities for importing any quantity within the specified quotas. Licences are generally distributed among

established importers keeping in view their share in the country's import trend. Import licensing has become a leading type of quantitative restriction during the post-war period, thanks to its following merits:

- It provides much closer control over the volume of imports.
- It tends to minimise speculative activity.
- It reduces excessive fluctuations in prices produced by the scramble to import before the quota is filled (in the absence of licensing system).
- It allows an even supply, which leads to continuity in availability of reasonable prices so that internal prices may be stabilised.
- It allows a high degree of flexibility in the restriction of imports.
- It permits a country to control the demand of its nationals for foreign exchange.

Licensing system has some drawbacks, such as:

(i) It creates a sort of monopoly among importers;

(ii) It leads to corruption in obtaining licences; and

(iii) It leads to black-marketing in imported goods by selling the licences at high premium rates.

2.6. EFFECTS OF A QUOTA:

Quotas are similar to tariffs. In fact, they can be represented by the same diagram. The main difference is that quotas restrict quantity while tariffs work through prices. Thus, a quota is a quantitative limit through imports. If an import quota of EC (Fig. 2.4) amount is imposed then price would rise to P_t because the total supply (domestic output plus imports) equals total demand at that price.

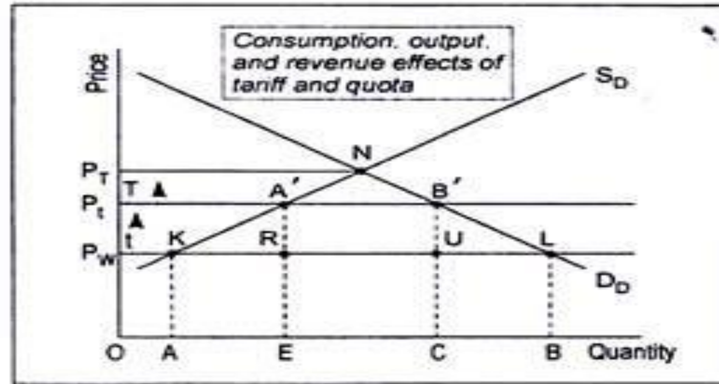

Fig.2.4. Effects of a Tariff and a Quota

As a result of this quota, domestic production, consumption, and imports would be the same as those of the tariffs. Thus, the output effect, the consumption effect and the import restrictive effect of tariffs and quotas are exactly the same. The only difference is the area of revenue. We have already seen that a tariff raises revenue for the government while a quota generates no government revenue. All the benefits of quotas go to the producers and to the lucky importers who manage to get the scarce and valuable import permits. In such a situation, a quota differs from a tariff. However, if import licences are auctioned-off to the importers then the government would earn revenue from the auction. Under these circumstances, the effect of a quota and a tariff are equivalent.

2.7.1 ADVANTAGES OF A QUOTA:

A quota is superior to a tariff on the following grounds:

i. Foreign Exchange Implication:

The main advantage of a quota is that it keeps the volume of imports unchanged even when demand for imported articles increases. It is because a quota makes the completely elastic (horizontal) import supply curve completely inelastic (vertical).

But a tariff permits imports to rise when demand increases, particularly if the demand for imports becomes inelastic. Thus, a quota leads to greater foreign exchange savings compared to tariff (which may even lead to an increase in foreign exchange spending because imports may rise even after tariff).

ii. Precise Outcome:

Another advantage of a quota is that its outcome is more certain and precise, while the outcome of a tariff is uncertain and unclear. This is so because the volume of imports remains unchanged if a quota is imposed. But this is not so in the case of a tariff.

iii. Flexibility:

Finally, Ingo Walter argues that "quotas tend to be more flexible more easily imposed, and more easily removed instruments of commercial policy than tariffs. Tariffs are often regarded as relatively permanent measures and rapidly built powerful vested interests which make them all the more difficult to remove."

2.7.2. DISADVANTAGES OF A QUOTA:

But its disadvantages are nonetheless unimportant:

i. Corruption:

A quota generates no revenue for the government. However, if the government auctions the right to import under a quota to the highest bidder then quotas are similar to a tariff. But a quota leads to corruption. Usually officials charged with the allocation of import licences are likely to be exposed to bribery. Under this situation the tariff is preferable to the quota.

ii. Monopoly Profit:

Secondly, a quota creates a monopoly profit for those with import licences. This means that consumer surplus is converted into monopoly profits. Thus, a quota is likely to lead to a greater loss of consumer welfare. If a tariff is imposed, domestic price will be equal to import price plus tariff'.

iii. Monopoly Growth:

Thirdly, allied to this disadvantage of a quota is that a quota is much more restrictive in effect as it restricts competition. Thus, a quota may ultimately lead to concentration of monopoly power among importers and exporters.

iv. Distortion in Trade:

Finally, a quota has the tendency to distort international trade much more than tariffs since its effects are more vigorous and arbitrary.

Thus, we will have to make a choice between a tariff and a quota. A tariff is usually considered a less objectionable method of trade restriction than an equivalent quota. A tariff permits imports to increase when demand increases and, consequently, the government is able to raise more revenue. In contrast, a quota is less obvious and more likely to remain in force for an indefinite period. For all these reasons, a tariff, while objectionable, is still preferable to a quota.

2.8. DUMPING AND ANTI – DUMPING MEASURES

Dumping is an international price discrimination in which an exporter firm sells a portion of its output in a foreign market at a very low price and the remaining output at a high price in the home market Haberler defines dumping as: "The sale of goods abroad at a price which is lower than the selling price of the same goods at the same time and in the same circumstances at home, taking account of differences in transport costs" Viner's definition is simple. According to him, "Dumping is price discrimination between two markets in which the monopolist sells a portion of his produced product at a low price and the remaining part at a high price in the domestic market." Besides, Viner explains two other types of dumping. One, reverse dumping in which the foreign price is higher than the domestic price.

This is done to turn out foreign competitors from the domestic market. When the product is sold at a price lower than the cost of production in the domestic market, it is called reverse dumping Two when there is no consumption of the commodity in the domestic market and it is sold in two different foreign market, out of which one market is charged a high price and the other market a low price. But in practice, dumping means selling of the product at a high price in the domestic market and a low price in the foreign market. We shall explain price determination under dumping in this sense.

2.9. TYPES OF DUMPING

Dumping can be classified in the following three ways:

1. Sporadic or Intermittent Dumping:

It is adopted under exceptional or unforeseen circumstances when the domestic production of the commodity is more than the target or there are

unsold stocks of the commodity even after sales. In such a situation, the producer sells the unsold stocks at a low price in the foreign market without reducing the domestic price. This is possible only if the foreign demand for his commodity is elastic and the producer is a monopolist in the domestic market. His aim may be to identify his commodity in a new market or to establish himself in a foreign market to drive out a competitor from a foreign market. In this type of dumping, the producer sells his commodity in a foreign country at a price which covers his variable costs and some current fixed costs m order to reduce his loss.

2. Persistent Dumping:

When a monopolist continuously sells a portion of his commodity at a high price in the domestic market and the remaining output at a low price in the foreign market, it is called persistent dumping. This is possible only if the domestic demand for that commodity is less elastic and the foreign demand is highly elastic. When costs fall continuously along with increasing production, the producer does not lower the price of the product more in the domestic market because the home demand is less elastic. However, he keeps a low price in the foreign market because the demand is highly elastic there. Thus, he earns more profit by selling more quantity of the commodity in the foreign market. As a result, the domestic consumers also benefit from it because the price they are required to pay is less than in the absence of dumping.

3. Predatory Dumping:

The predatory dumping is one in which a monopolist firm sells its commodity at a very low price or at a loss in the foreign market in order to drive out some competitors. But when the competition ends, it raises the price of the commodity m the foreign market. Thus, the firm covers loss and if the demand in the foreign market is less elastic, its profit may be more.

OBJECTIVES OF DUMPING:

The main objectives of dumping are as follows:

1. To Find a Place in the Foreign Market:

A monopolist resorts to dumping in order to find a place or to continue himself in the foreign market. Due to perfect competition in the foreign market

he lowers the price of his commodity in comparison to the other competitors so that the demand for his commonly may increase. For this, he often sells his commodity by incurring loss in the foreign market.

2. To Sell Surplus Commodity:

When there is excessive production of a monopolist's commodity and he is not able to sell in the domestic market, he wants to sell the surplus at a very low price in the foreign market. But it happens occasionally.

3. Expansion of Industry:

A monopolist also resorts to dumping for the expansion of his industry. When he expands it, he receives both internal and external economies which lead to the application of the law of increasing returns. Consequently, the cost of production of his commodity is reduced and by selling more quantity of his commodity at a lower price in the foreign market, he earns larger profit.

4. New Trade Relations:

The monopolist practices dumping in order to develop new trade relations abroad. For this, he sells his commodity at a low price in the foreign market, thereby establishing new market relations with those countries. As a result, the monopolist increases his production, lowers his costs and earns more profit.

3. Price Determination under Dumping:

Under dumping, the price is determined just like discriminating monopoly. The only difference between the two is that under discriminating monopoly both markets are domestic while under dumping one is a domestic market and the other is a foreign market. In dumping, a monopolist sells his commodity at a high price in the domestic market and at a low price in the foreign market.

a. Conditions:

Price determination under dumping is based on the following conditions or assumptions:

1. The main aim of the monopolist is to maximise his profit. He, therefore, produces that output at which his marginal revenue equals marginal cost. Since he sells his commodity in the domestic market and the foreign market

separately, he adjusts the quantity such wise in each market that marginal revenues in both markets are equal.

Given the marginal cost of producing the commodity, the most profitable monopoly output will be determined at a point where the combined marginal revenue of both the markets equals the marginal cost. In other words, dumping profit = $MR_H + MR_F = MC$.

-2. The elasticity's of demand must be different in the two markets. The demand should be less elastic in the domestic market and perfectly elastic in the foreign market. As a result, the monopolist sells his commodity at a low price in the foreign market and at a high price in the domestic market. Thus, the price and MR are related to each other by this equation: MR = p (=AR) (1 – 1/E), where e refers to the elasticity of demand.

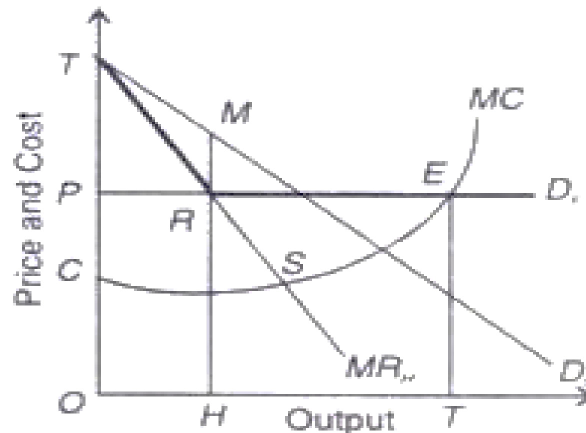

Fig.2.5. Price determination under dumping

3. The foreign market should be perfectly competitive and the domestic market is monopolistic

4. The buyers in the domestic market cannot buy the cheap commodity from the foreign market and bring it in the domestic market.

b. Explanation:

Given these conditions, price and output under dumping will be determined by the equality of the total marginal revenue curve and the marginal cost curve of producing the commodity. Figure 5 illustrates price-output determination under dumping.

The foreign market demand curve faced by the monopolist is the horizontal line PD_F which is also the MR curve because the foreign market is assumed to be perfectly elastic. The demand curve in the home market with

a less elastic demand for the product is the downward sloping curve D_H and its corresponding marginal revenue curve is MR_H. The lateral summation of MR_H and PD_F curves leads to the formation of $TRED_F$ as the combined marginal revenue curve.

In order to determine the quantity of the commodity produced by the monopolist, we take the marginal cost curve MC. E is the equilibrium point where the MC curve equals the combined marginal revenue curve $TRED_F$. Thus OF output will be produced for sale in the two markets. Since FE is the marginal cost, equilibrium in the domestic market will be established at point R where the marginal cost FE equals the MR_H curve (FE = HR).

Now OH quantity will be sold at HM price in the home market and the remaining quantity HF will be sold in the foreign market at OP (= FE) price. Thus the monopolist sells more in the foreign market with the more elastic demand at a low price and less in the home market with the less elastic demand at a high price. His total profits are TREC.

2.10. EFFECTS OF DUMPING:

Dumping affects both the importer and exporter countries in the following ways:

1. Effects on Importing Country:

The effects of dumping on the country, in which a monopolist dumps his commodity, depend on whether dumping is for a short period or a long period and what are the nature of the product and the aim of dumping.

1. If a producer dumps his commodity abroad for a short period, then the industry of the importing country is affected for a short while. Due to the low price of the dumped commodity, the industry of that country has to incur a loss for some time because less quantity of its commodity is sold.

2. Dumping is harmful for the importing country if it continues for a long period. This is because it takes time for changing production in the importing country and its domestic industry is not able to bear competition. But when cheap imports stop or dumping does not exist, it becomes difficult to change the production again.

3. If the dumped commodity is a consumer good, the demand of the people in the importing country will change for the cheap goods. When dumping stops,

this demand will reverse, thereby changing the tastes of the people which will be harmful for the economy.

4. If the dumped commodities are cheap capital goods, they will lead to the setting up of a now industry. But when the imports of such commodities stop, this industry will also be shut down. Thus ultimately, the importing country will incur a loss.

5. If the monopolist dumps the commodity for removing his competitors from the foreign market, the importing country gets the benefit of cheap commodity in the beginning. But after competition ends and he sells the same commodity at a high monopoly price, the importing country incurs a loss because now it has to pay a high price.

6. If a tariff duty is imposed to force the dumper to equalise prices of the domestic and imported commodity, it will not benefit the importing country.

7. But a lower fixed tariff duty benefits the importing country if the dumper delivers the commodity at a lower price.

2. Effects on Exporting Country:

Dumping affects the exporting country in the following ways:

1. When domestic consumers have to buy the monopolistic commodity at a high price through dumping, there is loss in their consumers' surplus. But if a monopolist produces more commodities in order to dump it in another country, consumers benefit. This is because with more production of the commodity, the marginal cost falls. As a result, the price of the commodity will be less than the monopoly price without dumping.

But this lower price than the monopoly price depends upon the law of production under which the industry is operating. If the industry is producing under the law of diminishing returns, the price will not fall because costs will increase and so will the price increase.

The consumers will be losers and the monopolist will profit. There will be no change in price under fixed costs. It is only when costs fall under the law of increasing returns that both the consumers and the monopolist will benefit from dumping.

2. The exporting country also benefits from dumping when the monopolist produces more commodity. Consequently, the demand for the required inputs

such as raw materials, etc. for the production of that commodity increases, thereby expanding the means of employment in the country.

3. The exporting country earns foreign currency by selling its commodity in large quantity in the foreign market through dumping. As a result, its balance of trade improves.

