

# A Study on Impact of Foreign Trade in India in The Post Liberalisation Era

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## Abstract

*Foreign trade makes a significant contribution to the economy growth of a country. The policy regime in India about the liberalization of the external sector has brought tremendous changes in India's foreign trade. So, the present study attempts to analyze the trend and composition of trade since 1991 and also to analyze the impact on the economic growth of India. The study reveals that though the total exports and imports both have increased the growth rate of imports is more than the growth rate of exports. It is also noted that manufactured goods compose the major portion of the export goods while petroleum and crude products contribute the major portion of the imported goods. The study also reveals that import has a negative influence on economic growth while export and economic openness are positively related to the economic growth of India.*

**Keywords:** Economic Growth, Economic Openness, Growth Rate, Export and Import

## Introduction

Foreign Trade is very crucial for a country's economic development as it has made an increasingly significant contribution to economic growth and substantially to the economic welfare of the people. The foreign trade of a country consists of the inward and outward movement of goods and services, which results in outflow and inflow of foreign exchange from one country to another country. No country in the world possesses the adequate facilities for economical production of all the goods and services that are consumed by its people. This implies that no country is self-sufficient in the sense that no country can produce all the goods that it needs. Hence, the need to trade with each other arises. Economies of scale and international specialization which is also the fruits of scientific and technological progress in the world would become more easily accessible through foreign trade (Agarwal, 1975). Developing countries need more goods to feed a rapidly growing population. Exports can be a leading sector in growth. It implies that increased earnings from the higher marketability of a country's commodities in the international market would stimulate the indigenous industrial activity within the country. This, in turn, brings many distinct benefits, viz., greater utilization of resources, larger employment opportunities, more foreign exchange, etc.

It was thus considered that foreign trade would make an impressive contribution to a country's development; hence it is considered to be not simply a device for achieving productive efficiency; but also an engine of growth. International trade has now become a vital part of development strategy, and it can be an effective instrument of economic growth, employment generation and poverty alleviation in an economy.

### Necessity of the Study

As a result of long-term poor economic performance under protectionist policies, many developing countries including India started removing their barriers to international trade in the late 1980s with an aim to improve the economic development of the country. During the time of independence, the foreign trade of India was typical of that of a colonial and agricultural economy, and the trade relations were mainly confined to Britain and other Commonwealth countries. During the period 1950 -1990, foreign trade of India suffered from strict bureaucratic and discretionary controls. Although the Indian foreign liberalization era started in 1970's but only in the late 1980's and early 1990's, drastic changes have started taking place as far as Indian foreign trade is concerned. In 1991, the Government of India introduced series of economic reforms to liberalize and globalize Indian economy. Since the initiation of economic reforms, India's outward orientation has started increasing. The Indian trade policy experienced various changes from time to time after its initiation and the major changes included simplification of procedures, removal of quantitative restrictions and substantial reduction in the tariff rates. The policy regime in India about the liberalization of the external sector has brought tremendous changes in Indians foreign trade. Thus, it is in this connection that the present study aims to analyze the trend and composition of the foreign trade since 1991.

### Objectives

The study aims to achieve the following specified objectives:

1. To analyze the trend and composition of foreign trade in India since 1991.
2. To examine the role of foreign trade in economic growth of India.

### Methodology of the Study

The study is based on secondary data collected from Statistical Handbook published by RBI. To examine the trend and composition of foreign trade in India after New Economic Policy of 1991 simple statistical tools like growth rate, percentage share calculations, and simple diagrams have been used. The growth rates of exports (  $X/X$ ), Import (  $I/I$ ) and GDP (  $I/Y$ ) are obtained by using the following formula:

$$Gr_t = \frac{Y_t - Y_{t-1}}{Y_{t-1}} \times 100$$

where Grt is the growth rate of variable Y for tth time period compared to its previous year and, it is represented as percentages.

To examine the role of foreign trade in economic growth of India, linear regression model has been used where Gross Domestic Product (GDP) at factor cost at constant price is taken as a measure of economic growth; and volume of export, import and economic openness in monetary terms are taken as variables of the study. Before applying Ordinary Least Squares (OLS) method, the stationarity of the concerned variables is tested using Augmented Dickey Fuller (ADF) Test. The following model is applied here examine the impact of trade on economic growth

$$Y_t = \alpha + \beta_1 X_t + \beta_2 M_t + \beta_3 O_t + u_t \quad t = 1, 2, 3, \dots, 22.$$

where  $\alpha$  and  $\beta_s$  are the coefficients and  $u_t$  is the error term which follows the normal distribution with mean zero and variance  $\sigma^2$ .

$Y_t$  is the Gross Domestic Product in period t,  $X_t$  is the export in time t.  $M_t$  is the import in time t.  $O_t$  is the economic openness in time t. The openness variable is measured as exports plus imports divided by GDP [ $O = (X + M)/GDP$ ].

