CHAPTER I

CONCEPTUAL ANALYSIS OF FOREIGN TRADE
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Foreign trade in the broadest sense is the sum total of all commercial transactions taking place between people residing in any one country and those residing in the rest of the world. This is a very important branch of economics as it unfolds manifold economic problems of an international nature. These problems are not simply mental inhibitions or obsessions but most practical day-to-day ones of the mundane world. Thus the analysis of the factors of foreign trade has always been comparative. Through a descriptive and narrative reference, we study the various ramifications of trade, and our deductive reasoning helps us to discern the uncorrelated and disconnected ones simmering throughout. A medley of human forces has been brought together to serve the consumer. The human agency faces very critical problems and squarely meets them through a rational approach. A host of arbitragers, bankers, carriers, financiers, underwriters

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1 C.P. KINDLEBERGER: "A deep and a very detailed study of this branch can help one to fully grasp the various implications of the international economic problems of the real world." INTERNATIONAL ECONOMICS III EDITION 1953, Page 2.
and warehousemen are on the daily activities of foreign trade. So foreign trade is carried on beyond the frontiers\(^1\) and it moves across due to complex factors.\(^2\) Each country with its natural resources is able to do sufficient trade with its neighbouring countries. Sometimes countries having advantages of cheap transport facilities and economic advantages are able to get the benefits of foreign trade.\(^3\) Francis Bacon has extolled very much about the significance of foreign trade.\(^4\)

The primary peculiarity of foreign trade is international immobility of the factors. Within a country,

\(^1\) ENIKE & SALERA: "National boundaries in themselves have no significance. They become quite important and attain significance when governments regulate commodities and services and also monies in their areas." INTERNATIONAL ECONOMICS III EDITION 1954, Page 3.

\(^2\) SIMON KUZNETS: "Foreign trade flows and other movements across the national boundaries are affected by many complex factors in which technological changes, social inventions, economic advantages, political revolutions and diversities in the structure and endowments of all play their part." SIX LECTURES OF ECONOMIC DEVELOPMENT - GREEN HILL FREE PRESS 1959 - Page 106.

\(^3\) ARTHUS LEWIS: "The extent to which a country participates in international trade depends partly upon its resources partly upon the barriers it places in the way of trade and partly upon its stages of development." THE THEORY OF ECONOMIC GROWTH (LONDON ALLEN AND UNWIN 1955), Page 340

\(^4\) "This realm is much enriched of late years by the trade of merchandise which the English drive in foreign ports and if it will be wisely managed, it must very much increase the wealth thereof; care being taken that the exportation exceed in value than importation; for then the balance of trade must of necessity be returned in coin or bullion." CECIL MONTAGUE "THE WORKS OF FRANCIS BACON", VOL. II, PAGE 385.
diversity in wage rate can be easily removed by the movement of labour force to the comparatively higher rate of wage centre.\(^1\) Thus the standard of living of labourers is also brought on par with the rest of the centres within the country.\(^2\) State intervention is another peculiarity. There may also be a national economic policy. Such an economic policy may exert a very great pressure upon all its industries. Monetary policy differs between countries.\(^3\) It is co-terminus with the economic policy of the country. But under foreign trade, different central banks are engaged in the international trading activities. Each central bank may adopt its own economic policy.\(^4\) For instance, the Reserve Bank of India may adopt a tight money policy when the Bank of England adheres to a cheap money policy. Further foreign trade is a two-way traffic. There is a trade in commodities and services\(^5\) so also a trade


2. Friedrich List: "Domestic trade is amongst us; international trade is between us and them". The National System of Political Economy (Translation by Sampson S. Lloyd, New York Longman & Green and Co. 1904), Page 34.


5. Harrod: "A country gains by foreign trade if and when the traders find that there exists abroad a ratio of prices very different from that they are accustomed at home. They buy what seems to them cheap and sell what to them seems dear. The bigger the gap between what to them seem low points high points, and the more important the article affected the greater will be the gain from trade be." International Trade Edition III, Page 4.
in currencies of the different countries. There may also be a national economic policy chalked out by the Government. But this measure of government control cannot proceed beyond her frontiers. The negative aspect of interference is known to exist in the regulative and restrictive attitude of the state. An orgy of statutory enactments may be imposed on all the industries and trade within the state boundaries and the sum total effect on international trade is very significant.

FACTORS DETERMINING THE EXTENT AND VOLUME OF TRADE:

Many causes may be responsible for the growth and development of foreign trade. The raison d'etre may be as follows: Due to many physical and climatic potentialities, a country may be the leading nation in foreign trade. On account of various agrarian and industrial revolutions, Great Britain could have vast and comprehensive world trade. An industrially advanced country may be in a position to export her manufactured goods to other countries. A politically well-settled nation commands peace and tranquillity. This gives the people an opportunity to improve their facilities in furthering trade and industry. Suppose Coup d'etat takes place in a country. There will be tension and insecurity.

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1. ARTHUR LEWIS: "The extent to which a country participates in international trade depends partly upon its resources partly upon the barriers it places in the way of trade and partly upon its stages of development." THEORY OF ECONOMIC GROWTH (LONDON ALLEN & UNWIN), 1955, Page 340.
All economic activities will come to a standstill. Neighbouring countries and foreigners may not be inclined to invest in a nation of turmoil and insecurity. Maritime trade and several shipping regulations have been responsible for the growth of international trade. The early colonial policy of Great Britain had been responsible for the growth of foreign trade. The Blue Water Policy\(^1\) had a very great effect in boosting it up. In fact commercial empire had been built up by Portugal. Most of the East Asiatic countries are beset with the problem of over-population.\(^2\) These countries were the source of raw materials for the western European countries. In fact, Czarist Russia was economically and industrially backward.\(^3\) The Western countries could help Czarist Russia with food and necessary capital for setting up industries. Most of the under-developed countries are

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1. **BLUE WATER POLICY**: "The whites had authority to steer their vessels on all broad expense without any interference from any corner of earth".

2. **MANDELBURG W**: "The basic criterion then becomes whether the country has got good potential prospects or raising per capita income for an increased population." PROSPECTS FOR INDIAN DEVELOPMENT, 1961, Page 31.

3. **S.S. BALZAK**: "But it has also the greatest Caspian depression. Deserts over large areas and must be irrigated to produce crops; bogs and swamps abound in other regions, requiring large scale drainage projects before the land can be farmed". ECONOMIC GEOGRAPHY OF THE U.S.S.R. 1955, NEW YORK, Page 2.
having this problem of capital building activities.\(^1\) A safe but cheap transport facility is an added asset for the country to engage in foreign trade.\(^2\) A country like the U.S.S.R. can well-engage and concentrate in her internal trade. However, such a country has also come into the arena of international trade.

**TRADE CONSTRAINTS**

Trade constraints may be deemed to be an important discussion. In every type of trade in some form or other, constraints do appear. As William Shakespeare has stated that the course of true love never runs smooth, so also the course of foreign trade never runs smooth. Constraint or an impediment may crop up from time to time. Constraint of a temporary nature can be overcome quickly. But if the same is of a permanent nature, the remedy may be in thoroughly examining the problems and re-phasing the trade accordingly. Attempts are made to analyse the concept in the light of the Indo-Soviet trade. These constraints are studied and discussed with the idea of overcoming and surpassing them and thereby ensure a smooth flow of trade for ever.

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\(^1\) EUGENE STALEY: "A country characterised (i) by mass poverty which is chronic and not by the result of some temporary misfortune (ii) by absolute methods of production and social organisation which means that the poverty is not entirely due to methods already natural resources and hence could presumably be lessened by methods already proved in other countries." "FUTURE OF UNDER-DEVELOPED COUNTRIES", New York 1969, Page 13

\(^2\) MILTON HICKS & PERCY HORDAN: "Certain commodities like coal and iron-ore are costly to transport from one place to another, iron and steel products, therefore can only be manufactured cheaply in the coal areas, or where transport costs are also vital factor in the distribution of these products." "PRINCIPLES OF ECONOMICS" (University Tutorial Press Ltd.) 5th Edn. 1949, Page 67
Under a broad analysis constraints may be either internal or external. Internal constraints are having their sources in the inland or within the national frontiers of the country. External constraints may be outcome of trade emanating from one country to another.

