
AN ANALYSIS ON THE PROPORTIONAL RELATIONSHIP BETWEEN TRADE OPENNESS AND ECONOMIC GROWTH IN INDIA

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ABSTRACT

Examining the causal link between Trade Openness, Financial Development, and Economic Growth in India over the post-liberalization period of post 1991 is the aim of this article. Growth is also thought to have a big influence on private credit, which is thought to lead to trade openness. Trade openness is causally impacted by financial development (private credit and money supply), which allocates resources efficiently to support both technical advancement and productivity growth. Therefore, the results lend credence to the growth-led trade theory. The neoclassical growth model links technical advancement to growth, which is made feasible by well-considered economic policies like foreign direct investment (FDI) in a number of national industries. India appears to be leading the way in this regard. This study looks at the impact that foreign direct investment (FDI) plays in the economic process in developing nations with varying trade policy regimes, using a novel paradigm from growth theory. The positive impact of foreign direct investment (FDI) on enhanced economic growth is stronger in countries that pursue an outwardly oriented trade policy than it is in those that adopt an inwardly oriented policy, is tested in this paper using cross-section data pertaining to a sample of 46 developing countries.

Keywords: Open economy, Foreign trade policy, Growth of economy.

INTRODUCTION

India's economic policies, like those of the majority of emerging nations, are focused on achieving sustainable economic growth. Numerous theoretical and empirical research have focused on the connection between financial developments, economic growth, and international commerce.

India has opened its markets for international trade and financial flows significantly over the past twenty years. The combined share of imports and exports in the Indian economy increased from less than 17 per cent of GDP in 1986 to around 35 per cent of GDP in 2019. India's trading and financial openness prove that there is a positive correlation between trade and financial openness, and that as a result, any further economic openness of the country may yield important impacts on its overall economic development¹. According to some findings, trade liberalisation has brought about lower industrial concentration and increased consumer surplus in the country while others state that foreign direct investment has not really effected significant changes on the side of supply. In general, trade openness can stimulate growth in India; however, it has a multifaceted effect that hinges upon several variables².

In 1980, the Indian economy was struggling with a trifecta of issues: a decline in foreign exchange, ballooning imports without a corresponding increase in exports, and high levels of inflation. These challenges prompted India to adopt a new approach to economic growth in 1991 - one driven by exports and supported by trade liberalization policies. This decision was not made lightly; it came as a response to a financial crisis and pressure from influential international organizations such as the World Bank and IMF³. The implementation of this new trade policy in 1991 was accompanied by a multitude of reforms. These included reducing import duties, allowing for private sector involvement in previously government-controlled industries, devaluing the national currency to boost exports, and addressing the adverse Balance of Payments (BOP) situation. Prior to the 1990s,

¹ Miss Catriona Purfield and Mr. Jerald A Schiff, 3 Trade and Financial Openness, IMF eLibrary, <https://www.elibrary.imf.org/display/book/9781589065680/ch03.xml>, Accessed on 20th Nov. 2023

² Suadat Hussain WANI, Trade Openness, Capital Formation, and Economic Growth: Empirical Evidence from India, *Eurasian Journal of Business and Economics*, 15(29), 35-49, (2022), <https://ejbe.org/EJBE2022Vol15No29p035-WANI.pdf>

³ Lingaraj Mallick & Smruti Ranjan Behera, Does trade openness affect economic growth in India? Evidence from threshold cointegration with asymmetric adjustment, Taylor & Francis online, <https://doi.org/10.1080/23322039.2020.1782659>

the share of trade in India's GDP had been in decline. However, since the turn of the millennium, there has been a consistent increase in the trade sector's.⁴

RESEARCH OBJECTIVE:

- ☐ To analyse the impact of openness of trade in the gross domestic production.
- ☐ To observe the influence and ambit of foreign trade policy upon the Indian economy.
- ☐ To observe the functioning of foreign direct investments and other trade transactions globally under the economic regime of India.
- ☐ To analyse how the post liberalization era have developed along with the maximum utilization of foreign interventions in the trade market.

RESEARCH QUESTIONS:

- ☐ Whether the open economy of India has a proportional influence on the growth of Indian economy?
- ☐ Whether foreign policies and foreign direct investments have a greater impact on trade market than trade partner relationship?

