CHAPTER 2

CONCEPT OF TRADE AND INTERNATIONAL TRADE: GROWTH ORIGIN AND DEVELOPMENT

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2.1 Introduction

2.1.1 Trade

Trade has been in vogue since ages in one sense or the other, with any name whatsoever, since ages when people did not have or associate any names to such a relationship. The concept of the word "TRADE", simply and effectively means a voluntary act done by and between two or more persons for the exchange of two or more items in between them, wherein all the parties to the transaction "believe" that the said transaction is for their benefit. On the other hand, trade is a vast word in itself and it includes innumerable types of relations between 'persons' in the eyes of law. Trade can be executed in kind versus kind (barter system) or in kind versus currency (modern day trade). It is a give and take kind of relationship, though there can be gratuitous transactions where only one person gives and the other accepts, but here also the reason for the gratuitous act does act as a type of kind in return (consideration).

Technically, trade can be said to represent a commercial transaction between two or more persons wherein the concerned parties enter into the relationship, voluntarily, believing that the proposed transaction is beneficial to them.

The parties to the trade transaction intend to enter into an agreement with each other over the price (in terms of cash or kind, depending upon the system of trade and era to which they belong), quality, quantity etc. features of the goods concerned and there is an understanding on the parties to the said agreement to abide by the conditions of the transaction. This in a way is similar to what we call a contract in today's world albeit without the complicated legal jargons involved in today's times. Parties to a transaction get confident when they are aware of the binding nature of the conditions, they are sure of the obligations being met, as otherwise there will be penalty imposed on the defaulting party. This represents a win – win situation for the parties to the specific transaction. There is an apparent gain and satisfaction for the concerned parties.

If this understanding is applied to numerous such transactions than we arrive at a trading system, which forms a major proportion of the economy to which it belongs. This results in gain and satisfaction for all the traders of that concerned economy. Thus it can be seen that better the trading system of an economy better are the prospects of the traders being prosperous and happy.

Trade relations continued between people of an area, kingdom or State in different eras. With time, travel became easier, people started to get an overview into the lives of others in different places. This view beyond the boundaries of their own States and the goods which were available or scarce led to the thought of trade beyond boundaries. The importance and need to expand trade beyond the boundaries was a new idea which germinated thereafter. It was felt that there were a number of restrictions in trade within the boundaries, specifically with regard to the goods; its quality and quantity, there were things unknown to people of one area which others had in abundance and vice versa. This led to a start of trade over the boundaries of the State which is termed in the Modern world as International Trade. With the passage of time and change in perceptions it was understood that to increase the total wealth of the State and its economy wealth had to be earned from outside the State. This earned wealth could shape the economy in a better shape and people could be happier. This brought about the importance of trade beyond boundaries in the minds of the people and rulers alike and came into existence the relationship which we know as International Trade.

2.1.2 International Trade

International trade is exchange of capital, goods and services across international borders or territories.[1] In most countries, it represents a significant share of gross domestic product (GDP). While international trade has been present throughout much of history; economic, social, and political importance has been on the rise in recent centuries.

Industrialization, advanced transportation, globalization, multinational corporations, and outsourcing are all having a major impact on the international trade system. Increasing international trade is crucial to the continuance of globalization. International trade is a major source of economic

[1] http.wikepidia.org

revenue for any nation that is considered a world power. Without international trade, nations would be limited to the goods and services produced within their own borders.

International trade is in principle not different from domestic trade as the motivation and the behavior of parties involved in a trade does not change fundamentally depending on whether trade is across a border or not. The main difference is that international trade is typically more costly than domestic trade. The reason is that a border typically imposes additional costs such as tariffs, time costs due to border delays and costs associated with country differences such as language, the legal system or a different culture.

It is known that any and every transaction which is legal has a binding force as it is governed by some law in force in the particular place in those particular times. So far as any transaction is limited to the same area where the same set of laws apply, there is no doubt about the binding force, but what would be the scenario in the event the two corresponding parties to the so called "contract" belong to two different parts of the world where the same law does not apply. This question would arise in the case of any International Trade. Therefore there is a need to analyze this situation in depth with a legal perspective which can never be ignored in any type of commercial transaction. Law plays a very important role and more so in the case of international agreements or international transactions.

There has been a shift in the mindset of people of one era to the other. It has been noted that the type of trade (be it domestic or international) carried on and the pattern being followed changed from one style to another due to different factors affecting them. Trade remained constant but the way of trade and the reasons behind the actions changed. Trade has evolved over the period of time and this evolution has brought about and associated more and more technicality to this simple transaction making it very complex. But at the same time these technicalities have made the transaction a very safe one for and between the parties concerned.

2.2 Evolution of Trade

Trade as we see today has evolved from a very raw and binary relationship in the ancient times. It is now that we can see a number of issues involved in a simple buy and sell transaction as we define trade. Today trade is not just a simple buy-sell relationship, the journey of trade from this simple buy-sell relationship to what we see today, is due to a number of variables impacting on it, one of them and the most important one as we have seen above is the **MIND** of the people of each era. The mind affected the way trade was carried out and mind itself was affected by a number of issues. This relation of issues affecting mind and mind affecting trade is in a pattern. In order to understand this behavior of people in different times and how it reflected upon the pattern of trade and how trade evolved, we shall use the following hypothetical philosophies. These philosophies can be associated and reasoned out to show us the evolution of trade from ancient times till today.

2.2.1 Natural philosophy: The theory of an undifferentiated whole

In the ancient times trade was more of a relationship for need; the need of one against the need of the other. What one had extra was exchanged for what he needed. There was no other issue involved making it a very simple transaction. Anyone could buy and sell anything; there was no specialization or compartmentalization amongst the people. Relationship was just plain and simple based upon the needs at that given moment. This pattern can be termed as an undifferentiated whole, meaning that there was no differentiation amongst who would be selling or buying in what, everybody could be dealing be dealing in almost anything that he possessed.

2.2.2 Conceptual Philosophy

Thereafter came the period of concepts. Different types of currencies came into existence, rendering trade a new meaning, that of wealth creation. It was then that the value and strength of money and its saving which started to be understood by the people. People started understanding that there was a different meaning of trade and this relationship could be made useful in earning some money. In fact earning money became a concept at that time. Once the concept of gathering money came in, it led to the other related human characteristic that of greed. This led to the thought that if a person specializes in a specific thing he can earn more and in a better way. Even the rulers of the time started to propagate this as this method was found to be wealth creating and leading to the strength of an economy. Not only did this have an effect on the economy of the State but also the effects of the same were to be seen all-round. The concept of specialization entered in the minds of the people. This concept gave huge dividends to the people and brought them riches, respect and glory. Specialization started taking place in all fields; you had teachers, masons, soldiers etc. This led to the State becoming more and more powerful. This theory was long serving and has served people for a very long period of time.

2.2.3 Present day Philosophy

Today we are in a world where a combination of the above two philosophies. We are in a manner back to the ancient ways of undifferentiated whole wherein people have more than one business or vocation, but we have the added value of the above mentioned conceptual theory. The experiences of the above theory are being utilized for a better way of doing trade in today's world.

Today, persons who are real masters in their own fields of work are recognised and in every aspect of life, whether professional or business or social, professional people are in vogue. Whenever a person needs help on any matter he seeks professional help. This word 'professional' means a person who is a master in his own field, or if seen in another way, a person who does one thing specially as his profession and has sound knowledge of that field, thus we can say that in a way we have gone back to the old days and started using the Natural philosophy.

There is also another aspect which shows that the conceptual philosophy also is in vogue today. Just a look at the giant corporates trying to get into each and every field other than their core businesses shows that the conceptual theory also is in vogue today. Therefore we can say that at present we are living in a world where a combination of both the know philosophies is used.