2.11. ANTI-DUMPING MEASURES:

The following measures are adopted to stop dumping:

a. Tariff Duty:

To stop dumping, the importing country imposes tariff on the dumped commodity consequently, the price of the importing commodity increases and the fear of dumping ends. But it is necessary that the rate of duty on imports should be equal to the difference between the domestic price of the commodity and the price of the dumped commodity. Generally, the tariff duty is imposed more than this difference to end dumping, but it is likely to have harmful effects on other imports.

b. Import Quota:

Import quota is another measure to stop dumping under which a commodity of a specific volume or value is allowed to be imported into the country. For this purpose, it includes the imposition of a duty along with fixing quota, and providing a limited amount of foreign exchange to the importers.

c. Import Embargo:

Import embargo is an important retaliatory measure against dumping. According to this, the imports of certain or all types of goods from the dumping country are banned.

d. Voluntary Export Restraint:

To restrict dumping, developed countries enter into bilateral agreements with other countries from which they fear dumping of commodities. These agreements ban the export of specified commodities so that the exporting country may not dump its commodities in other country. Such bilateral VER agreements exist between India and EU countries in exporting Indian textiles.

Conclusion:

It is generally observed that anti-dumping measures explained above harm rather than benefit the country adopting these measures. The producers of the country never want that commodities should be imported from abroad. They, therefore, pressurise the government to restrict the import of better and cheap imports by calling them dumped commodities. The reason for this is to misinterpret dumping. According to Article IV of GATT 1984, which now forms part of the World Trade Organisation (WTO), a country can adopt anti-dumping measures only if the dumped imports "injure" the industry of the country. A commodity is regarded as dumped which is exported to the other country at a value lower than its normal value. Or it will also be regarded as dumped if the export price of the commodity is less than its comparable price for final consumption in the exporting county. Under these situations, the importing country can impose anti-dumping duty, provided the margin of dumping is more than 2% of the export price or is more than 7% of the dumped import.

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UNIT - III

INTERNATIONAL FINANCIAL INSTITUTIONS

3.1. INTRODUCTION

In many parts of the world, international financial institutions (IFIs) play a major role in the social and economic development programs of nations with developing or transitional economies. This role includes advising on development projects, funding them and assisting in their implementation.

Characterized by AAA-credit ratings and a broad membership of borrowing and donor countries, each of these institutions operates independently. IFIs achieve these objectives through loans, credits and grants to national governments. Such funding is usually tied to specific projects that focus on economic and socially sustainable development. IFIs also provide technical and advisory assistance to their borrowers and conduct extensive research on development issues. In addition to these public procurement opportunities, in which multilateral financing is delivered to a national government for the implementation of a project or program, IFIs are increasingly lending directly to non-sovereign guaranteed (NSG) actors. These include sub-national government entities, as well as the private sector.

3.2. OBJECTIVES OF INTERNATIONAL FINANCIAL INSTITUTIONS:

The Fund has been established to achieve the following major objectives:

- To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income;
- To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation;
- To assist in the establishment of multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade?
- To shorten the duration and lessen the degree of disequilibrium in the balance of payments of members; and

- ❖ To promote international monetary co-operation through a permanent institution.

3.3. FUNCTIONS OF INTERNATIONAL FINANCIAL INSTITUTIONS:

The Fund is to perform various functions to realise the above-mentioned objectives.

Some of its major functions and activities are:

(a) Exchange Stability:

The Fund is required to promote stability in the foreign exchange rates of its member countries. The Fund Agreement seeks to attain the exchange stability by requiring members to agree with the Fund suitable gold or dollar (U.S.) par values (connection with gold severed in January 1976) for their respective currencies, so as to create a system of stable exchange rates. Each member of the Fund undertakes to establish and maintain the agreed par value for its currency, and to consult the Fund on any change in excess of 10% of the initial party. The Fund allows such alterations in exchange rates only for correcting fundamental disequilibrium in the balance of payments of the country concerned. But, now exchange values are no longer (since January 1976) determined in terms of gold, and so the IMF has ceased to have any direct impact on exchange values.

(b) Multinational Convertibility of Currencies:

The Fund makes arrangement for the multinational convertibility of the currencies of the member countries within the prescribed limits of the quota of each member. Since the Fund contains the currencies of all member countries, a member is entitled to purchase whichever currency it needs.

A member country can purchase foreign currencies every year up to 25% of its quota subject to the maximum limit of 200% of its quota. Thus, the Fund offers facilities to its members for additional liquidity.

(c) Assistance for Short-Term Payments Difficulties:

The Fund makes its foreign exchange resources available, under proper safeguards, to its members to meet short-term or medium-term payments difficulties.

(d) Promotion of International Trade:

The Fund seeks to promote international trade by inducing member nations to avoid restrictive currency practices and barriers to trade, such as multiple exchange rates, exchange control, etc. The countries retaining exchange controls are required to justify them.

(e) Allocation of Special Drawing Rights:

The Fund also supplements, as and when needed, the existing reserve assets of the participants in the Special Drawing Account. It also makes allocation from the Account to the member countries.

(f) Other Functions:

Its other functions include international monetary reform, recycling of petro-dollars to the oil-importing countries, etc. Recently, the Fund has to introduce a series of measures like the sale of its gold reserve delinking of the par values of currency from gold, etc. for increasing the supply of international liquidity and promoting greater monetary cooperation among member countries.

3.4. INTERNATIONAL MONETARY FUND (IMF):

3.4.1. Origin of IMF:

The origin of the IMF goes back to the days of international chaos of the 1930s. During the Second World War, plans for the construction of an international institution for the establishment of monetary order were taken up. At the Bretton Woods Conference held in July 1944, delegates from 44 non-communist countries negotiated an agreement on the structure and operation of the international monetary system.

The Articles of Agreement of the IMF provided the basis of the international monetary system. The IMF commenced financial operations on 1 March 1947, though it came into official existence on 27 December 1945, when 29 countries signed its Articles of Agreement (its charter). Today (May 2012), the IMF has near-global membership of 188 member countries. Virtually, the entire world belongs to the IMF. India is one of the founder-members of the Fund.

3.4.2. Objectives of IMF:

Article 1 of the Articles of Agreement (AGA) spell out 6 purposes for which the IMF was set up. These are:

I. To promote international monetary cooperation through a permanent institution which provides the machinery for consolation and collaboration on international monetary problems.

II. To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objective of economic policy.

III. To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

IV. To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

V. To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with the opportunity to correct maladjustments in their balance of payments, without resorting to measures destructive of national or international prosperity.

VI. In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balance of payments of members.

All these objectives of the IMF may be summarised:

To promote international cooperation; to facilitate the expansion and balanced growth of international trade; to promote exchange stability; to assist in the establishment of a multilateral system of payments; to make its general resources available to its members experiencing balance of payments difficulties under adequate safeguards; and to shorten the duration and lessen the degree of disequilibrium in the international balance of payments of members.

3.4.3. FUNCTIONS OF INTERNATIONAL MONETARY FUND:

The principal function of the IMF is to supervise the international monetary system. Several functions are derived from this. These are: granting

of credit to member countries in the midst of temporary balance of payments deficits, surveillance over the monetary and exchange rate policy of member countries, issuing policy recommendations. It is to be noted that all these functions of the IMF may be combined into three. These are: regulatory, financial, and consultative functions:

a. Regulatory Function:

The Fund functions as the guardian of a code of rules set by its (AOA—Articles of Agreement).

b. Financial Function:

It functions as an agency of providing resources to meet short term and medium term BOP disequilibrium faced by the member countries.

c. Consultative Function:

It functions as a centre for international cooperation and a source of counsel and technical assistance to its members.

The main function of the IMF is to provide temporary financial support to its members so that 'fundamental' BOP disequilibrium can be corrected. However, such granting of credit is subject to strict conditionality. The conditionality is a direct consequence of the IMF's surveillance function over the exchange rate policies or adjustment process of members. The main conditionality clause is the introduction of structural reforms. Low income countries drew attraction of the IMF in the early years of 1980s when many of them faced terrible BOP difficulties and severe debt repayment problems. Against this backdrop, the Fund took up 'stabilisation programme' as well as 'structural adjustment programme'. Stabilisation programme is a demand management issue, while structural programme concentrates on supply management. The IMF insists member countries to implement these programmes to tackle macroeconomic instability. Its main elements are:

(i) Application of the principles of market economy;

(ii) Opening up of the economy by removing all barriers of trade; and

(iii) Prevention of deflation.

The Fund provides financial assistance. It includes credits and loans to member countries with balance of payments problems to support policies of adjustment and reform. It makes its financial resources available to member

countries through a variety of financial facilities. It also provides concessional assistance under its poverty reduction and growth facility and debt relief initiatives. It provides fund to combat money- laundering and terrorism in view of the attack on the World Trade Centre of the USA on 11 September 2001. In addition, technical assistance is also given by the Fund. Technical assistance consists of expertise and support provided by the IMF to its members in several broad areas: the design and implementation of fiscal and monetary policy; institution-building, the handling and accounting of transactions with the IMF; the collection and retirement of statistical data and training of officials.

Maintenance of stable exchange rate is another important function of the IMF. It prohibits multiple exchange rates. It is to be remembered that unlike the World Bank, the IMF is not a development agency. Instead of providing development aid, it provides financial support to tide over BOP difficulties to its members.

Organisation and Management of the IMF:

Like many international organisations, the IMF is run by a Board of Governors, an Executive Board and an international staff. Every member country delegates a representative (usually heads of central banks or ministers of finance) to the Board of Governors—the top link of the chain of command. It meets once a year and takes decision on fundamental matters such as electing new members or changing quotas. The Executive Board is entrusted to the management of day-to-day policy decisions. The Board comprises 24 executive directors who supervise the implementation of policies set by the member governments through the Board of Governors. The IMF is headed by the Managing Director who is elected by the Executive Board for a 5 year term of office. Rights and obligations, i.e., the balance of Powers in the Fund is determined by a system of quotas. Quotas are decided by a vote of the Board of Governors. Quotas or subscriptions roughly reflect the importance of members in the world economy. It is the quota on which payment obligation, credit facilities, and voting rights of members are determined.

Financial Structure of the IMF:

The capital or the resources of the Fund come from two sources:

(i) Subscription or quota of the member nations, and

(ii) Borrowings.

Each member country is required to subscribe an amount equivalent to its quota. It is the quota on which payment obligations, credit facilities, and voting right of members are determined. As soon as a country joins the Fund, it is assigned a quota which is expressed in Special Drawing Rights (SDRs). At the time of formation of the IMF, the quota of each member was made up of 25 p.c. in gold or 10 p.c. of its net official holdings of gold and US dollars (whichever was less). Now this has been revised. The capital subscriptions or quota is now made up of 25 p.c. of its quota in SDRs or widely accepted currencies (such as the US dollar, euro, the yen or the pound sterling) instead of gold and 75 p.c. in country's own currency. The size of the Fund equals the sum of the subscriptions of members. Total quotas at the end-August 2008 were SDR 217.4 billion (about $341 billion). The Fund is authorised to borrow in special circumstances if its own resources prove to be insufficient. It sells gold to member countries to replenish currency holdings. It is entitled to borrow even from international capital market. Though the Articles of Agreement permit the Fund to borrow from the private capital market, till today no such use has been made by the IMF.

3.4.5. Special Drawing Rights (SDRs):

The Special Drawing Rights (SDRs) as an international reserve asset or reserve money in the international monetary system was established in 1969 with the objective of alleviating the problem of international liquidity. The IMF has two accounts of operation—the General Account and the Special Drawing Account. The former account uses national currencies to conduct all business of the fund, while the second account is transacted by the SDRs. The SDR is defined as a composite of five currencies—the Dollar, Mark, Franc, Yen and Pound. The SDRs are allocated to the member countries in proportion to their quota subscriptions. Only the IMF members can participate in SDR facility.

SDRs being costless, often called paper gold, is just a book entry in the Special Drawing Account of the IMF. Whenever such paper gold is allocated, it gets a

credit entry in the name of the participating countries in the said account. It is to be noted that SDRs, once allocated to a member, are owned by it and operated by it to overcome BOP deficits. Since its inception, there have been only four allocation to SDRs—the first in 1970, and the last in 2008-09—mainly to the developing countries.

Instruments of IMF Lending and Loan Conditionality:

The IMF Articles of Agreement clearly state that the resources of the Fund are to be used to give temporary assistance to members in financing BOP deficit on current account. Of course, the financial assistance provided by the Fund is loan. The following technique is employed: If a country calls on the Fund it buys foreign currencies from the IMF in return for the equivalent in the domestic currency. This, in legal and technical terms, is called a 'drawing' on the Fund. The technique, therefore, suggests that the IMF does not lend, but sells the required currency to the members on certain terms. This unique financial structure of the Fund clearly suggests that the Fund's resources cannot be lent for long time. It is meant to cover short run gaps in balance of payments.

The IMF's unique financial structure does not allow any member to enjoy financial assistance over a long time period. The total amount that a country is entitled to draw is determined by the amount of its quota. A member is entitled to draw an amount not exceeding 25 p.c. of its quota. The first 25 p.c. called the 'gold tranche' ('tranche' a French Word meaning slice) or 'reserve tranche' can easily be drawn by countries with BOP problems.This 25 p.c. of the quota is the members' owned reserves and therefore no conditions are attached to such drawings. This may be called 'ordinary, drawing rights; even the Fund cannot deny its use. However, no interest for the first credit tranche is required to be paid though such drawings are subject to repayment within 3-5 years period. The 'credit tranche' of 100 p.c. each equalling 25 p.c. of a member's quota are also available subject to the IMF approval and hence, 'conditional'. Originally, it was possible to borrow equal to 125 p.c. of one's quota. At present, borrowing limit has been raised to 450 p.c. of one's quota which must be redeemed within five years.

Borrowing methods used by the Fund are:

(i) Stand-by Arrangements:

This method of borrowing has become the most normal form of assistance by the Fund. Under this form of borrowing, a member state obtains the assurance of the Fund that, usually over 12-18 months, requests for drawings of foreign exchange (i.e., to meet short- term BOP problems) up to a certain amount will be allowed if the country concerned wishes. However, the stand-by arrangements can be extended up to 3 years while repayments are required to be made within 3-5 years of each drawing. The term "stand-by" here means that, subject to conditionality, a member has a right to draw the money made available, if needed. In most cases, the member does, in fact, draw.

(ii) Extended Fund Facility (EFF):

Stand-by arrangements to stabilise a member's BOP run usually for a period of 12-18 months. Developing countries suffer from chronic BOP problems which could not be remedied in the short run. Such protracted BOP difficulties experienced by the LDCs were the result of structural imbalances in production and trade. It then necessitated an adjustment programme and redemption scheme of longer duration. In the 1970s, the Fund recognised this idea and built up the EFF in 1974. The EFF is designed to provide assistance to members to meet their BOP deficits for longer period (3-4 years) and in amounts larger in relation to their quotas. Repayment provisions of EFF cover a period of 4-10 years. However, conditions for granting loans are very stringent. Drawings on this account since 2000 stand at over 50 billion dollar in SDRs.

(iii) Compensatory Financing Facility (CFF):

Apart from the ordinary drawing rights, there are some 'special finances' windows to assist the developing countries to tide over BOP difficulties. CFF, introduced in 1963, is one such special drawing provision. Its name was changed to Compensatory and Contingency Financing Facility (CCFF) in 1980, but the 'contingency' was dropped in 2000. Under it, members were allowed to draw up to 25 p.c. of its quota when CFF was introduced.

