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Enhancing Trade with Neighbors for Economic Development

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ABSTRACT

Different nations followed different paths to achieve development/growth and managed varying degrees of success. As various countries are different in their physical, economic, political and other characteristics, the theoretical basis and strategies followed by them to achieve their goal are also varied.

A large number of economists have empirically examined the relation between trade and development. Some have extended this to include the issue of poverty also. Most of the studies show that the countries which have followed policy of trade expansion, have achieved better growth rates, though it is difficult to conclusively prove that trade has resulted in higher growth rate.

The present study aims at examining the experience of India, Pakistan and China in this regard. These countries are not only important for South Asia but also for the whole world, because two most populous countries of the world with a huge market for all kinds of commodities are included in this. They are close neighbors but unfortunately have always faced the problem of strained relationship. There are many compelling historical and political factors which continue to obstruct process of normalization of relationship.

Following are the main objectives of this paper:

1. To analyze the relationship between trade and growth.
2. To examine the views and findings of various experts on trade and growth experience of various countries.
3. To examine the role of trade in the growth experience of India, Pakistan and China.
4. To examine the scope and potential of trade between India and Pakistan for achieving growth.

There is evidence to show that between India and Pakistan, a huge volume of trade is through unofficial route, also known as unofficial trade. In other words there is a huge potential of untapped possibilities of trade between two countries. A conscious and deliberate effort in this direction may not only help both nations to achieve many economic goals but also ease political tensions between two countries.

Enhancing Trade with Neighbors for Economic Development

INTRODUCTION

"A country's destiny is linked to its neighbourhood", said Prime Minister Narendra Modi in his historic address to the United Nations General Assembly on 27th Sep 2014. Although, destiny in this context embraces many aspects, economic growth and development is one of the most crucial aspects. There are a large number of divergent theories and models to explain how development can be achieved in a country. This paper deals with the proposal that trade (particularly with neighbours) can be used as a means to achieve growth and development.

The first part of this paper deals with the views of economists, who turned to international trade as an important catalyst to growth as well views of those who are opposed to free trade. Under the 'review of literature', the experience of different nations that used trade as a means in their quest for growth, development and removal of poverty, is examined. In the next section, the experience of India and its neighbors (China and Pakistan) is examined in this context. This paper also examines the potential of India's trade with neighbours, particularly with Pakistan. Among the South East Asian countries these three countries form a big chunk of market. So it is strongly recommended that efforts should be made to realize the full potential of trade with neighbours. This will increase economic activity and income, resulting in higher income and growth for all participant neighbours.

Considering the present state of political atmosphere in the Indian subcontinent, it may sound impractical .The fact that Prime Minister of Pakistan attended installation of Prime Minister Modi and the Chinese President decided to visit India soon after the new government took office, point towards some hope for future. Lack of friendly relationship with neighbours has a serious negative effect on the process of growth. All these three countries are raising their defense budget each year and there is a serious race to acquire better arms particularly between India and Pakistan. If we realize the importance and scope

of economic ties and improve bilateral relationship, it may reduce very heavy expenditure on defense. It will release large resources for investment for economic development.

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THEORETICALVIEWS

Among the recent economists, Myint (1958), Haberler (1961) and Viner (1953)had argued along lines similar to the classical doctrine of Adam Smith, Heckscher, Ohlin and Samuelson that trade and specialization can increase the 'extent of the market'. Free trade was considered as trade policy that could promote economic well-being and development of all the trading partners. However, many economists like Nurkse (1986), Singer (1982) and Prebisch (1950) raiseddoubts on this account. This idea that gained popularity since 1950s may be loosely termed 'structuralism'.The 'structuralist' thesis, called attention to the distinct structural problems of the third world countries.

One of the distinctive features of third world development was that, unlike European development, it was supposed to occur while these countries existed alongside already-developed Western countries and were tied to them through trade. This could give rise to distinct structural problems for development. Raul Prebisch (1950), economist associated with The United Nations Commission on Latin America, formulated the famous 'dependency' theory of economic development, wherein he argued that the world was drawn into a 'center-periphery' relationship among nations, where the third world was regressing into becoming the producer of raw materials for first world manufacturers and were thus condemned to a peripheral and dependent role in the world economy. Prebisch, concluded that some degree of protectionism in trade was necessary if these countries were to enter a self-sustaining development path. Import-substitution enabled by protection and government policy, rather than free trade and export-orientation was therefore, considered a

preferred strategy.