RESEARCH HYPOTHESIS

The larger open market of trade with higher international trade and greater integration to the economy, positively proportionate between trading sector and economic growth. This relationship is analysed based on the foreign direct investments, policies enhancing production and overall productivity.

RESEARCH METHODOLOGY

The researcher had followed the method of doctrinal, descriptive, and analytical for the entire

⁴ Id.

research. And the researcher had referred the books based on the given topic for the wide information that can be included in this research paper.

RELATIONSHIP BETWEEN TRADE OPENNESS AND ECONOMIC GROWTH

Economists such as Adam Smith and Paul Krugman have emphasised the significance of international commerce in a nation's economic development. Because policymakers are optimistic about trade openness, the link between growth and openness to the outside world is therefore hotly discussed⁵. The adoption of export-oriented industrialisation in the 1970s by countries like Hong Kong, South Korea, China, and Singapore led to accelerated economic growth, prompting many to abandon the ISI strategy and adopt export-led growth policies. The World Bank and IMF recommended the Washington consensus in the 1990s, recognizing trade openness as a crucial element for high economic growth. World Development Reports show that outward-oriented countries perform better than inward-oriented ones. Endogenous growth theories suggest that trade openness increases growth by enhancing the spill over effect⁶.

Brief historical development of open economy

Following gaining independence in 1947, India's exports were mostly plantation crops and raw resources, while its imports were mostly light consumer products and other manufactured commodities. The country's foreign commerce was essentially limited to Britain and other Commonwealth nations⁷. India's exports have expanded to include both conventional and non-traditional goods, while imports have mostly consisted of capital goods, petroleum products, raw materials, and chemicals throughout the past 60 years. India had stringent discretionary and bureaucratic constraints between 1950 and 1990, which resulted in a trade balance deficit. This is a hallmark of a developing nation striving for modernization and rebuilding. The Indian government began implementing changes in the middle of 1991 in an effort to liberalize and open

⁵ Supra note 2, at pg 36

⁶ Id, at pg 36

⁷ OPENNESS AND GROWTH OF THE INDIAN ECONOMY: AN EMPIRICAL ANALYSIS, OCCASIONAL PAPER NO. 150, EXPORT-IMPORT BANK OF INDIA, PG 1-99, 27, <https://www.eximbankindia.in/Assets/Dynamic/PDF/Publication-Resources/ResearchPapers/OP/21file.pdf>, Accessed on Nov 21st 2023

up the country's economy. The goal of external sector reforms was to connect India's economy with the global economy⁸.

Trade and exchange rate policy reforms were a crucial step in the structural reform process. India has become much more outward-oriented since the start of the economic reforms. The elimination of quantitative limits, a significant decrease in tariff rates, and the streamlining of processes were the main reforms to trade policy that occurred after 1991⁹.

Relation between open economy and economic growth

India's economy is among the fastest-growing in the world because to its strong growth. Driven by private consumption, investment activity, and domestic demand, India's real GDP grew at an estimated 6.9% annual rate in FY22/23¹⁰. Over the next ten to fifteen years, the nation is predicted to rank among the top three economic powers in the globe, with GDP growth rates in the first quarter of a fiscal year reaching 7.8%. India must accelerate employment growth and develop 90 million non-farm jobs between 2023 and 2030 in order to raise productivity and economic growth. To achieve 8–8.5% GDP growth between 2023 and 2030, the net employment rate must increase by 1.5% annually¹¹. The Indian government has implemented programs such as "Digital India," "Start-up India," and "Make in India" in an effort to boost the nation's economy and stabilize its finances. India's economy has grown at the quickest rate in the world over the last ten years, with an average GDP growth of 5.5%. By 2027, the nation's economy should rank third in the world, and by 2047, it should be a developed one¹².

In India, the introduction of trade liberalization has resulted in a reduction in industrial concentration and producer surplus, accompanied by a boost in consumer surplus. This change has also decreased the cost of importing essential inputs and technical knowledge through current account openness, positively influencing capital formation and overall economic growth¹³.

⁸ Id, at 27.

⁹ Id, at 28

¹⁰ About Indian Economy Growth Rate & Statistics, IBEF, <https://www.ibef.org/economy/indian-economy-overview>.

¹¹ Id

¹² Overview World Bank in India, The World Bank, <https://www.worldbank.org/en/country/india/overview>.