Internal constraints may be the outcome of physical forces, political factors, sociological forces and economic factors. Physical forces may be the physiographic conditions of a country like the non-availability of raw materials, ubiquitous lack of natural potentialities, climatic hazards, poor grade of raw materials and so on. This difficulty can be overcome by careful planning. A highly well-developed country overcome such hazards. In the 18th century, U.K. could import raw cotton and thereby localised cotton textile industry. Political factors are those which are the outcome of the stability of the government. Political factor is also the outcome of the policy of the Government which is declared on the floor of the house from time to time. A country without political stability is a country without status. Such a country loses confidence in the form of rest of the world countries. Further, a country which has hitherto been toeing the line of Market Economy may switch over to centralised economy. This may also have its attractions as well as repulsions. Social factors are the outcome of the nature of inhibitions of the society. If a community
is well advanced that means the country may be well advanced either in the field of technology or science. A Backward country cannot foster ahead of the developed country but be at the mercy of such advanced countries for technological and technical assistance. In fact all the developing countries of the world are looking to advanced countries like U.K., U.S.A. and U.S.S.R. for their development. Mobility is an additional factor that is also responsible for the country to develop. All the technical personnel are only concentrating in the industrial towns and not in the villages. Economic factors are the main ones which are responsible for policy decisions of the country as well as trade matters. Due to industrial conditions and fiscal conditions such economic policy decisions have to be taken. Industrial instability, strikes, lockouts and shortage of power supply, control of working hours, rationing of industrial raw materials are instances of industrial conditions. Fiscal measures may be the imposition of heavy excise duty, level of burden of duties, cess and other subsidies on certain industries. For instance, in our country the handloom industry is even today subsidised by the Government by collecting a cess from the cotton mill industry. Trade factors arise out of various situations like agreements, financial situations, tax structure, exchange rates, liquidity and business morality. When agreements are entered into between the
two countries to that extent both the countries surrender their rights and prerogatives to claim higher rates or prices. They have to honour their commitments. Financial commitments are very vulnerable. If payments due under agreement or trade are not made within the period of time, naturally, the other country may insist on the payment being made as per terms and conditions. The debtor country may seek the aid of international organisation like the IMF (only when it is a member of IMF) to temporarily tide over the crisis. Some can be met under the Lend Lease Agreement. Tax burden is another problem of the country. This constraint cannot be easily solved. Sometimes, the ruling Government imposes capital levy is a direct tax. A tax on import and export or some other regressive taxable rate may injure the trade and remain as constraint in the internal sphere also. Exchange rates are the fair weather cock. A favourable balance of trade and Balance of Payments, will reflect the true rate of exchange. Stability of the rate of exchange is maintained through the I.M.F. and prior to that through the movement of gold. And finally, business morality is the high water mark of a country's level of business dealings. Unscrupulous businessman may bring discredit to the country's fair name. By their clandestine and questionable tactics, the good name of the country will be sullied. The Times of India reported on the 24th May 1975 that even in U.S.S.R. nearly
39 cases of such unscrupulous businessmen have been detected and very deterrent punishment ranging from Death penalty has been awarded to all of them.

As a prelude to Indian economy, we come across under internal constraints instances of lightning strikes lockouts and non-availability of industrial raw material and persistent failure of power supply. Public as well as private sector industries are victims to them. This has retarded our economic growth and ultimately resulted in the loss of man-hour production. The latest credit squeeze policy has rendered most of the small industries powerless. Credit squeeze was introduced with the laudable idea of curbing inflation. But it has hit hard our exports.

Under agreement, we agreed to supply to U.S.S.R. electronic and thermostatic equipments. But as we had no industrial raw material for manufacturing them, we had to depend upon the Western European market at a higher cost and foreign exchange. As we were unable to get a lower price, we could not pass on the higher price to the buyer. We were at double disadvantage. We bought high and sold low.

In our beaming over-enthusiasm, we wanted to capture the Ethiopian market we offered to sell them cycles at a particular time and at a particular price. The bulk order placed by the Ethiopian trade agency has been fully and squarely met in a very record time. But with the same speed the order got rejected as our bicycles did not meet
with the specifications of the consumers of Ethiopia.

That an amount less we have sustained! Our Wagon Deal with U.S.S.R. is an academic example. Our price was fixed by them at Rs. 90,000 whereas our cost of production was Rs. 1,00,000/-.

**EXTERNAL CONSTRAINTS:**

Though there is to some extent unavoidable overlapping, we consider the essential features of external constraints. Exchange rate and exchange rate depreciation are the very common features under this. We are always the worst victims under this particularly in our trade with West European as well as U.S.A. markets. The latest Rupee Payment Agreement has to some extent relieved this burden. There is no international currency or the international liquidity. If there is one then there is no problem of international trade. During the days of the Gold Standard, this question did not arise. Now to some extent in a limited manner, International Monetary Fund is doing this function. But socialists countries have their unit of International Bank of Economic Co-operation. Many developing countries are able to make use of the International Bank of Reconstruction and Development. In the absence of such an international organisation, many countries could not have been able to build up her economy. Regional organisations like Customs Union, European Common Market
have their parts to play. They not only try to control the tariff questions within their frontiers but also reduce the cost. Among the socialist countries COMECON is a very important such association. Finally political issue is too very important. War, coup d'état, subjugation and insubordination to international authority are the various instances.

External Constraints may be due to the outcome of a war, which may end in total annihilation of the country and the State which might have already entered into commitments might not be existing and the new military government need not agree to such subsisting agreements. After a coup d'état, a revolutionary government might have been born. There is no obligation that the new government should honour the commitments of the past government. A government may be under subjugation and subjection through military prowess and strength of the neighbouring country. Such a government subjugated may not be able to honour its commitments. Though there is the comity under the United Nations, a particular member country due to reasons of its own may refuse to fulfil the obligations. Foreign governments are unable to meet their obligations due to obvious forms imposed by the other country. It may be due to impact of foreign taxation. The classical example is given by late Lord Keynes in a very analytical way. Sudden measures of boycott, embargo and non-intercourse

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may be adopted. ¹

Jacob Viner has admirably summed up several dangers which lurk under constraints. They may be present in both the forms of bilateralism as well as Multilateralism. The President's power to reduce the rates is at an ebb, even under G.A.T.T. (General Agreement in Trade and Tariff). This is easily eliminated by a 'Peril point provision' which takes away the President's authority to reduce rates. An 'Escape Clause' or escape provision can be introduced at the whim and caprice of the participating nation or countries. Such measures are invoking non-tariff provision: avoidance of use of Internal taxes and regulation applied to imported products so as to afford protection to domestic industry; freedom to transshipment of goods destined to another country, across the territory of the contracting party; standard rules regulating the conditions for the use of anti-dumping and countervailing duties; regulations in used for purposes of valuation of goods for customs duties, for the use of marks of origin so as to avoid their use as a means of restricting imports unduly; for export subsidies; for creation of Trade Corporations; for restriction of imports so as to safeguard the Balance of Payments position. More lenient revisions may be introduced for withdrawal of concessions, hitherto granted; for protecting the national

¹ Ibid, pp. 26
security interest and for Customs Union or free trade zones.¹

EVOLUTION OF TRADE THEORIES — MERCANTILISM:

The economic ideology that existed in the middle ages is known as Mercantilism. Von Thunen, Cirrah of Italy and David Hume are some of the protagonists of mercantilist doctrines. All that they advocated was to protect and safeguard the national interest. Some of their ideals were national self-sufficiency in the matter of food and agriculture. They also maintained that the nation should conserve gold and precious metals.² In their eagerness to do foreign trade with a neighbouring country they insisted that their nation should export but not import.³ But they never bothered about retaliation on the part of such countries. The Navigation Acts were the outcome of their policies. Between 1560 and 1750, there was a watershed of economy which never aroused any interest amongst the contemporaneous citizens of the country. Afterwards as the social class scanned it, there had been a gradual change. The crude and regulatory laws became out-moded. The rich traders and merchant princes who became more powerful began

² Ibid, Page 700
³ SNIDER A. DELBECQ: "Even the best Mercantilist thinker viewed more receipts as a stimulus to the national economy. They propagated an essential commercial policy, i.e., to develop an export surplus — the so-called favourable balance of trade .... At the same time imports were severely restricted except for the raw materials needed for domestic production and except for the precious metals. These devices were outright prohibition and high protective tariffs." INTRODUCTION TO INTERNATIONAL ECONOMICS IV EDITION, Page 168.
to discredit these ante deluvian principles. The spirit of individualism has ushered in new modifications and changes. People began to hate restrictions, impositions and controls. They resented authority and clamoured for the withdrawal of regnant regulations.

