CHAPTER – I

INTRODUCTION

1.1. The Problem:

The perception about the role of international trade in economic development of a country has gone through a number of changes in the post war period. During the 19th century particularly in the first half, an expanding export trade played a leading role in providing stimulus to growth of economy of Great Britain. Similarly Japan, Canada and Switzerland also gained from export-led growth.¹

In these countries, an expanding export trade gave a conspicuous momentum to the economy and helped it on its way to industrialization. The dormant or idle resources were drawn into economic activity for export production; increasing labour forces or capital stock was gainfully allocated and thus the benefits from specialization and economies of scale were fully derived. These benefits were derived by the primary producing countries which were still in the process of being settled. Trade enabled
them to bring into use their great unexploited natural resources and freed them from limitations of their own domestic markets. Further the areas that had natural resources whose products were in growing demand abroad also received an increasing amount of foreign capital to exploit those resources and to increase the supply of the products. This along with expansion of export, led to a culmination process of development in these countries. Thus for most of these countries trade was an "engine of growth".

During the 20th century, however, two divergent opinions emerged on trade being an engine of growth for the developing countries. They were reflected, for example, in the positions taken by Ragnar Nurkes and A. K. Cairncross on this issue. Nurkes was of the opinion that the 19th century trade growth nexus could not be as effective for the present day developing countries of the world for the simple reason that, "the 19th century conditions were different: they happened to be such that the growth of the dominant economy, Great Britain, did tend to transmit itself to the periphery through an even more than proportional expansion in demand for trade materials and foodstuffs. This mechanism of growth transmission is now in comparatively low gear." The reasons which he advanced to establish his case included: the low elasticity of demand for foodstuffs, agricultural production in the industrial countries, the
increased share of services in the consumers’ budget, the shift towards less material-intensive products in manufacturing, the substitution of synthetics for natural materials, and the reduction of import requirement in individual industries.\(^3\)

On the contrary, A. K. Cairncross considered the contribution of foreign trade to economic development of developing countries as unique. To him, “Trade is no mere exchange of goods least of all when it takes place between economics at different stages of development. As often as not it is trade that gives birth to the urge to develop, the knowledge and experience that make development possible, and the means to accomplish it.”\(^4\)

During the 1950s and 1960s following the writings of Prebisch\(^5\), Singer\(^6\), and Myradal\(^7\) that the commodity terms of trade of developing countries trend to deteriorate over time, many developing nations such as Argentina, Brazil, India and Mexico opted for the industrialization strategy of import-substitution. This strategy involved extensive use of trade barriers to protect domestic industries from import competition. It favoured production for the domestic market over the export market. But soon it was realised that this strategy was not free from limitations. By the 1970s many developing countries abandoned their import substitution strategy and shifted emphasis to export led growth. Since then the
developing countries in general have been increasingly participating in world trade.

The general arguments advanced in favour of international trade can be summarized as follows:

- It encourages division of labour and hence specialization of resources of production may be achieved. It will increase the efficiency of the labour which cannot be achieved without specialization in a particular field of production. As a result specialization takes place on international level. Different countries specialize in the production of different commodities. The net result is that each commodity is expected to be produced at the minimum cost. Jacob Viner has said that “Foreign trade involves some degree of specialization or of international division of labour, specialization however is not good thing in itself, but is a good one so far as it increases real income and yields a net national gain.”

- International trade prevents the rise of monopolies. It is because by importation of cheap commodities from abroad such efforts of the monopolies can be rendered ineffective. This way, international trade saves some consumers from being exploited by home monopolies. Hence, international trade restricts monopolization.
• It is argued that the encouragement of international trade brings about a revolution in the technique of production. Every country tries to make most efficient use of its resources in a specialized production to get maximum production at a minimum cost which is possible only after adopting new techniques of production. The consumers get commodities at lower price. If there is free competition in the international market the price will be the lowest without affecting the quality of the consumer’s goods. Each country wants that its products should be demanded the most therefore it will try to maintain the quality of the products.

