Export Liberalization and Growth Process in India

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1. Introduction

There is an extensive discussion on relationship between export growth and economic growth in economic development and growth literature. Mercantilist economists believed that a country should accumulate wealth and precious metals through emphasis on achieving trade surpluses. Classical economists argued that trade is a result of comparative advantage which leads to an efficient use of resources in each country and thus increases welfare by transmitting development through trade. As per classical point of view exports are simply the way to pay for imports and are justified for this reason.

The neoclassical view has been that growth can be achieved by export-led growth strategy. The export-led growth model was initially upheld with the success of Asia's miracle countries, which achieved extraordinarily high growth during the 1970s and mid-1990s, supposedly through export promotion. The growth records of Asian newly industrializing countries (NICs) - in particular, Hong Kong, Singapore, Korea and Taiwan and second-generation NICs (Malaysia and Thailand) - are cited as such examples. China is the latest country to join this group. The World Bank (1993) perceives that the experiences of these countries serve as a model for development, a view also supported by the US Agency for International Development and the International Monetary Fund (Giles and Williams, 2000). In words of Thirlwall, "the growth of exports plays a major part in the growth process by stimulating demand and encouraging savings and capital accumulation, and, because exports increase the supply potential of the economy, by raising the capacity to import" (Thirlwall, 1994, 365).

2. Export-Led Growth Strategy

There are a number of reasons within trade theory to support the Export Led Growth proposition (Giles and Williams, 2000). **First**, export growth means an increase in demand for the country's output in other countries which helps to increase the real output of the exporting country. **Second**, if the exports are expanded then the country's specialization in the production of export products gets promoted, this helps in boosting the productivity level and causes the general level of skills to improve in the export sector. This leads to a reallocation of resources from the (relatively) inefficient non-trade sector to the higher productive export sector and hence output growth of the exporting country. The outward oriented trade policy may also give access to advanced technologies and better management practices (e.g., Hart, 1983; Ben-David and Loewy, 1998) that may result in further efficiency gains. **Third,** an increase in exports may help in earning foreign exchange (Chenery and Strout, 1966), for importing inputs to meet domestic demand; debt servicing and preventing an overvaluation of the domestic currency.

But, the support for export-led growth is not universal. There have been some critics as well. It works till some countries are there to import. Paul Krugman described that there is no "miracle" …. He said: "Asian growth, like that of the Soviet Union in its high-growth era, seems to be driven by extraordinary growth in inputs like labor and capital rather than by gains in efficiency." Critics point out that the experiences in the East and Southeast Asian countries are unique in many ways and not necessarily replicable in other countries (Buffie, 1992). The UNDP report of November 2009, based on the study of the impact of the global financial crisis on the Asia-Pacific region (Chhibber, Ghosh and Palanivel, 2009) concludes that Asia's export-led growth model is unsustainable.

The export-led growth (ELG) model, which was once considered as an important force behind Asia's successful economies, is now under fierce attack and may not be developing nations' favourite development policy in the future. The sub-prime crisis led near-collapse in international trade that followed a synchronized global recession in 2008 has seriously shaken Asia's confidence in this growth policy.

3. Domestic Demand-Led Growth Model

Some economists have put together a critique of the export-led growth model and proposed a shift toward domestic demand-led growth. Most of them have argued that the emphasis on export-led growth of most East Asia countries had a series of negative effects. It prevented the development of domestic market growth and has reinforced the dependency of developing countries on the developed world, thus becoming vulnerable to slowdowns in the latter's markets. Export-oriented economies are extremely dependent on foreign (mostly Western) demand. The problem is that any economic recessions in Europe, Japan, or US results into slow growth in the developing world. These economists argue that the export-led growth model followed by East Asian countries for several decades is not an optimal strategy any longer and it is risky and dependent on the consumption pattern of the importing nations.