ADAM SMITH:

At a time when Great Britain could experiment with the individual growth and development through her pioneering efforts of Industrial Revolution new fangled thoughts and economic re-orientation of ideas came to contemporary men of eminence. As the founder of modern ideas, Adam Smith

1. RAVELIAN C.M.: "It is indeed useless to look for any date, or even for any period, when the Middle Ages "ended" in England. Yet even now we retain the medieval institution of the monarchy, the peerage, the commons in the parliament..... And useless we become a totalitarian state and forget all our Englishery, there will always be something medieval ..........The man who established our civil liberties in the 17th Century appealed to medieval precedents against the 'modernising' monarchy of the Stuarts. The pattern of history is indeed a tangled web. No single diagram will explain its infinite complication."

ENGLISH AND SOCIAL HISTORY. Longman and Orients New York, 1942, Pages 95-96.

2. ROBERTSON H.M.: "I have seen so many experiences and even the end is dearth, and lack of the thing that we seek to make cheap. Nature will have its course.....and never shall you drive her to consent that a penny worth of now shall be sold a forthing.....For who will keep a cow that may not sell the milk for as much as the merchant and he can agree upon." ASPECTS OF THE RISE OF THE ECONOMIC INDIVIDUALISM, New York, 1928. Page 70.

3. ELLSWORTH P.T.: "Each man is best fitted to be the judge of his own nation. Individual interests are not in conflict but are not in conflict but are subject to a natural harmony....and the continuous regulations of Government unnecessary." INTERNATIONAL ECONOMY III EDITION, New York, 1950. Page 47.

4. BOWLY: "In his analysis of exchange value and by adopting consumer's concept of wealth, can be found the traces of the subjectivist school." THE DEVELOPMENT OF ECONOMIC DOCTRINES - AN INTRODUCTORY SURVEY, Page 149-150.
advocated free trade and condemned protection and also decried all economic controls and regulations.\(^1\) As the founder of the modern ideals, he advocated free trade and condemned protection. He exposed the weakness and impracticability of the theme of conserving precious metals - once hailed by the Mercantilists as the greatest dogma. He treats foreign trade on par with domestic trade. He considered it as much responsible for increasing specialisation and for multiplying exchanges.\(^2\) If trade was well-attended and taken care of, gold will automatically look after itself. He holds the view that protective duties and tariffs are useless and hence hurtful. Along with free trade, he advocated government interference in the matter of defence industry.\(^3\) Secondly, he felt that if the neighbouring

\(^1\) Ibid: "His real contribution lay in attacking the numerous gild and government restrictions on trade. According to Smith, enforced self-sufficiency by way of contrast condemns families to a miserable scratch upon customs duties as contrary to the social interest and was inclined to regard the smuggler as a public benefactor." - Page 168-169.

\(^2\) SPANN O: "He had identified exchange value with the value and his theory relates only to the 'formal laws of value and of price". TYPES OF ECONOMIC THEORY London 1945, Chapter IV.

\(^3\) ALEXANDER GREY: "First as against the mercantilist tendency to consider that the interest of each nation consisted in beggaring its neighbours, has emphatically asserted the common interest of all nations in these matters. It is a familiar point alike to Physicocrats and to David Hume. The second point is his adumbration as against the Balance of Trade of another more important balance, the balance of the annual product consumption. This is the real test of prosperity and it may exist in a country without foreign trade, cut off from all other nations just as it may exist in the world viewed as a whole."

The DEVELOPMENT OF ECONOMIC DOCTRINES - AN INTRODUCTORY SURVEY - Page 149-50.
country could not show equality of treatment, he insists on government imposing heavy duties. He upheld the view that free trade need not be continued and imposition of a tax upon imports as a retaliatory measure. With due circumspection and reserve, efforts may be made to restore free trade.

**DAVID RICARDO:** The most theoretical dissertation on foreign trade is found in the writings of David Ricardo. He was anxious to show that a nation might properly import goods, that it could itself make with a lower expenditure of labour as long as its relative efficiency in making other exportable goods was even greater. He has earned universal applause for the first and pioneering analysis about the laws governing the movements of money. Suppose any country had an adverse balance of trade, excessive money will be exported and scarcity of money will be experienced. Scarcity of money will lead to an increase in

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1. **GIDE AND RIST:** *It must still be considered the most successful attempt made at embracing within a single purview the infinite diversity of the economic world.* HISTORY OF ECONOMIC THOUGHT, Page 118.

2. **HANKEY:** *In the whole book we find two pictures of Adam Smith - the one in which he is inspired by physiocrats and other advocates of individual liberty, taking refuge in the invisible hand.* HISTORY OF ECONOMIC THOUGHT, Pages 240-242.

3. **BELL J.F.:** *His abstract reasoning in analysing the economic problem was responsible for the methodological development and he will always be regarded as the master of deductions in economics.*

4. **GIDE AND RIST:** *So far as the theory of international trade is concerned, was his discovery of the laws governing the movements of money from one place to another and the admirable demonstrations which he has given us of this remarkable ebb and flow.* HISTORY OF ECONOMIC THOUGHT, Page 178.
its value and prices will fall. Low prices will naturally stimulate exports and money which had already gone to a foreign country will come back. He expected a perfect automatic in economic operation which might bring equilibrium. In fact his book 'POLITICAL ECONOMY AND TAXATION' contains a well-analysed chapter on Foreign Trade. The principle of cost of production to international trade first critically applied and demonstrated by D. Ricardo for the first time. This was his first working hypothesis in this field which could apply to the whole country. Had he applied from historical precedent and statistical analysis, he would have no critics relating to his doctrine.  

JOHN STUART MILL:  

J.C. Mill holds a very elaborate and broad view about internal as well as international trade. He has followed the footsteps of his predecessors, Adam Smith and David Ricardo. According to him, value in international trade are governed by a law of equation of international demand. His confirmed opinion is that money and credit in international trade does not in any way affect the law of equation of international demand. It is not the difference in the  

1 JOHN M. R. KEYNES: "Ricardo did not give historical or statistical facts to support his conclusions." SCIENCE AND METHODS OF POLITICAL ECONOMY, Page 222.  

2 ELLIOT SMITH: "For twenty years says Morley "no one at all open to serious intellectual impressions has left Oxford without having undergone the influence of Mill's teaching". VOLUME IV, Page 39.  

3 SCHUMPETER: "While classical economists considered economics as the science of wealth Mill preferred to call it both science and art i.e., the science of economics and the art of policy."
absolute cost of production which determines the interchange between nations, but between difference in the comparative costs. As he has made a very abstract exposition, it is very difficult to be adapted.

Mill also attempted to find out the potential gains from trade. Due to technological changes, the increased production should be supported by increased demand in the other country. If it is not, there is no potential gain at all. He advocates extensibility of foreign demand. If extensibility is unity, then the proportionate increase in the price of quantity purchased of one country will be equal to the proportionate reduction in the purchase of the quantity of commodity of the other country which is expressed in terms of the other commodity. Mill's extensibility ideal is similar to Marshall's electricity of demand. His work is totally eclipsed since he has made a very abstract calculation devoid of the effect of monetary part.

KARL MARX:

The great socialist Marx was born in the City of Trier on the 5th May 1818. He came of a cultured and well-to-do family. He studied mostly jurisprudence, history and philosophy and submitted his doctoral dissertation on

\[1\] Ibid: "Suppose that the ten yards of broad cloth cost in England as much labour as........fifteen yards of linen in Germany as much twenty........his supposition then being made, it would be in the interest of England to import linen from Germany and Germany to import linen cloth from England." PRINCIPLE OF POLITICAL ECONOMY BOOK III Pages 584-595, London 1940.
Epic rian philosophy. Even in his early days, the views of Hegelian ideals were visible. The then German Government deprived Ludwig Feurbach of his chair and refused to allow him to continue the place in the university. The left Hegelians including Marx left teaching and started 'Rheinische Zeitung' an opposition paper and its first issue appeared on the 1st January 1842. Both Marx and Bruno Bauer were the major contributors of articles to this Zeitung. Shortly Marx became the chief editor. Soon the paper was severely censored. So the editor had to resign. However, the paper had to be closed down. In Paris he published 'Deutsch-Franzosischo Jahrbucher.

It is here that he come in contact with Frederick Engels. Through his 'Poverty of Philosophy' he thoroughly demolished the ideals of Prodhan.

