Chapter - I
CHAPTER I
INTRODUCTION AND THEORETICAL BACKGROUND

“No One Can Resist an Idea Whose Time Has Come”

Victor Hugo, French Writer

BRICS was one such idea, when the term was coined by Goldman Sachs in 2001.

The buying and selling of goods and services across national borders is known as international trade. International trade is the backbone of modern, commercial world. As producers in various nations try to profit from an expanded market, rather than be limited to selling within their own borders. This type of trade is important as it promotes and encourages the growth, movement and purchase of different goods and services from one country to another. This means that what one country does not have it can purchase from another country. In the modern world, there is mutual interdependence of the various national economies. Today it is hard to find the example of a closed economy. All economies of the world have become open. But the degree of openness varies from one country to another. Thus, in the modern world no country is completely self-sufficient. Self-sufficiency in the sense that proportion of the goods and services consumed to their total output produced with in a country. But the degree of self-sufficiency varies from one country to another.

BRICS countries increasing contribution to world trade has changed dramatically. Trade between BRICS can be highly complementary. Brazil and Russia are strong in the commodity and natural resources sectors while China and India are net importers in these areas. India and China have cheap labour. China dominates the manufacturing sector. India’s strength lies in generic pharmaceuticals, software engineering, textiles and business process outsourcing.

Need for Trade

Trade is essentially an international transformation of commodities, inputs and technology which promotes welfare in two ways. It extends the market of a country’s output beyond national frontiers and may ensure better prices through exports. Through
imports, it makes available commodities, inputs and technology which are either not available or are available only at higher prices, thus taking consumers to a higher level of satisfaction. The foremost principle of foreign trade is that law of comparative costs which signifies that what a country exports and imports is determined not by its character in isolation but only in relation to those of its trading partners. There is always a need for trade because the countries have different capabilities and they specialize in producing different things. To compensate for what they don’t produce then have to involve trade with other countries. In the modern world no country is completely self-sufficient. Thus international trade is very important for all the countries in the world.

**Importance of Trade**

Economics deals with the proper allocation and efficient use of scarce resources. International trade is also concerned with allocation of economic resources among countries. Such allocation is done in the world markets by means of international trade under the concept of free trade. The best products are produced and sold in competitive market and benefits of efficient production like better quality and lower price are available to all people of the world. One fundamental principle international trade is that one should buy goods and services from a country which has the lowest price and sell his goods and services to a country which has the highest price. This is good for buyers and sellers and also the developing countries have the opportunities to accelerate the pace of their economic development. They can import machines and adapt foreign technology. They can send their scholars and technocrats to more progressive countries to gain more knowledge and skills which are relevant to the particular needs of their developing economies.

Even the richest countries buy raw material for their industries from the poorest countries. If every country produces only for its own needs, the production and consumption of goods would be limited. Clearly such situation hampers economic progress. Furthermore, the standard of living of the people all over the world would have no chance to improve. Because of internal trade people with money can acquire goods and services which are not available in their own countries. Hence, satisfaction of consumers can be maximized. The demand, supply and the prices are affected by the global events. Global trading provides countries and consumers the chance to be exposed to those services and goods that are not available in their own country.
International trading helps to developing countries use their resources effectively like technology, capital and labour. As many of the countries are gifted with natural resources and different assets (labour, technology, land and capital) they can produce many products more efficiently and sell at cheaper prices than other countries. A country can obtain an item from another country if it can’t effectively produce it within the national boundaries. This is the specialty of international trade. Global trading allows the different countries to participate in global economy encouraging the foreign direct investors. These individuals invest their money in the foreign companies and other assets. Hence, the countries can become competitive global participates. International Trade has exerted a profound influence on the economic growth of a country. It has been observed that with the opening up of the economy and liberalization of trade restrictions, the developing countries, especially countries like India and China, have grown over the years (Vijayasri 2013).¹

**Trade Policy Reforms and Integration**

An observation of past 50 years, trade's role in the world economy has increased dramatically. Trade has grown much faster than output and most of the countries have achieved the fastest economic growth have done by rapidly increasing their participation in world trade. Import substitution policies widely used in the 1950s, 1960s and 1970s were much less successful than the export oriented policies used in East Asia’s high growth economies. As a result policymakers in many developing economies began adopting policies for more open trade during the 1980s. By the late 1980s nearly all of the centrally planned regimes that had abandoned market based trade, had either collapsed or made dramatic reforms that gave birth to foreign trade and investment and it has prominent place in their development programs.

These reforms led to dramatic changes in developing economies involvement in international trade. Until the mid-1980s, most developing areas relied primarily on commodity exports, which exposed them to the high volatility and continuous decline in commodity prices and created concerns about dependence on imported manufactures.

But in the early 1980s many developing economies began to dramatically increase manufactured exports. By the late 1990s about 80 percent of exports from developing economies were manufactured goods, greatly easing earlier concerns about the role of trade. (World Bank 2002)\(^2\).

**Chart 1.1 Trade Structure Transformation**

1. Countries Low Involvement in Trade
2. Mainly Concentrate on Commodity Market
3. Thinking for Integration with the World
4. Make Change in Trade Policies
5. Followed Trade Liberalization
6. Change in Trade Pattern
7. Increasing Countries Participation in Global Trade

Continued increase in integration are far from inevitable as is clear from the concerns about globalization manifested in huge protests and it leads to a major international policy meeting since 1999. These concerns involved the enormous costs and risks and pose serious challenges to closer economic relations between countries. Integrating with the world is a choice that must be made by policymakers. (Wolf 2001)\(^3\). Moreover there is strong interdependence between the decisions of policymakers. Some major countries turn away from world markets as in the 1930s, the result could be a downward spiral in international trade that hurts even those countries wants to remain integrated with the world economy.

As pointed out by (Rodrik 1997)\(^4\) choosing policies to manage interactions with the world economy is not simple matter. Trade policy reform increasingly requires more than just reducing and streamlining border barriers, it also requires developing institutions. Many of the behind the border reforms needed to take advantage of the opportunities created by open trade regimes and require institutional capacity that is in short supply in developing economies. In addition supporting policies are likely to be needed to alleviate adverse impacts on particular groups. Globalization will likely be sustainable only if it is accompanied by policies that equip people to take advantage of the benefits offered by increased integration with the world economy.

**Changes in Trade Policies and other Barriers to Integration**

After the mid 1950 there has been extraordinary growth in world trade and economic openness. Since 1965 world trade has grown faster than world income in all but a few years of cyclical down turns. In the 1990s trade grew more than twice as fast as income. This rapid growth in the openness of world economies reflects a number of factors such as reductions in trade barriers, transport costs, and communication costs. It leads to increasing importance of trade in manufactures, for which two way trade is far more prevalent than for commodities and the fragmentation of production processes. Which leads to much more international trade in goods and services (Ng and Yeats 1999)\(^5\).

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GATT and Trade Policies

In industrial countries reductions in protection from the high levels reached in the 1930s. General Agreement on Tariffs and Trade (GATT) was established in 1947 and they continued under successive rounds of GATT negotiations. Reforms involved reducing tariffs and abolishing quantitative restrictions. But the liberalization process was neither smooth nor continuous. In the 1950s, agriculture escaped most multilateral disciplines. In the 1960s and 1970s exports of textiles and clothing from developing economies were subjected to a system of quotas that discriminated by country and violated all the fundamental principles of the GATT. As tariffs fell, nontariff barriers such as voluntary export restraints and antidumping rules became more important. Manufactures trade at the heart of the GATT liberalization process and reductions in protection were dramatic in industrial countries (Abreu and Marcelo 1996).

World Trade Organization

The formation of the World Trade Organization (WTO) in 1995 was a turning point development in the sphere of international trade. It was a major advancement in the multilateral trade regime, with the previous regime embodied in the form of a treaty known as the General Agreement on Tariffs and Trade (GATT). GATT was signed in 1948. Its primary objective was to see that obstacles to international trade mainly in the form of tariffs were reduced or removed in order to facilitate the movement of goods across borders. In the course of six to seven rounds of negotiation, it succeeded in getting countries to lower their tariff rates, thus enabling greater movement of goods. However, over time, the nature and character of global trade started to get very complex. Countries began to realize that GATT did not have all the answers to the questions posed by the increasingly complicated nature of global trade.

This led member countries to launch a new round of negotiations, from 1986-1994, known as the Uruguay Round (UR). This series of negotiations was much more elaborate and detailed. It not only covered trade in goods but also brought trade in services and intellectual property rights within the multilateral trading regime. Even

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within trade in goods, a far more thorough set of rules was discussed and negotiated. Further, trade in agricultural goods was brought into the fold of the multilateral trading regime in a major way. In GATT, trade in agricultural goods was minimal and at the fringes of the discussions. The end of the UR resulted in the formation of the WTO. GATT was a set of rules agreed upon by nations, the WTO is an institutional body which established a substantial set of rules regarding trade in goods including agricultural goods, agreements on trade in services and on trade-related aspects of intellectual property rights, as well as a strong and comprehensive mechanism to settle trade disputes between member countries. Notwithstanding these additions, the WTO retained some of the basic characteristics of GATT, such as the principles of non-discrimination embodied in the Most Favoured Nation (MFN) and National Treatment (NT) rules. WTO arrangements are generally a multilateral agreement settlement mechanism of GATT.

GATT was a set of rules agreed upon by nations; the WTO is an institutional body. The WTO expanded its scope from traded goods to trade within the service sector and intellectual property rights.

