CHAPTER 2
REVIEW OF LITERATURE

In the context of the present study, it is important to take cognizance of some of the studies pertaining to our research problem so that we could draw certain inferences in order to charter the course of our study in the right direction.

The present chapter is structured as follows: Section 2.1 presented theoretical reviews and section 2.2 provides empirical evidence which is further divided into three subsections. Sub-section 2.2.1 is devoted to studies related to bilateral trade, export competitiveness, direction of export and structure of trade, section 2.2.2 is related to FDI, and in section 2.2.3 past studies on gains from trade, potentialities of trade and export instability have been included. Conclusion of this chapter has been reported in the final section.

2.1 Theoretical Reviews

Adam Smith (1723-1790) is considered as the founder of theoretical study of International trade. Smith developed the theory of "absolute advantage" based on doctrines of the French economist François Quesnay (1694-1774). He argued that within their limited natural resources, countries should produce only those products which can be manufactured more cheaply and efficiently than their trading partners. In other words, the theory of absolute advantage, suggests that a country should export only those goods and services for which it is more productive and efficient than other countries, and import those goods and services for which other countries are better than it is, (Mahoney, Trigg, Griffin, & Pustay, 1998).

In 1817, David Ricardo, James Mill and Robert Torrens in the theory of comparative advantage demonstrated that free trade would benefit both weak as well as the strong countries industrially. In Principles of Political Economy and Taxation, Ricardo pointed out that when an inefficient producer sent the merchandise it produced best to a country able to produce it more efficiently, both countries benefit. In other words, a country can still produce
and export a product even though it cannot produce the product as cheaply as some other country, on the premise that this more expensively produced product can fetch more revenues in a foreign market than in the domestic market.

John Stuart Mill (1806-1873) suggested that in international market a country with monopoly pricing power could influence the terms of trade through maintaining tariffs, and getting reciprocity in trade policy. This theory was given by David Ricardo and others earlier. It was believed that trade surplus would grow following reciprocal, rather than free trade policies. This was against the philosophy of free trade. Within a few years the infant industry scenario was presented by Mill. The theory promoted that government had the "duty" to protect young industry, and to facilitate it to develop to full capacity. The policy was attractive to many countries on the way to industrialization. Milton Freidman also supported this thought, and demonstrated that under certain circumstances tariffs might be beneficial to the host country but not for the world at large.

Keynesianism and Keynesian theory is based on the ideas of 20th century British economist, John Maynard Keynes. According to this theory actions of individuals and firms at micro level can affect aggregate macroeconomic out comes, and the economy operates below its potential in output and growth. Many classical economists had supported Say's Law, that supply creates its own demand; however, Keynes maintained that aggregate demand for goods might not be sufficient in recession, thus could lead to high unemployment and loss of output. He argued that government policies should aim at increasing aggregate demand to enhance economic activity and reduce inflation and unemployment. The neoclassical macroeconomists of 1960s-1970s had criticized Keynesian theories.

In the 20th century, the Heckscher-Ohlin theory (H-O model) of international trade was the most influential version of the comparative advantage theory. Heckscher and Bertil Ohlin proposed that countries would export goods that they could produce efficiently given their land, labor, natural resources, and production technology, and import goods they could not produce efficiently had the same factors. Heckscher and Ohlin believed that countries could achieve comparative advantage through a combination of
factors such as financial resources, natural resources, and production technology. This was in contrast to Ricardo's version of comparative advantage based on labor productivity. Factor Endowment theory analyzed the effects that international trade has on the earnings of factors of production in the two trading nations (Salvatore, 1999). According to Ball McCulloch (1999), the Heckscher-Ohlin theory suggested that international and interregional differences in production costs could occur because of the differences in the supply of production factors.

Leontief, (1953), used input-output analysis to study the characteristics of trade flow between the U.S. and other countries, and found what has been named Leontief's paradox; "this country resorts to foreign trade in order to economize its capital and dispose of its surplus labor, rather than vice versa, i.e., U.S. exports were relatively labor-intensive when compared to U.S. imports. This is the opposite of what one would expect, considering the fact that the U.S.'s comparative advantage was in capital-intensive goods.

The new trade theory, developed by researchers like Helpman (1981), Krugman (1979), and Lancaster (1980) in the late 1970s and 1980s, was motivated by the failure of more traditional theories to explain some of the most significant facts about post World War II trade data. The "new trade theory" assumes that the global economy can support only a limited number of companies producing similar goods. Hence, the companies to produce certain goods first will capture a significant share of the market, hold patent rights, lead in development, therefore, certainly achieve economies of scale and scope. Economies of scale give countries trade advantages, because companies can charge less for products after increasing the size of their production facilities, because this increase will enable them to produce more goods. Economies of scope apply to integration of supplier, manufacture, and retail activities into a single company. This integration will allow the company to produce and sell goods at a less cost than individual manufacturers and retailers. Once a company achieves these advantages, other companies will find it hard to compete against it.

Finally, the growth of multinational corporations, especially in the 1980s and 1990s, contributed to the importance and necessity of international trade. With production and marketing operations in many countries, these
corporations account for a significant amount of the world’s sales, assets, and human resources in both home and in host countries. Many contemporary economists view multinational corporations as the facilitators of efficient international trade. Multinational corporations also have access to the raw materials and natural resources of a number of countries, and traditional comparative advantage theories do not hold ground here. According to Mahoney, the Global Strategic Rivalry theory was developed in the 1980s as a means to ‘examine the impact on trade flows arising from global strategic rivalry between Multinational Corporations.’ (Mahoney, et al 1998)

Soderston (1980), examined that the pure theory of international trade based upon the credo of comparative advantage demonstrated that when two countries move from the situation of autarky to that of mutual free-trade, then both the partners gains from the trade. Diakosavvas (1991), found that with the publication of Singer-Prebisch Thesis in 1950, the issue of terms of trade came to forefront of economic analysis, as they asserted that the terms of trade of the developing countries are bound to deteriorate progressively and inexorably as long as the present international economic order prevails.

2.2 Empirical Reviews:

The Empirical review of literature is divided under three sub-sections as follows:

2.2.1 Studies Related to bilateral trade, export competitiveness, direction of export and structure of trade

2.2.2 Studies Related to FDI

2.2.3 Studies related to gains from trade, potentialities of trade, and export instability.
2.2.1 Studies Related to bilateral trade, export competitiveness, direction of export and structure of trade

As early as in (1957) Mundell studied the production factors those were considered to be similar in all the countries and the regions. The international trade and mobility of the production factors carried a feature of substitution rather than being complementary for the countries where the trade barriers existed. Accordingly, while the increase in the trade barriers warns the factor movements, the barriers on the factor movements promoted the trade.

Chishti (1973) briefly analyzed the trade and payments arrangement and assessed their role in promoting India’s trade with Egypt, Afghanistan and Sudan. He concluded that the overall functioning of these trade and payment arrangements has been beneficial to India as well as to its partners. The general fears of the possibility of excessive unutilized balances, adverse terms of trade and diversions and distortions of trade have not materialized on the other hand, under the stringent foreign exchange conditions, the role of trade payments arrangements has been beneficial to India in facilitating the expansion of its trade with these countries.

