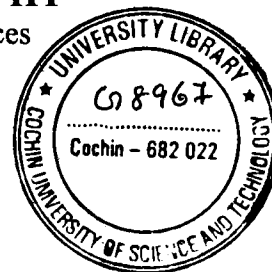


**A STUDY ON INDIA'S TRADE RELATIONSHIP
WITH SAARC COUNTRIES
WITH SPECIAL REFERENCE TO SAPTA**

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Thesis submitted to the
Cochin University of Science and Technology
for the award of the Degree of
DOCTOR OF PHILOSOPHY
Under the Faculty of Social Sciences



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CERTIFICATE

This is to certify that the thesis entitled “ **A STUDY ON INDIA’S TRADE RELATIONSHIP WITH SAARC COUNTRIES WITH SPECIAL REFERENCE TO SAPTA**” submitted by Shri. *M. Venkatesh* for the award of the Degree of Doctor of Philosophy by the Cochin University of Science and Technology is a record of bonafide research carried out by him under my supervision and guidance. The thesis has not previously formed the basis for the award of any degree, diploma, associateship, fellowship or other similar title of recognition.

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List of Abbreviations

ADB	Asian Development Bank
ASEAN	Association of South-East Asian Nations
CEC	Committee on Economic Cooperation
CIS	Commonwealth of Independent States
ESCAP	Economic and Social Commission of Asia and Pacific
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GDP	Gross Domestic Product
GEP	Group of Eminent Persons
GNH	Gross National Happiness
GNP	Gross National Product
IGG	Inter Governmental Group
IMF	International Monetary Fund
IPA	Integrated Program of Action
IPR	Intellectual Property Rights
JVs	Joint Ventures
LAIA	Latin American Integration Association
LDCs	Least Developed Countries
MNEs/Cs	Multi-National Enterprises/Companies
NAFTA	North American Free Trade Area

OECD	Organisation for Economic Cooperation and Development
OPEC	Organisation of Petroleum Exporting Countries
PTA	Preferential Trading Arrangements
RBI	Reserve Bank of India
RCA	Revealed Comparative Advantage
REA/REI/C	Regional Economic Association / Integration / Cooperation
RECSA	Regional Economic Cooperation in South Asia
RTA	Regional Trading Arrangements
SAARC	South Asian Association for Regional Cooperation
SACU	Southern African Customs Union
SADC	Southern African Development Community
SAFTA	SAARC Free Trading Agreement
SAPTA	SAARC Preferential Trading Agreement
SCCI	SAARC Chamber of Commerce and Industry
SITC	Standard International Trade Classification
SMCs	Small and Medium Countries
TMS	Trade, Manufacture and Services
TRIPS	Trade-Related aspects of Intellectual Property Rights
UNCTAD	United Nations Conference on Trade and Development
USA	United States of America
WTO	World Trade Organisation

CHAPTER – I

INTRODUCTION

In today's world no nation exists in economic isolation. A nation's economy, its industries, service sectors, levels of income and employment and living standards are linked to the economies of its trading partners. The benefits of international trade accrue in the forms of lower domestic prices, development of more efficient methods and new products and a greater range of consumption choices. In an open trading system, a country will import those commodities that it produces relatively at a higher cost. Since resources are channeled from uses of low productivity to that of high productivity, gains from trade are attained permitting higher levels of consumption and investment.

Over the past 20 years, world trade has grown twice as fast as real GDP deepening economic integration and raising living standards¹. The role of foreign trade in economic development is considerable and both are intimately connected. Trade can stimulate growth if exports are tending to increase faster than imports or be a brake on growth if imports are tending to increase faster than exports.

The dramatic growth of cross-border investment and international trade over the past two decades combined with explosive growth in global communications and technology. The FDI⁴ flow, which was \$160 billion in 1991 soared to \$1.1 trillion in 2000. And the volume of international trade also expanded dramatically

to 16 fold over the past 50 years, are an evident for well being of the nations through open trading system. However, it is generally accepted that the gains to a nation from free international trade may more than outweigh the losses to particular domestic firms and workers. Although free trade is often strongly advocated, many countries believe that the expansion in trade is best accomplished through the establishment of Regional Economic Association (REA) / Integration (REI). However, the emerging WTO regime has in no way undermined the process of regionalism. It has wide ranging implications for the global economy.

