5-1-1976

The common market for south Asian countries

Parashar C. Vora
Atlanta University

Follow this and additional works at: http://digitalcommons.auctr.edu/dissertations

Part of the Economics Commons

Recommended Citation

This Thesis is brought to you for free and open access by DigitalCommons@Robert W. Woodruff Library, Atlanta University Center. It has been accepted for inclusion in ETD Collection for AUC Robert W. Woodruff Library by an authorized administrator of DigitalCommons@Robert W. Woodruff Library, Atlanta University Center. For more information, please contact cwiseman@auctr.edu.
THE COMMON MARKET FOR SOUTH ASIAN COUNTRIES

A THESIS
SUBMITTED TO THE FACULTY OF ATLANTA UNIVERSITY
IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR
THE DEGREE OF MASTER OF ARTS

By
PARASHAR C. VORA

THE DEPARTMENT OF ECONOMICS

ATLANTA, GEORGIA

May 1976
In spite of massive foreign economic aid to countries in South Asia and their efforts to improve their export earnings through export subsidies, there persists an uncertainty regarding the quantity of annual aid. This, together with instability in their export earnings, has affected the economic performance of the countries in the region. Even the protective tariff policies of these countries act as an obstacle in utilizing available technology and resources efficiently. The United Nations Conferences on Trade and Development emphasize on increased trade among developing countries. An establishment of a common market or any other form of economic groupings will encourage trade and economic co-operation between the countries of South Asia in particular and developing countries in general.
Economists like Tinbergen has visualized a possibility of an integrated market between countries of Indian subcontinent. This study attempts to explore such a possibility. The study, being explorative, is certainly conjunctural in nature. Yet an attempt has been made to demonstrate that if a regional economic grouping is worked out between countries of South Asia, it will through trade creation and trade diverting effects, succeed in realizing the following:

1. The area as a whole, through trade among countries of the area, is likely to attain self-sufficiency in foodgrains. This will, in itself, impart momentum to economic development in the region.

2. The extended size of the market will provide a better opportunity for utilizing modern methods of production. The exploitation of complimentarities in industrial production will result in a better utilization of available irreproducible resources of the region. Such complimentarities could be explored in petroleum refining, petro-chemical, fertilizer production, packaging, and agriculture.

3. Such an effort demands an intensive study of the existing policies. This should be undertaken through the establishment of regional planning and regional trade and tariff commissions.

4. This study emphasizes that a removal of tariffs, on trade between these countries and acceptance of a common agreed tariff on imports from non-member
countries, will act as an incentive for rapid agricultural and industrial development in the region.
## LIST OF TABLES

<table>
<thead>
<tr>
<th>No.</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Gross Domestic Product By Activity (1969-1972)</td>
<td>62</td>
</tr>
<tr>
<td>2</td>
<td>Burma: Imports and Exports as Percentage of GNP: (1961-1971)</td>
<td>70</td>
</tr>
<tr>
<td>3</td>
<td>India: Imports and Exports as Percentage of GNP: (1961-1971)</td>
<td>71</td>
</tr>
<tr>
<td>4</td>
<td>Iran: Imports and Exports as Percentage of GNP: (1961-1971)</td>
<td>72</td>
</tr>
<tr>
<td>5</td>
<td>Pakistan: Imports and Exports as Percentage of GNP: (1961-1971)</td>
<td>73</td>
</tr>
<tr>
<td>6</td>
<td>Sri Lanka: Imports and Exports as Percentage of GNP: (1961-1971)</td>
<td>74</td>
</tr>
<tr>
<td>7</td>
<td>Population of South Asian Countries, (Mid-Year, in Million): (1964-1972)</td>
<td>75</td>
</tr>
<tr>
<td>8</td>
<td>Bangladesh: Exports and Imports to South Asian Countries: (1970-1974)</td>
<td>82</td>
</tr>
<tr>
<td>9</td>
<td>Burma: Exports and Imports to South Asian Countries: (1970-1974)</td>
<td>83</td>
</tr>
<tr>
<td>10</td>
<td>India: Exports and Imports to South Asian Countries: (1970-1974)</td>
<td>84</td>
</tr>
<tr>
<td>11</td>
<td>Iran: Exports and Imports to South Asian Countries: (1970-1974)</td>
<td>85</td>
</tr>
<tr>
<td>12</td>
<td>Pakistan: Exports and Imports to South Asian Countries: (1970-1974)</td>
<td>86</td>
</tr>
<tr>
<td>13</td>
<td>Sri Lanka: Exports and Imports to South Asian Countries: (1970-1974)</td>
<td>87</td>
</tr>
<tr>
<td>14</td>
<td>Per Capita GNP: (U. S. Dollars)</td>
<td>90</td>
</tr>
<tr>
<td>15</td>
<td>Production and Consumption of Foodgrains: (Mill. Tonnes)</td>
<td>92</td>
</tr>
<tr>
<td>16</td>
<td>Production and Consumption of Tea: (Thousand Matric tonnes)</td>
<td>93</td>
</tr>
</tbody>
</table>
17. Production and Consumption of Sugar: (Thousand Metric tonnes) ......................................................... 94

18. Income Elasticity of Imports .................................................. 97
CHAPTER I

INTRODUCTION

The Scope and Method:

The purpose of this paper is to explore the possibility of an alternative framework of economic policy which can expedite economic development in South Asia. The economic development based on trade and foreign aid has contributed to economic development in countries of this region. But instability in their export earnings in the wake of changing trade pattern in the world trade and uncertainty regarding the size of annual aid has affected the performance of these economies. In the subsequent section a general view of this is presented. Secondly, the efforts of developing countries to increase trade between themselves have succeeded in agriculture and not in industry. So if the establishment of a common market for South Asian countries is to be considered as an alternative to existing policies of tariffs and trade, we have to rely on the experience of these countries also.

The methodology followed here is principally descriptive in nature because of lack of any work of this nature for the region as a whole. Secondly, the availability of information
is scanty for some of these economies and thirdly, the experiences of less developed countries indicate that the regional groupings have succeeded in agriculture and not in industry. The economic malaise of the region under study is mainly due to slow agriculture development. A rapid growth in agricultural sector can then support the development of a viable industrial structure in these economies.

The development programmes, in countries of South Asia, give considerable importance to trade and foreign aid. It will be considered worthwhile to take a bird's eyevieview of the trade and aid situation in the following section.

**Trade and Aid; A General View:**

Since Adam Smith wrote that international trade can raise the general level of prosperity of a country, economists have attempted to show that the economic development of a country could be enhanced through trade. This importance to trade in a development process of a country has been labelled, by some economists, as 'new mercantilism'. The industrial revolution of the late eighteenth and early nineteenth centuries brought in its wake a scenario for markets and colonialism and the development of the theory of protection in the field of the theory of international trade. These developments were inspired not only by the need to protect markets for the manufactured goods but also for maintaining a continuous flow of raw materials needed for the working of growing manufacturing industries of the western Europe. This tendency was noticed
in the world trade of that time, in which Britain continued to export manufactured goods to its colonies and the latter exported raw materials to the former. This trend in the world trade is explained as 'N-L pattern', meaning thereby natural resources including land, fertility and other geographic factors and labour in the sense of human time availability respectively by Kiyoshi Kojima. In an article, he wrote,

"The world trade in the post war years has been characterized by a decline in the importance of 'vertical trade'-the exchange of foodstuffs and raw materials for manufactured goods, and the growth in the importance of 'horizontal trade'-the exchange of manufactured goods amongst advanced industrial countries."

This means that since second World War the trade between economies with similar production structures have grown considerably.

This development in world trade has placed underdeveloped countries, producing primary products they provided to industrial countries in the past, in a state of economic isolation. This has its own economic consequences such as less rapid economic growth due to lack of physical capital, the development of which was purposefully neglected rather than overlooked by the advanced industrialized countries of to-day, especially Britain which dominated them in the past. These countries never desired to duplicate their production structures in their colonies so that their prosperity may remain unaffected. This was done in the name of free market and free trade which

---

resulted in degrading some countries into a state of abject poverty and destitution of masses.

Since second World War, the industrialized countries of Europe have lost and are gradually losing control over their colonies politically but economically they control them through surplus capital which they lend and technology. Their prosperity and economic stability depend mainly on providing less developed countries -- countries they neglected in the past -- with capital and technology. It is, in this connection, Prof. Gunnar Myrdal wrote,

"As in the very early stages of the development of the welfare state in the western nations, so now in the world at large we can witness the spread of the idea that aid to poor nations constitute a sort of insurance against revolt on their part. For this reason aid would be in the interest of the rich nations." 2

Here Myrdal is explicit in stating the fact that western nations are avoiding economic crisis at home through extending aid. It is also implied that a reduction in aid to less developed countries will not only affect the viability of these economies but will create a situation of crisis in the advanced economies. This can be kept in abeyance only through more aid, which is the reason underlying in giving more aid in spite of differences between nations, so as to maintain the present state of dependance by allowing them to buy more and more of goods and services. Similar view is presented by Mrs. Robinson, when she wrote that the aid has succeeded in helping development

in specific cases but in most it has resulted in increasing dependence on aid which is hampering growth by consuming a larger and larger portion of aid to pay for the past aid. Thus in the post war years foreign aid is extended not out of pure benevolence or magnanimity on the part of developed countries but out of the economic necessity to keep their industries running proving thereby that aid and grants and/or technical collaborations are advantageous, mainly, to the donors in the following ways:

(1) This will provide markets for their industries and also jobs for a period of time;

(2) This will help their economies to operate at a level higher than would have operated. This helps them to avoid what Myrdal calls 'revolt on their part'.

(3) Even the attempts to encourage multilateral trade through tariff reduction and liberalization of quantitative restrictions are beneficial to the advanced industrial countries, in the sense, that

a. they have a competitive edge over newly industrializing countries in the world market,

b. the newly industrializing countries, in order to industrialize rapidly have pursued the policy of protection, which has diversified their economic structures as well as demand. This has also resulted in compelling the domestic consumers to pay a price higher than they would have paid

-5-
in absence of protection, thereby affecting their welfare.

c. the lack of strategic raw materials and markets for their manufactured goods has resulted in generating excess capacity in growing industrial sector in developing countries, thereby making higher cost of production imminent for them. This compelled these economies to pursue compulsorily a policy of export promotion through export subsidy, to earn foreign exchange, in the wake of inflation at home.

The existence of excess capacity can be blamed on many factors but is also due to a lack of co-operation and understanding among underdeveloped countries. This has resulted in duplicating their production structures in the name either of economic development or self sufficiency or national prestige. This duplication, to a greater extent, is made possible only because of foreign aid. Thus the foreign aid is providing an outlet for industries of the developed countries while on the other hand it has resulted in creating that production structure in the recipient countries which is burdensome on them. The aid has to some extent contributed in diversifying these economies but has also created excess capacity—a waste of resources at a very high price. As against these, the advanced industrialized countries, having fully realized the implications of the development efforts of developing countries,
have decided to embark upon integrating their economies, so as to avoid waste and unemployment by specialization in production of commodities in which they are better equipped. The formation of European Common Market and European Free Trade area are examples of it.

The establishment of European Common Market is a step in the direction of realizing the dream of united Europe dreamed by many European thinkers in the past as well as that of the goal put forward by European thinkers on the conclusion of the Second World War. They realized the fact that the future wars from the soil of Europe could only be averted by uniting countries of Europe. Same is true in case of Indian Subcontinent. War could be averted only through united efforts on the part of countries in that area. The countries in this area have special economic problems of greater urgency than waging wars among themselves. These problems are spearheaded by the problem of poverty, which has been described by Ronald Segal as a luxury for any westerner; the only alternative to the poverty in that area is death. In the face of poverty and destitution experienced by masses in that area, war is not only wasteful but absurd. Though absurd and futile, wars are waged in that area and they have been fought because of military wares made available to them by foreign aid. Here it should be mentioned again that "aid" has generated forces of "anti-aid" by fostering the growth of defense forces. The wars in that part of the world could be averted, if and only if, countries there are unitedly determined to get out of
shackles of an age old policy of "divide and rule" through understanding and co-operation which will help them to put their scarce resources to better economic uses.

One of the ways to do this is to establish a Common Market, thereby integrating their economies on the basis of what Sir Harrod called "agreed specialization" or "preferential trading" by Harry Johnson. The process of development, thus initiated, will not only change input mix and output composition but will also provide benefits of large scale production through expansion of markets, thereby reducing costs and increasing consumption and a higher level of Gross National Product. Here, it should be remembered that it is a limitation of the development economics that it overlooks the distributive aspects of G.N.P. It is this indifference towards the distribution of national income that has become an important cause for economic and political turmoil not only in developing countries but also in economically advanced countries. What is true of countries is also true between countries in their trading capacities in the world market. This can be improved, if not corrected totally, by increasing competitive strength, not through foreign aid and collaborations which has resulted in creating oligopolistic competitive structures through multinational corporations in the world trade, but by grouping of countries on certain principles.

The trade relations can be of considerable help only if parties in trade are of equal bargaining strength. In the face of growing multi-national corporations and their
activities, the countries in which the corporate structure is in its infancy is always in conditions of disadvantage in a competitive market. This handicap can be overcome by forming a common market which will increase competitive strength of these economies, by creating either a monopolistic or oligopolistic structure in production. This again opens up an interesting field of theoretical inquiry into the efficacy of the model of perfect competition as a tool in the analysis of international trade. In short, the formation of a common market between groups of countries will necessarily improve the bargaining strength of less developed countries. This can be formed on the basis of a commodity or commodities as has been demonstrated by the formation of OPEC, in last couple of years or by an agreement between countries for preferential treatment to each other's products in trade. The European Common Market is an example of the latter.

The modern methods of production in industrialized countries have created multi-national corporations for harnessing the benefits of large scale production. This has sometimes resulted in the expansion of market for products of industrialized countries. If less developed countries are industrializing by using contemporary methods of production, it is in their interest to expand market for their products, products of new industries, by regional or sub-regional groupings to compete effectively with advanced countries in the international market. Such efforts will reduce reliance on foreign aid and will result in better utilization of
their resources at a time when conservation of resources is considered important.

In recent years some developing countries of Latin America, Central America and East Africa have attempted to establish an economic grouping between themselves. A review of their efforts, its common characteristics will be considered an appropriate guide when such an idea is considered for South Asian countries.

**Review of Experiences in Economic Integration:**

Since 1959, interest in economic integration has been increasing and many developing countries have established either the common market or free trade areas by entering into agreements aimed at immediate liberalization of trade and gradual removal of all barriers to trade with member countries. They have also agreed to co-ordinate their policies regarding trade with nonmember countries. The ultimate aim for the establishment of such a union is to integrate their economies and to reap the benefits of large scale production through co-operation in trade and co-ordination of their economic policies and other development efforts. Because of the nature of the study the attention is focused mainly on developing countries, while the experiences of developed market economies and socialist bloc countries, in this respect, are left out of consideration.

Since the beginning of the last decade common markets or free trade areas have been formed between countries of
Central America, Latin America, East Africa, Caribbean Islands and Asia. The economic unions between countries of Central America, Latin America, Caribbean Islands are COMMON MARKET FOR CENTRAL AMERICAN COUNTRIES (CACM), LATIN AMERICAN FREE TRADE AREA (LAFTA), CARIBBEAN ISLANDS FREE TRADE AREA (CARIFTA), and EAST AFRICAN COMMUNITY (EAC) respectively. Such unions in Asia are REGIONAL CO-OPERATION FOR DEVELOPMENT (RCD) and ASSOCIATION OF SOUTHEAST ASIAN NATIONS (ASEAN). These developing countries have established either common markets or free trade areas with similar aims of trade liberalization, so it will not be out of place to summarize an agreement signed by the countries of one of these groups. Here the contents of the agreement signed by Central American Countries is summarized. It is as follows.