Srivastav and Ahmed (1986) analysed the direction of exports from India for the period 1960-61 to 1983-84. The countries such as USA, former USSR, UK, Japan and East West Germany had great share in India’s export and import trade. India’s export to the above mentioned free major trading countries declined over the period of study. The UK no more remained as the principal destination of Indian trade as it was in the pre-independence period in 1983-84. USA emerged as one of the major trading partners.

Veena (1992) analysed the direction of trade of Indian coffee exports using Markov chain model. She observed that India could not retain its previous market share of USA, Netherlands, Yugoslavia and other important countries. However, the actual quality exported to all these countries had increased due to increased quantity of Indian coffee exports. India retained its market share to former West Germany, while USSR and Italy lost their share.

Gulati et al (1994) in their study of export competitiveness of selected agricultural commodities identified the constraints in the export of fresh fruits, vegetables and processed fruits and vegetables. Canalization of onion
through NAFED has led to loss of share in export market because of intervention of NAFED, whenever there was escalation of price in the domestic market. The infrastructure for storage, transport, internal as well as international was largely inadequate. The interest on export finance was high (13 per cent) and it should be brought down to nine per cent per annum. Institutions such as farmers-exporters cooperatives like Maha grapes and Maha mango were considered most useful in the export promotion of fruits and vegetables. This is essential to ensure good quality product as well as remunerative returns to the farmers.

Safadi and Yeats (1994) found that since FTAs discriminated in favour of member countries, other exporters were naturally concerned about their trade being displaced. This study quantified these adverse "third party" effects of the North American Free Trade Area (NAFTA) agreement on South Asia. The key finding was that, due to major differences in the types of goods exported by NAFTA and South Asia, any of the latter's trade that was displaced will occur in a very narrow range of products. The textiles and clothing sector emerged as the principal sector of concern, given that the preferential removal of tariffs (in the 15 to 30 per cent range) and MFA quotas could provide Mexico with a formidable competitive advantage in the US market. However, domestic supply constraints (as evidenced by Mexico's serious and consistent under-utilization of its textile and clothing quotas), as well as NAFTA's domestic import content regulations, should limit the amount of trade in these sectors that Mexico displaces.

A partial equilibrium trade projection model developed by UNCTAD and the World Bank is used to measure the trade diversion that South Asia could experience as a result of NAFTA. The results suggest that the total exports decline could be in the neighbourhood of one per cent with the projections for Bangladesh slightly higher (due to the higher-than-average share of textiles and clothing in Bangladesh's total exports). The study argues that a successful completion of the Uruguay Round would considerably reduce South Asia's potential losses since it would lower the preference margins that NAFTA could provide member countries. To put the two events in perspective, this report notes that the trade gains South Asian countries
could experience from a successful completion of the Uruguay Round are around 100 times greater than the losses they might incur from NAFTA.

Moore (1994) studied the apparent competitive position of Mexico in relation to Asian products in terms of costs and the qualities and quantities of products supplied to the U.S market in 1993. Mexico was likely to make into the U.S clothing market. Mexico was producing a wide diversity of products but it was producing products of lower unit value. It is able to compete in these categories because of the preferences accorded to the country and may be because of its advantage of propinquity in a just in time scenario. At the moment Mexico was an important supplier in the market of trousers and jeans and brassieres. It might have been handicapped in the sales of woven shirts and women fashion products both by its needs to US fabric to gain the NAFTA preferences and because of its relatively higher labour costs. Exports of knit shirts from Mexico to the US had been increasing very rapidly. Until then the lower wage Asian countries appeared to have been handicapped by their lack of knowledge of the technology, but that was being remedied, and exports of cotton knit shirts to the US had also been increasing rapidly from India, and to lesser extent from Indonesia and Bangladesh.

Rao (1995) analyzed the export competitiveness of Indian onions in major markets using constant market share model over a period, 1979-82 to 1989-92. The importing countries used for analysis were Malaysia, Singapore, Srilanka, UAE and the rest of the importing countries grouped as others. Onion exports to Malaysia were fairly competitive, wherein 26 per cent of total change in exports was due to competitiveness of our exports in that market. The UAE was the only country where India’s onions were not at all competitive. Regarding onion exports to the world as a whole, only one per cent of the total change in exports was found to be due to competitive effect.

Bhat (1995) examined the causal nexus between export and economic growth in India for the year 1950-51 to 1993-94. Co-integration technique had been employed to pursue the objective. The empirical results revealed the existence of a bi-directional causal relation between export and economic growth in India. This may be attributed to the fact that export promotion measures in India allocate resources efficiently according to comparative advantage causing economic growth, which interacts with the scenario where
external economies associated with economic growth. However, the results derived from the analysis of co-integration technique are limited to the extent of existence of structural break and bias in a small sample.

Nachane and Lakshmi (1996) aimed to analyse the likely consequences on India of the formation of two trading blocs: The EC (European Community) and the NAFTA (North American Free Trade Agreement). The analysis surveyed the institutional background to the formation of the trading blocs and tried to prognosticate on the future evolution of their trading policies vis a vis less developed countries in general and India in particular. The analysis showed that the EC had strong trade creating effects whereas those of NAFTA were strictly limited. Trading blocs should not be perceived as threats to India's export prospects; rather they presented several opportunities for export expansion, if proper domestic policies are pursued. This study also surveys the gamut of issues related to South-South trade and concludes that the time was not yet ripe for Southern countries to form an effective regional trading bloc on their own.

Clark (1998) examined the incidence pattern of nontariff measures (NTMS) applied by the United States on imports from developing countries that had widely different levels of economic well-being. This study was conducted by employing Suit's index. This finding suggested that NTM applied by the United States expected to limit growth prospects for developing countries and the newer protections measure targets the more advanced countries. The influence of these measures was sufficient to reverse the overall average incidence pattern. When all the NTMs were considered, there was a slight tendency for NTM-covered trade to be concentrated among the higher income countries. He suggested that the United States should refrain from replacing them with unfair trade remedies or restrictive labour and environmental standards that would limit market access for products of export interest to the poorer developing countries.

Mahesh (2000) studied the export competitiveness of Indian tea by estimating the NPC and DRC under both importable and exportable hypotheses during the year 1998-99. The results revealed that under importable hypothesis the NPC and DRC were 0.71 and 0.66 respectively. The NPC was below unity, which indicated that the domestic tea was an effective
import substitute, where as the DRC was also less than one implying that the tea growers spend less than a rupee equivalent of foreign exchange on the production. Hence, it was profitable to use non-tradable inputs in the production of tea in India. Under exportable hypothesis, the NPC and DRC were 0.98 and 0.93 respectively. The NPC was less than unity which reveals that tea was competitive in the international market and it represents an effective export commodity where as DRC was also less than one implying its export competitiveness in the international market.

