THE EC'S SINGLE MARKET: ITS IMPLICATIONS FOR INDIAN EXPORTS OF AGRICULTURAL AND AGRO-BASED PRODUCTS

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CERTIFICATE

Certified that the dissertation entitled **THE EC'S SINGLE MARKET: ITS IMPLICATIONS FOR INDIAN EXPORTS OF AGRICULTURAL AND AGRO-BASED PRODUCTS** submitted by **Mr.S.GNANASEKARA PANDIAN** is in partial fulfilment for the award of the degree of **Master of Philosophy**, of this University. This dissertation has not been submitted for any other degree to any other University and is his own work.

We recommend that this dissertation be placed before the examiners for evaluation.

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TO MY

AMMA AND APPA

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CONTENTS

CHAPTER I

INTRODUCTION

One of the most important and striking global economic developments in international economic relations of the twentieth century was the formation of 'regional trading blocs'. However, such tendency towards the creation of regional trading blocs was motivated at the end of second World War. Soon after the end of the second world war, the Western countries realised the need for forming one political and economic unit, to minimise any chances of conflict, which could result in the outbreak of general war. The main factors responsible for the formation of regional blocs are political, economic, and cultural interests. When the fears of cultural deracination are intensified by the traditional nationalist sentiments, identity becomes an important issue. The formation of a regional bloc seeks to displace the traditional nationalistic sentiments with 'supranationalism'. The formation of a supranational agency was regarded as desirable in avoiding the multifarious nationalist attitudes of the countries. Hence, countries are hastily trying to form regional blocs, to protect themselves from the nationalist sentiments of their alien. But, the more successfully they become, the more of their power is transfused into the veins of a supranational agency, which has progressively stripped away the chunk of their nationalistic attitudes.

It is well known that the economic factors play an important role in the political configuration of a system. The relationship between political and economic stability is inseparable. With the undistorted economy, the countries could be expected to have political stability.[1] Hence, the move directed towards the formation of regional blocs, intends to have both political and economic motives. Usually, political motives may prompt in the first step in the regional economic integration, but, economic integration also reacts on the political sphere.[2] Likewise, if the initial stages are economic, the need for political unity arises at a later stage.[3] According to Belassa, "the economic integration appears as part of a political process and the final outcome of which is determined by essentially political factors".[4] Vajda sees that, political unification and economic integration as integral parts of a comprehensive plan of action to achieve greater economic efficiency, faster economic growth and a more harmonious

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1 For details see Augustin Kwasi Fosu, "Political Instability and Economic Growth : Evidence from Sub-Saharan Africa", <u>Economic Development and Cultural change</u> (Chicago), vol.40, no.4, July 1992, pp. 829-41.

2 Bela Balassa, <u>The Theory of Economic Integration</u> (London, 1961), p.7.

3 Ibid., p.7.

4 Ibid., p.7.

pursuit of national, political and economic objectives . Hence, countries enter into the regional blocs with political and economic objectives. In this system of bloc formation, one factor is used as a means for achieving another factor. As far as the Western industrialized countries are concerned, the drive towards the economic union was motivated by those, whose ultimate aim was the political union of Europe and who saw economic union as a means to more specific economic goals, such as improving the efficiency of resource allocation, increasing the degree of competition or increasing the rate of growth.

The reasons for the countries to enter into the regional economic arrangement are analysed as follows. The main objective of the regional economic arrangement is to increase the relative economic status of the participating countries in the arena of international trade. This is because of the role of 'mercantilism' playing in an international relations. Adam Smith held a definite view on the evolution of 'mercantilism' in international relations. In his work, "An Enquiry into the Nature and the Causes of the Wealth of Nations", he attacked mercantilism.[5] He saw

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[5] Frans Buelens, "The Creation of Regional Blocs in the World Economy", INTERECONOMICS (Hamburg, Germany), vol.27, May/June 1992, p.125.

international relations as a "Zero-Sum" game and concluded that mercantilism was responsible for conflicting relations between nations.[6] Hence, the countries with the objective of increasing the relative economic strength enter into a regional economic arrangement. This is achieved by increasing the efficiency and competitiveness of the participating countries of the regional economic arrangement. A central assumption, upon which the competitive model rests is that Ricardo's 'theory of comparative advantage'.[7] This theory suggest that, in a two-commodity, two-state world, states will secure gain by specialising in producing the commodity, at which they are relatively more efficient and by then exchanging a portion of their production with their partner, in order to obtain the second commodity. Hecksher-Ohlin theorem, which further elaborated the Ricardian theory of comparative advantage says that "the economies will export those commodities whose production requires the relatively more intensive use of those factors of production, with which they are well endowed".[8] This means a country will export those

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6 Ibid., p.125.

7 See David Ricardo, The Principles of Political Economy (London, 1969).

8 David K. Whynes and Roger A. Bowles, The Economic Theory of the State (Oxford, 1981), p.162.

commodities which make intensive use of its abundant factors of production, with which it is endowed. However, the sources available to each country for the purpose of production differ both qualitatively and quantitatively from those available to others.[9] No country in the world is well endowed in all the sources. The countries will seek 'comparative or absolute advantage' in the production of those commodities in which the production is ahead of other countries. The production capability of countries differ with the product resource, that has been available for the production of those commodities. Hence, with the given differing resource endowments, the possibilities of countries gaining from commodity exchange is hardly in doubt.[10] Hence, countries seek gains by entering in to a regional economic arrangement with its neighbours to ensure that the gains from absolute or comparative advantage is greater than those obtained from the commodity exchange.

It has been argued that the formation of regional trade bloc maximizes the welfare of the participating countries. 'Trade maximization' has always been accompanied by 'trade

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9 Ibid., p.162.

10 Whynes and Others, n.8, p.163.

liberalization'.[11] This trade liberalization could easily be experienced in enlarged economies. Moreover, the free trade among the member countries ensures that the benefits arising out of absolute or comparative advantages are greater in enlarged economies. The enlarged economy arises from the agglomeration of contiguous national economies. However, within the paradigm of inter-state relationships, countries will likely to pursue the logic of trade theory for gains from trade, which is achieved by some degree of specialization.[12] This could be obtained at the expense of abandoning some degree of sovereignty to others.[13] The formation of regional free trade bloc and its welfare effects remunerate the abandonment of some degree of sovereignty of member countries. Moreover, in a system of free trade, the conflicts in economic interests among the member countries would be curtailed. Under a system of free trade, Schumpter avers "there would be conflicts in economic interests neither among different nations nor among the corresponding classes of different nations".[14] Hence, in

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11 See S.M. Dutta, "Economic Regionalization in Western Europe: Asia - Pacific Economies (Macroeconomic Case: Microeconomic Optimization)", The American Journal of Economic Review, vol.82, no.2, May 1992.

12 Whynes and Others, n.8, p.163.

13 Ibid., p.163.

14 Ibid., p.165.

the free trade model, it is the vehicle of unhindered competition between trading partners that ensures the attainment of maximum potential of comparative advantage. The neo-classical approach seems to suggest that the more open the inter-state economic competition becomes, then the higher are the gains from the trade that may be realised, and accordingly, the lower will be the level of inter- state conflict.[15]

The relatively strong power position of a trading bloc, both economically and politically, is based upon the following three factors[16] :

(i) The loss of efficiency resulting from an orientation to the domestic or internal market is considerably less for a trading bloc than it would be for a single country.

(ii) A trade bloc is less reliant on imports from third countries and thus less vulnerable to retaliatory measures.

(iii) A bloc can also influence the 'terms of trade' in its own favour more easily than can individual countries.

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15 Ibid., p.165.

16 Diana Brand, "Regional Bloc Formation and World Trade", INTERECONOMICS, vol.27, November/December 1992, p.275.

On the basis of these three factors trade blocs are formed, by the structural adjustment of the integrated countries' economic and development policies. This enable the expansion of the market specialization and mass production, the use of production factors on a broader economic area, increased competitiveness, high profits and a better standard of living. The advantages one hopes to gain from regional trade blocs - consist in an increased economic power flowing - are evident from the fact that a large internal market allows market potential to be more fully exploited and better use to be made use of the benefits of specialization. Thus, the formation of regional trade bloc increases the competitiveness and consumer demands, there by strengthening the relative position of the concerned national economies in international trade. Each of these regional trade blocs are strengthening their own position and preparing themselves to meet the future challenges and capitalise the opportunities available at present or in the future at the cost of the non-member countries.[17] They are also attempting to improve the economic relationship with the rest and simultaneously trying to retain and increase their market share by enforcing and improving the

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[17] Binay Kumar, "EEC 1992 : Oppurtunities and Challenges", Monthly Commentary on Indian Economic Condition, (New Delhi), vol.xxx, no.12, July 1989, p.10.

competitiveness.[18] Such trading blocs are engaged in intra and inter-regional links and thus laying the ground work for greater political stability and lesser vulnerability to global policy shifts or recessions experienced earlier.[19]

The objective of the regional trade bloc is to increase the welfare of the member countries. According to Pareto, "an increase in one man's welfare leads to an increase in social welfare of any other members of the group". Within the region, Viner points out, "the bigger the size of the integrated market, involving more nation states, the greater will be the beneficial effects of economic integration". As far as the developed Western economies are concerned, an increase in the size of the market itself leads to an increased benefits. Hence, countries forming the regional trading bloc also form the single enlarged market thereby increases the benefits accruing from an enlarged market.

After the establishment of the regional trading blocs, countries try to maximize the economic gains arising out of the trading blocs, by removing the trade barriers, that hitherto disturbed the intra-regional trade. The basic

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18 Ibid., p.10.

19 Ibid., p.10.

principle lies behind the formation of regional trade bloc is to increase the intra-regional trade by increasing the efficiency and competitiveness of the participating countries. But, increasing the intra-regional trade by removing all the barriers among the member countries, need not necessarily increase the efficiency and competitiveness of the trade blocs. The rapid growth of intra- regional trade is not necessarily incompatible with increasing competitiveness.[20] Hence, increasing the intra-regional trade by removing all the barriers, results in certain degree of discrimination favouring the countries within the blocs and against the trade with outside the world. Whenever any such discrimination occurs, it leads to a distortion in the structure of international trade and hence to inefficiency, as trade is no longer able to conform to the principle of comparative advantage.[21] Finally, the trade blocs result an increased intra-regional trade and decreased trade with the non-member countries, without increasing the efficiency and competitiveness of the participating countries. An analysis of trade and foreign investment flows during the 1980's does not lend much support to the

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[20] Friedrich Von Kirchbach, "Euro - Asian Trade : The Stepchild Takes Over", Inter Economics, september/October 1992, vol.27, p.245.

[21] Brand, n.16, p.276.

conventional wisdom of emerging trading blocs in the world economy.[22]

The trade policy of the trade bloc is characterized by a dichotomy between the commitment to liberal GATT rules and the desire to shield domestic products from foreign competition.[23] The result is an increasingly complex trade policy regime, which is highly selective among products and extremely discriminating among the countries.[24] The GATT rules only allow members to group together into regional free zones, if they pledge that the trade barriers facing the third countries will not be increased.[25] The rise of trade blocs in a multilateral trading system reduces the importance of 'inter-dependence' and increases the importance of 'regionalism'. However, the threat of increased bilateralism and regionalism is inherent in the trade policies of the trade blocs. Indeed, a recent IMF study points out the fears about the creation of regional

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22 For further details see Ulrich Hiemenz, "Asian-Pacific Leadership : Implications for Foreign Economic Policy of Japan and the U.S" (Institute of World Economics, Kiel), Working Paper no.466, 1991.

23 Peter Nunnenkamp, "The World Economy at the Cross Roads", INTERECONOMICS, vol.27, September/October 1992, pp. 237- 240.

24 Ibid., pp. 237-40.

25 Brand, n.16, p.274.

trading blocs and the retaliatory measures taken to protect the domestic economy from the third countries. The study observes, "... fears about the creation of economic and trading blocs have been aroused by the increase in bilateral trading arrangements, retaliatory measures of a bilateral nature, and trade measures implemented within regional groups ...."[26] The trade blocs are bilateral in nature. Any steps taken to foster the two-way growth would alter the direction of growth in a multilateral trading system. This directional change in a multilateral trading system imposes challenges on countries, which have been late comers in industrialization and urbanization.[27] Hence, the process of bloc formation is advantageous to the countries of the trade blocs, with the consequence that non-member countries might become subject to relative decline.[28]

In this emerging scenario of regional trading blocs, the 'Single Enlarged Market'(SEM) of the European Community (EC) gains importance, because of its 'Fortress' nature. The procedures for the establishment of the SEM were completed by the end of 1992. The SEM has started its functioning from

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26 Ibid.

27 Kumar, n.17, pp.10-12.

28 Ibid., pp.10-12.

1 January 1993. The SEM is the single largest protectionist market in the world, consists of 346 million high spending consumers.[29] It accounts for about 20 per cent of world trade. For the EC, the volume of foreign trade accounts for about 50 per cent of its 'Gross Domestic Product'(GDP).

The average 'Gross National Product'(GNP) growth rate of the EC stands at 2.3 per cent per annum and the trade within the region grow at 8.3 per cent per annum.[30] The formation of the SEM is likely to create imbalances and distortions in international trade . The functioning of the SEM is Euro-centric and it is likely to weaken the third countries trade with the EC. In recent years, the EC's trade with the rest of the world has come down to 5 per cent per annum.[31] It finds that its intra-regional trade is more profitable than its overseas trade.[32] A continual increase in the share of the member countries' total exports is taken up by intra-community trade.[33] If the same trend is extrapolated until the year 2000, only 30 per cent of the

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[29] Ibid., pp.10-12.

[30] Brand, n.16, p.276.

[31] Ibid., p.276.

[32] Ibid., p.277.

[33] Ibid., p.278.

EC's trade will then be left over for the third countries.[34] The gradual move towards a 'Common European Currency' will undoubtedly generate tremendous positive effects in respect of the development of the intra-community trade.[35] The increase in intra-regional trade will gradually crowd out world trade, though it doesnot mean that world trade would decline in absolute terms. But, it does mean that the growth rate is likely to be concentrated chiefly within the EC.[36]

The external implications of the SEM are of considerable interest. The developing countries, with its diversified nature of economy, would be affected most by the creation of the SEM since these countries accounts for the world's largest poor. It is likely to weaken the developing countries bargaining power in international trade, and would adversely affect its economic development. The developing countries - non-contiguous and often heterogeneous - find themselves in a disadvantageous position in its trade with the EC. This is particularly true for India, which is just begining to globalise its economy and making the transition

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34 Ibid., p.278.

35 Ibid., p.279.

36 Ibid., p.279.

from an inward looking, import substituting, public sector based economy to an outward looking, export promoting, privatisation based market economy. Moreover, the SEM of the EC is its single largest partner and industrial collaborator. More than 40 per cent of its trade is traded annually with the EC. India exports 25 per cent of its product to the EC and imports 33 per cent of the products from the EC.[37] It's trade deficit with the EC has been increased by six fold.[38] At the end of 1992, India's trade deficit with the EC stood at ECU 3.30 billion, which is above 50 per cent of India's total global deficit, and is considered to be the largest for any developing country.[39] India's share in global imports of the EC continues to be negligible. In the last quarter century, India drew its benefits from its trade relations with the EC, but only as a non-associate partner in the outermost circle of the EC's external relationships. The E C's exports to India, constitute only 0.5 per cent of its total exports in the world trade, and its share in the E.C's total imports was a mere 0.4 per cent.

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37 Kumar, n.17, p.11.

38 Ibid., p.11.

39 Ibid., p.11.

India happens to have a predominantly agricultural economy, in which agriculture is a source of livelihood for about 70 per cent of its population. Agriculture remains the priority sector in India's economic development. The strategic importance of the agricultural sector in India's economic development primarily lies in the fact that it provides livelihood to about three-fourths of the country's population and accounts for about 38 per cent of the national income.[40] Agricultural exports constitute about 25 per cent of India's total exports.[41] Agriculture has been not only the prime economic activity of an overwhelming proportion of India's population but also the fulcrum around which its economy has revolved for ages.[42] India's exports to the EC mainly consists of agriculture and agro-based products. More than, 25 per cent of India's total exports to the EC are from agriculture, with food items alone constituting more than 90 per cent of total agricultural exports. The agro-based products also find important place

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[40] M. Dattareyulu, "India's Agricultural Exports : Performance, Policies, Problems and Prospects", Foreign Trade Review (New Delhi), vol.xxii, no.3, October-December 1987, p.302.

[41] Ibid., p.302.

[42] See R.C. Ummat, "Agro-Exports : Performance and Prospects", Monthly Commentary on India's Economic Condition, vol.xxx,349, no.1, August 1988, pp.17-22.

in India's external trade with the EC. They accounts for about 33.6 per cent of India's total exports to the EC.

The creation of the SEM is crucial for India, in its trade relation with the EC. In the S.E.M, trade policies are tightened to protect the national economies. This has been accompanied by the protectionist policies. All these protectionist policies ensure the "Fortress" notion of the EC. The discriminating policies, that have been announced to increase the intra-regional trade and to increase the industrial efficiency and competitiveness of the countries of the EC limits India's negotiating options in international trade. Whatever may be the changes taking place in the EC's trade policies, India is affected either directly or indirectly, because 50 per cent of India's global trade deficit is accounted for by the EC.

