CHAPTER 1
INTRODUCTION

One of the main economic activities in developing countries is agriculture. In addition to providing food security, this sector has an influential role in economic development, employment, and non-petroleum exports. Iran is not an exception in this regard and agriculture sector has specific importance, and since it long has played a remarkable role in non-petroleum export. Newly emerged phenomenon of economic globalization and removal of trade barriers of the countries are intensely getting shaped. Thus, it is expected that Iran will somehow manage to pace up with these commercial revolutions and get ready for competition and entering the international arena, and evaluate its potentials in the agriculture sector as quickly as possible, and come up with new ideas for business development regarding agriculture commodities. Because of its eminent and unique position among the Islamic developing countries and European Union countries, Iran can perform a crucial role in trade development. Concerning the trade relations between Iran and European Union, it should be said that European Union as a developed and strong economic block is engaged in commercial and regional agreements with many of the countries in the world.

The most accessible markets for Iran among the trade partners of EU member countries are Germany, France, Italy, England, and Netherlands. Therefore, the researcher has attempted to study more precisely the subject of mutual trade between Iran and the above-mentioned five countries. The issue of how a country can achieve high economic growth is one of the fundamental economic questions. An export-led growth hypothesis which states that exports are one of the keys to achieving high economic growth provides a possible answer to this fundamental question. Export of goods and services is an important source of foreign exchange reserves and can reduce balance of
payments problems, and creates employment opportunities. According to Abou-Sait (2005) an export-led growth strategy aims to provide producers incentives to export their goods through various policies. The strategy also aims at increasing the capability of producing goods that can compete in the world market using advanced technology and make provision for foreign exchange needed to import capital goods. Exports can help the country to integrate into the world economy and help to reduce the impact of external shocks on the domestic economy. They allow domestic production to achieve a high level of economies of scale. Studies such as Tsen (2006) states that the experiences of East Asian economies provide good examples of the importance of the export sector to economic growth and development. This indicates the role of exports as an engine for economic growth.

The world economy after World War II has become much more integrated. The first 20-30 years after World War II can be seen as a period characterized by shallow integration both globally and regionally (“Old regionalism”). With the Uruguay round of GATT negotiations, there were strong elements of deep integration (“new regionalism”).

According to the World Trade Organization (WTO), there are over 250 Regional Trade Agreements (RTA) currently in force. Most of these agreements have been concluded in the past 15 years and many new agreements are under negotiation.

Direction of trade data also show that Asia, as the third hub of world trade after Europe and North America, has become increasingly integrated. Iran as an Asian developing country has also regionalism and integration experiences such as ECO membership.

Trade is an integral part of the total development effort and national growth of an economy. This is, in fact, a crucial instrument for industrialization
while access to foreign exchange is essential for sustained economic development.

Although the foreign trade sector of Iran constitutes an important part of its economy, the country suffers from a chronic deficit in her balance of payments. The trade relations of Iran with other countries, especially with SAARC countries, do not show any hopeful sign for the desirable contribution to country’s economic development. Therefore this study is an attempt to find out the major determining factors of Iran’s trade using panel data estimation technique. We have applied generalized gravity model for our analysis.

Exports are important for the process of growth. They generate scarce foreign exchange reserves that are necessary to finance imports of goods such as energy and investment goods. These goods are crucial for the formation of capital and economic growth. Exports ease the pressure on the balance of payments and create the much-needed employment opportunities (Jordaan and Eita, 2008). An export-let growth strategy provides incentives through various government policies to producers to rather export their products. This increase the capability of producing goods and services that can compete in the world market using advanced technology which will provide foreign exchange needed to import goods and services. Exports can also reduce the impact of external shocks on the domestic economy.

Countries economy (local economies) depends largely on the expansion of worlds business. The availability of foreign markets makes these countries engaged in some activities which pave the way for a profitable production of goods and facilities. For example just few years in Post World War II era are remarkable shifts in business affairs from agriculture to industry. This fact is more tangible in Japan and some EU countries. This shift was known as a source of increase in productivity for agriculture and related industries.
New productions and activities in this area was recourse of enough motivation for new investment opportunities. This in turn would create a proper situation. For increase in production activities, the free market, investment and improvement in communication technologies as well as a shift in new technologies and a remarkable reduction in the gap regarding productive economy i.e. USA along with other world economies makes a proper situation. For investments in these areas a progress in economies, however, motivation new investments and creates a positive cycle in broadening international economy.