Verma (2002) in his paper “Export Competitiveness of Indian Textile and Garment Industry” has examined India’s competitive performance in the US and EU markets for MFA (ATC) product categories that were important in Indian export basket, and had found that Indian exports to the EU and the US were, on the whole, export-competitive. It had also delineated the changing landscape in the international trading environment which was likely to significantly impact global textile and clothing trade. To enhance the competitiveness of the industry, the study had highlighted areas requiring government policy intervention. The study concluded that while there was a little doubt regarding the immense potential that the Indian industry-specially garment sector- had, several policy reforms are needed urgently in order to unlock this latent capability. Besides, from the emerging nature of global trading environment, it appeared that market access would become an increasingly important aspect of translating competitiveness into export performance.

Aggarwal (2004) quantitatively assessed likely changes in market access opportunities for Indian exports owing to tariff reductions by the USA. The study identified particular products for India at the ISIC 4-digit level of disaggregation, which could be considered tariff sensitive. Regression analysis of the relationship between MFN tariff rates and India's exports to the US was used to assess in quantitative terms the likely impact of tariff reduction that may be agreed in the Doha Round. This analysis suggested that tariff cuts were not expected to benefit India's exports to the US in a major way. With the full implementation of the Chairman's formula for tariff cuts, increase in India's exports to the US would amount to 1.2 or 0.6 depending on the value of the B coefficient in the Chairman's formula. These findings were
in all likelihood substantially due to the tariff diversion effect of NAFTA preferences in favour of suppliers in Mexico, which was a competing country in many traditional items. It was expected that reduction of MFN tariff would alleviate the trade diversion effect of the NAFTA. The study had also attempted to decompose changes in India's total exports due to tariff reductions in the US into the competitive and market effects. The analysis suggested that the increase in India's exports would be mainly due to the competitive effect. This led the author to conclude that it was crucial for India to improve its competitiveness vis-a-vis its competitors in different markets.

Panagariya (2004) offered a comprehensive analysis of India's trade policy, particularly since 1991, and its impact on the economy. He provided evidence showing that trade liberalization had a major impact on the quality and availability of goods and services growth. The evidence on the productivity growth in the industrial sector varied across studies, however. He also explained why India lags behind China and what India must do to catch up. The strategy for the future liberalization, including a possible U.S.-India free trade area, was discussed.

Bhattacharya and Banerjee (2006) applied the gravity model to the panel consisting of India's yearly bilateral trade data with all its trading partners in the second half of the twentieth century. The main conclusions that emerged from their analyses were: (1) The core gravity model could explain around 43 per cent of the fluctuations in India's direction of trade in the second half of the twentieth century (2) India's trade responded less than proportionally to size and more than proportionally to distance (3) Colonial heritage was still an important factor in determining India's direction of trade at least in the second half of the twentieth century (4) India traded more with developed rather than underdeveloped countries, however (5) size had more determining influence on India's trade than the level of development of the trading partner.

Zhang (2006) in his study developed a staging framework to predict the trade-convergence relation, which harmonized the contradicting results from existing studies. By using Granger-causality and co-integration approaches, the study investigated the long-run relationship and two-way causal link
between international trade and convergence in three trade blocs, EU, ASEAN and NAFTA. The empirically estimated results supported the hypotheses, that is, the long-run and causality relation between trade and convergence depended on the developmental stage of the countries concerned. Specifically, if a country was at the stage of low developmental, free trade is associated with income divergence between this country and its poor and rich trade partners; causality is bilateral, trade causes divergence, and divergence causes trade. When a country surpassed a certain developmental level, its trade with other countries in the same stage was associated with income convergence between these countries; causality was bilateral, trade caused convergence, and convergence caused trade.

Sikdar (2006), made an attempt to provide an analysis of the prospects of bilateral trade between the neighbouring countries India and Bangladesh. The scope of viability of bilateral trading arrangements between these two countries was evaluated in the light of three indices, namely trade intensity index, revealed comparative advantage index and trade Complementarity index. On the basis of these indices the study concluded that while India had some potential to meet Bangladesh’s import demand, there had been a clear lack of such potential on the part of Bangladesh over the last two decades. Trade Complementarity indices reflected that it implied not only to goods in which individual economy was endowed with revealed comparative advantage but to overall trade.

William, (2006) presented an overview of India’s external trade, with a focus on trade with the United States and China. According to him since joining the WTO in 2001, China had emerged as the world’s third largest trading nation and an emerging competitor for the United States in many emerging markets, including India. Many analysts viewed President Bush’s March 2005 trip to India as part of a long-term strategy to contain China’s expansion in Asia. However economic cooperation between China and India had been growing and in 2005 China emerged as India’s largest single source of imports supplanting the United States. The study described India’s import market response to China’s ascension as its leading source of imports and how that had affected U.S. exports in the Indian market. It had also identified differences and similarities in India’s exports to the United States and China.
The study had explored why the United States was losing market share in India's import market and the role of other competitors, especially those in East and Southeast Asia, for a share of India's import market. The vast majority of India's imports from the United States and China were concentrated in Harmonized Tariff Schedule Chapter 84 (computers, components, and parts) and Chapter 85 (telecommunications equipment, components, and parts).

Basu and Datta (2007) analyzed the reason behind persistent bilateral trade deficit of Bangladesh with India. They found that the Bangladesh had export similarity with India and hence faced export competitiveness. The lack of match between Bangladesh export and Indian import also generated a constraint of Complementarity. They used different trade indices like and cosine measure to examine the extent to the trade similarity and Complementarity in inter-industry bilateral trade. The possibility of intra-industry trade between the two countries was also studied with the help of G-L indices. Finally, an econometric time series analysis was carried out to identify the determinants of Bangladesh bilateral export and trade deficit. Exports were found of random nature and trade deficit had perverse relation with exchange rate, driven by flow of remittances. They suggested that Bangladesh should pursue appropriate exchange rate policy and aim at increased diversification in her export structure in order to avoid Dutch disease and reduce the bilateral trade deficit.

Susanto et al. (2007) examined the effect of the U.S.-Mexico trade agreement under the North American Free Trade Agreement (NAFTA). The results suggested that the U.S. agricultural imports from Mexico had been responsive to tariff rate reductions applied to Mexican products. A one percentage point decrease in tariff rates was associated with an increase in U.S. agricultural imports from Mexico to the tune of 5.31% in the first 6 years of NAFTA and by 2.62% in the last 6 years of NAFTA. U.S. imports from Mexico had also been attributable to the pre-NAFTA tariff rates. Overall, the results indicated that the U.S-Mexico trade agreement under NAFTA had been trade creating rather than trade diverting.

Tiwari and Shahbaz (2011) explored the affect of India's exchange rate with US on Indian trade balance over the period of 1965-2008. They used
ARDL bounds testing approach to co-integration and for dynamic analysis IRFs and VDs. For dynamic analysis impulse response functions and variance decompositions were used. They found co-integrating relationship among the tested variable, positive impact of depreciation in Indian rupee against US dollar and trade policies in previous period on Indian trade balance while a negative impact of money supply and economic growth on trade balance in short span of time. Moreover, J-curve was validated in case of India with US.