<table>
<thead>
<tr>
<th>SI. No</th>
<th>Countries</th>
<th>Number of Service Sectors</th>
<th>Services Sectors</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Brazil</td>
<td>7</td>
<td>Business, Communication, Construction and Engineering, Distribution, Financial,</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Tourism, Travel and transport.</td>
</tr>
<tr>
<td>2</td>
<td>Russia</td>
<td>11</td>
<td>Business, Communication, Construction and Engineering, Distribution, Education,</td>
</tr>
<tr>
<td>3</td>
<td>India</td>
<td>6</td>
<td>Business, Communication, Construction and Engineering, Financial, Health, Tourism,</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Travel and transport.</td>
</tr>
<tr>
<td>4</td>
<td>China</td>
<td>9</td>
<td>Business, Communication, Construction and Engineering, Distribution, Education,</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Environment, Financial, Tourism, Travel and transport.</td>
</tr>
<tr>
<td>5</td>
<td>South Africa</td>
<td>8</td>
<td>Business, Communication, Construction and Engineering, Distribution, Environment,</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Financial, Tourism, Travel and transport.</td>
</tr>
</tbody>
</table>

Source: Centre for WTO Studies, India Institute of Foreign Trade
Besides merchandise trade, there has also been a sharp rise in trade in services for the BRICS economies. Almost all the BRICS countries clocked double-digit growth in the export and import of services. Of the 12 services sectors covered under the WTO’s General Agreement on Trade in Services (GATS), specific commitments have been made by Brazil in 7, Russia in 11, India in 6, China in 9 and South Africa in 8 service sectors.

WTO and BRICS Countries

The participation of the five countries in the WTO also reveals different levels of priority. India, Brazil and South Africa (IBSA) were three of the 23 Contracting Parties to the GATT, which entered into force in 1948. China was also one of the contracting parties to the GATT but with the Revolution of 1949, the Taiwanese government unilaterally decided to withdraw from the agreement. In 1986 the government of the People’s Republic of China requested the status of contracting party. A working group was created in 1987 and the accession of China was negotiated for 14 years. China participated as an observer to the Uruguay Round and signed the Final Act in Marrakesh in 1994 but its status as a member of the WTO was not recognized. Negotiations for the accession of China and Chinese Taipei continued and were completed in November 2001, when a new round of WTO negotiations was launched the Doha Round. Russia, after nearly two decades of negotiations, finally concluded its accession process to the WTO in December 2011.

The entry of China in the WTO was preceded by a profound process of adjusting its economy. This process represented an important political decision on the part of the Chinese government to reassert the country into the area of world trade, thus transforming trade into a driving force behind its economy. On the one hand, the accession was due to the decision by the Chinese Government to adapt an economic model based on the socialist principles of planned economy to a model of market economy, called the socialist market economy and to stabilize trade relations with other countries. On the other hand, it indicated the political will of WTO members to integrate China into the organization, which has as its main goal of trade liberalisation by means of trading rules and supervision of the application thereof. In this way, the interests of both sides were satisfied China, by transforming international trade into a central point of its
growth policy, needed the assurance that its exports would not be discriminated against, in accordance with WTO rules. The other members of the WTO, attracted by the vast Chinese market in the process of opening up, felt that the existing rules would ensure that the influx of Chinese products could be controlled.

Russia, in turn, together with other countries of the communist bloc, did not adopt the GATT in 1948. Only in 1993 with the collapse of the Soviet Union, did Russia request the status of contracting party to the GATT. Negotiations were extended until November 2011, when an agreement was finally reached between Russia and Georgia, which opposed the accession of Russia since the war between the two countries in 2008. In December 2011, the Ministerial Conference of the WTO approved Russia’s accession to the organization. Its ratification, however, is still pending (Thorstensen and Oliveira 2014)7

In short the activities of these countries in the WTO have shown various specificities, reflect the priorities of their international trade policies and identify the interests that they defend in the international trade arena.

**Trade Liberalization in Developing Countries**

In developing countries trade liberalization occurred much more slowly. The belief that infant industries could be nurtured behind protective barriers was appealing and taxes on commodity exports were a convenient way to raise government revenues. Import substitution policies were strongly supported by the vested interests that gained from protection. Tariff barriers became everywhere, as did nontariff barriers such as quotas and licenses. Foreign exchange restrictions often imposed large additional taxes on trade.

**Changes in Trade Pattern of Developing Countries**

Changes in trade policies and reductions in trade barriers have been associated with major changes in developing countries' role in the world economy. In particular as developing economies have lowered their trade barriers, the composition of their exports

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has changed enormously. Since the 1980s developing countries have drastically increased exports of manufactures and exports to other developing areas. In addition, exports of services have become much more important.

**Current Scenario of Developing Countries Trade**

Developed economies sent almost 30 per cent of their total exports to developing economies. Developing economies sent a little more than half of their total merchandise exports to other developing economies in 2013. In particular, 35 per cent were exported to developing Asia, 6 per cent to South and Central America and the Caribbean, 6 per cent to the Middle East and 4 per cent to Africa. Developing economies’ exports to the BRICS (Brazil, Russia, India, China and South Africa) totalled US$ 1,382 billion in 2013, representing 17 per cent of their total exports or 8 per cent of global merchandise exports. World merchandise exports in 2013 44 per cent originated from developing economies. 52 per cent from developed economies. 4.0% merchandise exports from developing economies grew by 4% in volume terms in 2013 5.0% Merchandise imports into developing economies grew by 5% in volume terms in 2013. (WTO 2013)

**Trade in Goods and Trade in Services**

International trade can be broadly distinguished between trade in goods (merchandise) and services. The bulk of international trade concerns physical goods, while services account for a much lower share. International trade largely relates to physical goods. Increasing trade in services accounts for a much lower share. As of 2013 world trade in goods has been valued at more than US$18.5 trillion, while trade in services has accounted for almost US$5 trillion. World trade in goods has increased dramatically over the last decade, rising from less than US$ 8 trillion in 2003 to more than US$ 18.5 trillion in 2013. Trade in services has also greatly increased between 2003 and 2013 (from about US$ 2 trillion to about US$ 4.7 trillion). As of 2013, the value of international trade of both goods and services has completely recovered from the dip in 2009 and largely surpassed pre-crisis levels.(UNCTAD 2014)

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9 UNCTAD(2014), Key Statistics and Trends in International Trade”
International trade is not anymore items can be packed and shipped. Technological change is redefining the border of what is tradable and expanding constantly the realm of tradability. Goods and services are become more and more traded and represent different complementary components of world trade. Liberalization process of services trade is gaining importance in the policy debates and it is a crucial issue in the trade negotiations.

The services sector has become the single largest economic sector in all developed market economies and most developing countries. The United States was the first major country to recognize the importance of the services sector both in its domestic and international contexts. This recognition may be largely attributed to the fact that services account for about two-thirds of the country's gross domestic product (GDP) and employment.

Most services are intangible, disembodied and nonstorable. As a rule, their production and consumption must occur at the same time and in the same place. While this is a serious constraint on tradability of services pointed out by Sauvant et al. 1985\(^\text{10}\). International transactions and services have nevertheless reached considerable proportions in foreign direct investment, more than in trade. Considering the share of services involved in international transactions is considerably lower than that of industry and agriculture. Share of services in GDP the potential for a substantial increase in international service transactions.

The term service covers a wide range of intangible and heterogeneous products and activities that are difficult to summarize within a simple definition. Services on the other hand have an intangible nature: they do not occupy physical space so they cannot be put inside packages or containers and then shipped. It cannot be stored in a warehouse, their movement is related to the movement of information like in a backup service and to the movement of people like in a consultancy. Services are either the result of a production activity that changes the conditions of the consuming units (transformation services) or facilitate the exchange of products or financial assets (margin services).

Services have a significant impact on growth and efficiency across a wide range of industries and overall economic performance. For instance, sectors such as transport, telecommunications and financial services are key determinants of the merchandise services and capital flow (Ariu2011)\(^\text{11}\)

**Distinction between Goods and Services**

Services and goods differ in many distinctive features. There are some important characteristics of services that clearly distinguish international trade in services from trade in goods.

According to Hill (1977)\(^\text{12}\) critical distinction between goods and services is that services are consumed as they are produced. As a result of this characteristic service transactions usually require interaction between user and provider. Goods on the other hand can be produced and stored for later consumption or transactions. Services are non tradable has been based on the perception that it requires interaction between user and provider. Services cannot be stored for transactions which take place after the time of production. This means that services cannot be stored for shipment and exchange at a later date. Interaction is a necessary aspect of service transactions and it does not mean that all services are non tradable. Because of technical change it is possible for the user and provider of services to interact at a distance. This interaction may be through electronic information flows and other modern telecommunications channels or through temporary physical movement.

Some economists have suggested the existence of complementarities between bilateral trade in goods and bilateral trade in services. In Markusen’s models, an increase in producer services varieties (varieties of intermediate services) confers a positive technological externality in final goods production. This in turn leads to an increase in total factor productivity (Lennon, Carolina 2009)\(^\text{13}\).

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Services Distinction Based on Physical Proximity

Based on the element of interaction between user and provider, Bhagwati 1984, 1985\textsuperscript{14} and Sampson and Snape 1985\textsuperscript{15} have developed a typology of services that is useful when considering trade in services. They divide services into those that require the physical proximity of the user and provider, and those that do not. Sampson and Snape refer to services that do not require the physical movement of the user or the provider. Bhagwati refers to these as long-distance services. Services require the physical proximity of user and provider.