With the treaty signed at MANAGUA on December 13, 1960, the Central American Common Market (CACM) came into existence. The signatories to this general treaty were Salvador, Guatemala, Costa Rica, Honduras and Nicaragua. The treaty of Managua constitutes a basic charger for the integration of these economies. The treaty establishes:

(a) The principle of immediate free trade in most products;

(b) Restrictions on trade in certain items by means of special regimes; involving progressive reduction of customs tariffs, import quotas, export and import controls; conclusion of agreements to regulate the internal movement of/or foreign trade in certain products; and maintenance of restrictions
imposed on trade in goods which are the subject of treasury monopoly;

(c) For a limited number of products, the treaty provides for the payment of import and export duties for an indefinite period or for the control of intra-regional trade.

The treaties between other developing countries reflected more or less the same provisions so instead of summarizing them individually, their achievements in the field of agriculture and industry are briefly stated in what follows.

In agriculture, the policy of free trade within the union has increased trade in agricultural commodities. In case of Central American Common Market, the inter-regional trade between 1960-1967 grew by 187.7 percent while the imports from outside the region increased by 38 percent. A similar trend emerges in case of Latin American Free Trade Area and East African Community.

In case of industry, their efforts did not meet with much success because of the problems regarding the location of industries and narrow nationalistic approach of the participating member countries.

In the subsequent pages an attempt has been made to review the concepts and theory of the customs unions. An attempt is also made to summarize empirical work on economic integration by some economists. This constitutes the subject matter of the next chapter.

Chapter 3, explores the possibilities of the formation of the common market for South Asian Countries. Here, an attempt
is made to explain the meaning of South Asia and apply different criteria for the establishment of the Common Market. This study indicates that the formation of such a union will make the region self-sufficient in its primary requirements such as food. The exploitation of necessary industrial complementarities could make agriculture viable in the region and this will provide necessary momentum for industrialization.

In the last chapter the observations of this study are summarized.
Meaning:

Any discussion pertaining to either customs union or a common market or an economic free trade area -- these being different forms of economic integration -- demands at the outset a clarification of the term "economic integration", a term that does not have a clearcut meaning in economics. Some interpreted it to include different forms of international co-operation, while others include social integration. Though the latter is an end result of it, economists have attempted to clarify its meaning as is considered appropriate for economic analysis. On this point Prof. Bela Balassa wrote,

"Under this heading and the argument has also been advanced that mere existence of trade relations between independent economies is a sign of integration."¹

A similar view is advanced by Geherels and Johnston. They wrote

"The term 'economic integration' is often used, and not unreasonably, simply to denote the presence of important links between a group of countries,

resulting from a considerable, though not unrestricted flow of trade."²

In this sense economic integration does exist between countries of South Asia like India, Pakistan, Burma, Bangladesh, Ceylon (Sri Lanka) and Iran, except between India and Pakistan in recent past. Since 1972, attempts are being made to reestablish trading relations between these two countries.

These kind of relations can't be considered economic integration because of payment problems and the existence of tariff and non-tariff barriers obstructing the flow of goods and services between trading countries. In the case of Europe's North Atlantic Community, according to Geherels and Johnston, integration does exist. This was the result of what they called

"Obligations entered into and frank discussion of trade and payments problems with OEEC, have unquestionably brought about a higher level of trade between member countries than could have been achieved without this type of collective pressure to remove or refrain from imposing restrictions."³

Amongst the South Asian countries efforts are being made towards trade liberalization without much success. These economists do not consider mere existence of trade relations as sign of economic integration. The issue here is not that of


³Geherels and Johnston, ibid, p. 277.
symptom but of actual integration of economies when group of countries desire to integrate their economies. What path should they follow?

The existence of trade relations, with tariffs -- high or low -- and quotas, imposed with some economic considerations to protect a country's industry or industries, to raise revenue and reduce demand for importables and diversify it for domestic goods and services, has not only constrained the development of their economies but have distorted their cost-price structures. The existence of such restrictions, in their present forms, in itself do not justify them being labelled as economic integration. If existing trade relations are not considered an example of economic integration, what then is economic integration?

From this discussion it can be inferred that economic integration is definitely something more than mere trade relationship between countries. An economic integration then is defined as

"A process and state of affairs. Regarded as a process it encompasses measures designed to abolish discrimination between economic units belonging to different national states; viewed as a state of affairs, it can be represented by the absence of various forms of discrimination between national economies."\(^4\)

This definition of economic integration clearly outlines the issues involved in establishing an integrated market in the form of a common market. This definition also makes it clear

that an economic integration does mean pursuing certain economic policies, making it thereby a subject matter of economic policy. Prof. Jan Tinbergen has defined economic integration from the point of optimum economic policy, as

"the creation of most desirable structure of international economy, removing artificial hinderances to the optimal operation and introducing all desirable elements of co-ordination and unification."\(^5\)

These definitions of economic integration by Balassa and Tinbergen do emphasize deliberate actions on the part of governments desiring to form a common market or an economic union. These can be seen from the following:

(a) as a process, when an integration is attempted, the member countries should take policy actions to abolish economic discrimination prevailing between different economic units of member countries of an economic union; meaning thereby that each member country has to consider and implement those measures -- agricultural, industrial, trade, monetary and fiscal -- that will reduce and gradually eliminating existing discrimination between producing and consuming units.

This, in turn, means that the Governments of the member countries should pursue the policies encouraging free flow of goods and services between member countries of the union. This implies that countries forming an economic union have to follow that economic policy of "internal free trade and external protection" more fanatically and a context broader than was followed by the United States in the past.

---

\(^5\)Jan Tinbergen: *International Economic Integration*, (Amsterdam, Elsevier, ), Chp. 6, p. 95.
(b) Tinbergen has attempted to go a step further than mere pursuance of policies by aiming at two major aspects of economic integration. These aspects as deduced from his definition, are

1. creation of the most desirable structure of international economy, which could be interpreted to mean that in the international trade the bargaining strength of both the parties -- buyers and sellers -- should be, ideally speaking, equal and economic disparities, if any, should be at the lowest possible level. What is true for buyers and sellers is also true with respect to countries in the trade also. This is necessary to avoid the repetition of the historical process. This is exactly what is implied in what Mrs. Joan Robinson wrote,

"Furthermore, the models imply trade between countries of equal weight and at the same level of development. This rules out imperialism and the use of power to foster economic advantage."6

The history provides us with abundance of examples to support what happened when trade between unequal partners took place.

2. Introducing all desirable elements of co-ordination and unification, thereby implying that the trade between developing and developed economies is not a case of trade between countries of equal economic strength. The creation of the most desirable structure of international economy does mean either that the trade between countries of

---

more or less same level of development should be encouraged
or the countries of the same level of development should make
common efforts to increase trade among themselves and to
bargain with the developed countries which are more or less
united through common market or some form of other agreements,
from a position of strength. Even the socialist countries are
united under COMCON. This indicates very clearly that
underdeveloped or developing countries, their number being large,
are competing for the market share of countries of the area
which are better organized. The markets of developing countries
are limited for their own use because of the existence of
tariffs and quantitative restrictions on trade between them.
If the former countries want to realize benefits of trade for
their development, they have to be better organized and
encourage trade amongst themselves in order to harness
benefits of modern technology through what Sir Harrod described
as "agreed specialization". The organization of developing
countries on a regional or sub-regional basis, also, opens
up an interesting possibility for theoreticians to consider
whether the theoretical tools framed around principles of
perfect competition are appropriate or not.

Tinbergen has also made explicit that any policy aiming
at the creation of the most desirable structure of international
economy does involve not only co-ordination of efforts but
also unification and harmonization of divergent economic
policies of member or participating countries in the union and
creation altogether of a new pattern of institutions operating
at a level higher than that of the national institutions and lower than that of the world institutions. This means that the regional institutions for the co-ordination of policies be created and secondly, to reallocate the resources and to determine the priorities for the use of the available resources regional planning be encouraged. This also implies that for the better co-ordination of economic policies of the participating countries the concept of national sovereignty needs modification. Thus, through his definition of economic integration, Prof. Tinbergen has clearly set forth the task facing countries intending to form an integrated market.

This discussion also shows that economic integration is definitely something more than mere co-operation in trade. It is in this sense that Geherels and Johnston has defined integration. They defined it to mean co-operation within the framework of a consultative body. They stated explicitly which was implicit in definitions of Balassa and Tinbergen. They have aptly summarized the content of economic integration as follows:

"1. agreement for gradual but complete elimination of tariffs, quotas and exchange controls on trade among member countries;
2. abandonment of the right to restore trade restrictions on a unilateral basis for the duration of agreement, regardless of difficulties that may arise;
3. joint action to deal with problems resulting from the removal of trade barriers within the community and to promote more efficient utilization of the resources of the area;
4. some degree of harmonization of national policies that affect price structure and the allocation of
resources, (e.g. social security and agricultural programmes) and of monetary and fiscal policies; and
5. free, or at least, freer movement of capital and labour." 7

All these mean that a successful working of an integrated market would involve a significant transfer of national sovereignty to regional institutions.

FORMS OF ECONOMIC INTEGRATION

The formation of an economic union or an integrated market between countries takes any one of the following forms. A brief discussion of these will not be considered out of place. The principles underlying all these are the same.

These forms are as follows.

1. A Free Trade Area.
2. A Customs Union.
4. An Economic Union.
5. A Complete Integration.

1. A Free Trade Area: In this form of integration, the tariff and other quantitative restrictions limiting trading activities between member countries are dismantled. In this form, each member country retains its own tariffs against non-member countries. Here the main emphasis of the grouping is on intra area trade and it will probably not extend beyond this.

7Geherels and Johnston, op. cit., p. 277.
2. A Customs Union: The emphasis, in this form of integration is not only on the suppression of discrimination in the field of commodity movements but also on equalization of tariffs on trade with non-member countries. In this form, there is a concerted commercial policy and a common tariffs for the union as a whole. According to Scammell,

"In trade negotiations, the customs union acts as a unit, and some degree of similarity in the economic policies of member countries is implicit in this agreement."\(^8\)

3. A Common Market: The common market pushes forward the customs union principle a step further than commercial policy into the fields of international resource allocation, tax harmonization and labour migration.

"Implicit in the arrangement is the concept of a unified market area, in which there is free movement of products, services and factors of production within what is probably also a geographically integrated regional grouping of nation states."\(^9\)

4. An Economic Union: In the establishment of an economic union, the aim is the fusion of constituent economies and as a prelude to this, it aims, not only to suppress restrictions on movement of commodities, as well as that of factors, but also to harmonize national economic policies in order to remove discrimination resulting from divergent national economic policies.


\(^9\)W. M. Scammell, ibid, p. 190.
5. A Complete Integration: Here the aim is unification of monetary, fiscal, trade, social and countercycli- 

crclinal policies and requires the setting up of a supra-national authority whose decisions are abiding for the member states.

THEORETICAL FRAMEWORK

Tariffs discriminate between commodities and countries. The regional trade groupings aim at removing discriminating tariffs on goods imported from member countries while retaining either individual or common tariffs on trade from non-member countries. This means that the countries forming a customs union or a free trade area or any other types of regional groupings follow a policy of trading by agreed preferences. This is necessary to minimize commodity and country discriminations in the trade between countries. It is in this connection Prof. Lipsey wrote, "The tariff system of any country may discriminate between commodities and/or between countries. The commodity discrimination occurs when different rates of duties are levied on different commodities, while country discrimination occurs when the same commodity is subjected to different rates of duty, the rate varying according to the country of origin." 10

The formation of the customs union or a common market discriminates against imports from non-member countries. Here the tariffs remain against non-member countries and that is why the theory of customs unions is considered as

"a special branch of tariff theory which deals with the effects of geographically discriminatory changes in trade barriers."

The theory of customs unions is concerned with the changes in economic relationships which result from these discriminations, for example, with changes in production and consumption patterns, the terms of trade, the balance of payments and the rate of economic growth.

The theory of customs unions is, mainly, concerned with the study of the effects of the establishment of such a union on the economic welfare of the masses in countries participating in a union. The gains or losses in a country's welfare position may arise from the following:

a. specialization of production according to comparative advantage, which is the basis of the classical theory of international trade,

b. economies of scale,

c. changes in terms of trade,

d. forced changes in efficiency due to increased foreign competition,

e. a change in the rate of economic growth.

According to Lipsey, the theory of customs unions as produced until this day explicitly deals with points (a), (b), and (c), while (e) poses an interesting possibility for investigation and (d) can be assumed away by assuming that production is carried out by processes which are technically

\[11\] R. Lipsey: ibid, p. 261.
efficient. This assumption makes one believe that the difference in the technological efficiency result in the creation of trade between countries. This assumption, though not wrong, has other implications relevant for international trade theory. These implications are as follows;

1. The technological change brought about by automation has created a condition wherein multi-national corporations have become indispensable and they are operating in a way not thought about in the theory. They operate in a way to take advantage of the principle of comparative costs as well as of the existing tariffs for their sole benefits. For this purpose they control multi-national markets both for acquiring necessary raw materials and disposal of finished products so as to guarantee economic viability of the available technology and profits. Thus markets are enlarged and interdependence increased considerably between countries.

2. When countries are using contemporary technology in industrializing their economies, they, too, are required to enlarge markets for their new products as well as for the viability of the technology they are using. This has to be undertaken in the wake of competition from well organized multi-national corporations. Thus the technology as a factor has, on the other hand, created a need for the enlargement of the traditional markets, while on the other it has
generated forces favouring concentration of economic power in the field of world trade. This also proves that technology as a factor does have effects on the trade between countries and some economists like Mainwaring have attempted to analyze international trade as a 'particular problem of the choice of technique.' He also contended, that the trade can exist even if techniques are same and rates of profits vary. This shows that not only technological differences but hosts of other factors are involved in trade between member countries in a union, between member countries and the rest of world and the union and the rest of the world, when a union is formed.

The earlier version of the theory of Customs union has been neatly summarized by Lipsey, in his survey article, in the following words.

"Free trade maximized world welfare; a customs union reduced tariffs and is, therefore, a movement towards free trade; a customs union will, therefore, increase world welfare even if it does not lead to a world welfare maximum."\(^{12}\)

How will this happen was demonstrated first by Viner, followed by Meade, Lipsey, Johnson and others. What follows is a brief summary of their contributions to the theory of the customs union.

\(^{12}\)R. Lipsey, \textit{ibid}, p. 262.
A: VINER'S APPROACH

Haberler, writing in 1943, saw the economic case for customs union as identical with the old classical argument for free trade but its theoretical foundation was laid by Jacob Viner, in his book 'THE CUSTOMS UNION ISSUE'. He explained the formation of a customs union between countries through two effects -- trade creation and trade diversion. These terms, according to Jaroslav Vanek, are

"descriptive of the two important effects that any discriminatory tariff arrangements among a group of countries is likely to have."

The formation of the customs union, according to Viner, results in a change in the national locus of production of goods purchased. It is the net change one of diversion of purchases to lower or higher duty free money cost source of supply, which will determine whether the union increases welfare or not. How this change will effect each participating member country of a union, taking them collectively, the rest of the world and the world as a whole. In order to study the effects of the customs union Viner formulated the concepts of trade creation and trade diversion. In clarifying the


meaning of these concepts he assumed that nominal import duties are of no importance. So when the effective protective duties are removed, two kinds of possible effects will be created. They are as follows:

1. There will be commodities, which a member country will now import from other member countries of the union. These are the commodities which it did not import previously because the price of the domestic protected product was lower than the price at any foreign source plus the duty. This is known as TRADE CREATION and Viner explained it as follows:

"This shift in the locus of production as between the two countries is a shift from high cost to a lower cost point, a shift which the free trader can properly approve, as a step in the right direction, even if universal free trade would divert production to a source with still lower costs." 15

2. With the formation of the customs union, one of the member countries of the union will now import from other member country or countries, those commodities which it previously imported from a third (non-member) country because that was the cheapest possible source of supply even after the inclusion of the duty. Here, in this case the trade is diverted from the low cost point and is a case of TRADE DIVERSION. Viner has summed this up as follows:

"The shift in the locus of production is now not as between the two member countries but as between low cost third country and the other, high cost member country, this is a shift of the type which the protectionists approves but it is not one which the free trader who understands the logic of his own doctrine can properly approve."16

3. There is also a third possibility, which has a considerable relevance for developing countries and is not mentioned explicitly by exponents of International economic integration. Viner has outlined this as a possibility as follows. It may happen that the consumption of a particular commodity may be zero in one of the member countries of the union because the import duty imposed may be so high or prohibitive, but the domestic production of that commodity may be impossible or very costly, prior to the formation of the union. Upon the formation of the union these prohibitive duties, which kept the consumption to a zero level, will be abolished. This will allow the country in question to import that commodity from other member country or countries, where its costs of production may be higher or lower as compared to its costs if domestically produced or elsewhere but is assumed to be lower than outside costs plus the duty on imports from outside the union. The original duty thus served as a sumptuary measure than as a protective or revenue measure.