Swaymi (2011) looked deep into the problems and potentials of trade between India and Pakistan. The study analyzed how SAFTA had in fact given a fillip to a better understanding between the two countries; how the latter has contributed to the furthering of the two countries' relations notwithstanding the fact that the bilateral disputes are out of the purview of the SAARC agenda. The article also focused on how the inclusion of bilateral problems has derailed the SAARC process.

2.2.2 Studies Related to FDI

Kumar (1995) observed four distinct phases in the evolution of FDI in India. (1) From (1948-67) during this period, the Government followed an import protection policy. However, the foreign exchange crises of 1957-58 led to liberalization in the government's attitude towards FDI. (2) From 1968-78 during this period the Government had a restrictive attitude to protect the domestic base of created assets. (3.) In the 1980's during this period a cautious de-regulation policy was adopted. This was reflected in the policy of (.a.) Liberalization of Industrial licensing rates, and (b.) Exception from foreign equity restrictions under FERA to 100 per cent export-oriented units. The policy concerning foreign ownership had become more flexible. (4.) In the 1990's during this period full scale liberalization took place accompanied by integration with the world economy. He also pointed out that one of the objectives of the current reform policies was to remove impediments for export oriented manufacture in general and to attract MNEs to locate efficiency seeking FDI in the country.

United Nations Report (1998) revealed that global market was a very competitive place for the host countries looking for investment capital as well
as for multinational corporations. Multinational corporations planned to expand overseas must take more innovative steps in their operations to be competitive. These steps included seeking bigger market shares, pursuing creative assets such as technology through research and development, and increased innovative capacity with the corollary of a skilled workforce. These people-made created assets take competition to a higher level.

Lensik et al (1999) examine the impact of uncertain capital flows on the growth of 60 developing countries during the 1990’s. They distinguished between total capital flows, official capital flows and private capital flows. For the three types of capital flows, they derived a yearly uncertainty measure. They have used the yearly uncertainty measures in Ordinary Least Square (OLS) as well as Generalized Method of Moments (GMM) estimates, to explain the impact of uncertain capital flows on growth. They conclude that both types of estimates suggest that uncertain capital flows have a negative effect on financial market and growth in developing countries.

Rangrajan (2000) investigates the capital flows and its impact on the capital formation and economic growth taking into the variable as net private capital flows, net direct investment, net official flows, net portfolio investment and other net investments in 22 countries during 1992 to 2000. If capital inflows were volatile or temporary, the country would have to go through an adjustment process in both the real and financial market. Inflows, which take the form of direct foreign investment, are generally considered more permanent in character. Capital flows can be promoted purely by external factors which may tend to be less sustainable than those induced by domestic factors. Both capital inflows and outflows when they are large and sudden have important implication for economies. When capital inflows are large, they can lead to an appreciation of real exchange rate. He concludes that the capital account liberalization is not a discrete event.

Sharma (2000) showed in his study that the demand for Indian exports increased when its export price fell in relation to the world price. He concluded that real appreciation of the rupee adversely affected India’s exports. Export supply was truly related to the domestic relative price of exports and higher domestic demand reduces export supply. According to this
study, FDI had no significant impact on export performance, statistically although co-efficient of FDI had a positive sign.

Kohli (2001) attempted to analyse the patterns and trends in capital flows into India in the 1990s and how these had affected the key macroeconomic variables in the economy. She studied the response of the policy makers to the new challenges posed by the partial capital account liberalisation. It was found that an inflow of foreign capital during this period had resulted in real exchange rate appreciation and had significantly impacted the domestic money supply. During a capital surge, these effects were countered through intervention and sterilisation.

Khanna (2002) examines the macro economic impact on Indian capital market as well as the corporate sector and what are the macro economic effects on inflows of capital to Indian and micro economic effects on the capital market during 1989 to 2002. He took the macro variable as FDI, FPI, NRI deposits, external assistance and GDP/GDS/GNP. He tells that entry of international capital flows helps to provide greater depth to the domestic capital market and reduce the systematic risk of the economy. He argues that advanced for liberalizing capital market for liberalizing capital market and opening them to foreign investor are to increase the availability of capital with domestic industries and commercial firms. On the other hand, the Indian stock market is today largely dominated by a small group of FII’s, are able to move the market by large intervened. He concludes that in case of India, the microanalysis of stock market also fails to provide any evidence that the entry of FII has reduced the cost of Indian corporate sector.

Rakshit (2003) studied the economic consequences of large capital inflows and accumulation of foreign exchange reserves and discussed policy options in the context of slowdown in growth, significant output gap and low absorption of foreign capital in the Indian economy. It was observed that (a) capital inflows produced a deleterious impact on the economy in the presence of demand deficiency, especially when the central bank did not mop up the inflows; (b) accumulation of reserves in excess of what is required for avoiding serious currency turmoil's entailed considerable costs; (c) given adequate foreign exchange reserves and an output gap, use of external funds by corporates or the government for financing domestic investment involved a
net loss to the economy even when the funds were interest-free; and (d) reliance on foreign capital was beneficial when there was full employment of resources and at the margin the expected return on domestic capital accumulation exceeded the cost of servicing external liabilities including the risks associated therewith. These considerations suggested some fairly straightforward policy imperatives in the present context. First, RBI intervention for preventing sharp swings in the exchange rate was necessary; but the rate should have been permitted to move towards the level commensurate with full employment of resources, their productivity and other economic fundamentals. This rules out depreciation (or beg-thyneighbour policies) as a means of boosting domestic demand. Second, for closing the output gap and raising the economy’s capacity to efficiently absorb foreign capital inflows, the focus had to be on public investment in physical infrastructure and the social sector. Third, while in the short run an easy money policy could play a supportive role in utilisation of domestic resources and foreign capital, it was important to accord top priority to building up of an economy-wide financial structure in the medium run in order to facilitate flow of funds to new and relatively small enterprises. Finally, regulation of non-FDI capital inflows needed to form an integral part of external sector management. The reason was that in view of their volatility the central bank had to keep a significant part of them as reserves so that the net amount of such inflows available for purposes of domestic investment would have been relatively small.

Jangsoo (2004) in his work “Korean Perspective on FDI in India: Hyundai Motors Industrial Cluster” examined India’s experience with FDI since 1991 and tried to look for the ways to promote FDI inflows, from Korean perspective. The Indian government’s attitude toward foreign investment had been changing in the post independence period. The new regime placed special emphasis on attracting a large amount of foreign capital. Therefore, further detailed empirical studies on FDI with industrial cluster were deemed to be necessary to understand more about spill over effects of FDI in India.

Guruswamy et al (2005) in their work “FDI in India’s Retail Sector: More Bad than Good?” observed that the entry of FDI in India’s retail sector
was inevitable. However, with instruments of public policy in its hands, the government could slow down the process. Japan has done this quite effectively. The government can try to ensure that the domestic and foreign players were more or less on an equal footing and that the domestic traders were not at a special disadvantage. The small retailers must be given the opportunity to provide more personalized service, so that their higher costs were not taken advantage of by large supermarkets and hypermarkets.