CHAPTER II

CONCEPTUAL FRAMEWORK FOR STUDYING THE EFFECTS OF SINGLE ENLARGED MARKET FOR NON-MEMBER COUNTRIES.

The possible effects of the SEM for the non-member countries are analysed by studying the effects of economic gains and losses of an enlarged economic area for the member and non-member countries respectively. In this conceptual framework, the effects of the SEM are analysed into two broader perspectives: (I) By studying the positive and negative effects of the SEM within the 'customs union framework'; and (II) By studying the nature of the protectionist policies used in the customs union, which is used to protect its domestic industries against the imports from the non-member countries.

STUDYING THE EFFECTS OF THE SEM FOR THE MEMBER AND NON-MEMBER COUNTRIES

'The theory of customs union' has been confined mainly to study the effects of agglomeration of contiguous national economies, on both the member and non-member countries. The 'customs union theory' has been defined as a branch of 'tariff theory', which deals with the effects of geographically discriminatory changes in trade barriers.[1]

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1 Melvyn B. Krauss, The Economics of Integration : A Book of Readings, (London, 1973), p.33.

The welfare gains and losses of the customs union could be studied from a number of different postulates. They are : (a) Trade creation; (b) Trade Diversion; (c) Economies of scale (d) Terms of trade effects; (e) Effective allocation of resources; (f) Cost-reduction effect; (g) Trade-suppression effect; and (h) Trade modification effect

The effects of customs union on both the member and non- members have been analyzed by various economists like Jacob Viner, Bela Balassa, R.G Lipsey, J.E. Meade, Kreinin Mordechai, Tibor Scitovsky, W.M. Corden, Richard Pomfret and others. Jacob Viner was pioneer in studying the effects of customs union on both the member and non-member countries. He provided the familiar concepts of 'trade creation' and 'trade diversion' and made a distinction between the trade creating and trade diverting effects of customs union.[2] In the later period, the trade creating and trade diverting aspects of customs union had further been analysed by W.M. Corden with the 'cost-reduction' and 'trade suppression effects of customs union.[3] Richard

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2 See Jacob Viner,. <u>The Customs Union Issue</u>, (New York,1950).

3 W.M.Corden, "Economies of Scale and Customs Union Theory", pp.33-43 in Alexis Jacquemin and Andre Sapir, ed., <u>The European Internal Market: Trade and Competition</u> (New York, 1989).

Pomfret studied the effects of customs union by adding the 'trade modification' aspect of customs union.[4] In addition to the trade creating and trade diverting effects of customs union, Bela Balassa analysed the effects of the customs union with the 'terms of trade' and 'production effect' aspects of an enlarged economic area.

The trade creating and trade diverting aspects of customs union are analysed as follows. Under the assumption of Zero-transportation costs, the world market price of any commodity will be equal to the cost of production in the lowest cost country.[5] It follows that, countries whose production costs are higher than the sum of the tariff and the world market price, will import the commodity from the lowest cost source, while other countries will produce it domestically.[6] Now, it is assumed that a customs union is formed between the geographically adjacent countries and the production cost varies greatly among the member countries of the union. As

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4 Wilfred Ethier and Henrik Horn, "A New Look at Economic Integration", p.73 in Alexis Jacquemin and Andre Sabir, ed., The European Internal Market : Trade and Competition, (New York, 1989).

5 Bela Balassa, The Theory of Economic Integration (London, 1969), p.25.

6 Ibid., p.25.

a result, some of the producers will capture the whole union market, the others stop the production. Now, the union countries are broadly classified into 'producing' and 'non-producing' countries . When the union is formed, the producing countries will capture the whole union market. The others going out of business. Hence the costs of production fall in the producing countries of the union. As a result of the agglomeration of contiguous national economies, a 'principle of specialization'[7] arises in customs union. Hence,the average costs of the producing countries' products fall. As a consequence of this, the total costs of producing the products also declines in customs union . This effect consists of two parts: (a) non-producing countries' expensive domestic production is replaced by the imports from producing countries', which are cheaper to produce; hence, there has been a movement to a cheaper source of supply through the opening up of trade between the member countries of the union. As a result of free trade among the member countries , some inefficient production within the union is replaced by imports from other efficient-member countries of the union, and this diminution of relatively inefficient production is known as

[7] Corden, n.3, p.34.

'trade creation'.[8] Hence, the trade creation entails a shift from high-cost to low-cost of source of supply; (b) the producing countries' now obtain their domestic supplies from the increased production and decreased production cost. This effect is called the 'cost-reduction effect'.[9]

In the formation of customs union, the member countries abolishes trade barriers among themselves and maintaining it against the non-member countries, by introducing 'common external-tariff' on goods imported from the non-member countries. It is assumed that this tariff rates are 'made to measure', at levels, designed to make the tariff inclusive import price just equal to average costs, including normal profits, hence avoiding any excess profits.[10] As this tariff level increases, the imports of the goods from the non-member countries to the union countries, will be restricted. This effect consists of two parts: (a) The non-producing countries of customs union replaces the import from the non-member country with those from the producing countries of the union. The latter are dearer than imports

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8 Mordechai E.Kreinin, Trade Relations of the EEC : An Empirical Investigation (New York, 1974), p.20.

9 Corden, n.3, p.34.

10 Ibid., p.35.

from the non-member countries, since otherwise the producing countries of the union would not have needed the formation of the customs union to break into the non-producing union countries' market.[11] As a consequence, imports from the non-member countries are replaced by relatively less efficient sources from within the union. This shift of purchases from the low-cost outsider to high-cost domestic producer is known as 'trade diversion'.[12] The trade diversion losses to the non-producing member countries of the union, will be equal to the loss of tariff revenue on imports from non-member countries.[13] For the union as a whole, the trade diversion loss may be less, since the producing countries of the union obtain their own profits at lower cost now, so that, there is the 'cost-reduction effect' equal to the extra-profits earned at home.[14]

The 'production reversal'[15] effect also seems less likely in the formation of customs union. This is based on the assumption that the production in the non-producing

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11 Ibid., p.36.

12 Kreinin, n.8, p.20.

13 Corden, n.3, p.36.

14 Ibid., p.36.

15 Ibid., p.36.

countries now starts and its producers drive the producing countries' producer out of business and capture the whole union market. His costs will be less than the producing countries' costs, so that this time there is a trade creation gain through the producing countries' obtain its needs from a cheaper source. The cost of the newly established producers, when they are supplying the whole union market must be greater than the cost of imports from the non-member countries, for otherwise they could have become established even before the union was formed.[16] When the imports from the non-member countries are replaced by domestic production, there is a 'trade-suppression effect'.[17] It is akin to the trade diversion effect, since a dearer source replaces a cheaper source, but this time the dearer source is a newly established domestic producer, not the partner country.[18] From this discussion, it is said that: (a) In non-producing countries, (which is now producing the commodities with the producing countries of the union), there will be a trade creation effect. It will have two components: the production effect results from the replacement of dearer domestic production by cheaper imports

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16 Ibid., p.36.

17 Ibid., p.36.

18 Ibid., p.36.

from the producing countries, and the consumption effect results from the increased consumption induced by the lower domestic price; (b) In producing countries, there will be a cost reduction gain going to its consumers.

The first step taken in the formation of customs union will be the agglomeration of contiguous national economies. As a result, the number of producers in the union will be reduced and the size of the firm will be enlarged. This is likely to increase the 'economics of scale' the 'efficiency' and the 'competitiveness' of the producers of the union. The enlargement of the firm size and the reduction of the number of producers will then lead to a cost-reduction gain. In addition, trade across the borders increases as a result of 'product differentiation'.[18] This would not affect the consumers demand in the union countries, since the number of firms the consumer can choose to purchase is the same as before; but the consumers choice is limited in choosing the variety of products produced in different customs union countries.

From the above mentioned discussion, it is summarized that, when the customs union is formed: (a) the production

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[18] Ibid., p.40.

will expand as the partner's market is takenover (cost-reduction effect) (b) the production of others will cease as the domestic market is vacated for the partner (trade creation effect); (c) the imports from third countries may cease, because they are replaced either by imports from the partner (trade diversion effect) or by domestic production (trade suppression effect). All these four effects will occur at the same time in the customs union.

All these four effects of customs union affect the third countries trade with the member countries of the union. The consequences of these four effects of the customs union are generalised as follows:

(i) The trade creation is always accompanied by trade diversion. The increase in trade creation also increases the trade diversion. The trade creation effects of the customs union increases the intra-regional trade of the customs union countries. At the same time, the trade diversion effect of the customs union diverts the third countries exports to the member countries in such a way, that some of the member countries' demands are satisfied by the supplies from the other member countries of the union. This diverting nature of the customs union results in 'trade-suppression effect'. As a result, third countries trade with the customs union countries will be restricted and reduced. (not in terms of the volume of increase; but, in terms of the rate of increase in volume)

(ii) The welfare gains of customs union increase with the increase of 'economies of scale' and 'efficiency'. This results in 'cost-reduction effect'. The cost reduction effect affects the international prices system and distorts the international commodity prices. The fluctuations in international commodity prices put the third countries in a disadvantageous position in its trade in a multilateral trading system, as even a small change in international commodity prices adversely affects the third countries trade with the rest of the world.

(iii) As a result of the cost reduction effects of customs union, the tariff rates will be increased against the third countries and in favour of the member countries. In a customs union , tariffs are provided to allow the domestic producer to cover his production costs plus the normal profits. It will be increased in such a way, that the prices of the protected products would be lower than the prices of any foreign sources plus the import tariffs. Otherwise, the prices of the imported products plus the import tariffs would be lesser than the prices of the domestic products in the member countries of the union. Moreover, the member countries of the union, trade among themselves without any tariffs on intra-regional trade. As a result of an elimination of tariffs on goods traded internally, a change in trade occurs with the third countries. This has been described as the 'trade-modification effect'. Hence, as the cost reduction, effect in the customs union countries increases, the trade modification effect also increases. The trade modification effect of customs union restricts the third countries trade with the custom union countries. Moreover, it prohibits the third countries from increasing its share in international trade.

II STUDYING THE NATURE OF PROTECTIONIST POLICIES USED IN CUSTOMS UNION

One of the important reasons for implementing the protectionist measures against the third countries and in favour of the member countries is that 'depressions' (whether of general cyclical type or of long-term type). The depression in falling prices of particular products, generally leads to an increase in falling prices. The falling prices automatically increase the protective incidence of specific measures. Moreover, the principle motive for the protection is defensive-to protect sectional income levels from decline-and it is natural, that when demands for the products of a country's industries fall, commercial policy should try to reduce or exclude foreign competition.[20] The main objective of this commercial policy is to exclude the foreign competitors in domestic market and also to increase the country's share in international trade, there by ensuring the economic growth and prosperity. It is generally said that, in prolonged prosperity, industries become less dependent on protection and are less likely to insist that a trade barrier be maintained as an insurate against intensified foreign competition in future.[21] The converse of this generalisation is that, the economic growth and prosperity reduces the protectionist nature of the commercial policies. However, in contrary to this popular view, in a prolonged prosperity, protected industries cannot be expected to rise their efficiency and competitiveness and they become more dependent on the protectionist measures. Moreover, the restriction of imports will stimulate the

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[20] Donald Altschiller, ed., Free Trade vs Protectionism(New York, 1988), p.11.

[21] Ibid., p.11.

expansion of some industries, it will cause other industries to reduce their scale of operations.[22] The latter are the relatively efficient export industries.[23] Thus protection results in a ' misallocation of resources' in the import-competing industry.[24] It will discourage investment in those industries, whose 'international comparative advantage' is the largest and will stimulate less profitable industries.[25] In the import-restricting country, the fact that export earnings may decline, will not necessarily weaken the demand for imports. As a result, protectionism can lead to an increase in the international indebtedness of that country and a decline in its credit worthiness.[26] In this situation, the protectionist polices cannot be expected to rise the protected countries' industrial efficiency and international competitiveness. Hence, it is clearly said that the protectionist measures that have been implemented against the outsiders, reduce their own industrial efficiency and international

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22 Sima Liberman, The Economic and Political Roots of the New Protectionism (New Jersey, 1988), p.138.

23 Ibid., p.138.

24 Ibid., p.138.

25 Ibid., pp.138-39.

26 Ibid., p.139.

competitiveness. This decreased efficiency and competitiveness again reflects in the intensification of the protectionist measures against the third countries.

II.1. METHODS OF PROTECTING THE DOMESTIC INDUSTRIES

There are generally three methods of protecting the national economies from external competitors. They are : (i) Subsidies; (ii) Tariffs; and (iii) Quantitative import restrictions. The economists have tendered to prefer the methods in the order, to prefer subsidies to tariffs, because they distort only the production pattern and not the consumption pattern; and to prefer both subsidies and tariffs to quantitative import restrictions because of a predisposition infavour of the price mechanism and because of the monopoly profits that may be reaped under a scheme of quantitative restriction by the holders of the licenses to import.[27] Moreover, the quantitative restrictions-whether on trade, consumption or production-can never achieve more than can be achieved by tariffs or subsidies, as there will always be a shadow tariff or subsidy implicitly in a quantitative

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[27] A.K. Dixit and V. Norman, Theory of International Trade(Cambridge, 1989), p.165.

constraint.[28] The final objective of all these protectionist measures is to achieve the desired productive effect with the rise in the standard of living of the people in the protected economies. All these protective measures have been used against the third countries in customs union. These protective measures have been intensified, when the participating countries of the customs union are increased. This is mainly due to a 'systemic change', that takes place in the formation of a single enlarged economic area. In this transition period, the member countries of the customs union, further intensify the protectionist measures against the third countries, in such a way that the welfare gains arising out of the formation of an enlarged economic area offset the welfare losses in customs union. These protectionist measures, which have been used to protect the national economies in an enlarged economic area, distort the third countries bilateral trade with the customs union countries and increases the third countries external trade deficit with the customs union countries.

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28 Liberman, n.22, p.139.

II.1.1 PROTECTING THE DOMESTIC MARKET THROUGH SUBSIDIES :

In a customs union, subsidies have been used as an effective protectionist measure in protecting the domestic industries against the third countries. The motives behind the induction of subsidies are of course many and varied. However, the general purpose of subsidy is to keep down the price of a commodity, that is to maintain a level of demand sufficient to prevent a decline in the activity of an industry. But, the purpose of giving subsidies has been misused in customs union to protect the inefficient domestic industries from the external efficient competitors. Generally, subsidies are given to an 'infant industry' to raise its efficiency and competitiveness in the wake of its establishment. Such subsidies are given to an infant industry, until it finds itself in an advantageous position in international trade. Soon after the infant industries gained the efficiency and competitiveness, the subsidies given to them should be stopped, otherwise, according to the 'economic theory of subsidy', it would result in the backwardness of its own industries.

The supportive arguments of subsidies should be analysed within the customs union framework. In a customs union, two kinds of subsidies are given to protect and promote the domestic production. They are : (i) Production subsidy; and (ii) Export subsidy. The production subsidy is given to encourage the domestic production and the export subsidy for the promotion of domestic products. In a customs union, the production subsidy analysis is supported by an infant industry argument. But, in real analysis, the production subsidy analysis should not be supported by the infant industry argument in the customs union framework. This is mainly due to the differing efficiency and competitiveness of the member countries of the customs union. When a country enters into the customs union, a systemic change takes place both in its production and promotion structures. This is transition period for countries entering into the customs union. In this transition period, the structural adjustment policies have been used in an the enlarged economic area, to reduce the economic disparities among the participating countries of the customs union. This is the first step taken in an enlarged economic area, to make the countries equally efficient and competitive. The structural adjustment changes, that have been taking place in the formation of customs union, are more likely to reduce the efficiency and competitiveness of the concerned national economies.

Moreover, in customs union the concept, 'infant' has been misunderstood and misused by the member countries. The concept 'infant' actually refers to an industry which is at the initial stages of its existence. An industry cannot be considered as an infant even after the decades of its existence, and it cannot become the infant industry, when it loses its relative efficiency and competitiveness against the third countries. Hence, an 'infant industry' is distinguished from an 'inefficient industry' in its period of existence.

Every industry at the initial stages of its existence will be relatively less efficient than the developed industries. At this stage, subsidy becomes necessary. But, the production subsidy argument of customs union seeks support from an infant industry argument. If an industry still shows relative weakness in its competition against the third countries, it should considered as an 'inefficient industry' and not as an 'infant industry'.

The members of the customs union argue that the member countries loses its relative position in its competition against the third countries, because of the structural changes, that have been taking place in the formation of customs union. The structural changes taking place in the customs union is a result of an agglomeration of diversified, contiguous national economies. However, at the same time, the agglomeration of contiguous national economies also results in an 'effective allocation of resources' and an 'economies of scale'. Moreover, in customs union, the welfare gains arising out of an enlarged economic area, outpaces the welfare losses arising out of the implementation of structural adjustment policies. Hence, in an enlarged economic area, an enlarged industry may be inefficient at the initial stages of its existence, but in the long run it results in an increased efficiency and an increased production. Hence, in the customs union framework, the infant industry argument given in support of the production subsidy becomes meaningless.