It can now draw up to 45 p.c. Since the mid- 1990s, this has been the least-used facility.

(iv) Structural Adjustment Facility (SAF) and the Enhanced SAF (ESAF):

In 1986 a new facility—the SAF—was introduced for the benefit of low income countries. It was increasingly realised that the so-called stringent and inflexible credit arrangements were too inadequate to cope with the growing debt problems of the poorest members of the Fund. In view of this, SAF was introduced which stood quite apart from the monetary character of the Fund. Under it, credit facilities for economic reform programmes are available at a low interest rate of 0.5 p. c compared to 6 p.c. for most Fund facilities. Loans are for 10 years with a grace period of five and a half years. LDCs facing protracted BOP problems can get assistance under SAF provided they agree to undertake medium-term structural adjustment programmes to foster economic growth and improve BOP conditions. An extended version of SAF—ESAF—was introduced in 1987. The ESAF has been replaced by a new facility, called Poverty Reduction and Growth Facility in 1999.

(v) Poverty Reduction and Growth Facility (PRGF):

The PRGF that replaced the ESAF in November 1999 provides concessional lending to help the poorest member countries with the aim of making poverty reduction and economic growth —the central objectives of policy programmes. Under this facility, low-income member countries are eligible to borrow up to 140 p.c. of its quota for a 3-year period. Rate of interest that is charged is only 0.5 p. c and repayment period covers 5 1/2-10 years, after disbursement of such facility. However, financial assistance under this facility is, of course, 'conditional'.

(vi) Supplemental Reserve Facility (SRF):

This instrument provides additional short-term financing to member countries facing exceptional BOP difficulties because of a sudden and disruptive loss of market confidence reflected in capital outflows of countries concerned. Consequent upon the eruption of East Asian financial crisis, the SRF was introduced in 1997. Till date (March, 2012), the top three largest borrowing nations are Greece, Portugal and Ireland from the IMF.

3.4.6. Working of the IMF:

There are two phases in the working of the IMF over the last 65 years. The first phase covers the period late 1940s (i.e., 1947) to 1971. This phase is popularly known as the 'Bretton Woods System'. The IMF system or the Bretton Woods System provides for exchange rate stability in the short run but allowed for the possibility of exchange rate adjustment when a country experienced 'fundamental' disequilibrium in its BOP accounts. Thus, the pegged exchange rate was adjusted in accordance with the IMF. Hence the name 'adjustable peg system'.

As the system was the source of some major problems, it was abandoned in 1971 and more flexibility was introduced in the monetary system. In other words, the demise of the Bretton Woods System made room for the floating exchange rate regime, requiring changes in the role of the IMF. After prolonged negotiations (1973-78), the IMF started its second-leg journey in 1978. The decade of the 1970s saw massive borrowing by the developing countries. It rose to $600 billion by 1982. Meanwhile, the rise in interest rates in the USA from 1979 and the appreciation of dollar caused tremendous difficulties to the developing countries in servicing their debts. On the other hand, the switch to the floating exchange rate system coincided with the deteriorating economic conditions in the industrialised countries.

Debt crisis that emerged in many developing countries had a dramatic effect. Mexico a Latin American country announced its failure to honour debt obligations. The IMF now played a crucial role to put the international financial system in order. It came in for mobilisation of additional financial resources so as to reduce the debt burden. As a result of this and other related measures, many countries regained access to the international banks and creditors and the severity of the debt problem moderated considerably in Latin America in the early 1990s.

With the breakup of the Soviet Union in 1989, a new category of countries, especially the erstwhile communist countries, joined the IMF. The IMF now came forward to assist countries undergoing transition from a centrally planned economy to a market-oriented economy. Privatisation is indeed a crucial element of the transition process. That is why the IMF is

providing financial assistance and technical support for the development of sound economic management and the privatisation of state enterprises.

In 1997, the East Asian financial crisis began when the currencies of the 'Asian tiger' economies (South Korea, Singapore, and Hong Kong, Taiwan) plummeted, and the stock market crashed. Rescue packages were launched by the IMF under strong authority conditions.

Achievements:

From this balance sheet of the working of the IMF, we are now in a position to evaluate its performance over the last 65 years or so. First, we state the achievements of the Fund. The IMF acts both as a financing and an adjustment-oriented international institution for the benefit of its members It has been providing financial assistance to the deficit countries to meet their temporary disequilibrium in BOP. The Fund aims at promoting exchange rate stability. In its early phase, the Fund made arrangements of avoidance of competitive exchange depreciation. It has made an attempt to solve the problem of international liquidity. To create international liquidity. Special Drawing Rights (SDRs)—an artificial currency—were created in 1969 as foreign exchange reserves to benefit the developing countries in particular. SDR allocations are made to member countries to finance the BOP deficits.

It is an institution through which consultation in monetary affairs takes place in an on-going way. It acts as a forum for discussions of the economic, fiscal and financial policies of member countries, keeping the BOP problems in mind. Previously, the poorest developing countries did not receive adequate treatment from the Fund. But from 1980s onwards—when the debt crisis broke out in poor countries—the Fund decided to divert its financial resources to these countries. In 1980s, centrally planned economies were not hitherto members of the Fund. With the collapse of the Soviet Union in 1989, ex-communist countries became members of the Fund and the Fund is providing assistance to these countries so as to instill, the principles of market economy. It has decided to finance resources to combat terrorism and money-laundering. Finally, the IMF has assisted its members in the formulation of appropriate monetary, fiscal, and trade policies.

Failures:

Despite these achievements, its failures are glaring. In other words, its success is, on the whole, limited. There are some serious charges against this institution that cannot escape attention. These are:

The Fund provides short-term finance to its members to tackle BOP disequilibrium. For this purpose, it adopted an adjustable peg system in the first phase of its life. But it failed to establish a stable exchange rate. Its role in controlling the competitive exchange depreciation policies adopted by the members was subject to serious scrutiny, although it was created to avoid devaluation as a BOP measure as much as possible. Truly speaking, the IMF is incapable of taking independent policy decisions. It complies with the 'order' of the superpowers. Further, it has minimal influence over the policy decisions of the major industrial powers. In these cases, its mandate to exercise 'firm surveillance' over some influential members or superpowers is virtually meaningless—it has no influence over the US deficits or European interest rates.

Secondly, the Fund imposes conditions on the poor countries while sanctioning loans. Now, it is ignoring its central concern—exchange rate management and the BOP problems. It is now championing the issue of 'market principle'. It suggests poor developing countries to cut expenditure-borrowing-subsidy, raise prices of state enterprises, privatisation of state-owned enterprises, etc. If such measures—most popularly known as structural adjustment programmes—are adopted only then the IMF credit would follow. It is said that the third world debt crisis is due to the Fund policies and working.

Thirdly, the Fund has failed to eliminate foreign exchange restrictions imposed by its members that hamper the growth of trade.

3.5. WORLD BANK

The World Bank (WB) was originally created as the International Bank for Reconstruction and Development (IBRD) in 1944 along with its twin, the IMF. Together they came to be known as the 'Bretton Woods' twin sisters'. When it was set up it was decided that this international bank would assist

in the economic reconstruction of the World War II-damaged European economies. In early 1946 this international bank launched its carrier as the multilateral development bank and since then the IBRD came to be known as the World Bank. Its headquarters is located in Washington, opposite the IMF building, and it lies as the next door neighbour of the White House.

3.5.1. Functions of World Bank:

Being twin sisters, membership in the IMF is a prerequisite for membership in World Bank (189 countries in 2022).

The Bank performs the following functions:

I. To assist in the construction and development of the territories of its members by facilitating investment of capital for productive purposes, including the 'restoration of economies destroyed or disrupted by war', and the encouragement of the "development" of productive facilities and resources in less developed countries.

II. To promote private investment and long run balanced growth of international trade and BOP equilibrium by means of guarantees or participation in international loans and investments.

III. To arrange loans made or guaranteed by it. So that more useful and urgent projects receive preference.

IV. To provide finance to projects from its own capital, funds raised by it and by participating with other members.

In addition, the Bank provides advice and expertise. It now puts more emphasis on institutional technical assistance and infrastructure assistance. Over the years, it has been able to generate and disseminate policy relevant knowledge. Today, it has been concentrating more on this asset rather than financial resources. This organisation is now called the 'knowledge bank'.

3.5.2. Objectives:

The purposes and objectives are constantly changing. For instance, in the early years, the Bank's investment concentrated on infrastructural build-up like power, transport, communications and irrigation. During the late 1960s and 1970s, the Bank went on financing agricultural projects more actively—particularly in the promotion of cash crops. However, in the 1980s, agricultural lending declined drastically.

Meanwhile, the WB decided to put emphasis on the alleviation of poverty in less developed countries in the late 1960s and 1970s. During Robert McNamara's Presidency (1968-81), the WB made a radical change in emphasis—the reduction of rural poverty as well as urban poverty. Since then all the Presidents reiterated the commitment to fight poverty, enhance growth with sustainability. It also introduced structural adjustment programmes (SAPs) in developing countries so that not only macroeconomic stability can be attained but also structural reforms aimed at accelerating growth can be undertaken. It has shifted its emphasis from the financing on specific projects towards non-project linked programmes. It works in developing economies with the focus of helping the poorest people and the poorest countries.

For all its clients, the Bank emphasises the need for:

(i) Investing in people, particularly through basic health and education;

(ii) Focusing on social development, governance and institution-building as the major elements of poverty alleviation;

(iii) Strengthening the ability of the governments to deliver quality services with greater efficiency and transparency;

(iv) Protecting the environment;

(v) Supporting and encouraging private business development and long-term planning.

Through its loans, policy advice, and technical assistance, the WB supports a broad range of programmes aimed at reducing poverty and improving living standards in the developing world including the achievement of the Millennium Development Goals (MDGs) by helping countries develop an environment for investment, jobs, and sustainable growth. The WB works with government agencies, non-governmental organisations (NGOs), and the private sector to formulate various assistance strategies.

Organisation:

Like the Fund, the Bank's structure is organised on a three-tier basis; a Board of Governors, Executive Directors and a President. The Board of Governors is the supreme governing authority. It consists of one governor (usually the Finance Minister) and one alternate governor (usually the governor of a central bank), appointed for five years by each member.

The Board is required to meet once every year. It reserves to itself the power to decide important matters such as new admissions, changes in the bank's stock of capital, ways and means of distributing the net income, its ultimate liquidation, etc. For all technical purposes, however, the Board delegates its powers to the Executive Directors in the day-to-day administration. The World Bank is like a cooperative, made up of 189 member countries. These member countries, or shareholders, are represented by a board of governors, who are the ultimate policymakers at the World Bank. Generally, the governors are member countries ministers of finance or ministers of development. They meet once a year at the annual meetings of the boards of governors of the World Bank group and international monetary fund.

At present, the Executive Directors are 19 in number, of which five are nominated by the five largest shareholders — the USA, the UK, Germany, France and India. The rest are elected by the other members. The Executive Directors elect the President who becomes their Ex-officio Chairman holding office during their presence. He is the chief of the operating staff of the Bank and is subject to the direction of the Executive Directors on questions of policy and is responsible for the conduct of the ordinary business of the Bank and its organisation.

3.6. SPECIAL DRAWING RIGHTS (SDRs)

Special Drawing Rights also known as the paper gold, are a form of international reserves created by the IMF in 1969 to solve the problem of international liquidity. They are not paper notes or currency, they are international units of account in which the official accounts of The IMF are kept. They are allocated to the IMF members in proportion to their fund quotas and are used to settle balance of payments deficits between them.

3.6.1. Working of SDR:

Under the new scheme of SDR, each member country is authorised to participate in the special drawing account on a specified basis.

A member country participating in SDR is free to use its holdings to meet the deficit in the balance of payment.

Possession of SDR is empowered to transfer its SDRs to the equivalent of the currency to another participating country which has been designated by the Fund.

For the participating countries, the SDRs are form of unconditional liquidity. At the same time, designated country has to provide 'currency convertible' to the country transferring its SDRs to it. Moreover, IMF has designated eight countries whose currencies could be obtained by a participating country against its SDR. Thus, it is a method of supplementing the existing reserve assets in the international liquidity. Here, it must be noted that the value of the SDR was measured in gold, one SDR being equal to 0.02857 ounces of gold. In 1976, IMF demonetised gold and SDR was linked with currencies of sixteen countries with one per cent or more share in the total SDR allocation.

3.6.2. Features of Special Drawings Rights (SDR):

The salient features of SDR are described as following:

- ❖ The SDR are required by the member countries to meet the requirement of international liquidity through credit creation of the bank.
- ❖ The allocation of SDRs was on the basis of quota system held by the individual member country.
- ❖ Special Drawing Rights have been created under Special Drawing Account.
- ❖ SDRs have been created to maintain the confidence of the people.
- ❖ SDRs are used by a participant country to remove the deficits in the balance of payment.
- ❖ IMF regulates SDRs which would accept as reserves and use for the settlement of international payments.
- ❖ The scheme of drawing rights has served the reserve assets as a store value rather than as a medium of exchange.
- ❖ A nation imposed an interest rate related to market rates on the amount of SDRs.
- ❖ SDRs are not only regarded as a pound or dollar but also as the inter-central bank currency.

- SDRs were originally dominated and expressed in terms of gold. The value of drawing rights is fixed in gold.
- SDRs provide the accumulation of Special Drawing Accounts.
- SDRs can be described as ‘Paper Gold’.

3.6.3. Evaluation of SDRs Scheme:

The SDR scheme has been considered significant bearing following advantages:

1. The SDRs schemes provides more facilities for reserve and creation of credit flexibility.
2. Special Drawing Rights permit unconditional increase of liquidity to meet the requirements of the country. In other words, under this scheme, there is no need to change domestic currency.
3. Another favour of SDRs is that it gives a permanent addition in international liquidity.
4. The scheme SDRs provide significant efforts to move away from gold standard. Thus, it relieves the world monetary authorities from maintaining an open market value of gold.
5. The payment and repayment of special drawing rights out of the special drawing account is easier and more flexible than under the fund schemes.
6. SDRs act both as a unit of account and a means of payment of International Monetary System.

Despite the above noted favourable points of Special Drawing Rights Scheme, they are subject to criticism. Some of the arguments are under mentioned:

1. SDRs scheme is purely financial in nature. Thus, there is probability of distrust in the new reserve assets.
2. It has been pointed out that though SDRs scheme is flexible to keep reserve of international liquidity yet there is doubt to be used to finance the acute deficits of payment.
3. It has been criticised that the value of SDRs is kept in parity only in the international money market and not within the artificially over—valued dollar.

4. It is doubted that the scheme of SDRs will solve the problem of international monetary relations because of its disturbances in the international monetary equilibrium and the currency gold switches. In fact, it is not much helpful to prevent the SDR gold switches.

5. SDRs scheme also suffers from the inequitable distribution and inefficiency among the member countries.

6. Some critics are also of the opinion that new scheme is in favour of USA (to solve the dollar crisis) and most disadvantageous the poor nations.

3.6.4. Operation of the SDR:

In 1970, SDRs were allocated by IMF for the first time. Under the Special Drawing Accounts, 3414 million SDRs were distributed among the 105 member countries. In 1971, under the second allocation, a total SDRs of 2940 million were distributed among 110 participants at the rate of 10.7 per cent of the quotas. Again in 1972, 3 billion was allotted to 112 participating countries. The largest allocation of SDR 2249 million was made to USA. India had received 326 million of SDRs.