16P. Robson, ibid, p. 33.
Viner, here mentioned that there is a clear loss for a country that removes the duty regardless of source if the other is a high cost supply source. It will be beneficial to the supplying country which will now get the advantage of the newly created market. Here Viner overlooks the consumption advantage that this country will derive as compared to zero consumption of that commodity in that country. This will on the contrary, increase the welfare of the people in that country as it provides an opportunity to consume at a cost lower than the one if produced domestically or imported with prohibitive duty. This will not be directly injurious to the outside world.

It is through these concepts of trade creation and trade diversion Viner has attempted to demonstrate that

1. the benefits from a customs union area as a whole derives from that portion of the trade between member countries which is wholly new trade, whereas

2. each particular portion of the new trade between member countries which is a substitute for trade with third countries as a consequence of the formation of the union is injurious for the importing country or countries, for the external world, for the world as a whole and is beneficial to the supplying member country.

Thus the formation of the customs union is beneficial only if trade creating force is predominant; is injurious if trade diverting effects are predominant. Vanek summarized this succinctly as follows;

-30-
"Liberalization within the group will create trade and this is broadly speaking, good. Liberalization within and no liberalization outside, is most likely to divert trade from countries within the union, and that is broadly speaking, bad."\(^{17}\)

The fundamental notion underlying this is that the trade in itself is good because it makes possible the flow of goods from low cost regions to high cost regions and this increases world income. If, then the volume of this beneficial phenomenon called trade is increased, there will be gain, if it is reduced on the other hand, there will be a loss in world income and efficiency.

**B. MEADE'S APPROACH**

In his book *THE THEORY OF CUSTOMS UNION*\(^{18}\) Prof. Meade has not only tried to show the limitations of Viner's theory but has also improved his theory so as to enable one to judge the benefits of the formation of the customs union.

Prof. Meade starts his analysis from Viner's conclusion that the trade diversion reduces welfare and the trade creation increases welfare in the countries forming the union. Meade described the former as uneconomic and wasteful and the latter as more economic and resulting into economic use of resources. His analysis was based in terms of three countries and one commodity model. From this he concluded that

\(^{17}\)J. Vanek, *op. cit.*, p. 2.

1. the trade creation effects of the union will result in economic and better uses of the available resources;

2. simultaneously with the trade creating effects, the trade diverting effects of the union also come into operation. In this case the trade is diverted from the most efficient source of supply to less efficient source of supply within the union, as well as from the least efficient to more efficient country. It is this movement in favour of less efficient from the most efficient source of supply which is uneconomic and wasteful. If looked from the other angle, as a movement from the least efficient source to a less efficient or more efficient source of supply, the trade diversion though considered uneconomic and wasteful, becomes partially beneficial to the member countries. This view is contrary to the views of Viner and Meade himself.

Prof. Meade is of the opinion that the establishment of the customs union may lead to a creation of new international trade because one of the partners can now export to and undercut another partner existing in the market; and this development represents a healthy development in a sense that it results in a shift of resources into more efficient and economic pattern of production. From this he generalizes safely that

"the formation of a customs union is more likely to raise than lower economic welfare, the higher
the initial duties on each others products which the partner countries remove."\textsuperscript{19}

This shows that the removal of duties on each others' products will have beneficial effects for the member countries of the union. This also suggests that the formation of the union will give rise to what Murray C. Kemp calls 'restricted trade' and as the trade with non-member countries -- rest of the world -- will be restricted by the existence of either individual tariffs or a common tariff for all the members of the union. This restricted trade between member countries will reduce the divergence between marginal rate of transformation between commodities in production and the marginal rate of transformation between commodities in international trade, which should be equal under the Paretian optimality conditions. A tariff destroys these equalities, its removal theoretically restores these equalities. The formation of a customs union results in abolishing such tariffs between member countries and retaining them through a common tariff policy, give rise to the restricted trade which is better than no trade situation between countries. Such a situation prevails among countries of south Asia considered in this thesis. On the basis of the previous premise it could be inferred that the formation of the union between countries of this area will definitely result in better and more economic use of their available resources and provide them with a better prospect of future development.

\textsuperscript{19}J. E. Meade: from Robson, \textit{op. cit.}, p. 51.
As regards Meade's contribution in the development of the theory of the customs union, Prof. J. Vanek observed,

"Prof. Meade was perhaps the first to realize the fact that even if we accept trade diversion as detrimental and trade creation as beneficial, we have yet to learn how to combine the two in arriving at a unique index of 'goodness'." 20

Merely adding the two may yield a very crude result indeed.

According to Vanek,

"The principal point made by Meade is that different types of trade diverted or created will carry different degrees of harm or good for the society. To identify and explain the co-efficients whereby trade creation and trade diversion ought to be weighed in constructing a unique indicator of the desirability of a customs union." 21

The method for constructing such a unique indicator, known as Meade Index, is shown by Meade as follows;

1. Multiplying the value of each element of diverted trade by the rise in the cost per unit of the diverted trade.

2. Multiplying each element of a newly created trade by the fall in the cost of the trade created.

In other words, by comparing the total value of all trade diverted with the total value of all trade created.

In analyzing Viner's theory Meade has tried to show that there are some gains involved even in trade diversion. This, he explained, is as follows:

---

20 J. Vanek, *ibid*, p. 3.

21 J. Vanek, *ibid*, p. 3.
"A reduction in the import duty levied on the exports of a partner country may totally divert existing trade from a cheaper outside source; but as it will reduce the market price of the product inside the importing country, there will be an expansion of the total imports of that country. And in so far as the initial price (including tax) in the importing country exceeded the cost of production in the partner country which provides the additional supplies, there is some economic gain to be set against the extra cost of production on the diverted trade."22

Prof. Meade also showed that with the formation of the customs union, when the trade between partner countries take place, a member country which was producing and consuming steel at a higher cost will get it at a lower cost which will increase not only trade in that commodity but also its consumption. This is the point that Viner has overlooked and Lipsey has analyzed in his work on the theory of customs union.

The formation of the customs union as pointed out by Meade may result in the loss of revenue with the abolition of customs duty. If the member countries are not prepared to adjust the balance in their revenue and expenditure, they should try to make good the loss in revenue by increased taxation. By neglecting the distributive aspects of the increased taxation, he arrived at the following conclusions:

1. If customs revenue is replaced by a rise in tax general consumption of some other products, it will cause an increased divergence between marginal values and marginal costs in that other line of economic activity and the loss due to trade contraction

22J. Meade, from Robson, op. cit., p. 58.
there must in part be set against the gain due to
trade expansion in the products on which customs
duties have been reduced. This view is much similar
to that expressed by Kemp, which we saw previously.

2. If the lost customs revenue is replaced by a rise
in a progressive income tax, this will cause an
increased divergence between marginal rewards and
marginal efforts for workers, entrepreneurs, savers
and so on. There will be as a consequence, some
contraction in efforts due to higher taxation and
this may have to be set against the expansion of
trade on which the customs duties have been abolished.

Meade's analysis, though an important advancement over
that of Viner's, is simple in theory when considered for
small changes in tariffs by the union. The "Meade's Index"
even though a simple one for theoretical construction may be
quite difficult to test empirically.

C. LIPSEY'S CONTRIBUTION

Prof. Richard Lipsey, in his article "The Theory of
Customs Union: Trade Diversion and Welfare", published in
1957 does not accept Viner's conclusion that the trade diverting
customs union reduces welfare. In his analysis, he introduces
price effects, in the sense that when the customs union is formed,
the import duties on imports from member countries are
abolished. This results in a change in relative prices of
goods and services in the domestic markets of member countries.
This price change has two important initial effects:

1. This may influence, the world location of production in several ways as analyzed by Viner and Lipsey labelled this as 'production effects' of union.

2. This will have a parallel effect on the location of world consumption, which he labelled as 'consumption effects of union.'

In his analysis of the effects of the customs union he gives importance to the consumption effects of the formation of the union because the welfare effects of the formation of the customs union can mainly be analyzed through the changes in consumption levels of masses. Here, he emphasized that the formation of a customs union will cause some changes in the pattern of consumption due to changes in the relative prices in the markets of member countries, even if the world production is fixed. The consumption effects therefore may operate even if there is no production effect. He also pointed out that the analysis of the formation of the customs union through trade creation and trade diversion effects and concluding therefrom that it is either good or bad, implies a welfare judgement.

"But the effects of a customs union on welfare must be a combination of effects on the location, and hence the cost of world production and on the location, and hence the 'utility', of world consumption."23

He analyzed the problem of welfare effects of trade diversion in the context of isolated, simple model of three countries and two commodities. For this he assumed that

a. Country A specializes in the production of a commodity say, wheat and obtains her requirements for other commodity, say, clothing, through international trade.

b. The price of clothing, in terms of wheat, is given as the size of the country is small and therefore is unable to influence the price of clothing.

c. The third country C provides clothing at a price lower than that at which country B supply clothing to country A. So in the absence of discriminating tariffs, country A will buy clothing from country C by exporting wheat.

It is with reference to this model that Lipsey has shown how an increase in welfare may follow from the establishment of trade diverting customs union, diverting trade from lower to higher cost sources of supply. How this welfare gains may be enjoyed by a country whose import trade is diverted as a result of the union, the union as a unit and by the world as a whole. As an analytical tool, he has employed indifference curves technique to show how the trade diverting customs union can increase welfare. For this he assumed that

1. the conclusions reached do not depend on the assumption of a unique community welfare function;
2. In country A, there is only one consumer, whose indifference map is, ipso facto, country A's community indifference map.

With the help of the indifference curves technique, he demonstrated how the trade diverting union can increase welfare. This can be shown diagrametically as follows.

Fig. 1 depicts the conditions prevailing in country A prior to the formation of the union. Here it is assumed that free trade existed before the formation of the union. In this fig. 1,

\[ \text{OD = A's production of wheat,} \]
\[ \text{DE = price ratio between wheat and clothing when the trade is with country C,} \]
\[ \text{G = free trade equilibrium position.} \]

Now prior to the formation of the union it is assumed that country A levies a tariff, on imports of clothing, of EF/OF percent. This has two possibilities;

1. If country A does not spend the tariff revenues, the new price line will be DF. The new equilibrium point will be H where the indifference curve I' is tangent to the new price line -- the domestic price line DF.

2. If the revenues are spent, that is if the revenues are returned to the consumers, then the new equilibrium will be somewhere on DE, at a point where an indifference curve has a slope equal to that of DF. The new equilibrium point will be
Fig. 1: TRADE DIVERSION AND ECONOMIC WELFARE
at a point where a line D'F', drawn parallel to DF cuts DE. This is at a point K in the diagram. Here at this point it will be impossible for the domestic consumer to trade along his domestic price line and reach higher indifference curve. Thus tariffs will lower the consumption of clothing and increase that of domestic wheat.

Now when the customs union is formed between countries A and B, the line showing terms of trade should be between the lines showing the lowest price ratio and the highest price ratio. That is the new price line should be on the left of DE and on the right of DF. Since no tariffs are levied on A-B trade, the new equilibrium should be somewhere along price consumption curve WHGZ. The welfare effect of the union on country A can be discussed by drawing a line DV from D touching OE at V, and tangential to indifference curve I' (a curve drawn through point K). This line DV shows terms of trade with country B, which leave country A as well as when the trade was with country C. From this it follows that,

a. if country A obtains terms of trade with country B worse than DE but better than DV, the trade diverting union must result in an increase in country A's welfare,

b. if she obtains any terms of trade better than DF but worse than DV, the trade diversion will occur but it will result in a loss of welfare for country A.
From this Lipsey concluded that country A might gain by entering a customs union whose sole production effect was to divert her import trade from lower cost to high cost sources of supply.

"This, 'according to Lipsey,' does not seem appealing but the possibility stems from the fact that whenever imports are subject to a tariff, the position of equilibrium must be on where an indifference curve cuts (and not tangent to) the international price line."\(^2\)\(^4\)

This is seen in the diagram as an area between the international price line DE and the line DV or the indifference curve I\(^n\). This shows that if tariffs on imports are abolished between countries forming a union, the trade, though restricted with non-member countries, will increase, and some member countries will definitely get goods at a price lower than if they were produced domestically. Here in the case of two countries A and B forming the union, if the final equilibrium position lies within this area -- between line DE and the curve I\(^n\) -- at terms of trade worse than DE, that is worse than in the case of free trade situation -- the trade carried on will increase.

This may be explained by referring to two opposite effects of the trade diverting customs union. These opposite effects are as follows.

1. The worsening of the terms of trade due to shift in the sources of supply from lower to higher cost.

\(^2\)\(^4\)R. Lipsey: ibid, p. 43.
This necessitates to export more than before in order to acquire a given quantity of imports or the same quantity of imports.

2. The removal of tariffs, with the formation of the union, eliminates the divergence between the domestic and international prices. This has the effect of allowing consumers in country A to adjust their purchases to a domestic price ratio which is equal to the rate at which wheat can be transformed into clothing by means of international trade. The final welfare effect of the trade diverting customs union must be the net effect of these two opposing tendencies; the first working to lower the welfare, and the second to raise it.

Another point which can be expressed in support of Lipsey is that the removal of tariffs on imports will have an income effect as it will increase the real income of the participating member countries. It will also increase the nominal income of consumers in these countries which will allow them to consume more of goods and services than before when national tariffs on imports existed. This has an advantage of expediting the development process in the union as a whole.

**BHAGWATI'S COMMENT ON LIPSEY'S ANALYSIS**

Prof. Bhagwati disagrees with the conclusion that Lipsey has arrived in his thesis. He maintains that Lipsey's comment that Viner has overlooked the possibility of improvement in
welfare associated with the formation of the trade diverting customs union by not considering the possibility of substitution in consumption. On this point Bhagwati maintains that

1. the absence of substitution in consumption is not a sufficient condition for a trade diverting customs union to be welfare reducing,

2. this rules out consumption gain to offset the terms of trade loss implicit in the trade diversion but variability in production can also be a source of gain,

3. Prof. Lipsey's analysis highlighting the consumption gains from trade diverting customs union though excellent is insufficient in its treatment of the question why Viner overlooked the possibility that the trade diverting union may none the less be welfare improving.

If his analysis is translated to general equilibrium model which allows variability in production, Bhagwati maintains that,

"a sufficient condition for trade diverting customs union to be welfare reducing is that the level of imports is fixed, and not that the pattern of consumption is fixed."25

If one considers the treatment of trade diverting customs union as outlined by Viner, it is difficult to say explicitly whether Viner assumed fixity of levels of imports or fixity of consumption as interpreted by Lipsey. Bhagwati

25J. N. Bhagwati: "Trade Diverting Customs Union and Welfare Improvement: A Clarification:"

-44-
is of the opinion that both these interpretations are
tenable but the greater plausibility is that for the fixity
of the level of imports. This so because Viner, in his
explanation of trade diversion, talks about a shift in the
locus of production from lower cost third country to a high
cost source of supply in the union. This shift, according
to Bhagwati, implies that the level of imports in a country
will be constant and \( dM=0 \). It is this which makes the trade
diverting customs union welfare reducing. Even the assumption
of fixity of the pattern of consumption in Lipsey's complete
specialization model will prove to be welfare reducing. The
alternative sufficient condition of fixed level of imports,
that is \( dM=0 \) also implies the same. Thus both these conditions
are consonant with Vinerian analysis.