The entire socialist doctrines on economic foundations are based on Marxian ideals who drew clear lines of distinction between capitalist methods and socialist methods. In fact the basis of David Ricardo has been adapted by Karl Marx in interpreting the cost of production theory. But he preferred to call it as surplus value. At a certain stage in the development of commodity production, money gets metamorphosed as capital.¹

¹Karl Marx: "The simplest form of the circulation of commodities is C-M-C the transformation of a commodity into money, and the retransformation of money into a commodity; selling in order to buy. However, side by side, with this form we find another, which is specifically different. We find the form C-M-E M-C-M, the transformation of money into commodities, and the retransformation of commodities into money, buying in order to sell. Money that circulates in the latter way is thereby transformed into capital, as already potential Capital." 'CAPITAL' by Karl Marx translated from the IV German edition by EDEW and CEDAR PAUL, Vol. I, Page 68.
The Commodity Circulation Formula was C-M-C (Commodity-Money-Commodity), i.e., the sale of one commodity for buying another commodity. The general formula for capital on the contrary is M-C-M (Money-Commodity-Money) purchased for the purposes of selling at profit. The increase over the original value of money put with circulation is known as surplus value. It cannot arise out of addition to price circulation and arise out of addition to price for the mutual losses and gains of buyers and sellers would equalise one another, whereas, what we have here is not an individual phenomenon but a mass coverage, i.e., a social phenomenon. It is human labour power that matters. Karl Marx had explained cost of production through the labour power contained in every section of the labour in manufacturing the commodity. The capitalist is able to buy the labour power at a very nominal cost. This is known as the exploitation theory of value. The capitalists grouped themselves into cartels and associations are able to market the products and derive large surplus profits. Karl Marx was the first to combine socialism with a historical and theoretical analysis of economic process and to transform socialism from a mere talk of Utopia into an authentic science. Since the days of Physiocracy, this is the first attempt on a large scale to grasp modern economic life in its totality and treat it as a generating force of the corresponding form of social organisation and development.
Marx's views on foreign trade: Marx deliberately pointed out that through slavery world trade has been developed by the capitalist country of U.S.A. Slavery, therefore, is an economic category of the highest importance. Without slavery North America, the most progressive country, would be transferred into a patriarchal land. You have only to wipe North America off the map of the nations and yet get anarchy total decay of trade and of modern civilization.  

If North America is wiped out, that means the end of world trade and modern civilization. Secondly in his critical reply to La Salle's Wage fund doctrine, he pointed out that world trade would be made possible soon with the co-operative effort of the workers. But the co-operative effort should come from the Government which should not managed by bourgeois economists and other vested interests.

Marxism Revisionism envisaged economic process in historic flux and objected to an analysis of economic phenomena in terms of universal laws and to a conception of market which overlooked the facts of social stratification.


Vladimir Illionov Lenin, the founder of the Modern Socialist Soviet Government calls Imperialism as the highest form of Capitalism in America and Europe and later in Asia fully developed in the period 1898-1914, the Spanish American War, 1898, the Anglo-Boer War (1898-1902), the Russo Japanese War 1904-05. In fact, the economic crisis in Europe in 1900 are aspects of several historical landmarks in the era of world history. Therefore, world trade and its expansion is something of a very recent phenomenon and is closely associated with capitalism. In the modern concept commercial supremacy implies industrial supremacy and those countries where industries are controlled by capitalists such a phenomenon is visible. In the period of manufacture, it is the commercial supremacy that gives industrial predominence. According to Kautskay, international trade would of lesser extent than under capitalism.

1 V.I.Lenin: "Imperialism has been responsible for the growth of capitalism. Its specific character is threefold (i) monopoly capitalism (ii) parasitic or decaying capitalism and (iii) Moribund capitalism. Monopoly manifests itself in principal forms (i) cartels, syndicates and trusts - the concentration of production has reached a degree in which gives rise to these combinations of capitalists (ii) the monopolistic position of big banks three or four gigantic banks manipulate the whole economic life of America, France, Germany (iii) seizure of the sources of the raw materials by the trusts and the financial oligarchy....(iv) the economic partition of the world by the international cartels has begun. Such international cartels which command the entire world market and divide it amicably among themselves - until the war redvides it already number over one hundred; the export of capital a highly characteristic phenomenon distinct from the export of commodities under non-monopoly capitalism closely linked with the economic and territorial political partition of the world is completed". MARX ENGELS MARX IV Eng. Edition, Page 354. Foreign Language Publishing House, Moscow, 1951.
Further, trade would be well-planned. Later Socialists have completely done away with private profiteers throughout the country of U.S.S.R. In India, the State Trading Corporation has been started with the object of carrying on India Soviet Trade with great circumspection. Joseph Schumpeter has admirably summed up this view. Through proper planning on India Soviet Trade with great foresight the vague interpretation and impact of foreign trade by bourgeois economists will be put an end to. Through state monopoly the undue profit-seekers would be totally eliminated from the arena of trade. Through autonomous corporations, large scale operations would be handled that means a blow to capitalism.

RECENT CONTRIBUTIONS TO TRADE THEORIES:

The international trade theories have been the doctrinaire approach of Western Economists from time to time with a conceptual and universal outlook. Starting from the times of Mercantilism Trade Theories gradually developed according to the trend of times. David Ricardo the eminent economist was the first to give a theoretical analysis on the

1 G.D.H. COLE: "Under a socialist system international trade will be of less extent than under capitalism. He bases his view on the anticipation that production will be planned with a view to consumption rather than to the sale of product and that whereas Capitalism is driven further and further afield in search of markets to absorb its increasing output." SOCIALIST THOUGHT MARXISM AND ANARCHISM, London, Macmillan, 1957. Page 434

2 J. SCHUMPETER: "The economy of foreign trade has always received undue attention from bourgeois economist and statesmen.................

............................greatly diminish the attention devoted to it and to foreign trade". CAPITALISM, SOCIALISM AND DEMOCRACY (Harper & Bros., New York, 1942. Pages 211-212.
basis of division of labour. Another very remarkable and pioneering work was the question of currency movement from one country to the other which in return may envisage exports and curb imports, etc. His successor John Stuart Mill sterilised the cost of production theory under the Comparative Costs and not on the basis of Absolute costs of production.

The legacy left behind by D. Ricardo has not been destroyed but only refined, modified and developed by later writers. F.W. Taussig has introduced the question of non-competing groups. According to Taussig, labour and other productive factors are mobile within the country but immobile amongst nations.1 Domestic price relationship is based on the cost of labour embodied in each unit of the commodity.

The German Economist Friedrich List wanted a system of protection.2 The slogan of List was "PROTECT THE BABE, NOURISH THE CHILD AND FREE THE ADULT". He wanted only such of those nations facing severe competition in the hands of powerful nations to adopt protectionist policy. Hla Myint's 'FOSSILISATION' is the latest addition and the most recent exposition of the classical theory of foreign trade. Through deductive explanation Hla Myint replaces the concept of "NATURAL RESOURCES" by the terms "SURPLUS NATURAL RESOURCES." A still barren desert, a decade back,

1 Ibid, Page 270.
2 List Friedrich, National Systems of Political Economy, London, 1932, Page 283
the Sahara, has now become a leading mineral oil producing area; not to speak of its rich iron ore deposits found there.\(^1\) Had it not been for civil war in America, cotton plantation in Egypt could not have been a reality. The Malagian Peninsula has no better conditions for the production of rubber than the Amazon Valley. It was only when the British brought from Brazil and started regular plantation in Malaya, that it proved much more economical than collection of rubber from trees growing wild in the area of Brazil. As transport has created greater, faster and efficient channels, of communications, an era of international trade seems to be arising with the international cooperation. A reduction of transport cost brings a profit to the producer and reduces the price to the customer. Some theories of western economists which consider foreign trade as an "ENGINE OF GROWTH" are meant only to provide theoretical justification for perpetuating the international division of labour.\(^2\)

The classical theory of international trade explained by differences in the comparative productivity of labour has now got its modern followers who have successfully explained differences in their relative shares of different countries of the world imports of different products by differences in their relative labour productivity in the relevant industries. The existence of the differences

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in comparative costs underlying international trade was nearly assumed and not explained by the theory. Contemporary theory attempts the more fundamental task of explaining these differences by differences in the ratios in which the countries are endowed with factors of production. This theory originated with HECKSCHER of America but was significantly elaborated by BERTYL OHLIN; in its contemporary form, it owes a great deal to analytical techniques and propositions contributed by SAMUELSON. This model assumes a perfectly competitive economy in which two commodities (call them X and Y) are produced by two factors of production (call them K and L) utilising production functions characterised by constant returns to scale and diminishing marginal rate of substitution between the factors. The quantities of the factors available are assumed to be such that at any given ratio of the price of K to the price of L, the production of X is K-intensive and the production of Y is L-intensive, in the sense that X employs a higher ratio of K to L than does Y. For the analysis of international trade the world is assumed to be composed of two such national economies, the production functions and factors are assumed to be identical in the two countries and the tastes of consumers, in the two countries are assumed to be similar, in the sense that at the same commodity price ratio, they will consume the two goods in roughly the same ratio.
STOLPER-SAMUELSON RELATIONSHIP:

Now let us consider the rise in the relative price of factor K. This will raise the relative price of commodity X which uses relatively more K than does commodity Y. It will induce a substitution of L for K in both the industries, raising the marginal product of K and lowering that of L in terms of both X and Y so that owners of K will unambiguously be better off and of L worse off regardless of their tastes for the two goods. The induced decrease in the ratios of K to L in both industries in combination with the fixed factor endowments will necessitate an increase in the production of X (the K-intensive commodity) and a reduction in the production of Y, if all factor supplies are to remain employed. Thus as long as the economy produces both goods, there is a unique relation between the commodity price ratio, factor price ratio the real incomes of factor owners and the pattern of production. An increase in the relative price of the factor used intensively in producing it, raises the real income of the factor and lowers the real income of the other factor and increases the output of that commodity at the expense of the other.

