Impact of Foreign Trade on India's Economic Growth

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Abstract

This paper examines how foreign trade has influenced India's economic growth in the post-2022 period, using official data for FY2022-23 to FY2025-26 and provisional figures for the first months of FY2026-27. It develops a conceptual framework in which foreign trade, comprising merchandise exports, services exports, imports of capital goods and intermediates, and trade policy, affects growth through five transmission channels: technology transfer, capital formation through imported inputs, scale and competition effects, foreign-exchange relief, and integration into global value chains. The framework treats infrastructure, human capital, institutions and macroeconomic stability as conditioning factors, and global demand, tariff policy, geopolitical shocks and the trade deficit as external risks. The evidence shows that total exports of goods and services rose from about US$776 billion in FY2022-23 to US$860 billion in FY2025-26, while real GDP growth stayed high, at 7.1 percent in FY2024-25 and
7.7 percent in FY2025-26. Services exports carried the expansion: their share in total exports increased from about 42 percent to about 49 percent, and the services surplus of US$214 billion offset roughly two-thirds of a merchandise deficit of US$333 billion in FY2025-26. Merchandise exports, by contrast, were almost flat at about US$440 billion, and the overall trade deficit widened to US$119 billion. The paper concludes that trade has supported growth mainly through services and imported inputs, that the benefits are conditional on domestic capability, and that tariff shocks, import dependence and a stagnant goods-export base are the main constraints. Policy implications are discussed.

Keywords: *foreign trade, economic growth, India, conceptual framework, services exports, trade deficit, free trade agreements, tariffs*

1. Introduction

The relationship between international trade and economic growth is among the oldest questions in economics. Classical theory holds that countries gain by specialising according to comparative advantage. Modern theory adds dynamic channels: access to foreign inputs and technology, economies of scale, competitive pressure that raises productivity, and learning by exporting. Empirical work has been more guarded, and economists continue to debate how large the causal effect of openness on growth is and under what conditions it materialises.

India offers an instructive case. After decades of import-substituting policy, the reforms of 1991 opened the economy, and trade expanded faster than output for most of the following thirty years. The period since 2022 is analytically distinct. It began with a post-pandemic recovery and a commodity-price shock, continued through a decline in global merchandise trade in 2023, and then brought a sharp rise in trade-policy uncertainty: punitive United States tariffs in 2025, a court ruling in February 2026 that reshaped the US tariff regime, the outbreak of conflict in West Asia on 28 February 2026, and a wave of new trade agreements with the United Kingdom, the European Free Trade Association, the European Union and others. How trade performed under these conditions, and what it contributed to growth, is the subject of this paper.

The paper has three aims. First, it sets out a conceptual framework that links foreign trade to growth and identifies the conditions under which the link holds. Second, it uses post-2022 data to assess the framework. Third, it draws out the policy implications. Section 2 reviews the literature. Section 3 states objectives and hypotheses. Section 4 presents the conceptual framework. Section 5 describes data and methods. Section 6 analyses trade performance since FY2022-23.

Section 7 evaluates the channels and the hypotheses. Sections 8 to 10 cover challenges, policy implications and conclusions.

2. Review of Literature

2.1 Theoretical foundations

Trade-growth linkages are explained through static and dynamic gains. Static gains arise from reallocating resources toward sectors of comparative advantage. Dynamic gains, emphasised in the endogenous growth literature by Grossman and Helpman (1991), arise because trade facilitates the diffusion of knowledge, expands the variety of intermediate inputs and allows firms to exploit scale. The export-led growth hypothesis, tested for developing economies by Balassa (1978) and Feder (1982), proposes that export expansion raises growth through higher factor productivity, relaxed foreign-exchange constraints and positive externalities from the export sector.

2.2 Cross-country evidence

Sachs and Warner (1995) found that open economies grew significantly faster than closed ones. Frankel and Romer (1999) used geographic characteristics as an instrument for trade and reported a positive effect of trade on income. Rodriguez and Rodrik (2000), however, criticised the measurement of openness and the robustness of these results, arguing that the evidence of a simple, universal link between low trade barriers and growth is weak once institutions and macroeconomic stability are considered. The balance of the literature therefore supports a conditional view: trade tends to promote growth when accompanied by sound domestic policies. This conditional view is built into the conceptual framework in Section 4.

