

CHAPTER-VII
SUMMARY,
CONCLUSION AND
RECOMMENDATIONS

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Summary and Conclusions

Chapter I

- Accelerating growth is one of the most critical problems of developing countries. One of the economic growth patterns is achievable through trade (export) development.
- Trade policy continues to be a real issue. A very restrictive trade policy probably permits other policies to get further out of line.
- Iran is an oil developing country and oil constitutes a big part of its economy.
- Iran's share in non-oil export from total export is small.
- International sanctions imposed on Iran, affected the economy including the oil sector.
- Dependency on oil output to finance the economy makes the country vulnerable against changes in international oil market such as fluctuation in oil prices and extensive widespread international sanctions, imposed by other nations.
- Iran's trade direction and pattern have been changed in past decades towards more trade with lower per capita countries.
- The trend of Iran's GNI per capita has shown the more similarity toward lower per capita income developing countries in recent years.

Chapter II

- The Islamic Republic of Iran came to exist in the Middle East in 1979 after the ruling monarchy under “Mohammad Reza Pahlavi” was overthrown.
- The Supreme leader is the chief of the state, the top of the government structure, the ultimate decision maker.
- In 2012, the country was the second-largest economy in MENA region in terms of GDP, second in the world in natural gas reserves and second largest OPEC oil producer.
- Iran’s economy grew by 5.4 percent in annual average during 1989-2008
- Iran’s annual average inflation rate was about 19.2 during 1990-2011.
- It is estimated that Iran’s population would be around 77 million in 2012.
- The double-digit unemployment rate is one of the biggest challenges of Iran’s economy.
- During the 1997-2011 period, annual average growth rates for agriculture, oil and gas, manufacturing and mining, and services sectors were about 20, 25.2, 22.6 and 23.2 percent respectively.
- During the Ahmadinejad government (2006-2011), oil export value was the highest in post-revolution era.

Chapter III

- In Adam Smith’s theory of the absolute advantage, he asserted that both nations gain from trade, if one nation is more efficient than the other one in producing a

commodity (which has absolute advantage in production of it) and exchange part of its output with another nation.

- In David Ricardo's theory of the comparative advantage, he asserted that differences in comparative cost of production determine pattern of trade that reflect a difference in technique of production.
- In the Heckscher-Ohlin theory, specialization and trade are determined by relative factor abundances. In their theory, Ricardo's labor theory of value is replaced by a multiple factors theory through increasing the factors of production to labor and capital.
- The Leontief empirical result known as "Leontief Paradox" shows apposite evidence to the conclusion of H-O theory.
- Linder asserted that the H-O theory is good to explain pattern of trade in primary products and agriculture goods, but it is inadequate to explain trade in manufactured goods.
- Linder's theory implies that companies in one country are generally eager to produce manufactured goods for which there is a large domestic market and export the surplus, thus a commodity will be potentially exported if there would be a large demand for it in the home market.
- Linder stated that consumer demand is determined strongly by income levels. Countries with high per capita incomes will demand high quality manufactured goods and nations with low per capita income will demand lower quality goods. Consequently, countries with similar per capita income will have overlapping demand structure and will likely demand similar manufactured goods.
- Linder's theory was criticized for its inability to explain the factors that determine the comparative advantage and the idea of strong home market as the creator of trade.

- Linder has not taken factors such as transport cost, man-made trade obstacles, geographic distance, and other major determinant of trade patterns into account.
- The empirical validity of Linder hypothesis is not clear. Several studies have found a significant impact of Linder effect and have supported Linder's proposition, but other have had weaker result or rejected his theory.
- Among more than forty empirical studies of the Linder theory, five have rejected hypothesis introduced by Linder. Rest of studies has gotten evidences implying approval for Linder trade theory.