Sampson and Snape observed that proximity services can be traded in several ways. These involve the movement of the user, the movement of the provider, or some combination of the two. Trade in services that requires movement of the provider, and in which all value added comes from the mobile factors. It is really factor mobility. This includes trade in the physical labor component of construction services. If the movement of the factor is not temporary, then it is effect labor migration or foreign investment. Services are traded by investment in the importing country or by labor movements with all value added coming from the investment or mobile factor itself. There is no real trade in the traditional sense it is only factor movements. Such factor movements can also be a mechanism for real trade in services. One cannot always distinguish between services that are traded separated services and traded as proximity services. Some services can be traded either way. In addition, the distinction becomes confused when a traded service involves some combination of separated and proximity elements. Because of the necessary interaction between user and provider and it is often necessary for the provider of services to establish a presence in the importing country. Once this presence is established services can then be traded through the local. In this way the final product being traded is a combination of a proximity service (the local activities that support interaction) and separated service. In this case trade based factor movement facilitates trade in separated services. Mobile factors (like cross-border movements of consultants


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and technical personnel) are mechanisms for interaction. Such interaction through services may also be an important determinant of the pattern of production and trade in goods. (Francois 1990)\textsuperscript{16}

**Static Benefits of Goods and Services**

In static models without market imperfections (such as monopolistic market structures, internal and external economies of scale or other distortions) restrictions on trade in goods reduce the level of real GDP which is equivalent to a loss in welfare. The restriction creates a wedge between domestic and foreign prices. Leading to a loss in consumer surplus that is greater than the gain in producer surplus arising from higher domestic production and in government revenue. The net impact on welfare is therefore negative. Restrictions on trade in services principle expected to have similar welfare costs as they too drive a wedge between domestic and foreign prices of services. Many of the empirical studies supported this view. It has been suggested that in the case of services, there is an additional twist in that many services are inputs into production and inefficient production of such services acts as a tax on production. Thus, goods liberalization in the absence of services liberalization could well result in lowering the effective protection for goods. (Mattoo et al. 2006)\textsuperscript{17}

**Trade in Goods and Trade in Services - Perspective of Liberalization**

Deardorff 2001\textsuperscript{18} has argued that there are large gains from eliminating barriers to trade in services facilitate trade. In theoretical models the impact of trade liberalization on economic growth is either absent or ambiguous. In a conventional neoclassical growth model trade does not affect the equilibrium or steady state rate of output growth because by assumption that growth is determined by exogenously given technological progress. In two sector models trade policy affects the allocation of resources between sectors and


hence the steady state is level of savings and capital accumulation. one-off effect on the steady state level of output (which can be positive or negative depending on how savings and capital accumulation are affected by trade policy) but not on the rate of growth.

In endogenous growth models the impact of trade liberalization on output growth can be positive or negative as emphasized by Rodriguez and Rodrik (1999)\(^\text{19}\). Resource allocation effects of trade policy changes promote sectors or activities that generate more long run growth; the impact is positive and negative. (Mattoo, et al. 2006)\(^\text{20}\)

**Origin of BRICS Countries**

Brazil, Russia, India, China and South Africa (BRICS) are leading emerging economies and political powers at the regional and international level. The acronym was originally coined in 2001 to highlight role of important emerging economies and only included Brazil, Russia, India and China (BRIC). It was pointed out that high growth rates, economic potential and demographic development were going to put BRIC lead position and it was argued that their increased relevance should also be reflected in their incorporation to the G7 (Jim 2011)\(^\text{21}\). The four countries themselves started to meet as a group in 2006 and it was only in 2010 that South Africa was invited to join the group which was then referred to as BRICS. South Africa’s entry into the group has come with a lot of controversy.

The acceptance of South Africa into the BRIC group necessitated a change of the acronym to BRICS, appears to be based on other factors than similarities it has with the original members as it appears to have lagging characteristics. The country is the smallest in terms of land area, population size, GDP savings as a percentage of GDP and value of exports and imports. This raises concerns of how it is grouped with economic giants like China. Amongst other reasons, the country’s inclusion is said to have been based on the fact that it has the largest economy in SSA and an advanced banking system. The country is also regarded as “the gateway to Africa”.

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\(^{20}\) Ibid.17

Due to geographic and demographic dimensions BRICS economies are severely influencing global development especially in Low Income Countries (LIC). They are promoting stability in trade and investment and cushioning global recession in the 2008 financial crisis.(IMF 2011a)\(^22\).

Goldman Sachs who argued that Brazil, Russia, India, and China deserve special attention as the largest and fastest growing emerging economies of the world and that by 2050, combined GDP of these four countries will be larger than that of the G7 (seven largest developed economies: USA, Canada, UK, Germany, France, Italy, and Japan) (Sachs 2001)\(^23\). In 2011 this prediction was largely accurate.

BRICS summits are presented table1.2. First and Seventh summit was held in Russia at different places. Russia and Brazil were presided over two summits. Rest of BRICS countries presided over only one summits. 8th summit held at India in the year 2016.

Brazil

Brazil is the largest country in both South America and the Latin American region. It is the world's fifth-largest country, both by geographical area and by population. It is the largest Portuguese speaking country in the world and the only one in the Americas. Bounded by the Atlantic Ocean on the east and has a coastline of 7,491 km (4,655 mi). It borders all other South American countries except Ecuador and Chile and occupies 47.3 percent of the continent of South America. Its Amazon River basin includes a vast tropical forest, home to diverse wildlife, a variety of ecological systems and extensive natural resources spanning numerous protected habitats. This unique environmental heritage makes Brazil one of 17 mega diverse countries.

Brazil remained a Portuguese colony until 1808, when the capital of the empire was transferred from Lisbon to Rio de Janeiro. In 1815 the colony was elevated to the rank of kingdom upon the formation of the United Kingdom of Portugal, Brazil and the Algarves. Independence was achieved in 1822 with the creation of the Empire of Brazil, a unitary state governed under a constitutional monarchy and a parliamentary system.


Map 1.1 Brazil

Source: World Atlas
The ratification of the first constitution in 1824 led to the formation of a bicameral legislature, now called the National Congress. The country became a presidential republic in 1889. An authoritarian military came to power in 1964 and ruled until 1985, after which civilian governance resumed. Brazil's current constitution formulated in 1988 defines it as a federal republic. The federation is composed of the union of the Federal District, the 26 states, and the 5,570 municipalities. Brazil has the world's highest population of Roman Catholics and is the world's most populous Catholic-majority country.

The form of government is that of a democratic federative republic with a presidential system. The president is both head of state and head of government of the Union and is elected for a four-year term with the possibility of reelection for a second successive term. The President appoints the Ministers of State, who assist in government. Legislative houses in each political entity are the main source of law in Brazil. The National Congress is the Federation's bicameral legislature, consisting of the Chamber of Deputies and the Federal Senate. Judiciary authorities exercise jurisdictional duties almost exclusively. Brazil is a democracy according to the Democracy Index 2010.

**Russia**

Russia also officially known as the Russian Federation. It is a country in northern Eurasia. It is a federal semi-presidential republic. Russia is the largest country in the world, covering more than one-eighth of the Earth's inhabited land area. Russia is the world's ninth most populous country with nearly 144 million people in November 2014. Extending across the entirety of northern Asia and much of Eastern Europe, Russia spans eleven time zones and incorporates a wide range of environments and landforms. From northwest to southeast ,Russia shares land borders with Norway, Finland, Estonia, Latvia, Lithuania and Poland (both with Kaliningrad Oblast), Belarus, Ukraine, Georgia, Azerbaijan, Kazakhstan, China, Mongolia, and North Korea. It shares maritime borders with Japan by the Sea of Okhotsk and the U.S. state of Alaska across the Bering Strait.

In Russian Revolution, the Russian Soviet Federative Socialist Republic became the largest and leading constituent of the Soviet Union abbreviated to USSR, the world's first constitutionally socialist state and a recognized world superpower and a rival to the United States which played a decisive role in the Allied victory in World War II.
Map 1.2 Russia

Source: World Atlas
By the end of 1990, the USSR or Soviet Union had the world's second largest economy, largest standing military in the world and the largest stockpile of weapons of mass destruction. Following the partition of the Soviet Union in 1991, fourteen Independent republic nations emerged from the USSR (Armenia, Azerbaijan, Belarus, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Tajikistan, Turkmenistan, Ukraine, Uzbekistan). As the largest most populous and most economically developed republic, the Russian Soviet Federative Socialist Republic (RSFSR) reconstituted itself as the Russian Federation and is recognized as the continuing legal personality (the sole successor state) of the Soviet Union.

According to the Constitution of Russia, the country is a federation and semi-presidential republic, wherein the President is the head of state and the Prime Minister is the head of government. The Russian Federation is fundamentally structured as a multi-party representative democracy, with the federal government composed of three branches: Legislative, Executive and judiciary.

India

India, officially the Republic of India and it is a country in South Asia. It is the seventh largest country by area, the second-most populous country with over 1.2 billion people, and the most populous democracy in the world. India is a federal constitutional republic governed under a parliamentary system consisting of 29 states and 7 union territories. A pluralistic, multilingual, and multi-ethnic society Bounded by the Indian Ocean on the south, the Arabian Sea on the south-west, and the Bay of Bengal on the south-east, it shares land borders with Pakistan to the west, China, Nepal, and Bhutan to the north-east and Myanmar (Burma) and Bangladesh to the east. In the Indian Ocean, India is in the vicinity of Sri Lanka and the Maldives; in addition, India's Andaman and Nicobar Islands share a maritime border with Thailand and Indonesia.

Home to the ancient Indus Valley Civilization and a region of historic trade routes and vast empires, the Indian subcontinent was identified with its commercial and cultural wealth for much of its long history.
Map 1.3 India

Source: World Atlas
Administration of the British East India Company from the early 18th century and administered directly by the United Kingdom after the Indian Rebellion of 1857, India became an independent nation in 1947 after a struggle for independence led by Mahatma Gandhi that was marked by non-violent resistance. Upon the promulgation of its constitution, India became a republic on 26 January 1950.

India is a federation with a parliamentary system governed under the Constitution of India, which serves as the country's supreme legal document. It is a constitutional republic and representative democracy, in which "majority rule is tempered by minority rights protected by law". Federalism in India defines the power distribution between the federal government and the states. The government abides by constitutional checks and balances. The Constitution of India, which came into effect on 26 January 1950, states in its preamble that India is a sovereign, socialist, secular, democratic republic. India's form of government, traditionally described as "quasi-federal" with a strong centre and weak states, has grown increasingly federal since the late 1990s as a result of political, economic, and social changes. Federal government composed of three branches: Legislative, Executive and judiciary.

China

China officially the People's Republic of China (PRC) is a sovereign state in East Asia. It is the world's most populated country. The PRC is a one party state governed by the Communist Party, with its seat of government in the capital city of Beijing. It exercises jurisdiction over 22 provinces, five autonomous regions, four direct-controlled municipalities (Beijing, Tianjin, Shanghai and Chongqing) and two mostly self-governing special administrative regions (Hong Kong and Macau) while claiming sovereignty over Taiwan.