An 'export subsidy' has also been used as an effective protective measure in restricting the imports from the third countries. This is given to an industry to promote its exports in the arena of international trade. The export subsidy argument should be analysed with the production subsidy argument in the customs union framework. This is mainly due to the fact that the export subsidy is given at the same time, when the production subsidy is also given. As discussed earlier, production subsidy given to an industry may result in an increased efficiency and an economies of scale. An economies of scale increases the productive nature of an industry, there by increasing the surplus of production. The increase in production increases the supply of commodities to the society. According to the 'law of supply and demand', whenever there is an increase in supply there will be a downward pressure upon the price. In addition, the cost-reduction effect of customs union also reacts on the downward price, which is arising out of an increased supply and decreased demand. The decreased prices of commodities encourages the consumers to consume much of the products produced domestically. This is evident from the fact that the formation of an enlarged economic area increases the intra-regional trade. The increase in intra-regional trade reduces the member countries extra-regional trade. At this stage, export subsidies given to the member countries to increase its exports results in surplus of production; there by results in price discrimination of commodities in international trade. The surplus of production in a customs union increases the world supply and decreases the world demand for the commodities. The world prices of any commodity is determined by world demand and supply. The surplus of production of the customs union increases the world supply of commodities. The adverse change in the supply of the union countries reduces the world demand, thereby reduces the world commodity prices considerably. At this stage, the export subsidies given to the member countries to increase its share in international trade results in price discrimination. In addition to this, the production costs of commodities and its higher transportation costs make the third countries commodity prices higher than those of the customs union countries. Hence, the demand in the commodity is shifted from foreign to domestic goods. The shift of demand from outside to inside supplies will also tend to depress the relative prices of imports, and so improve the union countries' terms of trade. As a result of this price variation, the third countries are also forced to lower down their marginal profits. The decrease in the marginal profit adversely affects the third countries negotiating options in international trade.

From the afore mentioned discussion the possible effects of subsidies, for both the member and non-member countries are summarised as follows.

1. A subsidy is not a first-best policy; it introduces distortions that offset its benefits.[29]

2. Once introduced, subsidies become permanent.[30]

3. A permanent subsidy prevents effective allocation of resources in the long run, thus creating a conflict between short run gains in output and income and long run efficiency losses.[31]

4. A permanent subsidy to the sector subject to the price fall will increase the employment and income in the short run, but creates a distortion in the long run.[32]

5. A misallocation of resources results in the 'misallocation of investments'. This would further distort the international trade.

6. The subsidies given to an industry or a sector result in a fall in an output price. A further fall in the output price of the subsidized sector implies a compensating increase in the subsidy.

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29 Alexander Hoffmaister, "The Cost of Export Subsidies" IMF STAFF PAPERS, vol.39, n.1, March 1992, p.174.

30 Balassa, n.5, p.27.

31 Harry Flam, Tosten and Lars E.O. Svensson, "Optimal Subsidies to Declining Industries : Efficiency and Equity Considerations", (Institute for International Economic Studies, University of Stockholm), Working Paper n.223, p.328.

32 Ibid., p.328.

7. The price fall will create an inefficiency in the form of an unemployment, because the wage rates are rigid in the short run.[33]

8. The factor of unemployment forces the government to make the subsidies permanent .

9. The subsidies given to domestic industries distort the world market price; hence, there is a fall in the world market price. The equity considerations now call for a further increase in subsidy.[34] Efficiency considerations, on the other hand, call for a decrease of the subsidy, already permits some unemployment.[35] Hence, a conflict arises between the efficiency and equity considerations.

10. Once introduced, subsidies become permanent and cannot be removed. In the long run, the dependency of domestic industries on subsidies will be heightened and they cannot be expected to sustain its development without the government supporting subsidies. Hence, the removal of subsidies reduces the efficiency of the domestic industries, which again results in the intensification of the protectionist measures.

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[33] Ibid., p.342.

[34] Ibid., p.343.

[35] Ibid., p.343.

11. The subsidy reduces the annual rate of productivity growth and its contribution to productivity growth has been negative.[36]

12. The effect(negative) of subsidy on productivity is greater than the effect of economies of scale.[37]

13. Export subsidies favour production in the country imposing those measures at the expense of production in other countries for foreign or for domestic market.[38] In so doing, they introduce distortions in international trade.[39]

14. An additional consideration is that export subsidies affect third country markets in distorting the conditions of competition among foreign exporters in these markets.[40] In so doing, they interfere with international specialization according to comparative advantage.[41]

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[36] Moshe Kim, Menahem Spiegel, "The Effects of Lumpsum Subsidies on the Structure of production and Productivity in Regulated Industries", (University of British Columbia, Vancouver), Discussion Paper no. 87-21, p.17.

[37] Ibid., p.17.

[38] Bela Balassa, "Subsidies and Countervailing Measures : Economic Considerations", Journal of World Trade, (Geneva), vol 23, no.2, 1989, pp.63-80.

[39] Ibid., pp. 63-80.

[40] Ibid., pp. 63-80.

[41] Ibid., pp.63-80.

All these findings are based on two-world, two-commodity model. If this model has been extended to n-world, n-commodity model (n-country customs union model), the implications for the third countries would be multiplied. Hence, the more the number of participating countries of the customs union using subsidies, the higher will be the adverse effects on the third countries.

II.1.2 PROTECTING THE DOMESTIC MARKET THROUGH TARIFFS

Tariffs have also been used as an effective protectionist measure by the customs union countries, against the imports from the third countries. Tariffs are generally announced with the objective of protecting the domestic industries and raising the revenue. They are now considered as an effective deterrent to imports that might endanger a domestic industry's sales or a nation's balance of payments.

In the formation of customs union, some structural changes have been made in the participating countries' economic structure. The countries forming a customs union start with tariff structures that are non-uniform advalorem.[42] In customs union, the tariffs on trade among the member countries have been removed. At the same time, the tariffs on imports from the third countries have still been maintained. The removal of tariffs between the member countries will now create trade partly at the expense of the member countries exports to non-member countries. As a result intra-regional trade increases with the decrease in extra-regional trade. In the case of constant costs, the exports of member countries to non-participating economies are not affected by the increase in the intra-regional trade. Under the assumption of increasing costs, some of the member countries'exports will be diverted from the non-member countries to the member countries of the union. The tariffs initially distort trade not only through reducing the total volume of a country's trade, but also through distorting the commodity pattern of its imports. This effect of the union in changing the commodity pattern of imports is called the 'import-pattern effect'.[43]

In the customs union, the intra-regional trade will be increased with the removal of tariffs on goods traded among

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[42] W.M. Corden, "Customs Union Theory and the Non-uniformity of tariffs", Journal of International Economics, vol.6, no.1, 1976, pp.99-106.

[43] Ibid., pp.99-106.

the member countries of the union. The intra-regional trade will be increased with the decreased extra-regional trade. As a result, the benefits arising out of the trade creation are always higher than those of trade diversion. Moreover, the standard analysis tells us that if there were an increase in total trade, there would be a possibility of a net gain even with trade diversion.[44] Therefore, the removal of tariffs on trade between the member countries and maintaining it against the third countries would distort the bilateral trade of third countries with the member countries of the union.

In customs union, the member countries announce higher tariffs on imports from third countries, with the objective of protecting the high-cost domestic products against the low-cost imports. This is to make the cost difference narrower among the member countries in the enlarged market. This is contrary to the principles of international trade theory, which is based on the principle of 'comparative cost advantage'.

Generally, tariffs result in positive and negative effects. The negative effects of tariffs does not affect

[44] Ibid., pp.99-106.

the intra-regional trading pattern of the member countries of the union. The formation of customs union results in 'zero-tariff' on intra-regional trade and increased common external tariff on extra-regional trade. The negative effects of an increased common external tariff for the member countries are explained as follows.

1. The higher the external tariff on those goods whose imports from outside remain, the greater the loss or less the gain.[45]

2. If the common external tariff exceeds the pre-union tariff on a good, the effect may actually be one of trade contraction.[46]

However, the negative effects argument of tariffs are incompatible with the customs union. The formation of customs union increases the intra-regional trade and reduces the extra-regional trade. Hence, the welfare losses arising out of an increased common external tariff on imports from the third countries will be compensated by the economic gain resulting from a zero-tariff on intra-regional trade. Moreover, the trade contraction effect of an increased

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[45] W.M. Corden, "Customs Union Theory and Non-uniformity of Tariffs", <u>Journal of International Economics</u>, Vol.6, No.1, 1976, pp. 99-106.

[46] Ibid., pp. 99-106.

common external tariff will generally occur on trade between the union countries and the third countries, and it creates a distortion between those commodities, which are imported from outside the union and those imported from the partner.[47] Hence, the member countries of the union are not affected by an increased common external tariffs. Morover, the negative effects of tariffs will not affect the trading pattern of the member countries within the region; but, it affects the third countries' trade with the member countries of the union.

Though the tariffs does not affect the trading pattern of the member countries, it alters the production pattern of the member countries. The classical economists have claimed that the artificial domestic protection of industries and the artificial limitation of the most efficient foreign producers results in 'misallocation of resources', that restricts the member countries economic welfare. In this way, the economic welfare of the member countries' are impeded by their own tariff structures. This results in market imperfections, factor immobility and price rigidity. The union countries, to avoid all these negative implications, restructure their own adjustment policies. As

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[47] Ibid., pp. 99-106.

a result, the tariffs announced against the imports of the third countries further increases the protectionist nature of the union.

II.1.3. PROTECTING THE DOMESTIC MARKET THROUGH IMPORT QUOTAS

Import quotas or restrictions on quantity are the most prevalent form of customs barriers in world trade.[48] Quantitative restrictions on trade have been the main means of increasing protection in the world economy in the last 25 years.[49] These are the quantitative restrictions imposed on the imports from the third countries. The arguments that have been advanced infavour of the import quotas in customs union are varied and at first sight appears plausible. The most popular argument is that import quota should be restricted to protect employment of workers in domestic industry.[50] Righteous indignation can be added, if the imports are produced by foreign labours working for low

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48 Predrag Kapor, "New Forms of Protectionism in World Trade", Review of International Affairs, (Belgrade), 39(923), 20 September 1988, pp. 28-30.

49 James E.Anderson, The Relative Inefficiency of Quotas (Cambridge, 1988), p.1.

50 I.L.G. Stewart, "Protectionism : The Threat to World Recovery", New Zealand Foreign Affairs Review, 34(2), April-June 1984, pp.23-26.

wages. This sort of argument advanced infavour of import quotas, brushes aside the elementary principle, that international trade is based on differences in cost. It also overlooks that cost of labour is a less significant factor than productivity and the workers with high wages may still turn out products more cheaply than workers with low wages.[51] However, the customs union countries argue that the protectionist import quotas have been erected for safeguarding the employment of their work force, who may be displaced if unlimited low cost imports are allowed. But a recent I.L.O. study has shown that the total elimination of trade barriers on imports from third countries would cause only a marginal reduction in the volume of employment in customs union countries.[52] Hence, the arguments of import quotas advanced with the purview of protecting the employment in customs union countries become meaningless.

Another argument put forward by the customs union countries in favour of import quotas is that it protects the domestic market from distortions and price fluctuations which could accrue from the low cost imports of third countries against the domestic products. They are also used

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[51] Ibid., pp. 23-26.

[52] Economic Times, 24 January 1981.

to restrict the exports of third countries to the customs union countries, so that the member countries of the union could increase its share in international trade. However, the import restricting measures that have been used to curb the imports from third countries affect the domestic economy in one way or in another way. Any measures that restricts a country's imports will also reduce its exports.[53] Any import-restricting measure will cause a change in relative prices in the country imposing such limitation.[54] This is because of the fact that profits from barriers of import quotas are concentrated on an economic branch, while the losses are distributed over a large number of consumers and taxpayers.[55] The consumer inevitably losses as market supplies are reduced by import quota barriers, and this has its immediate effects on domestic prices, since trade restrictions increase the cost of domestic production.[56] As a result of increased domestic prices, the prices of imports also increases and the consumers in the union will rearrange their expenditures. They will reduce their

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53 Liberman, n.22, p.138.

54 Ibid., p. 138

55 Kapor, n.48, pp.28-30.

56 Jurgen Notzold, "World Trade and Protectionism", Aussen Politik, (Hamburg), 35(4), 1984, pp.405-14.

purchase of imported goods and will increase their demand for domestically produced goods, import-competing goods, and exportables.[57] As the demand for home goods and import-competing goods rises, the home industries producing such goods will obtain larger benefits and will thus attempt to expand their scale of operation.[58] The increase in demand for home goods and import-competing goods forces the customs union countries again to intensity their protectionist measures against the third countries. Thus the principles of import quotas affect the third countries trade with the customs union countries and protect the high-cost domestic goods from the low-cost importing goods.

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[57] Sima Liberman, The Economic and Political Roots of the New Protectionism, (New Jersey, 1988), p. 138.

[58] Ibid., p. 138.

CHAPTER III

THE IMPLICATIONS OF SEM FOR INDIAN EXPORTS OF AGRICULTURAL PRODUCTS.

Development has been identified with economic growth.[1] Economic growth and industrialization throughout the world depend on the initial development of agricultural resource base.[2] Agricultural trade can be influential factor in shaping the pattern and extent economic growth and development.[3] Moreover, the agricultural expansion stimulate economic development. History bears the testimony to the fact that for the present day industrialised nations, agriculture has been the starting point and the sheet-anchor of their overall economic development.[4] Eventhough, growth in both agricultural production and trade has been slower than that in non-agricultural sectors, the relative expansion in agricultural trade compared with farm output has been faster than the comparable relative expansion in

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1 Dr K.V.R.V. Rao, "Balance Between Agriculture and Industry in Economic Development", The Indian Economic Journal, (Bombay), vol.34, no.2, October-December 1986, p.1.

2 M.L. Varma, "Agricultural Exports", Foreign Trade Review, vol.xxv, no.4, January-March 1991, p.321.

3 A.Vaidyanathan, "Instability in Agriculture : Extent, Causes and Consequences - A Review Article", Indian Economic Review, vol.xxvii, no.2, 1992, pp.211-22.

4 Varma, n.2, p.321.

non-agricultural sectors.[5] Since 1953, each 1% of increase in world output of all goods and services has been accompanied by an average increase of 1.3% in trade.[6] For agriculture, each 1% increase in output has been accompanied by a 1.8% trade increase.[7] Thus, agriculture's world wide dependence on trade has been growing even faster than industry's.[8] All these factors necessitate the importance of an efficient agricultural structure to achieve economic development.

Therefore, with efficient agricultural infrastructure, countries are expected to modernize their industrial sectors and strengthen their economies. Hence, trade in agricultural sector gains greater attention and importance.

The importance of agricultural trade is particularly true for Less Developed Countries (LDC's), who have a comparative advantage in the production of agricultural

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[5] James P. Houck, Elements of Agricultural Trade Policies (New York, 1986), pp.1-2.

[6] Ibid, p.2.

[7] Ibid, p.2.

[8] Ibid, p.2.

products.[9] The exports of agricultural products are used to pay for the import of capital goods, technology and other manufactured products, necessary for sustained growth in LDC's. In effect, the market for developed countries will expand and trade in agriculture products will be of mutual to both developed countries and LDC's.[10] However, the mutuality of interest is not so obvious in real world mainly because of poor bargaining power of LDC's in world market and tariff and non-tariff protection strategy followed by the developed countries.[11] The exports of LDC's fluctuates more than that of developed countries; because of the fact that the export of LDC's mainly comprise agricultural products having erratic supply. Instability is an inherent characteristic of agriculture everywhere.[12] Being dependent on weather conditions, area, yield and production of crops are liable to substantial variations from year to year.[13] The unstable exports tend to destabilise the

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9 See Suresh Pal, "Agricultural Exports of India : Issues of Growth and Instability", Indian Journal of Agriculture Economics, (Bombay) vol.47, no.2, April-June 1992, pp.185-94.

10 Ibid., p.185.

11 Ibid., p.185.

12 Vaidyanathan, n.3, p.211.

13 Ibid., p.211.

income of LDC's as long as export earnings constitute a significant proportion of national income which in turn has serious political and economic implications.[14]

As in the case of many LDC's agriculture continues to be an important sector in India. More than, 70% of its population is engaged in agriculture and agro-based sectors. India is dominantly an agrarian economy.[15] Agricultural sector is an important source of capital in India.Hence, India's trade centres around agriculture and agro-based sectors. Moreover, the foreign exchange gap can never be met unless agricultural exports make the requisite contributon to the country's export earnings.[16] The bulk of India's exports comprise agricultural commodities and agro-based products - manufacturised and semimanufacturised - their share in total exports having varied between 58 and 78%.[17]

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14 Pal, n.9, p.185.

15 V. Ratna Reddy and K. Badri Narayanan, "Trade Experience of Indian Agriculture : Behaviour of Net Export Supply of Functions for Dominant Commodities", Indian Journal of Agricultural Economics, vol.47, no.1, January-March 1992, p.48.

16 S.S. Mehta, "Strategy for Promoting Agricultural Exports from India", Foreign Trade Review, vol.xxiv, no.4, January-March 1990, p.369.

17 S.N Gupta, "Export Potential of Agricultural Commodities", Foreign Trade Review, April-June 1972, p.20.

The contribution of agricultural trade in India's foreign exchange earnings still continues to be higher.