### Results and Discussion

The findings of the study are divided into two sub-sections according to the objectives of the study. Trends and Composition of India's Foreign Trade

The impact of trade reforms is apparent from the changing structure of India's Foreign Trade in terms of trend and diversity of market and products. Figure1 presents the growth rates of GDP, total exports and total imports measured over the period 1991-92 to 2014-15. During the 1990s, Indian exports have performed well in certain years, and not so well in some other years. The growth rate was high in 1993-94 and 1995-96 at 29.9 percent and 28.6 percent respectively, but declined sharply in 1996-97 to 11.7 percent, and continuously till 1998-99 on account of the South East Asian crisis and Worldwide recession. It again recovered to 14.2 percent in 1999-2000, and reached the highest growth rate for the decade at 27.6 per cent in 2000-

01. However, the global economic slowdown and the events of September 11, 2001 led to a steep fall in the rate of growth of exports to 2.7 percent during 2001-02. The period since 2002-03 has recorded a steady export growth rate up to 2008-09. India's exports reached Rs. 8407.55 billion in 2008-09 and to Rs. 8455.34 billion in 2009-10. Thus, the growth of exports declined to 0.6 percent in 2009-10 in view of the global meltdown. But in 2010-11, exports made a huge jump up to Rs. 11429.22 billion and thus the growth rate of export recorded the highest of 35.2 percent. However, the cumulative value of exports in 2014-15 was Rs. 18964.45 billion and registered a growth rate of -0.4 percent (Table 1).

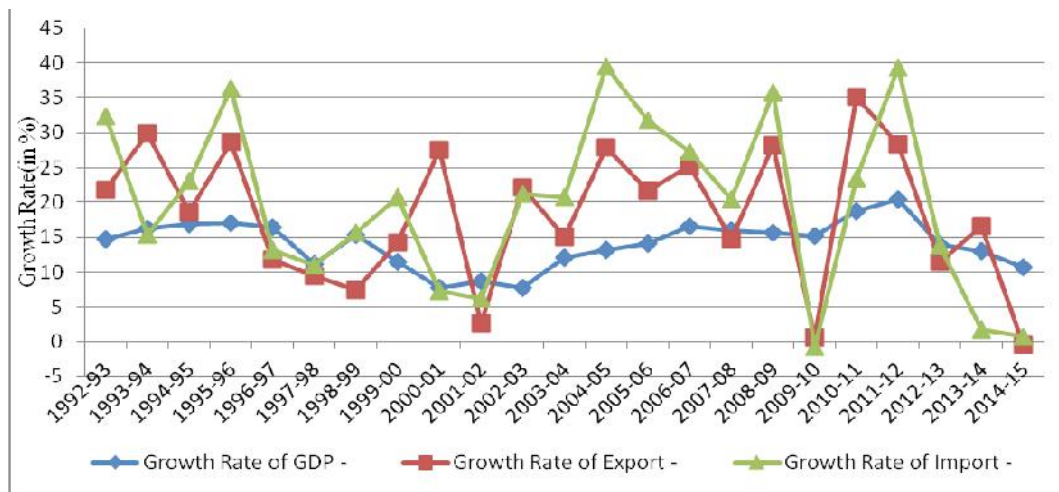
**Table 1: Trends of India's Foreign Trade (Rs. in Billion)**

Year	Gross Domestic Product	Growth Rate (in %)	Export	Growth Rate (in %)	Import	Growth Rate (in %)	Trade Balance
1991-92	613,528	-	440.42	-	478.51	-	-38.09
1992-93	703,723	14.7	536.88	21.9	633.75	32.4	-96.87
1993-94	817,961	16.2	697.51	29.9	731.01	15.3	-33.5
1994-95	955,386	16.8	826.74	18.5	899.71	23.1	-72.97
1995-96	1,118,586	17.1	1063.53	28.6	1226.78	36.4	-163.25
1996-97	1,301,788	16.4	1188.17	11.7	1389.20	13.2	-201.03
1997-98	1,447,613	11.2	1301.01	9.5	1541.76	11.0	-240.75
1998-99	1,668,739	15.3	1397.53	7.4	1783.32	15.7	-385.79
1999-00	1,858,205	11.4	1595.61	14.2	2152.37	20.7	-556.76
2000-01	2,000,743	7.7	2035.71	27.6	2308.73	7.3	-273.02
2001-02	2,175,260	8.7	2090.18	2.7	2452.00	6.2	-361.82
2002-03	2,343,864	7.8	2551.37	22.1	2972.06	21.2	-420.69
2003-04	2,625,819	12.0	2933.67	15.0	3591.08	20.8	-657.41
2004-05	2,971,464	13.2	3753.40	27.9	5010.65	39.5	-1257.25
2005-06	3,390,503	14.1	4564.18	21.6	6604.09	31.8	-2039.91
2006-07	3,953,276	16.6	5717.79	25.3	8405.06	27.3	-2687.27
2007-08	4,582,086	15.9	6558.64	14.7	10123.12	20.4	-3564.48
2008-09	5,303,567	15.7	8407.55	28.2	13744.36	35.8	-5336.81
2009-10	6,108,903	15.2	8455.34	0.6	13637.36	-0.8	-5182.02
2010-11	7,248,860	18.7	11429.22	35.2	16834.67	23.4	-5405.45
2011-12	8,736,039	20.5	14659.59	28.3	23454.63	39.3	-8795.04
2012-13	9,946,636	13.9	16343.18	11.5	26691.62	13.8	-10348.4