A present, there was three ways of using SDRs by the member countries:

1. To obtain US—Dollars, French—France or pound Sterling from member countries of provide currency in exchange for SDRs.

2. To use SDRs for obtaining balance of its own currency held by another participant by agreement with concerned participant.

3. To use SDRs to effect repurchases and pay charges in the Fund's General Account.

Thus, the countries are in a position to use SDRs for the purchase of other currencies and for the repayment of their debts. India had used 78.5 million SDRs is 1971 out of the total of 226.6 million possessed by her. The value of SDRs will be expressed in terms of the average value of 14 currencies rather than gold. In 1979, IMF decided to make fresh allocation of total SDR 12 billion at the rate of 4 billion for each of the three years. Inspite of this allocation, the proportion of SDR in non- gold reserves of Fund members continued to be low even to the less than 5 per cent. In July 1981, however, its value is expressed in terms of five major currencies.

Steps for Improvement:

IMF took measures for the improvement of the working of SDRs:

(i) The value of SDRs is linked with the standard basket of 5 currencies as of US dollars, French France, Japanese Yen and pound sterling.

(ii) In 1981, the rate of interest on SDRs has been increased from 1.5 per cent to 3.99 per cent

(iii) To promote the use of SDRs as an international reserve assets, ten official financial institutions have been organised as 'other holders' of SDRs.

A new proposal named 'Substitution Account' in the IMF was proposed for the benefit of member countries. Under this proposal, new SDRs would be created in exchange for the excess Dollar holdings of member countries and will be held by IMF in the Substitution Account. This would also create an asset in which private transactions could take place. But, it is a matter of regret that this proposal failed to evoke any positive response at the behest of developing and poor countries. To overcome the above noted problems the following remedial measures have been suggested. For distributing social saving of SDRs and linking SDRs with development assistance to developing countries, there should be link between development assistance and special drawing rights.

First, a regular expansion of Special Drawing Rights is needed so that the quantum of international reserves increases.

Second, the system of allocation of special Drawing Rights should be so modified that more special drawing rights as allocated directly to the developing countries in excess of their long run demand. This can be done in either of the two ways: (a). by increasing their IMF quotas and (b). By allocating Special Drawing Rights in excess of their fund Quotas.

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UNIT – IV

TRADE AGREEMENTS

4.1. Introduction

Ever since Adam Smith published The Wealth of Nations in 1776, the vast majority of economists have accepted the proposition that free trade among nations improves overall economic welfare. Free trade, usually defined as the absence of tariffs, quotas, or other governmental impediments to international trade allows each country to specialize in the goods it can produce cheaply and efficiently relative to other countries. Such specialization enables all countries to achieve higher real incomes.

Although free trade provides overall benefits, removing a trade barrier on a particular good hurts the shareholders and employees of the domestic industry that produces that good. Some of the groups that are hurt by foreign competition wield enough political power to obtain protection against imports. Consequently, barriers to trade continue to exist despite their sizable economic costs. According to the U.S. International Trade Commission, for example, the U.S. gain from removing trade restrictions on textiles and apparel would have been almost twelve billion dollars in 2002 alone. This is a net economic gain after deducting the losses to firms and workers in the domestic industry. Yet, domestic textile producers have been able to persuade Congress to maintain tight restrictions on imports.

The best possible outcome of trade negotiations is a multilateral agreement that includes all major trading countries. Then, free trade is widened to allow many participants to achieve the greatest possible gains from trade. After World War II, the United States helped found the General Agreement on Tariffs and Trade (GATT), which quickly became the world's most important multilateral trade arrangement.

The major countries of the world set up the GATT in reaction to the waves of protectionism that crippled world trade during—and helped extend—the Great Depression of the 1930s. In successive negotiating "rounds," the GATT substantially reduced the tariff barriers on manufactured goods in the industrial countries. Since the GATT began in 1947, average tariffs set by industrial countries have fallen from about 40 percent to about 5 percent

today. These tariff reductions helped promote the tremendous expansion of world trade after World War II and the concomitant rise in real per capita incomes among developed and developing nations alike. The annual gain from removal of tariff and nontariff barriers to trade as a result of the Uruguay Round Agreement (negotiated under the auspices of the GATT between 1986 and 1993) has been put at about $96 billion, or 0.4 percent of world GDP.

In 1995, the GATT became the World Trade Organization (WTO), which now has more than 140 member countries. The WTO oversees four international trade agreements: the GATT, the General Agreement on Trade in Services (GATS), and agreements on trade-related intellectual property rights and trade-related investment (TRIPS and TRIMS, respectively). The WTO is now the forum for members to negotiate reductions in trade barriers; the most recent forum is the Doha Development Round, launched in 2001.

As a result, many countries have turned away from the multilateral process toward bilateral or regional trade agreements. One such agreement is the North American Free Trade Agreement (NAFTA), which went into effect in January 1994. Under the terms of NAFTA, the United States, Canada, and Mexico agreed to phase out all tariffs on merchandise trade and to reduce restrictions on trade in services and foreign investment over a decade. The United States also has bilateral agreements with Israel, Jordan, Singapore, and Australia and is negotiating bilateral or regional trade agreements with countries in Latin America, Asia, and the Pacific. The European Union also has free-trade agreements with other countries around the world.

4.2. Meaning of Trade Agreement:

Trade agreement, any contractual arrangement between states concerning their trade relationships. Trade agreements may be bilateral or multilateral—that is, between two states or more than two states. For most countries international trade is regulated by unilateral barriers of several types, including tariffs, nontariff barriers, and outright prohibitions. Trade agreements are one way to reduce these barriers, thereby opening all parties to the benefits of increased trade. In most modern economies the possible coalitions of interested groups are numerous, and the variety of possible unilateral barriers is great.

4.3. General Agreement on Tariffs and Trade (GATT):

4.3.1. Introduction to GATT:

The General Agreement on Tariffs and Trade (GATT) is a multilateral trade treaty among countries to regulate international trade and tariffs in accordance with specific rules, norms or code of conduct. The world witnessed a regime of rigorous and extensive trade barriers during 1930's and the period of Second World War. The United States and its allies in Western Europe thought of creating conditions for liberal trade after the War. There was a proposal to create International Trade Organisation (ITO) to secure a reduction in tariffs and barriers to trade. At the UN Conference on Trade and Employment held in Havana in 1948, 53 countries adopted a Charter to create ITO. But the Havana Charter could not be ratified by the US Congress and the proposal was abandoned.

Simultaneously the negotiations were going on among 23 countries to relax trade and tariff restrictions at Geneva in 1947. Apart from agreeing upon certain trade concessions, these countries evolved a multilateral treaty which incorporated in advance the commercial policy clauses of the Havana Charter. This treaty was signed on October 30, 1947 and became effective on 1st January 1948. This treaty is known as the General Agreement on Tariffs and Trade (GATT). Since 1947, there have been eight rounds of negotiations among the member countries of the GATT for the promotion of free trade. The Uruguay Round of GATT negotiations culminated in the creation of World Trade Organisation (WTO) which came into existence on January 1, 1995. It has now fully replaced GATT.

4.3.2. Objectives of GATT:

GATT was originally conceived as interim or temporary arrangement until ITO could be constituted. Since the ITO proposal later had to be given up. GATT emerged as the singular permanent international arrangement having specific widely accepted rules of behaviour concerning international trade and tariffs. In December 1993, GATT membership had gone up to 117. The members of GATT were called as the contracting parties. The GATT was a binding contract among the countries which together accounted for over 90 percent of the world merchandise trade. Apart from 117 contracting parties,

there were thirty one such countries which applied the GATT rules de facto. The member countries met from time to time to discuss matters of common interest and enact provisions related to tariff and non-tariff barriers for ensuring free and larger multilateral international trade. Any country could join the GATT provided the existing contracting parties approved of its admission by a two-thirds majority. All the benefits from the provisions of the GATT automatically become available to a country as soon as it assumed the membership of GATT.

The country seeking GATT membership was expected to offer tariff and trade concessions to the existing members prior to its admission. Any member country could withdraw from the GATT after giving due notice. In such an eventuality, the other countries had the right to withdraw the concessions earlier given to the departing country by them. The GATT session used to be held annually to take important decisions. In between sessions GATT Council supervised the work of various committees, working groups and panels of experts. Its headquarters were located at Geneva. In case of all other Articles, the amendments required a two-thirds majority. The decision about the admission of new members too required a two-thirds majority. All other decisions could be made by the simple majority vote.

The rules of GATT, apart from making provision for reduction of trade barriers and enlargement of world trade, called for consultation with other contracting parties to waive trade obligations, to provide for settlement of trade disputes, and even to permit retaliatory action. In brief, the GATT simultaneously acted as the legislator of the 'rules of the game'; served as a forum for trade negotiations among the member countries and; acted as an international court to settle trade disputes among different member countries. The GATT agreement was based upon the fundamental principles mentioned below:

- The international trade should be carried on the basis of non-discrimination, reciprocity and transparency.
- The protection to the domestic industries should be given only by means of tariffs and by no other means.

- The most favored nation (MFN) principle should be followed by all the members. The members should enter into consultations for the avoidance of damage to the interests of the members.
- The multilateral negotiations should be carried to reduce tariff and non-tariff barriers to trade.
- The framework of these principles specified objectives of the GATT as below:
- To encourage full employment and large and steadily growing volume of real income and effective demand;
- To ensure the full use of world resources;
- To bring about the expansion of world production and exchange;
- To bring about a steady improvement in the living standards of people in member countries; and
- To settle the disputes through consultation within the framework of GATT.
- For the achievement of these objectives, the preamble of the GATT agreement requires the members to enter "into reciprocal and mutually advantageous arrangement directed to the substantial reduction of tariffs and other barriers to trade and the elimination of discriminating treatment in international commerce."

4.3.3. The GATT Conferences or Rounds of World Trade Negotiations:

Since 1947, there have been eight conferences or the 'Rounds' of global trade negotiations under the GATT.

The First GATT Conference or round of negotiations was held at Geneva in April 1947. This round of negotiations included 123 sets of bilateral negotiations and the results of this conference included- (i) complete elimination of certain duties and preferences, (ii) scaling down of duty preferences, (iii) the binding of duties at the existing levels; and (iv) the binding of duty free treatment.

The Second GATT Conference was held in 1949 at Annecy (France). By that time 10 more countries had joined the GATT raising the number of contracting parties to 33. In this round of trade negotiations 147 sets of bilateral negotiations converting about 500 items were completed.

The Third GATT Conference was held in 1950-51 at Torquay (England). Six new countries had joined the agreement by then. This meet could not make much headway. Out of about 400 bilateral trade negotiations, only 147 could be completed. The United States did not come forward with any more tariff concessions, as it insisted that it had already done much.

The Fourth GATT Conference was held in 1955-56 at Geneva (Switzerland). At this conference although the United States granted concessions in respect of her imports to the tune of 900 million dollars and secured concessions on exports amounting to 400 million dollars, yet it was not a success. No country was satisfied and several contracting parties had withdrawn from the negotiations.

The Fifth GATT Conference was held in 1960-61 again at Geneva. At this conference, the LDC's pointed out that the limit to which they could extend concessions on the basis of the principle of reciprocity has been already crossed and they were no more in a position to follow that principle. They also pointed out that the developed countries had avoided negotiations on products which were of vital interest to them (the LDC's). The latter wanted to have some unilateral tariff concessions from the developed countries.

The Sixth GATT Conference (1963-67), known as the Kennedy Round, was held at Geneva. 54 countries participated in this round of trade negotiations. The results of Kennedy Round included the tariff reduction by the advanced countries like the U.S.A, the EEC countries, Japan and Canada on an average to the extent of 35 percent.

The incidence of tariff reduction was not uniform in case of different groups of commodities. The maximum tariff cut had occurred in case of chemicals, paper etc. and it was the smallest in case of such products as fuels, iron and steel, textiles and tropical products. In addition, the deliberations were held on non-tariff barriers, agriculture and tariff reduction on the exportable products of the LDC's. No doubt, the Kennedy Round of the GATT negotiations could make a significant contribution in effecting substantial tariff cuts, yet the achievement was still short of objective. The non- tariff barriers could not be dismantled. However, there was greater awareness among the advanced

countries about the trade needs of the LDC's. On the whole, the Kennedy Round registered a remarkable advance.

The Seventh GATT Conference known as the Tokyo Round (1973-79) was held at Tokyo. This conference deliberated upon the issues including tariff reduction, removal or reduction of non-tariff barriers, coordinated scaling down of all trade barriers in selected sectors, trade liberalization in agriculture, multilateral system of safeguards, the tropical products and special interests of the LDC's.

Some of the more important results flowing from the Tokyo Round were as below:

(i) Tariff Reduction:

The tariff reduction agreed by the leading countries such as the USA, the EEC and Japan, on an average, was of the magnitude of 31 percent, 27 percent and 28 percent respectively. The negotiated tariff reduction by the contracting parties was to be phased over 8 year commencing from 1980.

(ii) Non-Tariff Barriers:

The Tokyo Round laid down a code of conduct for nations to follow in respect of non-tariff barriers. This code included- (a) agreement on a code about the government procurements, (b) uniformity in the application of duties in counter-veiling and anti-dumping cases, and (c) a generalized system of preferences to the manufactured, semi-manufactured and selected other exports of the LDC's countries. However, many products such as textiles, shoes, consumer electronics, steel and several other products that were of very vital interest for the LDC's remained excluded.

(iii) Removal of Technical Barriers:

An agreement was reached through Tokyo Round about the removal of unnecessary trade barriers existing in the form of technical standards. The provision in the agreement was made concerning complaints related to the violation of the code of technical standard by the contracting parties and redressal thereof.

(iv) Import Licensing Procedures:

The Tokyo Round resulted in an agreement concerning the simplification of import licensing procedures. It provided for automatic grant

of approval of the application on the inflow of goods, simplification of licensing procedure in case of quota and other import restrictions. It also provided for creating institutions and procedures for consultation and settlement of disputes between the contracting parties.

(v) Customs Valuation:

An agreement was arrived among the nations providing for a fair, natural and uniform system for the valuation of goods for customs purposes. It is true that the Tokyo Round extended the scope of GATT regulations to the non-tariff barriers. But the total outcome was designed to meet the interests of the United States, the EEC and other advanced nations. There was not much for the developing countries. In making the assessment of gains from the Tokyo Round, Salvatore remarked, "It has been estimated that the total static gains from trade liberalization under the Tokyo Round amounted to about $ 1.7 billion annually. With the dynamic gains arising from the economies of scale and greater all-round efficiency and innovations, the figure might rise to as high as $ 8 billion per year".

4.3.4. Role of GATT in the Uruguay Round:

The Trade Ministers of the GATT nations met at Punta del Este, Uruguay in Sept. 1986. The decisions taken by them paved the way for the Uruguay Round of multilateral trade negotiations which were launched in October 1986 in Geneva. Three prominent bodies were involved in the conduct of these negotiations. They included the Trade Negotiations Committee (TNC) to oversee the entire Round, the Group of Negotiations on Goods (GNG) to deal with negotiations related to commodities and the Group of Negotiations on Services. The negotiations at the Uruguay Round were quite comprehensive. This Eighth Round of GATT negotiation was originally thought to last for four years, but the complex issues involved in it led to the conclusion of negotiations at 15th December, 1993. Finally the member countries could hammer out an international agreement by the stipulated deadline.