India has got several advantages, which favour the growth of its agricultural exports. These are :

(i) a variety of agro-climate regions in India, with different soil profits ;

(ii) adequate irrigation potentials ;

(iii) multiple cropping pattern ;

(iv) presence of a large number of agricultural scientists and extension workers ;

(v) access to seasonably abundant labour, and

(vi) availability of satisfactory and well organised research system for support to production efforts.[18]

The export effort of Indian agricultural sector suffers from numerous limitations such as high cost of production, the lack of competitiveness, disability to catch up with the international developments, narrow products range, limited

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18 Mehta, n.16, p.370.

market range and the absence of co-ordinated approach to capitalize on the overseas market opportunities.[19]

The total world agricultural trades accounts for about $ 300 billion.[20] India's agricultural exports accounts for about $ 3 billion.[21] India's farm trade in total world agricultural trade accounts for about 1%. The EC is the leading importer and second largest exporter of agricultural commodities in the world. It accounts for about 25% of total world imports of agricultural products. The SEM of the EC is India's single largest market for its agricultural exports. India exports 26% of agricultural products and imports 31.6% of the products form the EC.[22]

India's total trade with EC amounted to ECU 4542 million in 1991 or 0.98% of extra-EC trade totalled ECU 46 billion in that year. India's exports of agricultural products to be the EC amounted to ECU 593 million in 1991 or 1.39% of extra-EC agricultural trade totalled ECU 42468

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19 Pal, n.9, p.185.

20 Ibid., p.370.

21 Ibid., p.370.

22 See UNCTAD, Hand Book of International Trade and Statistics, 1991.

million in that year. India's agricultural trade with the EC accounts for 20% of its total agricultural trade. Hence, whatever the changes take place in the EC affect India's agricultural trade with the EC directly or indirectly.

Major agricultural commodities exported to the EC by India are tea, coffee, spices, cashew, kernels, fruits and vegetables, oil seeds, oil and oil cakes, unmanufactured tobacco, raw cotton and jute, sugar, rice, pulses, lac, wood and timber, essential oils, bones, raw wool, bristles and fish and fish products.

The trade experience of India reveals that there has been a steady decline in their share in world agricultural exports.[23] However, the reasons for such decline cannot be attributed to the trade policies of India alone, but also to the trade policies of the EC in the SEM India's trade deficit with the EC is considerable. India's adverse balance of trade is mainly caused by its trade deficit in agricultural trade with the EC. In recent years, India's agricultural trade with the EC is undergoing a serious of challenges. The creation of the SEM and its trade policies have created 'Euphoria' among the Indian agricultural

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[23] Reddy and others, n.15, p.1.

exporters. This causes a distortion and a very high degree of instability in the export earnings from important agricultural products. The distortions cause production and consumption inefficiencies.[24]

In the EC economic inefficiency is resulted from its own policies. The economic inefficiency of the system resulted from the fact that more resources were used in agriculture than necessary as well as from the high and increasing public expenditure to support agricultural policies and agricultural prices.[25] In the EC, more than 60% of the total budget is being spent on agricultural support policies and prices, in the name of 'European Agricultural Guidance and Guarantee Fund' (EAGGF). The price support policies of the EC again result in an economic inefficiency of the European agricultural sector.

The detrimental situation of the EC farm trade in world agricultural trade has been resulting from the economic inefficiency of the European agricultural system. The

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24 A.K. Dixit and V. Norman, Theory of International Trade, (Cambridge, 1980), p.23.

25 Eckart Guth, "Agriculture in Europe : NewChallenges Ahead", Inter Economics, vol.27, September/October 1992, p.215.

inefficiency of agricultural trading pattern in any system results in an intensification of protectionist policies. It has been observed that agricultural protection tends to be lower in countries with low capital-land ratio, higher with high capital-labour ratio, and higher where the proposition of total household income spent on food is low.[26] However, this principle is contrary to the agricultural trading pattern of the EC, where the rate of protectionism is higher with low capital-labour ratio. In the EC, agriculture represents a piddling 3.5% of total EC output, far less than other sectors such as manufacturing, services and textiles.[27] The farming population consists of only 11 million, out of the total population of 340 million people. This accounts for about 3.2% of total employment force in the EC They operate 7 million holdings, many of them small family enterprises.[28] All these statistics show that the protection remains higher in the EC, despite the low capital-land ratio, low capital-labour ratio and high

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26 Arsenio M. Balisacan and James A. Roumasset, "Public Choice of Economic Policy : The Growth of Agricultural Protection", Review of World Economics(Kiel), 123, 1987, p.238-48.

27 Adam Zagorin, "Playing with Fire", Time,23 November 1992, p.27.

28 Ibid., p.27.

proportion of total household income spent on food. An average of 23% of European consumption goes on food.[29]

An important reason for the intensification of protectionist policies in the EC's is its increased agricultural trade deficit with the rest of the nations. The EC is the leading importer and second largest exporter of commodities in the world. It accounts for about 25% of total world imports. Hence, whatever the changes take place in the EC affects India directly or indirectly.

The implications of the SEM of the EC for India's exports of the agricultural products could be analysed within the customs union framework. Though the EC is said to be the leading importer and exporter of agricultural commodities, the economic gains arising out of its agricultural trade in total trade are very low. In recent years, the EC's trade deficit in agricultural trade has been increasing. This is mainly due to its EC's inefficient farm structure and production nature. The inefficient farm structure and its production nature finally results in market failure for agricultural products in the EC. The

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[29] See European Documentation (1991), "Consumer Policy in the Single Market", p.17.

market failure for agricultural products in the EC reduces the economic well being of the European farmers. At this time, price support policies have been announced by the governments, to put an end to the cyclical fluctuations and distortions that often arises in European agricultural sector.

'The Treaty of Rome' sets forth provisions for special treatments and favours agriculture in the Common Market. Article 38-47 of the treaty of Rome deals with agriculture. According to these articles, the operation and the development of the Common Market for the agricultural products must be accompanied by the establishment of a 'Common Agricultural Policy' among the member states. The policy commonly known as 'CAP', has been since its inception a target of criticism for its self-centered, 'inward-looking' character, more precisely for its concern merely with the economic well being of its own members without regard to its impact on the third countries. The CAP of the EC in its endeavour to safeguard the interests of the European farmers, has evoked a great many repercussion on countries outside the Community system. This is particularly true for India, for its impact on its exports of agricultural products, which are a source of its foreign exchange earnings.

The implementation of the CAP will be intensified in the SEM to reduce the agricultural trade deficit. The structural adjustment policies of the EC in the SEM would increase the EAGGF, which is the financial arm of the CAP. The increase in government support policies is mainly due to the disproportionate nature of the agricultural sector with the services and industrial sectors. As countries continue to grow further and their industrial and services sectors expand, the relative importance of agriculture production and employment declines.[30] In such circumstances, governments in these countries find it politically more costly not to accede to farmer's demand for protection.[31] Such protection is offered on the grounds of social equity and it acts to isolate farmers from pressures for structural change.[32]

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[30] H. Don, B.H. Gunasekara and Rodney Tyers, "Political Welfare Effects of Spreading Agricultural Protection to Developing Countries in the Asia-Pacific Region", Indian Journal of Agriculture Economics, vol.45, no.4, October-December 1990, p.495.

[31] Ibid., p.495.

[32] Ibid., p.495.

The purpose of the CAP, which is becoming increasingly comprehensive and complex, is both to prevent prices from being depressed by a rapid rise in output and to enable farm incomes to keep pace with other incomes despite the relatively low income elasticity of demand in agricultural products. The objective is to achieve a better adjustment of supply to demand through measures that enable market forces to play a greater role.[33]

Moreover, the objectives of maintaining stability and growth of agricultural income in the EC by means of price support policies have resulted in the prices of several agricultural products being at time considerably above the'World Market' prices or the prices of the low-cost suppliers. At the same time,reflecting the restructuring of the agricultural sector toward larger farm sizes and the rapid pace of mechanization,labour productivity in this sector has increased more rapidly than the total labour productivity.[34] This has led to significant increase in

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33 Rosenblatt and others, n.33, p.2

34 Julius Rosenblatt, Thomas Mayer, Kasper Bartholdy, Dimitrius Demekas, Sanjeev Gupta, and Leselie Lipschitz, "The Common Agricultural Policy of the European Community : Principles and Consequences", International Monetary Fund, Washington, D.C, November 1988, Occasional Paper No.62, November 1988.

self-sufficiency of the EC in most of the agricultural products covered by the CAP. As a result of the rapid increase of production relative to consumption, stock building and the EC's agricultural exports have risen rapidly, while agricultural imports have grown at a rate below that of total imports.[35]
Nevertheless, despite the price support policies of the EC agricultural produces prices have declined relative to industrial prices and the relative productivity gains have not been large enough to prevent farm incomes from deteriorating in recent years. Despite a trebling in real terms of the CAP's budget in past 30 years, farm incomes have fallen.[36]

The basic mistake which is older than the CAP is the belief that stable and adequate incomes for farmers can be achieved through agricultural price support.[37] However, this instrument is neither effective nor efficient. It is not effective because the development of producer prices has not ensured an adequate level of income for small-scale farmers which is one of the principal objective of the CAP,

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35 1Ibid., p.2.

36 The Economist (London), 23 May 1992.

37 Rosenblatt and others, n.33, p.2.

but has generated windfall gains for more efficient large-scale farmers.[38] It is not efficient because aiming at a stable and adequate incomes for all farmers has led to output and welfare losses for the economy as a whole.[39]

It has been argued that the CAP has maintained the agricultural prices in the EC above the world market prices. The domestic agricultural prices that are kept above the world market prices by a combination of tariffs, quantitative restrictions, variable levies and subsidies have direct effects on consumers and produces of the EC. Europe support of farmers about $49 billion in direct subsidies and $85 billion from consumers obliged to live with prices far above world level.[40]

As domestic market prices increase, internal consumption is curtailed, but production expands.[41] Hence, the protection has been offered through the price supporting policies. The protection afforded to agriculture through

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[38] Ibid., p.3.

[39] Ibid., p.3.

[40] The Economist , 23 May 1992.

[41] James P. Houck, Elements of Agricultural Trade Policies (New York, 1986), p.30.

pricing policies results in an excessive production in the EC Since an artificially high price is guaranteed, a farmer will seek to increase the output even if he dumps the crop on World Markets.[42] As shown in table 3.1,the excessive production expands the exports of the EC and contracts the imports of the EC from the third countries. This, accompanied by a growing output in other parts of the World without corresponding shifts in demand, depresses the World prices of agricultural products. Finally, the losers would not be farmers, but any agricultural importers who benefit from depressed world prices.[43]

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[42]The Economist (London), 23 May 1992.

[43]Ibid.

Table 3.1 : EC NET IMPORTS OF GRAINS AND AGRICULTURAL EXPORT SUBSIDIES.

Year	Export Subsidies (in million U.S. $)	Net Imports of Grains (million metric tons)
1974	739.5	12.3
1976	1857.5	21.8
1978	3696.3	6.5
1980	7517.1	-3.8
1982	4668.9	-10.0
1984	4901.2	-19.6
1986	7094.2	-18.6
1988	10837.0	-25.7
1989	10678.9	-26.6
1990	11969.3	-22.5
1991	11986.4	-27.2

Source : Ernest H. Preeg, "The U.S. Leadership Role in World Trade : Past, Present, and Future", The Washington Quarterly, vol.15, no.2, Spring 1992, p.82.

The excessive production in the EC affects India's agricultural trade with the EC in two ways : (i) The excessive production in the ECincreases its export nature and contracts the imports of the EC from India; (ii) The excessive production in the EC is accompanied by growing output in other parts of the world without corresponding shifts in demand. This depresses the world market prices of agricultural commodities.

The effects of depressed prices on the World market prices have been further exacerbated by subsidized EC exports of excessive production. The price support in the EC insulates domestic markets from external commodity price fluctuations, thereby destabilizing World commodity prices. Since, the import tariffs insulates the domestic prices in the face of the world price changes, the effect of output changes in the rest of the World are not reflected in the EC's domestic prices, nor do they elicit any supply or demand response within the EC.

The effects of the CAP on international prices have been shown in table 3.2

Table 3.2
EFFECTS OF THE CAP ON INTERNATIONAL PRICES
(% CHANGE IN WORLD MARKET PRICES)

SOURCE	CONCEPT	YEAR	WHEAT	GRAINS	RICE	RUMINANT MEAT	NON-RUMINANT MEAT	SUGAR	DAIRY
Koester & Schmitz (1982)	EC-9	1979	..	..	..	..	..	12.0	..
Koester (1982)	EC-9	1975-77	9.6	14.3	..	..	..	..	..
Koester & Valdes (1984)	EC-9	1980	4.6	..	..	10.5	5.9	9.7	28.3
Sarris & Freebairn (1983)	EC-9	1978-80	9.2	..	..	..	..	..	..
Anderson & Tyers (1984)	EC-9	1980	13.0	16.0	5.0	17.0	1.0	..	..
Tyers & Anderson (1986)	EC-10	1985	0.7	2.5	0.7	9.5	1.7	2.6	11.8
Matthews (1985)	EC-10	1978-82	0.7	2.9	0.1	4.5	3.6	6.0	10.5
Tyers & Anderson (1986)	EC-12	1980-82	6.0	5.0	3.0	18.0	4.0	7.0	25.0

Source: Julius Rosenblatt, Thomas Mayer, Kasper Bartholdy, Dimitrius Demekas, Sanjeev Gupta, and Leselie Lipschitz, "The Common Agricultural Policy of the European Community : Principles and Consequences", International Monetary Fund, Washington, D.C., Occasional Paper no.62, November 1988.

The greater the fluctuations in the world prices, the greater is likely to be the instability of incomes of agricultural producers and exporters. This would further weaken India's agricultural exports to the EC.

The effects of the CAP on the member countries of the EC have been analysed by various economists at different period of time. It has been mentioned in Table 3.3.

From this table, it has been analysed that:
(i) the price support policies of the EC given through the CAP to its farmers increases the burden on consumers and taxpayers ; (ii) the producers of agricultural products in the EC benefit from the CAP of the EC ;it stands at an average of $ 38 billion for all the commodities covered under the CAP ; (iii) the absolute effect of the CAP on the EC members is that it reduces the welfare effects of agricultural trade in the EC ; (iv) the relative effect of the CAP is that it reduces the community GDP by 0.27%; this amount is considerable, since agricultural trade in extra-EC trade is very low.

The effects of the CAP on international price stability have been shown in table 3.4. Seven important agricultural

Table 3.3

WELFARE EFFECTS OF THE CAP ON EC MEMBERS (in billions of U.S.dollars)

				Effects on				
							Total	
Source	Commodity(ies)	Countries	Year	Consumers	Taxpayers	Producers	Absolute	Relative
Koester & Schmitz (1982)	Sugar	EC-9	1978-79	..	..	..	-0.4	..
Morris (1980)	CAP Commodities	EC-9	1978	-43.5	-10.7	38.6	-15.6	-0.53% of EC-9 GDP Transfer ratio 1.40
Thomson & Harvey (1981)	CAP Commodities	EC-9	1980	..	..	..	..	Transfer ratio of 1.77
Australia, Bureau of Agricultural Economics (1985)	CAP Commodities	EC-9	1978	-34.6	-18.1	44.1	-9.4	-0.48% of EC-9 GDP Transfer ratio of 1.21
		EC-10	1983	-25.6	-20.8	39.7	-6.7	-0.32% of EC-10 GDP Transfer ratio of 1.17
Buckwell & Others (1982)	CAP Commodities	EC-9	1980	-35.4	-11.5	30.7	-15.4	-0.55% of EC-9 GDP Transfer ratio of 1.5
Tyers (1985)	Rice, Wheat, Grain Ruminant and non ruminant	EC-9	1980	-44.0	-0.9	13.9	-31.0	-1.1% of EC-9 GDP Transfer ratio of 3.23
Tyers & Anderson (1986)	Rice, Wheat, Grain Ruminant and non ruminant	EC-10	1985	-49.0	-2.2	27.2	-24.1	-1.3% of EC-10 GDP Transfer ratio of 1.88
Spencer (1985)	CAP Commodities	EC-9	1980	..	..	..	..	Approximately -0.9% of EC-9 GDP
Burniaux & Waelbroeck (1985)	CAP Commodities	EC-10	1995	..	..	..	..	-2.7% of EC-10 GDP
Tyers & Anderson (1987)	Rice,Wheat,Grains Ruminant and non ruminant	EC-12	1980-82	-42.3	-0.9	36.4	-6.8	-0.27% of EC-12 GDP Transfer ratio of 1.19
OECD (1987)	CAP Commodities	EC-9	1979-81	-27.8	..	..	..	..

Source: Julius Rosenblatt, Thomas Mayer, Kasper Bartholdy, Dimitrius Demekas, Sanjeev Gupta, and Leselie Lipschitz, "The Common Agricultural Policy of the European Community : Principles and Consequences", International Monetary Fund, Washington, D.C., Occasional Paper no.62, November 1988.