According to Deepak Nayyar, in large countries like India, where the domestic market is overwhelmingly important, sustained industrialization can only be based on the growth of the internal market. The vital fact that the macroeconomic inter connections between the foreign trade sector and the overall process of planning for industrialization are crucial. The solution to the problems of the national economy cannot be found through the foreign trade sector on the simple recipes associated with that. On the other hand, the problems of the foreign trade sector can be resolved to a considerable extent through an improved performance and a better management of the economy at home. In other words, the tail cannot wag the dog". (Nayyar quoted in Mishra and Puri, Indian Economy, 2008, PP. 498)

Palley (2002) asserts that Export-led growth has been at the center of the Washington consensus, and this focus on exporting and trade liberalization has harmed developing countries in several ways. Widely identified deficiency of export-led growth strategy is the "race to the bottom." Such growth can work for first-comers, but it falls apart once all try to clamber on board the export-led bandwagon. China's advent on to the world trading scene needs special mention in this regard. It is supplying huge labor force at low wages and its current population growth ensures that this will remain as it is in the future also. It is clear at this juncture that any developing country cannot possibly enter now the hierarchy of export-led growth system with production costs below those of China. It is making it impossible for new-comers to enter and survive in the system. If true, the export-led growth paradigm will find itself checkmated while new supplier countries will be unable to compete with China (Palley, 2002).

4. India's Case

Here the case of India has been analyzed with respect to export-led growth strategy and domestic demand led growth strategy. It has been tried to find out which strategy has contributed more to the country's development. To arrive at some definite conclusion, two different analyses are tried:

A. Granger causality test is applied to find causal relationship between export growth and economic growth on the one hand and domestic demand (proxy-Private final consumption expenditure) and economic growth on the other in pre and post reform periods.
B. Multiple Regression model is applied to macroeconomic accounting identity for finding out the relative contribution of different variables (private consumption, government consumption, gross capital formation and net exports) in economic growth.

A. Granger Causality Test

A question that frequently arises in time series analysis is whether or not one economic variable can forecast another economic variable. The most popular causality testing technique is developed by C.W.J. Granger. The technique rests on a simple and reasonable assumption: · If variable A causes changes in B, then one will observe that changes in A will precede changes in B.

In the present analysis Granger causality test is applied on variables Export and GNP and private final consumption expenditure (proxy to domestic demand) and GNP to find out whether growth was export-led in India or it was domestic demand-led.

This test will also establish whether the causality between the two variables is unidirectional, bilateral or independent. The causality is unidirectional when either growth in independent variable causes growth in dependent variable or vice versa. It is bilateral when both the variables cause each other. Independence is suggested when neither of them causes each other. Pre reform period results of Granger causality test relating to GNP and private final consumption expenditure are shown in Table-1:

Table-1: Granger Causality Test - Pre Reform Period

Sr. No.	**Dependent Variable**	**Independent Variable**	**F Statistics**	**n1**	**n2**	**p value**	**Significance Level**
1	Gross National Product	Private Final Consumption Expenditure	1.27816736	1	18	0.273079842	not significant
2	Private Final Consumption Expenditure	Gross National Product	1.01882986	1	18	0.326173675	not significant

Source: Author's calculations on the basis of time series data for pre and post reform period from various issues of Economic Survey, Government of India and National Accounts Statistics, CSO, Government of India

There were two null hypotheses in application of granger causality test in Table-1:

i. Change in Private Final Consumption Expenditure does not Granger cause change in GNP
ii. Change in GNP does not Granger cause change in Private Final Consumption Expenditure

The test results in Table-1 reveal that change in private final consumption expenditure and GNP change are showing independence. Neither of the variables Granger causes each other. This is concluded on the basis of p values which are not significant even at 5 percent level of significance. Thus, both null hypotheses are accepted in pre reform period.

Table-2: Shows the Granger causality test results of variables GNP and Exports for pre reform period.