Sethi and Patnaik (2005) attempted to examine the impact of international capital flows on India's financial markets and economic growth. They also examined trends and composition of capital inflows, changing pattern of financial markets in view of globalization, evaluated the impact of domestic financial policy variables on international capital flows and suggested policy implications thereof. By using monthly time series data, they found that Foreign Direct Investment (FDI) was positively affected the economic growth direct contribution, while Foreign Institutional Investment (FII) was negatively affected the growth prospects, in a small way attempted to test whether the international capital flows had positive impact on financial markets and economic growth. The empirical analysis used the time series data for April 1995 to December 2004 showed that FDI played unambiguous role in contributing to economic growth.

Yomogida (2006) in his paper, explored the impacts of international capital flows on income distribution within countries. Using a simple Ricardian setting with sector-specific capital, he examined whether the owners of capital and workers gained or lost from capital movements relative to a free trade baseline. He showed that the structure of commodity demand played a crucial role in determining the distributional effect of international capital movements. His findings showed that if countries were incompletely specialized in production and the world demand for the capital intensive good was strong, capital flows into the country having the higher capital productivity and the world production of capital intensive good expanded. As a result, the capital intensive good became less expensive, which benefited workers but hurt the owners of capital. However, if the demand for the capital intensive good was weak, the direction of capital movements was reversed, and the effects on income distribution were totally opposite.
Taneja (2006) identified the areas of trade and investment co-operation between Indo-Pakistan. On the basis of a survey conducted in three cities viz., Delhi, Mumbai and Amritsar the study examined the Characteristics of firms engaged in Indo-Pakistan trade. It also estimated the transaction costs of trade on the basis of a detailed examination of existing transport arrangement between the two countries and the impact of all extant non-tariff barriers. The study suggested that the most important step towards enhancing trade would be to adopt the MFN principle as the current policy inhibits trade, lacked transparency and led to high transaction costs. The study found that the transportation links between the two countries were inadequate and suggested that new rail and road links should be opened.

The study by Hoa (2007) displayed an evidence-based contribution to trade and regional integration area along with significant policy implications. As its novel features, it used a new econometric modelling policy approach that had won international acclaimed, namely the generalised gravity theory, (Tran Van Hoa, 2002a, 2002b, 2007a, 2007b) to constructed an Asia-India causal model of trade and growth. Using recent advances in applied economic modelling (Johansen, 1982; Tran Van Hoa, 2005) and development economics (Krueger, 2007), by using historical harmonised data from the OECD, CHELEM (France), Reserve Bank of India, and ICSEAD (Japan), the study provided efficient and robust empirical findings on the determinants of India's trade in goods, FDI and services with its major Asian economies and their linkage to economic growth (or welfare improvement) for more credible policy analysis.

Pradhan (2008) had analyzed the overall and regional trends in Indian direct investment flows into developing region since 1960s and explored various development impacts they had on host developing countries. Evidence indicated that developing region was the initial destination for Indian outward investing firms and continued to receive their attention over time. Developing region bound Indian FDI, which was led by a small group of Indian firms in a few selected developing countries in 1960s–80s, was now giving way to a more extensive pattern with large quantum of outward investment. A large number of Indian firms were found to be undertaking increased investment activities across different sub regional developing groups and for a variety of
firm specific motivations. The fact that developing region oriented Indian firms were operating in knowledge based industries and were undertaking local production activities than simply performing sales promotional functions, their presence could have been critical for host developing countries aspired to build their domestic capability in such technology intensive industries.

Sathye (2008) analyzed India's economic development in the light of the country's foreign direct investment inflows and outflows, using the theoretical framework of the Investment Development Path (IDP) Theory. The study investigated whether the relationship between India's economic development and its foreign direct investment flows showed a specific pattern, similar to the one described in the IDP theory. The results suggested that in the initial stages of development, this relationship showed a pattern which was similar to the one expected as per the IDP theory. However, in the third stage, the pattern was seen to be different from the one identified in the IDP theory. Izhar and Tariq (2009) attempted to analyse the behaviour of some macroeconomic variables in response to total capital inflows in India using quarterly data for the period 1994Q1-2007Q4. Time trend of all variables accepted nominal effective exchange rate-both export and trade based and current account balance exhibited instability over the period of study. Current account balance was found to be the only variable which was stationary in level form all other variables were stationary in first difference form. Co-integration test confirmed the long run equilibrium relation between total capital inflows (TCI) and real effective exchange rate-both trade based and export based and between TCI and nominal effective exchange rate-export based. Granger causality test confirms the bidirectional causality between real effective exchange rate-export based and TCI and between foreign exchange reserve & TCI and unidirectional causality from TCI to real effective exchange rate-trade based.

Kumar et al., (2011) examined the growth and structure of FDI inflows to India in pre and post liberalization period and detected the changes in the sectoral composition of FDI under the policy of liberalization. To calculate the compound annual growth rates they have fitted an exponential function. They concluded that FDI inflows had shown significant growth in the post
liberalization period. The compound annual growth rates of Actual FDI inflows during this period were found to be as high as 29.56 per cent. The analysis of structure of FDI in India revealed that after liberalization there definitely had been a shift in favour of service sector and a steep fall in the share of manufacturing sector. However, this trend matched the trend of change in the structure of FDI inflows to the developing countries and even the world.

Rao and Dhar, (2011) at the outset, dwelt on the ambiguities surrounding the definition and the non adherence of international norms in measuring the FDI inflows. The study found that portfolio investors and round tripping investments had been important contributors to India’s reported FDI inflows thus blurring the distinction between direct and portfolio investors on one hand and foreign and domestic investors on the other. These investors were also the ones who had exploited the tax haven route the most. These observations acquired added significance in the context of the substantial fall in the inflows seen during 2010-11.

In most countries, particularly those that had faced chronic current account deficits, obtaining stable long term FDI flows was preferred over volatile portfolio investments. This distinction between long term FDI and the volatile portfolio investments has now been removed in the accepted official definition of FDI. From an analytical point of view, the blurring of the lines between long term FDI and the volatile portfolio investments has meant that the essential characteristics of FDI, especially the positive spill-over’s that the long term FDI was seen to result in, are being overlooked. FDI that was dominated by financial investments, though a little more stable than the portfolio investments through the stock market, cannot delivered the perceived advantages of FDI. The net result was that while much of the FDI cannot enhance India’s ability to earn foreign exchange through exports of goods and services and thus cover the current account gap on its own strength, large inflows of portfolio capital causes currency appreciation and erodes the competitiveness of domestic players. The falling share of manufacturing and even of IT and ITES meant that there was less likelihood of FDI directly contributed to export earnings. India seems to have been caught in a trap wherein large inflows were regularly required in order to
To keep FDI flowing in, the investment regime had to be liberalised further and M&As were allowed freely. Even at the global level, the developmental impact of FDI is being given lesser importance notwithstanding the repeated assertions to the contrary in some fora. International data on FDI and its impact has never been unambiguous. If FDI has to deliver, it has to be defined precisely and chosen with care instead of treating it as generic capital flow. India should strengthen its information base that will allow a proper assessment of the impact that FDI can make on its development aspirations.