Covering approximately 9.6 million square kilometers, China is the world's second-largest country by land area and either the third or fourth-largest by total area, depending on the method of measurement. China's landscape is vast and diverse, ranging from forest steppes and the Gobi and Taklamakan deserts in the arid north to subtropical forests in the wetter south.
Map 1.4 China

Source: World Atlas
China is a cradle of civilization, with its known history beginning with an ancient civilization one of the worlds earliest that flourished in the fertile basin of the Yellow River in the North China Plain. For millennia, China's political system was based on hereditary monarchies known as dynasties. Qin Dynasty first conquered several states to form a Chinese empire the country has expanded, fractured and reformed numerous times. The Republic of China (ROC) overthrew the last dynasty in 1911, and ruled the Chinese mainland until 1949. After World War II, the Communist Party defeated the nationalist Kuomintang in mainland China and established the People's Republic of China in Beijing on 1 October 1949, while the Kuomintang relocated the ROC government to its present capital of Taipei.

The President of China is the titular head of state, serving as the ceremonial figurehead under National People's Congress. The Premier of China is the head of government, presiding over the State Council composed of four vice premiers and the heads of ministries and commissions. There have been some moves toward political liberalization, in that open contested elections are now held at the village and town levels. However, the Party retains effective control over government appointments: in the absence of meaningful opposition

**South Africa**

South Africa, officially the Republic of South Africa, is the southernmost country in Africa. It is bounded on the south by 2,798 kilometers of coastline of southern Africa stretching along the South Atlantic and Indian Oceans on the north by the neighbouring countries of Namibia, Botswana and Zimbabwe, and on the east by Mozambique and Swaziland, and surrounding the kingdom of Lesotho. South Africa is the 25th-largest country in the world by land area, and with close to 53 million people, is the world's 24th-most populous nation. It is the southernmost country on the mainland of the Old World or the Eastern Hemisphere.

South Africa is a multiethnic society encompassing a wide variety of cultures, languages, and religions. Its pluralistic makeup is reflected in the constitution's recognition of 11 official languages, which is among the highest number of any country in the world.
Map 1.5 South Africa

Source: World Atlas
Two of these languages are of European origin: Afrikaans developed from Dutch and serves as the first language of most white and coloured South Africans; English reflects the legacy of British colonialism, and is commonly used in public and commercial life, though it is fourth-ranked as a spoken first language.

The vast majority of black South Africans were not enfranchised until 1994. During the 20th century, the black majority sought to recover its rights from the dominant white minority, with this struggle playing a large role in the country's recent history and politics. The National Party imposed apartheid in 1948, institutionalizing previous racial segregation. After a long and sometimes violent struggle by the African National Congress and other anti-apartheid activists both inside and outside the country, discriminatory laws began to be repealed or abolished from 1990 onwards.

About 80 percent of South Africans are of sub-Saharan African ancestry divided among a variety of ethnic groups speaking different Bantu languages, nine of which have official status. The remaining population consists of Africa's largest communities of European (white), Asian (Indian), and multiracial (coloured) ancestry. Since 1994 all ethnic and linguistic groups have had political representation in the country's constitutional democracy, which comprises a parliamentary republic and nine provinces.

South Africa is a parliamentary republic, although unlike most such republics the President is both head of state and head of government and depends for his tenure on the confidence of Parliament. The executive, legislature and judiciary are all subject to the supremacy of the Constitution, and the superior courts have the power to strike down executive actions and acts of Parliament if they are unconstitutional.
Table 1.2 BRICS Summits

<table>
<thead>
<tr>
<th>Sl. No</th>
<th>Date (s)</th>
<th>Host Country</th>
<th>Host Leader</th>
<th>Host Location</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st</td>
<td>16 June 2009</td>
<td>Russia</td>
<td>Dmitry Medvedev</td>
<td>Yekaterinburg</td>
</tr>
<tr>
<td>2nd</td>
<td>15 April 2010</td>
<td>Brazil</td>
<td>Luiz Inacio Lula da Silva</td>
<td>Brasilia</td>
</tr>
<tr>
<td>3rd</td>
<td>14 April 2011</td>
<td>China</td>
<td>Hu Jintao</td>
<td>Sanya</td>
</tr>
<tr>
<td>4th</td>
<td>29 March 2012</td>
<td>India</td>
<td>Manmohan Singh</td>
<td>New Delhi</td>
</tr>
<tr>
<td>5th</td>
<td>26-27 March 2013</td>
<td>South Africa</td>
<td>Jacob Zuma</td>
<td>Durban</td>
</tr>
<tr>
<td>6th</td>
<td>14-16 July 2014</td>
<td>Brazil</td>
<td>Dilma Rousseff</td>
<td>Fortaleza Brasilia</td>
</tr>
<tr>
<td>7th</td>
<td>14-16 July 2015</td>
<td>Russia</td>
<td>Vladimir</td>
<td>Ulfa</td>
</tr>
</tbody>
</table>

Economic Significance of BRICS Countries to the Global Economy

The high growth rates in China and India and recently also Russia have increased the BRICS countries importance to the global economy. Over the last 10 years the BRICS share of the global economy has increased. Another characteristic of the BRICS countries economic development is that generally their economic growth has fluctuated more strongly than the case for the developed countries. This tendency magnifies the significance of the BRICS countries to the global economy. The fluctuations in their growth explain a relatively larger share of the global cyclical fluctuations than their economic weight.

BRIC Countries Convergence

The BRICS countries growth has led to a considerable absolute increase in prosperity. The World Bank describes Brazil, China and South Africa as "upper middle income" countries while India is a "lower middle income" country and Russia as High income country, non OECD. Relative to the mature market economies the development in prosperity measured by purchasing-power-adjusted GDP per capita (current prices) has varied considerably among the five BRICS countries. While China and India have managed to relatively augment their prosperity compared to the USA, Brazil has become relatively poorer.
Higher population growth in India has meant that only a relatively moderate catch-up effect has been achieved from its high economic growth. The opposite is the case for China, whose population count has expanded at a slower rate than the USA’s since 1991. According to the US Census Bureau, population growth in all BRIC countries is expected to diminish over time. As a result of this demographic trend future economic growth greater extent leads to increases in prosperity.

Jensen and Larsen 2009\textsuperscript{24} explained that greater openness has increased the global economic significance of the BRICS countries. These countries still have strong growth potential, especially in view of their large, young populations. The key challenge faced by the BRICS countries will be to maintain robust and sustainable growth in order to reduce the gap in living standards to the mature market economies.

**Trade in Goods and Trade in Services – BRICS Countries**

Respective trade in goods and services, capital flows and foreign direct investment (FDI), the focal point of global economic dynamics might be shifting slowly from OECD-countries to the BRICS in coming years. Next to other emerging economies like Saudi Arabia or Venezuela, BRICS are also becoming more important donors in the international financial architecture. There are significant differences in dimension and orientation of development cooperation among BRICS countries, correlating to differences in growth intensity, economic and trade structures, degree of market liberalisation, per-capita-income as well as history and tradition.

Some countries of the “next eleven” are questioning the gain in power of BRICS because they are hoping to play a bigger part in international organizations themselves. In that respect other emerging economies are implementing SSC (south –south cooperation) according to BRICS patterns. (Tudoroiu 2012)\textsuperscript{25}


\textsuperscript{25} Tudoroiu, Theodor (2012), “Conceptualizing BRICS: OPEC as a Mirror”, Asian journal of political science Centre for International Peace and Security Studies, Montreal Quebec, 30 May, pp. 15-26
Sach (2008) predicts that “China and India respectively will become the dominant global suppliers of manufactured goods and services. While Brazil and Russia will become the dominant suppliers of raw materials. Trade in goods and services provide multiple sectoral opportunities for cooperation among the BRICS countries, which can be mutually beneficial. Brazil is major producer of bio-fuels and may eventually be a major energy provider to the Chinese and Indian economies which have significant energy demands. Brazil also dominates the export of agrochemical products, which feature prominently in the import baskets of Russia, India and China. Russia’s vast natural gas and oil reserves can help sustain the energy demands of the other BRICS economies. India’s robust service sector growth gives it a competitive advantage. China’s export of manufactured goods, machinery and textile products feeds the global consumer markets. South Africa holds vast mineral deposits essential for industrial development in other countries, and its growing service sector makes it an increasingly investment friendly destination.

BRICS as a group, account for over 40% of the world’s labour force. While India, South Africa and Brazil may reap a demographic dividend in the coming decades, China has seen a sharp deceleration in its population growth rate while Russia has had no growth in its population in the last decade. According UN projections, by 2020, the working age population is expected to rise by 240 million in India and by 20 million in Brazil. China demographic projections suggest that its labour force will peak by coming years and decline thereafter. In Russia, the working population is projected to decline sharply by 20 million in the next decade. A growing population will yield a demographic dividend only if there is a matching increase in the available jobs.