¹³ Ghosh Dastidar, Sayantan, (2017), Impact of Remittances on Economic Growth in Developing Countries: The Role of Openness, Global Economy Journal, 17, (2), 12

Notably, the services sector has effectively taken advantage of the growing global demand for services. However, the demand for manufacturing has been hindered by domestic inefficiencies and inadequate infrastructure. Additionally, the relationship between openness and growth in India is intricate, and is influenced by several factors such as the efficiency of the services sector, labor migration, and financial flows. While existing studies suggest a positive correlation between openness and growth, the specifics may vary based on these factors¹⁴.

CONSEQUENCES OF GOOD FOREIGN, TRADE POLICY & DIRECT INVESTMENT ON ECONOMIC GROWTH

Increased foreign investment and a transition to an economy that is more focused on services have resulted from India's economic liberalization, a set of policy measures intended to open up the nation's economy to the outside world. Over the past 20 years, the total percentage of imports and exports has doubled, reflecting the rising openness of the Indian economy. Trade liberalization and capital account liberalization are proceeding, and India is anticipated to gain a great deal from its sustained access to international markets. By reducing barriers to business formation and import duties, the Indian government has worked to promote economic liberalization¹⁵. This has led to the expansion of sectors such as software, telecommunications, digitalization, and the automotive industry. India has made significant strides toward a free-market economy around the turn of the twenty-first century, with a rise in financial deregulation and a decrease in government intervention. Opportunistic takeovers and the speed of changes, which affect India's appeal as a location for FDI, are two possible obstacles and policy consequences associated with FDI.

Trade markets are heavily impacted by foreign policies and foreign direct investments (FDI), however their effects differ from those of trade partner relationships. Foreign direct investment (FDI) and international commerce have a complicated connection; FDI promotes export expansion in the nations of origin. Policies can encourage foreign direct investment (FDI) by establishing

¹⁴ Monojit Chatterji, Sushil Mohan and Sayantan Ghosh Dastidar, RELATIONSHIP BETWEEN TRADE OPENNESS AND ECONOMIC GROWTH OF INDIA: A TIME SERIES ANALYSIS, *Journal of Academic Research in Economics*, 2014, vol. 6, issue 1 (March), 45-69.

¹⁵ Soumyen Sikdar, *Openness and Growth in the Indian Economy*, Oxford Academic, <https://doi.org/10.1093/oso/9780199496464.003.0005>, Pages 124–150, Published: November 2019

free trade zones or enhancing the business climate for multinational corporations (MNEs)¹⁶. They can also impede FDI by putting in place limitations or impediments to international commerce and FDI integration. FDI is bidirectional causative; economic growth is a result of FDI inflows and vice versa. Since FDI is less volatile and shows a sustained commitment, it is frequently the favoured method for luring foreign investment. However, the relationship between FDI and trade openness is complex and may vary depending on factors such as service sector efficiency, labour migration, and financial flows. In conclusion, while both foreign policies and FDI have a significant impact on trade markets, their influence may differ from that of trade partner relationships¹⁷.

Indian foreign trade policies and implications

India is determined to make a mark in the global trade market and has set ambitious goals to increase its share from 2.1% to 3.5% by 2020. With the announcement of the new foreign trade policy on March 31, 2023, we are entering a new era of global competitiveness. This policy lays down a comprehensive plan to boost India's position as a key player in the global market. To achieve this, various measures such as remission of export duties and rebate of taxes have been introduced¹⁸. The ultimate aim is to double our exports to \$900 billion by 2020 and to reach \$2 trillion by 2030, with no end date in sight. This policy is built on the pillars of trust and partnership with our exporters, while also adapting to the changing needs of the time. With the FTP 2023, India is confident in its ability to establish itself as a major force in the world of trade.

Some recent developments in India's foreign trade policy include: The new FTP is introducing a one-time Amnesty Scheme for exporters to close the old pending authorizations and start afresh. It encourages recognition of new towns through the 'Towns of Export Excellence Scheme' and exporters through the 'Status Holder Scheme'. The FTP 2023 is facilitating exports by streamlining the popular Advance Authorization and EPCG schemes and enabling merchanting trade from

¹⁶ Dalmia, Taru, and David M. Malone. "Historical Influences on India's Foreign Policy." *International Journal*, vol. 67, no. 4, 2012, pp. 1029–49. JSTOR, <http://www.jstor.org/stable/42704945>. Accessed 22 Nov. 2023.