2.3 History and Development

We shall analyze the advent of trade since the ancient times of the Indus Valley Civilization till the modern times and see the differences in the trading system and the reasons therefore in such periods.

2.3.1 Indus Valley Civilization

The Indus Valley civilization, the first known permanent and predominantly urban settlement that flourished between 2800 BC and 1800 BC boasted of an advanced and thriving economic system. Its citizens practiced agriculture, domesticated animals, made sharp tools and weapons from copper, bronze and tin and traded with other cities. Evidence of well laid streets, layouts, drainage system and water supply in the valley's major cities, Harappa, Lothal, Mohenjo-daro and Rakhigarhi reveals their knowledge of urban planning. They eventually overused their resources, and slowly died out. There have been few weapons found in the Indus Valley, showing that they were peaceful people, and they did not get slaughtered by the Aryans.

Though ancient India had a significant urban population, much of India's population resided in villages, whose economy was largely isolated and self-sustaining. Agriculture was the predominant occupation of the populace and satisfied a village's food requirements besides providing raw materials for hand based industries like textile, food processing and crafts. Besides farmers, other classes of people were barbers, carpenters, doctors (Ayurvedic practitioners), goldsmiths, weavers etc. Religion, especially Hinduism, played an influential role in shaping economic activities. The Indian caste system castes and sub-castes functioned much like medieval European guilds, ensuring division of labour and provided for training of apprentices. The caste system restricted people from changing one's occupation and aspiring to an upper caste's lifestyle. Thus, a barber could not become a goldsmith and even a highly skilled carpenter could not aspire to the lifestyle or privileges enjoyed by a Kshatriya. This barrier to mobility on labour restricted economic prosperity to a few castes. Pilgrimage towns like Allahabad, Benares, Nasik and Puri, mostly centred around rivers, developed into centres of trade and commerce. Religious functions, festivals and the practice of taking a pilgrimage resulted in a flourishing pilgrimage economy.

In the joint family system, members of a family pooled their resources to maintain the family and invest in business ventures. The system ensured younger members were trained and employed in the family business and the older and disabled persons would be supported by the family. The system, by preventing the agricultural land from being split ensured higher yield. Along with the family-run business and individually owned business enterprises, ancient India possessed a number of other forms of engaging in business or collective activity, in particular, the sreni which was a complex organizational entity that shares many similarities with modern corporations. This was being used in India from around the 8th century BC until around the 10th century AD.

The use of such entities in ancient India was widespread including virtually every kind of business, political and municipal activity. The sreni was a separate legal entity which had the ability to hold property separately from its owners, construct its own rules for governing the behavior of its members, and for it to contract, sue and be sued in its own name. Some ancient sources have rules for lawsuits between two or more sreni and some sources make reference to a government official (Bhandagarika) who worked as an arbitrator for disputes amongst sreni from at least the 6th century BC onwards. There were between 18 to 150 sreni at various times in ancient India covering both trading and craft activities. This level of specialization of occupations is indicative of a developed economy in which the sreni played a critical role. Some sreni could have over 1000 members as there were apparently no upper limits on the number of members. The sreni had a considerable degree of centralized management. The headman of the sreni represented the interests of the sreni in the king's court and in many official business matters. The headman could also bind the sreni in contracts, set the conditions of work within the sreni, often received a higher salary, and was the administrative authority within the sreni. The headman was often selected via an election by the members of the sreni, who could also be removed from power by the general assembly. The headman often ran the enterprise with two to five executive officers, who were also elected by the assembly.

2.3.2 Coinage

Punch marked Silver Ingots, in circulation around 5th century BC and the first metallic coins were minted around 6th century BC by the Mahajanapadas of the Gangetic plains were the earliest traces of coinage in India.[2] While India's many kingdoms and rulers issued coins, barter was still widely prevalent. Villages paid a portion of their agricultural produce as revenue while its craftsmen received a stipend out of the crops at harvest time for their services. Each village, as an economic unit, was mostly self-sufficient. The first documented coinage is deemed to start with 'Punch Marked' coins issued between the 7th-6th century BC and 1st century AD. These coins are called 'punch-marked' coins because of their manufacturing technique. Mostly made of silver, these bear symbols, each of which was punched on the coin with a separate punch. Dating of regular dynastic coin issues is controversial. The earliest of these coins relate to those of the Indo-Greeks, the Saka-Pahlavas and the Kushans. These coins are generally placed between the 2nd century BC and 2nd century AD. Hellenistic traditions characterise the silver coins of the Indo-Greeks, with Greek gods and goddesses figuring prominently, apart from the portraits of the issuers. These coins with their Greek legends are historically significant, as the history of the Indo-Greeks has been reconstructed almost entirely on their evidence. The Saka coinage of the Western Kshatrapas are perhaps the earliest dated coins, the dates being given in the Saka era which commences in AD 78. The

[2] RBI Monetary Museum: Ancient India Coinage

Saka era represents the official calendar of the Indian Republic.

Surplus of Indian manufactures, like the muslin of Dacca, calicos of Bengal, shawls of Kashmir, steel and iron works, silk, and other textiles and handicrafts, agricultural products like pepper, cinnamon, opium and indigo were exported to Europe, Middle East and South East Asia in return for gold and silver.

2.3.3 Maurya Empire

During the Maurya Empire (c. 321-185 BC)[3], there were a number of important changes and developments to the Indian economy. It was the first time most of India was unified under one ruler. With an empire in place, the trade routes throughout India became more secure thereby reducing the risk associated with the transportation of goods. The empire spent considerable resources building roads and maintaining them throughout India. The improved infrastructure combined with increased security, greater uniformity in measurements, and increasing usage of coins as currency enhanced trade.

During this time, the Arthasastra ("science of state") was written by the Chanakya, an adviser to Chandragupta Maurya. The Arthasastra is one of the most important ancient texts on economics, politics and administration. It was a treatise on how to maintain and expand power, obtain material gain, and administer an empire. It covers both theory and implementation and contains many clear and detailed rules

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[3] http.wikepedia.org

regarding the governing of an empire. The economic situation in the Maurya Empire is comparable to the Roman Empire several centuries later, which both had extensive trade connections and both had organizations similar to corporations. While Rome had organizational entities which were largely used for public state-driven projects, Maurya India had numerous private commercial entities which existed purely for private commerce. This was due to the Mauryas having to contend with pre-existing sreni hence they were more concerned about keeping the support of these pre-existing private commercial entities. The Romans did not have such pre-existing entities to contend with; hence, they were able to prevent such entities from developing.

2.3.4 Mughal Empire

During this period, Mughal India was the second largest economy in the world. The gross domestic product of India in the 16th century was estimated at about 24.5% of the world economy, in comparison to China's 25% share.[4] An estimate of India's pre-colonial economy puts the annual revenue of Emperor Akbar's treasury in 1600 at £17.5 million, in contrast to the entire treasury of Great Britain in 1800, which totaled £16 million. The gross domestic product of Mughal India in 1600 was estimated at about 22.6% of the world economy, in comparison to China's 29.2% share.[5] By the 17th century, the Mughal Empire expanded to almost 1,000 million acres

[4] www.wikepedia.com

[5] Angus Maddison (2001). The World Economy: A Millennial Perspective, OECD, Paris

($4,000,000 km^2$), or 90 per cent of South Asia, and a uniform customs and tax administration system was enforced. Annual revenue reported by the Emperor Aurangzeb's exchequer exceeded £100 million in 1700 (twice that of Europe then). Thus, India emerged as the world's largest economy, followed by Manchu China and Western Europe.

2.3.5 Nawabs, Marathas & Nizams (1725 – 1775)

During this period, Mughals were replaced by the Nawabs in north India, the Marathas in central India and the Nizams in south India. However, the Mughal tax administration system was left largely intact. China was the world's largest economy followed by India and France. The gross domestic product of India in 1750 was estimated at about 80 per cent that of China.