Georgantopoulos and Tsamis (2011) investigated the causal relationship between economic development as measured by GDP per capita and foreign direct investment for a European Union (EU) member country, Greece, by applying cointegration tests and Granger causality analysis, during the period 1970 - 2009. Robust empirical findings drew from the Johansen cointegration analysis suggested the existence of a long-run equilibrium relationship. Furthermore, Granger causality test indicated that no bi-directional causal links on the FDI-GDP relationship were found. However, there was a one-way causality running from GDP to FDI, as results for the one and two year lags implied, strongly indicated that foreign capital penetration Granger-caused economic growth in Greece. Hence, adequate tax incentives, infrastructure quality and promotion of the human capital base, could guarantee inflow of foreign funds in the future, as evidenced imply for the case of Greece.

2.2.3 Studies related to gains from trade, potentialities of trade and export instability.

Chishti (1974) tried to found out that the affects of terms of trade movements on the various sectors of the national economy like balance of payments, national income, domestic prices, revenue of the government and general economic development etc. She analysed the time period from 1930-31 to 1967-68 and divided the time period in five sub periods. The study showed that NBT remained unfavourable from 1939-40 to 1948-49, except once in 1941-42. In the subsequent years the terms of trade remained favourable in
three years from 1949-50 to 1953-54. In the subsequent years the remained favourable from 1954-55 to 1959-60 but remained highly favourable for all the eight years from 1960-61 to 1967-68 and the index of terms of trade increased from 115 in 1960-61 to 124 in 1967-68 (base 1958=100).

Thriuvananthakarai (1976) calculated India's terms of trade over the period 1960-61 to 1969-70 and concluded that the index of NBTT increased from 100 in 1960-61 (base year), to 104.1 in 1964-65 and subsequently remained below 100 up to the year 1968-69. Thus according to this study terms of trade remained favourable from 1960-61 to 1964-65 and unfavourable from 1965-66 to 1969-70.

The study by Tandon and Hatti (1978) showed that NBTT (base=100) of India remained favourable continuously over the period 1960-70. The index of terms of trade improved from 111 in 1960, to 113.7 in 1966 and 116 in 1970. Thus, according to their study terms of trade remained favourable in 1960's. The study was based upon 84 per cent of imports and 92 per cent of exports of India. Tandon (1978) reported in his study that India's and BTT (base 1958-59=100) remained highly favourable in all years from 1958-59 to 1968-69. The index of terms of trade increased rapidly from 100 in 1958-59, to 119.7 in 1963-64 and then reached to 128.4 in 1968-69. Thus India experienced favourable terms of trade during 60's. Economic survey (base 1968-69=100) showed that India's TOT remained favourable from 1970-71 to 1973-74 and deteriorated after that and the index of terms of trade remained between 70.95 from 1974-75 to 1978-79. Hence terms of trade remained unfavourable to India from 1973-74 to 1978-79. The economic survey (base 1978-79=100) showed that NBTT remained unfavourable from 1983-87 to 1988-89 continuously from six years.

Toh (1982) investigated industry-specific determinants of intra-industry trade for the United States' manufacturing industries for both 1970 and 1971, in separate regressions. Only those industries for which industry-specific variables were available were used: 112 industries at the 4-digit level of aggregation. The parameters for product differentiation, using the Hufbauer (1970) Index, trade with high income countries, the concentration ratio, and product cycle variables all had their expected signs with significance in all regressions estimated—all positive except for the concentration ratio. The
U.S. export share, used to capture international oligopolistic market structure, always had a negative parameter value, complementing the concentration ratio, but was only significant in the 1970 regressions. The parameters for average distance slipped, negative in the 1970 regressions and positive in the 1971 regressions was always insignificant. The parameters for tariff and non-tariff barriers were positive and negative, respectively, but rarely significant. The overall effect of the parameter(s) for economies of scale was found to be always positive and significant. The three models estimated used an overall calculation for economies of scale and the components of that variable separately, with the combined effect being the same.

Balassa (1986) tested the country-specific hypotheses of intra-industry trade on a set of 38 countries that were major exporters of manufactured goods—trade data was for the year 1971. Major exporters were defined as those countries that had manufactured exports exceeding $300 million in 1979 and those exports accounted for at least 18% of their total exports. Estimates were obtained for all countries together, as well as separated the 18 developed and 20 developing countries. Countries were deemed to be developed if their 1973 gross domestic product per capita was found to be greater than or equal to $2250 U.S. The dependent variable was an adjusted Grubel-Lloyd Index and estimation was undertaken using ordinary and non-linear least squares.

The results of Helpman (1987) were not as promising as those of Balassa (1986a, 1986b). Intra-industry trade, measured by the Grubel-Lloyd Index, was regressed against a set of explanatory variables for fourteen industrial countries. Twelve years of data (1970 - 1981) were used, but each year was considered in a separate regression. Two models were estimated for each year: one with the absolute value difference of GDP per capita and the separate GDP values of each county and the second model with the absolute value difference of GDP per capita, the sum of the GDP values of the countries, and a relative country size variable. Estimation was undertaken using ordinary least squares.

Bergstrand (1990) used the Grubel-Lloyd Index for fourteen industrialized countries and 1976 international trade data. This study differentiated itself from the previous literature by incorporating capital-
labour endowment ratios, and their corresponding inequalities, into the analysis. Two regression models were estimated, one with the capital-labour endowment ratio variables, and other without. The regressions were estimated using ordinary least squares. In the first regression, without the capital-labour endowment ratio variables, all variables had the expected sign on their parameters, with significance, excepted average GDP per capita, which was negative and significant. In the second regression, all of the variables in the first regression had the expected sign, with significance. The change in sign for the average GDP per capita was attributed, by Berg strand (1990), to the inclusion of the capital-labour endowment ratio variables. The parameter for the inequality variable had its expected negative sign, with significance. The average capital-labour endowment ratio also had a significant and negative sign, but Berg strand (1990) had no prior expectation for the sign of this variable.

Sarkar and Singer (1990) studied the terms of trade between the developing countries' manufactured and developed countries manufactured over the period of 18 years from 1970 to 1987. They concluded that the unit value of manufactured export of the developing countries declined by one per annum in term of both the SDRs and dollars. They were of the view that the Singer – Prebisch thesis was held not only for the exchange of primary commodities of the developing countries for the manufacturers for the developed countries, but also for the manufacturers for the developing countries vis-a-vis the manufacturers of the developed countries.

Jeromi and Ramanathan (1993) examined the growth and instability in world pepper markets for the period 1975 to 1990. An exponential model of the type $1/t = ae^{bt}$ was fitted to estimate the growth rate of pepper trade, and the instability index was calculated using the residuals of the exponential trend equation. Among the exporting countries, Srilanka recorded the highest annual compound growth rate of 24.59 per cent with a high degree of instability. This was mainly due to its low base in the initial year. The positive and statically significant growth rate and stable index was recorded in case of India. In contrast, the growth rate of pepper imports ranged from a negative level of 2.56 per cent for Argentina to a high and positive level of
11.64 per cent for Saudi Arabia. The instability indices varied between 0.07 (Japan) to 0.55 (Egypt).