Issues at the Uruguay Round:

The GATT nations were engaged in serious negotiations at the Uruguay Round concerning the following main issues:

(i) Tariff Reduction:

In the sphere of tariff reduction, the object was to bring about further relaxation of tariff barriers. In the Mid-Term Review of the negotiations, a target for an average reduction of tariff by about 30 percent was set.

(ii) Non-Tariff Barriers:

The commencement of the Uruguay Round, it was recognised that about 50 percent of the world trade was affected by the non-tariff trade barriers. As these were applied discriminatively against the specific countries, there was the fear that they would defeat multilateralism and lead to bilateralism. In addition, they could result in retaliation, decline in the flow of world trade and specialisation, misallocation of world resources, slowdown of structural adjustments and growth in developing countries and a trade war injurious for all the countries of the world. The Uruguay Round of trade negotiations was to discourage the GATT nations from resorting to non-tariff trade barriers.

(iii) Trade in Services:

GATT has emphasised essentially on the trade in goods. There were little regulations related to trade in services. The relative importance of trade in services has considerably increased in the post-war period. In the latter half of 1980's, the trade in services accounted for more than 50 percent of the value- added in industrial countries and constituted over 20 percent of international trade. The exclusion of services from the GATT negotiations was therefore regarded as a major weakness of the existing system. That made this issue as of prime importance in the Uruguay Round of talks among the trading parties.

(iv) Intellectual Property Rights:

A major issue at this Round was one of the Trade Related Intellectual Property Rights (TRIPS). The U.S.A. has been since long insisting upon proper safeguards to the intellectual property rights of the researches in the

advanced countries on the international plane. The Eighth Round of the GATT addressed itself to this matter related to patents, copyrights etc.

(v) Foreign Investments:

The Uruguay Round of trade negotiations was meant to evolve proper rules for the governments to follow about flows of investment among the different countries.

(vi) Agriculture:

Agriculture had remained generally excluded from the GATT jurisdiction in the earlier rounds. Most of the countries, both developed and less-developed, had jealously shielded their agriculture from foreign competition through tariffs, quota, subsidies, health regulations etc. The elaborate protective domestic agriculture support programmes were considered too restrictive and responsible for high costs to consumers. In addition, these were found to interfere with the international specialisation of resources and were likely to cause serious trade disputes.

The less developed countries, faced with acute food shortage, had to maintain the regime of agricultural support programmes through subsidies and the public distribution system. The advanced nations, having large food surpluses were also found to be retaining the agricultural support programmes.

(vii) Textiles:

The Uruguay Round of Trade negotiations were also concerned with trade in textiles and clothing. In this sphere, the object was to seek integration of this sector into the GATT and the eventual elimination of the Multi-Fibre Arrangement (MFA) and other restrictions on textile and clothing as these were found inconsistent with the GATT.

(viii) Settlement of Disputes:

The GATT dispute settlement mechanism was found to be very slow and cumbersome. It was, therefore, necessary to review the dispute settlement system of the GATT and to make it more effective and expeditious.

4.3.5. Role of GATT in the Dunkel Draft:

The Uruguay Round of trade negotiations, which had started in September 1986, continued to drag on. Exasperated by complex, tough and

protracted wrangling over different issues involved in the negotiations, Arthur Dunkel, the Director- General of the GATT since 1980, finalized a nearly 500 page draft called as Dunkel Draft, on his own and circulated it among the member countries in December 1991 on a take-it or leave-it basis.

The draft dealt with all the issues under discussion in the Uruguay Round including services, intellectual property rights, sui generis protection in the field of biotechnology, farm subsidies, free trade in food grains, buffer stocks and public distribution system, textiles and clothing, foreign investment, research and development, tariff and non-tariff restrictions and settlement of disputes. He wanted, in this way, to save the Uruguay Round from collapse. However, in the process, he was found to be siding firmly with the developed countries and, as a corollary, tilting against the less-developed world. He wanted to set up the agreement by April 1992 but the row over farm subsidies between the U.S.A. and the European Community (EC) prevented any agreement. The wrangling continued between the EC, the U.S.A. and Japan until the United States enforced deadline of December 15, 1993, when the final agreement was reached after effecting several modifications in the Dunkel Draft.

Although some of the proposals of the Dunkel Draft are likely to have adverse repercussions for India in the long run, the short term adverse effects are limited. The acceptance of these proposals, it is estimated would cause an expansion of global trade by almost 213 billion dollars. India may also be benefitted to the extent of about 4.6 billion dollars. Some of the negative aspects of the proposals will get diluted subsequently when the provisions of the agreement are implemented. It is advisable for India to avoid isolation and seek redressal of its grievances through multilateral or bilateral negotiations.

GATT and Developing Countries:

A large majority of the contracting parties of the GATT was in the category of the developing countries. But those countries had throughout a peripheral importance. Almost entire wrangling at the different rounds of GATT negotiations was meant for serving the trade and other interests of a few developed countries.

The less developed countries were confronted with a number of problems related to international trade. Those included the need for some measure of protection to their agriculture and industries from foreign competition, instability in the international prices of primary products, decline in their share in world trade, worsening terms of trade vis-a-vis developed countries, persistently widening BOP deficits and increasing burden of external debt. The developed countries, always preoccupied with extracting their own pound of flesh at GATT negotiations, had adopted an attitude of callous disregard of the problems of the poor countries.

Prior to the Kennedy Round (1963-67), there was little gain for less developed countries from the GATT except that they were allowed to use some measure of quantitative trade restrictions to adjust the BOP deficits. The tariff reduction by the developed countries also brought, to a limited extent, some benefit for them.

On paper clause XVIII of the GATT had made provision for such special benefits as:

(i) Permission to impose quantitative restrictions for safeguarding their external financial position and for building up of adequate foreign exchange reserves for executing their development programmes;

(ii) Permission to provide concessions to home industries for promoting their development;

(iii) Introduction of trade and other measures for the establishment of an industry; and

(iv) Permission to employ quantitative and other restrictions to improve their balance of payments position.

The major hurdle for the developing countries in obtaining trade concessions was on account of the principle of reciprocity. The developing countries were unable to provide equivalent tax concessions to the developed countries. Consequently, they could not secure desired concessions from the developed countries. During the period before the Kennedy Round, tariffs on aggregate imports of manufactured goods by developed countries averaged 11 percent. But these were 17 percent on those from the less developed countries. In addition, no initiative had been taken by them about the

relaxation of trade barriers on agricultural and tropical products of the less developed countries.

The recognition of special problems of less developed countries concerning trade, tariff and payments led to the appointment of committee of experts that submitted its report in 1958. This Report was called as the Haberler Report. This report stressed upon the reduction of tariffs and taxation on industrial and primary products of the less developed countries.

Some of the steps adopted under GATT to benefit the less developed countries in the subsequent years included the acceptance of the principle of non-reciprocity for LDC's in the matters of reduction or removal of tariff and other trade barriers and introduction of Generalized System of Preferences in 1970. The Tokyo Round (1973-79) made some advance in this respect. It paved the way for trade concessions in the export of raw, semi-processed and processed tropical products by the developed countries. However, textiles and clothing, one of the principal exports of the LDC's like India, remained subjected to restrictive provisions of the Multi-Fibre Agreement (MFA). Although GATT attempted to extend preferential or special treatment to the less developed countries, yet the escape clause and safeguard rules of the GATT amounted to the denial of trade benefits to them.

Right from the beginning, the GATT remained a hand-made for the advanced countries and the LDC's had been discriminated. Even the agreement forged in December 1993 had several negative aspects such as the retention of MFA in case of textiles and clothing, inclusion of trade in services under GATT provisions, Trade-Related Intellectual Property Rights, statutory obligations of opening up of domestic market for imports from abroad, restriction of export subsidies, reduction in tariffs, substitution of quantitative trade restrictions by tariffs.

4.3.6. Defects of GATT

Although the GATT was evolved to promote free multilateral trade in the world and to specify norms of trade behaviour applicable to all the contracting parties, yet the actual functioning of the GATT exposed several of its defects or deficiencies:

(i) No Enforcement Authority:

The GATT, no doubt, advocated multilateral system of international exchange based upon the principle of reciprocity. It had attempted to prescribe an international code of conduct in the sphere of trade. But there was no enforcement authority to oversee the compliance of GATT regulations by contracting parties and to settle their trade disputes. The United States had opposed the institution of an International Trade Organisation right from the days of Havana Charter. The agreement forged in December 1993 has made provision for the creation of a World Trade Organisation (WTO). If this organisation operates on a non-discriminatory basis and restrains the contracting parties from resorting to unilateral trade restrictions, the GATT aims and objectives would be properly fulfilled.

(ii) Quantitative Trade Restrictions:

The GATT had certainly ensured the scaling down of tariff structure but the quantitative trade restrictions remained for a long time outside the GATT ambit. Consequently, the developed countries had used with impunity the quantitative trade restrictions such as import quotas, export subsidies, voluntary export restraints, health and safety regulation etc. Even though the December 1993 agreement of GATT disapproved the adoption of quantitative trade restrictions and the substitution of tariffs in their place, it did not prohibit the contracting parties from taking recourse to them.

(iii) Difficulty in the Formulation of General Rules:

There was much diversity in the membership of GATT. The contracting parties had varied economic and political motives. They were also at different stages of development. The diversities existing among them created difficult problems in framing and implementing uniform general rules of conduct concerning trade, tariffs and payments.

(iv) Principles of Reciprocity and Non-Discrimination:

The GATT had been stressing upon the principles of reciprocity and non-discrimination. The reciprocity meant that two contracting parties must provide equivalent benefits or concessions to each other. It also implied that they could adopt equivalent trade restrictions too. The principle of non-discrimination, at the same time, emphasised upon the uniform policy for all

the contracting parties. There seems to be an inbuilt bias and contradiction on account of these two principles.

(v) Neglect of Agriculture:

Although trading in agriculture products was a matter of prime importance for the less developed countries, yet it remained for long outside the GATT purview. The contracting parties continued to follow the farm support policies resulting in food surpluses that could be exported only with the help of export subsidies. It was only at Kennedy and Tokyo Rounds that the agreements could be arrived at about some categories of primary products.

(vi) Commodity to Commodity Based Negotiations:

The practice of commodity-to- commodity based negotiations invariably benefitted the countries having stronger bargaining power vis-a-vis others. In addition, this approach was responsible for the prolonged deliberations at the various rounds of GATT negotiations.

(vii) Little Benefits for the LDC's:

Although the majority of the members of the GATT were in the category of the LDC's, yet GATT had provided little benefit to these countries. The GATT failed to assure just terms of trade for them. They could not secure easy and liberal access to the markets of developed countries. Even at present, there are about 100 MFA types of restrictive trade arrangements in the world. The commodity-to-commodity based approach has proved to be detrimental to the interests of these countries. This approach creates difficulty in their future planning of production and exports. The GATT did not permit any compensation to the less developed countries on account of injury to their economies caused by the actions of developed countries and such countries

(viii) Non-Representative Body:

It is true that the membership of the GATT had progressively expanded over the years. But for a long time, the East European countries of erstwhile Soviet block and China remained outside the GATT. It was therefore criticized as a non-representative body. During the recent years, even these countries have shown interest in joining the WTO. With their inclusion, the ranks of

developing countries have got further strengthened and there may perhaps be better recognition of their interests and problems.

(ix) The 'Escape' and 'Safeguard' Clauses:

The Article XIX of the WTO incorporated safeguards and escape clauses. It authorised the contracting parties to adopt protective measures in case of need such as severe balance of payments problems and prevention of the flow of subsidised imports or in the event of dumping. Though these clauses were supposed to be temporary measures but in practice had become almost permanent feature of the international trading system.

(x) Free Trade Area or Customs Union:

Under the Article XXIV of the GATT, the member countries could organise themselves into free trade areas or customs unions. The strong regional trading block such as European Union (EU), North American Free Trade Association (NAFTA), Association of South East Asian Nations (ASEAN) and Asian Pacific Economic Co-operation (APEC) have emerged. They have created serious distortions in the world trade. They have undermined the basic GATT principles of non-discrimination and reciprocity and weakened the GATT.

4.4. WORLD TRADE ORGANISATION:

4.4.1. Definition of World Trade Organisation:

WTO is officially defined as the legal and institutional foundation of the multilateral trade system. Unlike GATT, the WTO is a permanent organisation created by international treaty ratified by the governments and legislatures of member states. As the principal international body concerned with solving trade problems between countries and providing a forum for multilateral trade negotiations, it has global status similar to that of the International Monetary Fund and the World Bank.

4.4.2. Structure of World Trade Organisation:

WTO is headed by a director-general (currently Mr. Renato Ruggiero, former Italian trade minister) who has four deputies from different member states. The WTO's ruling body is the General Council, comprising each member country's permanent envoys. It sits in Geneva on an average once a

month. Its supreme authority is the ministerial conference, to be held every two years. The General Council appoints the director- general to a four-year term after consultations among member countries. WTO started with 125 countries. But seven more states including China, Russia were admitted later on as members. Members range from the top four world trade powers—the United States, the European Union, Japan and Canada—to the increasingly influential emerging developing economies of Asia to some of the world's poorest countries, like Bangladesh, Guinea.

WTO Bodies for Administration:

The two important bodies in WTO have been set up to perform its various functions:

1. Dispute Settlement Body (DSB):

The DSB, on which all member countries can sit, usually meets twice a month to hear complaints of violations of WTO rules and agreements. It sets up expert panels to study disputes and decide if the rules are being broken. The DSB's final decisions, unlike those of a similar but less powerful body in the old GATT, cannot be challenged.

2. Trade Policy Review Body (TPRB):

The TPRB is a forum for the entire membership to review the trade policies of all WTO member countries. Major trading policies are reviewed every two years, others every four years. Other major bodies are the Council for Trade in Goods, the Council for Trade in Services and the Council for Trade-Related Aspects of Intellectual Property Rights (TRIPS).

4.4.3. FUNCTIONS OF WTO:

WTO has the following five functions to perform:

(1) The WTO provides the framework for implementation, administration and operation of multilateral trade agreements reached at Uruguay Round.

(2) The WTO provides the forum for further negotiations among its member states concerning their multilateral trade relations with regard to the matters included in the agreements reached at Uruguay Round.

(3) The WTO undertakes the task of settlement of disputes among the member states, which arise from their different understandings of the rules and procedure agreed upon.

(4) The WTO administers the 'Trade Review Mechanism.'

(5) In order to evolve a coherent global economic policy to promote free and fair trade among the different countries, WTO cooperates in an appropriate manner with the IMF; World Bank and its affiliated agencies.

The Guiding Fundamental Principles and Features of WTO:

The following fundamental principles have been provided for the functioning of WTO as a multiple trading system: These principles represent the salient features of WTO.