During this period, about two-thirds of the civil service in India was still dominated by Muslim officers though the Maratha empire expanded to almost 250 million acres ($1,000,000 km^2$), or 34 per cent of Indian landscape, while the Nizam's dominion expanded to almost 125 million acres ($510,000 km^2$), or 17 per cent of Indian landscape. A devastating famine broke out in the eastern coast in early 1770s killing 5 per cent of the national population. Thereafter the gross domestic product of India in 1775 was estimated at about 70 per cent that of China.[6]

[6] *ibid*

2.4 British Rule and East India Company

In the middle of the seventeenth century, Asia still had a far more important place in the world than Europe.[7] The riches of Asia were incomparably greater than those of the European states. The industrial techniques showed a subtlety and a tradition that the European handicrafts did not possess. And there was nothing in the more modern methods used by the traders of the Western countries that Asian trade had to envy. In matters of credit, transfer of funds, insurance, and cartels, neither India, Persia, nor China had anything to learn from Europe.[8] This was the situation when the East India Company began its trading activities in the early 17th century. Initially, the British traders had come to India with hopes of selling Britain's most popular export item to Continental Europe - British Broadcloth, but were disappointed to find little demand for it. Instead, like their Portuguese counterparts, they found several Indian-made items they could sell quite profitably in their homeland. Competing with other European traders, and competing with several other trade routes to Europe, the early British Traders were in no position to dictate terms. They had to seek concessions with a measure of humility and offer trade terms that offered at least some benefits to the local rulers and merchants. While Aurangzeb (who had, perhaps, seen the connection between growing European Trade concessions and falling revenues from the overland trade) attempted to limit and control the activities of the East India Company, not all

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[7] J. Pirenne, 'History of the Universe', 1950

[8] Auguste Toussaint, 'History of the Indian Ocean' translated by June Guicharnaud in the year 1966

Indian rulers had as much compunction about making trade concessions. Besides, the East India Company was willing to persevere; fighting and cajoling for concessions, it built trading bases wherever it could along either side of the lengthy Indian coastline.

In this period, relations between Indian and Britishers were not lacking in cordiality and the East India Company included employees from both worlds. Friendships between the two nationalities developed not only within the context of business relations, but even beyond, to the point of inter-marriage. Unaffected by the pompous stuffiness of the British gentry, the British employees of the East India Company made the most of life in India - dressing in cool and comfortable Indian garments, enjoying Indian pastimes and absorbing local words in their dialect. With as yet unprejudiced eyes, these British traders delighted in the delicate craftsmanship and attractiveness of Indian manufactures and took good advantage of their growing popularity in Britain and France. So lucrative was the trade that even though India would accept nothing but silver (or gold) in return, the East India Company prospered.

Considering the long route (around the African Cape) that the British had to take in reaching England, it was surprising that they made as much money as they did. But other factors outweighed this disadvantage. First, owing to their legally sanctioned monopoly status in England, they had substantial control on the British market. Second, by buying directly at the source, they were able to eliminate the considerable mark-up that Indian goods enjoyed en-route to Europe. Thirdly, the

East India Company probably enjoyed better economies of scale since their ships were amongst the largest in the Indian Ocean. In addition, they were able to develop new markets for Indian goods in Africa, and in the Americas.

And finally and perhaps, most significantly as has been believed, "although the East India Company was not itself engaged in the transatlantic slave trade, the link was very close and highly profitable."[9] In fact, in the 18th century, the British dominated the Atlantic slave trade transporting more slaves than all the other European powers combined. In 1853, Henry Carey - author of 'The Slave Trade, Domestic and Foreign' wrote: "It (the British System) is the most gigantic system of slavery the world has yet seen, and therefore it is that freedom gradually disappears from every country over which England is enabled to gain control." The Atlantic slave trade was hence, a vital contributor to the financial strength of the East Indian Trading Companies. So much so that by the middle of the 17th century, the East India Company was re-exporting Indian goods to Europe and North Africa and even Turkey.

Unsurprisingly, this was to have a severely disastrous effect on the Ottomans, the Persians, the Afghans, since much of the revenues of these states came from the India trade. It also seriously impacted the revenues of the Mughals, and while the activities of the Arab and Gujarati traders were not entirely eliminated, their trade was much curtailed, and largely reduced to the inter-Asian trade which continued unabated. In

[9] Veronica Murphy, 'Europeans and the Textile Trade' (Arts of India 1550-1900)

any case, the Mughal state was unable to resist centrifugal forces and rapidly disintegrated. This left the East India Company with considerably more leverage and emboldened it to expand its activities, and demand even greater concessions from Indian rulers.

But even as the Indian rulers were granting more concessions, there was a rising chorus of voices bemoaning the loss of "European" silver to Asia. At the end of the 17th century, the silk and wool merchants of France and England were unwilling to put up with the competition from Indian textiles which had become the rage in the new stylish societies of Europe. Not only did they seek bans on such trading activities of the East India Company, they also sought and won restrictions on the purchase of these items in their respective nations. These prohibitions, while not entirely eliminating the smuggling of such items, nevertheless squeezed out most of the trade, impacting the revenues of the regional Indian states that had only recently broken off from the centralized Mughal state and Bengal was the first to face the consequences.

Having lost the opportunity to profit from the Indian textile trade, the East India Company was not hesitant in changing character. In 1616, Sir Thomas Roe, an envoy of the East India Company had declared to the Mughals that war and trade were incompatible. But already in 1669 (even before the bans on the textile trade), Gerald Ungier, chief of the factory at Bombay had written to his directors:

"The time now requires you to manage your general commerce with the sword in your hands"

In 1687 came the reply from the directors, advocating a Goa like British dominion in India. The French Dupleix was more or less of similar view. Still earlier, in 1614, the Dutch Jan Pieterzoon Coen, had written to his directors: "Trade in India must be conducted and maintained under the protection and favour of your weapons, and the weapons must be supplied from the profits enjoyed by the trade, so that trade cannot be maintained without war or war without trade." [10]

The Opium Trade of the 18th century (which eventually led to the Opium Wars) , when the Royal British Navy worked more or less hand in hand with the commercial interests of the East India Company, exemplified precisely such a link between war and trade. From the intertwining of war and trade, colonization was only a small step away. Plassey was an indicator of new dynamics in Indo-British relations.

Contrary to the views of several apologists for colonial rule, who still argue that the defeat of India had solely to do with "congenital flaws" or the centuries old "ennui" or " weak character of the Asian", or the "inability of the Indians (and other Asians) to govern themselves", advanced a different thesis. There were compelling economic imperatives that drew the European India Companies into the path of imperialism and although monopoly rights assured the India Companies of the exclusive privileges of buying and selling, it did not

[10] Auguste Toussaint's: History of the Indian Ocean, translated by June Guicharnaud in the year 1966

guarantee that they could buy cheap. For that, political control was essential. [11]

A second problem for the East India Company was that their profits were in direct conflict with those of their British-based competitors. Under these circumstances, as long as the profit motive was paramount (which it was), the Battle at Plassey, and the Opium Wars could be seen as logical outcomes of circumstances where continued profits by legal and honorable means were simply not possible. But, had the East Company comprised of "Gentlemen Traders" as some historians have claimed, they could not have switched so easily from trading in Indian Textiles, to trading in Opium for Tea which, in modern language - would surely be described as a form of "drug-running"! Had the traders of the East India Company been "men of honour", denied the right to profitable trade, they would have simply gone bankrupt, as so many do in the world of business!

