

TRADE AS AN ENGINE OF ECONOMIC GROWTH: A CASE OF INDIA

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Abstract

International trade is inextricably linked to development. Most fast growing economies also have a dynamic trade sector. But is there a stable quantitative relationship between the exports & prosperity of developing countries like India? This study examines international trade as an engine of growth in developing countries, a case study of India. A review of the literature reveals that countries that are more open to international trade tends to experience higher growth rate and per-capital income than countries who do not trade or closed economy. The primary objective of the study is to test the impact of international trade (Exports) on economic development in India. In the paper, data were collected mainly from secondary sources, e.g. Reserve Bank of India bulletin. The test for the study is Ordinary Least Square analysis. The study reveals that export is highly significant to international trade

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INTRODUCTION

International trade is the exchange of capital, goods, and services across international borders or territories. In most countries, such trade represents a significant share of gross domestic product (GDP). While international trade has been present throughout much of history (see Silk Road, Amber Road), it's economic, social, and political importance has been on the rise in recent centuries. It is the presupposition of international trade that a sufficient level of geopolitical peace and stability are prevailing in order to allow for the peaceful exchange of trade and commerce to take place between nations. Trading globally gives consumers and countries the opportunity to be exposed to goods and services not available in their own countries. Almost every kind of product can be found on the international market: food, clothes, spare parts, oil, jewelry, wine, stocks, currencies and water. Services are also traded: tourism, banking, consulting and transportation. A product that is sold to the global market is an export, and a product that is bought from the global market is an import. Imports and exports are accounted for in a country's current account in the balance of payments.

The classical and Neo-classical economics believed that participation in international trade could be a strong positive force for economic development. There are so many reasons that support the role of international trade to economic development. Promoting exports could directly lead to economic development either through encouraging production of goods for export or allowing accumulation of foreign exchange with importation of capital inputs. There are various standard methods that have been tested in detecting the relationship between trade and economic growth, and the result vary accordingly. Although there are some disagreements among economist due to the different approach, some authors opined that international trade has a strong positive relationship with growth while other authors are against this background and they opined that there is a negative relationship between trade export led and growth of the economy. Openness to trade tends to spur growth, helps in stabilizing prices and promotes efficiency gains through increased competition. It allows countries to take advantage of specialization and economies of scale. In the long- run, trade openness enhances and facilitates productivity increases which are a key factor in sustained development.



REVIEW OF LITERATURE

There are fair amount of literature on the empirical investigation of the export led growth Trade liberalization is an important component of Structural Adjustment Programme (SAP) which aimed at opening up economics to increased international trade. Frankel and Roma (1999) and Irwin and Tervio (2002) in their separate and independent studies also suggested that countries that are more open to trade tends to experience higher growth rates and per-capital income than closed economy. There have been several studies that have found some association between exports (or export growth) and output (GDP) levels (or output growth). For the case of developing countries analytical work originally focused on correlations between exports and income [Emery (1967), Maizels (1968), Kravis (1970)], moving on to studies with limited samples [Balassa (1978)], followed by studies focusing on aggregate production functions that included exports as an explanatory variable [Feder (1982)]. Klanow and Rodriguez-Clare (1997)

used general equilibrium model to establish that the greater number of intermediate input combination results in productivity gain and higher output, despite using the same capital labor input which exhibits the economies increasing international trade return to scale. Sinha and Sinha (1996) having studied a cross section and the role of balanced trade, that is, export minus imports, to illustrate the role of international trade on growth and development, they found a positive relationship between growth and export trade to imports $(X-M) / (GDP)$. The growth rate of selected Asian countries GDP for various decades of 1951 to 1990, it suggests that export promotion is an important contributor of economic growth. Sachs and Warner (1995) using a cross- country growth model argued that trade liberalization leads to higher growth rates in poorer countries than in richer countries. In support of this, Ajayi (2003) reports that the removal of barriers to trade has increased the flow of trade by 16 percent fold in the last 50 years, with the world exports of goods and services almost tripled in real terms between 1970 and year 2000. However, the share of developing countries or third world countries' contribution to world trade is still very low because their exports are predominantly primary products which do not contribute much to Gross Domestic product (GDP) of such countries compared to trade on manufactured or finished goods. Balassa (1986) argued that the favorable effects of trade especially export on economic growth would be higher if such a country employs outward-looking industrialization strategy. Since such strategy would be more efficient utilization of the productive resources. While countries with inward-oriented strategy industrialization would have limited effort to increase export growth. Because in such countries or economies there is not enough domestic production that will encourage export of locally made goods and services that will encourage growth via international trade and secondly, there is no proper encouragement through funds or resources for producing manufactured products that acts as a constraint to production. Similarly, Asafu-Adjaye and Chakra borty (1991) having carried out an empirical analysis found evidence which is constraint with the weak relationship between exports and real output for inward looking countries. They provided a super erogeneity test for export and found that export were weakly exogenous implying inward oriented strategy was ineffective to development strategy when prematurely initiated.