Table-2: Granger Causality Test - Pre Reform Period

Sr. No.	**Dependent Variable**	**Independent Variable**	**F Statistics**	**n1**	**n2**	**p value**	**Significance Level**
3	Gross National Product	Export	3.82776539	1	38	0.057788744	not significant
4	Export	Gross National Product	2.20943064	1	38	0.145419878	not significant

Source: Author's calculations on the basis of time series data for pre and post reform period from various issues of Economic Survey, Government of India and National Accounts Statistics, CSO, Government of India

As per Table-2 export change and GNP change are not causing each other in pre reform period. This existence of independence in change of dependent and independent variables is concluded because p values are not significant even at 5 percent level of significance. Therefore; any null hypotheses cannot be rejected.

Granger causality test results between GNP and private final consumption expenditure for post reform period are shown in Table-3:

Table-3: Granger Causality Test - Post Reform Period

Sr. No.	Dependent Variable	Independent Variable	F Statistics	n1	n2	p value	Significance Level
1	Gross National Product	Private Final Consumption Expenditure	22.3357627	1	15	0.000270461	(<0.1%) ****
2	Private Final Consumption Expenditure	Gross National Product	18.5737092	1	15	0.00061957	(<0.1%) ****

Source: Author's calculations on the basis of time series data for pre and post reform period from various issues of Economic Survey, Government of India and National Accounts Statistics, CSO, Government of India

The test results in Table-3 reveal that causal relationship between the two variables is bilateral. This indicates that change in private final consumption expenditure causes change in GNP and at the same time GNP change also causes change in private final consumption expenditure. This is concluded because P values are significant at 0.1% level in both the cases. The cause and effect bilateral relationship between these two variables is well established and both the null hypotheses are rejected.

Table-4: Granger Causality Test - Post Reform Period

Sr. No.	Dependent Variable	Independent Variable	F Statistics	n1	n2	p value	Significance Level
3	Gross National Product	Export	17.1898946	1	16	0.00075956	(<0.1%)****
4	Export	Gross National Product	0.04651033	1	16	0.831976028	not significant

Source: Author's calculations on the basis of time series data for pre and post reform period from various issues of Economic Survey, Government of India and National Accounts Statistics, CSO, Government of India

As shown in table-4, in case of GNP as dependent variable and exports as an explanatory variable, causality is established at 0.1% level of significance. It means change in export is causing change in GNP and first null hypothesis is rejected. However, when the test is conducted for exports as dependent variable and GNP as independent variable, causality is not established. The p values are found insignificant at 5 percent level. It indicates that GNP change does not cause change in export. But if due to adoption of certain policy measures by the government, efforts are made to encourage exports, it causes an increase in GNP. Thus, second null hypothesis is not rejected and there is only unidirectional causal relationship between export growth and GNP growth.

In literature available on government policies relating to exports promotion, we find that in post reform period certain export promotion instruments were used by the government in India and export led growth strategy was adopted. This resulted in increased export which in turn helped in increasing GNP. On the other hand increased GNP automatically pushed the consumption levels up which further caused an increase in GNP. Had any policy measure to directly increase the consumption expenditure been adopted by the government in India, the GNP growth must have been even faster.

The policy suggestion on the basis of this result is obvious. The government in India should adopt a mixed policy which increases both export growth and domestic demand growth to promote overall growth rate as the two policies do not seem incompatible.

B. Multiple Regression Model

In the present section analysis is performed in terms of macroeconomic accounting identity which is as follows:
$Y=C_p + C_g + I + X – M$

Where Y stands for national income, C_p is private consumption, C_g is government consumption, I is gross domestic capital formation, X is exports and M is imports of goods and services. In multiple regressions if regression is significant between national income and exports it is referred to as export-led growth.