RYBCZYNSKI THEOREM:

Alternatively let us consider an increase in the quantity of one factor available to the economy, the commodity price ratio and therefore the factor price ratio and factor-
intensities remaining constant. To absorb the increased quantity of the factor while paying it the same price, the economy must release a quantity of the other factor to work in combination with it. This can be only done by contracting the industry that uses the other factor intensively and expanding the industry that uses the augmented factor intensively thereby freeing some of the other factor for re-employment with the additional supply of augmented factor. Hence at constant commodity prices, an increase in the quantity of a factor implies an increased in the quantity of a factor, implies an increased output of the commodity that uses it intensively and a reduction in the output of the other commodity.

The Western doctrines are not acceptable to the Socialists and Communist Countries. These countries envisage economic process in the historic flux and critically object to an analysis of economic phenomena in terms of universal law and to a conception of the market which ignores totally the fact of social stratification.

SOCIALIST INTERNATIONAL DIVISION OF LABOUR:

Since 1953, there has been a greater realisation among the socialist countries to obtain deficient raw materials and fuels to increase their production and thus cut down costs. This process they term as socialist division of labour. Indo-Soviet Trade can be visualised under the above category.

MODERN INTERPRETATION OF THE COMPARATIVE COST THEORY:

Modern writers have adopted a different line of approach to the subject of comparative cost analysis. They are analysed as EQUAL DIFFERENCE IN COST, ABSOLUTE DIFFERENCE IN COST AND COMPARATIVE DIFFERENCE IN COST. The theory of comparative costs was applied to the theory of international trade in the first place by David Ricardo. This is the most important theoretical dissertation on foreign trade.

(i) EQUAL DIFFERENCES IN COST:

In Country A 20 days' labour can produce 200 units of silk

20 days' labour can produce 100 units of jute

In Country B 20 days' labour can produce 160 units of silk

20 days' labour can produce 80 units of jute.

In Country A since 20 days' labour produces 200 units of silk and 100 units of jute, the cost ratio between sale of jute - 200 : 100 of one unit of silk is equal to half a unit of jute. In Country B, the cost is similar to or identical with that of Country A. In Country B, the rate is 160 : 80 units. Expressing thus in terms of ratios we can say:-

200 units of silk in A/160 units of silk in B - 100 units of jute in A/80 units of jute in B.

When the cost ratios are equal, suppose Country A were to export 40 units of silk to Country B. In return Country B may send on the ratio of limit of silk that is half unit
of jute. Thus country A will get 20 units of jute from Country B. There is no use in exporting or importing unless there is some margin of gain in doing so. Thus the conclusion under equal cost difference is that there is no gain to any country from the angle of international trade. Hence there is no possibility of international trade taking place.

(ii) **Absolute Difference in Cost**

In Country A
- 20 days' labour can produce 200 units of silk
- 20 days' labour can produce 100 units of jute

In Country B
- 20 days' labour can produce 100 units of silk
- 20 days' labour can produce 200 units of jute.

In the above illustration Country A has an absolute advantage in the production of silk over Country B and conversely, country B has an absolute advantage in the production of jute. Country A's superiority in silk can be shown as under

\[
\frac{200 \text{ units of silk in A}}{100 \text{ units of silk in B}} = \frac{100 \text{ units of jute in A}}{200 \text{ units of jute in B}}
\]

Country A will specialise in silk production and Country B will concentrate in jute production. Country A will be prepared to enter into trade so long as it can secure more than half unit of jute for one unit of silk. Country B will be prepared to give as much as two units of jute for one unit of silk. There is every certainty for international trade taking place under absolute difference in costs.
(111) **COMPARATIVE DIFFERENCES IN COST:**

Country A 20 days' labour will produce 200 units of silk
20 days' labour will produce 200 units of jute

Country B 20 days' labour will produce 80 units of silk
20 days' labour will produce 160 units of jute

Comparatively cost differences imply that one of the two countries has an absolute advantage in the production of both the commodities but its comparative advantage is greater in the production of one commodity than in the production of the other. In the foregoing illustration, Country A has an absolute advantage in the production of both the commodities. Her cost of production is lower than Country B's. However, her comparative advantage is better in silk than in jute.

\[
\frac{200 \text{ units of silk in A}}{80 \text{ units of silk in B}} = \frac{200 \text{ units of jute in A}}{160 \text{ units of jute in B}}
\]

Conversely country B has cost disadvantages in the production of both the goods but its comparative cost disadvantage is less in the production of jute than in silk.

\[
\frac{160 \text{ units of jute in B}}{200 \text{ units of jute in A}} = \frac{80 \text{ units of silk in B}}{200 \text{ units of silk in A}}
\]

International trade will be beneficial to both the countries if each of them specialises in the production of that commodity by which it has comparative cost advantage. The internal cost ratio in A between jute and silk is one unit of silk = one unit of jute. Therefore, A will be prepared to specialise in silk and export part of it so long as he
can get more than one unit of jute for one unit of silk. The internal cost ratio in B will be one unit of silk = 2 units of jute. Any rate between 1 to 2 units of jute for one unit of silk will benefit both the countries. International trade is possible under these conditions.

CRITICAL APPRAISAL OF RICARDIAN THEORY OF COMPARATIVE COSTS (CLASSICAL):

The theory of Comparative costs runs as follows:

<table>
<thead>
<tr>
<th>Country A</th>
<th>Country B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wine</td>
<td>90 man hours</td>
</tr>
<tr>
<td>Cloth</td>
<td>90 man hours</td>
</tr>
</tbody>
</table>

Assuming that there is no trade restrictions between the two countries A and B, Country A has an absolute advantage as she can produce cheaply. However, she can buy cloth from Country B as she can save 10 man hours labour in her Country (A). So also Country B can import wine from Country A as she could save 20 man hours labour. In the above example, Country A could specialise in wine production and Country B in cloth production. They can exchange their resources based on cost structure only. Suppose, by sheer coincidence, one country is able to make goods at 80% of labour expenditure, then there can be no trade at all.

CRITICISMS:

(1) The output of labour in terms of their wages in the two countries alone is considered, thereby leaving out too many other factors like transport, customs duty, etc.,
involving cost. This assessment is static and rigid. Such a conclusion based on narrow premises is extended by classi­cals to complex modern factors unhesitatingly and also to problems involving numerous commodities.

(ii) After specialisation has proceeded at a certain stage, cost ratios tend to change considerably. The constant cost ratios may not be maintained always. Either the cost factor may be increasing cost or diminishing cost. Therefore, it may not be profitable to carry division of labour beyond the point at which increasing costs completely wipe out the cost difference between the two countries.

(iii) It is incorrect to assume internal mobility within the country. There cannot be such free and effortless perfect mobility within the country. From a depressed industry within a country, factors do not move to other industries. Due to international specialisation, under which a country works, it may be unable to change from one pattern to another.

(iv) 'Natural Endowments' need not be the criterion to back the international division of labour. It would be hard to sustain the view that the 19th century division of labour made the fullest and most rational use of endowments of each particular country. Even without natural advantage a country may produce a commodity without importing from its neighbours.

(v) It is too unreal to assume "no transport cost". At times, the cost of transport may be higher than the cost of production. Rosenthal funnily remarks that unless the
foreign exporter carefully plans his transport costs and terms in advance, the profit which he might anticipate might be totally eroded and wiped out.

(vi) Classical conclusion of complete specialisation between the two countries can hold good only when the "dice is loaded by assuming trade in two commodities of approximately equal value and consumption and between the two countries of approximately equal economies. Therefore, these are normal assumptions.

(vii) Though Karl Marx has adopted Ricardo’s Labour theory, he has made an entirely different approach to it by interpreting it as human labour power and not merely as number of manhours.

(viii) Marx’s followers are dead against the classical interpretations since the entire human labour power is brutally controlled and exploited by the capitalists for their personal profit motive.