The Prebisch-Singer thesis resounded particularly with Marxian thinkers as it included shades of arguments against imperialism. Many third world governments adopted the language and policies of the structuralists and/or the Neo-Marxians in the 1960s and 1970s. 'Neo-Colonialism', 'core-periphery' and 'dependency' were the catch-words of those days. However, as time moved on, these policies of import substitution and protection, seemed to fail to yield their promised fruit, and a Neoclassical (or, more accurately, Neo-Liberal) countermovement initiated by the voices of Bauer (1973), Balassa (1978) and Krueger (1990) began to gain more adherents. Their thesis was simple i.e. government intervention did not improve development, it in fact thwarted development. The emergence of huge bureaucracies and state regulations, they argued, suffocated private investment and distorted prices, making developing economies extraordinarily inefficient.

REVIEW OF LITERATURE

Bhagwatiand T.N. Srinivasan (2004) have taken up theoretical and empirical analysis of impact of free trade on poor countries. They have used both static and dynamic arguments to state that expansion of trade has helped poor countries. The low income population in a country is most affected by inflation. When a country aims at expansion of trade, it is important for them to control inflation and maintain stability. This definitely helps the low income group.

Dynamic argument is provided by citing the example of two countries -China and India, which have a large part of population below poverty line. During 1980-2000 real GDP grew at an annual average rate of 10% in China and 6% in India. During these two decades both countries achieved significant reductions in poverty when they grew rapidly. The incidence of poverty, by agreed measures, declined from 28% in 1978 to 9% in 1998 in China. By the Government of India's estimates, poverty incidence fell from 51% in 1977-78 to 27% in 1999-2000. This is also the period when these two countries integrated themselves into world market. On the other hand, the period prior to 1980 is marked by low growth rate, no reduction of poverty level and restrictions on external relations.

Roemerand Mary Kay Gugerty (March 1997), have examined the relationship between economic growth and poverty, the question, whether growth reduces poverty. They conclude that there is every reason to believe economic growth reduces poverty. GDP growth of ten

percent per year is associated with income growth of ten percent for the poorest 40% of the population. For the poorest 20% the elasticity of response is 0.921; GDP growth of 10% is associated with income growth of 9.21%. This study also indicates that more outwardly oriented countries grow more quickly, leading to greater poverty alleviation.

There is little evidence to support the contention that economic growth and outward-oriented policies will hurt the poor. Countries with higher rates of economic growth over the last 30 years have achieved greater reductions in poverty.

Dollar and Aart Kraay (2007) have provided evidence that, increased trade has strongly encouraged growth and poverty reduction and has contributed to narrowing the gaps between rich and poor worldwide. They have focused on the experiences of a small group of developing countries that have seen large increases in trade over the past 20 years. These countries are referred as the "post-1980 globalizers", for example. Argentina, Bangladesh, China, India etc. Per capita GDP growth in the post-1980 globalizers accelerated from 1.4 percent a year in the 1960s, to 2.9 percent a year in the 1970s, to 3.5 percent in the 1980s and 5.0 percent in the 1990s. It is also seen that those countries which did not participate in the process of expansion of external sector did lag behind. Their conclusion is that trade liberalization leads to higher growth of average incomes and growth of average incomes increases the incomes of the poor proportionately. However, Dollar and Kraay do agree that this result cannot be considered as conclusive and the experience is not exactly same for all the nations.

Howard L. M. Nye and Sanjay G. Reddy have critically examined the proposition given by Dollar and Kraay in their paper, "Trade, Growth, and Poverty". Dollar and Kraay claim to present evidence that trade liberalization leads to faster growth in average incomes, and that this growth in average incomes in turn increases the income of the poor "proportionately", thus leading to decreased absolute poverty. Dollar and Kraay suggest that one of the surest ways for less developed countries to alleviate poverty is to pursue policies of trade liberalization. Nye and Reddy do not agree with this. They argue that growth in national income need not increase the income of the bottom quintile. Further, even if this were true in a particular country, it would not imply that the bottom quintile benefits to the same extent as does the rest of the nation from an increase in national income. In any event, there is evidence that the incomes of poor (as distinguished from those of the bottom quintile of the income distribution) do grow at a slower rate than do average incomes. In particular, there is some