Business theories are much more related to creating a new pattern in market. This determines the type of goods in which countries prefer to manage their businesses. The quantitative question remains as how many goods are suitable enough for business and world market? How these goods create a proper situation for countries to progress? Hence a new understanding in holistic business, pares the way for new business strategies for these countries and their market place.

One of the most common tools which are suitable enough for business research is gravity Model. In fact many researches have been done in this model. This method is especially useful in international business theories. Deardorf(1998) states: These models are the most successful among all in which their flexibility come in progress for double trade theories, these models have created the most powerful and clear experimental findings.

The main models (tools) in this research have an analytical base which clarifies the double trade relations based on GDP per capita and total GDP. This along with geographic distance between business partners creates the whole involved process.
The present tool along with a strong theoretical base was introduced in 1966. This tool has been used by many researchers especially in recent years despite of its simplicity this model has been introduced as the main theory in Iran and its business partners (which include 5 countries). These countries are both among economy partners and historical business partners with Iran.

In this research, the selected partners are from countries of member EU. This study examines gravity Model as nx1 in which the double trade of Iran and its partners are included. At first 3 main models are selected to set business between Iran and these 5 countries. The first model is selected based on descriptive variables of GDP, GDP per capita and the distance between Tehran and the capital of business partner countries.

This research is trying to evaluate a flexible with the main focus on equality variable for business in Iran’s economy. This chapter clarifies the necessity, statement, objective, hypothesis, data source, problems and research questions.

1.1. The statement of problem and research questions

Economic profits pave the way for political, economical, even cultural relations between countries. Regarding the world economy, the need for expansion in international communications and local partnerships this area is a remarkable one to be considered.

To account special characteristics of countries economies, we might have a glance on world economy and a need for creating a better situation for national markets to enter international competition. In recent years, international trade is taken into prior consideration for many countries. In this era, a new mode of communication technology has created new modes of business between countries around the world. The increase in goods trade and related facilities as well as foreign investments helps the betterment of such traders.
The world trade, its growth and consequences i.e. the importance in transition of investment the owners in economy refers to the theory of creating of a greater economy by coming together of smaller national economies. This theory investigates new trade policies and economic co-operations which rely mainly on a reduction and omission of any obstacle in business between countries.

Those countries, who share enough profits from a set of economic activities, may be able to mingle the free trade with protective policies. They can reduce any obstacle in such relations but outcast non-member countries. Such policies have many layers in inter-connection between member countries.

For oneness in each country, a new system is introduced. This automatically broadens the relation between countries and respectively broadens the present economic system. When markets expand and expense patterns differ from a previous policy, new activities in this new system create more job opportunities, increase in production and a better situation for all sections within the country.

In this regard all countries could remove created obstacles and enter to this oneness in world economy, we might keep in mind that this oneness in economy does not follow an economic pattern without any variations. This is mainly because of political and cultural interferences.

These models are proper tools in international business which create a mutual relation at the same time for both the importer and exporter countries. These models are considered as a draft to Nuton’s gravity in physics: the capacity for two business sub groups (the gravity) would increase with a production in economic issues (physical capacity) and would decrease by geographical distance.
The application of gravity in international trade is very much the same as a base section in economy. The successful experience of this model was clarified in many research activities around such theoretical issues which created a new era in world economies. This theoretical basis was a start for just after 80s which is considered as a refined model in international trade. One of the main characteristics of this model is its flexibility with more expand models.

Gravity Model is now one of the most successful issues among experimental economy. A number of such issues are used for evaluating various methods in business areas i.e. supportive and free effect and local concerns, the proposed agreements in trade areas, the influence on non-member countries and the effect of national boarders. In recent years this model has been applied for above mentioned issues. These issues are accompanied by some other criteria like immigration (double balance affairs and foreign investment as well).

The practical concerns of such theories are still challengeable enough but the outcomes have pretty well organized these challenges. The previous studies regarding inter-connection between countries trade could be evaluated through nx1. Therefore nx1 for single evaluation has been marginalized. Therefore this new model is considered as a new analytical method for selecting different business strategies.