If one looks into the analysis both of Lipsey and
Bhagwati one finds that both are avoiding an answer to a
question, what would be the effects of the changes in the
domestic prices of goods and services as well as of imports
due to the abolition of import tariffs, on

1. the demand for goods due to changes in the domestic
price as the shift in the locus of production takes
place from a low cost external source to a high
cost member country, thereby compelling consumers
to adjust their demands to a new price level --
higher than the previous one,

2. the demand for imports as well as the consumption
of imported commodity may decline if they are to be
made available at higher prices than before. This will, in reality, encourage a strong substitution effect in favor of goods that are domestically produced, whether inferior or not, and are substitutable.

Prof. Harry Johnson has commented upon the positions taken by these two economists. He wrote that the difficulty in their analysis arises due to the definition of trade diversion accepted by them. In his view, Lipsey limits preferences in a specific fashion applicable to all cases, whereas Bhagwati does not restrict preferences but the outcome of the exercise of preferences so as to produce a specific result in any particular case and so implicitly imposes restrictions on preferences that vary from case to case. In this connection Prof. Johnson wrote,

"For analytical purposes, it seems far more elegant and practically useful to define trade diversion as diverting initially existing trade and trade creation as involving additional trade, even if it is new trade in an existing product whose source is switched as a result of customs union. Then trade diversion is always welfare reducing, trade creation always welfare increasing, and the net effect of customs union depends on the balance of trade diversion and trade creation (changes in quantities being weighted by the appropriate welfare gain weights, and abstraction being made from domestic distortions and other obvious general equilibrium consideration."

The expression of different views on the benefits of the formation of the customs union has given rise to an unending

---

controversy in the field of the theory of the customs union. Whether they are welfare promoting or not has led some to the formulation of testable hypothesis and its empirical testing has been undertaken especially in relation to the formation of the European Common Market. In the subsequent section a brief summary of such empirical studies, undertaken by different economists, is provided.

THE EMPIRICAL STUDIES

The empirical studies regarding the theory of the customs unions with respect to the European Common Market has been done by economists like P. J. Verdoorn, L. H. Janssen, and L. B. Krause. Prof. B. Balassa has not only done such a study but has succinctly reviewed works of previously mentioned economists. These studies were undertaken to consider the desirability of a union with reference to its trade creating and trade diverting effects. Though numerous criteria have been put forward for appraising the change of trade creation and trade diversion in a union, there is a sort of general agreement among economists that

"an a priori judgment regarding the net effect of customs unions on trade flows cannot be made."27

It is this belief that has led to an increasing interest in empirical studies of trade creation and trade diversion in a customs union.

---

Such investigations are divided into two categories. They are ex-ante studies and ex-post studies.

a. **Ex-ante studies.** In these types of studies attempts are made to evaluate possible repercussions before the union is formed. Prof. Balassa places work of Verdoorn, Janssen and Krause in this category. Verdoorn and Janssen used a general equilibrium model in their investigation and inquired into the effects of changing one variable—elimination of internal tariffs in the union—on trade flows and on terms of trade. Their studies have been criticized on theoretical as well as on empirical grounds. They have also been criticized for underestimating prospective trade creation effects because of their failure to take account of intra-industry specialization following the elimination of tariffs within the union. Krause has been criticized for overestimating the trade diverting effects of the EMC for U.S. exports by assuming high supply elasticity for the dominant suppliers within the European Economic Community.

b. **Ex-post studies.** In these types of studies attempts are made to study the possible repercussions of the formation of the union after it is established. Prof. Balassa places works of A. Lamfalussy, J. Waelbroeck and those of himself in this category. In the ex-post studies, the actual effects of integration on trade flows, the rise of intra-area trade as a proportion of the total (intra and extra area) exports and imports of the ECM countries has often been interpreted.
as a demonstration for the trade creating effects of the Common Market. In this connection Balassa observed,

"These results may conceivably be explained by the increasing importance of the E.E.C. in world markets and by changes in its competitive position."\(^{28}\)

To separate the trade diverting and trade creating effects of the customs union from that of the factors, such as the position of the E.E.C. in world markets and changes in the competitive position of the union as a whole, Lamfalussy has suggested that

1. changes in the share of E.E.C. as an import market, in the exports of participating and non-participating countries be studied and compared;

2. the relative performance of the E.E.C. countries in the markets of the community and elsewhere should be examined.

Alexandre Lamfalussy considered changes in trade flows between 1958 and 1960 and between 1960 and 1962 and found no evidence for either trade creating or trade diverting effects of the common market. Similar conclusion was arrived at by R. L. Major, who studies the share of individual exporters in common market imports for eleven commodity groups. The procedure followed by Lamfalussy is open to objection in the sense that such a study, undertaken in a piecemeal fashion does not provide fully consistent results.

\(^{28}\)B. Balassa, *ibid*, p. 2.
In order to correct limitations of Lamfalussy's analysis J. Waelbroeck suggested that comparisons should be undertaken between actual and hypothetical trade flows. The hypothetical trade flows should be calculated by assuming the structure of world trade, as indicated by earlier year trade matrix, has remained unchanged. By extrapolating the 1951-52 world trade matrix to 1959-60 and 1960 matrix to that of 1962 and first half of 1963, Waelbroeck concluded that the existence of a common market effect on the composition of the world trade can hardly be doubted. In this connection he observed,

"The results obtained by the use of these procedures do not permit us to judge whether the observed 'deformation' of the world trade matrix has been due to trade creation or trade diversion." 29

The finding that actual intra-E.E.C. trade exceeds hypothetical trade calculated under assumption of an unchanged composition of world trade, is compatible with trade creation as well as trade diversion.

"The common market countries trade more with each other either because the reduction of intra-area tariffs has created new trade or because trade has been diverted from extra-area to intra-area channels". 30

In order to indicate whether trade creation and trade diverting effects of the E.E.C. are indicating Waelbroeck used

---

29 J. Waelbroeck, from Balassa, *ibid*, p. 3.

30 A. Balassa, *ibid*, p. 3.
the method of Tinbergen and two other Finnish economists. By comparing them with the actual trade figures, he found the following:

1. That intra-area trade has increased considerably more than the Finnish Model would have led us to expect, and
2. at the same time there is no evidence for the trade diversion from North America and from other E.F.T.A. (European Free Trade Area) countries.

Balassa questioned the validity of the method, by doubting whether it is appropriate to apply average income elasticity of export supply and import demand, calculated from the cross section analysis of all trading countries. These elasticities, he feels, are higher for industrial countries and lower for Less Developed countries. This is because of the increased specialization within the industrialized countries, tends to raise their share of the foreign trade in their G.N.P., while opposite is the case for Less Developed countries when they prefer to industrialize under protection. It is this high income elasticities in Common Market countries, that, in part, explains internal trade creation as well as external trade creation.

Verdoorn and Schlochtern undertook the cross section study of some 38 commodities to explain inter-community differences in expansion of imports into the Common Market, by utilizing as explanatory variables a weighted average of internal and external tariff reductions and index representing
'effective import demand'. The index of effective import demand was derived by calculating an unweighted average of the rates of change of imports of commodity in question into the United Kingdom, Sweden, Denmark and Switzerland and is taken to reflect the expansion of trade that would have taken place in the absence of the formation of the E.C.M.

Their study provide some evidence of trade creating and trade diverting effects of the E.E.C. Balassa commented that these authors used the evidence and the results derived therefrom as evidence of trade creation only. If tariff reduction results in trade creation, the opposite that the increase in tariff will result in shifts in imports from the third country is also equally true. Their method is also open to objection on the following grounds:

1. The calculation of substitution elasticities from cross section data, and
2. one may question the validity of using data of four E.F.T.A. countries with lower growth rates and rather different economic structure as a yardstick for the expansion of trade that would have taken place in the absence of the establishment of the Common Market, especially in view of the fact that by 1962, there might have been an 'E.F.T.A. effect'.

Any empirical work pertaining to the study of the effects of the formation of the Common Market should aim at
1. abstracting from the effects of economic growth on trade flows,
2. ensuring the comparability of the estimates of trade creation and trade diversion,
3. providing for a disaggregation of the results according to the main categories of commodities; and
4. indicating the effects on individual supply area.

By keeping these requirements in mind, Balassa outlined the method for dealing with these problems, which can be summed up in a nutshell as follows:

1. A comparison of ex-post income elasticities of import demand in intra-area and extra-area trade for periods preceding and following integration should be undertaken. From this he deduced following criteria to judge whether trade creation or trade diversion has taken place or not. For this he assumed that the income elasticities of import demand would have been unchanged in the absence of integration.

   a. A rise in the income elasticity of demand for intra-area trade-imports would indicate gross trade creation.

   b. An increase in the income elasticity of demand for import from all sources of supply would give expression to trade creation proper.
c. A fall in the income elasticity of extra-area imports would provide indication of the trade diverting effects of the union.

Thus, according to Prof. Balassa, the establishment of the Common Market has been the single largest influence affecting trade flows in E.E.C. and long run influences or special factors would not have appreciably altered the relationship between imports and G.N.P.

It is by comparing the relationship of internal and external trade with G.N.P. between pre-integration and post-integration periods, this method works out changes in the growth rate of national income and provides comparable estimates of trade creation and trade diversion. Based on this method Balassa has come to the conclusion that both the trade creation and trade diversion effects are visible in context of the European Common Market. His conclusions are as follows:

1. There is a trade diversion in food and raw materials from foreign to partner countries.

2. With the exception of semi-manufactures and non-durable consumer goods, included in the group of other manufactures, the establishment of the Common Market appears to have led to trade creation in the manufactured goods.

3. In case of machinery and transport equipment, an increase in the income elasticity of demand for extra-area imports provides an evidence for the 'external trade creation'.

-54-
Prof. Balassa has been criticized for neglecting the impact of the union on the trade in intermediate goods. H. Askari expressed the view that the inclusion of effects of the establishment of the union on such a trade are likely to effect his estimates adversely.
CHAPTER III

THE COMMON MARKET FOR SOUTH ASIAN COUNTRIES

What is South Asia?

Having reviewed the theoretical developments and empirical studies pertaining to the theory of Customs unions, an attempt has been made here to study whether the establishment of a Common Market for South Asian Countries can help them in their efforts for rapid economic development, which is in reality disturbingly slow. Before exploring such a possibility it is desirable to answer, at the outset, questions such as What is South Asia? Why a Common Market for them? Will it be helpful to them in their development?

In history and politics, the notions such as South East Asia, Middle East Asia or Far East Asia have a distinct and definite meaning. These terminologies exclude countries like India, Pakistan, Bangladesh, Sri Lanka and Burma as well as other countries in that sub-continent. In short all these countries were either the part of the former British Empire or they were indirectly controlled by the Britishers. In this area all countries except India and Pakistan are small if measured in terms of their population. A similar classification is followed by the Food and Agriculture Organization (FAO) in
its study "POPULATION AND FOOD SUPPLY IN ASIA". This study has divided the continent of Asia in seven sub-regions. This division is as follows:

1. South Asia: Sri Lanka, India, Nepal, Pakistan, Bangladesh.
3. Japan
4. China
7. Israel

This classification puts the countries of Indian Sub-continent in the sub-region of South Asia. The meaning of the term South Asia covers not only the countries in this classification but also Burma and Iran. This is because of the following reasons.

a. In the treaty aiming at the establishment of ASEAN Burma is not included,
b. Burma and Iran are those countries that can be included in this classification if the criteria of proximity for the regional grouping is applied.
c. These two countries, historically, have trading relations with India (undivided India) and geographically these countries have a common border, thereby indicating that if the geographical proximity is considered as a criteria for the common market, they can be easily included in South Asia.

d. In the vicinity of this region Iran is the country which has surplus investible capital and a resource that can earn not only required foreign exchange but can also provide necessary input for the development of agriculture, which is deficient, in that region.

The other countries in the proximity of the countries of South Asia are Afghanistan, Nepal, Bhutan and Sikkim, which are not included in this study only because information pertaining to them are sketchy, but they could be included in the union.

The other study pertaining to the socio-economic conditions in South Asia is done by Swedish economist Prof. Gunnar Myrdal in his 'Asian Drama'. In this study he described the term "South Asia" as to cover the regions of South Asia as well as that of East and South-east Asia, as described in the FAO study. But the sub-region South-east Asia excludes India, Pakistan, Bangladesh, and Ceylon. These countries together with Afghanistan, Nepal, Butan and Sikkim then becomes South Asia. The latter countries are excluded in this study while Iran and Burma are included for the reasons explained above.
Why Common Market?

Having explained the meaning of South Asia as well as why Iran is included in this study, the next question to be answered is why Common Market for them? The common market as a form for integration is preferred because this region, rather than the countries included in this region except Iran, were the part of the British Empire. As a consequence, they represent similarity in their organization, especially in their administration. They represent a long cultural tradition and trading relations among themselves even before the Europeans ruled them. Burma was the part of the British India prior to the Second War while Pakistan came into existence due to partition of India in 1947 and Bangledesh which was East-Pakistan prior to 1971. Most of the countries were a part of India and integration of their economies through a common market will provide an opportunity for better allocation of resources and mobilization of labour between countries, thereby providing an environment congenial to the better exploitation of the resources of that sub-continent and the modern technology.

What Determines Their Size?

Having answered why the common market as a form of economic integration is preferred, it is necessary to inquire into the size of the economies of the countries of this region. This is necessary because economic integration should be encouraged between small countries. Simon Kuznets
has described certain characteristics which can help in determining the economic size of these countries. Before discussing these characteristics, determining the size of a nation, it is desirable to define the word "small nation". Kuznets defined a small nation as

"an independent sovereign state, with a population of ten million or less."¹

If one accepts, literally, this definition, it can mean that India and Pakistan are made up of many small nations. The economic development of small nations is hampered not only by their size but also by both the technological and economic factors. Before discussing these factors it is desirable to answer question pertaining to their size. Kuznets has given the following characteristics:

1. The economic structure of small nations is typically less diversified than that of larger units. This means that some of the full variety of industries observed in developing larger nations is either lacking or barely represented. It means that "the economic structure -- the proportional distribution of output and of productive factors -- of small nations is more concentrated in a few industrial sectors."²


²Simon Kuznets, ibid, p. 15.
From this it can be concluded that in small nations, economic activity is less diversified and certain industries are predominant in the industrial sector. Is this characteristic visible in the economies of countries of the region under study? Table 1 provides a bird's eye view of these economies through the composition of Gross Domestic Product by kinds of economic activity. This information indicates that

a. in all countries, except Iran, agriculture is an important activity, contributing between 33 percent to 50 percent of their G.D.P. The agricultural sector includes farming, hunting, forestry and fishing. This is followed by miscellaneous sector -- made up business and service sectors -- contributing 25 percent to 30 percent of their G.D.P. The contribution of the industrial sector is between 15 percent to 20 percent.

b. In case of Iran, only 16 percent of her G.D.P. comes from agriculture, 51 percent to 55 percent from miscellaneous activities such as finance, insurance, real estate and business services as well as other services such as community, social, personal and governmental. The contribution of the industrial sector to her G.D.P. is only 13 percent.