If the regression is more significant between private and government consumptions then the strategy is referred to as domestic demand led growth. In multiple regression analysis GNP is taken as dependent variable and private final consumption expenditure, government expenditure, gross domestic capital formation, exports and imports are explanatory variables. The multiple regression equation for the above mentioned variables is as:

$$y = \beta \quad + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \beta_4 x_4 + \beta_5 x_5$$

The multiple regression results for all the variables in pre reform period are shown in Table-5

Table-5: Multiple Regression Results in pre Reform Period

Time Period (pre reform period)	**Pre Reform Period**					
	Unstandardized Coefficients		**Standardized Coefficients**		**Significance**	**At %**
	B	**Standard Error**	**Beta**	**t-value**		
Constant	4798.248	2468.957569		1.943431	0.07097126	Insignificant
Private Final Consumption Expenditure	0.645699	0.099226161	0.459873225	6.507342	9.9033E-06	Insignificant
Government Final Consumption Expenditure	2.082636	0.415291363	0.292877771	5.014879	0.00015387	0.10%
Gross Domestic capital Formation	0.01654	0.031912184	0.0049935	0.518293	0.61181433	Insignificant
Export of Goods and Services	1.428098	0.498869225	0.120796806	2.86267	0.01185851	5%
Import of Goods and Services	1.210895	0.557766534	0.125228963	2.170971	0.04639101	5%

Source: Authors calculations on the basis of time series data on above mentioned variables r pre and post reform periods from various issues of National Accounts statistics, CSO, Government of India.

It is shown in Table-5 that multiple regressions between export of goods and services and GNP_{FC} are significant at 5% level of significance. Regression is also significant between import of goods and services and GNP_{FC} at 5% level of significance but the relationship is stronger between exports and GNP_{FC} as compared to the relationship between imports and GNP_{FC} which is evident by the higher "t" values in case of exports of goods and services. Though the regression between exports and GNP_{FC} is significant but it is even more significant, i.e. at 0.10 % level, between government final consumption expenditure and GNP_{FC}. This indicates that exports have been instrumental in raising GNP_{FC} but the influence of government final consumption expenditure on GNP_{FC} has been even stronger in pre reform period. Post reform period multiple regression results are presented in Table-6

Table-6: Multiple Regression Results in post Reform Period

Time Period	Post Reform Period					
	Unstandardized Coefficients		Standardized Coefficients		Significance	At %
	B	Standard Error	Beta	t-value		
Constant	-14950.1	25299.10264		-0.59093	0.56650829	Insignificant
Private Final Consumption Expenditure	1.058924	0.191663159	0.627851413	5.524923	0.00017938	0.10%
Government Final Consumption Expenditure	0.224173	0.836354441	0.025192763	0.268036	0.79363153	Insignificant
Gross Domestic capital Formation	0.74089	0.220904721	0.332178646	3.353888	0.00643314	1%
Export of Goods and Services	1.008055	0.633560395	0.267466571	1.591095	0.13989545	Insignificant
Import of Goods and Services	-0.78858	0.715742935	-0.241874963	-1.10176	0.29408999	Insignificant

Source: Authors calculations on the basis of time series data on above mentioned variables for pre and post reform periods from various issues of National Accounts statistics, CSO, Government of India.

In Table-6 we find that regressions are significant only in cases of private final consumption expenditure and gross domestic capital formation. Other variables like Exports, imports and government expenditure have not been able to influence GNP_{FC} significantly. The level of significance is as high as at 0.1% in case of private final consumption expenditure. It is noted as 1% regarding gross domestic capital formation. This indicates that in post reform period the most influential variable in raising GNP_{FC} has been private final consumption expenditure in spite of introduction of export promotion instruments and liberalized trade.

In pre reform period it appears that the strategy has been a mix of both the export-led growth and domestic demand led growth towards achieving higher rates of growth or rather it was domestic demand led but weakly speaking. In post reform period export-led growth strategy completely lost ground to domestic demand led growth strategy in achieving the objective of raising GDP. This phenomenon may be due to various reasons but one main reason that can be highlighted is declining trend of demand for goods and services in international market. In spite of various export promotion measures adopted by the government of India, low demand in international market in last two decades resulted in near failure of export-led growth strategy in India. The success of domestic demand led growth can be highlighted also by the fact that due to strong domestic demand only India did not suffer much in recent global recession.