Yet, what is even more significant is that even after The East India Company had regained sizeable profits from the Opium trade, it served as no deterrence to future acts of aggression. It had become like the proverbial man-eating tiger, which having tasted blood once, would be driven to tasting it again and again. After Plassey, the East India Company had been able to force the cultivation of opium in sufficient quantities in India, and hence, procure sufficient volumes of tea for the British market, reaping significant profits. Yet, now military attacks were also to be directed against Indian (and other Asian) ships

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[11] R. Mukerji's: Rise and Fall of the East India Company, 1958

engaged in the inter-Asian trade. These attacks were to lay the ground-work for the battles against the Coromandel rulers and the Marathas whose revenues from this trade dwindled. While Plassey may have been a matter of "survival" for the East India Company, the subsequent battles were not in that category. Some historians tried to argue that competition with the French precipitated the battles in South India, but such a view is contradicted by a Frenchman, no less!

"The victory at Plassey and the establishment of sovereign rights, England had demonstrated to all of Europe that it was no longer necessary for it to send precious metals obtained from the "New World" to India. She could trade on the basis of revenue acquired from taxing subjects and commodities, whereas other European countries had to trade at a "loss", with "metal currency". The extension of English sovereignty in India, would exempt Europe from sending capital into India. " The people who have enough control over India to reduce substantially the exportation of European metallic currency into Asia, rule there as much for Europe's benefit as for their own; their empire is more common than particular, more European than British; as it expands, Europe benefits, and each of their conquests is also a real conquest for the latter. All the sound and fury now echoing across Europe about England's hegemony in India are the shrieks of a blind delirium, as an anti-European uproar; it might be thought that England was taking away from every European state what it was conquering from those of Asia, whereas, on the contrary, every part of Asia that she takes for herself, she, by that very fact, takes for Europe."[12]

In fact, this view tallies quite closely with the observations of several later analysts who found it paradoxical that inter-European rivalries and conflicts reduced in the 18th century when compared to the 17th century, and decreased still further after Plassey. In essence, the race for the colonization of India had been won by the British, and what Abbe de Pradt was saying was that it was in French interest to enjoy the "general" benefits of this victory and not bemoan the loss of "specific" benefits from the British victory.

The situation was summarized and simplified in these words referring to the forced taxes that were extracted by the East India Company from the people of Bengal: "For more than two centuries the Europeans had found that the trade with Bengal whether carried on by companies or by the individual free traders or by illicit means had always been so much in favor of Bengal that the balance had to be supplied in cash. Now after Plassey supplies were at last found in Bengal by means independence of commerce."[13]

The export, import, and manufacture of goods moved from the hands of independant Indian merchants to intermediaries hired by the British East India Company. Often this required force. Sepoys of the East India Company were sent to destroy the factories owned by Indian rivals to the East India

[12] Abbe de Pradt's: "Les Trois Ages des colonies, Paris, 1902"

[13] N.K Sinha's: An Economic History of Bengal, 1962

Company. Independent weavers who refused to work for the pitiful wages that the East India Company offered had their thumbs cut off. "The trade of the country merchant began to stagnate. Armenian, Mughal, Gujarati and Bengali merchants found their free trade daily fettered and loaded."[14]

After Plassey, the East India Company also moved to impose it's monopoly on the internal over-land trade. In a matter of three decades after Plassey, the East India Company achieved a virtual stranglehold on the economic and political life of Eastern India. Just as Abbe de Pradt had predicted, the benefits of colonization did not go exclusively to the British. French, Dutch and Danish rivals were also able to take advantage of the trade monopoly established by the British East India Company. With the decline of the Indian merchants, they were able to buy Indian goods at lower prices. Secondly, corrupt employees of the British East India Company engaged in considerable price gouging, cheating and local thuggery. They preferred to repatriate this illegally acquired wealth from India through French and Dutch rivals to escape detection of their cheating and to avoid taxes and customs duties in Britain. Even as Indian rivals to the British East India were wiped out, European rivals continued to survive and flourish for another 30-40 years.

The East India Company enjoyed not only the substantial and cosmopolitan nature of the backing, but also the motivations and direct self-interest of its backers. The East India Company had a very cosmopolitan association with it's French and

[14] *ibid*

Dutch rivals and it continued operating until 1769 and 1798. At least one-fifth of its nominal capital of pound 3,200,00[15] was in Dutch hands, and a large proportion of that capital came from financiers in Amsterdam, Paris, Copenhagen, and Lisbon, who were also directly concerned in the company's affairs. The commercial activity of the French, the Dutch, and the Danes in the Indian Ocean during the eighteenth century clearly showed that "the time had arrived when Europeans at home or overseas who had a stake in the maintenance of European power anywhere on the Indian continent were one and all forced to take part in the work of building a British empire in India".[16]

Thus, Plassey was to be only the first of several assaults that no regional Indian power was able to fend off successfully. While united India had largely held off the Europeans, and divided India had temporarily held off divided Europe, divided India was no match for united Europe. The conquest of India continued with conclusive defeats of the Marathas in 1818, the Sikhs in 1848 and the annexation of Awadh in 1856. 1857 was a brave attempt to rollback the victories of the East India Company, but instead it now brought on the might of the entire British imperial government. The Indian colonies of the British East India Company became British Colonial India - and so began a new phase of colonial plunder from the sub-continent. The l created an institutional environment that did stabilize the law and order situation to a large extent. The British foreign policies however stifled the trade with rest of

[15] Furber in Cambridge, Mass: Article on the East India Company, 1948

[16] *ibid*

the world. They created a well developed system of railways, telegraphs and a modern legal system. The infrastructure the British created was mainly geared towards the exploitation of resources of India. By the end of the colonial rule India inherited an economy that was one of the poorest in the world and totally stagnant, with industrial development stalled, agriculture unable to feed a rapidly accelerating population. They were subject to frequent famines, had one of the world's lowest life expectancies, suffered from pervasive malnutrition and were largely illiterate. It was a phase that saw constant challenges to British hegemony in the region, but it was not till 1947 that a new era could be ushered.

Hence, for almost 200 years, there was a systematic transfer of wealth from India to Europe. Although Britain may have been the primary beneficiary, it's allies in Europe and the new world benefited no less. British Banks used their Indian capital to fund industry in the US, Germany and elsewhere in Europe. The industrial revolution and the development of modern capitalism was based on the colonization of India and the rest of the world. It was the forced pauperization of the colonized world that allowed nations such as Britain, or the US to industrialize and "modernize". Any serious analysis of modern capitalism must take this into account.

The formal dissolution of the declining Mughal Dynasty heralded a change in British treatment of Indian subjects. During the British Raj, massive railway projects were begun in earnest and government jobs and guaranteed pensions attracted a large number of upper caste Hindus into the civil service for the first time. China was the world's largest economy followed by the USA, UK and India. The gross domestic product of India in 1875 was estimated at about 30 per cent that of China (or 60 per cent that of the USA).[17] British cotton exports reach 55 per cent of the Indian market by 1875. Zoroastrian business conglomerates like Tata and Godrej begin to dominate textile, mining and durable goods industries. During this period, India became a net importer from net exporter of food grains.

The Great Depression of 1929 had a very severe impact on India, which was then under the British. During the period 1929–1937, exports and imports fell drastically crippling seaborne international trade. The railways and the agricultural sector were the most affected. The international financial crisis resulted in the soaring prices of commodities. The discontent of farmers manifested itself in rebellions and riots.

The fall of the Rupee

After its victory in the Franco-Prussian War (1870-71), Germany extracted a huge indemnity from France of £200,000,000, and then moved to join Britain on a gold standard for currency. France, the U.S. and other industrializing countries followed Germany in adopting a gold standard throughout the 1870s. At the same time, other countries, such as Japan, which did not have the necessary access to gold or those, such as India, which were subject to imperial policies that determined that they did not move to a

[17] Auguste Toussaint's: History of the Indian Ocean, translated by June Guicharnaud in the year 1966

gold standard, remained mostly on a silver standard. A huge divide between silver-based and gold-based economies resulted. The worst affected were economies with a silver standard that traded mainly with economies with a gold standard. With discovery of more and more silver reserves, those currencies based on gold continued to rise in value and those based on silver were declining due to demonetization of silver. For India which carried out most of its trade with gold based countries, especially Britain, the impact of this shift was profound. As the price of silver continued to fall, so too did the exchange value of the rupee, when measured against sterling. Thus creating a huge gap in the value of rupee as against the pound and other European currencies.