This information reflects that these countries are basically agricultural economies with more or less same level of industrialization, thereby proving that they are of the same level of development. Being agricultural economies the
<table>
<thead>
<tr>
<th>COUNTRY OR AREA</th>
<th>YEAR</th>
<th>GROSS DOMESTIC PRODUCT</th>
<th>AGRICULTURE, HUNTING, FORESTRY &amp; FISHING</th>
<th>MINING, QUARRYING, INDUSTRIES, EXTRACTIVES</th>
<th>MANUFACTURING INDUSTRIES</th>
<th>ELECTRICITY, GAS AND WATER</th>
<th>CONSTRUCTION</th>
<th>WHOLESALE AND RETAIL TRADE, RESTAURANTS, MOTELS, COMMERCE</th>
<th>TRANSPORT &amp; COMMUNICATIONS, STORAGE</th>
<th>(MISCELLANEOUS)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangladesh</td>
<td>1969 (A)</td>
<td>100.0</td>
<td>45.76</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>12.02</td>
<td>6.84</td>
<td>19.34</td>
</tr>
<tr>
<td></td>
<td>1972 (A)</td>
<td>100.0</td>
<td>55.63</td>
<td>9.56</td>
<td>0.46</td>
<td>6.02</td>
<td></td>
<td>9.55</td>
<td>5.55</td>
<td>16.71</td>
</tr>
<tr>
<td>Burma</td>
<td>1970 (A)</td>
<td>100.0</td>
<td>38.30</td>
<td></td>
<td>1.39</td>
<td>10.37</td>
<td>0.64</td>
<td>1.95</td>
<td>7.19</td>
<td>34.13</td>
</tr>
<tr>
<td></td>
<td>1972 (A)</td>
<td>100.0</td>
<td>37.31</td>
<td>1.59</td>
<td>10.05</td>
<td>0.60</td>
<td>1.86</td>
<td>5.17</td>
<td>7.03</td>
<td>35.13</td>
</tr>
<tr>
<td></td>
<td>1973 (A)</td>
<td>100.0</td>
<td>38.47</td>
<td>1.62</td>
<td>9.51</td>
<td>0.62</td>
<td>1.76</td>
<td>6.72</td>
<td>5.05</td>
<td>36.22</td>
</tr>
<tr>
<td>India</td>
<td>1970 (B)</td>
<td>100.0</td>
<td>43.62</td>
<td></td>
<td>0.95</td>
<td>12.45</td>
<td>1.05</td>
<td>4.89</td>
<td>9.29</td>
<td>4.72</td>
</tr>
<tr>
<td></td>
<td>1972 (B)</td>
<td>100.0</td>
<td>46.28</td>
<td>0.99</td>
<td>14.14</td>
<td>1.17</td>
<td>5.45</td>
<td>10.33</td>
<td>5.37</td>
<td>16.25</td>
</tr>
<tr>
<td></td>
<td>1973 (B)</td>
<td>100.0</td>
<td>45.17</td>
<td>0.96</td>
<td>14.33</td>
<td>1.15</td>
<td>5.85</td>
<td>10.66</td>
<td>5.32</td>
<td>16.56</td>
</tr>
<tr>
<td>Iran</td>
<td>1970 (A)</td>
<td>100.0</td>
<td>18.16</td>
<td></td>
<td>12.86</td>
<td>1.52</td>
<td>4.64</td>
<td>7.26</td>
<td>4.86</td>
<td>50.68</td>
</tr>
<tr>
<td></td>
<td>1971 (A)</td>
<td>100.0</td>
<td>15.74</td>
<td></td>
<td>12.61</td>
<td>1.45</td>
<td>4.66</td>
<td>6.83</td>
<td>4.19</td>
<td>54.52</td>
</tr>
<tr>
<td></td>
<td>1972 (A)</td>
<td>100.0</td>
<td>15.11</td>
<td></td>
<td>12.98</td>
<td>1.39</td>
<td>4.80</td>
<td>6.74</td>
<td>4.15</td>
<td>54.84</td>
</tr>
<tr>
<td>Pakistan</td>
<td>1971 (A)</td>
<td>100.0</td>
<td>33.56</td>
<td></td>
<td>0.50</td>
<td>14.14</td>
<td>1.54</td>
<td>3.30</td>
<td>13.26</td>
<td>6.04</td>
</tr>
<tr>
<td></td>
<td>1972 (A)</td>
<td>100.0</td>
<td>33.50</td>
<td></td>
<td>0.58</td>
<td>14.29</td>
<td>1.46</td>
<td>3.51</td>
<td>12.98</td>
<td>6.56</td>
</tr>
<tr>
<td></td>
<td>1973 (A)</td>
<td>100.0</td>
<td>36.71</td>
<td></td>
<td>0.59</td>
<td>14.86</td>
<td>1.44</td>
<td>3.78</td>
<td>14.54</td>
<td>7.34</td>
</tr>
<tr>
<td>Sri-Lanka</td>
<td>1969 (A)</td>
<td>100.0</td>
<td>33.88</td>
<td></td>
<td>0.64</td>
<td>9.19</td>
<td>0.48</td>
<td>6.27</td>
<td>15.22</td>
<td>8.85</td>
</tr>
<tr>
<td></td>
<td>1970 (A)</td>
<td>100.0</td>
<td>32.83</td>
<td></td>
<td>0.60</td>
<td>9.90</td>
<td>0.56</td>
<td>6.47</td>
<td>16.17</td>
<td>9.98</td>
</tr>
<tr>
<td></td>
<td>1971 (A)</td>
<td>100.0</td>
<td>31.95</td>
<td></td>
<td>0.68</td>
<td>9.43</td>
<td>0.62</td>
<td>5.88</td>
<td>15.94</td>
<td>8.99</td>
</tr>
</tbody>
</table>

(A) = Former Standard National Account  
(B) = Present Standard National Account

solution of their economic problems lie in not only the rapid development of agriculture but also in diversification of their economic activities. This means that they should try to displace the surplus labour in the agricultural sector to other sectors by developing industrial (secondary) sector and the service (tertiary) sector of economic activities. For the latter their markets are inadequate and their development necessitates integration of their economies. Their agricultural sector is imbued with a characteristic which is least explained in the literature on economic development. It is Myrdal who pointed to this in the following:

"Broadly speaking, there are two distinct types of farming practiced throughout most of the world. The more sparsely populated countries, such as North America, Australia and the Soviet Union, utilize their soil extensively, and the types of crops they grow and the space in which they grow them produces a very low output per unit of land. In the more densely populated lands with high man/land ratios, such as parts of Europe, China and Japan, intensive land utilization, with high yields per hectare is practiced South Asia fits into neither of these main groups. It forms a third and very unfortunate category, namely, that of extensive land use with a high man/land ratio."³

This naturally results in disastrously low level of nutrition, real income and consequent low efficiency in production. The industrial sector in these countries is the least developed of all sectors and in that to it is the consumer goods

sector, excluding consumer durables, which is predominant. This is seen from Table 1. This table also indicates that the economic activity is principally concentrated around agriculture. For this marked tendency Kuznets gave the following explanation:

"It is the size of the area and its limiting effect on the supply of natural irreproducible resources that imposes constrain on the development efforts of small nations."^{4}

The countries in the South Asia are small and their development efforts are constrained by the availability of the natural irreproducible resources. Myrdal wrote that in this area no country except India has potentialities for higher industrialization because of the lack of resources. In this connection it can be stated that Prof. Mahalanobis in the beginning of the second Five Year plan of India, wrote that India has iron ore deposits much larger than that of the United States but its per capita consumption of steel is not even one third of that of the United States.

Without discussing much of the content of Myrdal's opinion, we can say that given the resources that India has, the prosperity of the region can be enhanced only if proper complimentarities in the production processes are explored and exploited. In this context of complimentarities, the report of the working group of "EXPERTS ON TRADE LIBERALIZATION" mentioned,

\[\text{---}
\]

^{4}S. Kuznets, op. cit., p. 16.

-64-
"Some countries within the region might be inclined towards closer economic co-operation but not fully aware of the present and even greater complimentarity among their economies. This complimentarity on which mutually beneficial liberalization of trade could be based, would be more clearly revealed by an examination of existing production and trade patterns, co-ordinated resource studies and harmonized industrial planning."6

Such complimentarities could be developed between these countries in production of commodities like tea processing and packaging, rubber manufacturing between India and Sri Lanka; petroleum refining, petro-chemicals and fertilizers industries between India, Iran and Burma; Jute cultivation and manufacturing between India and Bangladesh; and co-operation in agriculture development between India and Pakistan. The possibilities for the development of complimentarities could be vigorously pursued in the wake of the formation of the economic union.

The other problem faced by countries of this region is that of the availability of natural resources suitable to a given technology which plays an important role in the development process. The availability of the technology also plays an important role in determining the size of the market of the national economy. The contemporary technology, by creating a need for an enlarged market to harness the benefits of economies of scale acts as a constraint, if an economy is unable to provide the required size of the market. It also means that the technology makes small nations' economies

"sub-optimal". Tibor Scitovsky discusses the problem of the size of a nation from the technological point of view. According to him,

"Technologically, an economy can be too small if its market is too small to provide an adequate outlet for the full capacity output of the most efficient plant in a given industry."\(^7\)

From this it can be inferred that the minimum size of an economy is generally different for different industries making an economy too small for some industries but not for other industries in the economy. It is this conflict between the minimum or optimum scale of plant for some industries and the limited market of small nations that acts as a factor responsible for making some modern industries such as aircraft manufacturing, heavy machine building, automobiles and transport equipment, uneconomical. These industries can be effectively developed in this region only through economic integration of the economies of the region as well as the regional integration of some of the services such as air transportation -- international and civil aviation. This also indicates that

"there is a technological determinant of the composition of foreign trade which is completely neglected in the classical theory of international values."\(^8\)

This also means that the technological factors introduce complexities in trade analysis because of the existence of


\(^8\)T. Scitovsky, *ibid*, p. 282.
the intermediate goods and trade in them. Even it is assumed that an economy is large enough to provide an adequate domestic market for an optimum sized plant in all industries producing final goods, there are possibilities that it may be sub-optimal for the requirements of equipments, services and other intermediate products when the market for them is considered. This is so because there may not be an adequate domestic market for them in the economy, proving thereby that these activities could be provided at a reasonable cost only if the market for them is expanded. This shows that the technological factors make an optimum size of an economy variable thereby making, technological optimum size for an economy very much larger than one might think at first. This discussion on the role of technological factors in determining the size of an economy also shows that it can work as a constraint on development efforts of underdeveloped economies. It also indicates that the technological innovations and their use in the production process in the economy are working against developing economies. In this context Myrdal observed,

"It may be true that South Asian entrepreneurs and states have vastly superior technology available to them than was available in the pre-industrial revolution period in the West. But what is more important is that the West is moving toward much higher levels of technical and scientific achievement. Only to a very minor extent does this help South Asia."\(^9\)

\(^9\text{G. Myrdal, op. cit., p. 67.}\)
For the developing countries this available contemporary technology -- scientific and technical developments -- is not as beneficial as it is thought about and the contemporary economic writings on this subject conceal this fact. On this point Myrdal observed,

"Most economic writings have concealed the obvious fact that this advance in the West had, and is having a detrimental impact on the development prospects of South Asia. Advancing technology in the West has already caused deterioration in the trading position of the South Asian countries."10

This deterioration is caused by developing substitutes for raw materials they imported previously from these countries of South Asia. The examples of these are the development of synthetic fibre for cotton yarn, polythelyne packing material for jute. This restricted their markets in the Western economies thereby affecting their economic conditions. These are seriously affected by reduction in the mortality rates in the area by developments in the field of medicine. This does indicate that this area can't rely much on the export trade with developed countries. They have then to rely more and more on markets of their own or of their neighbors or of both. These markets are small as well as underdeveloped due to the existence of the nonmonetised sector and also due to underdeveloped transport and communications. By integrating their economies with those of their neighbors they can not only enlarge market for their new industries but also

10G. Myrdal, ibid, p. 67.
also utilize contemporary modern technology more effectively in their development process.

When an economic structure of an economy -- of the region under study -- demonstrates a tendency towards concentration of economic activity in the primary sector, its reliance on foreign trade is increasing and its importance in economic activity is greater than in larger economies. This is true for both developed and underdeveloped small economies. Tables 2-6 give a clear picture of the importance of the foreign trade in the economies of South Asia. The study of these tables indicates that the share of imports and exports, measured as a percentage of the Gross National Products, is high in case of Burma, Iran and Sri Lanka (between 11 percent and 21 percent respectively). It is considerably lower in case of India and Pakistan. In case of India the share of imports and exports as a percentage of her national product is on the average approximately 6.1 percent and 4.0 percent respectively. For Pakistan it is approximately 8.11 percent and 5.16 percent respectively. This shows that countries like Burma, Bangladesh (for which the statistical information is scanty), Iran and Sri Lanka are small while India and Pakistan are larger units. This information also shows that economies of India and Pakistan are larger units. This information also shows that economies of India and Pakistan are relatively more diversified in their economic activities. This supports Kuznets premise that the ratio of foreign trade to national income rises as the average size of population declines. Table 7 gives information per-
### TABLE: 2


<table>
<thead>
<tr>
<th>YEAR</th>
<th>GNP (MILL. KYATS)</th>
<th>IMPORTS AS PERCENTAGE OF GNP</th>
<th>EXPORTS AS PERCENTAGE OF GNP</th>
</tr>
</thead>
<tbody>
<tr>
<td>61</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>62</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>63</td>
<td>7923</td>
<td>111.5</td>
<td>128.8</td>
</tr>
<tr>
<td>64</td>
<td>7572</td>
<td>129.3</td>
<td>112.6</td>
</tr>
<tr>
<td>65</td>
<td>8416</td>
<td>117.8</td>
<td>107.3</td>
</tr>
<tr>
<td>66</td>
<td>8282</td>
<td>75.2</td>
<td>92.7</td>
</tr>
<tr>
<td>67</td>
<td>8586</td>
<td>74.1</td>
<td>59.0</td>
</tr>
<tr>
<td>68</td>
<td>9815</td>
<td>85.9</td>
<td>52.6</td>
</tr>
<tr>
<td>69</td>
<td>-</td>
<td>78.5</td>
<td>62.9</td>
</tr>
<tr>
<td>70</td>
<td>-</td>
<td>77.0</td>
<td>51.8</td>
</tr>
<tr>
<td>71</td>
<td>-</td>
<td>64.4</td>
<td>60.3</td>
</tr>
<tr>
<td>72</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

(AVR. 11.94) (AVR. 11.22)

**SOURCE:** ECONOMIC SURVEY OF ASIA & FAR EAST, 1973.
TABLE: 3


<table>
<thead>
<tr>
<th>YEAR</th>
<th>GROSS NATIONAL PRODUCT (BILL. RS)</th>
<th>IMPORTS (MILL. RS.)</th>
<th>EXPORTS (MILL. RS.)</th>
<th>IMPORTS AS PERCENTAGE OF GNP</th>
<th>EXPORTS AS PERCENTAGE OF GNP</th>
</tr>
</thead>
<tbody>
<tr>
<td>61</td>
<td>160.4</td>
<td>1084.5</td>
<td>660.1</td>
<td>6.76</td>
<td>4.12</td>
</tr>
<tr>
<td>62</td>
<td>171.8</td>
<td>1124.1</td>
<td>668.2</td>
<td>6.54</td>
<td>3.89</td>
</tr>
<tr>
<td>63</td>
<td>197.2</td>
<td>1179.5</td>
<td>774.1</td>
<td>5.98</td>
<td>3.93</td>
</tr>
<tr>
<td>64</td>
<td>231.0</td>
<td>1342.9</td>
<td>812.8</td>
<td>5.81</td>
<td>3.52</td>
</tr>
<tr>
<td>65</td>
<td>240.9</td>
<td>1380.0</td>
<td>803.0</td>
<td>5.73</td>
<td>3.33</td>
</tr>
<tr>
<td>66</td>
<td>277.1</td>
<td>2019.0</td>
<td>1155.2</td>
<td>7.29</td>
<td>4.69</td>
</tr>
<tr>
<td>67</td>
<td>325.7</td>
<td>2095.0</td>
<td>1209.7</td>
<td>6.43</td>
<td>3.71</td>
</tr>
<tr>
<td>68</td>
<td>331.0</td>
<td>1928.0</td>
<td>1320.7</td>
<td>5.82</td>
<td>3.99</td>
</tr>
<tr>
<td>69</td>
<td>368.2</td>
<td>1663.0</td>
<td>1376.3</td>
<td>4.52</td>
<td>3.74</td>
</tr>
<tr>
<td>70</td>
<td>-</td>
<td>1593.3</td>
<td>1519.8</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>71</td>
<td>-</td>
<td>1804.3</td>
<td>1538.5</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>72</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