(a) Non-Discrimination:

This is the most important principle on which WTO has been founded. The principle of non-discrimination means two things:

(1) All trading partners will be granted the most favoured nation (MFN) status, that is, each member state of WTO will treat every other member state equally as the most favoured nation doing trade. No discrimination will be done by a member of state between different trading states who are also members of WTO. However, some exceptions have been provided in this regard, for example, in case regional trade agreements exist.

(2) Foreign goods, services, trademarks, patents and copyrights shall be given the same treatment as is given to nationals of a country.

(b) Free Trade:

The objective of WTO, as in case of GATT, is to promote free trade among nations through negotiations. For this purpose WTO has to work for progressive liberalisation of trade through reduction in tariffs and removal of quantitative restrictions on imports by member countries.

(c) Stability in the Trading System:

Under WTO agreements member states are committed not to raise tariff and non-tariff trade barriers arbitrarily. This provides stability and predictability to the trading system.

(d) Promotion of Fair Competition:

WTO system of multilateral trading system provides for transparent, fair and undistorted competition among the various countries. Rules such as Most Favoured Nation (MFN) treatment to all trading parties, equal treatment to foreign goods, patents and copyrights as with nationals ensure fair

competition among trading countries. Besides, WTO agreement provides for discouraging unfair competitive practices such as export subsidies and dumping (that is, selling products abroad below domestic prices to gain market access).

(e) Special Concern for Developing Countries:

WTO has shown special concern for the developing countries as it has given them more time to adjust to agreements under it and also some special privileges. An important feature of WTO is that it would deal with not only the disputes in the area of trade in goods but a whole range of issues such services and intellectual property rights.

(f) Market Access Commitment:

WTO agreements which seek to establish multilateral trading system require the member countries to undertake market access commitment on reciprocity basis. In fact, market access is ensured by abolishing non-tariff barriers as well as by reducing tariffs.

The understanding on market access requires that member countries will cut tariffs on industrial goods and agricultural products by about 37 per cent. In order to provide market access for the products of developing countries to the USA, USA agreed to cut down farm subsidies. The developing countries are also required to reduce agricultural subsidies to the level of 10 per cent of the value of agricultural produce. In the area of trade in services, market access has been ensured by giving Foreign Service suppliers the same treatment as domestic service suppliers.

(g) Decision at the Ministerial Level Meeting:

Another feature of WTO agreement is that it has upgraded decision-making at the ministerial level. Important decisions regarding trade related matters are to be taken at the Ministerial level meetings. Ministerial level meetings have now been incorporated in the legal structure of WTO.

(h) Wider Range of Issues:

Another important feature of WTO is that it will deal with not only issues and disputes relating to trade in goods but also the whole range of issues concerning trade in services and intellectual property rights.

(i) Multilateral Trading System:

most important features of WTO is that it seeks to establish just and fair multilateral system of international trade wherein the developed countries, the developing countries, and the least developing countries all have equal opportunities for market access for their products in foreign countries and wherein discriminatory trade barriers and unjust Government support to exports by different countries have been eliminated.

4.4.4. Objective of WTO:

The objective of WTO agreements is to establish a multilateral trading system in order to promote free and fair trade among nations. Thus, Dunkel Act on which WTO has been founded is wedded to liberalisation of trade based on comparative costs. For the purpose of trade liberalisation, it provides for a multilateral trading system.

Accordingly, this provides for a multilateral framework for trade not only in industrial and agricultural goods but also in services and also to protect trade related intellectual property rights (TRIPS). By committing the member countries to give Most Favoured Nation (MFN) treatment to all trading partners, it has sought to discourage bilateral trading so as to encourage multilateral trading system.

4.5. WTO Agreements and Liberalisation:

We discuss below various WTO agreements which seek to promote liberalisation of trade:

1) Liberalisation of trade in manufactures.
2) Liberalisation of agricultural trade
3) General Agreement on trade in services (GATS)
4) Trade related Intellectual Property Rights (TRIPS)
5) Trade related Investment Measures (TRIMS).

(1) Liberalisation of Trade in Manufactures- Agreement on Tariff Bindings and Tariff Reduction:

The main agreements with regard to trade liberalisation in manufactures are – Firstly, the provision for expansion of tariff bindings which prevent the developed countries from increasing tariff rates in future beyond a particular level. Tariff bindings cover 99 per cent of imports.

Secondly, the agreement provides for reduction in tariff rates by the developed countries by 40 per cent from 6.2 to 3.7 per cent. Thirdly, the agreement provides for expansion of duty-free access from 20 to 43 per cent of their imports by the developed countries. It is however important to note that gain to the developing countries from tariff reduction by the developed countries is not very significant. The average reduction of tariffs on their imports to the developed countries is estimated at 30 per cent and in case of labour-intensive industrial products such as textiles, clothing, leather goods and certain processed primary products such as fish products which are regarded as sensitive, the reduction in tariffs is less than even the average reduction of 30 per cent. On the other hand, the offers of tariff cuts on imports of manufactures by the developing countries are estimated at about one-third of the average tariff reduction by the whole world. The expansion of tariff bindings which prevent the developing countries from increasing tariffs in future represent significant gains for the developed countries.

(2) Liberalisation of Agricultural Trade:

To achieve liberalisation of agricultural trade, agreement on agriculture was also reached during multinational trade negotiations resulting in the establishment of WTO in 1995. Agreement on agriculture was highly significant as agriculture was a highly protected sector in the developed countries. This distorted world prices of agricultural products as it prevented the developing countries to realise the benefits of their comparative advantage. As a result, exports of developing countries could not increase significantly.

Agreement on agriculture includes the following conditions:

(a) Tariffication:

It was agreed that existing non-tariff barriers imposed by the member countries would be replaced by suitable tariffs which would provide almost the same level of protection. This is called tariffication.

(b) Tariff Bindings:

The agreement on agriculture also required that developed countries would reduce their tariff bindings by an average of 36 per cent within six

years from 1995. The developing countries were required to reduce tariffs by an average 24 per cent over a period of 10 years, while the least developed countries are not required to make any commitment regarding reduction of tariffs on their farm products.The developing countries were permitted to indicate only their maximum bindings. For example, India declared maximum bindings of 100 per cent on farm products and 300 per cent on edible oils.

(c) Subsidies and Domestic Support Policies:

Reduction in agricultural subsidies and domestic support prices is another important aspect of agreement on agriculture. The developed countries such as USA and the countries of East European Union (EU) maintain high level of agricultural subsidies and other domestic support programmes to protect their farmers and prevent imports from the developing countries. As a result, exports of farm products of the developing countries suffer a lot. WTO agreement on agriculture requires that subsidies on farm products should not exceed 10 per cent of the value of agricultural production.

Besides, it was agreed that product-specific subsidies, non-product specific subsidies on fertilizers, irrigation, power and seeds etc. were also not to exceed 10 per cent of the value of agricultural output. Agreement on agriculture also provided that countries with closed agricultural markets will have to import agricultural commodities to the extent of 3 per cent of their domestic consumption, going up to 5 per cent over six years. However, developing countries which were facing balance of payments problems were exempted from this rule of compulsory imports.

Agreement on agriculture also provides that countries are free either to give patents on agricultural products or to evolve an effective sui generis (i.e. special) system of protection for plant breeder rights. It implies freedom of multiplication and exchange of indigenously produced seeds or plants in the country. In other words, the farmers are free to retain seeds from their own harvests for their uses and exchange with each other. The only exception is seeds evolved genetically through the tools of high-tech biotechnology. The patent fee would be payable if the seed or plant varieties

bought are genetically superior to and more productive than the local varieties. Thus, the farmers will have to pay a patent fee on branded seeds or plant varieties imported from developed countries. The commercial sale of such seeds would be affected by patents.

(3) GATS (General Agreement on Trade in Services):

The General Agreement on Trade in Services (GATS) has been one of the major achievements of Uruguay Round of negotiations which now forms part of WTO legal framework. GATS cover all service sectors including financial services, telecommunications, transport, tourism, audio-visual and professional services. GATS require some basic obligations to be fulfilled by all member countries of WTO with regard to international trade in services.

GATS applies to services provided by service suppliers of one country and sold to consumers of another country (for example, tourism). It also applies to services provided by the commercial presence of a supplier of one country in the territory of another (for example, bank of a country providing banking service in another country). It is equally applicable to services supplied by companies of one country in the territory of another. However, GATS shall not cover services provided by the government which are not supplied on a commercial basis.

GATS require countries to provide most favoured nation treatment (MFN) to all member countries. It implies that equally favourable treatment is to be accorded to service suppliers of all member foreign countries. GATS also require that member countries should have transparency in their trade in services. This implies that each country should promptly publish all its relevant law and regulations pertaining to services including international agreements pertaining to trade in services to which the country is a signatory. Besides, each member country shall provide all information sought by any other member country relating to any service covered by GATS. Further, the countries are required to accord Foreign Service suppliers the same treatment as domestic service suppliers.

The countries may be exempted from GATS if they face balance of payments difficulties. They may also be exempted from GATS for national

security reason as well as for purposes of protecting public order. The GATS requires that the countries would provide market access to Foreign Service suppliers.

Hence, they would not impose restrictions on the number of service suppliers, total value of service transactions, and the total number of service operations, joint ventures through which service may be supplied and the participation of foreign capital. The GATS has excluded labour movement from its purview. It allows countries to apply immigration laws to regulate the entry of persons into their territories. Countries are specifically allowed to apply visa requirements selectively to some countries and not to others.

(4) TRIPS (Trade Related Intellectual Property Rights) Agreement:

One of the most controversial agreements of Uruguay Round of negotiations relates to Trade- Related Intellectual Property Rights or briefly known as TRIPS. The agreement regarding TRIPS requires member countries to provide patent protection to all products or processes in all fields of technology.

This protection is granted subject to the following three conditions:

- The product or the process is a new one
- It contains an inventive step
- It is capable of industrial application for 20 years from the grant of the patent.

TRIPS agreement covers the following seven intellectual properties:

- Patents.
- Copyrights and other related rights.
- Geographical indications.
- Industrial designs.
- Trademarks.
- Layout designs of integrated circuits.
- Undisclosed information including trade secrets.

Patents shall be available without discrimination as to the place of invention, the field of technology and whether products are imported or locally produced. The patent-holder would enjoy exclusive marketing

rights for a particular period. Anybody else seeking to manufacture and sell the product would have to establish that there has been no violation of the patent-holder's rights. The term of patent under the new regime would be 20 years from the date of the filling of the application. Since the patent would be available for products or processes, it would be possible in chemical- based products like drugs and pharmaceuticals, agro-chemicals, alloys and food products to take patents for new products for 20 years and process patents thereafter for another 20 years. The countries which do not have product patent in certain areas (in India, agriculture and horticulture, technologies relating to atomic energy and chemical-based products like chemicals, alloys, drugs and pharmaceuticals, agro-chemicals, food products and so on are exempt from product patents) are given 10 years transition period for the introduction of product patents.

The countries are free to give patents or adopt an effective sui generis system of protection for plant breeder rights enshrined in the International Union for Protection of New Plant Varieties (IUPOV) convention. A period of five years was given to implement the provisions of the TRIPS agreement. In respect of copyrights and related rights India is a signatory to the Berne convention. Likewise, in respect of layout designs and integrated circuits India is signatory to Washington Treaty whose main obligations have also been incorporated in the TRIPS.

(5) TRIMS (Trade related Investment Measures) Agreement:

TRIMS agreement refers to conditions or restrictions imposed on foreign investors. This agreement requires that investment regulations by member countries have to give same treatment to domestic products and imports. The TRIMS agreement specifically forbids imposing restrictions on operations of an enterprise which result in protecting domestic products and making imports disadvantageous. The foreign trade related restrictions on investment by foreign enterprises were generally imposed by developing countries including India. The following conditions which favour domestic production were prohibited under TRIMS agreement:

1. Local content requirement:

That is, foreign enterprises must use a certain amount of locally produced inputs in production of products.

2. Trade balancing requirement:

That is, imports by a foreign enterprise shall not exceed a certain proportion of exports by it.

3. Trade and foreign exchange balancing requirements.

4. Domestic sales requirement:

This requires an enterprise to sell a certain proportion of its output locally. However, it was agreed that subsidies applicable solely to domestic enterprises and government procurement policy in favour of domestic producers will not violate the TRIMS agreement. Thus, under TRIMS agreement, investment regulations have to accord same treatment to domestic products and imports. The TRIMS agreement requires removal of quantitative restrictions on imports and exports. However, exemptions are allowed if a country is suffering from balance of payments problems. The industrialised countries were required to eliminate conditions covered under TRIMS by July 1, 1997. Developing countries were required to do so by 2000 and least developed countries were required to eliminate them by 2002.

India notified the TRIMS required by it before 2000. It notified two TRIMS conditions – (1) Relating to local content requirements in the production of certain pharmaceutical products and (2) Dividend balancing requirements in the case of investment in 22 categories of consumer items. These were to be eliminated by 1-1-2000. The developing countries, including India, requested for extension of transition period for the elimination of the notified TRIMS. In view of the failures of the Seattle Ministerial Conference and Cancun conference no final decision was taken on this request of the developing countries.

WTO's Hong Kong Declaration and Developing Countries:

After failures at Seattle and Cancun, the ministerial meeting in Hong Kong in December 2005 negotiated trade liberalisation to conclude Doha Round on Development. In Nov. 2001 in the Ministerial meeting at Doha the developed countries (the US and EU) and developing countries, it was

agreed to start new round of talks to promote development through trade liberalisation, hence the name 'Doha Round on Development'. The two successive ministerial meetings at Seattle and Cancun failed to arrive at an agreement acceptable to the LDCs and developing countries. It may be noted that Uruguay Round of 1994 resulted in setting up of WTO in Jan. 1995. It may be further noted that the agenda of Uruguay Round as well as its outcome discriminated against developing countries. The trade negotiations of Doha Round are meant to remove this discrimination against the developing countries. During the negotiations developed countries have been raising irrelevant issues so as to protect their agriculture and textiles industry through tariffs and non-tariff barriers (NTB) so as to prevent free and fair trade from the viewpoint of developing countries.

On the other hand, at the conclusion of Uruguay Round, the developed countries succeeded in extracting an agreement regarding the inclusion of services and intellectual property rights – the two issues which concern them most. In return for this agreement on services and intellectual property rights, they agreed to eliminate over a period of 10 years high tariff and non-tariff barriers on textiles, agricultural products, sugar- the products which are of special interest for developing countries. However, the developed countries did not fulfil promise on one protest or the other. Commenting on this duplicity on the part of developed countries, Stiglitz writes, "When the Uruguay Round began there was a grand bargain to expand the trade agenda to include services and intellectual property rights—the two issues which are of particular concern to developed countries. In return developed countries were to make major concessions on agriculture—the livelihood of the vast majority of people in developing countries — and textile quota, the only trade area (besides sugar) in which quantitative restrictions persist. In the end developed countries got what they wanted, and developing countries were told to be patient – eventually the developed countries would fulfil their part of the deal. Even as the rich countries urged developing countries to make quick adjustments, they claimed that they needed a decade to make the transition to a quota-free

textile regime. In truth they were buying time; they did nothing for a decade and when the quota finally ended last January (i.e., Jan. 2005) they pleaded they were still not prepared and thus concluded a three-year extension with China."