Table 3.4

EFFECTS OF THE CAP ON INTERNATIONAL PRICE STABILITY
(Percent share of variability of
the world price owingto the CAP)

SOURCE	CONCEPT	YEAR	WHEAT	GRAINS	RICE	RUMINANT MEAT	NON-RUMINANT MEAT	DAIRY PRODUCTS	SUGAR
Svedberg (1981)	EC-6	1967-72	..	7.0	..	..	..	..	..
Sarris & Freebairan (1983)	EC-9	1978-80	19.8	..	..	..	..	..	..
Schmitz & Koester (1984)	EC-10	1982		..	..	..	..	..	8.5
Anderson & Tyers (1984)	EC-9	1980	50.0	33.0	12.1	25.0	0.0	..	..
Tyers (1985)	EC-9	1980	44.0	24.0	6.0	11.0	7.0	..	..
Tyers & Anderson (1986)	EC-10	1985	24.0	5.0	9.6	16.7	22.0	60.0	5.0
Tyers & Anderson (1987)	EC-12	1980-82	32.8	15.1	15.8	37.4	0.0	50.0	20.2

Source: Julius Rosenblatt, Thomas Mayer, Kasper Bartholdy, Dimitrius Demekas, Sanjeev Gupta, and Leselie Lipschitz, "The Common Agricultural Policy of the European Community : Principles and Consequences", International Monetary Fund, Washington, D.C., Occasional Paper no.62, November 1988.

products have been taken into consideration for this analysis. This is because of the fact that these products play an important role in international agricultural trade. On the basis of this analysis, the general effects of the CAP on international prices and international price stability have been analysed.The analysis of this table shows that the CAP of the EC changes the international commodity prices considerably. As a consequence of this, commodity prices fluctuate greatly in international trade. A drastic change of prices and greater instability puts the net exporting countries in a disadvantageous position in its trade with the EC. A research was undertaken by Tyers and Anderson in 1987 to study the effects of the CAP on international price stability. According to this report, the prices of changes in world agricultural market fluctuates between 15.1 per cent for gains to 30% for dairy products.

The effects of the CAP on Indian agricultural exports have been analysed as follows. The implementation of the CAP in the EC increases the agricultural commodity prices. The increase in commodity prices decreases the welfare effects on consumers and taxpayers. It is considered that buyers in Europe will have to cover 62% of the cost of subsidies to farmers through the higher prices.[44] When the EC elevates the domestic market price above the international levels, it curtails its exports from the third countries ; otherwise the consumers demand would be diverted towards the imported goods. Moreover, the CAP in the EC decreases the welfare effects of the consumers and taxpayers. The decrease in welfare effects of the consumers increases the commodity prices, thereby increases the consumers demand in the EC. According to Cecchini report, the national income of the EC would be increased by 5.3% of GDP in the SEM. The increase in domestic demand on account of an increase in the national income has a decreasing effect on export earnings.[45] Hence, the EC in an attempt to increase the export earnings announces certain import restricting measures against the imports of third countries.

Generally, an export promotion is fostered by import liberalisation. However, in the EC the export promotion is not fostered by import liberalisation, but by import restricting policies. The effects of the abolition of the CAP on world trade have been shown in table 3.5.

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[44] The Economist (London), 21 May 1988.

[45] Suresh Pal, "Agricultural Exports of India : Issues of Growth and Stability" India Journal of Agriculture Economics, vol.47, no.2, April-June 1992, pp.185-94.

Table 3.5
EFFECTS OF THE ABOLITION OF THE CAP ON WORLD TRADE
(Change in volume)

	CONCEPT	YEAR	NET IMPORTS TO THE EC	NET IMPORTS TO DEVELOPED COUNTRIES	NET IMPORTS TO DEVELOPING COUNTRIES	TOTAL VOL TRADED
WHEAT						
Koester (1982)	EC-9	1975-77	..	-8.5	-3.4	18.6
Anderson & Tyers (1984)	EC-9	1980	14.7	..	..	..
Tyers (1985)	EC-9	1980	14.7	..	..	12.3
Tyers & Anderson (1986)	EC-12	1980-82	..	4.5	-4.9	-4.0
GRAINS						
Koester (1982)	EC-9	1975-77	..	-10.0	-5.3	68.5
Anderson & Tyers (1984)	EC-9	1980	26.0	..	..	..
Tyers (1985)	EC-9	1980	26.0	..	..	23.2
Tyers & Anderson (1986)	EC-12	1980-82	..	4.0	2.3	0.0
RICE						
Anderson & Tyers (1984)	EC-9	1980	-0.2	..	..	..
Tyers (1985)	EC-9	1980	-0.2	..	..	..
Tyers & Anderson (1986)	EC-12	1980-82	..	3.8	-4.0	-1.0
SUGAR						
Tyers & Anderson (1986)	EC-12	1980-82	..	2.3	-2.9	0.0
DAIRY						
Tyers & Anderson (1986)	EC-12	1980-82	..	14	-22.0	17.0

Source: Julius Rosenblatt, Thomas Mayer, Kasper Bartholdy, Dimitrius Demekas, Sanjeev Gupta, and Leselie Lipschitz, "The Common Agricultural Policy of the European Community : Principles and Consequences", International Monetary Fund, Washington, D.C., Occasional Paper no.62, November 1988.

From this table, the effects of the abolition of the CAP on world trade has been analysed as follows :

With the removal of the CAP in the EC:

(i) Net imports to the EC will be increased.

(ii) Net imports to the other developed countries also increases.

(iii) Net imports to developing countries will be reduced.

(iv) Total volume of agricultural goods traded, in international trade expands.

The effects of complete liberalization of the CAP on the welfare of the developing countries have been shown in table 3.5(1).

From these tables, it has been said that complete liberalization of the CAP decreases the welfare of the developing countries. However, this reduction in the welfare effects of the developing countries becomes negligible, when compared to the rate of inflation arising out of an implementation of the CAP.

Table 3.11

EFFECTS OF A COMPLETE LIBERALIZATION OF THE CAP ON THE WELFARE OF NON-EC COUNTRIES

(Change in real income : in billions of 1980 US dollars)

SOURCE	COMMODITY(IES)	CONCEPT	YEAR	DEVELOPING COUNTRIES
Koester (1982)	Wheat,Grains	EC-9	1979	-0.5
Koester & Schmitz (1982)	Sugar	EC-9	1979	-2.3
Andorson & Iyers (1984)	Wheat,rice,grains Ruminant & non-ruminant meat	EC-9	1981	-3.7
Iyers (1985)	Wheat,rice,grains Ruminant & non-ruminant meat	EC-9	1980	-1.8
Matthews (1985)	Wheat,rice,grains Ruminant & non-ruminant meat	EC-10	1978-82	-0.5
Tyers & Anderson (1986)	Wheat,rice,grains Ruminant & non-ruminant meat	EC-10	1985	-5.9
Tyers & Anderson (1987)	Wheat,rice,grains Ruminant & non-ruminant meat	EC-12	1980-82	-10.5

Source :Julius Rosenblatt, Thomas Mayer, Kasper Bartholdy, Dimitrius, Demekas,Sanjeev Gupta, and Leselie Lipschitz, The Common Agricultural policy of the European Community : Principles and Consequences", IMF, Washington, D.C., Occasional Paper no.62, November 1988.

From the above discussions, it is clearly said that

(i) The CAP of the EC has increased the burden on the consumers, taxpayers and commodity produces.

(ii) The CAP has reduced the Community GDP.

(iii) The CAP has greatly increased the international commodity prices.

(iv) The CAP has increased the price instability in international trade.

(v) The CAP has increased the inflation.

From the analysis of the CAP, it is said that the CAP of the EC has been effectively used to protect the domestic economy against the imports from the third countries. This exerts adverse effeects on India's exports of agricultural products.

The implications of the SEM on Indian exports of agricultural products to the EC are analysed within the customs union framework. The impact of the SEM on the EC has been shown in table 3.6.

As already discussed in the conceptual framework of the SEM, six important economic effects are likely to take place in SEM. They are (i) trade creation ; (ii) trade diversion ; (iii) positive production effect ; (iv) cost-reduction

IMPACT OF SEM ON EUROPEAN COMMUNITY

STUDY/REFERENCE	PERIOD	GDP INCREASE	PRICES DECLINE	EMPLOYMENT	PUBLIC FINANCE	EC's EXTERNAL TRADE
Hermes Model & National Models	1993	4.5%	6%	1.8 million (Addn.is 5-6)	..	..
Cecchini Report	1995	5.3% (4.3-6.4)	6.1%	1.8 million	+2.2% of GDP	+1% of GDP
Anderson Model	1995	6.5%-7.5%	4-5%	4.4-5.7 million	..	External Balance Worsen

Source : Rajesh Mehta, "Impact of Single European Market on India's Exports : A Macro-econometric Analysis", Research and Information System, New Delhi, Discussion Paper, May 1992.

effect; (v) trade suppression effects and (vi) trade modification effect. All these effects are likely to take place at the same time. The trade creation and trade diversion effects of the SEM on India's exports have shown in table 3.7. The impact of the SEM on India's exports have been analysed on the basis of (i) Cecchini report; (ii) Anderson report; and (iii) Hermes model.This has been analysed as follows:

Table 3.7 : IMPACT OF SINGLE ENLARGED MARKET FOR INDIA'S EXPORTS TO THE EC

(% difference from baseline solution. Avg. over 1993-96)

Variable	Change in prices	Change in GDP	Change in India's Exports to the EC
Scenario I. (Cecchini Report)			
Trade Diversion	-6.1%	+5.3%	-2.1969
Trade Creation	-6.1%	+5.3%	6.3181
Total Effect	-6.1%	+5.3%	1.0849
Scenario II (Anderson)	-7.0%	+4.5%	-1.5935
Trade Diversion	-7.0%	+4.5%	8.3447
Total Effect	-6.1%	+5.3%	1.1025
Scenario III (Hermes Model)			
Trade Diversion	-6.0%	+4.5%	-2.1586
Trade Creation	-6.0%	+4.5%	5.3644
Total Effect	-6.0%	+4.5%	1.0778

Source :Rajesh Mehta, "Impact of Single European Market on India's Exports : A Macroeconometric Analysis", RIS Discussion Paper, May 1992, p.20.

Cecchini Report :

According to Cecchini report, commodity prices are expected to decline sharply in the SEM of the EC. This cost-reduction effect of the SEM is calculated to be at 6.1%. At this rate the 'trade diversion' effect of the SEM on Indian exports stands at -2.19%.[46] Hence, India's exports to the SEM would sharply decline by 2.19%. India's exports to the EC accounts for about 25 per cent of India's total trade. It's agriculture trade accounts for about 25 per cent of its total trade with the EC. Hence, a decline of 2.19% in India's total exports, causes a serious injury to India's balance of trade. This is particularly true for India's agricultural products, since agricultural products accounts for about 25 per cent of India's total commodity exports to the EC. In the EC the income levels are expected to increase by 5.3% of GDP (an average of 4.3% and 6.4%). At this rate,

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46 Rajesh Mehta, "Impact of Single European Market on India's Exports : A Macro-econometric Analysis", Research and Information System for the Non-Aligned and other Developing countries, New Delhi, Discussion Papers, May 1992, pp.1-21.

the trade creation effect of the SEM on Indian exports stands at 6.3%.[47] Hence, India's exports are expected to increase by 6.3%. Taking into consideration both the trade creation and trade diversion effects, the overall effects of the SEM on Indian exports are likely to increase India's exports to the EC by an average of 1.08% per annum.[48] This amount of increase is negligible for agricultural products since India exports 25 per cent of its agricultural products to the EC.

Anderson Report :

According to the Anderson report, the cost-reduction effect of the SEM is calculated to be constant at 4.5%. At this rate the trade diversion effect of the SEM on Indian exports stand at -1.59%.[49] Hence, India's exports to the SEM would decline by 1.59%. (The income level is expected to 7.0% of GDP (an average of 6.5% and 7.5%). India's agricultural exports, according to the trade diversion, would decline by 1.59%. The income level in the SEM period is expected to increase by 7.0% of GDP (an average of 6.5%

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[47]Ibid., pp.1-21

[48] Ibid., pp 1-21.

[49] Ibid., P. 20.

and 7.5%) At this level trade creation level of the SEM on India's exports stands at 8.34%[50]. The overall effect (taking into consideration both the trade creation and trade diversion effects) of the SEM on India's agricultural exports are likely to be increased by 1.10%[51] per annum.

Hermes Model :

According to the Hermes model, cost-reduction effect of the SEM is calculated to be 6%. At this rate, the trade diversion effects of the SEM on India's exports stands at -2.16%[52]; Hence, India's exports to the SEM would decline by 2.16%. India's agricultural exports would also decline by 2.16%. The income level in the SEM period is expected to increase by 4.5% of GDP. At this level, the trade creation of the SEM on India's exports stands at 5.37%[53]. The overall effects of both the trade creating and trade diverting nature of the SEM on India's agricultural exports

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50 Ibid., P 20

51 Ibid., P 20

52 Ibid., P 20

53 Ibid., P 20.

are likely to be increased by an average rate of 1.07%[54] per annum.

From the analysis these three models, it is summarised that as the cost-reduction effect increases in the SEM, the trade diversion effect also increases.As a result of an increase in the trade diversion effect, the trade diversion, trade modifications and trade suppression effects of the SEM also increases. When compared to the trade diversion, trade modification and trade suppression effects of the SEM, the trade creation effect of the SEM is negligible. Hence, the loss arising out of the formation of the SEM is higher than the benefits arising out of it. This is particularly true for India's exports of agriculture products to the SEM. Taking into consideration both the increase in the EC's external trade in the SEM period (1% of GDP) and the vastness of the SEM market for India's agricultural exports, the increase of an average of 1.08% per annum (an average of the results of three models) for India's agricultural exports becomes negligible, since the SEM absorbs 25 per cent of India's agricultural products. Without considering the nature of protectionist policies used in the SEM, the increase of 1.08% per annum of India's

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54 Ibid., P 20

agricultural exports would increase India's exports of agricultural products to the EC by 2.21-per cent. This change in India's agricultural exports to the SEM would not reduce India's external trade deficit with the EC, since 50% of India's global deficit is caused by the EC. When considering the nature of the protectionist policies used in the SEM, an average increase of 2.21% of India's agricultural products to the EC, becomes negligible in the SEM.

The formation of the SEM decreases the agricultural commodity prices in the EC. Eventhough, the agricultural commodity prices remain higher in the EC market than the World market prices. Hence, the consumers of the EC shift their demand from domestic producers to the import of the third countries. It makes India to find the access in the EC, but, this entry is prohibited by the import control measures of the EC in form of 'tariffs', 'import quotas' and 'anti-dumping policies'. In addition to this, the government support prices are also given to the European farmers through the CAP in the name of 'subsidies'. This restricts the consumers of the EC shifting their demand from domestic products to the imports from the third countries, thereby restricts India's exports of agricultural products to the

EC. The subsidies given to the European farmers increases the production of commodities in the EC, thereby increasing the world supply of agricultural commodities. In the EC, subsidies result in surplus stocks of butter (75,000 tonnes), sugar (3 million tonnes), wheat (90 million tonnes), and other food grains (30 million tonnes).[55] The increase in supply reduces the world prices of commodities. World agricultural markets are grossly imbalanced with supplies running well ahead of demand at current depressed world prices.[56] Price supports to farmers are too high and incentives to maintain or expand products are too great.[57] Moreover, the subsidies given to the European farmers by restricting India's exports of agricultural products to the EC decreases the efficiency of agricultural trading pattern in the EC.The high price supports to farmers are an ineffective way of achieving socio-economic objectives in the rural sector in the long time.[58] Despite all these

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[55] H.P.Singh, "Dunkel Proposals and Its Impact on Indian Agricultural Sector", Economic Affairs (Calcutta), vol.38, Quarter 1, March 1993, pp.52.

[56] J.M.C.Rollo,"The Second Enlargement of the European Economic community: Inclusion of Portugal, Greece, Spain", Journal of Agricultural economics, Vol xxv, Do.2,May 1989,PP.333-344.

[57] Ibid., PP.333-344

[58] Ibid., P 333-344

support policies, farm employment has sharply declined in the EC. The price adjustment gap between the world prices and domestic prices paid to farmers has widened dramatically since the turn of the decade.[59] Moreover, the prices paid to farmers for several commodities in the EC are more than double the world prices.[60]

In the EC government support prices are given under names like 'Public Subsidy Equivalents' (PSE) or 'Consumer Subsidy Equivalents' (CSE).[61] The PSE given to the farmers of the EC is about 40 per cent of the total value of output. The price support policies of the EC completely shielded its producers from declining world prices and the production in the EC is enhanced by productivity growth, continued unabated. The result was an escalating market imbalances and build-up stocks. This will have a major depressing effect on the prices of world agricultural commodities. However, the government support prices given to

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59 Ibid., P.333-344

60 G.L.Miller, The Political Economy of International Agricultural Policy Reform (canberra,1986),

61 A PSE (Public Subsidy Equivalents) or CSE (Consumer Subsidy Equivalents) is a measure in cash terms of the direct subsidy that producers would be willing to accept as compensation for the removal of any given support measures.

the farmers of the EC does not affect the domestic prices of agricultural commodities, rather it affects the agricultural commodities exported from India.

The Associated Chambers of Commerce and Industry of India, in its summary report on "Restructuring Indian Industry to Meet the Challenges of the EC 1992", has found out the possible effects of the SEM on major Indian agricultural exportables. It has been shown in the table 3.8.