(ix) Socialist thinkers discard the Ricardoian theory as it is not fully representative. As a doctrine, it encourages only the growth of capitalism at the expense of labour. Socialist approach is broad-based as it envisions a classless society with ample scope of uniform growth and development and it also curbs undue concentration of power and authority in the hands of a few.

(x) Marxism Revisionism is also opposed to this doctrinaire thinking as they look at the problem with a historical perspective and they plan future programmes and strive at the real cost.
As a prelude to Russian Economy which is discussed in this volume elsewhere, the constraints are fit to be discussed at length here also. The Soviet Union is offering comparatively cheaper facilities and concessional provisions to the members of COMECON known as Council of Mutual Economic Assistance (C.M.E.A.). Such rates and concessions may also be extended to under-developed as well as developing countries. It is alleged that U.S.S.R. and other East European countries are adopting SWITCH TRADE. This has been pointed out that commodities like Mica, Coffee beans raw and roasted and coir products are being utilised in this direction. It is reported that these products are sold by the U.S.S.R. Government to West European market in order to offset their indebtedness arising out of foreign trade with them.

Foreign tourists visiting U.S.S.R. complain of high rates charged by the host country particularly in the matter of consumable goods as they are heavily imposed with customs duties. In the matter of certain commodities like ferrous materials, newsprint the price quoted by the U.S.S.R. Government is high. Then ultimately there is also the constraint about quality product. Of course, Indo-Soviet
Trade may be fraught with dangers but it is proceeded on a very careful and cautious manner. In the present context, centrally planned economies on account of their philosophy of State-ownership and other historical factors have to depend upon themselves. Thus autarkic policies played in their own economy for purposes of development. It was also thought that such centrally planned economies were not interested in international trade but only use such trade agreements to aggrandise their political needs. Since 1953, there has been a remarkable change on the basis of international socialist division of labour and such countries obtain deficient raw materials and fuels to increase their production and cut down costs to the minimum. So U.S.S.R. and other East European countries look to not only developed nations for participation in International trade but also to the developing nations like India. Through personal contacts the discussions are concluded through protocol agreements not only in trade but also payment question.
Refined Classical Doctrines:

From the time of Ricardo and Mill down to the present the essentials of their theory of international trade have remained relatively intact.

F.E. Taussig has provided the answer to problems raised by noncompeting groups of labour and by the existence of capital charges. Taussig's approach can be explained analytically by enumerating major assumptions.

1. Labour and other productive factors are mobile within a country and immobile among nations; Countries with the more productive labour can support the higher levels of wage, provided equilibrium conditions prevail. High wages always evidence high rate of productivity. They are the sign of competitive strength. The per unit costs of producing commodity A in country X are based on the wage paid to each worker in country X divided by the productivity of the worker in the same country. Some classical writers have asserted that per unit costs are not necessarily equal to wage expense per unit of output, but need only be in some fixed proportion. It makes little difference to the subsequent argument which position is taken. Both suppositions are unrealistic.

2. Domestic price relationships are based on the cost of the labour embodied in a unit of each commodity. If commodity A is exported from country X to country Y, then the ratio of wages to labour productivity in the making of
A in X, the unit total costs of A in the country X and the price of A in the country X must all be lower in X than in country Y.

3. Composition within each country prevents undue profiteering. That means composition within the country encourages profit under perfect competition. The price quoted in country X for the commodity A comprises the due or the necessary element of profit. That means cost of production of per unit or average cost is equal to marginal cost which is equal to price. The question of higher element of profit arises where the marginal cost is the lowest marginal revenue is higher than marginal cost and price is higher than marginal revenue.

4. Domestic commodity and factor prices are a function of money supply; An increasing quantity of money in X will raise the wage rates per unit costs and commodity prices in that country.

5. Increased supplies of a commodity at any time can always be produced at the same unit cost as before; Assuming the first supposition, it can be seen that when the cost of production is arrived at it is based on economies of scale to production. This is governed by the law of variable proportion.

6. There are no cost obstruction to the transfer of goods among countries. Suppose country X has to rely on imports of commodity A, if the same commodity produced in
country X is higher than that charged by country Y for the same commodity.

7. The balance of payments consists only of trade items; and

8. Countries are on an automatic gold standard. If country X has a favourable balance with country Y, the quantity of money in country X will increase while it decreases in country Y. Assuming that the country is on automatic gold standard, suppose a country with an export surplus, will be receiving gold or money. This in return creates inflation, prices will rise, exports will decline, and this country will import and have a less favourable terms of trade than it could. Thus Taussig has refined the older theory.

NON-COMPETING GROUPS:

In the basic theory, labour is each country is assumed to be homogenous and to differ between countries only in productivity. Yet it has long been recognised that in any country labour force consists of many different groups of labour (technical skilled, semi-skilled and unskilled, to mention one common classification) among which mobility is far from perfect. The distinct categories of labour with rather well marked and enduring differences in wages become known as non-competing groups. The mere existence of such groups would not affect the theory of international trade provided in each country, the relative scale of wages were the same. But if, for example wages of unskilled labour were specially low in one country, because this kind of
labour was unusually abundant, that country could produce some commodity or commodities at a lower money cost than its competitors even though it had no comparative advantage. The same would be true, were skilled labour or any other of the non-competing groups, the one with abnormally low wages, or if wages of all groups especially depressed in some particular industry. Abnormally low wages for a particular kind of labour, in other words, act as a substitute for real comparative advantage.

Taussig developed this point at some length, yet he thought non-competing groups served to explain only special situations, such as existed in the German Chemical Industry and in the American Iron and Steel Industry before 1914. In the former employers could obtain highly skilled chemical workers at abnormally low rates of pay, while in the latter, as unusually large supply of unskilled immigrant labour reduced its wage level to an extraordinary degree. To a considerable extent, Taussig felt, the ability of both industries to export rested upon these facts. Barring a few such exceptional cases, however, the basic doctrine of comparative advantage requires no modification. This is because - at least in the Western nations the hierarchy of non-competing groups and the relative differences in their wages were about the same.

CAPITAL CHARGES:

Taussig treated capital charges in a similar manner
while admitting interest on capital as an element in money cost, he held that it would have no effect on the relative prices of commodities unless it bore with unequal weight on different goods.

For this to be true, (1) interest rates have to differ among countries and (2) the relative use made of capital as compared with labour would have to vary from one industry to another. Thus a country enjoying low interest rates would have a price advantage equivalent to one caused by the basic principle of comparative costs only in industries in which capital was used in relatively large quantities. Since the national differences in interest rates were judged to be not considerable and since Taussig implied that the relative use of capital did not vary greatly between industries the range of influence of interest rates is restricted to a special set of circumstances. As with non-competing groups, its introduction does not lead to a radical modification of our first conclusions.

By permitting diversity of wages between different groups of labour and differences in interest rates to play a role only in exceptional circumstances, Taussig was able to retain the doctrine of comparative labour costs as the dominant principle explaining international price differences and thus the direction of specialisation and trade.

The so-called natural endowments cannot be regarded as an absolute and unchangeable criterion on which to back the
international division of labour.¹ It would be hard to sustain the view that the 19th century division of labour made the fullest and most rational use of endowments of each particular country. Even without natural advantage a country may produce a commodity without importing from its neighbour. Each country may adopt a restrictionist policy. Classical economists assume no transport costs. This is too unreal. At times, the cost of transport may be higher than the cost of production. A commodity cannot be exported or imported unless the differences in cost between the two countries exceed the cost of transporting it from one country to the other. Classical conclusion of complete specialisation between two countries can hold good only when the two commodities and two countries have equal significance.

**Balance of Payments:**

Balance of payments of a country is a summation of all transactions between it and the rest of the world.² During a given period of time, a record of economic transactions of the residents of the country with the rest of the world is comprehensively compiled. Such balance of payments happen to be itemised statements of the international accounts of a country may be drawn up to cover any period of time. The word balance may mean a credit or debit balance. Over a period of time, the imports from and exports to the foreign country may be offset or show either a credit or debit balance.

¹ Ibid: Page 70.
Different classifications have been applied relating to the various aspects of balance of payments. The easiest form is given below:

I. 1. Merchandise sales or purchases,
   2. Services rendered or received,
   3. Tourists' expenditure, 'migrants' remittances, etc.
   4. Interests and dividends receipts and payments,
   5. Exports and imports of gold.