26 Ibid. 23.
Table 1.3 Profile of BRICS Countries

<table>
<thead>
<tr>
<th>Sl.No</th>
<th>Variables</th>
<th>Brazil</th>
<th>Russia</th>
<th>India</th>
<th>China</th>
<th>South Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Area (Km²)</td>
<td>835840.0</td>
<td>16376870.0</td>
<td>297319.0</td>
<td>9388211.0</td>
<td>1213090</td>
</tr>
<tr>
<td>2</td>
<td>Average Population Growth (1990 – 2013)</td>
<td>1.3</td>
<td>-0.2</td>
<td>1.6</td>
<td>0.8</td>
<td>1.8</td>
</tr>
<tr>
<td>3</td>
<td>Unemployment Rate</td>
<td>6.7</td>
<td>5.5</td>
<td>3.6</td>
<td>4.1</td>
<td>24.3</td>
</tr>
<tr>
<td>4</td>
<td>Poverty Rate</td>
<td>21.4</td>
<td>11.1</td>
<td>29.8</td>
<td>2.8</td>
<td>23</td>
</tr>
<tr>
<td>5</td>
<td>Income Inequality (Gini Coefficient)**</td>
<td>53.9</td>
<td>42.3</td>
<td>36.8</td>
<td>41.5</td>
<td>57.8</td>
</tr>
<tr>
<td>6</td>
<td>Life Expectancy**</td>
<td>73</td>
<td>69</td>
<td>65</td>
<td>73</td>
<td>52</td>
</tr>
<tr>
<td>7</td>
<td>Literacy Rate</td>
<td>91.33</td>
<td>99.7</td>
<td>74.4</td>
<td>95.1</td>
<td>94.3</td>
</tr>
<tr>
<td>8</td>
<td>Savings (% of GDP)*</td>
<td>14.64</td>
<td>28.12</td>
<td>30.32</td>
<td>51.28</td>
<td>14.17</td>
</tr>
<tr>
<td>9</td>
<td>Inflation (Consumer Prices)</td>
<td>6.20</td>
<td>6.76</td>
<td>10.91</td>
<td>2.63</td>
<td>3.31</td>
</tr>
<tr>
<td>10</td>
<td>FDI Inflows US $ Current Prices Million</td>
<td>64045.33</td>
<td>79262</td>
<td>28199.45</td>
<td>123911</td>
<td>8187.935</td>
</tr>
</tbody>
</table>

Source: World Bank, UNCTAD Various Issues

** Taken from Centre for WTO Studies, India Institute of Foreign Trade, 2013

* Estimates 2012

The unemployment rate is nearly 24 per cent in South Africa, 5.5 per cent or more in Brazil, Russia, 3.6 per cent India, and about 4% in China. With a large informal sector and a significant proportion of the workforce still underemployed, there is an ever
growing need for skill and human resource development. More and better jobs require investment in education, healthcare and soft skills to train the workforce for employment in the 21st century. The literacy rate in Brazil, China, Russia, and South Africa ranges from 91 per cent to 95 per cent. In India, the literacy rate is just 74.4 per cent.

Income inequality, as measured by the Gini-coefficient remains a concern in all the BRICS. Brazil, South Africa and India still have over 20% of their sizable population under the poverty line. Russia has also seen a sharp rise in poverty and inequality since the 1990s. Only China has seen a sharp fall in its absolute poverty numbers. In case of inflation, it is very high in the country of India and then followed by Russia, Brazil, South Africa and China.

China’s saving is impressive and it is 51.28 percent of GDP. In case of India is 30.32 per cent and then followed by the Russia, Brazil and South Africa. In terms of FDI inflows, China biggest recipient and followed by Russia, Brazil and India. FDI inflows to South Africa is small comparison with other BRICS Countries.

**Chart 1.2 GDP of BRICS Countries (1990 – 2013)**

(US $ Current Prices Million)

Source: UNCTAD
Together, Brazil, Russia, India and China accounted for about a quarter of the global GDP. This trend is set to continue over the coming decades. By 2020, the BRIC grouping is projected to account for a third of the global economy (in PPP terms) and contribute about 49% of global GDP growth. By 2050, Brazil, Russia, India and China will displace most of the current G-7 countries. Only the United States and Japan are expected to be counted amongst the largest economies of the world. The BRICs are clearly moving from the bantam weight to the heavyweight category (IIFT2013).27

**Chart 1.3 GDP Per capita of BRICS Countries (1990 – 2013)**

GDP Per capita of BRICS is presented the chart 1.2. In terms of per-capita income the BRICS are starting from a relatively low baseline. In 1990 GDP per capita was high in Russia and then followed countries like South Africa, Brazil, India and China. But for the period 2013 GDP per capita was high in Russia and then followed countries like Brazil, China, South Africa and India.

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27 Indian Institute of Foreign Trade (2003), Centre for WTO Studies, New Delhi.
Intra BRICS Countries Trade

Chart 1.4 Trade between Brazil and Rest of the BRICS Countries (By Destination)

Source: Centre for WTO Studies, India Institute of Foreign Trade (2013)

Chart 1.5 Trade between Russia and Rest of the BRICS (By Destination)

Source: Centre for WTO Studies, India Institute of Foreign Trade (2013)

Chart 1.6 Trade between India and Rest of the BRICS Countries (By Destination)

Source: Centre for WTO Studies, India Institute of Foreign Trade (2013)
Chart 1.7 Trade between China and Rest of the BRICS Countries (By Destination)

Source: Centre for WTO Studies, India Institute of Foreign Trade (2013)

Chart 1.8 Trade between South Africa and Rest of the BRICS Countries (By Destination)

Source: Centre for WTO Studies, India Institute of Foreign Trade (2013)

Chart 1.3 to 1.7 represents BRICS trade by destination. China is the largest trade partner for each of the other BRICS with trade share ranging between 72 to 85 per cent in intra BRICS trade. India has a share ranging between 8 to 26 per cent in intra BRICS trade. Brazil’s trade share is in single digit except with China where its share is 30 per cent. Russia has a small slice of intra BRICS trade in all market.
Table 1.4 Regional Trade Agreement among BRICS Countries

<table>
<thead>
<tr>
<th>BRICS Members</th>
<th>RTAs</th>
<th>RTA Member from BRICS</th>
<th>Date of Signature</th>
<th>Date of Enforcement</th>
<th>Type of Agreement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>Global System of Trade Preferences among Developing Countries</td>
<td>India</td>
<td>13th April 1988</td>
<td>19th April 1989</td>
<td>Partial Scope Agreement</td>
</tr>
<tr>
<td>MERCOSUR</td>
<td>India</td>
<td>25th January 2004</td>
<td>1st June 2009</td>
<td></td>
<td>Partial Scope Agreement</td>
</tr>
<tr>
<td>China</td>
<td>Asia Pacific Trade Agreement</td>
<td>India</td>
<td>31st July 75</td>
<td>17th June 76</td>
<td>Partial Scope Agreement</td>
</tr>
<tr>
<td>India</td>
<td>Asia Pacific Trade Agreement</td>
<td>China</td>
<td>31st July 75</td>
<td>17th June 76</td>
<td>Partial Scope Agreement</td>
</tr>
<tr>
<td></td>
<td>Global System of Trade Preferences among Developing Countries</td>
<td>Brazil</td>
<td>13th April 1988</td>
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<td>MERCOSUR</td>
<td>Brazil</td>
<td>25th January 2004</td>
<td>1st June 2009</td>
<td></td>
<td>Partial Scope Agreement</td>
</tr>
<tr>
<td>South Africa</td>
<td>South African Customs Union</td>
<td>South Africa</td>
<td>Under Negotiation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Russia</td>
<td></td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>South Africa</td>
<td>South African Customs Union</td>
<td>India</td>
<td>Under Negotiation</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: WTO RTA Data Base
In recent years, most developing countries have signed RTAs with other developing countries. Typically, some of these RTAs have agreements on investment and services added to the usual agreement on trade in commodities. These are often called WTO plus agreements.

Table 1.4 indicates that India and Brazil are linked via RTA with the MERCOSUR group of countries. India is currently negotiating an RTA with SACU (where South Africa is the dominant member). The countries of BRICS countries are probably much more strongly linked by RTAs to other regional members. For example, China and India are only linked via the APTA which is not an effective RTA and involves a large number of countries. RTAs may have some impact on trade promotion.

**Trade Policies of BRICS Countries**

BRICS members, presented their international trade in different priorities. For China, for three decades international trade has been a central element of the economic policy based on capitalism with a strong state presence. China prioritised the export of goods via state and foreign enterprises, and liberalized its imports. Only at the beginning of 2011 did China signal that it intended to focus economic growth on its domestic market. For India, Brazil and South Africa (IBSA) the priority was the development of the domestic market, via the expansion of demand and controlling inflation, with international trade being less important. India and South Africa kept their economies closed and only since 1990 have they begun to open their activities, giving greater weight to international trade. India gave priority to service exports. Even today there is a high level of protection, especially in the area of agriculture. Brazil opted for a model of internal development, but since the late 1980s, the country has opened its economy and it has transformed its agricultural sector into a major exporter. For Russia, which is transitioning from a planned economy to a market economy, trade came to represent the fastest way to reduce dependence on activities related to energy products, such as oil and gas: hence its interest in joining the WTO, as it aims to diversify its international trade and to boost its economy.
Institutional Framework for Trade Policies of BRICS Countries

Brazil

In Brazil the formulation, adoption, coordination, and implementation of trade policy in goods and services are the responsibility of the Chamber of Foreign Trade and it is created in 1995. It is a part of the Government Council of the Presidency of the Republic. Its main decision making body is the Council of Ministers, comprising of the Minister of Development, Industry and Foreign Trade and the Ministers of the Civil House. Chamber of Foreign Trade coordinates the implementation of its decisions but each ministry remains responsible for implementing matters within its competence. Other public bodies must consult the Chamber of Foreign Trade on decisions related to trade policy issues except financial market issues which lie within the jurisdiction of the National Monetary Council and the Central Bank.

According to the guidelines devised by the Chamber of Foreign Trade the Ministry of Development, Industry and Foreign Trade is in charge of implementing trade policy through the Secretariat of Foreign Trade which is divided into four departments they are Foreign Trade Operations, Trade Remedies, International Trade Negotiations and Planning and Development of Foreign Trade Policies. The Ministry of Finance formulates and implements economic policy (WTO Trade Policy 2009).

Russian Federation

The Ministry of Economic Development (MED) and the Ministry of Industry and Trade (MIT) are the federal executive bodies responsible for regulation of foreign trade in the Russian Federation (Working Party Accession RF 2010). Since 1 January 2010, the legal basis for the customs tariff of the Russian Federation has been the Agreement On Common Customs and Tariff Regulation between the Governments of the Republic of Belarus, the Republic of Kazakhstan and the Russian Federation (hereafter Agreement on Customs Regulation) establishing the Common External Tariff of the CU (CET). According to the Agreement on Customs Regulation, the CU Commission can issue

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28 WTO Trade Policy Review of Brazil (2009), (WT/TPR/S/212 and WT/TPR/G/212)
decisions determining CET tariff rates. The rates are based on negotiations among the CU Parties. The Government Commission for Economic Development and Integration is responsible for establishing the position of the Russian Federation on customs and tariff policies, including the development of proposals to set or change import duty rates. The CET is based on the Harmonized Commodity Description and Coding System.