2.5 Republic of India

2.5.1 Socialist Reforms (1950-1975)

Before independence a large share of tax revenue was generated by the land tax, which was in effect a lump sum tax on land. Since then land taxes have steadily declined as a share of revenues and completely replaced by sales taxes[18]. Moreover, the structural economic problems inherited at independence were exacerbated by the costs associated with the partition of British India, which had resulted in about 2 to 4 million refugees fleeing past each other across the new borders between India and Pakistan. The settlement of refugees was a considerable financial strain. Partition also divided India into complementary economic zones. Under the British, jute and cotton were grown in the eastern part of Bengal, the area that became East Pakistan (after 1971, Bangladesh), but processing took place mostly in the western part of Bengal, which became the Indian state of West Bengal in 1947. As a result, after independence India had to employ land previously used for food production to cultivate cotton and jute for its mills.

Nehru's industrial policies were intended to encourage the growth of diverse manufacturing and heavy industries, yet because of state planning, controls and regulations the result was impairment of productivity, quality and profitability. The Indian economy lumbered along with an anemic rate of growth, and chronic unemployment amidst entrenched poverty

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[18] Economic survey of India 2007: Policy Brief OECD

continued to plague the population. Toward the end of Nehru's term as prime minister, India would continue to face serious food shortages despite hoped for progress and increases in agricultural production. There was mass starvation in states like Bihar due to socialist controls on the economy. Farmers as well as industrialists were ham-strung with controls (License Raj) on their freedom to run their respective businesses.

2.5.2 Economic liberalization

Service markets which would enjoy much lighter burden of regulation and other obstacles became more successful than still regulated sectors. For example, world-famous business process services are very lightly regulated.[19] Economic liberalization in India in the 1990s and 2000s led to large changes in the economy.

2.5.3 2000 - Present

National Democratic Front led by BJP, was in helm of economic affairs from 1998-2004. During this period there were two finance ministers, viz., Yashwant Sinha (1998-2003) and Jaswant Singh (2003-2004). The main economic achievement has been the telecomm revolution in India after the same was opened up for private players. Today India boasts of one being one of the best and fastest growing telecomm players in the world. The universal license in this field allowing CDMA license holders to provide GSM services and vice versa has been a revelation. NDA started off the

[19] *ibid*

Golden Quadrilateral road network connecting main metros of Delhi, Chennai, Mumbai and Kolkata. The project, still under construction, was one of the most ambitious infrastructure projects of independent India. Simultaneously, North-South and East-West highway projects were planned and construction was started. Many irrigation projects have been implemented. Power generation is being given optimum thrust and we can see numerous power generation projects coming up at present and also being planned for the future. The Government too is following a policy of giving benefits for such projects.

Banking and Insurance sectors also have been opened up for private players and one can see lot of professionalism in the services of these two sectors.

In fact many sectors have been opened up for private players and now almost every sector has a private competitor providing much required competition benefiting the consumer on the whole.

2.6 Important Theories of Trade

2.6.1 The Theory of Mercantilism

Mercantilism was the theory of trade espoused by the major European powers from roughly 1500 to 1800. Adam Smith, following the usage of some of the Physiocrats, gave the name of the "commercial" or "mercantile" system, which later became, with the aid of the Germans, the now familiar "mercantilism." Many writers, however, assign "mercantilism" only to the period after about 1620, and distinguish with varying degrees of emphasis between the "bullionist" doctrines of the earlier period and the "balance-of-trade" doctrines of the later period.

This theory advocated that there is a certain fixed amount of wealth in the world and it is in nations' best interests to accumulate it, through wealth, a nation can achieve power and a country achieves wealth through producing and exporting more goods then they import. Therefore a nation should export more than it imported and accumulate bullion (especially gold) to make up the difference. The exportation of finished goods was favored over extractive industries like farming. This theory was invented to serve the interest of the empire, not the colony

Mercantilism was a reaction against the economic problems of earlier times when states were too weak to guide their economies and when every town or principality levied its own tariffs on goods passing through its borders. The modern age brought the rise of powerful nation states (Holland, France, Spain and England) and was marked by almost constant warfare. Money (bullion) was needed to support ever-expanding armies and navies. Mercantilist concepts developed from this need. Underlying this theory was the belief that wealth was finite. If one nation hoped to grow richer, it had to do so at the expense of some other nation.

The development of colonies became very attractive during this era. Wealth could be kept by a nation if its colonies provided raw materials to the mother country and the mother country could sell finished goods to the colonies. In England the application of mercantilist theory led to the development of a skilled labor force at home and the creation of a large navy and merchant marine.

However, mercantilism also led to inflation and alienation in the colonies. It also resulted into wars and creation of colonies after being taken over by the powerful countries. The theory of mercantilism was put into practice in the English colonies.

The grounds most commonly given for distinguishing between the two periods as above are:

(1) that, before 1620, stress was put on the importance of a favorable balance in each transaction of each merchant, whereas in the later period the emphasis was on the aggregate or national balance of trade;

(2) that, before 1620, concern about the state of the individual balances was due to anxiety that the country's stock of bullion be not reduced, whereas in the later period there was anxiety that it be increased;

(3) that, before 1620, the chief economic objective of trade policy was to protect the national currency against exchange depreciation, whereas after 1620 this was a minor objective, if a matter of concern at all;

(4) that, in the early period, the means advocated and employed to carry out the objectives of the prevailing trade policy were close regulation of the transactions of particular individuals in the exchange market and in coin and bullion, while in the later period the policy recommended and put into practice was to seek the objective of a greater stock of bullion indirectly by means of regulation of trade rather than directly through restrictions on exchange transactions and on the export of coin and bullion.

The actual course of official policy seems to give no strong support to this chronological contrast between the bullionist and the balance-of-trade doctrines. In the earlier period, it is true, regulation of the foreign trade and exchange transactions of the merchants had been stricter and more detailed than it subsequently became. But the outstanding changes in legislation and in administrative practice extended over a long period, and all of any importance occurred long before 1620 or did not occur until long after. The institution of the Staple, which served as an instrument of regulation of individual transactions, finally expired with the loss of Calais in 1558, although it had already been moribund. The Statutes of Employment, requiring foreign merchants to pay for the English commodities which they bought, in part at least, in coin or bullion, had become inoperative long before the end of the sixteenth century. The Royal Exchanger, with his control over exchange transactions, went out of existence practically, if not legally, when Burleigh, in the reign of Elizabeth, refrained from exercising his prerogative of nominating the holder of the office, although Charles I attempted unsuccessfully to revive the institution as late as 1628. The restrictions on the export of coin and bullion had been relaxed during the reign of Elizabeth. They were more strictly enforced, as far as gold was concerned, in the reign of James I, in accordance with a proclamation of 1603, but even stricter regulations were laid down by Charles I in 1628, and it was not until 1663 that gold and silver bullion and foreign coin could be freely exported, and not until 1819 that English coin or bullion derived therefrom could be legally exported. In other words, the "bullionist" regulations were either repealed or had become obsolete long before 1620, or persisted and even were strengthened long after 1620. Prohibitions and customs duties on imports and exports imposed for trade regulative purposes originated centuries before 1620, and although the customs system was revised during the reign of James I, and again by Walpole in the 1720's, in order that it might more effectively serve the purpose of procuring a favorable balance of trade, it continued until late in the nineteenth century to be a medley of provisions of miscellaneous character serving in unascertainable proportions the largely contradictory purposes of fiscal needs, trade regulation, special privileges to favored individuals or groups, and foreign diplomacy.