2.3 Evidence on India

Bhagwati and Srinivasan (1975) and Krueger (1978) documented the costs of India's restrictive trade regime, including rent-seeking and inefficiency. Joshi and Little (1996) and Ahluwalia (2002) reviewed the post-1991 reforms and credited external liberalisation, together with industrial deregulation, with improving growth performance, while noting that reform remained incomplete in areas such as labour markets and agriculture. Panagariya (2008) argued that openness and the shift in policy orientation were central to India's growth acceleration. At the firm level, Topalova and Khandelwal (2011) showed that lower tariffs on inputs raised productivity in Indian manufacturing firms, supporting the imported-inputs channel. Bhagwati and Panagariya (2013) argued that growth is the primary driver of poverty reduction, which gives trade policy an indirect distributional significance.

2.4 Research gap

Much of the existing work concentrates on merchandise trade or on the decades immediately after 1991. Fewer studies integrate the role of services exports, recent trade agreements and the effects of the global tariff shocks of 2025-26 within a single framework. This paper addresses that gap by combining a conceptual model with the latest available data.

3. Objectives and Hypotheses

The study has the following objectives:

- To develop a conceptual framework linking foreign trade to India's economic growth.
- To analyse the level, composition, direction and financing of India's trade from FY2022-23 to FY2025-26.
- To assess, using post-2022 evidence, the channels through which trade affects growth.
- To identify structural constraints and recommend policy measures. The working hypotheses, each tied to a link in the framework, are:

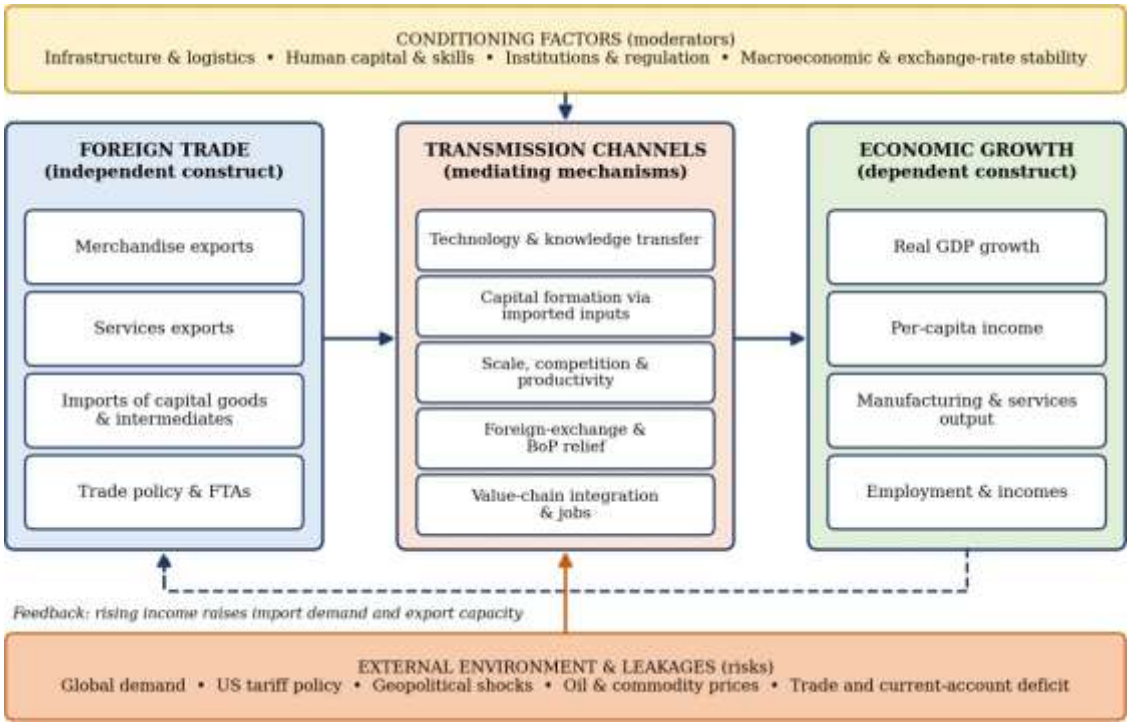
- H1: Higher export earnings and trade openness are associated with sustained GDP growth.
- H2: Services exports contribute disproportionately to growth and external balance relative to goods exports.
- H3: Imports of capital goods and intermediate inputs raise productive capacity and are complementary to, not a substitute for, domestic growth.
- H4: Import dependence in energy, gold and electronics, together with external shocks, reduces the net benefit of trade.

4. Conceptual Framework

4.1 Purpose and logic

The framework in Figure 1 organises the trade-growth relationship into five elements: an independent construct (foreign trade), a set of mediating mechanisms (transmission channels), a dependent construct (economic growth), moderating conditions that determine how strongly the channels operate, and external risks and leakages that can erode the gains. A feedback loop recognises that growth itself alters trade, because rising incomes raise import demand and enlarge productive capacity for export.