OBJECTIVES OF THE STUDY

One of the basic techniques to identify the important role of trade and growth is to notice the effectiveness of export promotion that is outward -looking strategy in fostering economic growth. The purpose of this study is to test the impact of international trade on economic development in India.

METHODOLOGY

The model is built or designed to provide an informed better understanding of international trade as an engine of growth in India. Using annual data for India over the period 2004 - 2014, the relationship between international trade and economic growth in India is hereby investigated by applying regression analysis for the study. The work estimates one model i.e. growth. The model can be expressed in its functional form as

$$GDP = F (EXPT) \text{-----} 1$$

For estimation purpose, equation 1 is recast in terms of logarithms as

$$LGDP = \alpha_0 + \alpha_1 EXPT + U_t \text{-----} 2$$

Where:

GDP =Gross Domestic Product

EXPT =Export

Ut =Error term

Table 1

Year	Exports (In billion Rs.)	GDP at Market Prices (In billion Rs.)
2004-05	3753.40	32422.09
2005-06	4564.18	35432.44
2006-07	5717.79	38714.89
2007-08	6558.64	42509.47
2008-09	8407.55	44163.50
2009-10	8455.34	47908.38
2010-11	11429.22	52823.83
2011-12	14659.59	56330.49
2012-13	16343.19	58998.49
2013-14	18941.82	61958.41

Source: RBI Report, 15 Sep. 2014

Figure 1

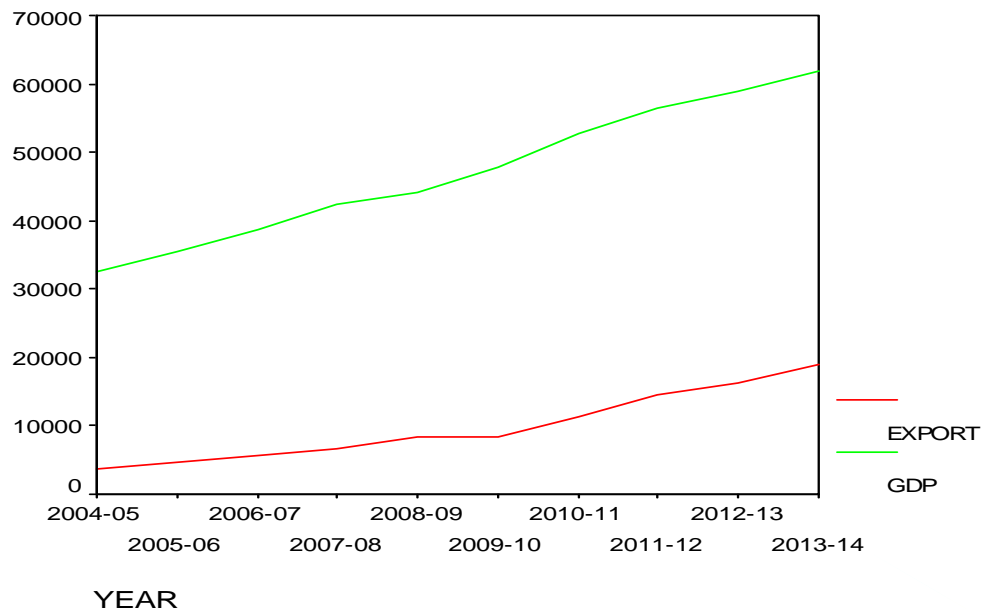
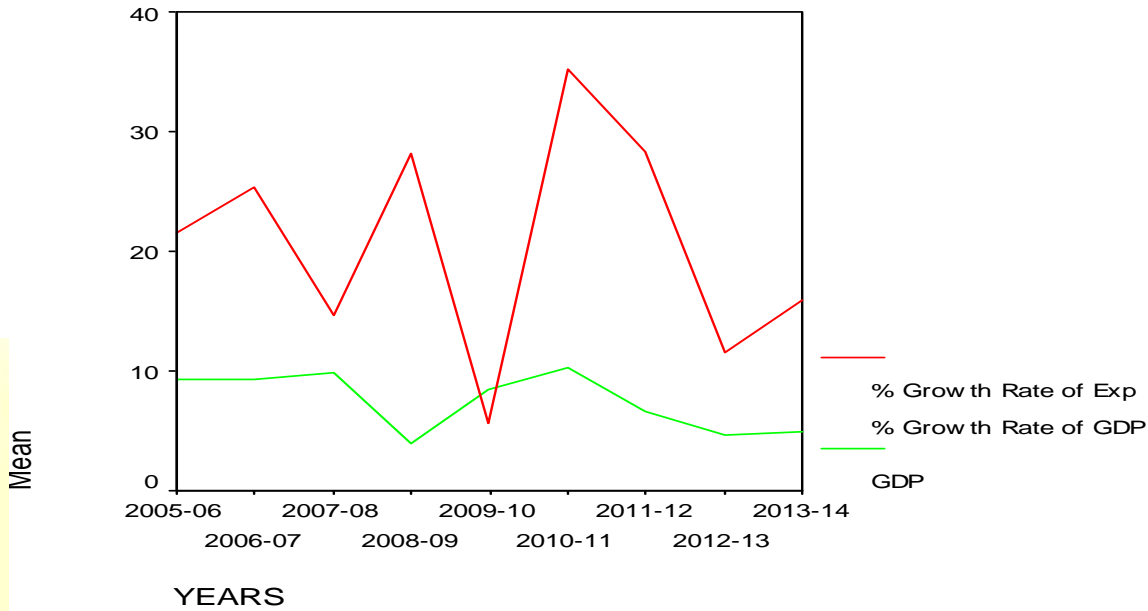