Hong Kong Conference was meant to negotiate trade issues relating to agriculture, non-agriculture services and intellectual property rights so as to achieve trade liberalisation for promoting economic development. The problem with regard to agriculture is that the developed countries, the US and EU, provide export subsidies and also give financial support on a large scale to their agriculture resulting in cheapening of their agricultural products. This distorts trade between the countries as it prevents market access in developed countries for products of developing countries which have comparative advantage in their production. Developing countries discovered that their gains from trade with developed countries were far less than they were made out to be and LDCs (Least Developed Countries) felt that they were actually worse off by agreeing in Uruguay Round of talks resulting establishment WTO. Thus developed countries lost their credibility.

With the above background the Ministerial Conference at Hong Kong adopted a declaration which called for conclusion in 2006 of trade negotiations launched at Doha in Nov. 2001. This Hong Kong declaration established time frame and targets in specific areas of trade liberalisation. The following agreement which addresses some of the concerns of developing countries related to agriculture was reached:

1. First, it was resolved to complete Doha Round on Development in 2006 and conclude negotiations for liberalisation of trade between members of WTO.

2. Elimination of Agricultural Export Subsidies:

The agreement was reached in Hong Kong that export subsidies given by the developed countries will be eliminated by the year 2013 in a phased manner. While the earlier proposal was to phase these export subsidies by 2010, the EU, the largest provider of export subsidies, sought a longer phase-out period. Thus, the agreed end-date of 2013 gives the EU a level

of comfort of phasing out its export subsidies as a part of its next phase of reforms of the common agricultural policy (CAP).

This is an achievement of the developing countries as it was contended by its earlier Trade Commissioner of WTO, Pascal Lamy, that Doha declaration had not mandated elimination of export subsidies in the developed countries. It may be noted further that under the agreement developing countries like India will continue to have the right to provide marketing and transport subsidies on agricultural exports for 5 years beyond the date for elimination of all forms of subsidies.

Agreement on TRIPS:

On December 6, 2005, the General Council of WTO adopted the amendment to the TRIPS to address public health concerns of developing countries which was reaffirmed by Hong Kong Declaration. This amendment enables manufacturing and export of pharmaceutical products under compulsory license to countries with limited or no manufacturing capacities in the pharmaceutical sectors. On Trips, CBD (Convention of Bio-Diversity) on relationship and protection of traditional knowledge, India along with a number of other developing countries which are rich in bio-diversity proposed that the Trips Agreement of WTO should be amended to provide for – (i) disclosure of source of the traditional knowledge used in the invention; (ii) disclosure of evidence of prior informed consent under the relevant national regime; and (iii) disclosure of evidence of benefit sharing under the relevant national regime. With this amendment the use of India's natural herbs such as Neem, Arjuna, Ashavagandha and others for preparing medicines and also certain plant varieties such as Basmati rice will get protection from the use by multinational companies.

WTO Negotiations and India:

In Hong Kong India made some modest gains in the field of agriculture, industrial products and TRIPS. A good number of issues concerning liberalisation of global trade were yet to be resolved. However, much depends on future negotiations during which several issues, particularly regarding market access for industrial goods and services were

to be resolved. Whether in these future negotiations, developed countries will adopt an attitude which ensures fair and free trade from the viewpoint of LDCs and developing countries. Already the developed countries propose to link lower farm subsidies by them to greater market access for non-agricultural goods in the developing countries.

This is against the letter and spirit of Hong Kong Declaration. And it is these kinds of tactics of the developed countries that Joseph Stiglitz predicted and thought that due to this Doha Round on Development will collapse. This issue and other ones were to be resolved in a meeting of group G-6 to which India along with Brazil had been invited. The other members invited in this meeting of G-6 were the US, European Union (EU), Japan and Australia.

After the suspension in negotiations during July 2006 due to the wide differences in the positions of WTO members, especially on agricultural domestic support and market access, there was a resumption of negotiations on Nov. 16, 2006, and again on Feb. 7, 2007, in Geneva on the suggestions that the framework of negotiations, inclusiveness and the progress made so far be preserved and attempt should be made to arrive at an outcome that strikes a balance between development of the developing countries and interests of the developed countries. However, due to difference in the positions of USA and European Union on the one hand and the developing countries including India, China, Brazil on the other no final agreement could be reached.

During the negotiations while safeguarding the interests of India's poor agricultural producers remains paramount for India, making gains in services negotiations where it is a demander is no less important. In the case of industrial tariffs, India's growth and development concerns need to be addressed along with other developing countries. In our view it must be made clear to the developed countries that the artificiality of prices arising out of the substantial domestic agricultural subsidies provided by the developed countries must be dealt with firmly if we are to make any headway towards fair trade in agriculture. Developing countries have a right to use the flexibilities provided in Hong Kong declaration to protect

their small and medium enterprises and their infant industries like automobiles. Therefore, in future trade negotiations no compromise is made on flexibilities in connection with agriculture and industrial products granted to the developing countries in Hong Kong declaration.

Trade Facilitation Agreement at Doha Round Negotiations:

An important issue of Doha Round Negotiations relates to the agreement on trade facilitation for easing of customs procedures and movement of goods between countries. A draft of agreement on trade facilitation was worked out by WTO members on December 14, 2009. The draft text was revised six times in 2010 through discussions in the meetings of negotiating group on trade facilitation. India has been actively participating in these meetings and has given a few proposals regarding trade facilitations on which agreement could not be reached. Developing countries do not want to change their trade procedures but expect others to do so. Least developed countries, in general, do not want to undertake any binding commitment.

Capacity constraint and lack of resources are two major factors that prevent developing countries (and least developed countries) from taking on binding commitment regarding trade facilitation. However, there were general indications that developed countries might not invest in building infrastructure in these countries, although the July 2004 Framework Agreement clearly linked commitments by developing countries to provide support and assistance for infrastructure development by the developed countries. It is important that this linkage is respected, especially by the developed countries, before any agreement on trade facilitation is finalised. Before final agreement on trade facilitation is reached, it needs a solution where it does not have to compromise on its minimum support price (MSP) for agricultural products which is the most critical requirement for India's food security policy. Therefore, India is pushing for a change in rules to ensure its grain document programme and minimum support price for rice and wheat are not affected by subsidy cap of 10 per cent of the value of production which has been fixed by WTO.

The exemption from this 10 per cent of the value of production of these crops is valid only up to 2017. That is, beyond 2017, the value of India's procurement of these products at the minimum support prices would not exceed this ceiling of 10 per cent of the value of production and therefore this would affect India's food security programme as with future rise in procurement prices would breach this 10 per cent subsidy cap. This violation would invite penalty on India under WTO agreement. Therefore, India is insisting that its food security concerns must be addressed before international agreement on easing of trade procedures is reached.

Bali Agreement:

Negotiations on trade facilitation went on for years. This trade facilitation will help large exporters such as the US, EU and China. In Bali in 2013 WTO members agreed to finalise the trade facilitation agreement by July 31, 2014. Unfortunately despite food security concerns having not been addressed along with finalising trade facilitation agreement, India's then UPA government agreed for trade signing this agreement by July 31, 2014. When the Negotiating Group (which included India) meeting was held in the last week of July 2014, there was NDA government which refused to sign the agreement saying that its food security concern should be first addressed. As a result, there was deadlock in negotiations on trade facilitation agreement.

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UNIT – V

FOREIGN TRADE

5.1. Introduction to India's Foreign Trade:

India's foreign trade was largely determined by the strategic needs of the British colonial powers prior to its independence in 1947 Like other colonies, India too was a supplier of raw materials and agricultural commodities to Britain and other industrial countries and it used to import the manufactured goods from Britain. The dependence of colonial India on Britain for manufactured goods hindered the process of industrialization and obliterated the indigenous handicraft and cottage industries. As a part of the British strategy, India had to export more than its imports prior to World War II, so as to meet the unilateral transfer of payments to Britain by way of the salaries and pensions of the British officers, both military and civil, dividends on British capital invested in India, and interest on sterling loans. This helped India to achieve a favourable trade balance. In April 1946, India was able to build a huge sterling balance of Rs. 17.33 billion, even after paying of the sterling debt. However, the share of raw materials in India's exports declined from 45 per cent in 1938-39 to 31 per cent in 1947-48 whereas the share of manufactured goods increased from 30 per cent in 1938-39 to 49 per cent in 1947-48.

It was only after independence that India's trade patterns began to change in view of its developmental needs. India, as a newly independent country, had to import equipment and machinery that could not be manufactured domestically, in order to create new production capacity and build infrastructure, known as developmental imports. It also had to import intermediate goods and raw material so as to make full use of its production capacity, known as maintenance imports. Moreover, as a newly developing country, it had to import consumer goods such as food grains that were in short supply domestically, in order to curb inflationary pressures. Such heavy dependence on imports adversely influences a country's balance of trade. It necessitates the need to expand exports to finance its imports.

India's exports grew significantly from US$1,269 billion in 1950-51 to US$155.5 billion in 2007-08 whereas imports increased from US$1,273

billion to US$235.9 billion during the same period. Exports have shown an increase of about 20 per cent during the last four decades, in four phases, i.e., during 1972-77, 1987-90, 1993-96, and 2000-04. India's overall exports (Merchandise and Services combined) in April-December 2022 is estimated to exhibit a positive growth of 16.11 per cent over the same period last year (April-December 2021). As India's domestic demand has remained steady amidst the global slump, overall imports in April-December 2022 is estimated to exhibit a growth of 25.55 per cent over the same period last year. India's overall export (Merchandise and Services combined) of USD 61.82 Billion in December 2022. The exports exhibited a negative growth of (-) 5.26 per cent over the same period last year. Overall import in December 2022* is estimated to be USD 73.80 Billion, exhibiting a negative growth of (-) 1.95 per cent over the same period last year.

5.2. Features of Volume, Composition and Direction of India's Foreign Trade are as follows:

1) Increasing Share of Gross National Income:

India's foreign trade plays an important role in the Gross National Income. In 1990-91, share of India's foreign trade (import export) in net national income was 17 per cent which in 2006-07 rose to 25 per cent. In 2006-07 exports and imports as percentage of GDP were 14.0 per cent and 21 per cent respectively.

2) Less Percentage of World Trade:

Share of India's foreign trade in world trade has been declining. In 1950-51, India's share in total import trade of the world was 1.8 per cent and in export trade it was 2 per cent. According to World Trade Statistics, India's share in world trade has gone-up from 1.4 per cent in 2004 to 1.5 per cent in 2006 and estimated to be 2 per cent in 2009.

3) Oceanic Trade:

Most of India's trade is by sea, India has very little trade relations with its neighing countries like Nepal, Afghanistan, Myanmar, Sri Lanka, etc. Thus, 68 per cent of India's trade is oceanic trade: Share of these neighing countries in our export trade was 21.8 per cent and in import trade 19.1 per cent.

4) Dependence on a Few Ports:

For its foreign trade, India depends mostly on Mumbai, Kolkata, and Chennai ports. These ports are therefore, over-crowded. Recently, India has developed Kandla, Cochin, and Visakhapatnam ports to lessen the burden on former ports.

5) Increase in Volume and Value of Trade:

Since 1990-91, volume and value of India's foreign trade has gone up. India now exports and imports goods which are several times more in value and volume. In 1990-91, total value of India's foreign trade was Rs 75,751 and in 2008-09, it rose to Rs 22, 15,191 crore. Of it, value of exports was Rs 8, 40,755 crore and that of imports was Rs 13, 74,436 crore.

6) Change in the Composition of Exports:

Since independence, composition of export trade of India has undergone a change. Prior to independence, India used to export agricultural products and raw materials, like jute, cotton, tea, oil seeds, leather, food grains, cashew nuts, and mineral products. It also exported manufactured goods. But now in its export kitty are included mostly manufactured items like, machines, ready-made garments, gems and jewellery, tea, jute manufactures, Cashew Kernels, electronic goods, especially hardware's and software's which occupy prime place in exports.

7) Change in the Composition of Imports:

Since Independence, composition of India's import trade has also witnessed a sea change. Prior to Independence, India used to import mostly consumption goods like medicines, cloth, motor vehicles, electrical goods, iron, steel, etc. Now it has been importing mostly petrol and petroleum products, machines, chemicals-, fertilizers, oil seeds, raw materials, steel, edible oils, etc.

8) Direction of Foreign Trade:

It refers to the countries with whom a country trades. Main changes in the direction of foreign trade are as under: In the year 1990, in exports the maximum share, i.e., 17.9 per cent was that of Eastern Europe, i.e., Romania, East Germany, and U.S.S.R., etc. In import trade, maximum share, i.e., 16.5

per cent was that of OPEC, i.e., Iran, Iraq, Saudi Arabia, Kuwait, etc.

9).Mounting Deficit in Balance of Trade:

Since 1950-51, India's balance of trade has been continuously adverse except for two years, viz., 1972-73 and 1976-77, besides it has been mounting year after year. In 1950-51 balance of trade was adverse to the tune of Rs 2 crore and by 1990-1991 it rose to Rs 16,933 crore. After the policy of liberalization, the country has witnessed a rapid increase in it. In 1999- 2000 it rose to Rs 77,359crorc and in 2008-09 it amounted to 5, 33,680 crore. Fast rise in the value of imports and slow rise in the value of exports accounted for this tremendous rise in balance of trade deficit.

10) Trend towards Globalization:

Globalization and diversification mark the latest trend of India's foreign trade. India's foreign trade is no longer confined or a few goods or a few countries. Presently, India exports 7,500 items to about 190 countries and in its import- kitty there are 6,000 items from 140 countries. It unveiled the changing pattern of India's foreign trade.

11) Changing Role of Public Sector:

Since 1991 the role of public sector in India's foreign trade has undergone a change. Prior to it, State Trading Corporation (STC), Minerals and Metals Trading Corporation (MMTC), Handicraft and Handloom Corporation, Steel Authority of India Ltd. (SAIL), Hindustan Machine Tools (HMT), Bharat Heavy Electrical Limited (BHEL), etc., used to play significant role in India's foreign trade. As a result of implementation of the policy of liberalization, the importance of all these public sector enterprises has diminished.

5.3. Volume and composition of trade:

A country's analysis of foreign trade can be made in terms of its three main profiles: (i) volume, (ii) composition and (iii) direction.

Volume of Trade:

It relates to the size of international transactions. Since a large number of commodities enter in international transaction, the volume of trade can be measured only in terms of money value. The trends in the value of trade over time help to identify the basic forces that may be operating at different periods

in the economy. However, mere absolute changes in the value of trade is not a satisfactory guide. Hence, it is necessary to find the changes in the value of trade by relating them to two variables, viz.

i. Share of exports/imports in GDP, and

ii. Share of exports/imports in world trade.

The share of exports/imports in GDP indicates the degree of outward-orientation or openness of an economy in regard to its trade. This, in a broad way also reflects the nature of trade strategies adopted in the country. The ratio of exports to GDP could also be interpreted to reflect the average supply capability of the economy in terms of its exports. It can therefore be called as average propensity to export. A similar ratio between imports and GDP gives the average propensity to import. However, the relative share of exports in output under an efficient allocation of resources will be less in bigger economies than in smaller economies. The share of exports in the world trade indicates the importance of the country as a nation in the world economy. It reflects the market thrust that the country is able to realise in the presence of the various competitors in the world market. Changes in this ratio, thus, indicate the shift in the position of the comparative advantage of the country. Further, changes in the exports may be compared to the changes in the value of imports. It is the relationship between two variables, which is known as the terms of trade (TT), i.e. the terms at which exports exchange for imports. Terms of trade can be defined in respect of (i) net barter terms of trade, (ii) gross barter terms of trade, and (iii) income terms of trade.