II. Long term lending and borrowing.

TRADE EQUILIBRIUM:

Based on western doctrine, in an economic state of affairs, this term equilibrium means a balance of opposing forces; any departure from which tends to set these forces in operation to restore economic balance again. It represents a state of balance of payments over the relevant time period which makes it possible to sustain an open economy without severe unemployment on a continuing basis. Suppose, there is physical tallying of both the sides, it cannot be termed as having attained a state of equilibrium. Its important characteristics are:

(i) Equilibrium should be able to eradicate unemployment;

(ii) It sets in motion unrestricted and uncontrolled flow of free economy to cope up with the operations of trade.

(iii) Its economic viability lies in its sustenance within the given period of time, viz., within one year.
On the basis of time, as an important factor the distinction between static and dynamic equilibrium can be drawn. Short-term oscillation and long-term oscillation are the two forces. Static equilibrium is reached when exports equal imports within a short-term. Dynamic equilibrium is characterised by the physical movement of short-term capital and gold. If the above factors are not strictly adhered to, then disequilibrium sets in. The disequilibrium may set in due to one or more of the following reasons.

**Disequilibrium**

- Trade
- Individual
- Investment
- Monetary
- Cyclical
- Secular
- Structural

The first one is due to undue arbitrage in the commodity operations. If prices tend to equalize, this disequilibrium will vanish automatically. Individual disequilibrium is a phase of difference between domestic market price and the international price for the identical product. If there is parity between the two rates, it means equilibrium. If any disparity prevails, then it is known as Individual disequilibrium. This reflects itself in the Balance of Payments. Investment disequilibrium is a corollary to individual disequilibrium. When the international interest rates show divergence, the investors grow repugnant and with
the result they do not invest abroad. Monetary disequilibrium means that the volume of effective money in a country does not bear in relation to the level of business activities, viz., there is visible tendency towards general expansion and/or contractions of output and income as well as employment. Cyclical disequilibrium means that the income pattern of different countries with different elasticities vary in a recurring manner. Secular Disequilibrium is known as long term disequilibrium. This is due to deep-seated changes in the economy of the country. Foreign borrowing or lending may become rather incongruous when compared to domestic savings over investment. Structural disequilibrium may arise at the level of goods when there is a fluctuation in demand or supply. This also may arise at the factor level, i.e., when the factor prices fail to attract factor endowments.

METHODS OF ARRESTING DISEQUILIBRIUM:

(1) CORRECTION OF ADVERSE BALANCE OF PAYMENTS: Through the mechanism of price reduction, export would be stimulated and import discouraged and curtailed. This results in shrinkage of wages, interest and other incomes through the contraction of credit. In the blooming days of the Gold Standard there was an automatic but temporary efflux of gold.

(2) IMPOSITION OF TARIFFS AND QUOTA SYSTEM: This is a severe step taken by the ruling government by directly
restricting imports. But this has got a train of successive reactions from the exporting country. This is useful to curtail imports. But exports will decline in the long-run.

(iii) **BY DEFLATION OF THE COUNTRY'S CURRENCY:** This is an artificial but official rate of deflation adopted by the country in the international sphere. In the normal international market the currency will be highly quoted or dear to purchase in which case its rate is pegged down by the country. That is currency-contract prices will fall or diminish. This tends to stimulate exports and check down imports. But this method of deflation is not without dangers.

(iv) **BY DEVALUATION:** A country's currency is depreciated only in terms of foreign currencies. Internal value of the currency remains unaltered. This is a very aggressive step as the devaluing country has to lose a vital portion if its large foreign investments and in the long-run results in the erosion of confidence which it hitherto commanded in the arena of international trade.

(v) **BY EXCHANGE CONTROL:** Under the first method a strong Trade Union in the country may oppose any move to reduce the living wage conditions. It may try to topple the ruling government itself: Under the second method, the country has to get a similar retaliatory method of imposition of tariff. Deflationary measures are also having the aforesaid consequences. Devaluation may thoroughly shake
the confidence of other countries which repose faith on this country. So, by statute the Government may compel exporters to surrender their foreign currency to the central bank and this is pooled and carefully rationed and equitably distributed amongst the importers of the country.

These methods are not acceptable to the Communist countries. When we examine the economic aspects of Indo-Soviet Trade, we find that trade is juxtaposed with Aid programmes. So, there is an integral inseparable unity between trade and aid. That is why it is known as TIED CREDITS. Though it is openly pointed out that there is no question of foreign exchange involving in this type of trade, as we are allowed to pay in rupees under RUPEE PAYMENTS AGREEMENTS, it has to be admitted that the Rupee value is decisively quoted by the Soviet Government from time to time by means of official modifications. Such a notification fixed the value of Rouble in terms of Indian Rupee. A debtor is always at a disadvantageous position over a creditor. So, without going into the ethics of how the valuation has been arrived at, we meekly submit to the rate as specified by the Soviet Officials. This point is highlighted by the Author through a simple illustration. As from 1st January, 1961, the gold content in the rouble was raised from 0.222168 gms. to 0.987412 gms. The official exchange rate with effect from November 1957 are:

1 Dollar = 82.9 Kopeks
1 £ = 2.16 roubles.

1 STATESMAN YEAR BOOK, 1972-73 - Page 1400 - Macmillan London, Editors: John Parker
At the moment, one dollar is equal to Rs. 7.30. On the above calculation Rs. 7.30 = 82.9 kopeks. That means one rupee will be equal to nearly 11.36 kopeks. But the official rate is Rs. 1 = 8.35 kopeks. The latest position is still precarious as the team of officials of U.S.S.R., have come to India to re-fix the parity rates between the Indian Rupee and the Russian Rouble. Even though they assure that the Indo-Soviet trade would not be eclipsed by this rate. This will be observed only in the case of international postal and embassy transactions and that too over and above the free limits prescribed from time to time. As a prelude to Russian Economy which is discussed in this volume elsewhere, the constraints are fit to be discussed at length here also.

The Soviet Union is offering comparatively cheaper facilities and concessional provisions to the members of COMEBON known as Council of Mutual Economic Assistance (COMECON).

**ROLE OF INTERNATIONAL MONETARY FUND IN THE BALANCE OF PAYMENTS**

I.M.F. was formed to channelise the international payments. Actually, it is a substitute for the erstwhile Gold Standard Mechanism. This Fund had started its operations from 1st March 1947. The theme of the IMF is well brought out by various authors. The aim of I.M.F. is to give confidence to its members by making the Fund's resources available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity. When Gold Standard
could not be effectively operated during the thirties due to economic depression and the II World War disturbed exchange parities. Many countries started this institution as an exchange stabilizer. First this was planned and started as a Dollar-Pound Sterling Parity unit. Mr. Ivor Booth, the Chairman of the Executive Directors had admirably summed up the chief functions, viz., to help to restore international balance, to help its members in establishing the convertibility of their currencies and to minimize the impact of business fluctuations. I.M.F. also encourages liberal exchange policies by negotiating stand-by agreements with interested member countries receive the Fund's guarantee within the specified period of time. Due to impact of the International trade a particular country may have to resort to exchange depreciation. This may have its ill effects. Probably there will be retaliation. But the fund is able to get over those difficulties by supplying the necessary assistance temporarily.

Thus summarising its role in the matter of Balance of Payments, the I.M.F. serves as a short term credit institution. Any member country with an adverse balance of payments can seek assistance from the Fund. Secondly, the Fund provides a mechanism for improving short-term balance of payments position. In fact the Fund tries to maintain an orderly adjustment of exchange. No member country can resort to competitive exchange depreciation.
The I.M.F. has adopted the rule that currency purchased from it by member countries should not remain outstanding for more than three to five years. A schedule of charges on the use of Fund's resources put teeth into the rule. Through mandatory consultations, the Fund places pressure on the country to repurchase its currency with gold or an acceptable currency. This is not a source of capital like that of the International Bank for Reconstruction and Development known as "World Bank".

In 1963, the Council for Mutual Economic Assistance (COMECON) agreed to establish an International Bank for Economic Co-operation (IBEC) to facilitate multilateral clearing within Soviet Block. The capital of IBEC is 300 million transferable Roubles (330 million dollars) at the parity of exchange of which the Soviet Union has subscribed 116 million roubles. The eight members of the IBEC include all the European countries in the Soviet Block and Mongolia. Operations were begun on 1st January 1964. IBEC may grant credits to the monetary authorities of the COMECON countries for settlement needs within the system, seasonal credits to offset fluctuations in export receipts, promotion credits, to increase trade within the block, balance of payments loans to finance deficits and loans for multinational construction projects. IBEC may also accept deposits from member countries in transferable roubles, in gold, and in fully convertible Western currencies.
The financing of trade between the Soviet Block and the West has become an important function of I.M.F.