The market based services started developing only in the first part of the 1990s and it is followed domestic reforms, privatization, and liberalization of the Russian economy. To create a favourable economic and investment climate in the sphere of services, the Russian Federation embarked on a series of actions to reduce constraints in the economy, involving streamlining of procedures for company registration, downsizing the list of types of activities subject to licensing, and reduction of the frequency of inspections of enterprises. The economic reforms have created new services sectors while contributing to the development of existing ones. The domestic regulatory system is struggling to keep pace with the dynamism of the services markets in Russia.

As per existing domestic legislation some services continue to be subject to licensing. A license issued by a Federal Executive body or the executive body of a particular region can be thereby used to pursue the licensed activity throughout the entire territory of the Russian Federation.

Administrative reforms have been introduced, aiming at separating the legal regulatory functions and the control or supervision of activities between different Federal Executive bodies and ensuring the independence of the Federal Executive bodies from service suppliers. Formulation of state policy and legal regulation has been assigned to the relevant ministries in accordance with their competence. The function of control or supervision has been assigned to the Federal services. There are certain sectors wherein the Federal Executive bodies responsible for the regulation of the respective service (IIFT 2012)\textsuperscript{30}.

India

Trade policy is formulated and implemented mainly by the Ministry of Commerce and Industry along with other ministries and agencies including the Ministry of Finance, the Ministry of Agriculture and the Reserve Bank of India. The Ministry of Commerce and Industry is to formulate and implement India’s international trade and commercial policy.

The Director General of Foreign Trade (DGFT) advises the Government in the formulation of India’s Foreign Trade Policy (FTP) after consulting with various trade bodies such as the Federation of Indian Export Organizations, Export Promotion Councils, Commodity Boards and leading industry associations. The FTP is issued every five years but it is reviewed periodically in view of changing domestic and international situations. The FTP is updated through the issue of notifications by the Director General of Foreign Trade, attached to the Ministry of Commerce and Industry. The Tariff Commission within the ministry issues recommendations on the appropriate tariff levels. Tariff and other duties are under the purview of the Central Board of Excise and Customs (CBEC) in the Ministry of Finance.

India considers trade policy as an instrument to attain its overall economic policy objectives of growth, industrialization and self-sufficiency. After global economic and financial crisis India has sought to arrest and reverse the declining trend of exports and to provide additional support especially to sectors hit badly by the global recession asserted in the 2009-14 FTP. India’s short term objective according to the latest FTP is to achieve annual export growth of 15%. The long-term objective is to accelerate the export growth rate to 25% per annum and double India’s share in global trade by 2020. In order to meet these objectives, India implements a mix of policies including tax incentives and credit facilitation. Although India aims to provide a stable trade policy regime to reach its long-term goals and it also uses trade policy to attain short-term goals such as (WTO trade policy, Review of India 2011).
China

China's overall trade policy aims to accelerate the opening of its economy to the outside world to introduce foreign technology and knowhow to develop foreign trade and to promote economic development that is mutually beneficial for its trading partners. China's main laws covering international trade include the Foreign Trade Law, the Customs Law, and the Regulations on Import and Export Tariffs which contain the tariff schedules as well as laws and regulations relating to standards, anti-dumping measures, countervailing and safeguard measures and intellectual property rights. Various trade related laws and regulations have been adopted in recent years, including the Enterprise Income Tax Law which unified income tax rates for all companies (domestic or foreign-invested). The Anti Monopoly Law is the first comprehensive competition law in China, the Patent Law which inter alia increased penalties against infringement and the Administrative Regulations on Foreign Investment in Telecommunications Enterprises (Amended) which lowered the minimum registered capital requirement for foreign-invested basic telecommunication providers.

The Ministry of Commerce (MOFCOM) is responsible for policy coordination and implementation in respect of all trade related issues. Other key agencies influencing trade policies are the National Development and Reform Commission (NDRC) which is in charge of overall national economic and social development policy and the Ministries of Finance, Agriculture, Transportation and Land and Resources. An institutional change in the State Council conducted in 2008 and some agencies responsible for China's trade policy implementation. The change involved relocating regulatory functions between some ministries and agencies as well as creation of new ministries and agencies. Consequently the National Bureau of Energy, the Ministry of Industry and Information Technology (MIIT), the Ministry of Transport and the Ministry of Environmental Protection were established and the Commission of Science, Technology, Industry for National Defense (COSTIND), the Ministry of Information Industry (MII) and the Ministry of Construction were abolished.

Several industry associations also collect and share information to identify and deal with problems related to industries which discuss trade policy issues that affect their
industries and represent their sectors to the Government. These include the China Coal Industry Association, China Iron and Steel Association, China National Textiles and Clothing Association, China Machine Industry Federation, China Petroleum and Chemical Industry Association, China Light Industry Federation, China Building Material Industry Association, and China Nonferrous Metals Society (WTO trade policy, Review of China 2010)32

South Africa

The Department of Trade and Industry (DTI) is responsible for formulating and coordinating the country’s trade and industrial policies. The other departments and agencies also take important initiatives on trade policy such as the Departments of Finance, Agriculture, Health, and Mineral and Energy Affairs as well as the South African Reserve Bank. The private sector is quite instrumental in forwarding proposals and recommendations to the DTI. The National Economic Development and Labour Council (NEDLAC), the International Trade Administration Commission (ITAC) that replaced the Board on Tariffs and Trade (BTT), and the Industrial Development Corporation (IDC). The IDC and Parliamentary Committees continue to play a key role in assisting the DTI in carrying out periodic reviews and assessments of trade policies. The DTI has evolved to become a key player in modernizing and streamlining South Africa’s trade and industrial developments

The International Trade Administration Commission (ITAC) is responsible for tariff investigations, amendments, and trade remedies in South Africa and on behalf of SACU. In addition Trade and Investment South Africa (TISA) are mandated to promote investment, particularly FDI and export development in South Africa. Companies and Intellectual Property Registration Office (CIPRO) is mandated to regulate services and business entities effectively in order to gain investor confidence and to stimulate economic growth (WTO trade policy, Review of SCU 2009)33

Recent Trends in BRICS Countries.

The New Development Bank (NDB), formerly referred to as the BRICS Development Bank. It is a multilateral development bank operated by the BRICS countries (Brazil, Russia, India, China and South Africa) and it is as an alternative to the existing American and European-dominated World Bank and International Monetary Fund. The bank is set up to foster greater financial and development cooperation among the five emerging markets. The goal of the bank is to "mobilize resources for infrastructure and sustainable development projects in BRICS and other emerging economies and developing countries". The bank is headquartered in Shanghai, China. Each participant country holds an equal number of shares and equal voting rights, and none of the countries will have veto power.

The association of five major emerging national economies, Brazil, Russia, India, China and South Africa (BRICS) has a special responsibility towards helping the world achieve its goal of ending extreme poverty, reducing inequality and achieving sustainable development, as they collectively represent some of the world’s greatest challenges and achievements. BRICS countries still house nearly half of the world’s poor and with the exception of Brazil have experienced a rise in inequality in recent years (OXFAM Policy 2014). The creation of a BRICS Bank and with it the promise of reforming the global development architecture offers a real and concrete opportunity for governments of these countries to ensure development of financing those who are poorest and most marginalized.

In a press release issued during the 2013 Durban BRICS Summit, Oxfam said ‘BRICS leaders are blazing a trail in reforming the global financial architecture. If the BRICS Bank fights poverty and inequality it could be a big success. But if it focuses only on big ticket schemes that fail to directly benefit poor people it could do more harm than good’

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Need for the study

World where competitiveness and it is a driving force to economic development, trade in goods and trade in services play a vital role in ensuring a competitive economy. Service industries provide the infrastructure and allowing modern economies to functioning properly by linking geographically dispersed economic activities or supplying inputs to competing in the domestic and global markets.

Research Gap

There were numerous studies conducted on trade goods and trade in services. Each study gives new impetus for further research and its findings had some policy relevance in the respective study period. Most of the studies concentrated trade in goods and trade in services separately and on liberalization. Whereas very few studies carried out trade in goods and trade in services of BRICS countries. The present study is an attempt to fill the gap or add one more study to existing research in International trade by an extensive analysis on Trade in goods and Trade in services of BRICS countries.

Statement of the Research Problem

International trade in goods requires inputs from several service industries such as transportation, insurance and finance in order to complete and facilitate international transactions. Restrictions on the ability of national service providers to provide these services across borders and within foreign countries create additional costs and barriers to international trade. Trade in services provides the same mutual economic gains made possible by trade in goods. It permits international specialization on the basis of comparative advantage. It increases efficiency of domestic industries through increased competition and it enriches consumer choice by widening the range of available services. Lot of interest has been generated in trade in services since the formulation of General Agreement in Trade in service (GATS) under WTO. Theoretically said to be trade in goods and trade in services are somewhat interlinked. In this regard an important question arises that whether the trade in goods cause trade in services and vice versa. An in- depth analysis of Trade in goods and Trade in services of BRICS countries would help to understand the role of trade in goods and trade in services among BRICS countries. Hence, the present study.
Objectives of the Study

1. To study the growth pattern of trade in goods and trade in services of BRICS countries.

2. To measure long run relationship between trade in goods and trade in services of BRICS countries.

3. To find out the structural break of BRICS countries trade in goods and trade in services after the formation of group.

Hypotheses of the Study

1. There is no significant change in the growth pattern of trade in goods and trade in services of BRICS countries during the period under study.

2. There is no long run relationship between trade in goods and trade in services of BRICS countries during the period under study.

3. There is no structural break in BRICS countries trade in goods and trade in services after the formation of group.

Scope of the study

The study helps to understand the exports and imports of trade in goods and trade in services of BRICS countries. In this context, the present study will immensely useful to the officials and the related administrator who are involved in policy making in respect of goods and services of BRICS countries. The findings of the study especially estimate of growth pattern of trade in goods and services their relationship would contributed to the policy formulation. The methodology and analysis of present study may help to formulate and design their research problem.