(AVR. 6.1) (AVR. 3.88)

### IRAN: IMPORTS & EXPORTS AS PERCENTAGE OF GNP (1961-1971)

<table>
<thead>
<tr>
<th>Year</th>
<th>GROSS NATIONAL PRODUCT (BILL. RIALS)</th>
<th>IMPORTS (MILL. RIALS)</th>
<th>EXPORTS (MILL. RIALS)</th>
<th>IMPORTS AS PERCENTAGE OF GNP</th>
<th>EXPORTS AS PERCENTAGE OF GNP</th>
</tr>
</thead>
<tbody>
<tr>
<td>61</td>
<td>348.6</td>
<td>46.09</td>
<td>66.04</td>
<td>13.22</td>
<td>18.94</td>
</tr>
<tr>
<td>62</td>
<td>374.9</td>
<td>41.82</td>
<td>69.45</td>
<td>11.15</td>
<td>18.52</td>
</tr>
<tr>
<td>63</td>
<td>399.8</td>
<td>39.22</td>
<td>69.67</td>
<td>9.81</td>
<td>17.43</td>
</tr>
<tr>
<td>64</td>
<td>440.4</td>
<td>50.67</td>
<td>94.96</td>
<td>11.51</td>
<td>14.75</td>
</tr>
<tr>
<td>65</td>
<td>499.7</td>
<td>65.15</td>
<td>98.71</td>
<td>13.04</td>
<td>19.75</td>
</tr>
<tr>
<td>66</td>
<td>540.3</td>
<td>70.32</td>
<td>99.18</td>
<td>13.01</td>
<td>18.36</td>
</tr>
<tr>
<td>67</td>
<td>602.9</td>
<td>85.24</td>
<td>146.20</td>
<td>14.14</td>
<td>24.25</td>
</tr>
<tr>
<td>68</td>
<td>675.1</td>
<td>102.74</td>
<td>142.37</td>
<td>15.22</td>
<td>21.09</td>
</tr>
<tr>
<td>69</td>
<td>772.5</td>
<td>115.75</td>
<td>159.03</td>
<td>14.98</td>
<td>20.59</td>
</tr>
<tr>
<td>70</td>
<td>852.1</td>
<td>125.63</td>
<td>178.37</td>
<td>14.74</td>
<td>20.93</td>
</tr>
<tr>
<td>71</td>
<td>-</td>
<td>142.31</td>
<td>200.12</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

(AVR. 13.08) (AVR. 19.46)

**Source:** ECONOMIC SURVEY OF ASIA & FAR EAST, 1973.
<table>
<thead>
<tr>
<th>YEAR</th>
<th>GROSS NATIONAL PRODUCT (MILL. RS.)</th>
<th>IMPORTS (MILL. RS.)</th>
<th>EXPORTS (MILL. RS.)</th>
<th>IMPORTS AS PERCENTAGE OF GNP</th>
<th>EXPORTS AS PERCENTAGE OF GNP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961</td>
<td>3863.0</td>
<td>305.6</td>
<td>190.5</td>
<td>7.91</td>
<td>4.93</td>
</tr>
<tr>
<td>1962</td>
<td>4101.1</td>
<td>351.5</td>
<td>189.2</td>
<td>8.57</td>
<td>4.61</td>
</tr>
<tr>
<td>1963</td>
<td>4416.1</td>
<td>423.2</td>
<td>198.3</td>
<td>9.58</td>
<td>4.49</td>
</tr>
<tr>
<td>1964</td>
<td>4920.6</td>
<td>474.0</td>
<td>235.2</td>
<td>9.65</td>
<td>4.78</td>
</tr>
<tr>
<td>1965</td>
<td>5404.2</td>
<td>496.7</td>
<td>251.5</td>
<td>9.19</td>
<td>4.65</td>
</tr>
<tr>
<td>1966</td>
<td>6131.8</td>
<td>428.4</td>
<td>286.1</td>
<td>6.99</td>
<td>4.67</td>
</tr>
<tr>
<td>1967</td>
<td>6525.7</td>
<td>524.4</td>
<td>307.1</td>
<td>8.04</td>
<td>4.71</td>
</tr>
<tr>
<td>1968</td>
<td>7133.8</td>
<td>474.2</td>
<td>343.0</td>
<td>6.65</td>
<td>4.81</td>
</tr>
<tr>
<td>1969</td>
<td>7739.5</td>
<td>493.0</td>
<td>324.5</td>
<td>6.37</td>
<td>4.19</td>
</tr>
<tr>
<td>1970</td>
<td>-</td>
<td>547.9</td>
<td>344.4</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1971</td>
<td>-</td>
<td>436.8</td>
<td>317.1</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1972</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1973</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

(AVR. 8.11) (AVR. 5.16)

TABLE: 6

SRI LANKA: IMPORTS & EXPORTS AS PERCENTAGE OF GNP (1961-1971)

<table>
<thead>
<tr>
<th>YEAR</th>
<th>GROSS NATIONAL PRODUCT (MILL. RS.)</th>
<th>IMPORTS (MILL. RS.)</th>
<th>EXPORTS (MILL. RS.)</th>
<th>IMPORTS AS PERCENTAGE OF GNP</th>
<th>EXPORTS AS PERCENTAGE OF GNP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961</td>
<td>668.7</td>
<td>170.3</td>
<td>173.3</td>
<td>25.47</td>
<td>25.91</td>
</tr>
<tr>
<td>1962</td>
<td>770.6</td>
<td>166.0</td>
<td>180.8</td>
<td>23.69</td>
<td>25.81</td>
</tr>
<tr>
<td>1963</td>
<td>725.9</td>
<td>149.0</td>
<td>173.1</td>
<td>20.53</td>
<td>23.84</td>
</tr>
<tr>
<td>1964</td>
<td>779.3</td>
<td>197.5</td>
<td>187.6</td>
<td>25.34</td>
<td>24.07</td>
</tr>
<tr>
<td>1965</td>
<td>807.3</td>
<td>147.4</td>
<td>194.9</td>
<td>18.36</td>
<td>24.14</td>
</tr>
<tr>
<td>1966</td>
<td>835.3</td>
<td>202.8</td>
<td>170.0</td>
<td>24.28</td>
<td>20.35</td>
</tr>
<tr>
<td>1967</td>
<td>908.8</td>
<td>173.8</td>
<td>169.0</td>
<td>19.12</td>
<td>18.60</td>
</tr>
<tr>
<td>1968</td>
<td>1065.5</td>
<td>217.3</td>
<td>203.5</td>
<td>20.39</td>
<td>19.10</td>
</tr>
<tr>
<td>1969</td>
<td>1177.7</td>
<td>254.3</td>
<td>191.6</td>
<td>21.59</td>
<td>16.27</td>
</tr>
<tr>
<td>1970</td>
<td>1292.6</td>
<td>231.3</td>
<td>202.1</td>
<td>17.89</td>
<td>15.63</td>
</tr>
<tr>
<td>1971</td>
<td>1328.9</td>
<td>198.6</td>
<td>194.7</td>
<td>14.94</td>
<td>14.65</td>
</tr>
<tr>
<td>1972</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

(AVR. 21.05)  (AVR. 20.76)

### TABLE: 7

POPULATION OF SOUTH ASIAN COUNTRIES; (MID-YEAR IN MILLIONS)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangladesh</td>
<td>54.22</td>
<td>55.24</td>
<td>56.29</td>
<td>57.35</td>
<td>58.44</td>
<td>59.55</td>
<td>60.67</td>
<td>62.97</td>
<td>65.36</td>
</tr>
<tr>
<td>India</td>
<td>472.13</td>
<td>482.53</td>
<td>493.21</td>
<td>504.16</td>
<td>515.41</td>
<td>526.99</td>
<td>538.88</td>
<td>550.82</td>
<td>562.47</td>
</tr>
<tr>
<td>Pakistan</td>
<td>24.08</td>
<td>24.81</td>
<td>25.54</td>
<td>26.30</td>
<td>27.08</td>
<td>27.89</td>
<td>28.66</td>
<td>29.78</td>
<td>30.55</td>
</tr>
</tbody>
</table>

aining to the population of countries included in this study as the constituent of South Asia. When this information is combined for study with the information in tables 2-6, it appears that Kuznets observation is correct.

Thus, if economies are small -- some being small due to technological factors and some due to economic one -- they fail to provide competitive conditions necessary to spur utmost efficiency and establish technically the most efficient plants in the economy. This creates a need for establishing a technologically optimum size of an economy to provide incentives for the building of an optimum sized efficient plants in the economy. This means that

"the technical optimum size of the economy is a necessary condition but not sufficient condition to ensure the utilization of the most efficient means of production."11

The creation of an economic union between countries of the South Asia will not only provide an opportunity to harness the advantages of modern technology but will also create conditions for competition necessary for efficient production. It is this that will spur momentum to the development process in that region.

This discussion, also, suggests that a heavy reliance on foreign trade, especially on increased export earnings through export promotion, by countries of this area has resulted in creating uncertainty in their development efforts due to

instability in their export earnings created mainly by instability in the prices of the products they export as well as due to the political factors such as war, their leanings towards socialistic policies etc. Same is true in the case of foreign aid reduced or discontinued by the developed countries mainly for the political reasons. This means that the stable growth in the production in these countries is not possible due to the uncertainty regarding either to the quantum of their export earnings or the amount of aid they are likely to receive from year to year. In other words, the stable growth in production in these countries is possible, if and only if, their export earnings are stable and growing at a stable rate, capable of financing their import requirements for industrialization. This seems impossible in the face of the competition from the developed countries as well as latter's tendency to expand trade horizontally among themselves only. This is also considered impossible in the face of mass production technology and its utilization in both developed and developing countries. On this point Scitovsky observed,

"Today, the condition of efficient production is very often the large scale production at a stable rate of a relatively few varieties of products. In other words, mass production methods to be profitable require a market outlet that is large, homogenous, and stable overtime; and these requirements rule out reliance on export markets, except to a very limited extent."12

12T. Scitovsky, ibid, p. 284.
This means that conditions of efficient production require a reliance on an homogenous export market. This is possible if and only if the neighboring countries increase trade among themselves. This is indispensable for developing countries because their export capability to stand in the competition with developed countries is limited by the strength of their economies and by their number in the world market. The technological changes and the consequent reduction in the demand for certain primary products of this region by industrialized countries have adversely affected the development of countries of the South Asia in particular and that of developing countries in general. Their development can be expedited by increasing trade among themselves. In this connection Balassa observed,

"By reason of low income elasticity of demand for primary products and technological changes leading to the replacement of certain raw materials, the import demand of industrial countries for primary commodities does not rise at a rate commensurate with the increase of their national income."\(^{13}\)

This tendency has resulted in a decline of per capita exports and attempts to expand production above the projected import demand of the developed countries, will result in lower export earnings because of low price elasticity of demand for their products. The existence of import quotas for certain commodities like textiles in developed countries also affect

their export earnings. These factors, coupled with gradual tariffs, reflect that exports earnings are likely to be less responsible to their export promotion programmes.

The economic development in these countries of the South Asia requires that they rationalize their demand through the rationalization of production of varieties of goods and services, so as to make their demand more or less homogenous. If considered in a broader context it is clear that countries in this region exhibit a pattern of demand which is homogenous especially when their dietary pattern and climate conditions are taken into account. So the integration of their markets through the formation of the common market will provide an outlet large enough to utilize mass production methods efficiently. This will impart an element of stability in their development efforts by limiting rather than reducing their reliance on the export markets of the developed countries. Thus the establishment of a common market between countries of South Asia will create conditions for freer trade and efficient production in this area. This is essential when

"a producer is investing in mass production equipment guaranteeing of stable and expanding market becomes a necessary condition and economic union provides this."16

Thus, the above discussion suggests that the acceptance of the nineteenth century premise that the development process could be fostered through trade is obnoxious because the technological and scientific revolution has changed the whole climate for development through trade, by making trade disadvantageous to newcomers in the development process. This has created a situation of choice by posing alternatives — either to have no trade and develop, or protected trade and distorted development or free trade and possibility of no development. This also suggests that if trade is not all too beneficial, what then is the alternative? It is in this context of restricted trade that Murray C. Kemp observed the following,

"When, however, world prices depend upon the amounts offered and demanded by the tariff imposing country, complications appear. For in this case the average and marginal rates of transformation through trade diverge; and it is to the average rates that under free trade marginal rates of substitution and transformation through domestic production are equated. Hence a single-country Paretian optimum is not necessarily reached under free trade. The possibility emerges that an appropriate system of taxes and subsidies on imports and exports, combined with lumpsum redistributive transfers between individuals, would leave everyone in the tariff ridden country better off than in a particular free trade situation."17

This argument for restricted trade as advanced by Kemp can also be applied to the theory of the customs union as it is

nothing but a novel way of applying the principles of Tariffs to a region made up of a group of countries. The establishment of a common market involves a common tariff wall for the member countries. This means that a proper combination of a union tariff policy and a tax cum subsidy policy for imports and exports could result in bringing about an efficient allocation of resources. With a redistributive transfer of resources between member countries, it will increase welfare of the masses in the member countries.

This means that a restricted trade with developed countries and freer trade with member countries, through economic integration by trade liberalization, can help the countries of South Asia to improve their economic conditions, by increasing the pace of their development. The establishment of a common market among the countries of South Asia will facilitate the exploitation of the advantages of comparative costs, economies of scale through enlarged market and industrial complimentarities. If the share of the respective country in the trade of a neighboring country is considered, it is found that the trade between them is either meagre or non-existent. This can be clearly seen from the information given in tables 8-13. This also suggests that there are possibilities for the expansion of trading relations which are not fully exploited for the development purposes. The establishment of the common market which implies that trade between member countries is preferred to trade with non-member countries. Such a preference in trade will not only
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>BANGLADESH</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>BURMA</td>
<td>-</td>
<td>-</td>
<td>1.7</td>
<td>1.52</td>
<td>2.53</td>
<td>-</td>
<td>-</td>
<td>1.47</td>
<td>1.27</td>
<td>1.56</td>
</tr>
<tr>
<td>INDIA</td>
<td>-</td>
<td>-</td>
<td>0.72</td>
<td>5.80</td>
<td>8.50</td>
<td>-</td>
<td>-</td>
<td>17.13</td>
<td>21.92</td>
<td>7.05</td>
</tr>
<tr>
<td>IRAN</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>0.52</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>PAKISTAN</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>0.14</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>SRI LANKA</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>TOTAL WORLD EXPORTS/IMPORTS</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>BANGLADESH</td>
<td>-</td>
<td>-</td>
<td>5.97</td>
<td>9.16</td>
<td>9.84</td>
<td>-</td>
<td>-</td>
<td>3.58</td>
<td>5.72</td>
<td>4.96</td>
</tr>
<tr>
<td>BURMA</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>INDIA</td>
<td>8.12</td>
<td>11.27</td>
<td>3.95</td>
<td>0.31</td>
<td>0.05</td>
<td>13.65</td>
<td>8.01</td>
<td>6.76</td>
<td>1.12</td>
<td>0.57</td>
</tr>
<tr>
<td>IRAN</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>0.002</td>
<td>0.003</td>
<td>0.023</td>
<td>0.005</td>
<td>0.31</td>
<td>0.37</td>
<td>0.53</td>
</tr>
<tr>
<td>PAKISTAN</td>
<td>1.79</td>
<td>2.82</td>
<td>1.78</td>
<td>3.15</td>
<td>4.00</td>
<td>1.46</td>
<td>1.11</td>
<td>0.027</td>
<td>0.47</td>
<td>1.69</td>
</tr>
<tr>
<td>SRI LANKA</td>
<td>14.41</td>
<td>12.12</td>
<td>14.09</td>
<td>3.25</td>
<td>11.92</td>
<td>0.22</td>
<td>-</td>
<td>0.07</td>
<td>-</td>
<td>0.0003</td>
</tr>
</tbody>
</table>

| TOTAL WORLD EXPORTS/IMPORTS | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