1.2. Research Gap

During the recent years, many studies have been conducted trade and especially the cooperative trade in the Middle East area by Iran with neighbor’s professional researchers. The present study will try that investigate Mutual Trade between Iran and some countries member EU.
So, the present study scrutinizes the mutual trade using an exponential model and this type of trade is in the form of economic cooperation and cross continental. The researcher will carry out the study using variables such as exports, import, geographical distance, population, economic penetrability (the ratio of import to GDP) and foreign currency rate and a figurative variable in the form of standard gravity mode. The researcher is trying to investigate the effects of GDP of countries, geographical distance, foreign currency fluctuation, and population of countries on exports and import. Detailed literature review in discussed in chapter II.

**1.3. Objectives of study:**
The study aims of the following objectives
1. To Analyses the Impact of GDP growth rate on Export and Import of Iran
2. To Analyses the Impact of Importing price ratio on domestic price in bilateral trade.
3. To Analyses the Impact of the openness Economy on trade
4. To Analyses the Impact of Exchange rate on trade of the Iran
5. To investigate the effects of geographical distance in mutual trade
6. To Analyses the Impact of Trade and Co-operation Trade on Bilateral Trade
7. To investigate Impact of trade of primary commodities of Iran with some members of EU, such as The Netherlands, Italy, Germany, France and England

**1.4. Hypothesis:**
1. The more the geographical distance between countries, the trade relationship between the countries is expected to be limited
2. The more the population of the trade partner and higher volume of GDP, the more it is expected to be the volume of export.
3. TR/GDP variable indicates the openness economy of the country the more open the country is, the more would be the trade, so we expect a positive sign for this variable.

4. The more the Export price of J country to Export price of Iran, the lowest it is expected to be the volume of export.

5. The more the Importing price ratio to domestic price (increase abroad price), the trade relationship between the countries is expected to be limited.

1.5. Data Source

The study is to conduct a cross country analysis base data of bilateral trade flows between Iran and its five trading partners, the two countries GDPs and per capital GDPs, and distance between all of the mention countries. The data on the bilateral trade flows – in total and sectors’ imports and exports – was obtained between 1987 to 2006, and values are expressed in real terms of billions of U.S. dollars. The data sample consists of most of Iran major trading partners, including Germany, England, France, Italy, and The Netherlands. Although the data set was limited by the amount of information available, we tried to select, from countries of member of EU that would well represent the bilateral trade flows with Iran.

The study used Econometrics Methods include: Gravity model, Import demand function and Simultaneous equation for Estimation of Bilateral Trade between countries. The data on GDP and population are collected Iran’s National Account published by the Bank of Iran and also from the IMF’s International Financial Statistics.

To collect the required information and statistical data, the researcher will make use of the libraries and different Internet sites including the statistical and administrative centers.
1. Statistical and Census Center and Statistical Year book of Iran
2. Central Bank of Iran (The Annual Report of Iran’s Economy)
3. The Customer of Iran (Statistical and Foreign Trade Year Book of Iran)
4. Institute of Commercial Studies of Iran
5. Trade and Commercial Centers in Iran
6. Embassies of Germany, France, the Netherlands, England, and Italy in Iran

1.6. Limitation of the Study

With respect to the title of the research, it is required to collect the statistics, data and information of individual countries of the Union during the 10 year period of the study. This causes limitations because:

1. It causes the obtained results of Iran’s trade with some countries of the Union be imbalanced.
2. Some countries of the Union have no relations with Iran concerning exports and imports.
3. The economic system of Iran is more of governmental type, and only over the last few years has it started to denationalize some part of the economy; therefore, studying to find the coefficient, similarities, differences etc, will cause problems. Hence, the researcher has tried to insert a figurative variable into the methodology of the researcher to evaluate the penetrability of Iran’s economy.

To meet the problems and minimize the limitations, the researcher has contemplated to pick out only a few countries of the Union which have more trade and commercial exchange with Iran.
1.7. Chapter scheme

- Chapter I. Deals with Introduction, Research Gap, Objective, Hypothesis, Methodology and Data Source

- Chapter II. This chapter expressed expends about Theoretical Background and Review of Literature mentioned models in this study.

- Chapter III. This chapter deals about Theoretical Background of Trade Policies between Iran and European Union which includes: Regional and bilateral Trade, Trade policies of EU, Agriculture Trade policies of EU and Agriculture Trade policies of Iran.

- Chapter IV. This chapter to uses on research Methodology adopted for the study.

- Chapter V- This chapter discusses about empirical analysis of Trade between and EU countries.

- Chapter VI. Suggestion and Conclusion