2013-14	11,236,635	13.0	19050.11	16.6	27154.34	1.7	-8104.23
2014-15	12,433,749	10.7	18964.45	-0.4	27370.87	0.8	-8406.42

Source: Various Issues of Handbook of Statistics on the Indian Economy, Reserve Bank of India

Fig 1: Growth Rates of Imports, Exports, and GDP

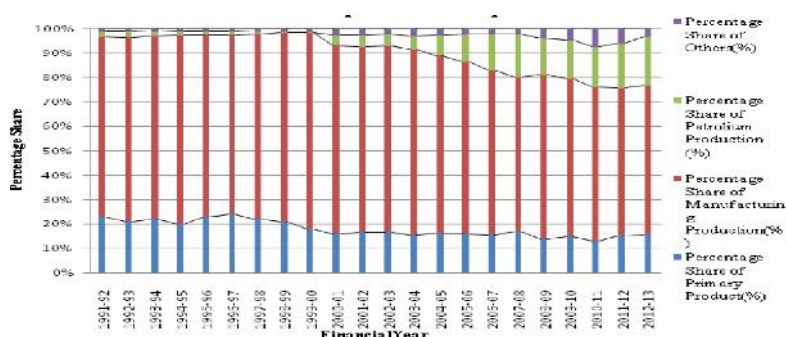


In case of imports, it crossed Rs. 1000.00 billion for the first time in 1995-96 and then it declined steeply. The growth rate of imports was low in 2001-02 (Table 1). It regained in 2002-03 and had grown steadily after that and touched 39.5 percent in 2004-05 and then declined up to 20.4 percent in 2007-08. In 2008-09, the growth rate again touched by 35.8 percent. But deceleration started from October 2008 and led to a negative growth rate of -0.8 percent in 2009-10. It regained in the consecutive year and reached the maximum of 39.3 percent in 2011-12. However, the cumulative value of imports for the period 2014-15 was Rs. 27370.87 billion and

registered a growth of 0.8 percent.

Liberalization and trade reforms have also led to some changes in the composition of India's foreign trade. The composition of foreign trade implies the composition of exports and imports of a country. Exports bring out the fact about the goods that a country has and how much of these it can and are willing to sell, and import indicates what types of goods a country lacks and how much of them it can get. The composition of foreign trade related to exports and imports of different commercial products are shown in Figure 2 and Figure 3.

Figure 2: Commodity Composition of India's Export

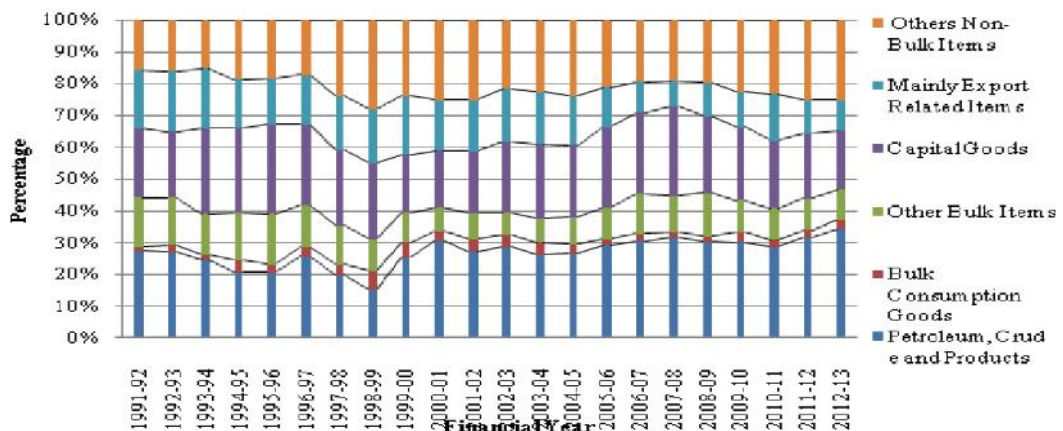


The highest share in total export is of manufactured goods followed by primary goods. But it is also observed that from 2000-01, the share of manufactured goods is continuously falling. On the other hand, from the same year, the percentage share of petroleum products to total export is increasing continuously. It is also seen that over the periods 1991-92 to 2012-13, primary products experience fluctuations in its share to total export and the percentage of other exported goods constitutes a small share to the total export. The primary products are composed of agriculture and allied products and ores and minerals while the manufactured goods are composed of leather and manufacture, chemicals and related products, engineering goods, gems and jewellery, handicrafts, textile and textile products and other manufactured goods (Figure 2).