Nachane and Prasad (1998) examined India's trade balance in the 1980s. The approach attempted was of examining the bilateral trade balances of India with nine trading partners from the non-communist bloc. The long-run equilibrium relations were studied via two VAR models in Johansen's multivariate co integration framework. Five hypotheses of interest were singled out for attention. The nominal and real exchange rates consistently emerged as important influences on the trade balance. However, as the exchange rates failed weak exogeneity tests, policy implications were not clear cut.

Wasim (1998) made an attempt (a) to measure the openness of Pakistan's economy; (b) to estimate the commodity-wise growth and instability in terms of value, quantity and unit-value of major exports of Pakistan; (c) to study the ranking of major export commodities according to their instability indices; (d) to study Pakistan's share of major commodities in world exports. The major findings were that (a) the growth in the value of major exports was higher than that in the value of minor exports; (b) the export quantity of some of the commodities was constrained by the increasing domestic demand; (c) the value of some of the most major exports was more unstable than that of the minor exports.

Brown et al. (2001) used the Michigan Model of World Production and Trade to simulate the economic effects on the NAFTA member countries and other major trading countries/regions of a prospective new round of WTO multilateral trade negotiations, the variety of free trade agreements (FTAs) that the NAFTA members had negotiated or were considering, the adoption of a system of common external tariffs by the NAFTA members. They estimated that an assumed reduction of post-Uruguay Round tariffs on agricultural and industrial products and services barriers by 33 per cent in a new WTO trade round would have been increased world welfare by $613.0 billion, with gains of $177.3 billion for the United States, $13.5 billion for Canada, $6.5 billion for Mexico, and significant gains for all other industrialized and developing countries. If there were global free trade, world welfare would have been increased three-fold to $1.9 trillion and the country/region gains would have
been similarly larger. Regional FTAs such as an expansion of NAFTA to include Chile and a Western Hemisphere FTA would increase global and member-country welfare but much less than a new WTO multilateral trade round would. Separate bilateral FTAs negotiated or being considered by Canada, Mexico, and the United States would have positive, though generally small, welfare effects on the partner countries, but potentially disruptive sectoral employment shifts in some countries. There would be trade diversion and detrimental welfare effects on some non-member countries for both the regional and bilateral FTAs analyzed. If the NAFTA members were to adopt a system of common external tariffs to replace their existing differentiated external tariffs, a system based on trade weights would have less distortive effects on trade and welfare than a system based on simple averages or production-weighted tariffs.

Kaushik and Karol (2000) tried to study the effects of export instability on economic growth in the new economic environment by using time series data for the period 1984-85 to 1998-99. To understand the relationship between export and economic growth, export instability had been studied in neo-classical production function. The study concluded that export performance especially, frequent variability in export growth, had an adverse impact on country’s economic performance. The study also attempted to examine the two stages through which export instability tended to affect imports of capital, the results suggested that export instability in capital goods imports, although the evidence was less extensive with respect to latter variable.

Velavan (2004) studied the growth rate of export and import of cashew in India and the world. It was observed that import growth rate was 10.14 per cent per annum and the export growth rate was 8.88 per cent per annum. The import and export growth rate was lower in post-liberalization period than the pre liberalization period. This trend was supposed be due to the composition from the other nuts and reduction in the yield of cashew in the major exporting countries. The import growth rate (20.89%) of raw nuts in India was higher than the export growth rate of produced nuts (6.31%). This was considered to be due to large scale dependence of raw materials to meet the domestic and export demand by India.
The study by Feridhanusetyawan (2005) on preferential trade agreements (PTAs) in the Asia-Pacific region had proliferated rapidly over the past five years and was creating a complex web of intersecting bilateral and regional trade agreements. This study described the proliferation of these PTAs, discussed their characteristics and implementation, and assessed their potential effects. Realizing the potential gains from Asia-Pacific PTAs required a commitment to liberalize sensitive sectors, to maintain consistent provisions, and to enforce agreements. Other factors, included administrative complications, also could undermine any potential gains.

Cremers and Sen (2005) explored the steady state welfare implications of permanent transferred in a two-country, two-sector overlapping generations model. As the golden rule and with Walrasian stability, they demonstrated that the change in the (static) terms of trade always worked in favor of a transferred paradox. The conditions under which the transfer paradox was obtained were independent of factor intensity rankings and also whether the donor or recipient had the higher savings propensity. In contrast, conditions under which changed the inter-temporal terms of trade delivered a Pareto-improving transferred depended upon both of the above and also on the initial position of the world capital-labour ratio relative to the golden rule.

Pradhan (2006) Using gravity model, estimated the magnitude of India’s export potential to the six-member Gulf Cooperation Council (GCC) countries, namely, Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates (UAE), who were currently negotiated a Free Trade Agreement (FTA). The researcher used an augmented gravity model to analyzed India’s world export flows and the coefficients thus obtained were incorporated to predict India’s export potentials to the six-member GCC countries. This model had been estimated using the ordinary least square (OLS) technique with panel data. The dependent variable in all these tests was total merchandise exports (constant US dollars), in log-linear form between country-pairs of India with other 150 countries of the world. The estimated results showed that the gravity equations fit the data set and delivered plausible elasticities of the variables incorporated. All specifications of the gravity model were naturally sensible with statistically significant t-statistic, although export potentials differed from one to another.
Lederman, Olarreaga and Rubiano (2007) explored the extent to which the rapid growth of China and India in world markets was affecting Latin America’s trade specialization pattern. To this end authors constructed a measured of Revealed Comparative Advantage (RCA) by 3-digit ISIC sector, country and year, which accounted for both imports and exports (Völlrath, 1991). They then explored the correlation of these RCA measures between LAC and the two Asian economies. Results suggested that the specialization pattern of LAC economies—with the exception of Mexico—had been moving in opposite direction to the trade specialization pattern of China and India. Labour intensive sectors (both unskilled and skilled) were the more likely to be negatively affected by the growing presence of China and India in world markets, whereas natural resource and scientific knowledge intensive sectors were likely to benefited from China and India’s growth.

Delgado (2007) evaluated the South Asia Free Trade Agreement (SAFTA) within the global structure of overlapping regional trade agreements (RTAs) using a modified gravity equation. First, he examined the effects of the Trade Liberalization Program which started in 2006. SAFTA would have a minor effect on regional trade flows and the impact on custom duties would be a manageable fiscal shock for most members. Second, the study ranked the trade effects of other potential RTAs for individual South Asian countries and SAFTA: RTAs with North American Free Trade Agreement (NAFTA) and the European Union (EU) dominated one with the Association of South East Asian Nations (ASEAN).