(i). Net Barter Terms of Trade:

Also called as the commodity terms of trade, this measures the relative changes in the import and export prices.

This is expressed as:

$$N = P_x/P_m$$

Where P_x and P_m are price index numbers of exports and imports respectively. A rise in N indicates that a larger volume of imports could be received in exchange for a given volume of exports. However, the net barter terms are relevant only when nothing enters into the trade between countries except sales and purchases of merchandise.

(ii). Gross Barter Terms of Trade:

This is the ratio of the physical quantity of imports to the physical quantity of exports.

This is expressed as:

$$G_t = Q_m / Q_x$$

Where Q_m and Q_x are the quantity of volume index numbers of imports and exports respectively. A rise in G, is regarded as a favourable change in the sense that more imports are given volume of exports.

Income Terms of Trade:

This is expressed as:

$$I = P_x . Q_x / P_m$$

A rise in I indicates that the nation's capacity to import, based on exports, has increased, i.e. it can obtain a larger volume of imports from the sale of its exports.

Composition of Trade:

It is indicative of the structure and level of development of an economy. For instance, most of the developing countries depend for their export earnings on a few primary commodities (PCs). These countries export raw materials of agricultural origin and import manufactured industrial products, thus, denying themselves the benefits of value added. As an economy develops, its trade gets diversified. It no more remains dependent on a few primary commodities for its export as it begins to export more of manufactured industrial goods importing industrial raw materials, capital equipment and technical know-how.

Manufactured exports create greater value addition than the PCs as they go through more stages of processing. The manufacturing sector has greater linkages with the rest of the economy and hence, the downstream effects on exports from these sectors are likely to be greater than primary exports.The commodities entering the trade could also be classified by various other criteria such as value added per unit of output, productivity of labour, capital intensity in production, the strength of backward and forward linkages, etc. The shifts in the commodity composition of trade in these categories would bring out the nature of structural changes concerning

income generation, employment effect and overall industrialisation through linkage effects, etc.

Directions of Trade:

The direction of the trade is indicative of the structure and level of economic development. As a country develops and its trade gets diversified, it has to seek new outlets for its exports. Its horizon of choice in terms of imports also gets widened. The country begins to trade with an increasingly large number of countries.

5.4. Foreign Trade Promotion Measures and Schemes

Foreign Trade leads to the global division of labour and specialisation. In India, there is no shortage of workforce which is one of the reasons why the Indian government promotes and supports policies and schemes to increase foreign trade. The Indian government has initiated several incentives and plans to assist businesses in increasing the competitiveness of their exports. The government has also established a variety of organisations for helping firms do international business with infrastructure and marketing.

1. Duty Drawback Scheme:

As goods destined for export are not consumed in the country, they are exempted from numerous excise and customs duties. Any such tariffs paid on export items are refunded to exporters upon the provision of evidence of exports to the relevant authorities. Such a refund is known as duty drawback. Some notable duty drawbacks include a refund of excise duties paid on goods which are meant for export, and a refund of customs duties paid on raw materials and machinery imported for export manufacture (also known as a Customs Drawback).

2. Export Manufacturing under Bond Scheme:

This facility allows firms to produce goods without paying excise and other charges. The firms who want to use such facilities have to give an undertaking or bond mentioning that they are manufacturing goods for export and will export such products after their manufacturing.

3. Exemption from Payment of Sales Taxes:

Goods intended for export purposes are exempted from sales tax. For a long period, income received from export activities was excluded from paying

income tax. However, this benefit of income tax exemption is now available only to 100 per cent Export Oriented Units and units established in Export Processing Zones (EPZs)/Special Economic Zones (SEZs).

4. Advance Licencing Scheme:

This is a scheme that allows an exporter to get duty-free domestic and imported inputs for the manufacturing of export goods. Because of this, the exporter is exempt from paying customs duty on commodities imported for use in the manufacture of export goods. Advance licences are accessible to both categories of exporters; viz., the exporters who export on a regular basis and exporters who export on an ad-hoc basis. Regular exporters can avail of such licences against their production plans. Firms that export on an ad-hoc basis can also obtain these licences against particular export orders.

5. Export Promotion Capital Goods Scheme (EPCG):

The principal goal of EPCG is to stimulate the import of capital goods for export production. Under this scheme, the exporting firms can import capital goods at negligible or lower customs duty rates, subject to real user conditions and compliance with specified export obligations. If the manufacturers meet the aforementioned standards, they will be able to import capital goods at a zero or concessional rate of import duty. Under this scheme, supporting manufacturers and service providers can also bring in capital goods. Industrial units can be more benefitted from this scheme who are looking to modernise and upgrade their current plant and machinery. Besides, service export enterprises can also use this facility to import products such as computer software systems needed for developing software for export purposes.

6. Scheme for classifying Export Enterprises as Export Houses, Trading Houses, and Superstar Trading Houses:

With the goal of promoting established exporters and assisting them in selling their products in foreign markets, the government grants certain export firms the designation of Export House, Trading House, and Superstar Trading House. This kind of recognition is granted to a company if it has achieved a certain average export performance in the previous selected years. Aside from meeting a minimum of past average export performance, such

export enterprises must also meet other standards outlined in the import-export policy. Various types of export houses have been identified in order to establish the marketing infrastructure and skills necessary for export promotion. These houses have received national recognition for export promotion. They need to operate as highly professional and prominent institutions and act as a vital tools for export performance.

7. Export of Services:

Various kinds of service houses have been recognised in order to enhance service exports. These houses are recognised based on the service providers' export performance. Hence, on the basis of their export performance, they are referred to as Service Export House, International Service Export House, and International Star Service Export House.

8. Export Finance:

Funding is required by the exporters in order to manufacture goods for export purposes. Besides manufacturing, finance is also required after the shipment of goods because payment from importers may take some time. Therefore, authorised banks provide two types of export funding to the exporters; viz., Pre-shipment Financing (or Packaging Credit) and Post-shipment Finance. The former includes granting finance to an exporter for the purchase, processing, manufacturing, or packing of products for export purposes. However, the latter includes providing finance to the exporter from the date of credit extension to the date of shipping goods to the export country. Exporters can obtain credit at a low-interest rate.

9. Export Processing Zones (EPZs):

Export Processing Zones are industrial estates which act as enclaves from Domestic Tariff Areas (DTA). These are often located near seaports or airports and are meant to provide an internationally competitive duty-free environment for low-cost export production. This enables EPZ's products to compete in worldwide markets, both in terms of quality and price. These zones have been established at several locations around India, including Kandla (Gujarat), Noida (Uttar Pradesh), Santa Cruz (Mumbai), Falta (West Bengal), Cochin (Kerala), Chennai (Tamil Nadu), and Visakhapatnam (Andhra Pradesh). The Santa Cruz Zone is exclusively for electronic products as well

as gem and jewellery items. All other EPZs deal with a variety of goods. EPZs have recently been changed to Special Economic Zones (SEZs), which are a more advanced kind of export processing zones. Except for labour and banking government, these SEZs are exempt from all rules and regulations governing imports and export units. The government has also approved the development of EPZs by the private, public, or joint sectors. The inter-ministerial committee on private EPZs has already authorized plans for the establishment of private EPZs in Mumbai, Surat, and Kanchipuram.

5.5. Recent Trends in India's Foreign Trade

1. Huge Growth in the Value of Trade:

The total value of foreign trade which was Rs. 1,972 crore in 1950-51, gradually increased to Rs. 2,835 crore in 1960-61 and then to Rs. 3,487 crore in 1965-66. After that the value of trade increased at a quicker pace from Rs. 3,169 crore in 1970-71 to Rs. 9,301 crore in 1975.-76 and then rose significantly to Rs. 19,260 crore in 1980- 81. Thereafter, the total value of trade rose significantly to Rs. 30,553 crore in 1985-86 to Rs. 63,097 crore in 1989-90 and to Rs. 91,893 crore in 1991-92 and then to Rs. 1,17,063 crore in 1992-93 and finally to Rs. 22.15,191 crore in 2008-09. Thus during the period from 1950-51 to 1970-71 total value of trade rose by only 60.9 percent. Again during the period 1970-71 to 1980-81, total value of foreign trade rose significantly by 597 per cent, i.e., by nearly 6 times. But during the period 1980-81 to 1990-91, total value of trade rose by 293.3 per cent, i.e., by nearly 4 times. In 2008-09 the value of trade recorded an increase of 32.79 per cent over the previous year.

2. Higher Growth of Imports:

Another peculiarity that can be seen from this trend is that there has been consequential higher growth in respect of imports of the country since 1951. Thus the total value of imports which was Rs. 1,025 crore in 1950-51 gradually rose to Rs. 1,634 crore in 1970- 71, i.e., by only 59 per cent. Since then the value of imports started to rise at a very faster pace and thus reached the level of Rs. 12,549 crore in 1980-81 and then to Rs. 43,193 crore in 1990-

91 showing an increase of 667 per cent and 244 per cent during the last two decades respectively.

3. Inadequate Growth of Exports:

Another very peculiar situation that the country has been facing is a very slow growth in respect of its exports. In the initial period, total value of exports in India rose marginally from Rs. 947 crore in 1950-51 to Rs. 1,535 crore in 1970-71, showing an increase of only 62 per cent. But since then the growth of exports in the country could not keep pace with the growth in imports. Total value of exports rose gradually to Rs. 6,711 crore in 1980-81 showing an increase of 337 per cent over 1970-71 and then to Rs. 32,553 crore in 1990-91, showing an increase of 385 per cent over the value of 1980-81. In 1993-94, the value of exports rose considerably to Rs. 69,751 crore showing a growth of 29.9 per cent over the previous year.

In 2008-2009, the value of exports rose to Rs. 8, 40,755 crore showing a growth rate of 28.2 per cent over the previous year. Again in 2009-2010 (Apr.-Jan.) the value of exports stood at Rs. 3, 72,096 crore showing a negative growth of 19.9 per cent over the previous year. Due to the introduction of various export promotion measures since the devaluation of rupee in 1966, the value of Indian exports recorded some increase but this increase in exports was totally inadequate considering the sizeable growth in the value of imports. This has resulted in a persistent and widening trade deficit in the country. The factors which were mostly responsible for this low growth of exports include un-favourable terms of trade for Indian primary (agro-based) goods, inadequate export surplus, and adoption of the policy of protectionism by developed countries and long period of business recession in developed country in recent years.

4. Mounting Trade Deficit: Deficit in the Balance of Trade:

As a result of higher growth of imports and slow growth of exports the country has been experiencing a mounting trade deficit since 1980-81. During the last 45 years period, the country has recorded a small surplus in its trade only in two years (viz., in 1972-73 and in 1976-77). Due to adverse balance of trade situation, the extent of trade deficit in India gradually rose from Rs. 78 crore in 1950-51 to Rs. 949 crores in 1965-66. Recording a decline to Rs. 99

crore in 1970-71, the extent of trade deficit rose from Rs. 1,229 crore in 1975-76 to Rs. 5,838 crore in 1980-81 and then considerably to Rs. 10,640 crores in 1990-91. But after the introduction of some changes in the trade policy and due to considerable import compression the extent of trade deficit declined remarkably to Rs. 3,809 crore in 1991-92. Accordingly, the annual average deficit in balance of trade which was Rs. 108 cu.re during the First Plan gradually rose to Rs 747 crore during the Third Plan. But due to import compression and boosting exports, the annual average trade deficit declined to Rs. 167 crore during the Fourth Plan. But since then the annual average deficit in balance of trade rose significantly from Rs. 810 crore during the Fifth Plan to Rs. 5,716 crore during the Sixth Plan and then to Rs. 7,720 crore during the Seventh Plan. In 1992- 93 the extent of trade deficit again rose to Rs. 9,687 crore due to huge increase in import. But during 1993-94, the extent of trade deficit declined to Rs. 3,350 crore due to considerable increase in exports. But during 2008-2009, the extent of trade deficit again rose to Rs. 5, 33,681 crore. Again during 2009- 2010, the extent of trade deficit further rose to Rs. 2, 31,110 crore (April-Sept.).

India's overall exports (Merchandise and Services combined) in April-December 2022 is estimated to exhibit a positive growth of 16.11 per cent over the same period last year (April-December 2021). As India's domestic demand has remained steady amidst the global slump, overall imports in April-December 2022 is estimated to exhibit a growth of 25.55 per cent over the same period last year. India's overall export (Merchandise and Services combined) of USD 61.82 Billion in December 2022. The exports exhibited a negative growth of (-) 5.26 per cent over the same period last year. Overall import in December 2022* is estimated to be USD 73.80 Billion, exhibiting a negative growth of (-) 1.95 per cent over the same period last year. The resilient growth of the Indian economy during the first half of the current financial year, the fastest among major economies, bespeaks strengthening macroeconomic stability. However, global growth forecasts indicate downturn in global economic activity and trade. As per Global Composite PMI report (January 2023), new export orders have been contracting for the tenth successive month in December. The report also indicated that India and

Ireland were the only nations to register growth of economic activity in December 2022. In spite of the high base, highest ever record of exports last year, India's overall exports (Merchandise and Services combined) in April-December 2022 is estimated to exhibit a positive growth of 16.11 per cent over the same period last year (April-December 2021). December last year has been the second highest monthly export (Merchandise and Services) during 2021-22. As such, due to high base effect, the overall export (Merchandise and Services combined) of USD 61.82 Billion in December 2022 exhibited a negative growth of (-) 5.26 per cent over the same period last year (December 2021). India's merchandise exports exhibited a positive (y-o-y) growth in 11 out of 30 sectors in December as compared to the same period last year and imports have increased in 17 out of 30 sectors (y-o-y). Among the QE commodity groups, Iron Ore (185.76%), Oil Meals (53%), Electronic Goods (36.96%), Other Cereals (16.87%), Tea (15.97%), Rice (13.3%), Tobacco (13.07%), Ceramic Products & Glassware (11.67%), Fruits & Vegetables (8.03%), Cereal Preparations & Miscellaneous Processed Items (4.9%), RMG Of All Textiles (1.02%), registered positive growth (y-o-y) in December 2022. The exports of Electronic goods during the period April – December 2022 recorded USD 16.67 billion as compared to USD 10.99 billion during the same period last year registering a growth of 51.56%. Exports of petroleum products in April – December 2022 was USD 70.28 billion registering a growth of 52.15% over USD 46.19 billion in April – December 2021. More than USD 6 Billion worth of Smartphones were exported during the period April-November 2022. In the Textile sector, Cotton yarns exports declined because there was continuous price rise of raw materials throughout 2022. Exports of Indian Textile apparels and RMG textiles got a major hit due to recessionary trend in major economies. Given the cumulative growth until December 2022 and the indicators of the slowdown in global economic activity, there is cautious optimism on international trade in the last quarter of the current financial year.

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