If, however, the dividing line be set at about 1560, instead of about 1620, the contrast may be made with respect to actual trade regulation that such devices as the Staple, the Royal

Exchanger, and the Statutes of Employment had been important in the first period, and were repealed or permitted to become inoperative in the later stage. For the earlier period also, it can be said that there was much more concern about the menace to the national stock of bullion from the operations of brokers and merchants in paper exchange than there was in the later period, and on this question 1620 serves fairly well as the approximate date at which doctrinal controversy cleared away many of the older illusions about the consequences of unregulated exchange transactions. In the controversy over the exchanges at the beginning of the seventeenth century, the new views which were expounded chiefly by Misselden and Mun won a definitive victory over the old views as presented by Malynes and Milles, and in the later literature a spokesman for the older views is only rarely to be encountered. Perhaps for the first time, a matter of economic policy was made the occasion for a war of tracts, and the tracts seem, moreover, to have exerted an immediate and traceable influence on government policy. But commentators who have not explored the earlier literature nor examined carefully the later literature have applied to the entire contents of these tracts what was true only, if at all, of their arguments with respect to paper exchanges, and have attributed to Misselden and Mun priority with respect to doctrines which were already old and established and to Malynes and Milles final utterance of doctrines which still had a long life to live.

Opposition to mercantilism was contained in the doctrine of laissez faire.

2.6.2 Laissez Faire Era

The exact origins of the term "laissez-faire" as a slogan of economic liberalism are uncertain. The first recorded use of the "laissez-faire" maxim was by French minister René de Voyer. Thereafter, another champion of free trade, Marquis d'Argenson, quoted:

> *"Let it be, such should be the motto of every public power, ever since the world is civilized..... A detestable principle that we cannot grow only by being lowered by our neighbors! There is nothing but mischief and malignity of heart that are satisfied with that principle, and interest is opposed to it. Let it be, damn it! Let it be!!)"*

According to historical folklore, the phrase stems from a meeting between the powerful French finance minister Jean-Baptiste Colbert and a group of French businessmen led by a certain M. Le Gendre. When the eager mercantilist minister asked how the French state could be of service to the merchants, Le Gendre replied simply "Laissez-nous faire" ('Leave us be,' lit. 'Let us do').[20]

The laissez faire slogan was popularised by Vincent de Gournay, a French intendant of commerce in the 1750s. Gournay was an ardent proponent of the removal of

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[20] The anecdote on Le Gendre is briefly referenced in J. Turgot's "Eloge de Vincent de Gournay," *Mercure*, August, 1759

restrictions on trade and the deregulation of industry and economic prosperity in France. Gournay was delighted by the LeGendre anecdote, and forged it into a larger maxim all his own: "Laissez faire et laissez passer" ('Let do and let pass'). His motto has also been identified as the longer "Laissez faire et laissez passer, le monde va de lui même!" ('Let do and let pass, the world goes on by itself!'). Although Gournay left no written tracts on his economic policy ideas, he had immense personal influence on the thinking of his contemporaries, notably the Physiocrats, who credit both the 'laissez-faire' slogan and doctrine to Gournay.[21]

Prior to Gournay, P.S. de Boisguilbert, had enunciated the phrase "on laisse faire la nature" ('let nature run its course').[22] Laissez-faire was one of a number of French "free trade" and "non-interference" slogans coined in the seventeenth century. D'Argenson, during this time, was better known for the similar but less-celebrated motto "Pas trop gouverner" ("Govern not too much").[23]

The first known English-language use of "laissez faire" was in 1774, by George Whatley, in the book Principles of Trade, which was co-authored with Benjamin Franklin. But only with the advent of the Anti-Corn Law League did the term receive

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[21] J. Turgot, *op cit.* V.R. Marquis Mirabeau, in *Philosophie rurale* 1763 P.S.DuPont de Nemours, in *Ouevres de Jacques Turgot,* 1808–11, Vol. I, p.257 and p.259 (Daire ed.)

[22] "Tant, encore une fois, qu'on laisse faire la nature, on ne doit rien craindre de pareil", P.S. de Boisguilbert, 1707, *Dissertation de la nature des richesses, de l'argent et des tributs.*

[23] DuPont de Nemours, *op cit,* p.258. Oncken (*op.cit*) and Keynes (*op.cit.*) also credit the Marquis d'Argenson with the phrase "*Pour gouverner mieux, il faudrait gouverner moins*"

much of its (English) meaning.[24] Nonetheless, it was probably James Mill's reference to the "laissez-faire" maxim (together with "pas trop gouverner") in an 1824 entry for Encyclopedia Britannica that really brought the term into wider English usage.

2.6.2.1 The laissez-faire economic philosophy

Laissez-faire activists support little or no state intervention on economic issues, which implies free markets, minimal taxes, minimal regulations, private ownership of property and free circulation of labor. They support certain kinds of negative liberty as opposed to positive liberties, such as wealth redistribution, given by the state. However, some laissez-faire proponents, like progressive libertarians prefer negative income tax as a replacement to the existing welfare system, arguing that it is simpler and has fewer of the "perverse incentives" of "government handouts".

Their opposition to wealth distribution is based on the belief that it takes capital from the most productive sectors of the economy and gives it to the less productive sectors, and is enforcing economic egalitarianism, which reduces productivity and the incentive to work. They may further argue that any temporary equality of outcome gained by redistribution would quickly collapse without coercion because people have different levels of motivation and native abilities, and would make different choices based on their differing values. Material

[24] Abbott P. Usher et al. (1931). "Economic History—The Decline of Laissez Faire". *American Economic Review* 22 (1, Supplement)

inequality, they argue, is a necessary outcome of the freedom to choose one's own actions without imposing on others.

Supporters of laissez-faire favor a state that is neutral between the various competing interest groups that vie for privileges and political power in a country. They are critical of mixed economies on the grounds that it leads to an interest-group politics where each group is seeking to benefit itself at the expense of another and the consumer. They oppose government funding or regulation of schools, hospitals, industry, agriculture, and social welfare programs.

According to them, any government intervention such as regulation, protectionism, creating legal monopolies, competition laws, or taxes, interfere with this judgment being reflected accurately in the price and the maximization of economic utility. Their opposition of competition law and the U.S. Food and Drug Administration, stating that they are corrupt and benefits the corporations instead of the consumer.

They tend to believe that minimizing taxes decreases the chance that the government would fund bad programs and prevents citizens from needing government assistance because they have more of their own money.

Many self-identified laissez-faire believers, while believing in freedom on economic issues, may be socially conservative on personal issues. This is not a contradiction as it merely reflects their belief that the best economy is a free market economy but that the best society is a moral society. These examples include the U.S. Constitution Party and various members of the Old Right. They may prefer drug prohibition and restrictions on pornography, which beliefs are opposed to the libertarian ideology of both personal and economic freedom. Many laissez-faire proponents feel that the government should require the enforcement of intellectual property, trade agreements and other interventionist policies. This includes various organizations such as the Cato Institute and the Independent Institute.

Like the mainstream neoclassical economics, the Austrian School and the Chicago school of economics support the subjective theory of value, which says that only a buyer and seller, while using information shared and available in the marketplace, can determine how valuable goods or services are to them and thereby set a mutually agreeable price. They contend that supply and demand, as ordered by the incidence of independent, subjective marginal utility valuations in a free market, are the only sensible means of establishing prices. Moreover, they believe that only prices rendered in a free market can synthesize and communicate the preferences and relevant, time-sensitive data to millions of consumers and producers alike, and that any attempt to objectify these transactions by a centralized authority will fail.