According to the Assocham research paper, some of the agricultural products exported from India to the EC are likely to benefit in the SEM due to an increase in internal demand in the EC However, the increase in internal demand would be met by two sources; (i) by the 'European Free Trade Area' (EFTA) countries which are forming an 'European Economic Area' (EEA) with the countries of the E.C; and (ii) by the Central and East European countries, who have got an 'associated member status' with the EC Hence, Indian exports of agricultural products to the SEM would be diverted by those from the counteries the EFTA and Central and East European countries. This argument has been based on international transportation costs.[62] Sampson and Yeats have shown that a nation disadvantageously located in relation to its major export markets may have considerable latitude in offsetting transportation costs.[63]

Table 3.8 : EFFECTS ON MAJOR INDIAN AGRICULTURAL EXPORTS

Product	Native of Effect	Reasons
Tea	Positive effect	Increase in internal demand
Coffee	Positive effect	Increase in internal demand
Spices	Negative effect	Rigid quality tests
Tropical fruits & nuts	Negative effect	Intense competition from ACP countries. Packaging and hygienic requirements.
Tobacco	Negative effect	Domestic health regulations.
Rice	Uncertain	Solely depending on international market price.

Source : The Associated Chambers of Commerce and Industry of India, "Restructuring Indian Industry to Meet the challenges of EC 1992", Summary Report of Proceedings and Background Paper, August 1991, p.31.

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62 See Won W.Koo and Donald W.Larson, eds., Transportation Models for Agricultural Products (Bolder,1985).

63 Musa Pinar, Earl A.Stennis and Abdul M. Turay, "Transportation Cost Subsidies-A Criterion for Policy to Promote International Trade", Journal of World Trade Law, 18(3), March-June 1984, p.225.

Since, transportation costs are related to distance, nations that are not favorably located in relation to their major export markets are at a comparative disadvantage in production.[64] Musa Pinar, Earl A. Stennis and Abdul M. Turay's findings show that the exporting countries which encountered high transportation costs to reach their export markets might not be able to capture the market, eventhough they have an absolute advantage in production.[65] India has got an absolute or comparative advantage in the production of many of the agricultural products. However, the disadvantages in transportation costs will have an offset effect on an absolute or comparative advantage of India's agricultural exports to the SEM Hence, the competitiveness of India's exports is also affected by high freight rates-both air and sea.[66] From this argument, it is concluded that India is at a competitive disadvantage vis-a-vis some other EFTA and Central and East European countries which have a favourable geographic location with regard to the SEM of the EC

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64 Ibid., p.225.

65 Ibid., pp.224-34.

66 S.S. Mehta, "Strategy for Promoting Agricultural Exports from India", Foreign Trade Review, vol.xxiv, no.4, January-March 1990, pp.369-76.

The technological innovation of the EC in the SEM for the production of agricultural commodities also affects India's exports of agricultural products to the EC The technological innovation develop substitutes for farm products from India. Jute has been under threat from polypropylene.[67] The consumption of sugar in beverage industries is threatened by corn based and artificial sweetness.[68] Substitutes are also being developed for cocoa, coffee and tea. The production prices of these substitutes are much lower than those of original natural products. Enzymes and fermentation technology have been developed by flavour chemists to create cocoa substitutes that costs 50% of actual cocoa extracts.[69] In the S.E.M, there are chances for some of India's agricultural exports to be replaced by strong substitutes.

However, india's exports of agricultural products to the EC faces an average tariff rate of 3.3% and food products faces an average tariff rate of 13.8%.[70] India's

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67 Ibid., pp.369-76.

68 Ibid., pp.369-76.

69 Ibid., pp.369-76.

70 Refik Erzan and Karsenty, "Products Facing High Tariffs in Major Developed Market Economy Countries : An Area or Priority for Developing Countries in the Uruguay

exports of agricultural products to the EC faces high tariff barriers; 45.9% of its total agricultural exports faces high tariff barriers (above 10%) and 39.4% of its exports faces low tariff barriers (less than 10%).[71] Hence the EC by imposing higher tariffs on India's exports of agricultural products, closes its domestic market. The rate of openness of the EC for the imports from the developing countries have been shown in table 3.9. This clearly shows the restrictive nature of the domestic market of the EC.

TABLE 3.9 : THE OPENNESS OF THE EC FOR THE IMPORTS OF AGRICULTURAL PRODUCTS FROM DEVELOPING COUNTERIES (trade as percentage of apparent consumption).

Product Group	Year	Rate of Openness (in percentage)
	1982-83	9.02
Agriculture	1984-85	10.40
	1986-87	8.42

Source : UNCTAD, Hand Book of International Trade and Statistics 1989.

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71 Ibid., pp.

The trade losses arising out of higher tariff rates on India's exports of agricultural products outpaces the welfare gains arising out of the benefits from 'General Systems of Preferences' (GSP). India's agricultural products benefitting from the EC's GSP scheme is hardly in doubt. Only 9.3% of India's total agricultral exports to the EC gains from the EC's GSP. The trade gains arising out of only one or few schemes, under GSP, for India's agricultural exports will be very small compared to the trade loss, arising out of the trade diversion effect of the SEM.

From the above discussions, it is concluded that the creation of the SEM of the EC is crucial for India, for its exports of agricultural products to the EC. Moreover, the import restricting policies have also been used successfully to restrict the imports from India. Hence, in the SEM, India is in a disadvantageous position in its trade with the member countries of the EC.

CHAPTER IV

THE IMPLICATIONS OF THE SEM FOR INDIAN EXPORTS OF AGRO-BASED PRODUCTS.

Agriculture is a declining industry; its share of national output and national employment declines as real per capita income increases. Agricultural sector is clearly associated with agro-based sectors. Hence, an increase of protectionist measure in one sector increases the protectionist nature of the other sector. In this context, the adverse effects of the SEM on India's exports of agricultural exports also affect its exports of agro-based products to the EC. A rigid interlink has been identified between the agricultural and agro-based sectors in India's economic structure. In India, agriculture is a prominent sector, hence the development of agro-based industries assumes vital importance because they have both the crucial backward and forward linkages with the agricultural sector.

The role of textiles and clothing production in a developmental process is an important one.[1] It has been noted that textiles and clothing accounts for an important part of the production and exports of a newly industrializing country at the early stages of its development.[2]

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1 Carl B. Hamilton, "The New Silk Road to Europe" (Institute for International Economic Studies, University of Stockholm), Seminar paper no. 468, June 1990.

2 Ibid.

industrializing country at the early stages of its development.[2]

India's economic structure is agrarian in nature. Hence, its international commodity trade centres around agro-based products. India's exports of agro-based products mainly consist of textiles and clothing. Therefore, the export earnings from textiles and clothing sectors play an important role in deciding India's foreign trade balance. In this context, India's exports of textiles and clothing to the EC gains importance.

The world trade in textiles, clothing, fibres and textile machinery constitutes more then 10 per cent of world trade in manufactures.[3] Most of this trade, 55-60 per cent, takes place among the developed countries.[4] Among the developed countries, the EC accounts for about 20 per cent

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2 Ibid.

3 Carl Hamilton, "Follies of Policies for Textile Imports in Western Europe" in H.W. Singer, Neelamber Hatti and Rameshwar Tandon, ed, New Protectionism and Restructuring (New Delhi, 1988), p.627.

4 Ibid., p.627.

of world textiles and clothing market of $18Ø billion.[5] Moreover, the EC is the world's largest importer and exporter of textiles and clothing. It's export share in textiles and clothing in its total trade accounts for about 3.7 per cent and 2.7 per cent respectively. Imports of textiles and clothing into the EC in 1988 were valued at $ 36 billion, out of which approximately two-thirds ($ 22.5 billion) were of clothing and the balance textile imports.[6]

India's share in world trade of textiles and clothing is less than 2 per cent. Textile and clothing exports together constitute about one-fifth of India's total exports. The share of clothing and textiles in India's total exports has risen from 6.15 per cent and 4.45 in 1983 to 11.4 per cent and 9.51 per cent in 1988. India remains a marginal supplier of textiles and clothing.

The main destination for India's exports of textiles and clothing is the EC The SEM of the EC is India's single largest market and absorbs about 3Ø per cent of its exports of textiles and clothing. India's share in the volume of

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5 Parameshwaran Iyer, "EC 1992: Impact on Indian Textile Exports", Foreign Trade Review, Vol. XXVI, nos. 1&2, April-September 1991, p.29.

6 Ibid., p.3ØØ.

extra-EC imports has remained at about 3.5 per cent. Since 1978, it's value share in extra-EC imports has declined from 4 per cent in 1978 to 3.7 per cent in 1988. The growth in the volume of increase of exports to the EC is becoming restricted due to the gradual movement of the EC towards the formation of the SEM.

The movement of the EC towards the formation of the SEM is likely to distort India's bilateral trade with the EC especially relating to textiles and clothing. The lack of industrial efficiency and international competitiveness forces the EC to shelter its market from the third countries by the protectionist policies. In the EC, textile and clothing industries have long been declining.[7] In addition, the declining nature of an employment in the EC's textile and clothing sectors also increases the need for protectionism in the EC. In the last two decades, employment in textile and clothing sectors in the EC has declined from 4.1 million to 2.0 million, or by 51 per cent.[8] At the same time, the number of people working in the EC's textile ad clothing sectors remains large and continues to give an

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7 William R. Cline, The Future of World Trade in Textiles and Apparel (Washington : DC,1987), p.113.

8 Ibid., p.114

important political dimension to trade and industrial policies in these sectors.[9] A combination of factors have been responsible for the deterioration of labour situation in the EC's garment industry. They are :

1. The cheap imports from the low wage countries, which have to some context, adversely affected the economies of the domestic textile industries[10].
2. Extensive use of 'Computer Aided Design' (CAD) and 'computer aided manufacturing' (CAM) systems have partly automated some of the critical segments of the garment industry.[11]
3. The surging phenomenon of 'International Subcontracting' to preferential trading partners has dampened the industry at home.[12]
4. The textile and clothing industries are stagnating in the EC, where the industrial production is focused more towards the sophisticated capital-intensive

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9 Ibid., p.113

10 Charu Gupta, "India in the EC's Clothing Trade", <u>Foreign Trade Review</u> ,vol.xxvii, no.2, July-September 1992. p.197.

11 Ibid., p.197.

12 Ibid., p.197.

industry.[13]

5. High wage rates have always proved to be a major disadvantage to the labour-intensive character of the industry.[14]

The displacement of labourer from textile and clothing industries to other capital intensive industries results in an under-employment of labour in these sectors. This results in a rising wage cost, which further results in an erosion of its industries in international textile and clothing trade. The development changes taking place in other industries are incompatible with the improving competitive structure of the E.C's textile and clothing industries.

In this context of structural adjustment in trade policy formulation, the SEM of the EC gains much attention. The SEM is crucial for India, in its trade with the EC. The formation of the SEM will have a series of important effects on the EC's textile and clothing sectors, as in other sectors. The formation of the SEM will have a significant effect on extra-EC trade including India's trade with the EC

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13 Ibid., p.197

14 Ibid., p.197.

Four major consequences of the SEM are reported as follows:

1. Significant reduction in costs:[15] Resulting from an improved exploitation through the economies of scale in production.
2. Improved efficiency :[16] Resulting from a setting of prices closer to costs of production under the pressure of more competitive markets.
3. Adjustment between industries:[17] On the basis of a fuller play of comparative advantages in an enlarged market.
4. Increased innovation:[18]New business processes and products are generated by the dynamics of internal market.

The overall impact of these factors on India's exports of textiles and clothing to the EC is likely to be quite significant in view of the fact that in 1989-90, textile and clothing items accounted for about 30 per cent of its total

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15 Iyer, n.5, p.29.

16 Ibid., p.29.

17 Ibid., p.29.

18 Ibid., p.29.

exports to the EC[18] India, the traditional supplier of textiles and clothing has lost its market share in the EC, since the early 1960s to the newly industrializing countries of the South-East.

In the SEM efforts have been made to improve the efficiency and international competitiveness of the declining textile and clothing industries. Improving the competitiveness in the SEM has been associated with the intensification of protectionist policies against the imports from the third countries. Textiles and clothing are the most systematically and comprehensively protected sectors in the world today.[20] The salient feature of international protection in textile and clothing is its longevity and its seemingly inexorable rise over time.[21] This is true for the EC's imports of textiles and clothing from the third countries. In the SEM the inefficient, high cost domestic industries are protected from the efficient and low cost imports by the protectionist policies.

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18 O.P. Sharma, "Europe 1992: Implications for India's Exports" Foreign Trade Review, vol.xxxvi, nos.1&2, April-September 1991, p.13..

20 Cline, n.7, p.145.

21 Ibid., p.10.

The structure of Indian textile industries has undergone a profound changes during the last forty years.[22] Unlike the trend in western economics, the Indian textile industries have become more fragmented with a decline in the degree of integration.[23] As the degree of integration increases in the EC, the rate of protectionist measures also increases. In the SEM, the import policies of the member countries are restructured to protect the interests of Southern states and Denmark, whose export structure revolves round its textile and clothing industries. As already discussed in Chapter-II, the increase in the level of disparity in economic infrastructure among the member countries of the EC increases the protectionist nature of its trade policies. As a result, trade policies are increased in such a way that even the smallest exporting countries of the EC would benefit from the formation of the SEM.

The implications of the formation of the SEM on India's exports of textiles and clothing could be analyzed in two sections.

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[22] Sushil Khanna, "Technical Change and Competitiveness in the Indian Textile industry", Indian Institute of Management (Ahmedabad)W orking paper no.113(89), p.11

[23] Ibid., p.11.

A. By studying the nature of India's textile and clothing industries, its industrial efficiency and international competitiveness and

B. By studying the nature of protectionist measures used by the EC against the imports from India

A. THE NATURE OF INDIA'S TEXTILE AND CLOTHING INDUSTRIES

The very structure of the textile and clothing industries and the technology have been influenced by the changes taking place in other industries, especially petrochemical and microelectronics industries.[24] Hence, without improving the structure of its allied industries, the structure and efficiency of textile and clothing industries cannot be improved. As far as the India's textile and clothing industries are concerned, parallel changes have not taken place in accordance with its allied industries. Moreover the structure of its industries, instead of becoming integrated, has become more fragmented, with a decline in the degree of integration. The fragmentation of its industries has resulted in the degradation of its industrial efficiency and international competitiveness. However, in the EC the advanced stages of integration have

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24 Ibid., p.3.

already been achieved in textile and clothing sectors. Plant and technical economies of scale have already been exploited to a large extent. Commercial economies of scale still to be exploited will lead to further homogeneity of tastes and prices.[25] The structural changes taking place in the EC's textile and clothing industries have increased the stagnation in India's textile and clothing industries. As a result, India's international competitiveness in textile and clothing sectors has been affected. Hence India, the traditional supplier of textiles and clothing losses its market share in the EC.

India's exports are primarily cotton based.[26] High value items, particularly silk products do not account fro even 5 per cent of its textile exports. [27] As a consequence India's exports to the EC stand of the lower ene of the SEM.[28] Moreover, the 'unit value realisation' of India's textile and clothing exports to the EC is very

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[25] Gupta, n.10,p.194.

[26] Export-Import Bank of India, "What India can Export to Industrialised Market: A Study", Occasional paper no.9,August 1990.

[27] Ibid.

[28] Ibid.

low,[28] putting India at the lowest end of the market (see Table 4.1). The unit value of selected items in the SEM has shown in 4.1.

Table 4.1

UNIT VALUE OF SELECTED ITEMS : COMPARISON IN EC MARKET

(Price in ECU/piece)

Country	Ladies' blouses		Ladies' dresses		Ladies' Overcoats		Ladies' Woven fabrics	
	1982	1989	1982	1989	1982	1989	1982	1989
Hong Kong	5.42	8.93	6.95	16.44	8.08	16.42	4.72	4.36
Turkey	3.91	6.81	4.86	4.53	15.38	15.92	3.48	4.21
South Korea	3.25	5.97	8.71	12.33	16.63	17.90	NA	NA
India	4.17	3.82	8.69	5.93	8.35	7.74	4.0	3.50

Source : Commission of the European Countries.

The table 4.1 indicates the following:

1. The unit values for India's exports of textiles and clothing are relatively low. It varies from 100 per

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28 Iyer, n.5,p.83.

clothing to the EC.

Since its unit value realization is much lower than that of that of other countries (lower by 300 per cent to 100 per cent), India's exports of textiles and clothing have to be increased by more than 300 per cent.

3. As a result of its low unit value, the profits accruing from its exports are also low in the EC.

B. THE NATURE OF PROTECTIONIST MEASURES USED BY THE EC AGAINST INDIA'S EXPORTS OF TEXTILES AND CLOTHING

The implications of the SEM on India's exports of textiles and clothing could be analysed within the customs union frame work. The formation of the SEM has eliminated

(i) the barriers of customs union and the national protection in the EC;

(ii) harmonised taxes and duties in the EC; and

(iii) established common product standards among the member countries of the EC.[30] The combined effects of eliminating

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30 Associated Chambers of Commerce and Industry of India (ASSOCHAM), "Restructuring Indian Industry to Meet the Challenges of the EC 1992", Summary Report of Proceedings and Background Paper, August 1991.

all the barriers and its subsequent effects have resulted in

(i) the rationalisation of production and increased production on the lines of comparative advantage and benefit;

(ii) an increase in the scale of production with the adoption of common standards and subsequent reduction in costs;

(iii) an increased competition and the reduction of monopoly power; and

(iv) convergence of price levels and strengthening moves in the direction of mergers.