Table 2

Year	% Growth Rate of Exports	% Growth Rate of GDP
2004-05	-	-
2005-06	21.6	9.3
2006-07	25.3	9.3
2007-08	14.7	9.8
2008-09	28.2	3.9
2009-10	5.7	8.5
2010-11	35.2	10.3
2011-12	28.26	6.6
2012-13	11.5	4.7
2013-14	15.9	5.0

Figure 2



Regression equation derived from Table1 is of form:

$$GDP = 28364.874 + 1.898 EXPT + U_t \text{-----} (3)$$

Summary of Parsimonious ECM Model

Variables	Coefficient	Std. Error	T-statistic
EXPORT	1.898	0.143	5.96
R-Squared	0.95635222		
Adjusted R-Squared	0.95089625		
Durbin-Watson	0.89886809		
F- statistic	175.28		
mean dependent var	47126.199		
S.D. dependent var	10179.152		
Prob.(F-statistic)	0.000000		

The Equation (3) deals with the relationship between level of GDP and level of total exports. It shows that the coefficient of total export Variable is statistically significant at 5 % level with positive sign suggesting that higher exports are associated with higher economic performance.

For R2, it suggests that 96% of the total variation has been explained by the EXPT and the lag of GDP taken together. The Adjustment R squared shows that 96% of GDP has been explained by EXPT. The Durbin Watson (DW) test of .89886809 shows that there is no serial correlation in the system.

Co integration Test Result

Having confirmed statistically the variables we proceed to examine the presence or non presence of co integration among the variables when a co integration relationship is present; it means that the variables have long run relationship. In the co integration result the likelihood ratio (LR) and EXPT share a common trend and long-run equilibrium or relationship.

CONCLUSION

The study clearly indicates that there exists a significant and positive relation between exports and Gross Domestic product (GDP) for the whole period under study i.e. 2004-05 to 2013-14. The study focuses on finding the relationship between international trade and economic development in India. Ordinary least squares is employed in the empirical analysis. The result shows that the level of export is highly significant or important on international trade. The result shows that the level of export is highly significant or important on international trade.

The policy implication of the study is that the government should consider exporting more goods and services in order to promote international trade which is a veritable tool for economic growth. Equally, the government should monitor its currency vis-à-vis other currencies i.e. their rate of exchange, since the study has analyzed the impact of exchange rate on economic development in India. Export (EXPT) is statistically significant in explaining Gross Domestic Product (GDP).

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