They are against various price controls, in almost all circumstances.[25] They argue that price controls cause shortages due to the shortages in supply of the low price. They

[25] Piergiorgio Odifreddi, Arturo Sangalli, Freeman J Dyson: *The mathematical century: the 30 greatest problems of the last 100 years* (2006) p. 122

are also against certain regulations such as minimal wages and labor unions, stating that these may cause unemployment and reduction of purchasing power of the workers. They are for free circulation of labor. Some may argue for a negative income tax in place for these inequalities, as they state that it is more efficient than labor laws.

2.6.2.2 History of laissez-faire debate

Europe

In nineteenth century Britain, laissez-faire capitalism found a small but strong following by such Manchester Liberals as Richard Cobden and Richard Wright. In 1867, this resulted in a free trade treaty being signed between Britain and France, after which several of these treaties were signed among other European countries. The newspaper The Economist was founded, partly in opposition to the Corn Laws, in 1843, and free trade was discussed in such places as The Cobden Club, founded a year after the death of Richard Cobden, in 1866.[26,27]

British laissez-faire was not exclusively unregulated due to companies legislation.[13] The Limited Liability Act 1855 and the Joint Stock Companies Act 1856 were examples.

However, Austrian scholars consider that laissez-faire was never the main doctrine of any nation, and at the end of the eighteen-hundreds, European countries would find themselves

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[26] Scott Gordon (1955). "The London Economist and the High Tide of Laissez Faire". Journal of Political Economy 63 (6)

[27] James L. Richardson, *Contending Liberalisms in World Politics*, 2001, Lynne Rienner Publishers

taking up economic protectionism and interventionism again. France for example, started cancelling its free trade agreements with other European countries in 1890. Germany's protectionism started (again) with a December 1878 letter from Bismarck, resulting in the iron and rye tariff of 1879.

Although the period before the American Civil War was notable for the limited extent of the federal government, the Austrian School suggest that there was a considerable degree of government intervention in the economy—particularly after the 1820s. Notable examples of government intervention in the period prior to the Civil War include the establishment of the First Bank of the United States and Second Bank of the United States as well as various protectionist measures (e.g., the tariff of 1828). Several of these proposals met with serious opposition, and required a great deal of horse trading to be enacted into law.

Most of the early proponents of laissez-faire capitalism in the United States subscribed to the American School (economics). This school of thought was inspired by the ideas of Alexander Hamilton, who proposed the creation of a government sponsored bank and increased tariffs to favor northern industrial interests. Following Hamilton's death, the more abiding protectionist influence in the antebellum period came from Henry Clay and his American System.

In the mid-19th century, the United States followed the Whig tradition of economic liberalism, which included increased state control, regulation and macroeconomic development of infrastructure.[14] Public works such as the provision and regulation transportation such as railroads took effect. The Pacific Railway Acts provided the development of the First Transcontinental Railroad.[28] In order to help pay for its war effort in the American Civil War, the United States government imposed its first personal income tax, on August 5, 1861, as part of the Revenue Act of 1861 (3% of all incomes over US $800; rescinded in 1872).

The Great Depression

There is much debate over the relationship between laissez-faire capitalism and the onset of the Great Depression. Some economists and historians (such as John Maynard Keynes) argue that laissez-faire capitalism fostered the conditions under which the Great Depression arose.

Other scholars, such as Milton Friedman and Murray Rothbard say that the Depression was not a result of laissez-faire economic policy but of government intervention in the economy and massive credit expansion by the Federal Reserve.

2.6.2.3 Objectivism and laissez-faire capitalism

Objectivism is often associated with 19th-century capitalism. This theory supported as well as promoted patent and copyright laws believing that these are legitimate interventions and this theory promoted an aggressive foreign policy of free trade and supported going to war only in the interests of protecting individual rights.

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[28] Guelzo, Allen C. (1999), *Abraham Lincoln: Redeemer President*, Grand Rapids, Mich.: W.B. Eerdmans Pub. Co

Objectivist politics begins with ethics: The question of if, and if so why, a rational agent needs a set of principles in his life. In the objectivist view, proper ethics tells an individual how to preserve his individual rights while interacting with, benefiting from cooperation with, and trading with, other individuals in society. That is, it determines the principles that constitute a moral social system.[29] According to Ayn Rand, the only social system that fully recognizes individual rights is capitalism:

> When I say "capitalism," I mean a full, pure, uncontrolled, unregulated laissez-faire capitalism—with a separation of state and economics, in the same way and for the same reasons as the separation of state and church.[30]

Although Objectivist literature does not use the term "natural rights," the rights it recognizes are based directly on the nature of human beings. Since human beings must make choices in order to survive, the basic requirement of a human life is the freedom to make, and act on, one's own independent rational judgment, according to one's self-interest.

2.6.2.4 Laissez-faire today

The Austrian School

The Austrian School considers that many modern nations today are not representative of laissez-faire capitalism, as they usually involve significant amounts of government intervention

[29] Ayn Rand, the founder of Objectivism, 1962

[30] *ibid*

in the economy. This intervention includes: a central bank, minimum wages, corporate welfare, anti-trust regulation, nationalized industries, intellectual property, licenses and welfare programs among other forms of government intervention; subsidy programs for businesses and agricultural products; government ownership of some industry (usually in natural resources); regulation of market competition; economic trade barriers in the form of protective tariffs-quotas on imports-"fair trade" or internal regulation favoring domestic industry; and other forms of government favoritism. The now-ubiquitous worldwide money regulating agencies such as the U.S. Federal Reserve System (although it is technically privately owned) and other government owned-and-operated central banking systems as criticised by mainly Austrian School scholars, are seen as artificial at best and damaging at worst. The Austrian School consider the now-ubiquitous agencies such as the Food and Drug Administrations, environmental regulations, and the War in Iraq, illegitimate interventions of the state.

The Austrian School is against the current neoliberal version of globalization. They argue that free-trade agreements and intellectual property laws are only protecting the multi-national corporations at the expense of the people. Many of them are also against global organizations such as the United Nations, associating them as a world government which undermines the independence of the state. They may also oppose international organization such as the International Monetary Fund, which uses a Keynesian inflationary approach that contradicts their support of private currencies by Austrians.

The Chicago School prefers some form of competition law, school vouchers, a central bank, intellectual property and prefer Milton Friedman's negative income tax as a replacement to the existing welfare system, arguing that it is simpler and has fewer of the "perverse incentives" of "government handouts".

According to the 2008 Index of Economic Freedom and The Economic Freedom of the World, issued by the Heritage Foundation and the Fraser Institute respectively, seven countries with the most free economies in the former index are currently the following: Hong Kong, Singapore, Ireland, Australia, United States, New Zealand and Canada (all of them former constituents of the British Empire). Hong Kong is ranked number one for 14 consecutive years in the Index which attempts to measure "the absence of government coercion or constraint on the production, distribution, or consumption of goods and services beyond the extent necessary for citizens to protect and maintain liberty itself." Because of this, Milton Friedman described Hong Kong as laissez-faire state and he credits that policy for the rapid move from poverty to prosperity in 50 years.[31] Much of this growth came under British colonial control prior to the 1997 resumption of sovereignty by the People's Republic of China. Note that the economic freedom scales are relative, and Hong Kong may not be considered "laissez-faire", especially those

[31] www.wikipedia.org

who identify with the Austrian school. Central banks, school regulations, environmental regulations and government ownership of housing are some examples of economic intervention in Hong Kong.