Total bulk imports are composed of petroleum, crude, and products, bulk consumption goods which

include cereals and cereal preparations, edible oils, pulses, etc. and other bulk imported items while the non-bulk imports are composed of capital goods, export-related items which include pearls and precious stones, organic and inorganic chemicals, textile yarn, fabrics, sugar, and finally other imported non-bulk items. It is observed from figure 3 that the share of non-bulk imports to total import is higher than the share of bulk imports to total imports. Under bulk imports share of petroleum, crude and products are the highest followed by other bulk items. The share of bulk consumption goods to total bulk imports is the lowest. It is also seen that under non-bulk imports, the share of capital goods is the highest followed by the share of other items. The share of export-related goods and other non-bulk imports experience fluctuations in its share to total non-bulk imports. Bulk consumption goods capture the lowest share in total imports (Figure 3)

**Figure 3: Commodity Composition of India's Import**



### Impact of Trade on Economic Growth

Using non-stationary variables in the model might lead to the spurious regression which cannot be used for precise prediction (Gujarati, 2003). Hence, our first step is to determine whether the variables have unit roots, that is, whether it is stationary and the

order of integration. To identify the stationary of the variables under study Augmented Dickey-Fuller (ADF) test is applied. Table 2 shows the result of unit root test and the order of integration. It is seen that all the variables are stationary.

**Table 2: Unit Root Test Summary Statistics (Augmented Dickey-Fuller)**

Variables	ADF Test Statistics	Critical Values			Order of Integration
		1%	5%	10%	
GDP	4.439	-3.750	-3.000	-2.630	I(0)
Export	5.155	-3.750	-3.000	-2.630	I(0)



Import	5.004	-3.750	-3.000	-2.630	I(0)
Economic Openness	2.666	-3.750	-3.000	-2.630	I(0)

**Source:** Calculated on the basis of Statistical Handbook on Indian statistics 2012-13.

Table 3 presents the result of the regression analysis depicting the impact of foreign trade on economic growth. The value of R<sup>2</sup> in the model is 0.98 which shows that 98 percent of the variation in the

dependent variable is explained by the independent variables of the model. The one percent variation in the dependent variable remains unexplained by independent variables of the study.

**Table 3: Impact of Trade on Economic Growth (GDP)**

Variables	Co-efficient	t-values	Prob. Value	ANOVA
Intercept	8505.06*	6.619472	0.00000	R <sup>2</sup> = 0.987 Adj. R <sup>2</sup> = 0.985 F Stat. = 460.549*
Export	4.396539*	2.961271	0.00836	
Import	-3.45091*	-4.23555	0.000497	
Economic Openness	96288.33*	7.340794	0.00000	

**Source:** Calculated by Statistical Handbook on Indian Statistics 2012-13.

**Note:**\* denotes parameters are significant at less than one percent.

The adjusted R<sup>2</sup> shows that asymptotically the variables can explain approximately 98 percent of the total variation. The implication is that the model has the goodness of fit. F-statistic tests the overall significance of the model under study. The value for the F-statistic is 460.54 and is significant. The result of regression analysis shows that export and economic openness have the significant positive impact on GDP while import has a negative impact on GDP. The results confirm the importance of foreign trade on expansion and growth of Indian economy. Although import is negatively related with GDP, the overall impact of trade on economic growth represented by economic openness is positive and highly significant (Table 3).

### Conclusion

Over the study period, it has been observed that total exports of India have increased since the adoption of New Economic policy in India. Although India is facing a continuous deficit in its balance of payment but the overall prosperity is unbounded. In spite of fluctuations in GDP growth rate, the volume of trade is increasing day by day. The composition of India's exports has grown up significantly. The export of petroleum has shown a considerable increasing trend. The major portion

of Indian exports is in manufactured goods. The composition of India's imports has also grown up significantly. It has also shown a positive and increasing trend during the period under study. The share of imports of petroleum and crude products and other non-bulk items have increased significantly while the imports of food grains and export-related items have declined. The study also indicates that post liberalization era has certainly helped India in achieving high growth in the economy as there has been a rapid growth of imports of capital goods and technical raw materials to meet the requirement of industrialization and growing imports of petroleum products for meeting industrial and consumption requirement. It is also found that though import has a negative influence on economic growth, the volume of trade reflected by economic openness has a positive impact on the economic growth of India and its magnitude is increasing continuously.

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