Chapter IV

- The Pre-Revolutionary period can be considered as an almost free trade system controlled by an imperial family, and post-revolutionary period as more state oriented.
- During the 1931-76 period, main export and import partners of the nation were Soviet Union, West Germany, United States, and Japan.
- In post-Revolution, the country's contemporary international view has been shaped by a wide variety of factors such as; the early revolutionary ideology, diplomatic dispute with the United States and the West, the Iraqi-imposed war, instability in the global oil market, domestic political uncertainties, high inflation rates, etc.
- The country's foreign trade policy was based on non-alliance, non-dependence and relative self-sufficiency from East and West.
- The country gave especial priority in its foreign relations first to its neighbors, Muslim countries, non-aligned countries and finally developed countries.
- The country imposed a complicated range of tariff and non-tariff regulations. Tariff rates ranged from five to 100 percent of import value

- In the first decade after the Islamic Revolution, the value of import followed a downward trend. In the second decade, import trend tended to rise gradually. In the third decade, the value of import increased by the average of 59 percent a year.
- The composition of imports in post-revolution has shown no change compared to pre-Revolution era.
- The industrialization of the country has been based on import-substitution strategy of development.
- Since the Islamic Revolution, the country had become more dependent on oil revenues.
- The actual level of non-oil exports during FYDPs shows a significant gap between the goals as stated in the plans and the actual levels achieved.
- The realistic valuation of exports, the introduction of a realistic equivalent rate for the foreign exchange, removal of bureaucratic laws, etc improved non-oil export values.
- Since Revolution, there was effort to change the composition of non-oil exports from traditional items to industrial goods. However, this objective of changing was far from being happened and this trend was eventually shifted toward traditional goods and raw materials.
- Goods such as carpets and pistachios have a major share in the exports. However, those from chemical industries and the melting of metals have also increased considerably.
- The direction of foreign trade has been partly political due to harsh economic and political situations, such as imposed sanctions, and forced the country to seek new economic partners.

- Since 2005, Europe's trade with the country has declined dramatically, especially after imposing new round of sanctions over the banking system, crude oil and petrochemical products exports.
- Since 2009, Asian trade with the country is growing significantly
- Comparing pre and post-Revolution top trade partners of the country indicates considerable changes.
- Before the Revolution, the United States was the third largest exporter to and first largest importer from the country. However, the United States' sanction limited bilateral trade.
- Germany has been one of the most important trading partners of the nation for several decades. Economic sanctions against the country dropped the amount of trade between two countries dramatically. However, Germany is still the leading trading partner of the country in West and one of the main export partners of the nation
- The UAE, among Persian Gulf countries, had the closest economic relations with the nation. The UAE acts as a conduit and a third party trans-shipper for the nation. Through Dubai, Iran is able to import goods that cannot be imported directly as sanctions and other legal barriers have increased the difficulty of dealing directly with them. Bilateral trade between two countries rose steadily throughout the last decade. The trade relationship is heavily weighted in the UAE's favor. The International sanctions against Iran adversely affected the bilateral trade.
- Chinese-Iranian relations improved sharply especially due to international sanctions that reduced the West's position in the country and gave China more opportunities to become involved in the nation's domestic market.
- Iran and India's economic and commercial relations covered many sectors in both countries .The trade relations have traditionally focused on India's import of Iranian crude oil.

- The International sanctions imposed on the country make it increasingly difficult to get cash for energy exports. China and India provided goods and services in exchange. These reserves gave them more bargaining power. Until now, the only way for the country to get its money is through accepting barter products in return.
- Iran and Turkey as neighbors are traditional trading partners. Several factors make the two nations closer to each other: common economic interests, political Islam, and collaboration against the birth of Kurdish federation.
- Trade sanctions reduced Iranian exports to US and EU, and trade diverted toward Asian, Latin American, and African markets.
- The sanctions have restricted global trade with the country. Many companies cut their dealings with the country altogether.

Chapter V

- Linder Hypothesis is tested for the period 1992-2012 in Fixed-Random Effect model, Gravity model A, and Gravity model B, through three Linder effects, which are LINDER1, LINDER2 and LINDER3.
- Data related to 127 countries is divided to five groups. The first group (Base group) includes all cross-sections, and the rest four groups are divided based on their GNI per capita levels according to the World Bank Atlas method (2012) classification to Low income (23 countries), lower middle income (27 countries), upper middle income (36 countries) and high income (41 countries).
- Results of panel data unit roots tests show that RTRADE, GDPIR, REXCHANGE, LINDER1, LINDER2, LINDER3 and LOG (REXCHANGE) are stationary on level. GDPP, LOG (SUM1) and LOG (SUM2) are non-stationary which, after one time difference will be stationary that is integrated of order unity.
- Results of the Johanson Fishert panel cointegration imply that there are long-run relationships among time series variables in models of this study.