Limitation of the Study

The study covers only BRICS countries. It is highly difficult to represent all economies. The study is done only using secondary data. The available data may not be as accurate as desired. The definition adopted by those who collected those data may be different; units of measure may not match. The study confined only trade in goods and trade in services of BRICS countries from 1990 to 2013.
Concepts Used in the Study

Regional Trade Agreements

WTO defined regional trade agreements (RTAs) are as reciprocal trade agreements between two or more partners. They include free trade agreements and customs unions.

Preferential Trade Arrangements

According to WTO Preferential Trade Agreements (PTAs) are agreements among a set of countries involving preferential treatment of bilateral trade between any two parties to the agreement relative to their trade with the rest of the world. Preferences however, need not extend to all trade between the two and the coverage could depend on the type of PTAs.

Custom Union

GATT Article XXIV: 8(a) defines a customs union as a single customs territory substituting for two or more customs territories and having two characteristics: (a) duties are eliminated on substantially all trade between the constituent territories, and (b) substantially the same duties are applied by each member to trade with nonmembers.

Economic Integration

Bela 1987 defined economic integration both as a process and as a state of affairs. Considered as a process, economic integration comprises the set of political and economic measures "designed to eliminate discrimination between economic units that belong to different national states". Interpreted as a state of affairs, "it represents the absence of various forms of discrimination between national economies". The process of economic integration, then, can be regarded as the path that is followed between decreasing level of economic discrimination among countries.

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Theoretical Background

The field of international economics covers both international financial transactions and international trade in commodities and services. The theory of international trade is that branch of economic theory concerned with trade between nations and more broadly, with all aspects of the economic relations between nations. The concept of a nation in this context is somewhat ambiguous and a matter of degree rather than of kind, but not so much so as to cause serious difficulty. To the classical economists, the distinguishing characteristic of a nation was the combination of internal mobility and international immobility of factors of production, an approximation that is, if anything, more appropriate to the twentieth than to the nineteenth century and still dominates the theory of international trade.

Economist believes that if countries engage in international trade, they can mostly benefit under a free international trade environment. The major main theories on international trade are Mercantilist theory of trade, Theory of Absolute Advantage, Ricardian Comparative Advantage Model on gains from specialization and Heckscher-Ohlin model who believes that factor proficiency differences are the reasons for countries engage in international trade because of the gains from specialization and income distribution effects, New International Trade Theory which examines the economies of scale and the why countries engage in international trade basing on a firm level perspective.

Two of the basic questions that the theory of international trade has to answer are what determines the pattern of trade and who gains from trade. Economics does have answers to these questions – one that go back more than 150 years- in the theories of Comparative Advantage and the gains from trade. These theories, formulated 1815 and usually connected with the name of David Ricardo, the theory of Comparative Advantage or, as it sometimes called, the theory of comparative cost, it is one of the oldest still unchallenged theories of economics. Before exploring the basic theory of comparative advantage and the gains from trade, shall take a brief look at its historical background.

Mercantilist Theory of Trade

The economic doctrine that prevailed during the first two centuries of the development of the modern nation state, the seventeenth and eighteenth centuries was
mercantilism. Mercantilism is a theory that states that nations should accumulate financial wealth through exports and discouraging imports. This was accomplished through trade surpluses, government intervention and colonization.

Trade surpluses, government intervention and colonization worked together. Trade surplus was maintained through the colonization of under developed territories for their raw materials. The country would colonize these under developed countries ship the raw materials needed for export back to the home country and export the finished product around the world (Sawyer and Sprinkle 2005)\(^37\). The government intervention occurred when they banned certain imports or imposed a tariff on these imports. At the same time, the government would subsidize their own industries to expand exports. Mercantilism was the credo that Adam Smith and David Ricardo rebelled against.

In short this theory concentrates on export activities and much emphasis on gold and silver which were not true wealth of a country. Trade includes both export and import. In modern world application of this type of trade theory is not possible. Adam Smith saw clearly that a country could gain by trading. Smith argued a whole country could gain by trading with other countries. So these lead to give rise of other trade theories.

**The Theory of Absolute Advantage**

The theory of Absolute Advantage was formulated by Adam Smith. Theory can be considered as forerunner to Ricardo theory of Comparative Advantage. The absolute advantage theory was the ability of a nation to produce a product more efficiently than any other nation using the same amount or fewer resources. The difference in this theory is that trade should not be banned or restricted by tariffs but allowed to flow freely according to the demand of the market. This theory also states that the objective be that the people of the country have a higher living standard by being able to obtain goods more cheaply and in greater abundance. The theory measures a nation's wealth on the living standards of the people and not on the money the country has in its reserve (Sodersten and Ree 2004)\(^38\).

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Practical application of this theory in trade is very complicated. How would a country without having any absolute advantage in producing any good, join and gain from free trade with other countries. Adam Smith rested plea for non-interference - for free trade as the best policy for trade between nations. Smith’s argument seems convincing but it is not very deep. It was left to Torrens and Ricardo to produce the stronger and more argument for the benefits from trade contained in the Theory of Comparative Advantage.

Comparative Advantage Theory (Gains from Specialization)

Ricardo did not object to Smith’s analysis. It is obvious that if one country has an absolute advantage over the other in one line of production and the other country has an absolute advantage over the first in a second line of production, both countries gain by trading. A great deal of trade, perhaps most trade, is governed by such differences.

Countries engage in international trade because they stand to gain if they specialize in the production of products with low opportunity cost. To Ricardo countries should understand their factor endowments then direct production to the best alternative in utilizing the available resources. A country undertaking such specialization would then engage in international trade with others countries to get those products which are of second best alternative in utilization of resources. Theory using the opportunity cost theory. Noting that resources are scarce, a country has to give up production of one product in order to produce the other. To know which one to give up, a country has to determine where it would have higher output if the same resource available was utilized in the production of either product. A country would specialize in production of that product whose utilization of the available resource produces the most output. In opportunity cost terms, a country should specialize in production of that product whose cost for failure to produce it is higher than that of the second alternative (Krugman and Obstfeld, 2004)\(^{39}\). Countries are endowed differently and so they have different opportunity costs. The difference in opportunity cost is what would enable countries to engage in international trade with each other so as to get the disadvantaged products.

To sum up the above with the use of what he called the Absolute and Comparative advantages. To him even if a country would produce more of the two products than the other country (Absolute Advantage), it should specialize in producing that product in which it has an advantage in utilization of the available resources (Comparative Advantage).

**Overview of the Adam Smith and David Ricardo Trade Theories**

Tracing back the evolution of what today is recognized as the standard theory of international trade, one goes back to the years between 1776 and 1826, which respectively mark the publications of Adam Smith’s Wealth of Nations (1776) and David Ricardo’s Principles of Economics (1951). The two volumes herald the formulation of a theory of free trade based on the unprecedented success of England in the respective fields of industry and trade. For Smith, the division of labour, in the nascent large scale industries of his homeland England provided the base for lowering labour costs which ensured effective competition across countries.

It was left to Ricardo to sort out the basic premises of a theory of free trade, which Smith had initiated. Industrial capitalism in Ricardo’s England was at a relatively advanced stage as compared to what it was in Smith’s time, both with rapid growth of large-scale industries and captive markets in overseas colonies. Imports of wage goods (corn) had a special role by cheapening wage goods and hence labour cost for industry in Ricardo’s England. Free trade, as opposed to the Mercantilist policies of protection, was championed by both Smith and Ricardo as a route to achieve production efficiency at a global level. Ricardo’s cost calculations, despite his concerns for the introduction of machinery on a large scale, were based on labour hours, which were treated as a single homogeneous input with production (in a two commodity world) subject to constant costs.

In short both comparative and absolute advantage, which was considered both necessary, as well as sufficient to ensure mutually gainful trade across nations.

**Role of Demand in Trade Theory**

For the Benthamite utilitarianism that became prominent by the first two decades of the twentieth century, the Ricardian doctrine missed out the role of demand as an
explanation of the terms of trade in exchange. It was for J.S. Mill to do the balancing act by introducing the notion of “Reciprocal Demand.” A few years later Alfred Marshall further advanced the role of demand in terms of the “offer curve” construct, which according to him, completed the Ricardian trade theory by determining the ‘terms of trade’. However, the supply-side embedded in these theories had in the meantime changed drastically from the Ricardian notion of fixed labour time inputs to ‘real costs’. These costs for Marshall were measured by the subjective disutility or sacrifices of labour at the job. In addition output was subject to diminishing returns, with changing factor proportions rather than with constant factor (labour) coefficients as in Ricardo. Units of a “representative bale” of goods offered by the respective nations in the two-country model bore the mark of demand as well as supply. Factors settled the terms of trade at a stable equilibrium, as long as goods exchanged were of a “normal” category, with elastic demand and production was not subject to increasing returns. Possibilities of multiple equilibrium, as arose when the above conditions were not fulfilled, were carefully avoided by Marshall by assuming that all costs are irreversible, even when subject to increasing returns (Bharadwaj1989)40

Theory of Overlapping Demand: New Role of Demand in Trade Theory

Deviating from the supply-side explanations of the pattern of trade, an alternate explanation of the pattern of trade was offered in 1964 in terms of “overlapping demand” by a Swedish economist Staffan Linder 196141. Representative demand in the trading nations for a range of goods that are typically demanded at the respective per capita income determine, according to Linder, the feasibility of trade across nations. To produce and trade, representative demand in the respective countries needs to have an overlapping zone in terms of the range of goods that are produced and consumed in common. In terms of the above interpretation of trade, it is demand and not supply that comes to the centre stage as an explanation of trade. Linder’s notion of trade overrides the earlier emphasis on supply-based explanations of trade in terms of comparative cost or factor endowments.