Figure 1: Conceptual Framework of Foreign Trade and Economic Growth



Source: Author's construct, drawing on the endogenous growth and export-led growth literature (Section 2).

4.2 Constructs and their definitions

Foreign trade is treated as a multidimensional construct with four components. Merchandise exports represent external demand for goods produced in India. Services exports, led by software, business and professional services and global capability centres, represent a labour-skill-intensive export that does not require physical shipment. Imports of capital goods and intermediates represent the inflow of machinery, components and technology that raise domestic productive capacity, and are distinguished from imports of consumption goods and from energy and gold, which are treated as leakages. Trade policy and agreements, including tariffs and free trade agreements, define the terms on which these flows occur.

The transmission channels are the mechanisms through which these components affect output. Technology and knowledge transfer occurs through imported machinery, foreign investment and exposure to foreign buyers. Capital formation through imported inputs allows domestic firms to expand output at lower cost. Scale, competition and productivity effects arise from larger markets and import competition. Foreign-exchange and balance-of-payments relief arises when export earnings finance the import of essential inputs and ease the external constraint. Value-chain integration links Indian firms to international production networks and generates employment.

Economic growth is the dependent construct, measured by real GDP growth, per-capita income, sectoral output (manufacturing and services) and employment and incomes.

4.3 Moderating conditions and external risks

Following the conditional view of Rodriguez and Rodrik (2000), the strength of each channel is assumed to depend on conditioning factors: infrastructure and logistics, human capital and skills, institutions and regulation, and macroeconomic and exchange-rate stability. The same level of trade can therefore yield different growth outcomes in different settings. External risks and leakages operate on the channels from outside the domestic economy. These include weak global demand, tariff policy in major markets, geopolitical disruption, energy and commodity price volatility, and a large trade and current-account deficit that must be financed.

4.4 Propositions

The framework yields the testable propositions summarised in Table 1, each corresponding to one of the hypotheses in Section 3.

Table 1: Framework Propositions and Indicators

No.	Proposition (link in framework)	Main indicators	Data source
H1	Exports and openness raise growth, through the foreign-exchange and scale channels	Total exports; trade/GDP; real GDP growth	Ministry of Commerce; MoSPI
H2	Services exports raise growth and external balance more than their weight suggests	Services share in exports; services surplus; services GVA growth	Ministry of Commerce; RBI; MoSPI
H3	Imported capital goods and intermediates raise capacity (capital formation, technology channels)	Non-oil, non-gold imports; gross fixed capital formation; electronics exports	Ministry of Commerce; MoSPI
H4	Energy, gold and electronics import dependence and external shocks reduce net gains	Merchandise deficit; current-account deficit; FDI and FPI flows	Ministry of Commerce; RBI

Source: Author's compilation.

5. Data and Methodology

The study is descriptive and analytical and uses secondary data for the financial years 2022-23 to 2025-26, with provisional figures for April to July 2026 where available. Trade data are from the Ministry of Commerce and Industry's press releases. Balance-of-payments and capital-flow data are from the Reserve Bank of India, and GDP data are from the Ministry of Statistics and Programme Implementation (MoSPI). Services trade figures are Reserve Bank estimates compiled by the Ministry, and the most recent months are provisional and subject to revision. Totals and ratios such as the services share in exports and the services surplus are the author's calculations from the published figures.

Three cautions apply. First, trade figures are revised after first release, so figures for the same year may differ slightly across releases; the latest available values are used, and small differences should be expected against other sources.

Second, MoSPI moved GDP to a new base year (2022-23 prices) in 2026, so growth rates before and after the revision are not strictly comparable. Third, with only four complete annual observations, formal time-series estimation of a growth regression is not feasible. The standard specification used in the literature, relating GDP growth to openness, exports, imports, foreign investment and capital formation, would require quarterly or monthly data over a longer window and tests for stationarity and cointegration; it is left for future research. The assessment here is therefore a structured evaluation of evidence against the propositions of the framework, and the results indicate association and consistency, not proof of causation.

6. Trade Performance since FY2022-23

6.1 Policy background

Table 2 places the period in the longer history of trade policy. The phases to 2022 are summarised from the literature, and the final phase is the focus of this paper.