These economic parameters of the SEM, result in an economic benefits for the member countries. They are estimated as follows : (1) the scale of production in the EC is expected to increase by 2 per cent of GDP; (2) an increase in GDP is expected to be around 5 per cent per annum; (3) an average income is expected to rise by 4 to 7 per cent;[31]

An increase in income is expected to rise the consumer demand in the EC. An excessive consumer demand could be met with the surplus of products produced by their own members of the South (Greece, Italy, Portugal, and Spain) and Denmark

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[31] Ibid.

(see Table 4.2) As a result, extra-EC trade would be reduced with the increase in intra-EC trade. This also reduces India's exports of textiles and clothing to the SEM.

Table 4.2

EXPORTS AND IMPORTS OF CLOTHING OF EC IN 1988 ('000 ECU)

COUNTRIES	EXPORTS	IMPORTS	NATURE
Germany	2009.002	7526.132	Deficit
France	1207.950	2286.34	"
Italy	2757.752	8893.625	"
Netherlands	126.220	1218.009	"
Belgium-Luxembourg	114.304	453.693	"
United Kingdom	844.813	2877.530	"
Ireland	49.146	55.693	"
Denmark	483.136	454.970	Surplus
Greece	159.006	15.678	"
Spain	398.977	155.529	"
Portugal	589.959	17.009	"
EC-12	8695.317	15954.216	Deficit

The income elasticities and price in elasticities of India's exports of textiles and clothing to the EC has been shown in table 4.3.

Table 4.3

INCOME AND PRICE ELASTICITIES FOR INDIAN, EXTRA - EC AND INTRA-EC EXPORT OF TEXTILES AND CLOTHING OF EC MARKET : 1987-88

Category	Income Elasticities			Price Elasticities		
	India	Extr -EC	Intra -EC	India	Extra -EC	Intra -EC
Cotton yarn	15.30	0.97	2.55	-2.4	0.15	-0.01
Woven Fabrics	3.39	1.43	1.44	-1.69	-0.32	0.85
T-shirts	3.42	1.84	2.33	-0.26	-0.28	-0.07
Men's Trousers	3.33	1.17	-0.91	1.45	0.06	1.86
Women's blouses	1.26	1.68	2.69	1.04	-0.65	0.50
Men's shirts	4.92	1.64	4.13	0.80	-0.36	-0.99
Ladies shirts	1.29	4.48	3.63	0.22	-0.56	-0.79
Ladies suits	5.26	0.02	0.01	0.03	-1.00	-1.00
Table/Toilet Linen	1.88	1.55	2.77	0.88	-0.52	-0.02

From the Table 4.3, it is revealed that, India enjoys fairly high income elasticity of demand in the EC. Hence, it is said that trade creation possibilities for India's exports of textiles and clothing would be more in the SEM. However, at the same time, the trade creation possibilities in the SEM should be analyzed with other concepts like trade diversion effect, trade suppression effect, trade modification effect and the cost-reduction effect.

The formation of the SEM, according to Cecchini report, increases the community GDP by per cent and reduces the cost of production by per cent.[32] As a result of an increase in efficiency and competitiveness of the member countries, the production costs decline in the EC. This cost reduction effect of the SEM also forces the net exporting countries to lower down their prices in the SEM. In this context, India's marginal profits from its exports of textiles and clothing could also be lowered down. Hence, the trade creation possibilities arising out of an enlargement of the market, would be marginalised by the cost-reduction effect and its subsequent effects.

The trade diversion possibilities for India's exports of textiles and clothing could be analyzed as follows. As already discussed in chapter III, India is disadvantageously

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32 Commission of European Communities, "The Economics of 1992", 1988.

located in relation to its major market i.e. the SEM of the EC (the transportation cost argument).[33] They will have considerable effects on India's export earnings.[34] Since, transportation costs are related to distance, nations that are favourably located in relation to its major markets are at a comparative cost advantage in production[35]. The findings of Musa Pinar, Earl A. Stennis and Abdul Turay show that the transportation costs have some implications for international trade.[36] The exporting countries which encounter high transportation costs to reach their major markets, might not be able to capture the markets, even though they have an absolute advantage in production.[37] This could be realised from table. 4.4, which shows the international Yarn and fabric costs in the EC (Germany), India and South Korea.

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33 See Alexander J. Yeats, "A Comparative Analysis of the Incidence of Tariffs and Transportation Costs on India's Exports", Journal of Development Studies (London), vol.15, no.1, October 1977, pp.97-107 and Won W. Koo and Donald W. Larson, eds., Transportation Models for Agricultural Products (Boulder, 1985).

34 Ibid, pp.97-107.

35 Musa Pinar, Earl A. Stennis and Abdul M. Turay, "Transportation Cost Subsidies : A Criterion for Policy to Promote International Trade", Journal of World Trade Law, 18(3), March-June 1984, p.234.

36 Ibid., p.234.

37 Ibid., p.225.

Table 4.4

INTERNATIONAL YARN AND FABRIC COSTS IN GERMANY, INDIA AND SOUTH KOREA

	Germany		India		South Korea	
Description	Yarn	Fabric	Yarn	Fabric	Yarn	Fabric
Waste	0.1199	0.022	0.1015	0.019	0.1214	0.023
Labour	0.3414	0.351	0.0935	0.044	0.1145	0.023
Power	0.2387	0.100	0.2219	0.090	0.1690	0.068
Aux Material	0.0745	0.068	0.1040	0.070	0.0861	0.067
Capital	0.6601	0.363	0.7059	0.329	0.4806	0.245
Raw Material	1.4550	0.273	1.2500	0.232	1.4700	0.273
Total Cost	3.3896	1.175	2.4768	0.784	2.4416	0.725

Source : Sushil Khanna, "Technical Change and Competitiveness in the Indian Textile Industry", Indian Institute of Management (Calcutta), Working Paper Series no.113(89), p.19.

The costs of production for textiles and clothing in India is much lower than the EC and more or less equal to

South Korea. However, this comparative advantage in production costs is compensated by the disadvantage in transportation costs. Though the unit values of textiles and clothing exported from India to the EC are lower than those of the Central and East European and East Asian countries, the exports of these countries continue to increase in the EC.

Table 4.5 UNIT VALUE OF SELECTED ITEMS IMPORTED INTO THE EEC-1989 (ECU/KG)

Country	Ladies blouses	Ladies Skirts	Gents Shirts	Trou-sers	Shir-ts	All
Hongkong	6.95	8.08	5.48	7.27	8.23	19.04
South Korea	5.97	12.33	5.02	-		19.60
India	3.82	5.93	4.76	5.63	5.60	17.09
China	-			5.31	4.40	11.34
Morocco	5.97	9.51	6.30	6.74	6.94	16.39
Tunisia	5.64	8.64	7.83	7.40	6.44	16.54
Turkey	6.81	4.53	5.41	8.78	6.26	15.81
Poland	10.14	-	7.63			
Taiwan	16.39					
Yugoslavia	9.77	18.36	6.75	12.23	13.63	27.04
Mauritious	-		5.03	6.63		

Table 4.6 TOP SUPPLIERS OF TEXTILES & CLOTHING (% Share)

Country	Description	1988	1989
Turkey	Clothing	9.34	10.89
	Textiles	10.43	10.93
Yugoslavia	Clothing	4.94	5.27
	....	..	..
Switzerland	....	..	..
	Textiles	7.49	7.32
Morocco	Clothing	4.28	5.14
	....	..	..
Tunisia	Clothing	3.88	4.73
	....	..	..
Hong Kong	Clothing	14.51	13.07
	....	..	..
China	Clothing	10.67	10.26
	Textiles	6.43	5.95
South Korea	Clothing	7.23	5.20
	....	..	..
U.S.A	....	..	..
	Textiles	7.85	8.03
Austria	....	..	..
	Textiles	6.91	7.38
India	Clothing	4.02	4.52
	Textiles	7.01	6.29
Pakistan	Textiles	5.38	5.80

In this context, the countries of the EFTA and the countries of Central and Eastern Europe are advantageously located in relation to the SEM. Furthermore, the countries of the EC have decided to enlarge the size of the market by forming an 'European Economic Area' (EEA) with the EFTA countries[38].

38 Eckart Guth, "Agriculture in Europe : New Challenges Ahead", Inter Economics, vol.27, September/October 1992, p.217.

Moreover the countries of Central and Eastern Europe have acquired an associated member status and are given preferential access in the SEM. Other countries like Morocco, Tunisia and Turkey have also acquired an associate member status with the preferential access. The preferential access given to these countries which are already in an advantage position in transportation costs restricts India's exports of textiles and clothing products to the EC.

Hence, India faces stiff competition from (i) the countries of the EFTA; (ii) the countries of Central and Eastern Europe; (iii) the associated members; and (iv) the countries of newly industrializing East Asian region. As a result of an increased competition, the countries try to reduce their profits in the SEM This could not affect the trading pattern of the newly industrialising countries of East Asia and Central and East European countries, since the rate of expansion in trade of textiles and clothing for these countries are higher than those for India (see Table 4.7) The price reduction strategy of the competing countries in the EC would adversely affect India's trading pattern with EC since these exports account for majority of India's exports to the EC Hence, the trade diversion possibilities are more for India in the SEM. There is no doubt, that there would also be the trade creation effects for India's export of textiles and clothing to the EC However, at the same time, the trade diversion effect would off set the gains of the trade diversio effect. The trade diversion effect of the SEM would suppress India's exports of textiles and clothing in the SEM, thereby results in 'trade-suppression effect'. Hence, in the EC, the cost-reduction effect of the SEM results in trade diversion and trade suppression effects. All these effects of the SEM would prevent India from increasing its share in the EC.

The implications of the SEM on India's exports of textiles and clothing could also be studied by analyzing the nature of the restrictive measures used by the member countries against the imports from the third countries.As discussed in Chapter-II, the differing industrial efficiency and competitiveness of the participating countries of the customs union results in an imposition of protectionist measures against the imports of from the third countries. These import restrictive measures are in the form of tariffs, quotas and anti-dumping policies.

The imposition of tariffs increases the prices of the imported commodities. An increase in imports prices rises the prices of competing domestic goods. Hence, the consumers shift their demand from imports and toward domestic goods. At this time, the continuation of tariffs against the imports reduces the industrial efficiency and international competitiveness of the protected sectors[38]. The reduction in industrial efficiency again reflects in the production structure and weakens the export structure of the protected sectors. Hence, the importing countries find themselves in a disadvantageous position in its trade with the outsiders. This further increases the nature of the protectionist policies used against the imports from the third countries. An import quota measures have also been used against the import of the third countries in the SEM. The imposition of import quotas reduces the imports from the third countries, thereby allowing the domestic industries to operate freely.

In addition to tariffs and import quotas, anti-dumping policies have also been used against the low cost imports from the third countries. In the EC, it is said that dumping is detrimental to competition. The counter argument for this runs as follows. International trade is based on comparative cost advantage. In the EC, the agglomeration of contiguous

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[38] See S. Devadoss, "Market Interventions, International Price Stabilization, and welfare Implications", American Journal of Agricultural Economics, vol.74, no.2, May 1992, pp.281-90.

national economies to form the SEM, increases the economic growth rate of the member countries. This is accompanied by an increase in the purchasing power of the people. The increased purchasing power of the people also increases the demand for commodities. This finally results in the commodity price hikes in the EC. Hence in the EC, the commodity prices are increased without increasing the efficiency of domestic industries. At this time, the consumers in domestic market tend to shift their demand from the high cost, inefficient products to low cost, efficient products.[40] The shift in consumer demand forces the importing countries to impose anti-dumping policies against the imports from the third countries. In this context, dumping is not detrimental to competition, rather it encourages the competition in the import restricting countries.

The discriminating nature of anti-dumping policies in the EC against the imports from India could be analyzed as follows. When compared to intra-EC trade, extra-EC trade is relatively low. India's share in extra-EC is less than 1 per

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40 Juergen B. Donges, "Whither International Trade Policies : Worries About Continuing Protectionism", pp.72-73 in Kimberley Ann Elliot and John Williamson, eds., World Economic Problems, Special Report (Institute for International Economics, Washington DC), 7 April, 1988.

cent. This small amount of exports to the EC cannot be expected to injure the domestic industries of the EC. From this argument, it is clearly said that India's exports are innocuous to domestic industries of the EC, even if India is dumping its commodities in the EC. Despite all these arguments, anti-dumping policies have been imposed against the imports from India. This shows the import restricting nature of the EC's anti-dumping policies against the import from India.

In this scenario of the EC's import restricting policies, India's bilateral relationship with the EC has been analyzed. India's exports of textiles and clothing to the EC are conditioned by the 'Multi Fibre Agreement' (MFA); where 68 items come under the MFA regulations.[41] For India, there are import restrictions against payment of duty for 11 out of total 68 items coming under MFA.[42] The MFA announces quantitative measures on imports. In the SEM, anti-surge mechanism was introduced to prevent sudden increase in imports within agreed quotas. The MFA mechanism for India reads"... If the imports from a supplier (India)

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[41] Indo-German Chamber of Commerce (Bombay), " Textile Exports to EEC : MFA- Quotas, 1987 to 1991" , P.1.

[42] Ibid., p.2.

country exceed the previous calendar year's total imports into the community of the respective category by more than 1 per cent for Group I; 5 per cent for Group II, quantitative limits may be fixed either for the whole of the community or only for certain member countries...[43] The EC's MFA quotas for India's exports of textile and clothing to the member countries of the EC have been shown in table. 4.8.

TABLE 4.7 THE EC'S MFA - QUOTAS FOR INDIAN EXPORTS OF TEXTILES AND CLOTHING TO THE MEMBER COUNTRIES OF THE EC

No.	Description	Unit	Year	Annual Quan. Limits
	Group I-A			
55.05	Woven fabrics of cotton, other than gauze, terry fabrics, narrow woven fabrics, pile fabrics, cheniple fabrics, tulle and other net fabrics.	tonne	1987	42470
			1988	43213
			1989	43969
			1990	44739
			1991	45522
55.09	(a) of Which other than unbleached or bleached	tonne	1987	7486
			1988	7935

[43] Ibid., p.6.

			19898411
			19908916
			19919451

Group I-B

60.04	Shirts, T-shirts, light weight fine knit roll, pole or turtle necked jumpers and pullovers, undervests and the like, knitted or crocheted.	1000 piece	198710407 198810865 198911343 199011842 199112363
61.01	Men's or boy's woven breeches, shorts other than Swimwear and trousers,women's or girl's woven trousers and slacks, of wool, of cotton or man made fibres.	1000 piece	19873749 19883936 19894133 19904340 19914557
60.05	Women's or girl's blouses, shirts and shirt blouses, whether or not knitted or crocheted, of wool, cotton or man made fibres	1000 piece	198732287 198833094 198933922 199034770 199135639
61.03	Men's or boy's shirts, other than knitted or crocheted,	1000 piece	198728443 198829225

	of wool, cotton or man made		198930029
	fibres.		199030855
			199131703

Group II-A

62.02	Bed linen, other than knitted	tonne	19878417
	or crocheted, table linen,		19888838
	toilet and kitchen linen other		19899280
	than		19909744
			199110231
	knitted or crocheted, other th-	tonne	19872067
	an of terry twelling or similar		19882191
	terry fabrics of cotton.		19892322
			19902462
			19912610

Group II-B

61.02	Women's or girl's woven over-	1000	19872626
	coats, cloaks, and capes, ja-	pieces	19882784
	ckets and blazers, of wool, of		19892951
	cotton, of man made textile		19903128

	cotton, of man made textile fibres.		1990	3128
			1991	3315
60.05	Women's or girl's dresses, of wool, of cotton or man made fibres.	1000 piece	1987	8820
			1988	9173
			1989	9540
			1990	9927
			1991	10318
60.05	Women's or girl's shirts, including divided skirts.	1000 piece	1987	6870
			1988	7145
			1989	7431
			1990	7728
			1991	8037
61.02	Women's or girl's suits and ensembles, other than knitted or crocheted, of wool,of cotton or man made fibres excluding ski-shirts.	1000 piece	1987	4637
			1988	4869
			1989	5112
			1990	5368
			1991	5636

Source :Indo-German Chamber of Commerce, Bombay, "Textile Exports to EEC: MFA-Quotas - 1987 to 1991, 1992.

In the EC, India's exports of textiles and clothing benefit from the EC's 'Generalised system of Preferences' (GSP). However, in the EC, it is observed that the product coverage of GSP schemes in high tariff items was significantly narrower compared to lower tariff items, and those products covered by the GSP were relatively lower tariff items among the high tariff imports. In the EC, the GSP coverage in high tariff product is almost equal to those in lower tariff items. The GSP coverage in high tariff product was 69.3 per cent compared to 77.9 per cent for lower tariff items. Some of India's key products benefitting from the EC's GSP scheme has been shown in tables 4.8 and 4.9.