The South Asian Association for Regional Co-operation (SAARC) comprises the seven countries of South Asia. i.e., Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. SAARC is a manifestation of the determination of the people of South Asia to work together towards finding solutions to their common problems in a spirit of friendship, trust and understanding and to create an order based on mutual respect, equity and shared benefits. The primary objective of the Association is the acceleration of the process of economic and social development in member states, through collective action in agreed areas of co-operation

South Asian nations¹¹ have not only a shared culture and a common history, but also, a common destiny in the 21st century. South Asia constitutes 3% of world area, but houses 22% of the world's population. South Asia also makes an

integrated condominium of common rivers, mountain system, ocean and a conjoint ecological system.

The region suffers from massive balance of payments burden, mass unemployment, high population growth rate, large concentration of poverty, low rate of economic growth, constant food shortage, worsening terms of trade, largely illiterate, considerable malnourished, and also the least gender sensitive region of the globe.

The combined GDP⁴ of South Asia US \$ 609 trillion is only 1.8% of the world GDP. Unsurprisingly therefore, per capita incomes are low. In 2000 the average per capita income stood at \$ 490 and therefore poverty is a serious problem confronting the south Asian economies.

The South Asian economies differ rather significantly in size. For example³, India accounts for more than three-fourth of the region's GDP while Sri Lanka and Nepal contribute only 2.7% and 0.9% to the regional GDP respectively. Pakistan and Bangladesh comprise medium sized economies in the region and account for 11.7 and 8 percent respectively of the regional GDP. There are also sharp variations in per capita incomes across the countries, Sri Lanka's per capita income (US\$ 860) is over three times that of Nepal (US\$ 241). Whereas Bangladesh, India, and Pakistan's per capita income is US\$ 373, 459, and 516 respectively.

The Imports⁴ of South Asia increased from \$37.7 billion in 1990 to \$78.1 billion in 2000, indicating an annual growth rate of 9.8 percent, but the Exports increased at a more rapid rate of 12.06 percent, from \$27.3 billion in 1990 to \$65.2 billion in 2000. India's bilateral trade with the SAARC countries accounts for a small share in her trade. India's Imports from SAARC countries increased marginally from 0.54% of the total Imports in 1991 to 0.73% in 2000. Whereas, the Exports rose to 4.43% in 2000 compared to 1.78% in 1991 (More than doubled).

Due to the growing protectionist tendencies in the international market and the increasing competition among suppliers, particularly in the developing world, the need to evolve feasible strategies for regional economic co-operation in South Asia is becoming more and more apparent. This is evidenced by the recent tempo of activities in this regard in the South Asian region. Increased regional economic co-operation would help reduce the economic dependence of the South Asian countries on the developed countries in the future. Given the possibility that trade with the rest of the world does not offer very happy prospects in the future, intra regional trade could facilitate growth and development of the South Asian countries on the basis of the regional self-reliance. Such regional economic co-operation is considered feasible because intra regional, historical, cultural, geographical and developmental commonalities are much stronger than intra regional differences in political and economic structures and perspectives. Besides, the sub continental economy of the South Asian region offers potentially

vast and undeveloped markets, and is blessed with huge endowments of material and human resources. Against this background, the present study attempts to review the trade structure and technological flows among SAARC countries and to indicate a few areas for future co-operation. Also undertakes a detailed analysis of the pattern of “revealed Comparative” advantage and the extent of trade complementarity in South Asia, with a view to ascertaining whether or not the SAPTA (Saarc Preferential Trading Agreement) and the existing trade structures of individual countries can support the regional economic co-operation initiatives.

1.1 STATEMENT OF THE PROBLEM :

The International economic environment and the global political balance have undergone revolutionary changes since the beginning of 1980s. The Introduction of this development has consequently led to a continuous erosion of multilateral frame work of trading system: increasing internationalization of production, application of various protective unfair trade policies and comparative disparity on the distribution of benefits from the existing trading system. Further, the formation of regional grouping of organizations has become a trend in the world economies since the post world war-II, not only to strengthen gradual economic integration for overcoming barriers of global trade policies but also to exploit the potential of complementarities for a better allocation of available resources to mutual comparative advantage.

The trend towards excessive regionalisation of world markets vis-à-vis the formation of different regional blocks have created a common threat to the prospects of a multilateral trading system and opening door for bilateralism, despite the efforts of WTO to evolve a multilateral free trading system under the frame work of new round of trade negotiations.