• The next argument in favour of international trade is that each country can utilize its surplus in terms of raw materials, manufactured goods, extra manpower etc. In the absence of international trade if the domestic supply is not matched by appropriate demand, internal disequilibrium will result. This can be avoided by creating external demand which is possible by encouraging international trade.

• Another argument is that international trade encourages mutual co-operation among nations. It has a two-way benefit. Rich nations get their extra capital invested in countries where raw materials are
in abundance without adequate capital. The poor nations on the other hand get the process of growth initiated which might have not been possible due to lack of capital. Therefore, international trade encourages social, economic and political co-operation among nations. International trade also helps poor countries in the period of their crisis. In the absence of international co-operation underdeveloped countries will be helpless. Even the short-term crisis may lend these countries in severe economic instability.\textsuperscript{9}

There is no major disagreement on the fundamental proposition that international trade and investment are the major engines of growth for developing countries through many mechanisms: foreign exchange earnings, learning, technology transfer, innovation, and productivity improvement. International trade rules could also have a positive effect for market development, for transparency and for good governance. However, there is also a widespread consensus in recognizing that while necessary, an outwardly-oriented policy regime is not sufficient, nor could it be a substitute for sound development policy which entails a stable macro-economy; investment in education, infrastructure, and institutions; social policies and environmental protection. In other words, the prospects for a new consensus on trade and development rest on recognizing that the relationship between openness in trade and finance
and development, while positive, is not as automatic or exclusive as some recommendations seem to suggest, and that development policy is something much more complex and varied. Indeed, that development is a multifaceted transformation of societies. It is also apparent from this perspective that it would be wrong to blame trade liberalization or “globalization” for failure to achieve development goals that could not be reasonably be expected from trade alone in the first place, or only with an excessive optimism about its power for development.

While recognizing the importance of systemic openness, developing countries reiterate a number of important messages: the need for more access to developed country markets, for more flexibility and for more technical assistance.

**Access:** more access to markets involves mainly, in there view: elimination of high tariffs and of non tariff barriers in sectors in which developing countries have comparative advantages; elimination of tariff escalation; tougher disciplines in the application of trade remedy laws by developed countries and further strengthening of disputes resolution mechanisms. It also entails more access for their skilled labour to global markets for services. In turn, it must be stressed that more access to international investment flows requires developing countries to improve
their investment climate (from macro-disciplines, to investment protection, to the core factors of competitiveness).

**Flexibility:** More flexibility, a case often coded under the term “differential treatment”, is stated by developing countries as necessary to manage the transition on periods, and also to be able to use a variety of policies and instruments to promote development. This is an area of heated controversy that will benefit greatly from developing countries being specific about the nature and scope of flexibility that is deemed appropriate.

**Technical Assistance:** Developing countries, some international organizations and experts, frequently argue the case for massive flows of technical assistance, and also for more finance for development needs, and these symposia were no exception. Many developed countries also recognize these technical assistance needs and are in fact providing significant amount of it. Trade related technical co-operation is necessary even for ensuring that countries, particularly the least developed countries, implement existing commitments. The reservations some countries express regarding the feasibility of their obtaining sufficient benefits from trade negotiations, or about being marginal participants in this process, stem partly from perceived restrictions to pursue a
pro-active, fully engaged, positive agenda in trade negotiations. Technical assistance is seen as essential to overcome these restrictions.\textsuperscript{10}

In India too, the perception about the importance of international trade in economic development has gone through changes during the last six decades or so. Influenced by the writings of Prebisch and Singer, India like many other developing countries opted for the policy approach of industrialization through import substitution after gaining independence in August 1947. Imports were regulated both by quantitative restrictions and exceptionally high tariff rates. Tariffs varied widely across sectors and commodities. The tariffs and quotas taken together while promoted development of industries in the country, discouraged competition, economic efficiency and expansion of exports.