## Table 10

### India: Exports and Imports to South Asian Countries (1970-74)

(As Percentage of World Exports & Imports)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangladesh</td>
<td>-</td>
<td>-</td>
<td>3.5</td>
<td>5.89</td>
<td>1.86</td>
<td>-</td>
<td>-</td>
<td>0.09</td>
<td>0.69</td>
<td>0.58</td>
</tr>
<tr>
<td>Burma</td>
<td>1.32</td>
<td>0.68</td>
<td>0.41</td>
<td>0.07</td>
<td>0.04</td>
<td>0.46</td>
<td>0.47</td>
<td>0.11</td>
<td>0.01</td>
<td>0.003</td>
</tr>
<tr>
<td>India</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Iran</td>
<td>1.72</td>
<td>1.41</td>
<td>1.40</td>
<td>1.31</td>
<td>1.94</td>
<td>5.33</td>
<td>6.65</td>
<td>7.27</td>
<td>7.06</td>
<td>12.82</td>
</tr>
<tr>
<td>Pakistan</td>
<td>0.02</td>
<td>0.0009</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>1.96</td>
<td>1.73</td>
<td>0.61</td>
<td>0.32</td>
<td>0.60</td>
<td>0.18</td>
<td>0.06</td>
<td>0.08</td>
<td>0.05</td>
<td>0.03</td>
</tr>
</tbody>
</table>

**Total World Exports/Imports**

|          | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>BANGLADESH</td>
<td></td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
<td>0.06</td>
</tr>
<tr>
<td>BURMA</td>
<td></td>
<td>-</td>
<td>-</td>
<td>0.009</td>
<td>0.01</td>
<td>0.008</td>
<td>-</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>INDIA</td>
<td>3.98</td>
<td>4.22</td>
<td>3.65</td>
<td>3.38</td>
<td>3.61</td>
<td>2.34</td>
<td>1.47</td>
<td>1.34</td>
<td>1.16</td>
<td>0.9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>IRAN</td>
<td></td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PAKISTAN</td>
<td>1.08</td>
<td>0.81</td>
<td>0.19</td>
<td>0.14</td>
<td>0.11</td>
<td>0.35</td>
<td>0.24</td>
<td>0.11</td>
<td>0.41</td>
<td>0.95</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SRI LANKA</td>
<td>0.21</td>
<td>0.01</td>
<td>-</td>
<td>-</td>
<td>0.09</td>
<td>0.05</td>
<td>-</td>
<td>-</td>
<td>0.22</td>
<td>0.17</td>
<td></td>
<td></td>
</tr>
<tr>
<td>TOTAL WORLD EXPORTS/IMPORTS</td>
<td></td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>BANGLADESH</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>0.19</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>0.03</td>
</tr>
<tr>
<td>BURMA</td>
<td>0.37</td>
<td>0.30</td>
<td>0.06</td>
<td>0.10</td>
<td>0.41</td>
<td>0.16</td>
<td>0.12</td>
<td>0.42</td>
<td>0.57</td>
<td>0.57</td>
</tr>
<tr>
<td>INDIA</td>
<td>0.01</td>
<td>0.002</td>
<td>0.05</td>
<td>0.006</td>
<td>-</td>
<td>0.02</td>
<td>0.04</td>
<td>0.008</td>
<td>0.003</td>
<td>-</td>
</tr>
<tr>
<td>IRAN</td>
<td>0.74</td>
<td>0.74</td>
<td>0.41</td>
<td>1.54</td>
<td>5.99</td>
<td>2.71</td>
<td>3.36</td>
<td>1.24</td>
<td>0.97</td>
<td>1.29</td>
</tr>
<tr>
<td>PAKISTAN</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>SRI LANKA</td>
<td>1.56</td>
<td>1.99</td>
<td>2.24</td>
<td>1.39</td>
<td>4.78</td>
<td>0.57</td>
<td>1.37</td>
<td>3.74</td>
<td>3.29</td>
<td>2.78</td>
</tr>
<tr>
<td><strong>TOTAL WORLD</strong></td>
<td><strong>100.0</strong></td>
<td><strong>100.0</strong></td>
<td><strong>100.0</strong></td>
<td><strong>100.0</strong></td>
<td><strong>100.0</strong></td>
<td><strong>100.0</strong></td>
<td><strong>100.0</strong></td>
<td><strong>100.0</strong></td>
<td><strong>100.0</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

**COMPUTED FROM: "DIRECTION OF TRADE", (IMF-IBRD), Annual 1970-74.**
### SRI-LANKA: EXPORTS AND IMPORTS TO SOUTH ASIAN COUNTRIES (1970-74)

(As Percentage of World Exports & Imports)

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>EXPORTS</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th>IMPORTS</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>BANGLADESH</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>BURMA</td>
<td>0.12</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3.84</td>
<td>3.98</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>INDIA</td>
<td>1.06</td>
<td>0.54</td>
<td>0.49</td>
<td>0.39</td>
<td>0.14</td>
<td>9.75</td>
<td>10.59</td>
<td>5.34</td>
<td>2.97</td>
</tr>
<tr>
<td>IRAN</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>0.07</td>
<td>0.13</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>PAKISTAN</td>
<td>2.12</td>
<td>5.72</td>
<td>7.78</td>
<td>8.24</td>
<td>8.12</td>
<td>2.50</td>
<td>3.41</td>
<td>4.06</td>
<td>4.01</td>
</tr>
<tr>
<td>SRI LANKA</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

**Total World Exports/Imports**

|             | 100.0   | 100.0  | 100.0  | 100.0  | 100.0  | 100.0   | 100.0 | 100.0 | 100.0 | 100.0 |

increase trade between them but will also provide them with an opportunity to develop rapidly.

Theoretically, the union between neighboring countries is preferred to one between countries, geographically located at a distance. In this connection Tinbergen wrote,

"Economic integration should as a rule be undertaken by a group of neighboring countries. Trade relations are more intensive between countries that are closer together than between distant countries."\(^{18}\)

The countries, included in the region under study, are neighboring countries having a long history of trading relations, which are disrupted mainly by political reasons in the past. This means that the trading relations between these countries can and should be improved on a priority basis if the tensions of poverty are to be eased. All countries in South Asia, excluding Iran, were a part of the British Empire as a consequence of which they have a demonstrable degree of homogeneity. If the religion is included as a factor for integration, the region overtly becomes a heterogeneous group but this is the case with any country or region in world. The point in favor of this region is that the religions as practiced in this region, except Islam and Christianity, have originated in India. If the other two religions are considered, it also shows that they have originated in the countries neighboring India and they are

practiced in this region also and represent a singular mode of behaviour and thought. Above all, these countries have similar economic problems and an urge to develop as rapidly as possible. How to develop rapidly through their efforts is a question for them and the formation of a common market is a way to answer that question.

The hypothesis, that the trading relations should be established between countries of same level of development, if accepted, also justifies that the trading relations between countries of South Asia be strengthened. Whether these countries of the region are at a more or less same level of development can be judged from Table 1. If per capita GNP is the criteria to determine the level of development then it is between $80 and $100 for all countries except Iran. This can be studied from Table 14. This table also indicates that this region is made up of two income groups. One with per capita income higher than $100 per year and the other with lower one. Bringing them together will provide deficient regions with investible resources that can be utilized for investment purposes in the area. This will to that extent help this area to reduce its reliance on foreign aid.

The Benefits of The Common Market:

The purpose, here, is to show how far the formation of an economic union can help these countries in reducing the tensions resulting from their economic malaise? This explor-
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>BANGLADESH (a)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>(b)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>BURMA</td>
<td>77</td>
<td>78</td>
<td>76</td>
<td>68</td>
<td>82</td>
</tr>
<tr>
<td>(a)</td>
<td>75</td>
<td>78</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>(b)</td>
<td>92</td>
<td>99</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>INDIA</td>
<td>86</td>
<td>93</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>(a)</td>
<td>366</td>
<td>407</td>
<td>485</td>
<td>571</td>
<td>-</td>
</tr>
<tr>
<td>(b)</td>
<td>317</td>
<td>352</td>
<td>420</td>
<td>494</td>
<td>-</td>
</tr>
<tr>
<td>IRAN</td>
<td>172</td>
<td>176</td>
<td>181</td>
<td>116</td>
<td>-</td>
</tr>
<tr>
<td>(a)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>(b)</td>
<td>162</td>
<td>174</td>
<td>175</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>SRI LANKA</td>
<td>106</td>
<td>109</td>
<td>125</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

(a) Per Capita Gross Domestic Produce: (Purchaser's Value)

(b) Per Capita National Income: (Market Prices)

ed by considering following two propositions:

1. If an economic union is formed between countries under study will it be self-sufficient in meeting its foodgrains requirement? and

2. will there be trade creating and trade diverting effects of the union?

If the common market is established between countries of South Asia, it is implied that the trade between member countries is preferred to that with non-member countries. Secondly, there will be a common tariff imposed on trade, especially imports competing with the products of member countries, with non-member countries. The dismantling of the tariff walls between member countries will encourage movements of goods and services as well as those of factors between member countries. This will encourage freer trade in place of the existing restricted trade with the neighboring countries. Before exploring this possibility any further it is desirable to see what will be its effect on an immediate economic problem of this area such as the food problem. This is studied in relation to the supply and demand for cereals as they constitute a staple item in their consumption.

Tables 15-17 give information pertaining to consumption and the production of cereals, tea and sugar. The calculations for table 15 are based on the assumptions -- that the demand for cereals is mainly determined by the rate of growth in the population in the region because an increase in per capita income is meagre or very slow; and that it being
## Production and Consumption of Cereals (Mill. Tonnes)

<table>
<thead>
<tr>
<th>YEAR</th>
<th>BANGLADESH PROD. CONSU. DIFF. (+or-)</th>
<th>BURMA PROD. CONSU. DIFF. (+or-)</th>
<th>INDIA PROD. CONSU. DIFF. (+or-)</th>
<th>IRAN PROD. CONSU. DIFF. (+or-)</th>
<th>PAKISTAN PROD. CONSU. DIFF. (+or-)</th>
<th>SRI LANKA PROD. CONSU. DIFF. (+or-)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961</td>
<td>6.97 3.82 +3.15</td>
<td>62.75</td>
<td>3.47 3.66 -.19</td>
<td>15.92</td>
<td>.96</td>
<td>1.46 -.50</td>
</tr>
<tr>
<td>1962</td>
<td>7.75 3.90 +3.85</td>
<td>63.72</td>
<td>3.61 3.78 -.17</td>
<td>15.35</td>
<td>1.06</td>
<td>1.50 -.44</td>
</tr>
<tr>
<td>1963</td>
<td>7.87 3.99 +3.88</td>
<td>62.31</td>
<td>3.33 3.89 -.56</td>
<td>17.14</td>
<td>1.08</td>
<td>1.53 -.45</td>
</tr>
<tr>
<td>1964</td>
<td>8.61 4.07 +4.54</td>
<td>64.49</td>
<td>3.55 4.00 -.45</td>
<td>17.75</td>
<td>8.84 +8.91</td>
<td>1.10 1.57 -.47</td>
</tr>
<tr>
<td>1965</td>
<td>8.19 4.15 +4.04</td>
<td>70.43</td>
<td>4.67 4.02 +.65</td>
<td>16.96</td>
<td>9.16 +7.80</td>
<td>.79 1.61 -.82</td>
</tr>
<tr>
<td>1966</td>
<td>6.79 4.24 +2.55</td>
<td>57.14</td>
<td>5.43 2.24 +1.19</td>
<td>16.57</td>
<td>9.30 +7.27</td>
<td>1.01 1.66 -.65</td>
</tr>
<tr>
<td>1967</td>
<td>7.91 4.33 +3.58</td>
<td>60.42</td>
<td>5.70 4.37 +1.33</td>
<td>20.65</td>
<td>9.64 +11.01</td>
<td>1.19 1.71 -.52</td>
</tr>
<tr>
<td>1968</td>
<td>8.14 4.43 +3.71</td>
<td>75.66</td>
<td>5.69 4.50 +1.19</td>
<td>21.31</td>
<td>10.70 +10.61</td>
<td>1.39 1.79 -.40</td>
</tr>
<tr>
<td>1969</td>
<td>8.08 4.53 +3.55</td>
<td>77.72</td>
<td>5.26 4.63 +.63</td>
<td>21.11</td>
<td>11.10 +10.01</td>
<td>1.41 1.90 -.49</td>
</tr>
<tr>
<td>1970</td>
<td>8.26 4.63 +3.63</td>
<td>81.25</td>
<td>4.85 4.76 +.09</td>
<td>10.05</td>
<td>11.50 +7.55</td>
<td>1.65 1.94 -.29</td>
</tr>
<tr>
<td>1971</td>
<td>11.82 11.61 +.21</td>
<td>8.30 4.73 +3.57</td>
<td>89.30</td>
<td>83.44 +5.86</td>
<td>4.70 4.95 -.25</td>
<td>20.19* 11.91 +8.28</td>
</tr>
<tr>
<td>1972</td>
<td>9.80 11.61 -1.81</td>
<td>7.66* 4.85 +2.81</td>
<td>104.41</td>
<td>85.20 +17.20</td>
<td>21.85* 12.35 +9.50</td>
<td>1.46 2.02 -.56</td>
</tr>
<tr>
<td>1973</td>
<td>*10.002 13.20 -3.20</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>92.062 86.98 +5.08</td>
</tr>
</tbody>
</table>

* Approximate
1 Total Food Grains Output
2 From Reserve Bank of India Bulletin: May '75

(2) Statistical Year Book for Asia & Far East, 1972.
<table>
<thead>
<tr>
<th>YEAR</th>
<th>BANGLADESH</th>
<th>BURMA</th>
<th>INDIA</th>
<th>IRAN</th>
<th>PAKISTAN</th>
<th>SRI LANKA</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>PROD.</td>
<td>CONSU.</td>
<td>DIFF.</td>
<td>PROD.</td>
<td>CONSU.</td>
<td>DIFF.</td>
</tr>
<tr>
<td></td>
<td>(+or−)</td>
<td>(+or−)</td>
<td>(+or−)</td>
<td>(+or−)</td>
<td>(+or−)</td>
<td>(+or−)</td>
</tr>
<tr>
<td>1961</td>
<td>321</td>
<td>140</td>
<td>+181</td>
<td>11</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1962</td>
<td>354</td>
<td>136</td>
<td>+218</td>
<td>12</td>
<td>5.55</td>
<td>+6.15</td>
</tr>
<tr>
<td>1964</td>
<td>346</td>
<td>149</td>
<td>+197</td>
<td>10</td>
<td>5.08</td>
<td>+4.32</td>
</tr>
<tr>
<td>1965</td>
<td>372</td>
<td>163</td>
<td>+209</td>
<td>13</td>
<td>9.70</td>
<td>+3.3</td>
</tr>
<tr>
<td>1966</td>
<td>366</td>
<td>184</td>
<td>+182</td>
<td>13</td>
<td>6.40</td>
<td>+6.54</td>
</tr>
<tr>
<td>1967</td>
<td>376</td>
<td>181</td>
<td>+195</td>
<td>16</td>
<td>5.47</td>
<td>+10.53</td>
</tr>
<tr>
<td>1968</td>
<td>385</td>
<td>186</td>
<td>+199</td>
<td>20</td>
<td>6.34</td>
<td>+13.66</td>
</tr>
<tr>
<td>1969</td>
<td>402</td>
<td>203</td>
<td>+199</td>
<td>19</td>
<td>6.51</td>
<td>+9.49</td>
</tr>
<tr>
<td>1970</td>
<td>396</td>
<td>-</td>
<td></td>
<td>20</td>
<td>6.18</td>
<td>+13.82</td>
</tr>
<tr>
<td>1971</td>
<td>422</td>
<td>-</td>
<td></td>
<td>21</td>
<td>7.63</td>
<td>+13.37</td>
</tr>
</tbody>
</table>