Since the late 1950s more than forty economic co-operation and association arrangements have been formed among developing countries⁵. Their experience has shown that most of them disintegrate prematurely in an atmosphere of hostility and recrimination or otherwise they became inactive and continue to exist but only on paper. It is possible to assess the success of regional economic co-operation among developing countries only in the longer term i.e., after the development of a productive sector capable of responding to increases in inter regional demand. Further, REA (Regional Economic Association) is necessary among developing countries in order to increase the group's bargaining power in its economic and sometimes political external relations.

SAARC was founded by the Dhaka declaration of 1985 as a regional grouping of seven South Asian developing countries viz., Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Srilanka. After successful establishment of SAARC as an association for political affairs, all the seven countries literally agreed to form a regional block for economic activities. That dream came to realize ultimately when SAPTA was founded on 11th day of April 1993.

The main aim of the present study is to analyse India's foreign trade with SAARC countries individually and with the Region (which is consortium of less developing countries) as a whole under SAPTA agreement and to investigate the changes before and after the formation of SAPTA. This study on the changes in India's foreign trade from 1991-92 to 1999-2000 is expected to be useful in evolving suitable policy prescriptions that would lead to improving the trade with SAARC countries and there by improving the country's balance of payments position.

1.2 SIGNIFICANCE OF THE STUDY :

Foreign Trade assumes significance because they form the core component of the process of country's growth and employment generation. Therefore it becomes a matter of paramount importance to study the various options for improving the Foreign Trade relationship with various countries and developing countries in particular. Our experience with European Union market for Indian exports and various rigidities in terms of newer trade barriers makes us to think of the possibilities of improving and diversifying trade to the countries closer to us. An enquiry into the achievements of SAPTA, its problems and prospects is extremely significant in this context.

1.3 OBJECTIVES OF THE STUDY :

Following are the specific Objectives of the present study:

1. To analyze the trends in India's aggregate exports and imports for the period 1991-92 to 1999-2000.
2. To analyze the SAARC intra regional trade before and after implementation of SAPTA
3. To facilitate in identifying the appropriate Policy instruments and strategies for achieving the objectives of regional economic co-operation.
4. To study the possibilities for promotion of Intra-regional trade through Preferential trading arrangements, Joint ventures, Technology Transfer and Investments.
5. To outline the scope for Co-operation in areas like Regional projects, Physical infrastructure and Regional Tourism.
6. To make recommendations to improve and consolidate India's trade with SAARC countries.

1.4 HYPOTHESIS :

- (1) SAPTA has not led to improvement of India's Trade with SAARC countries
- (2) There is no Trade Complementarity that exists between SAARC countries

1.5 METHODOLOGY :

The methodology followed in this study is a broad analytical framework encompassing the various facets of regional economic co-operation. This framework is considered useful for two important reasons. The first is that it provides a rational basis for establishing regional economic co-operation. This helps in removing the apprehensions about the prospects of regional economic co-operation. Specific commodities/products and industries have been identified for the expansion of intra-regional and intra-industry trade and for the establishment of joint ventures in the member countries. The second reason is that this framework also facilitates in identifying the appropriate policy instruments and strategies for achieving the objectives of regional economic co-operation. The study has also outlined the supporting institutional mechanisms in areas related to trade and investment. Such mechanisms often play a crucial role in strengthening the efforts of regional economic co-operation.

Furthermore, The issues concerning regional trade liberalization are many, and to understand the ground realities, there is a need for having varieties of databases and adoption of number of suitable approaches. In this study we have attempted to examine intra-regional trade over a period of time. In the context of existing intra-regional trade, attempt has been made to examine coverage and effectiveness of each round of SAPTA on individual member countries.

1.5 (A) Sources of Data and Tools of Analysis :

For the purpose of the study, both Primary and Secondary data were used. Primary data are collected through interviews and discussions with the traders/agents to get their views on improving the trade relationship with SAARC countries. For examining Intra-regional trade among SAARC member countries, we have used data provided by Direction of Trade Statistics, IMF, World Bank, ADB, RBI, plan documents of Government of India, Study reports of the various Universities, Directorate of Industries etc., To trace the bilateral and intra-regional trade behavior, we have used time series data for the period 1990-2000. For data on Tariff and non-tariff barriers and Concessions, the information provided by the SAARC Secretariat is used. It may be noted that different rounds of SAPTA were signed and implemented at different points of time. We used “before and after” approach to examine the effectiveness of each round of SAPTA on India from the specific supplying partner country.

In Balassa’s RCA index⁸, it is argued that if a country exports a relatively substantial part of its domestic production and if this performance index is better than the internationally practiced norms, the product is considered to be competitive. We have used the same logic to identify the potential product for each country. Similar to Balassa’s argument, it may be argued that a country has competitiveness in those products, which are exported substantially as compared to other products in the export basket of the country.