However at a press conference on 11 September 2006, Donald Tsang, the Chief Executive of Hong Kong said that "Positive non-interventionism was a policy suggested by a previous Financial Secretary many years ago, but we have never said that we would still use it as our current policy.... We prefer the so-called 'big market, small government' policy." Responses in Hong Kong were widely divided, some see it as an announcement to abandon the positive non-interventionism, others see it as a more realistic response to the government policies in the past few years, such as the intervention of the stock market to prevent brokering.[32]

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[32] *ibid*

2.6.3 Comparative Costs Doctrine

The classical theory of international trade was formulated primarily with a view to its providing guidance on questions of national policy, and although it included considerable descriptive analysis of economic process, the selection of phenomena to be scrutinized and problems to be examined was almost always made with reference to current issues of public interest. This was true even of the classical discussions of the mechanism of international trade, but it was more conspicuously true in the field which is sometimes called "the theory of international value," where the problems were expressly treated with reference to their bearing on "gain" or "loss" to England, or on the distribution of gain as between England and the rest of the world. Recognition of its "welfare analysis" orientation is essential to the understanding and the appraisal of the classical doctrine. Although the classical economists did not clearly separate them, and shifted freely from one to the other, they followed three different methods of dealing with the question of "gain" from trade:

(1) the doctrine of comparative costs, under which economy in cost of obtaining a given income was the criterion of gain;

(2) increase in income as a criterion of gain; and

(3) terms of trade as an index of the international division and the trend of gain. This chapter will deal with the doctrine of comparative costs.

The doctrine of comparative costs originated as an improvement and development of the eighteenth-century criticism of mercantilist policy, and it has continued to command attention mainly because of its use as the basic "scientific" argument of free-trade economists in their attack on protective tariffs. Protectionists have an obvious motive for attacking the doctrine, but it has also been rejected by economists whose animus seems to arise from the fact that it was one of the outstanding products of the English classical school, by economists who deal with it as an exercise in pure price theory and as such find it unsatisfactory, and by economists who believe that they have at their command a superior technique than it affords for the appraisal of commercial policy. Never widely accepted on the Continent, the doctrine now is clearly on the defensive everywhere.

The doctrine of comparative costs maintains that if trade is left free each country in the long run tends to specialize in the production of and to export those commodities in whose production it enjoys a comparative advantage in terms of real costs, and to obtain by importation those commodities which could be produced at home only at a comparative disadvantage in terms of real costs, and that such specialization is to the mutual advantage of the countries participating in it. In the exposition of the doctrine the "real" costs are expressed as a rule in terms of quantities of labor-time, but with the implication, as throughout the classical theory of value, that these quantities of labor-time correspond in their relative amounts within each country to quantities of subjective cost. The legitimacy of this assumption that labor-time costs are proportional to real costs is examined at length later.

There has been some measure of confusion as to the nature of the comparisons between costs which the doctrine contemplates. According to Cairnes:

... when it is said that international trade depends on a difference in the comparative, not in the absolute, cost of producing commodities, the costs compared, it must be carefully noted, are the costs in each country of the commodities which are the subjects of exchange, not the different costs of the same commodity in the exchanging countries.[33]

But it is not costs at all which are directly to be compared, but ratios between costs, and it is unessential whether the cost ratios which are compared are the ratios between the costs of producing different commodities within the same countries or the ratios between the costs of producing the same commodities in different countries.

In the beginnings of free-trade doctrine in the eighteenth century the usual economic arguments for free trade were based on the advantage to a country of importing, in exchange for native products, those commodities which either could not be produced at home at all or could be produced at home only at costs absolutely greater than those at which they could be produced abroad. Under free trade, it was argued or implied, all products, abstracting from transporation costs, would be produced in those countries where their real costs, were

[33] www.oil.libertyfund.org

lowest. The case for free trade as presented by Adam Smith did not advance beyond this point.[34]

In an earlier chapter, however, it has been shown that several writers prior to Adam Smith, and especially the author of Considerations on the East-India Trade, 1701, stated the case for free trade in terms of a rule which would provide the same limits for profitable trade as does the doctrine of comparative costs, the rule, namely, that it pays to import commodities from abroad whenever they can be obtained in exchange for exports at a smaller real cost than their production at home would entail. Such gain from trade is always possible when, and is only possible if, there are comparative differences in costs between the countries concerned. The doctrine of comparative costs is, indeed, but a statement of some of the implications of this rule, and adds nothing to it as a guide for policy.

Many of the classical economists, both before and after the formulation of the doctrine of comparative costs, resorted to this eighteenth-century rule as a test of the existence of gain from trade.

This explicit statement that imports could be profitable even though the commodity imported could be produced at less cost at home than abroad was, it seems to me, the sole addition of consequence which the doctrine of comparative costs made to the eighteenth-century rule. Its chief service was to correct the previously prevalent error that under free trade all

[34] Adam Smith's: The Wealth of Nations, 1776

commodities would necessarily tend to be produced in the locations where their real costs of production were lowest.

Ricardo presented the doctrine of comparative costs by means of an illustration[35], in which the quantity of wine which required for its production in England the labor of 120 men could be produced in Portugal by 80 men, while the cloth which in England required the labor of 100 men could be produced in Portugal by 90 men. Portugal would then import cloth from England in exchange for wine, even though the imported cloth could be produced in Portugal with less labor than in England.[36]

Torrens clearly preceded Ricardo in publishing a fairly satisfactory formulation of the doctrine. It is unquestionable, however, that Ricardo is entitled to the credit for first giving due emphasis to the doctrine, for first placing it in an appropriate setting, and for obtaining general acceptance of it by economists.

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35 Ricardo's: "My Principles" (1817)

36 www.oil.libertyfund.org

2.7 Geography and Composition of Global Trade

Over the past 25 years patterns of international trade have been changing in favor of trade between developed and developing countries. Developed countries used to trade mostly among themselves, but the share of their exports to developing countries grew marginally from 1985 to 1995. But after 1995 and more so after the new millennium the change has been drastic, developing countries have become major exporters to the developed countries, to the extent that now there is a huge hue and cry among some of the developed countries to control their imports from the developing nations. The financial situation of the **"so called developed countries"** at present is in shambles as compared to that of countries like India. The sub-prime mortgage crisis in the US created a huge turmoil in the financial status of the country. This spilled over to the European countries and in the year 2008 many of the so called strong economies of Europe like UK had to take stringent steps to save its economy, which even today has not come to par. Today we know about the so called **"PIGS"** nations, being Portugal, Iceland, Greece and Spain, which are in shambles. No one knows when these countries could go bankrupt and therefore the world and especially Europe might have to come to the rescue of these countries. Whereas, countries like India are gaining due to their overall development and also due to it being a not too open economy. The one time big disadvantage of India, huge population, has now become and is considered by all as one of its great strengths.

At present developing countries have increased trade among themselves. Still, developed countries remain their main trading partners, the best markets for their exports, and such developed countries which had been the main source of their imports are now not so much in demand for the imports as now these countries have become major exporters. Therefore the import-export ration which had always been in favour of the developed countries has now turned the tide and is favouring the developing nations. Most developing countries' terms of trade deteriorated in the 1980s and 1990s because prices of primary goods—which used to make up the largest share of developing country exports—have fallen relative to prices of manufactured goods.

There is no finality about whether this relative decline in commodity prices and whether it is permanent or transitory, but developing countries that depended on these exports had suffered heavy economic losses slowing down their economic growth and development. In response to these changes in their terms of trade, many developing countries increased the share of manufactured goods in their exports, including exports to developed countries. The most dynamic categories of their manufactured exports are labor-intensive, low-knowledge products (clothes, carpets, some manually assembled products) that allow these countries to create more jobs and make better use of their abundant labor resources. Whereas countries like India started riding on the Information Technology and Software boom. The huge, enterprising and knowledgeable population of India became its strength and India has become one the major software exporters in the world today. The Software exports from India have grown to a few billion dollars and are still rising. Since the year 2000 the scenario changed and now the developing countries, special countries like China, India, Brazil and others are in the best financial shape. China became the biggest beneficiary of this overall export boom due to the conditions prevailing in the country. It has become one of the fastest or the fastest growing economies in the world today and is considered that it might cross the US in financial power in the coming years.

Also, developing countries' imports from developed countries are mostly capital- and knowledge-intensive manufactured goods—primarily machinery and transport equipment—in which developed countries retain their comparative advantage.