TABLE 4.8

INDIA'S KEY PRODUCTS BENEFITTING FROM GSP

Clothing (except fur clothing)	13740	18.1	1190	8.7
Cotton fabrics, Woven (except narrow or special fabrics)	1214	7.2	61	5.0
Floor Coverings	788	8.0	61	7.7
Text Fabrics (excluding narrow, special, non cotton)	1312	12.8	56	4.2

Source: Guy Karcenty and Sam Laird, "The GSP, Policy Options and the New Round", Review of World Economics, 123(2), 1987, p.272.

TABLE 4.9

INDIA'S GSP QUOTAS & CEILINGS IN THE EC, 1987,1988,1989.

DESCRIPTION	UNIT	1987		1988		1989
Cotton Yarn	tonnes	2284	..	..	2153	2153
Woven cotton fabrics	tonnes	11926	..	..	12300	12300
Fabrics of man made fibres	tonnes	....	10.0	..	600	N.A.
T-Shirts, etc.	1000ps.	4307	..	1793	..	1793
Jersys,cardigans,etc	1000ps.	4730	..	..	1437	N.A.
Trousesrs,slacks	1000ps.	188	..	1667	..	1667
Women's blouses	1000ps.	6638	..	926	..	926
Shirts	1000ps.	6572	..	1826	..	N.A.
Cotton terry fabrics kitchen linen etc.	tonnes	803	..	..	125	N.A.
Stockings,socks,etc.	1000pas	..	3.45	..	3037	N.A.
Underpants,briefs	1000ps.	..	99.00	..	1922	N.A.
Women's coats	1000ps.	190	..	216	..	216
Men's suit	1000ps.	..	6.6	..	94	N.A.
Jackets,blazers	1000ps.	114	..	..	77	N.A.
Pyjamas, bathrobes	tonnes	194	..	..	107	N.A.
Bed Linen	tonnes	1491	..	221	..	221
Dressers	1000ps.	2255	..	376	..	N.A.
Skirts	1000ps.	935	..	248	..	N.A.
Women's suits	1000ps.	166	..	118	..	118

Source : Economic Times, 29 August 1987 and Report of the Ambassador's committee on the Single European Market 1992 and India.

From these tables, it has been observed that the GSP coverage given to India's exports of textiles and clothing to the EC cover only low tariff imports. An average tariff rate for the exports of textiles and clothing to the EC is 10.5 per cent . For India, lower tariff exports (among the high tariff exports) are covered under the EC's GSP scheme. India's exports benefit from the EC's GSP coverage are only 9.2 per cent of its total exports to the EC. This would not be enough to accentuate India's textile and clothing exports to the SEM. Moreover, only few products (in number terms) are covered under the EC's GSP coverage. In recent years, the GSP quota limits for these exports have not been lowered down in the EC.(see table 4.9). In the SEM, the GSP quota limits for these exports to the EC would further be lowered down to safeguard the high cost textile and clothing industries of the EC. There is no doubt, that the export structures of these products have been expanded through the EC's GSP scheme. However, at the same time, the exports of other products have been disturbed in the EC.

From the above mentioned discussion, a list of items have been identified in the EC showing differing movements of intra-EC share in total EC import and the share of India in extra-EC import. This has been shown in table 4.10. It also shows the 'Revealed Comparative Advantage' (RCA) of India's

Table 4.11

LIST OF ITEMS SHOWING DIFFERING MOVEMETS OF SHARE OF INTRA-EC TRADE IN TOTAL EC IMPORT AND SHARE OF INDIA IN EXTRA-EC IMPORT

COMMODITIES	1986 RCA	1986 RANK	1988 RCA	1988 RANK
A. Items showing complementary in the movements of the two shares				
(i) Improved together				
Silk	2.42	26	5.17	17
Waste material from Textiles	0.07	64	0.74	45
(ii) Fluctuated in the same direction				
Cotton	1.61	33	0.44	54
Floor coverings, etc.	21.03	6	17.97	5
B. Items showing competetivity in the two shares				
Cotton fabrics woven	7.21	13	10.54	8
Non-cotton fabrics	0.64	44	1.10	35
Tulle,lace & embroidery	9.31	11	10.05	10
Textile articles	6.38	16	7.98	13
C. Intra-EC share declined, India/extra-EC share fluctuated				
Synthetic and regenerated fibres	0.13	59	0.37	55
Textile yarn & thread	1.86	29	3.64	21
Made-up articles	2.17	27	1.45	32
Women's outwear (not knit)	10.83	9	2.15	26
Knitted out wear (non-elastic)	1.74	32	2.97	22

O.P.Sharma,"Europe 1992: Implications for India's Exports", Foreign Trade Review,vol.xxvi,nos.1&2, April-September 1991.

textile and clothing exports in the EC.

From this table, it has been said that the movements of India's exports of textiles and clothing to the EC have not been accelerated impressively. Furthermore, the RCA is also in relative decline in the EC.

In the SEM, India's exports of textiles and clothing to the EC would be restricted by tariffs, import quotas and anti-dumping policies. There are two reasons for the EC for restricting the imports from the third countries. (i) The declining nature of an employment in the EC's textile and clothing industries. In the EC, the labourers have started moving from the labour-intensive to the capital intensive sectors. In the last two decades, the employment in these sectors, has declined from 4.1 million to 2 million or by 51 per cent. However, the reason for the displacement of labour runs as follows. The productivity charges have been responsible for more jobs lost than due to low priced imports.[44] One study tried to investigate the causes of jobs lost in six EC countries and found that productivity increases had a negative impact which was four times the

[44] Sri Rama Khanna, International Trade in Textiles : MFA Quotas and a Developing Exporting Country (New Delhi, 1991), p.32.

impact of net import penetration.[45]

(ii) Another reason for the imposition of protectionist measures in the EC against the imports from the third countries is its high cost industries of the South. Unlike the other industries, textile and clothing industries are not profitable in the EC. Moreover, the development of these sectors is mainly based on the development of the agricultural sector. The differing nature of an agrarian structure of the member countries induces the differing nature of the unequal economic structure of the member countries of the EC, there by increases the production costs widely among the Community members. The production costs of the commodities in the EC remain higher than those of the third countries. As a consequence, imported commodities find a place in the SEM. The low cost import of commodities from the third countries to the SEM would be restricted in the SEM by the imposition of anti-dumping policies. The definition of anti-dumping code is defined in Article VI, Section 1 of the 'General Agreement on Tariffs and Trade' (GATT)[46]. It is defined as the sale of imported merchandise at less than the normal value of the product.

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[45] Ibid., p.32.

[46] See Richard D. Boltuck, " An Economic Analysis of Dumping", Journal of World Trade, 21(5), October 1987, pp.45-54.

The arguments advanced in favour of the imposition of anti-dumping policies are based on the assumption that the low cost imports disrupt the domestic market, thereby stimulates the transfer of labour from the textile and clothing industries to the capital intensive sectors.

The analysis of anti-dumping policies in the EC should be analyzed with the economic effects of quantitative restriction. In the EC restrictions are announced with the purpose of increasing the costs of imported commodities. In this situation, anti-dumping policies are also imposed against the imports from the third countries. This results in an economic inefficiency of the system. The fall in an efficiency again reflects in an intesification of protectionist policies against the imports from the countries.

India's exports of textiles and clothing to the EC are also subjected to the anti-dumping policies. These arguments show that the EC is trying to close its market against the imports from the third countries, despite the adverse consequences of the protectionist policies. Table 4.12 shows the rate openness of the EC for the imports from the third countries. In the EC, the rate of openness for India's textile and clothing exports varies from 5 per cent to 18 per cent of apparent consumption of the EC countries.

TABLE 4.10 EEC'S OPENNESS FOR IMPORTS FROM DEVELOPING COUNTRIES

(Trade as percentage of apparent consumption)

Product Group	Year	Openness
	1982-83	4.23
Textiles	1984-85	4.61
	1986-87	4.60
	1982-83	14.34
Clothing	1984-85	16.08
	1986-87	18.09

Source : UNCTAD, Hand Book of International Trade and Development Statistics, 1989.

The rate of openness of the SEM would be restricted with the rise in the protectionist policies. The protectionist policies are contrary in nature to each other. The imposition of tariff may lead to a deficit in the balance of payments, instead of a surplus[47]. Hence, the imposition of tariffs results in an adverse effects. Moreover, it is clear that no tariff may exist that would yield a solution superior to that under free trade[48]. The imposition of import quotas and anti-dumping policies restricts the imports from third countries and makes the domestic industries to operate freely within the domestic market. As a consequence, import restricting policies result in an industrial inefficiency and the backwardness of its international competitiveness[49]. The economic inefficiency of a system again reflects in an intensification of protectionist policies against the third countries.

From the above mentioned discussion, it is concluded that India's exports of textiles and clothing to the EC would be affected in the SEM. There would be both trade creation and trade diversion effects in the SEM. However, the benefits

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[47]Harry G. Johnson, " Tariff, and Balance of Payments: Comment", Journal of Economics, vol.72, no.4, November 1958, pp.301-302.

[48]See Jagdish Bhagwati and V.K. Ramaswami, "Domestic Distortions, Tariffs and the Theory of Optimum Subsidy", Journal of Political Economy (Illinois, Chicago), vol.71(1), February (63), pp.44-50.

[49]James E. Anderson, The Relative Inefficiency of Quotas, (Cambridge, 1988), P.1.

arising out of trade creation would be curtailed by the trade diversion losses. There would be an increase in India's exports of textiles and clothing to the SEM, but this rate of increase would not be enough to curb the trade diversion losses. Other subsequent effects of the SEM are also likely to take place in the EC. The cost-reduction effect of the SEM would result in either trade modification or trade suppression effect. Therefore, the formation of the SEM restricts India's exports of textiles and clothing to the EC, thereby restricting India's share in international trade. This would increase India's trade deficit with the EC. Hence, the formation of the SEM would adversely affect the employment in India's textile and clothing industries. The labourers are expected to displace from the labour intensive to capital intensive sectors. As a result, real investment in these sectors are expected to decline. Hence, the formation of the SEM results in trade diversion effect, which further results in an 'investment diversion'. The investment diversion affect the process of industrialization and mechanization in these sectors. This would further weaken India's textile and clothing industries, its industrial efficiency and international competitiveness.

CHAPTER V

CONCLUSION

Agriculture and agro-based sectors are the sources of capital in India. They are also the factor in the socio-economic development. These sectors are also the labour intensive, with more than 70 per cent of India's population is engaged, directly or indirectly, in these sectors. Hence, whatever the changes take place in these sectors affect its working population and stimulates them to displace from agricultural and agro-based sector to capital intensive sectors.

Risks and uncertainties are characteristics of traditional agriculture in India. Since the dependence on agriculture is more in India, the risks and uncertainties, that arise in its agricultural sector distort the whole economic system. Hence, to sustain economic development, these sectors should be protected from external vibrations.

The relationship between population growth and food supplies is unique in less developed economies. This is particularly true for India, where an explosion of population compels the supplying nature of the agricultural and agro-based sectors. The consumption of food is high in India. Much of its products produced domestically are consumed by its population. Despite the higher consumption rate, agricultural and agro-based sectors play an important role in India's foreign trade and external earnings. This ensures the importance of agricultural and agro-based sectors in India's socio-economic development. In India, the export earnings from the agricultural and agro-based sectors form a major proportion of the country's total export earnings. The export of these products have helped India to earn valuable foreign exchange for their industrialization and economic growth. However, the export prices and earnings from the agricultural and agro-based products are liable to substantial fluctuations due to the combination of factors affecting both supply and demand.

The problems of exports instability in India's agricultural and agro-based sectors are exacerbated by the restricted trade policies of the SEM, against India's exports of agriculture and agro-based products. India's exports of agriculture and agro-based products require commodity price stabilisation and the removal of trade barriers. India's trade experience with the EC shows that, India is at the lower end in extra-EC trade. The past experience of India's trade with the EC reveals that the import restricting policies have been successfully used in the EC against India's exports of agriculture and agro-based products.

The price discriminating nature of the EC's CAP increases the surplus of production, thereby reduces the international commodity prices considerably. This also forces India to lower down its marginal profits in international commodity transaction. Hence, the CAP of the EC not only distorts India's bilateral trade with the EC, but also distorts its international trade by reducing the demand for its products in other markets. Moreover the government support policies of the EC increase the dependence of the European farmers. This support policies of the EC states have neither improved the competitiveness of the European farmers nor increased the farm efficiency in the EC. Rather, it increased the regional disparities among the member countries of the EC. The regional disparity in the EC has resulted in an unequal developments and regional income differences among the member countries. In this situation, the government support prices given to the European farmers have resulted in farm inefficiency and incompetence. The farm inefficiency and incompetence makes the protectionist policies permanent in the EC.

In the EC, the imposition of import quotas against the imports of agriculture and agro-based products from India has restricted the imports from India. However any import restricting measure will mean the degradation of its own industrial efficiency and international competitiveness. This again reflects in an intensification of protectionist measures against the imports from India. In addition to quota restrictions, tariffs have also been imposed against the imports from India. They have also acquired the restrictive nature of the imports from India.

International trade is based on comparative advantage in costs and production. The comparative advantage in production is based on factor endowments and the comparative costs advantage depends on comparative advantage in production. The imposition of anti-dumping policies try to sideline these elementary principles of international trade. According to the supportive arguments of the price support measures of the EC, subsidies should increase the competitiveness of the European farms and its production. Naturally, the increase in production should reduce the international commodity prices. Finally, the market should be opened for the third countries. However in the EC, the subsidies result in an increased production without an increase in the European farm efficiency. This increased production has reduced the international commodity prices, instead of reducing the domestic market prices. Despite all these factors, the EC is trying to protect its inefficient sectors against the low cost imports from India, with the fear that the consumer demand in the EC would be shifted from the domestic sources to the low cost imports from India. Hence, the anti-dumping policies of the EC should be viewed not only with its injurious nature, but also with the protectionist nature of other policies.

From these arguments, it is proved that the protectionist policies of the EC imposed against India's exports of agriculture and agro-based products are aimed at discriminating India's exports to the EC. This results in an imperfect competition in trade between the EC and India. The imperfect competition is the ingredient of the SEM, under which India is expected to loose from trade.

The findings of this study are summarised as follows:

(1) India's trade experience with the EC shows that the protectionist policies remain higher in the EC.

(2) In the EC, protectionist policies are in the form of (i) subsidies; (ii) import quotas; (iii) tariffs; and (iv) anti-dumping policies.

(3) The protectionist policies of the EC restrict India's exports of agricultural and agro-based products to the EC.

(4) The subsidies given to the European farmers through the CAP increases the agricultural production in the EC; thereby restricts imports from India.

(5) The increase in production increases the world supply of agricultural commodities, thereby decreases the demand for it. This distorts the equillibrium between the supply and demand.

(6) The distortion in equilibrium between supply and demand, reduces the international commodity prices for agricultural products.

(7) A sharp decline in international commodity prices affects India's exports of agricultural commodities to the EC.

(8) The subsidies given to the European farmers affect the efficiency and international competitiveness of the European farms. This calls for import restricting policies in the form of tariffs and import quotas

against India's exports of agricultural products to the SEM.

(9) The decline in an industrial efficiency and international competitiveness in the EC's agricultural sector reflects in its agro-based sectors also. This forces the EC to impose import restricting measures against India's exports of agro-based products to the SEM.

(10) The decline in an industrial efficiency and international competitiveness makes the protectionist policies permanent in the SEM.

(11) The anti-dumping policies imposed against India's exports of textiles and clothing are aimed at protecting the inefficient, high cost domestic industries from the efficient, low cost imports from India.

(12) The income elasticities for India's exports of agriculture and agro-based products are low; hence, the 'revealed comparative advantage' is also low in the SEM.

(13) In the SEM, there are substitutes for India's exports of agriculture and agro-based products. This limits India's share in extra-EC trade.

(14) The transportation costs are higher for India's exports of agriculture and agro-based products to the SEM. This offsets India's comparative advantage in production .

(15) In the SEM, the trade losses arising out of the trade diversion, the trade modification, the trade suppression, and the cost-reduction effects are higher than the trade gains arising out of the trade creation effect.

(16) As a consequence of trade diversion, an investment diversion also takes place.

(17) The increase in cost-reduction effect also increases the trade diversion effect. This would adversely affect India's exports to the SEM.

(18) The distortion in India's exports of agriculture and agro-based products, affects its 'terms of trade'.

(19) In the SEM, India faces stiff competition from (i) the countries of the EFTA; (ii) the countries of Central and Eastern Europe; and (iii) the associated members of the EC.

(20) As a result of an increased competition , India is forced to reduce its marginal profits in the SEM.

(21) The restrictions for India's exports and a reduction in marginal profits in the SEM, increases India's trade deficit with the EC.

(22) The decline in India's export earnings reflects on its domestic industries of agriculture and agro-based sectors, which are highly sensitive to external oscillations.

(23) The decline in India's export earnings of agriculture and agro-based sectors stimulates the labourers engaged in these sectors to displace from the agriculture and agro-based sectors to the capital intensive sectors.

(24) The fall in export earnings reduces the importation of capital goods, which are necessary for the production of manufactured goods. As a result, India's economic development would be affected. This would result in stagnation in India's socio-economic development.

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