Various Journals, Books, Working Papers etc., also form the sources of Secondary data.

1.5 (B) Sampling Design :

The Primary data were collected using multiple methods such as Questionnaire, Interviews and Discussions. Discussions method was largely used. A list of registered companies and traders who are actively dealing with Saarc countries was obtained from the offices of the Joint Director General of Foreign Trade, Kochi, Bangalore and New Delhi. This list had 32 organisations from Kochi, 116 organisations from Bangalore, and 200 from Delhi. To restrict the sample size to 100 and to give equal representation to all the three regions, all the 32 organisations of Kochi and 34 Organisations each from Bangalore and Delhi region were randomly selected. Questionnaires were sent to all the 100 organizations. However 9 Organisations from Kochi, 2 from Bangalore, and 5 from Delhi did not respond. After receiving the completed questionnaires, the researcher personally interviewed officers of the organisations for further clarifications. Repeated visits were required in some of the cases.

Interviews and discussions were also held with Experts/Academicians/Research Scholars etc., to get a deep insight into the problems, prospects and policy formulations etc., in the SAARC region.

The Data collected were edited, processed and analysed using appropriate statistical tools.

On the basis of analysis, conclusions are drawn and recommendations are made.

1.6 SCHEME OF THE STUDY :

The scheme of the thesis is as follows :

The first Chapter contains the Introduction, Objectives of the study and Methodology of the study. In chapter II Review of literature is outlined. In Chapter III Origin and Development of Regional Economic Integration has been discussed. Chapter IV contains two sections viz., (a) analysis of Revealed Comparative advantage (b) Trade Complimentarity. An overview of Analysis of Intra-regional Trade of SAARC countries is presented in chapter V. Regional Co-operation in Other Areas viz., Possible opportunities/promotion of trade through Investments, Joint ventures and Technology Transfers, Physical infrastructure, Regional Projects, Regional Tourism and Energy Co-operation etc., is discussed in Chapter VI. Summary, Recommendations and Conclusions have been detailed in Chapter VII.

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CHAPTER - II

REVIEW OF LITERATURE

The existing literature on the subject provides mixed responses on the implications of different rounds of SAPTA on regional trade. It is noted that a limited number of studies have been conducted on the subject and few of them are selected and reviewed in three parts. The first part is of general nature and consists of all those studies, which examine the association between trade and development/economic growth. It also deals with the studies those connected with the estimation of export and import functions in particular. In the second and third part, some of the studies, which are connected with the intra-SAARC trade and studies related to SAPTA are reviewed respectively.

2.1 General Studies :

Ransi Sahney and William DipPietro¹ pointed out that in recent years investigation of the relationship between export expansion and economic growth has received considerable attention in the literature. The findings strongly support the argument that export expansion leads to higher economic growth thereby suggesting the overall superiority of an export led growth strategy for development to one of import substitution. The theoretical argument maintained in the study is that export expansion results in both more efficient use of resources and adoption of latest technology. Hence the authors state that several empirical

studies assessing the importance of exports for economic growth in developing countries have used exports as a factor of production by estimating production function based growth equation. DiePietro and Sahney conclude from their findings that export expansion contributes to overall economic growth and that the importance of exports changes with the level of development.

Kaorussi investigated the relationship in a sample of 73 countries. Using data for the period 1960-78, he found that export expansion is associated with better economic performance for both groups low as well as middle-income countries. He also tried to determine through examining the commodity composition of exports, how the relationship between the growth of exports and economic growth is affected by the extent of development.

Sukumar Nandi and Basudeb Biswas² have done empirical work to investigate the relationship between exports and economic growth in India. Their econometric results show that in Indian context, causality runs one way i.e., export growth causes growth of national income and hence they conclude that it leads to support the hypothesis that exports can help economic growth of a country. However, they do point out that this is contrary to the view in the literature that export growth cannot be helpful in the context of countries like India. Nandi and Biswas do admit that the study done is based on Indian data only and that a more broad based study covering a number of countries may shed more light in this direction. Empirical investigations reveal that the developing

countries' import demand of various goods has been sensitive to relative price differences on the one hand, between imports and domestically produced goods and on the other, between imports from developing and from developed countries. These results support the view that growing trade among developing countries, in particular, their imports from each other has not been due merely to income growth but relative price differences between developed and developing country suppliers have played a major role.