Pillania (2008) in his analysis stated that Indian economy and foreign trade were on a growth trajectory. Indian exports had come a long way in value terms from the time of gaining independence in 1947. The total value of India’s merchandise exports increased from US $ 1.3 billion in 1950-51 to US $ 63.8 billion in 2003-04 – a compound rate of 7.6 per cent. Trade growth had picked up post liberalization of 1991. The composition of trade was now dominated by manufactured goods and services. India services exports shared in global exports was more than doubled of that of Indian manufacturing exports. East Asian countries, particularly China had become a major trading block. There was huge untapped potential for Indian foreign trade in years to come.
Miankhel et al. (2009) examined the trade potential of Australia using the trade gravity stochastic frontier model and estimated the trade potential for nearly 65 trading partners. In particular, they corrected for the biasness from “behind border measures”, which the traditional gravity model would not have been able to address. The results indicated that the measure for biasness was statistically significant and it was high for Agriculture, Forestry, and Fishing products and Mineral products. The estimation results for all products classifications showed that considerable potential existed on individual country basis compared to collective estimates. In Agriculture, Forestry, and Fishery products (SIC 0) products, there was also considerable potential for Australia to increase its trade with key ASEAN and East Asian countries. In SAARC region, the key trading partners of India and Pakistan provided the most trade potential for Australia. Additionally, the results also indicate that trade in Mineral products (SIC 1) was very important for the Australian trade and the growth of China and Japan would be very crucial for the export growth of Australia. As compared to Mineral products, manufactured products (SIC 2) tended to have less export potential for Australia. Apart from the existing level of trade, Australia also needs to focus on trade from emerging countries that were liberalizing their markets for economic growth, which could form important avenue for its exports.

Saini (2009) reported findings from the survey of India’s textiles and clothing exporters. The survey method had been used to identify and assess the impact of Non-Tariff Measures (NTMs) and the Cost of Compliance (COC) expenditure by the exporters. A structured questionnaire had been used to gather data from a sample of 135 exporters across eight export centres of India i.e. Bangalore, Chennai, Coimbatore, Ludhiana, Mumbai, New Delhi, Panipat and Tirupur. Results revealed that the EU and USA were most restrictive region/country covering nearly three-fourth of total NTM incidences. The technical regulations, product & production process standards and conformity assessment for technical barriers were the most frequently used NTMs among the aggregated five categories. The average COC as percentage of turnover was inversely related to the firm size, which was 0.63% for large firms and 1.32% for small firms. However, about 58% of the firms spent less than 0.5% of their turnover on COC which was much lower
than overall average of 1.12% and only 26% firms spent more than 1% of their turnover in complying with NTM standards. The COC was not exorbitant and justifiable given its long term benefits.

Some of the common issues about NTMs were buyer nomination of the suppliers and testing & certification agencies, stringent social compliance measures, and discriminatory treatment on the basis of standards, import duty and other benefits. Unexpectedly, the NTMs were not only seen as marketing and promotional tool but also they promoted efficiency and competitiveness within the industry. Further, financial crisis has reduced the export orders/volumes and the impact was seen to be more severe on high end fashion garments where product and market diversification was unlikely due to ever changing customer preferences.

Brooks and Ferrarini (2010) calculated the decline in costs involving merchandise trade between the People’s Republic of China (PRC) and India during the period 1980–2008. Drawing from the recent literature, a comprehensive measure of trade costs was derived from a theory-founded gravity model of international trade, which could be computed on the basis of observed bilateral trade flows and gross domestic product data. The analysis revealed that trade costs had declined sharply since the 1980s, accounted for a large and increasing portion of growth in total trade between the two countries. Whereas the reduction of trade costs accounted for less than one third of the increase in trade between the PRC and India during the 1980s, lower costs seemed to explain about three quarters of trade expansion during the 1990s, and up to nearly 85% in 2001-2008.

Ghirmaya et al. (2011) examined the causal relationship between export instability. Income terms of trade instability, investment and economic growth by using the co-integration analysis and the multivariate error correction model. In addition, reverse causality was also tested by examining whether output and investment caused export instability and income terms of trade instability. The data utilized were drawn from a sample of 14 developing nations. The co-integration results indicated that export and income terms of trade instability had long-run relationships with output. For most countries, instability in the income terms of trade was negatively related to output while the results for export instability are mixed with respect to
causality. It seemed that export instability and income terms of trade instability played a causal role in the development process via a variety of avenues.

Singla and Singh (2012) analyzed the trends in India's terms of trade with China. For this purpose, they had computed India's Net Barter Terms of Trade (NBTT) with China for the period from 1992-93 to 2007-08. They found that for most of the years, during the study period, India experienced favourable terms of trade with China as compared to its overall unfavourable terms of trade. However, it had also been found that India's terms of trade were greatly influenced by one single commodity named iron ores & concentrates.

2.3 Conclusion

After the perusal of existing literature on the research problem, we can safely conclude that the principle of comparative advantage has failed to appreciate a variety of economic and trade phenomena, and also “encourages” lack of competitiveness. Contemporary explanations of why countries engage in export and import is based on concepts of competitive advantage, overlapping demand, economies of scale, and economies of scope. According to the competitive advantage theory of Michael E. Porter, a country can marvel in trading provided it has the right demand conditions, competitive environment, production factors, supporting industries, adequate structures, and strategies. In the absence of these conditions for a particular industry or a product, import of these goods becomes inevitable.

After reviewing the studies related to FDI in section 2.2 of chapter 2, we can safely conclude that FDI patterns contributing to the growth of the emerging markets have undergone significant changes over time. The FDI trend in last decade indicates a shift of flows from the developed World to the developing World and emerging markets. The foregoing discussion about theoretical as well as empirical literature review revealed that countries with greater openness i.e., those which pursued export/import led growth strategies reaped huge benefits from foreign direct investment. Economic growth increased the size of the host country market and strengthened the incentives for market seeking FDI. It was noticed that bigger diversity of types of FDI
led to more diverse types of spill over's and skill transfers which proved more favourable for the host economy.

It can be exhibited from the studies made by Tandon and Hatti (1978), Chisti (1974), Sarkar and Signer (1990) that the main cause of deterioration of terms of trade is low income elasticity of demand for imports from the developing countries. Technical progress in the developed countries tends to reduce the demand for imports from the developing countries because the course of technical progress is such that less and less amount of primary inputs is required to produce the given product. The structure of product and factor market is much more monopolistic in the developed countries than in the developing countries. While the fruits of technical progress in the developed countries remained in the developed countries in the form of higher wages and profits. The developments of synthetic substitutes have been reducing the demand of developed countries for certain raw material from the developing countries.

Many studies analysing potentialities of trade have stressed that free trade between two countries or regions would provide maximum mutual gains from trade for participating countries (Bano and Paswan 2010, Miankhel, Shandre and kaliranj, 2009). To sum up, these studies observed that the trade potentialities can be estimated by matching the export supply for a given commodity, of a country with the import demand for that commodity of trading partner. By matching the import demand with export supply for a given commodity an estimated can be gained of the possibility of trade expansion under the most favourable competitive conditions after subtracting existing trade.