

ELASTICITIES OF SUBSTITUTION FOR INDIA'S IMPORTS¹

H. BANNERJI

THE feasibility of regulating the balance of foreign trade of a country by relevant price changes, brought about, for example by devaluation, depends on the value of the price elasticities of goods entering into foreign trade. The effect of imposition of tariffs by a country on its terms of trade is also determined by these elasticities. It is, therefore, worthwhile to attempt an estimate of these elasticities for India, especially when foreign balance has proved to be the most vulnerable point in her development programme. These elasticities are by no means the only factor determining import demand; the influence of income is important.² And for constructing a complete model we need to know also the relevant supply and wage flexibilities. Much of the qualitative thinking on these matters has, however, run on simpler lines, and are sustained by an implicit faith in high values of the price elasticities.

The price elasticities relevant for our analysis are 'partial' elasticities since import demand relates to a part of the market only. When total demand is met partly by imports and partly by production at home, the competing prices are home prices and prices for imports. When the demand for a commodity imported from a particular country is considered, the competing prices are those charged by the countries supplying the commodity. We could try to test the partial elasticities directly by introducing in each demand equation the price charged by the market considered, as well as the price in the competing market. If we consider two markets and assume the two prices to be the only factors determining the demands for the commodity in the respective markets, we shall have two demand equations :

$$\begin{aligned}q_1 &= f(p_1, p_2) \\q_2 &= F(p_1, p_2)\end{aligned}$$

where $q_1 + q_2$ constitute the aggregate demand for the two parts of the market considered and p_1 and p_2 are the competing prices. It is of course

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² cf. Banerji : Analysis of Import Demand, *Artha Vijnana*, Vol. I, No. 3, Sept. 1959.