5. Micro Analysis

In the previous section relationship between export growth and economic growth is analyzed in pre and post reform periods, using macro data for overall exports/imports and development. While introducing the reforms it was thought that reforms would not only encourage exports but would also shift the pattern of trade towards India's comparative advantage by making macro policies more coherent. The resultant impact was expected to be a direct link between export growth and economic growth. The empirical analysis in earlier section reveals that in post reform period impact of export growth on economic growth was less effective than the impact of private final consumption expenditure on growth. In the present section, an industry wise analysis is undertaken. This analysis may bring out micro-level factors of comparative advantage to the focus and complement macro-level studies.

6. Import Intensity of India's Exports

It is considered imperative here to find the import content in major exports to find foreign exchange earnings per unit of export and import intensity of exports. This may give us some idea of contribution of changing export composition to overall growth. For this purpose latest input-output table prepared by CSO, government of India is used. The 130 commodities x 130 commodities I-O table for India for the year 2007-08 is the main source for data presented in Table – 7. This is the latest year for which a comprehensive and consistent I-O table for the Indian economy is available from official sources, that is, CSO, 2010.

The necessity of data provided in I-O Table was felt because it is difficult to estimate import intensity of exports from the aggregative macro-economic data on exports, imports and their commodity-wise composition. In item-wise break-up of exports and imports data a uniform system of industry-wise classification is not followed. Importing and exporting industries are different. Besides, the data on imports relate to total import requirements rather than import requirement for domestic manufacturing. This data is not directly useful for estimating import intensity of exports. Table-7 gives an idea of import content in major exports. In this table those industries are selected and considered export oriented where the value of exports is more than half million as per the export column of I-O table where figures are given in Rs. Lakh.

Table – 7: Import Content in Major exports

Sr. No.	Commodity / Industry	EXPORT (Rs. in lakh)	IMPORT (Rs. in lakh)	Net Foreign exchange earnings per unit of export (Ex-Im/Ex)	Import intensity (Im /Ex)
1	Gems & jewellry	15328772	14762206	0.037	0.96
2	Readymade garments	4731281	88970	0.98	0.02
3	Other non metallic minerals	4043602	7525531	-0.86	1.86
4	Petroleum products	2719541	2646252	0.03	0.97
5	Iron, steel and ferro alloys	2275548	2732006	-0.2	1.20
6	Organic heavy chemicals	2115956	2877733	-0.36	1.36
7	Communication equipments	1917007	2054855	-0.07	1.07
8	Motor vehicles	1814251	936738	0.48	0.52
9	Miscellaneous food products	1450727	700857	0.52	0.48
10	Other non-electrical machinery	1395855	3913882	-1.8	2.80
11	Non-ferrous basic metals	1302767	7429219	-4.7	5.70
12	Cotton textiles	1058724	108749	0.91	0.11
13	Other electrical Machinery	976500	1002953	-0.03	1.03
14	Drugs and medicines	903724	653198	0.28	0.72
15	Synthetic fibers, resin	781281	1426251	-0.83	1.83
16	Rubber products	694370	250850	0.64	0.36
17	Iron ore	665057	72518	0.89	0.01
18	Fishing	651617	15025	0.98	0.02
19	Electrical industrial Machinery	641534	696419	-0.09	1.09
20	Leather and leather products	629680	159555	0.75	0.25
21	Miscellaneous metal products	590688	364865	0.38	0.62
22	Miscellaneous textile products	569373	232407	0.59	0.41
23	Edible oils other than vanaspati	568142	1259029	-1.22	2.22
24	Wheat	529671	31655	0.94	0.06
25	Art silk, synthetic fiber textiles	511066	259027	0.49	0.51
26	Plastic products	507058	421151	0.17	0.83
Source: Based on CSO Input - Output table - 2007-08, Government of India					