The mid-1980s however, witnessed a marked change in India’s attitude and policy towards foreign trade.\textsuperscript{11} This change was initiated in 1985 when two officials committees-one on trade policies headed by Abid Hussain\textsuperscript{12} and another on controls chaired by M. Narsimham\textsuperscript{13} - recommended selected deregulation of controls on international trade and on controls in private investment (Tendulkar and Sen, 2003).\textsuperscript{14} These recommendations were accepted and implemented in the middle of 1980s. The change was intensified in mid-1991 when India faced with problems such as insurmountable external debt, unmanageable balance of
payments situation, high possibility of acceleration in the rate of inflation and unsustainable fiscal deficit introduced certain major policy reforms on industrial, trade and public sector fronts along with measures of stabilization for reduction in fiscal and current account deficits. The reforms introduced in the trade sector included rationalization of exchange rate, liberalization of imports, incentives to exporters and simplification of procedural formalities and fostering of transparency (Sharan and Mukherje, 2001). Since then the new trade regime has been refined and tuned in many directions. The basic objective underlying these changes in trade policy has been the creation of environment for achieving rapid increase in exports, raising India’s share in world exports, and making exports an engine for achieving higher economic growth. The focus of these reforms have been on liberalization, openness, transparency and globalization with a basic thrust on outward orientation (GOI, 2001-02).

Following the reforms and other various policy initiatives taken by the government, there has been a perceptible change in India’s export performance during the period 1991-92 to 2007-08, both at overall level and across commodities. The commodity composition of export basket has changed in favour of technologically intensive and industrial products, such as engineering goods.
Exports of engineering goods have emerged as the single largest item of total Indian exports pushing aside other categories of exports.

1.2. Objective of the Study:

In the above background, our objective in this study is primarily to analyse the export performance of engineering goods from India during the period 1991-92 to 2007-08 in detail with a view to assess as to whether India has been able to realise its full potential in the field of such exports. Within the framework of this broad objective, the specific objectives set out for the study are as follows:

(i) To study growth, composition and direction of India’s engineering goods exports during the period 1991-92 to 2007-08;

(ii) To identify factors that have helped the export performance of engineering goods during the period under study;

(iii) To examine constraints and problems faced by engineering goods exports.

(iv) To suggest measures which should be taken to realize the full potential of exports of engineering goods in the years ahead.
1.3. **Hypotheses of the Study:**

Following hypotheses have been tested in the study:

(i) Expansion of world trade in engineering products have contributed to the expansion of engineering exports from India.

(ii) Trade reforms introduced in the Indian economy since 1991 and the export incentives provided by the government through their effects on supply have resulted in a positive improvement in the export performance of engineering goods.

1.4. **Database and Methodology:**

The study is based mainly on secondary sources of data, which include publication of various authors as well as the publications of government. Other sources of data include publications of Economic Intelligence Service, Mumbai, various newspapers and other sundry publications. Due acknowledgement has been given to them at appropriate places.

The study has as its period of reference the years from 1991-92 to 2007-08. This is a period which has experienced significant reforms in the India's external sector and for which comparable export statistics are adequately available.
The methodology used is simple, analytical and involves calculation of percentages, arithmetical averages and year to year as well as compound growth rates. Yearly growth rates are computed as under:

\[ G_t = \frac{Y_t - Y_{t-1}}{Y_{t-1}} \times 100 \]

Where: \( G_t \) = Growth rate for period t.

\( Y_t \) = Value of the Variable in period t.

\( Y_{t-1} \) = Value of the Variable in period t-1.

The compound annual rate of growth has been worked out by estimating the function:

\[ Y = AB^t \]

Where, \( Y \) = Value of exports of commodity

\( B \) = Growth rate or \((B - 1) \times 100\).

\( t \) = time variable

The significance of the growth rates has been tested by applying t-test and estimating \( R^2 \).
1.5. Plan of the Study:

The study is organized in six chapters including the present one. Chapter II is devoted to a brief review of existing literature on India’s exports in general and that of engineering goods in particular. Chapter III provides an overview of the growth of engineering sector in India over the years, its present status and the main challenges before it. Chapter IV provides an empirical analysis of growth, composition and structural changes in India’s exports of engineering goods at aggregate as well as at disaggregate levels during the period of study. Broad trends in commodity and geographical diversification of exports are discussed in this chapter. It also analyses factors that have influenced export performance of the engineering sector. Chapter V analyses the problems and prospects of exports of these goods. Finally, Chapter VI summarises the study and offers policy suggestions.
References:


3. _____p. 23.