At the initial stages of the formation of the I.M.F. U.S.S.R. was occupying the fourth place and then it withdrew its membership. It was followed by China later. India is a permanent member of the I.M.F. Indo-Soviet trade is outside the scope of I.M.F. and settlement is made by Rupee Payment. At the current moment, the Indo-Soviet Credit Agreement contains the Gold Clause of parity and the gold content of the Rupee is indicated as 0.186621 gms. of fine gold per rupee. This is the indirect way of linking rupee to rouble under I.M.F.

BILATERALISM AND MULTILATERALISM

Trade carried on between the two countries only is known as bilateral trade. In a practical world beset with imperfect conditions, it is not possible to enjoy the full benefits of multilateral trade. This view is stressed by Ragnar Frish. Between 1930-31, the West European countries tried to introduce bilateral dealings. Amongst the earliest forms of bilateral trade, barter deals were undertaken by private firms. These measures were quite common prior to the II World War. Agreement had to be reached on what commodities would be exported, and also in what quantities and value. Upon receipt of the goods, the importer in each country paid the exporters in the importing country's currency. Private compensation requires that the individual exports and imports of each transaction offset each other. The Clearing Agreement is another
aspect of bilateralism. One great drawback to all such devices is that they force nations to buy mainly from their customers but under free exchange on account of international division of labour, the tendency is to buy in one country and sell to another. A much wider and somewhat larger in scope is the Payments agreement. It can be extended to payments not necessarily arising out of exchange of merchandise including outstanding debts. Countries which build up substantial credits in those countries having strict exchange control regulations prior to the introduction of such controls as a result of the operation of bilateral agreement. A payments agreement provides the means to thaw it by prescribing that certain percent of payments for imports into the creditor country's clearing account shall be earmarked for the liquidation of accumulated debt. The debtor country must hold import from the creditor country sufficiently so that the agreed proportion of the value of its exports actually become applied to debt retirement.

PHILLIP A.S. TAYLOR: "Bilateralism denotes a system of special trade and payments art agreements between pairs of countries. This is always contrasted to a system of multilateral trade." A NEW DICTIONARY OF ECONOMICS, London Routledge & Kegan Paul, 1967. Page 17.


VILMER JACOB: An essay on 'Bilateralism' appearing in Custom Union Issue (Carnegie Endowment of International Peace, New York, 1950-
The chief peril to multilateral trade in the present world may be bilateralism. The chief problem of international commercial and economic Comity of nations may be ineffective in curbing this tendency. There are many devices by which Government authority or private monopoly can interfere with the courses of international trade when it is free or unrestricted. These devices may be like the venerable methods of protective tariffs to the more versatile methods of under or over-developed exchange rates, multiple (or discriminatory) exchange rates, direct quantitative control of imports and sometimes of exports through exchange control, quota system, clearing and compensation agreements, cartels and finally as a sort of culmination, i.e., State Trading. In fact, multilateral trade is to be achieved as the objective of international trade. The pre-war system of multilateral trade rested on the economic strength of the U.K. and the continuing export of capital from U.K. In the 20th Century, the relative decline of the British power and the disruptive effects of the two wars and an intervening economic depression have brought about its disintegration. The essence of multilateral settlement involves a 'closed circuit' of net balance between

2 TIMIR GITOVSKY: "In appraising the social desirability of an economic action from the international point of view, of all ramifications of that action must be fully taken into account whereas from the national point of view, the welfare of domestic nationals alone is relevant and the losses suffered and the benefits gained by foreigners are ignored." "TWO CONCEPTS OF EXTERNAL ECONOMICS." Journal of Political Economy, April 1944, Page 190.
the respective trading nations. Let us illustrate this by an example. Country A has a net export balance with Country B. Country B has a net export balance with Country C. However, the inference is each country A, B and C should have identical net balance of export. By a not work of multilateral trade, the individual trader is free to buy and sell in international markets in accordance with his own judgment. In more significant terms, the international trade can bring about the highest gains only to the particular participants where there is a multilateral structure that fully reflects the comparative costs of national economies. Multilateral trade accompanied by multilateral convertibility of currencies had long been considered as the best method for ensuring the maximum advantage from international specialisation. An imposition of restriction of free country could not find the dearest market to sell while the importing country should not go in for the cheapest market to buy. Thus it is believed that bilateralism is a form of restriction imposed upon trading countries. In the modern times many developing countries have toed the line of bilateral methods despite dangers.

The special features of Indo-Soviet Trade as a bilateral trade agreement are introduced:

1. These are instruments of agreements which cover a period of five years; the objectives of bilateral and trade and payments agreements can be summed up as:
(a) These are instruments of agreements which open up direct trade contact with centrally planned economics.
(b) Obtaining capital goods and industrial raw materials without additional drafts on foreign exchange resources of convertible currency.
(c) Stabilising the prices of traditional exports.
(d) Reducing the dependence on traditional export markets.
(e) Utilising imports for automatic expansion of exports and
(f) Opening up of markets for some non-traditional exports.

These agreements are all very comprehensive documents which inter alia deal with matters regarding economic co-operation and technical assistance.

(ii) They are outcome of Protocol trade talks carried out by the representatives of both the governments.

(iii) Mode of payments is in terms of inconvertible rupee.

(iv) Items of export and import are clearly defined and agreed upon

(v) Targets of exports and imports are also indicated.

U.A.R. SOVIET TRADE
Long-term trade agreements
U.A.R. occupied nearly 4.7% of Soviet trade

SOVIET FINNISH TRADE
Similar long term trade agreements
Finland occupied 3% of Soviet foreign trade.

Inconvertible Egyptian pounds Settlement made in Finnish Kronars

Source: Soviet Foreign Trade, page 24
Soviet Review Vol. 5, No. 18,
March 12, 1968.

U.A.R. Soviet Trade and Soviet Finnish Trade are more or less carried on similar lines. The bilateral agreement plays a major role in the matter of trade and payments also.

Both these agreements are drawn on friendship non-aggression and mutual assistance between the two countries, viz., U.S.S.R. and U.A.R., so also U.S.S.R. and Finland.


U.S.S.R.-Finnish trade has been carried on above lines which are noted below:

GAINS OF TRADE:

The classical economists applied comparative cost theory with a view to assess the terms of trade and thereby tried to establish through division of labour the economic advantages and gains of trade. Elsewhere in this Chapter attempts have been made to demonstrate with numerical example, the difference in cost, viz., absolute differences in cost, equal differences in cost and comparative differences in cost. In order to assess the benefits accruing to India from her trade under the bilateral arrangements, the following criteria have had to be evolved. These are considered appropriate as guide posts to judge the benefits from trade under bilateral payment agreements:

(i) Whether India could have established significant trade with the centrally planned economies of Soviet Union and other East European countries without the trade and payments agreements;

(ii) Whether the composition of the high level of trade established is advantageous to India;

(iii) Whether the export prices secured from the Soviet Union and other East European countries are higher than those secured from other countries, whether the import prices from these countries are lower than the prices of imports from the convertible currency countries, and whether the terms of trade have moved in favour of India;
(iv) Whether the increased trade with these countries is at the cost of trade with convertible currency areas;
(v) Whether these agreements have limited the freedom enjoyed by India in formulating her commercial policy to suit her changing needs; and
(vi) Whether the quality of products and the terms of sale compare favourably with the quality and the terms of sale from convertible currency areas.

The above have to be viewed in totality, for no single criterion applied in isolation will enable full appreciation of the overall direct gains or loss flowing from such trade. The issues raised above, regarding the terms of trade are dealt in detail in Chapter IV and V.

CONCLUSION:

On the basis of economic principles, the study of Indo-Soviet Trade has been made on the grounds of well-set doctrines of classical economists, the neo-classical economists and Soviet economic theoreticians. Before we could consider the different aspects of Indo-Soviet Trade we have made efforts to summarise the doctrines of international economics from Mercantalists till the present day and the role of international monetary institutions with their impact on international trading are analysed. Efforts are also made to compare Western concepts of international trade with those of Karl Marx. International Trade involves
certain basic principles of multilateralism vs. bilateralism. Multilateralism has got its superiority in the matter of settlement of intercontinental indebtedness through Balance of Payments. The study of Indo-Soviet Trade is governed on the novel method of Bilateral settlement. Bilateralism involves clearing agreements. In the present context it is unique and envisages face payments easing foreign exchange crisis. This is a manna from Heaven. Thus the special attractions inviting a developing country to enter into bilateral trade are (i) clearing agreements and (ii) no conversion of the national currency. Therefore Indo-Soviet Trade has grown into larger dimensions. By and large Indo-Soviet Trade is a bilateral trade based on Marxist as well as socialist ideals in which no private individual can be a profiteer. Institutional buying and settling is encouraged.

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