Out of 26 such industries, where the value of exports is more than half million as per the export column of I-O table, 12 industries have exports more than one million units. The Table-7 shows that all the traditional export commodities are less import intensive as compared to the non-traditional commodities. Ten industries where import content per unit of export is more than one unit are - Other non metallic minerals, Communication equipments, Iron, Steel and ferro alloys, Organic heavy chemicals, Edible oils other than vanaspati, Electrical industrial Machinery, Synthetic fibers and resin, Other electrical Machinery, Other non-electrical machinery and Non-ferrous basic metals. All these industries are non-traditional from the point of view of exports. Other industries where import content per unit of export is less than one are - Gems and jewellery, Readymade Garments, Petroleum products, Motor Vehicles, Miscellaneous Food Products, Cotton textile, Drugs and medicines, Rubber Products, Iron ore, Fishing, Leather and Leather Products, Miscellaneous metal products, Miscellaneous textile products, Wheat, Art Silk Synthetic Fiber textiles and Plastic Products.

The table reveals that import intensity of export commodities is in the range of 0.01 for iron ore to 5.70 for non-ferrous basic metals. Increasing export of all the non-traditional commodities, which has been a result of export promotion policies, import intensity is greater than one. These are also the sectors which earn import entitlement for producing exportable commodities. If the export promotion policies result in additional exports which are import-intensive and also earn an import entitlement, then the net value to the country of the export earnings is likely to be significantly negative.

It is a general contention that higher the import intensity of exports, lower is the net increase in the final demand in the economy on account of increased exports and hence lower is the direct indirect effects in terms of growth of income and output….Increased import intensity for exports also implies lower linkage effects on the domestic economy. Thus, increasing exports by importing more is also a strategy basically aiming at trade balance rather than overall development of the domestic economy. This might be one of the reasons of insignificant effect of Exports on GNP in post reform period (Multiple regression models).

To a very limited extent, it becomes a part of the 'export-led growth' strategy. The genuine export promotion strategy has to be an integral part of the overall growth strategy of the country because it would generate linkage effects to the rest of the economy and direct and indirect effects on income, output and the indirect tax revenue of the government (Dholakia, 1992).

On the basis of the foregoing analysis it can be concluded that successful export-oriented industries are those which use less imported inputs and contribute more to the foreign exchange earnings. Such industries are – Readymade Garments, Miscellaneous Food Products, Cotton Textiles, Rubber Products, Iron Ore, Miscellaneous Textiles, Fishing and Leather and Leather Products. The industries like – Non-metallic Minerals, Organic Heavy Chemicals, Other non-electrical Machines, Non-ferrous Basic Metals, Other Electrical Machinery and Electrical Industrial Machinery which have started showing high exports recently, are highly capital and import intensive also.

For arriving at some concrete conclusion each industry is required to be studied separately. However, on the basis of present analysis it can be inferred that the industries which can really be called export-oriented and are net foreign exchange earners are labour intensive, agro-based, traditional or raw material based. If there is any non-traditional industry which has been a successful exporter is Information Technology Industry.

7. Conclusions

It is argued by Jesus Felipe (2003) that the encouragement of a gradual shift to Domestic Demand Led Growth is a welcome effort. However, perhaps choosing either export-led growth or domestic demand led growth is not the issue. **Firstly,** because these two strategies are not incompatible strategies. **Secondly,** because the countries in the region need some form of export-led growth to achieve economies of scale. It is about achieving a *golden combination* between export-led growth and domestic demand led growth.

A more balanced and equitable international arrangement in world trade should therefore, lead to smaller trade surpluses and smaller trade deficits across countries in the world, since more developing countries will be able to share in the benefits of international trade. What may happen is a move towards greater balance between the external and internal sources of growth and the adoption of a middle-path strategy between Export Led Growth and Domestic Demand Led Growth.

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