Prabirjit Sarkar³ examines the patterns of trade movements of inter-regional terms of trade between the developing and developed market economies for the period 1950-80. He comes to the conclusion that the post-second world war period saw a tremendous growth in world trade in merchandise. During the three decades (1950-80), world exports and imports (of visible) rose at an abnormal growth rate of about 11 percent. Over the three decades the rates of growth accelerated from 6.4 percent during 1950-60 to above 9 percent during 1960-70 and further to above 10 percent in the last decade, 1970-80.

V.L.Rao⁴ states that foreign investments into India as a result of the trade policy changes announced since July 1991, is encouraged to increase at a faster rate. Foreign investors urged India to allow foreign firms to hold 100 percent stake in subsidiaries, cut tariffs and improve infrastructure. He states that trade reforms and other economic reforms are a good thing for any country. However, their usefulness depends on a credible and stable macro economic framework and

the institutional and other mechanisms to implement and sustain the reforms. Emphasis should shift from debates on market vs. State, liberalization vs. non-liberalization and privatization vs. Nationalization to (a) identifying the optimal form and sequencing of economic liberalization and (b) effective Government business partnership.

Sen and Das⁵ points out that trade policy in India has been subject to significant shift since the beginning of the 1990's. Their observations are that, the policy of import liberalization implemented since early nineties seems to have inflated the import bill by causing expansion in the volume of imports both in absolute terms and as proportion to GDP when both imports and GDP are measured in current prices. The export link to imports seems to have lost its purpose especially with the premium based incentives to exporters open to sharp fluctuation and down trends. The export linked import licensing has contributed to an increase in the value of licenses issued.

M.S.Rao⁶ has well reviewed recently some of the studies in which either import or export or both functions are estimated by Ordinary Least Squares (OLS) method and thereby computed income and income and price elasticity. Here a brief review of recent studies is presented. Murthy and Sastry estimated export function for India by using export price, world real income, domestic industrial activity and time as explanatory variables. The function is estimated for India's aggregate exports as well as for individual export items. For the period 1950-62,

Da Costa estimated a linear export function in which industrial activity abroad was taken as one of the explanatory variables in addition export prices and world income. He estimated a linear export function in which industrial activity abroad was taken as one of the explanatory variables in addition to export prices and world income. He estimated export functions for India with regard to some individual world countries and for selected consumer goods and raw materials. By using both linear and log linear forms. Wadhwa estimated price and income elasticity for 1954-70, explanatory variables being export prices and world income. World exports was used as a proxy for world income in his study. Biswas also estimated export demand elasticity with respect to price and world income by using data pertaining to India's exports from 1952-53 to 1972-73. In his study, while using world exports as a proxy for world income, India's exports were not excluded from world exports. He used variables in current prices as well as constant prices. In his analysis of India's engineering exports, K.C.Reddy estimated aggregate export function in which the explanatory variables are domestic demand for the products, world demand, export prices and a policy variable. In a similar way, D. Harinarayana analyzed the determinants of engineering exports at the aggregate level. RITC division as well region wise and the study also included country wise analysis at disaggregate level. The explanatory variables included are relative prices (ratio of price for India's engineering goods to the price of engineering exports of the competitors), world income, domestic demand and the growth of import substitution. In most cases, these variables are considered to be significant. M.S. Rao as a part of his study,

estimated exports and import functions for the data pertaining to 1962-85. Income and price elasticity were estimated for India's aggregate exports as well as for individual commodity groups. In his study, world exports was used as a proxy for world income as it was done in most of the studies. In many studies reviewed above, export price and income elasticity are less than one. While import price and income elasticity are more than one in some studies, it is observed that they are less than one in others. Further the import price elasticity is positive in certain cases and negative in others.

2.2 SAARC STUDIES :

Raj Pandey examines the prospects of Trade Expansion in the SAARC region. The Association was set up to accelerate the process of economic, social and cultural development and promote and strengthen collective reliance through joint action in certain agreed areas of co-operation. His conclusion is that though the trade performance of the region and the countries individually has been quite impressive (they achieved far higher rates of export growth during the 1986-87 period than the developing countries) they have experienced huge and progressively increasing trade deficits which may partly explained by their inability to create export surplus and partly because of a weak world growth environment. He uses the trade intensity index to measure the extent to which one country's share in another country's exports (imports) is larger or smaller in relation to the former. The major conclusion emerging from the above analysis is that the fundamental cause for the existing low level of intra-regional trade is the