¹⁷ Prasad, Eswar S., et al. "Foreign Capital and Economic Growth." *Brookings Papers on Economic Activity*, vol. 2007, no. 1, 2007, pp. 153–209. JSTOR, <http://www.jstor.org/stable/27561577>. Accessed 22 Nov. 2023

¹⁸ Foreign Trade Policy of India, IBEF, <https://www.ibef.org/economy/trade-and-external-sector>.

India¹⁹. The government has been working on striking important deals with the European Unions and Governments of various countries to increase the country's contribution towards economic development and growth in the global market. Significant changes to foreign trade policy such as enabling payment and settlement in the Indian Rupee and opening of new trade corridors have been introduced. Overall, India's foreign trade policy aims to promote exports, facilitate ease of doing business for exporters, and strengthen the country's integration with the global export control regime.

Indian foreign direct investments and the implications.

An important non-debt funding source for India's economic development has been foreign direct investment (FDI), which is a major force behind economic progress. International businesses make investments in India in order to take advantage of the nation's unique investment benefits, which include tax exemptions and much cheaper salaries. Along with other advantages, this helps India advance its technology capabilities and generate employment²⁰. India has been receiving these investments due to the government's business-friendly policies, dynamic business environment, growing economic clout, and increased global competitive. India has implemented a number of programs and regulations to increase foreign direct investment (FDI), including the India Investment Grid (IIG) and the Made in India initiative. FDI in India is not without possible obstacles and policy ramifications, though.

Following the COVID-19 epidemic, India modified its Foreign Direct Investment (FDI) policy to safeguard domestic firms against "opportunistic takeovers/acquisitions." With the new policy, the Ministry of Commerce and Industry will be responsible for closely examining all FDI²¹. Despite government initiatives like Production Linked Incentives meant to boost investment, the rate of changes has slowed recently. Since foreign direct investment (FDI) is more likely to occur in nations with absentee or inefficient markets, the policy implications of FDI in India are noteworthy. The policy framework of India is essential for drawing foreign direct investment and

¹⁹ Hardeep Singh Puri, INDIA'S TRADE POLICY DILEMMA AND THE ROLE OF DOMESTIC REFORM, Carnegie India, https://carnegieendowment.org/files/CP_298_Puri_Trade_A5_Web.pdf, Accessed on 22nd November 2023.

²⁰ Supranote 17

²¹ Id

fostering economic growth. To sum up, foreign direct investment (FDI) has a big impact on India's economy. It helps with economic growth, job creation, and technical improvements²². However, the nation's desirability may be impacted by the speed of reforms and the policy structure.

CONCLUSION

The study looks at the connection between capital formation, trade openness, and India's economic expansion. The WDI World Bank gathered time-series data between 1992 and 2019. To get a deeper understanding of the correlation between trade openness and economic growth in India, the composite trade openness index was employed. According to the empirical results, trade openness has a negative effect on economic growth, which is consistent with other studies. Additionally, the study discovered that during the study period, imports in India exceeded exports. The study's policy implications include the necessity of export-expansion measures and trade reforms. In the near term, there is a negative correlation between economic growth and human capital performance.

Trade theories, ranging from Mercantilism to New Trade models, focus on three dimensions: export as a leading sector, export as a balancing sector, and export-linked import liberalization in developed and developing countries. The IMF, World Bank, and WTO aim to promote balanced trade in goods and services, with responsibilities divided among them. The ILO ensures labor standards and sets minimum standards of basic labor rights, which is crucial in the context of trade and migrant labor issues. India has emerged as a leading proponent of services trade liberalization under the GATS, shifting from facilitating trade in goods to focusing on services as an independent entity with four modes of supply for cross-border trade. These theories explain how differences between countries lead to trade and gains from trade.

A significant constraint of the research is its feeble justification for the influence of imports on the expansion of GDP. An advantageous expansion might incorporate manufacturing productivity utilizing a structural examination of the concurrent error hierarchy. The Future research might look at whether Trade across borders may be a potent constructive factor in the decrease of poverty and disparities in emerging nations by generating employment, particularly both for low-skilled

²² Id

labourers and by decreasing the disparity in pay between employees of varying degrees of education and competence, Interactions among several areas of India. The deeper connection with Potentially, the global economy lessen poverty by means of the establishment of fresh employment in the export sector. But increased transparency also increases the level of competition from imports for previously shielded businesses.