The Heckscher-Ohlin Theory of International Trade

The dominant model of comparative advantage in modern economics called Heckscher-Ohlin model, is a theory of long-term general equilibrium in which the two factors are both mobile between sectors and the cause of trade is different countries having different relative factor endowments. This model gives some interesting insights into the effects of trade on factor use and factor rewards not least that the free movement of goods between countries may bring about the equalization of real payments to factors of production, even though those factors are by assumption unable to move between countries in search of higher real rewards. This does not happen in the classical model unless get a particular combination of technologies. Nor does it happen in the specific factor model in general, even though that the specific factors model in its industry specific capital formulation may be thought of as a medium term version of Ohlin model (Bhatia 2006)\(^{42}\).

Model left out a number of important factors. The model is not complex enough to examine how international trade affects income distributional within a country. It never highlighted on specific terms for the winners and losers. It assumes all countries are identical except for their differences in resource endowment although in reality know that countries differ not only in factors of production but also in how they achieve productivity out of those endowments. Ohlin model assumes that countries have factor differences in a way that one country has higher proficiency levels than the other. Another most important assumption is that countries are identical except with regard to endowments. The tests and preferences are the same and technology is a constant in the two countries.

Countries have same factor endowment; its productivity in respect to production of a particular product differs between two countries. As such, a country should specialize in the production of a product in which factor productivity is higher. In other words, each country has a comparative advantage in the production that requires relatively less of the factor with which it is well endowed. Through international trade, there is tendency towards equalization of factor prices across the two nations. In this sense, international trade and factor movement are substitutes.

Looking closely it is clear that factor price equalization can be achieved if there is absence of complete specialization, similar technology and convergence of free trade relative prices which in turn requires absence of trade restrictions. But does every individual gain from international trade? The answer is No, within each country owners of the abundant factor gain while owners of other factors lose from trade liberalization. Aggregate welfare increases in both countries –the sum of the gains exceeds the sum of individual losses. In principal losers could be compensated at the national level. However, this requires separate redistribution policies to make everyone better off.

Failed to explain why there is inequality in highly open countries. Predicted that owners of abundant factors will gain from trade and owners of scarce factors will lose. But, while this mechanism might be at work, the evidence shows that it is not the dominant factor that matters. Changes in technology, changes in consumer preferences, and exhaustion of resources and discovery of new ones all affect income distribution. Economists put most of the blame on the bias of technology transfer and the resulting premium paid on education as the major cause of increasing income inequality in developing countries. In any case trade liberalization may trigger technological change which, in turn affects inequality.

Theory states that those country rich in capital will have comparative advantage in capital intensive good, and labour rich country will have the comparative advantage in labour intensive good.

The New Trade Theory on Why Countries Engage in International Trade

New Trade Theory (NTT) is a collection of economic models in international trade which focuses on the role of increasing returns to scale and network effects, which were developed in the late 1970s and early 1980s. New trade theorists relaxed the assumption of constant returns to scale, and some argue that using protectionist measures to build up a huge industrial base in certain industries will then allow those sectors to dominate the world market. New trade theory takes a different approach from the Ricardian and the Heckscher-Ohlin models on why countries engage in international trade. Both Ricardo and Heckscher assumed constant returns to scale where to them if all factors of production are doubled then output will also double. But a firm or industry may have increasing returns to scale or economies of scale in way that when all factors of
production are doubled, output more than doubles which will necessitate a bigger market and thus forcing firms to engage in international trade where there is a larger market. The New Trade Theorist noted that the bigger the size of a firm or industry the more the efficiency of its operations in that the cost per unit of output falls as a firm or industry increases output. The increase in output must be met with an increase in the market size if it has to be sustainable (Sen, 2010).\(^{43}\)

The New Trade Theorist noted that the existence of economies of scale makes large firms to be more efficient than small firms and the industry may consist of a monopoly or a few large firms. Production may be imperfectly competitive in the sense that excess or monopoly profits are captured by large firms. In other words New Trade Theory on why countries engage in international trade is opposed to the assumption made in the Ricardian and Heckscher models that there is perfect competition in the market in that all income from production is paid to owners of factors of production and there is no “excess” or existence of monopoly profits. To New Trade Theorists, countries engage in international trade because of the notion of economies of scale. To them the presence of scale economies leads to a breakdown of a perfect competition and creates more efficient firms which continue to expand on the markets because of increased outputs. The New Trade Theorists explained that because engaging in international trade increases market size, this decreases the average cost in an industry described by monopolistic competition.

Two types of economies of scale were considered in explaining that countries engage in international trade. The first one is the internal economies in which average costs of individual firms will fall as they produce more output and become larger and the second one is the external economies of scale in which average costs of the industry in a country will reduce as it produces more output and grows larger.

In short New Trade theory mentioned economies of scale and stated that when countries engage in international trade variety of goods those consumers can buy also increases thus increasing their welfare. As average costs decrease consumers also benefit from a decreased price.

Economic Integration

Traditional economic theory asks two questions relating to trade liberalisation and the formation of a preferential trade agreement (PTA) – whether a free trade area (FTA) or a customs union (CU) – what is the welfare impact on each member country, the bloc as a whole and the rest of the world?; and can two or more countries form a trade bloc such that it makes the rest of the world worse off? The first question is investigated by Viner (1950) who introduced the concepts of trade creation and trade diversion.

In the trade creation, a low-cost RTA member country replaces the high-cost domestic producers and each country produces a good to which they have comparative advantage (Yamarik and Ghosh 2004)\(^{44}\). It is a creation of trade that would have not happened if the tariff had not fallen. Trade creation always increases both the world and national welfare. (Sawyer and Sprinkle 2004)\(^{45}\).

It is important to examine the trade diversion effect to find out the overall impact of regional trade agreements on world trade and welfare. The trade diversion is known as a negative outcome of regional trade agreements, because of the export losses the non-member may face. The trade diversion occurs when the members of trade union substitute an efficient nonmember country with less efficient, but under RTA less costly member country (Pardo et al. 2009)\(^{46}\).

Viner analyzed the second best situation of a three country one good case, where the highest price (least efficient) producer of a good, country A has the opportunity to form a union with either the second highest price producer B, or the most efficient producer C. If ‘A’s tariff is nondiscriminatory but not prohibitive before the union, so that it is importing from the least cost source C, then a free trade union with B where both A and B shut out C using a common external tariff on C will be “trade diverting”. A will now import from B at a higher than pre-union price. Of course, if both A and B were inefficiently producing the good before the union.


\(^{45}\) Ibid. 37.

**Custom Union Theory**

Customs Unions (CUs) within this type of accord, member countries remove all barriers to trade among themselves and adopt a common set of tariffs to be applied to third countries, consequently the adoption of intra-CU rules of origin and the need for customs inspection become obsolete. The level of the common tariff is critical in determining the economic outcome of a CU and may be relevant in defining other domestic economic policies given its potential impact on public revenues.

Viner’s custom union theory that examines trade creation is based on perfect competition in commodity and factor markets in a partial equilibrium framework. Examines the effects on both small and large countries. In the model, the tariff reduction increases the trade between the members of the union and the trade flows between members and non-members stay unchanged if the union is trade creating. Therefore, the welfare of the members and of the world increases. Viner’s theory explains the trade effects well in a perfect competition. Model does not take into the consideration the role of the government in the decision making or other factors that may influence the end result in the imperfect competition framework.

Differently Emanuel Ornelas (2005b) developed a model that explains the general trade effects of the regional trade agreements in an imperfect competition framework. The main idea in his theory is based on the influence of special interest groups on government decision making, which is essential part in the theory as governments are the ones who decide whether to join RTA.

The conclusions of Ornelas model are slightly different in comparison with Viner. This is because Ornelas model depicts that the trading block creates trade both within a bloc and with the non-members. Ornelas model is used as a theoretical basis to explain the possibility to RTA to be trade creating, as it widely takes into the consideration the role of the government in the decision making and determines external tariffs endogenously. Both of these factors are essential when forming regional trade agreements.

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Trade creation and Trade diversion is an important concept in trade. Trade creation is may be said to be a good thing and trade diversion is a bad thing.

**Trade Diversion in the Political Economy Approach**

In the model, Krishna (1998) suggests that governments are more supportive towards the RTAs with the trade diverting feature. This is because the profits gained of the possible member countries have to be larger under the bilateral agreement in order to governments to support the agreement. This makes the establishment of the agreements more challenging and brings out the possibility of trade diversion, because only seldom larger profits are gained by increasing the market shares in other member’s market. If the regional trade agreement allows firms in the member countries to displace the firms from non-member countries in each other’s markets, the RTA surely enhances profits for all members’ firms. Of course, this happens at the expense of outsiders.

**Trade Diversion and FTA Tariffs**

Richardson (1993) considers a three-country case where two small open economies, Home and a partner country, form a free trade area, excluding the third large country (rest of the world). Home produces ‘n’ good each using labour and sector-specific capital, plus good that uses only labour. All goods are produced with constant returns to scale technology. Home’s government chooses tariffs to maximize as objective function that is a weighted sum of the welfare of labor and capital owners. Since their welfare is augmented by the redistribution of the tariff revenue to labor and capital owners (in some predetermined proportion), tariffs are endogenously determined in equilibrium. Suppose the FTA leads to a sudden decrease in Home’s tariff revenue as the FTA partner country captures Home’s market. Then, Home’s government will lower protection on imports from the rest of the world just enough to resume importing from the rest of the world and gain back some tariff revenue (Bohara et al. 2004).

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Based on these theories, we can see that how many different factors are included in international trade. These theories have developed throughout the years and will continue to develop as time goes on. International trade continually fluctuates due to all the different factors involved in the production of goods and services exported and imported throughout the world.

Chapter Scheme

Chapter I was devoted to introduction about trade in goods and trade in services general and particular BRICS countries and theories of international trade, reviews of past empirical studies were discussed in chapter II, chapter III presents a detailed description of research methodology, it includes description of data collection procedures and methods of analyses. Chapter IV deals the analysis on the growth pattern of trade in goods and trade in services of BRICS countries, long run relationship between trade in goods and trade in services and structural break of trade in goods and trade in services of BRICS countries were presented in chapter V, chapter VI summarises major findings and conclusion.