Computed From: Statistical Year Book for Asia & Far East, 1972

(a) Data for Bangladesh & Burma are not available.
## TABLE: 17

PRODUCTION AND CONSUMPTION OF SUGAR (000 Metric Tons)

<table>
<thead>
<tr>
<th>YEAR</th>
<th>BANGLADESH PROD.</th>
<th>BANGLADESH CONSU.</th>
<th>BURMA PROD.</th>
<th>BURMA CONSU.</th>
<th>INDIA PROD.</th>
<th>INDIA CONSU.</th>
<th>IRAN PROD.</th>
<th>IRAN CONSU.</th>
<th>PAKISTAN PROD.</th>
<th>PAKISTAN CONSU.</th>
<th>SRI LANKA PROD.</th>
<th>SRI LANKA CONSU.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>PROD. DIFF. (+or-)</td>
<td>CONSU. DIFF. (+or-)</td>
<td>PROD. DIFF. (+or-)</td>
<td>CONSU. DIFF. (+or-)</td>
<td>PROD. DIFF. (+or-)</td>
<td>CONSU. DIFF. (+or-)</td>
<td>PROD. DIFF. (+or-)</td>
<td>CONSU. DIFF. (+or-)</td>
<td>PROD. DIFF. (+or-)</td>
<td>CONSU. DIFF. (+or-)</td>
<td>PROD. DIFF. (+or-)</td>
<td>CONSU. DIFF. (+or-)</td>
</tr>
<tr>
<td>1961</td>
<td>46</td>
<td>-</td>
<td>3095</td>
<td>-</td>
<td>133</td>
<td>-</td>
<td>138</td>
<td>-</td>
<td>4.0</td>
<td>-</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1962</td>
<td>61</td>
<td>-</td>
<td>3036</td>
<td>-</td>
<td>155</td>
<td>-</td>
<td>211</td>
<td>-</td>
<td>10.0</td>
<td>-</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1963</td>
<td>67 66</td>
<td>+1.0</td>
<td>2497 2673</td>
<td>-176</td>
<td>165 413</td>
<td>-248</td>
<td>316 341</td>
<td>-25</td>
<td>5.3 212</td>
<td>-206.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1964</td>
<td>54 99</td>
<td>-45.0</td>
<td>2839 2516</td>
<td>+323</td>
<td>185 543</td>
<td>-358</td>
<td>257 333</td>
<td>-76</td>
<td>6.8 228</td>
<td>-221.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1965</td>
<td>71 112</td>
<td>-41.0</td>
<td>3493 2776</td>
<td>+717</td>
<td>242 544</td>
<td>-302</td>
<td>314 415</td>
<td>-101</td>
<td>8.0 210</td>
<td>-202.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1966</td>
<td>64 119</td>
<td>-55.0</td>
<td>3633 3141</td>
<td>+492</td>
<td>356 578</td>
<td>-222</td>
<td>525 527</td>
<td>-2</td>
<td>10.0 224</td>
<td>-214.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1967</td>
<td>71 68</td>
<td>+3.0</td>
<td>2357 2561</td>
<td>-204</td>
<td>457 592</td>
<td>-135</td>
<td>555 568</td>
<td>-13</td>
<td>8.0 291</td>
<td>-283.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1968</td>
<td>75 55</td>
<td>+20.0</td>
<td>2375 2400</td>
<td>-25</td>
<td>458 652</td>
<td>-194</td>
<td>429 585</td>
<td>-156</td>
<td>8.5 290</td>
<td>-281.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1969</td>
<td>80 85</td>
<td>-5.0</td>
<td>4190 3122</td>
<td>+1063</td>
<td>557 680</td>
<td>-123</td>
<td>541 597</td>
<td>-56</td>
<td>10.1 305</td>
<td>-294.9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1970</td>
<td>90 95</td>
<td>-5.0</td>
<td>4634 3767</td>
<td>+867</td>
<td>617 707</td>
<td>-90</td>
<td>770 625</td>
<td>+145</td>
<td>15.7 311</td>
<td>-295.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1971</td>
<td>95 97</td>
<td>-2.0</td>
<td>3959 4438</td>
<td>-479</td>
<td>650 740</td>
<td>-90</td>
<td>590 650</td>
<td>-60</td>
<td>10.9 299</td>
<td>-288.1</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


(a) Data for Bangladesh are not available.
an essential basic requirement its price elasticity of demand will be less than 1. If masses are to be provided with what they are actually getting (0.91 lbs. per capita per day) the annual demand for cereals for the region as a whole will be around 124.0082 million tons for 1971 while its production for that year was around 131.44 million tons, leaving thereby a surplus of around 7.4 million tons. This information suggests that with the freer trade in agricultural products and concerted efforts for agricultural development in the region, can make the region capable of meeting its food requirements.

Tables 16-17 give a picture about the production and consumption of tea and sugar for the region. In the case of tea, the region as a whole has a surplus, while in the case of the latter commodity it has a deficit which could initially be made good by imports and later on through the expansion in its production. Thus the formation of the union between these countries may result in narrowing the gap between the international prices and the domestic prices of agricultural products thereby providing better price incentives to the farmers. It will also result in eliminating illegal exports of foodgrains to the neighboring scarce regions.

If a common market is formed there will be possible effects of trade creation and trade diversion. This reflects that the formation of the common market will result in a shift in the sources of imports from non-member to member country or countries and from one member to the other. The demand for imports is principally determined by the changes in the incomes
of the importing countries. So the possibility for the trade creation or trade diversion can be studied by estimating the income elasticity of demand for imports. If an elasticity co-efficient is greater than 1, the trade creation effects will be dominant. This will indicate that with the increase in income the import requirements will be increasing. If the co-efficient is less than 1, the trade diverting effects will be dominant. This indicates that with increase in the income the demand for imports will be increasing less rapidly and the increased demand will be met in increasing proportion by domestic production of the commodity or commodities in question. This possibility should be explored commoditywise but here it is explored by considering the overall possibility. This is given in table 18. This table indicates that the trade creation will be dominant in case Iran and Pakistan. In case of India, Burma, Sri Lanka these coefficients are negative but greater than 1, meaning thereby that the demand for imports are negatively related with the growth in income and reflecting thereby that these economies are likely to be diversified and will be capable of relying more and more on the domestic production. This interpretation is likely to undergo a change because the imports are restricted in these countries as a result of which the impact of increased income is not fully reflected in the demand for imports. The imports are restricted or prohibited to encourage import substitution in these economies. This has resulted in imposing prohibitive tariffs on imports of different types of commodities in these
<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>INCOME ELASTICITY OF IMPORTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>BANGLADESH</td>
<td>-</td>
</tr>
<tr>
<td>BURMA</td>
<td>3.770634</td>
</tr>
<tr>
<td>INDIA</td>
<td>-1.862298</td>
</tr>
<tr>
<td>IRAN</td>
<td>+1.1320 (0.906312)</td>
</tr>
<tr>
<td>PAKISTAN</td>
<td>+1.80084</td>
</tr>
<tr>
<td>SRI LANKA</td>
<td>-2.3255</td>
</tr>
</tbody>
</table>

**SOURCE:** Computed From: (1) ECONOMIC SURVEY FOR ASIA & FAR EAST, 1973.
(2) STATISTICAL YEAR BOOK FOR ASIA & FAR EAST, 1972.
economies. Their rates vary from commodities to commodities as well as from country to country. This can be seen from the following information.

The United Nations study on "Inter-regional Trade flows: Effective Protection and Income Distribution" for the countries of the ECAFE region, shows that the rate of effective protection in case of India, where the nominal and protective tariffs are same, is between 15 percent and 120 percent. For Iran the average tariff rate is between 11.7 percent on paper and 315.8 percent on beverages, the highest rate being 411 percent on pears. In case of Pakistan the rates of effective as well as nominal tariffs are different for West Pakistan and East Pakistan (Bangladesh). The nominal tariffs in case of the former varies between 39 percent and 75.1 percent on metal products, 362.7 percent on wood products and 897.2 percent on edible oils. In the case of the latter, (East Pakistan: Bangladesh) the nominal tariff rate varied between 38.3 percent and 66.3 percent, the effective rate is 11.85 percent on fertilizers and 4837.0 percent on textiles. In Sri Lanka the nominal tariff is levied by categorizing the goods between essential and non-essential; the nominal tariffs on essential goods are between 5 percent to 19 percent and between 50 percent to 310 percent on non-essential goods. The average tariff rate being 115 percent. The effective protection rate is 452.4 percent.

The imposition of a high tariffs for the protection of the domestic industries has created a divergence between the
world prices of these protected goods and their domestic prices thereby putting an undue premium on the production of goods that are not essential for the development in these countries. This distortion has resulted in creating a situation of malallocation of resources in these economies which can be corrected by reducing the divergence between international and the domestic prices as well as the profitability between different sectors in the economy. The establishment of the common market can possibly create this situation because it aims at imposing, as a common tariff, that rate of tariff which is the lowest effective rate in the region. Such a reduction of tariffs will definitely encourage trade between member countries and provide masses with a real income higher than they had before the union.

Thus, the increased trade between these countries will pave the way for rapid industrialization in the region. This is because the prospects of self-sufficiency in basic requirements of life such as food, coupled with the possibility of the availability of inputs for fertilizers and other industries and larger markets for industrial products will result in better utilization of available resources and reduced reliance on foreign aid, the uncertainty of which has affected their performance.
CHAPTER IV

THE CONCLUDING REMARKS AND THE SUMMARY

The discussion in chapters 1 and 3 emphasized considerably the fact that the economic development, based and initiated on foreign aid, imparts uncertainty in the process of development itself. This uncertainty ultimately affects the end in itself. The process of economic growth in developing countries can be initiated by providing foreign capital at a stable rate. This will also facilitate the development at a stable rate. The stable rate of foreign capital inflow in developing countries, its quantum, as estimated by experts should at least be 1 percent of the GNP of developed countries. This target, though not impossible to realize, is not realized for reasons known only to politicians. The truth of the matter, as it relates to the students of economics, is that the foreign aid is not forthcoming in the required quantum. On the other hand the aid requirement is continually increasing with the intensification of the development efforts in countries of South Asia in particular and developing countries in general. If the aid fails to expand, the alternative is to tighten their belts to raise necessary resources for development purposes which they are unable to do as they have no waist due to poverty and economic underdevelopment. The other
alternative is suggested by Soviet academician and physicist Andrei Sakharov. He suggested,

"It is necessary to have a tax on the developed countries equal to 20 percent of the national income for next fifteen years. The introduction of such a tax would automatically lead to a significant decrease in expenditures for weapons. Such a joint aid would considerably help to stabilize and improve the position of most underdeveloped countries; it would limit the influence of extremists of all types . . . . Mankind can develop painlessly only by viewing itself in the demographic sense as a unit, as one family without divisions into nations, except from the point of view of hisotry and traditions."1

Sakharov's programme points to two aspects such as a higher proportion of aid with consequences to spurt economic development and the reduced expenditures on weapons and viewing mankind as one unit like a family -- an ideal similar to that of "VASUDHAIV KUTUMBAKAM", world as a family, -- rooted in Indian philosophy. The idea of 20 percent of tax on the combined national incomes of the developed countries is considered not only unfeasible but is unacceptable to many. A higher proportion of aid -- 5 percent to 10 percent -- is not an unfeasible proposition to many economists like Bhagwati, if proper care is taken through training and education.

Technology and Economic Integration

As regards to his second proposition, the technological and scientific revolution of the twentieth century has

created a need for altering an old concept of nationalism. This is the need of the time if a total war is to be averted. In this connection Mrs. Robinson wrote,

"Ever since the application of scientific technology to means of destruction, each war starting a little above the level at which the last ended, has changed Marshall's agreeable vision of industry at the services of mankind into a nightmare of terror."\(^2\)

The use of technology and scientific knowledge in defense production has resulted in compelling developing countries to spend more and more of their scarce resources for defense purposes at a time when they are badly needed for investment in their economies. This is because of the fact that all the wars that have been waged since second World War were in Asia. This has affected their morale. Even the present tension is in the Near East Asia. To avoid wars in that part of the world it is in their interest to rely on their efforts, as no development is possible without sweat and toil on the part of the populace of the region. This can be done through regional sub-grouping of the economies. This will put the industry at the service of mankind because this requires one to live in peace with one's neighbor. A failure to realize the dangers of rigid nationalism in the present world will make mankind more miserable in the future than it is now. This is because of the entropy law as it involves the notion of irreversibility meaning thereby,

"that certain processes go in one direction only and can never be repeated except at a far greater cost on the whole." ³

Two world wars are an example and the second law of thermodynamics - the entropy law - is that

"the natural state of things is to pass from order to disorder. Whence the notion of entropy as time's arrow." ⁴

The modern technology and its use in fields of economic activities has brought into operation entropy law and demands expansion of markets and better relations with neighboring countries to improve economic conditions of masses. This has remained an inevitable consequence of the Industrial Revolution. A better utilization of available resources in this technological age, demands integration of markets not only between countries of South Asia but elsewhere also. The formation of a common market in South Asia will help fostering a rapid development in the countries of the region by exploiting the economies of the large scale production and will lead them towards greater regional self reliance through better use of the modern technology and available resources.

Failure to do this may result in what Nicholas Georgenscu-Rogen feels,

"When the bonanza (of cheap fuel) disappears, we may get into the kind of experience similar to that of species like fish which they find they have to


⁴N. Wade, ibid, p. 448.
adapt to living in a shallower waters. But in our case it would be a political and sociological change, not a biological modification. Evolution even exosomatic evolution, is not reversible—man would rather die in the penthouse than live in the cave."^5

If this happens what will happen to Marshall's vision of industry at the service of mankind? In this context Mrs. Robinson quotes Marshall in the following:

"The problem of social aims takes on new forms in every age: but underlying all is the one fundamental principle: viz. that progress mainly depends on the extent to which the strongest, and not merely the highest, forces of human nature can be utilized for the increase of social good. There are some doubts as to what social good really is; but they do not reach far enough to impair foundations of this fundamental principle. For there has always been substratum of agreement that social good lies mainly in that healthful exercise and the development of faculties which yields happiness without pall, because it sustains self respect and is sustained by hope."^6

The formation of the common market between South Asian countries will not only give self respect and hope to people in that area that their economic future will be better than it was or is. This may be possible through integration because it will lead to channelizing efforts in the direction of reconstruction of those economies which will bring better life for them. The establishment of the common market may result in

1. reducing tariffs, which will reduce the divergence between world prices and the domestic prices of

5N. Wade, ibid, p. 450.

6J. Robinson, op. cit., p. 71.
consumer's as well as capital goods because it involves reduction of tariffs with non member countries and tariff abolition between member countries. This will result in freer trade between members and restricted trade with non-member countries. This is a situation of the second best for welfare maximization and is considered desirable by many economists. This situation of freer trade is better than a situation of no trade with neighboring countries.

2. The trade between countries measured as a proportion of total world trade is negligible. An increase in trade among themselves will create conditions congenial for rapid development by expanding markets through understanding and will encourage specialization in production through agreements which will help this area to exploit new complimentarities in production and use viably the modern technology by restricting trade with developed countries.

3. The development of modern industries through agreed specialization will provide necessary inputs for the development of agriculture in the area. This will make the area self-reliant in agriculture.

4. These developments will create more jobs and higher incomes for the people in the area.

5. It is desirable that the prevailing tensions of war in that area be avoided. One way to do this is to
live with understanding with neighboring countries. The formation of the common market may help in creating a climate for this.

Policy Suggestion

If one has to make policy based on this study, they would be

1. A regional commission made up of experts be formed to formulate, implement and evaluate the tariff policy for the union.

2. A regional planning body be established to formulate development plans and determine location of industries in the region. It should also prepare a blueprint for harmonizing policies of different members of the union.
BIBLIOGRAPHY

BOOKS:


**ARTICLES**


**STATISTICAL MATERIAL**


United Nations, "Statistical Year Book For Asia and Far East, 1972."