Model I

- GLS, LS and SUR GLS methods have been used in the Model I to test hypothesis for all five groups that are Base group, high income, upper middle income, lower middle income and low income.
- Results of Model I show for two groups that are high-Income group and low-income group, LINDER1 is significant and negative which approves Linder hypothesis. In Base group, upper-middle income and lower-middle income, LINDER1 is not significant, while in case of Tobit model (only applicable for base group), LINDER1 is also significant and negative.

Model II

- GLS method has been used to test hypothesis for Model II in all groups that are Base group, high-income group, upper-middle income group and low-income group.
- Results of Model II show for three groups that are Base group, upper-middle income and low-income groups, LINDER2 is significant and negative which approves the Linder hypothesis. For high-income group and lower-middle income, LINDER2 is not significant.
- In Model II except HI group, in base group, upper-middle income, lower-middle income group and low-income group, LNDIS is significant and negative which implies that there is the negative effect of distance on bilateral trade between Iran and potential trading partners.
- In Model II, dummy variable that related to common border is positive and significant and dummy variable for membership in OPEC is negative and significant (only applicable in Base group). Time dummy variable is negative and significant only in case of Base group while in remaining four groups is insignificant.

- In Model II, except in case of high-income group, economic size of countries has positive and significant effect on total trade in Base group, upper-middle income group, lower-middle income group and low-income group.

Model III

- GLS and LS methods have been used to test the hypothesis in Model III for Base group, high-income group, upper-middle income group, lower-middle income group and low-income group.
- In Model III, results show only in Low Income group, LINDER3 is significant and negative. In Base group, high-income group, upper-middle income group and lower-income group, LINDER3 is not significant.
- In Model III, LNDIS is negative and significant in all five groups that are Base group, high-income group, upper-middle income group, lower-middle income group and low-income group, which implies the negative effect of distance on bilateral trade.
- In Model III except in high-income group, size of country and Population have positive and significant effect on share of trade in Base group, upper-middle income group, lower-middle income group and low-income group.
- Dummy variable that related to common border is positive and significant and dummy variable for membership in OPEC is negative and significant (only applicable in Base group). According to results, time dummy variable shows negative and significant effect on total trade in Base group, high-income group and lower-middle income group. It does not show any significant effect on trade in upper middle-income group and low-income group.

Chapter VI

- Empirical evidences derived from results of three models of this study indicate the existence of the Linder effect for Iran. This sentence is significant not only in base group, HI and UMI, but also surprisingly, it is strong and significant in LI among three models of this study.
- According to evidences, the size of the countries, which is measured, by GDP, aggregate GDP, aggregate GDP per capital and population in most of the groups in this study (except HI group) show positive, strong and significant effect on Iran's trade.
- The results for effect of the real exchange rate on trade in this study are mixed (both negative and positive) but mostly insignificant.
- There are strong evidences in this study about the negative and significant impact of distance among trade partners on Iran's trade (range between -0.59 and - 4.32).
- Empirical evidences of this study shows that time dummy variable does not have significant effect on trade in UMI group and LI group. This variable has negative and significant effect in other groups (range between -0.14 and -0.55).
- Results imply the strong effects of dummy variables of common border (range between 0.87 and 0.91) and membership in OPEC (range between -1.48 and -1.3) on trade in this study.

Recommendations

Line of actions

- The international sanctions imposed by UN, USA, EU, etc on the country severely affect the domestic economy. The country is facing several problems. For instance, getting foreign currencies (mostly US dollar and Euro) from export of goods is increasingly difficult. In addition, the international banking channels have almost become non-existent. As a result, domestic product markets have been paralyzed due to high dependency on imported intermediate capital goods, growing isolation of the country due to its nuclear program, and declining

bilateral trade, etc. Many of its domestic and international problems can be solved if the government initiate following steps:

- The country should improve political and economical bilateral relationships with friendly countries and initiate them as well with other countries that are against Iran.
 - The country should initiate discussions and negotiations about sanctions imposed by USA, EU, etc.
 - The country should start diplomatic contact with the USA and attempt to establish diplomatic channels to set up embassy for further economic and trade relations. This will help to hold frequent meeting and discussions to sort out related problems with the USA
 - The country should be pragmatic on issues related to nuclear programs, and follow the World trends to sort out such problems. This will help the country to improve relationships with other nations.
 - The country should be careful on controversial issues such as holocaust and be realistic in international policies and relations of the country with the World. This will help the country to find new friends to improve trade, economic and political relationships.
 - The country should attempt to develop beneficial relationships with the countries who can be strategic, political and economic partners.
- The government record shows that Iran officially submitted an application to join the WTO in 1996. Countries in same trade block enjoy less trade barriers and more free trade compared to non-member countries. The country would get great benefit from joining the WTO, which allows its products to access to markets of

other member countries and to compete on equal terms with them. However, the country has not been allowed to join the WTO as the USA opposed the country's membership. Problem related to join to WTO can be solved through these line of actions:

- The country should initiate negotiations with friendly countries to support its membership in the WTO.
 - The country should initiate the regional and strategically trade blocks with friendly countries and its strategic partners such as Russia, China, India, Middle eastern countries, South Asian countries, Latin America, African countries, etc to improve the present domestic and international economic situations.
 - The country should improve its relationships with the friendly countries to attract foreign direct investment in oil industry and other sectors as well to improve economic sectors positions and Iran's economy in general.
 - The country should initiate diplomatic negotiations with the USA and the West to redress current situations. This can help the country to solve issues regarding to international sanctions and that will pave the way to join the WTO.
 - The country should attempt to follow procedures and guidelines which others countries do as pre-conditions for joining the WTO and provide proper situations in domestic economy to ease joining to the WTO.
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- The economy of Iran largely depends on oil resources (50 percent of the government budget). The current conditions proved that oil price fluctuations in international markets affect the country's economy, which causes disruption in economic decision-making. In this situation, even Iran cannot get predicted returns from oil, in the international markets because

exogenous factors such as international sanctions, problems related to negotiations with super power about nuclear program, etc are not predictable. Linder (1961) asserted that countries, which have ability to reallocate factors of productions, probably are passing through a process of economic growth under trade that reflected in rising per capita income. Therefore, with the line of statement given by Linder, Iran can solve dependency of its economy on oil by switching over to manufactures exportable goods. If it so happens, Iran may have good and strong economy in the world. However, the following lines of actions are to be taken:

- The country can solve this problem by developing exports of manufacture goods, which are possible by a large-scale production of high quality exportable goods. It will increase per capita income levels. This also happened in case of UAE, when it restructured its economy in favor of manufactures exportable goods.
- The country should improve its economy based on manufactures non-oil trade such as capital goods-machinery. If the domestic market is unable to demand enough capital goods, the surplus capital goods can be exported. As a result, the economic development of the country is likely to happen by foreign trade and non-oil export. The country will also probably change the demand-consumption patterns and will increase number of foreign and domestic competitors.
- The country requires increasing the scale of productions of manufacture goods. If the domestic market conditions permit industries to produce sufficiently a large scale of operation in target manufacture goods, the industry becomes competitive in world markets.

- The country should change demand preferences through changing process of production with high quality manufacture goods so that domestic consumers substitute them for low quality imported goods, and the surplus will be exported.
- Lastly, as a result of surplus in domestic economy, the country can increase per capita income based on trade. Further, the country can improve its bilateral trade relationships with developed countries and thus, even the country will get benefits of high quality importable products as well.

Scope of further study

- There are few studies about empirical validity of the Linder theory in developing countries. This study provides some insight about existence of the Linder hypothesis between Iran as developing county and with developed and other developing countries. If more studies are to be conducted to illustrate the validity of Linder theory, and the connections between per capita income similarity and bilateral trade in other developing countries, the issue related to subject matter will further enrich the literature.
- The World Bank classifies countries according to their per capita GNI annually. In this study, the 2012 classification of countries has been used. The study observed that the classification of countries in every year changes their groups and so result could be different. In this way, there is further scope of study.
- This study has been tested for the period 1992-2012 in Iran. The Linder theory can be tested for another period or another country to check the validity of the hypothesis during a different time period and in different countries.
- Linder (1961) first noted the role of product quality on trade. He argued that richer countries have a comparative advantage in the production of high-quality goods. He also argued that they spend larger proportions of their income on high-

quality goods. He then concluded that the congruence of production and consumption patterns leads countries with similar income per capita to trade more. Testing the effect of product quality on bilateral trade can be an interesting further aspect of the Linder theory.