Table 2: Phases of India's Trade Policy

Phase	Period	Main features
Import substitution	1950s to 1980s	High tariffs, import licensing, export pessimism; India's share in world exports declined.
Liberalisation	1991 to 2000	Rupee devaluation, tariff cuts, removal of most import licensing, opening to foreign investment.
Export boom	2000 to 2008	Rapid growth in services exports (IT and business services) and in merchandise exports.
Global shocks	2008 to 2014	Global financial crisis, weak external demand, high oil prices, wider current-account deficit.
Strategic trade policy	2014 to 2022	Make in India, Production Linked Incentive schemes, GST, selective tariff increases.
Agreements and shocks	2022 to present	Post-pandemic recovery; trade agreements with Australia, EFTA, the UK and others; US tariff shocks; West Asia conflict.

Source: Author's compilation from the literature and Ministry of Commerce and Industry publications.

6.2 Overall trade trends

Table 3 and Figure 2 show India's merchandise and services trade over the four years. Total exports of goods and services were about US$776 billion in FY2022-23 and FY2023-24, rose to US$825 billion in FY2024-25, and reached a record US$860 billion in FY2025-26, an increase of 4.2 percent over the previous year. Total imports rose faster, to US$979 billion, so that the overall trade deficit, which had narrowed to US$78 billion in FY2023-24, widened to US$119 billion in FY2025-26.

Table 3: India's Merchandise and Services Trade, FY2022-23 to FY2025-26 (US$ billion)

Year	Merch. exports	Merch. imports	Merch. deficit	Services exports	Services imports	Services surplus
2022-23	451.1	716.0	−264.9	325.3	182.1	143.3
2023-24	437.1	677.2	−240.2	339.6	177.6	162.1
2024-25	437.7	721.2	−283.5	387.6	198.7	188.8
2025-26	441.8	775.0	−333.2	418.3	204.4	213.9

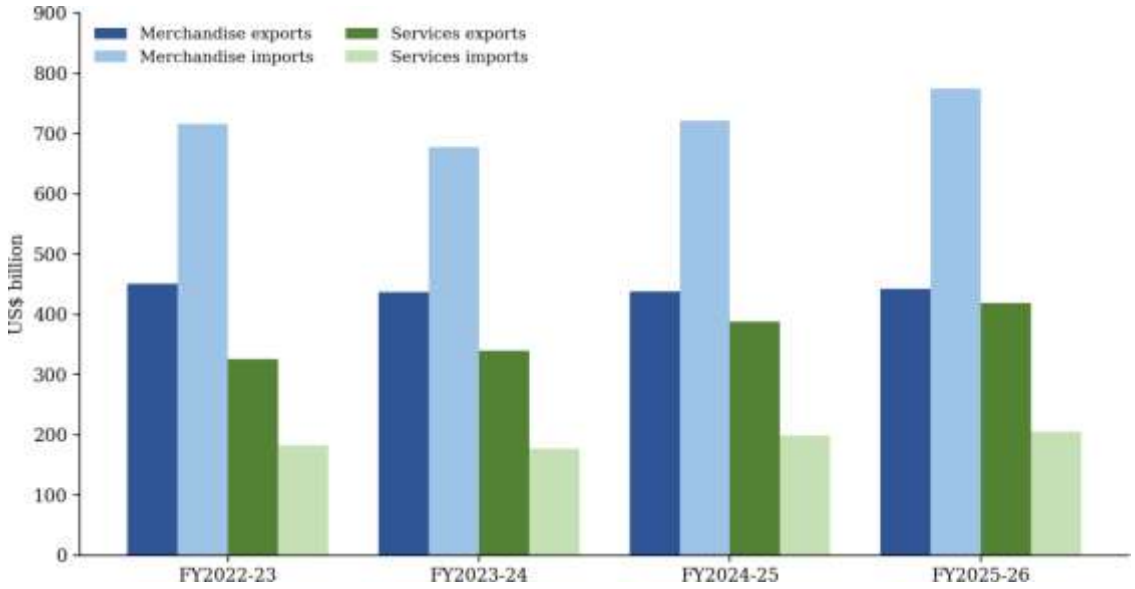
Source: Ministry of Commerce and Industry press releases (April 2024 and April 2026). Services surplus calculated by the author. Figures are subject to revision.

Table 4: Total Trade and the Role of Services

Year	Total exports	Total imports	Overall trade deficit	Services share in total exports (%)
2022-23	776.4	898.0	−121.6	41.9
2023-24	776.7	854.8	−78.1	43.7
2024-25	825.3	919.9	−94.7	47.0
2025-26	860.1	979.4	−119.3	48.6

Source: Ministry of Commerce and Industry; services share calculated by the author.

Figure 2: Merchandise and Services Trade, FY2022-23 to FY2025-26



Source: Ministry of Commerce and Industry; plotted by the author.

The data show a two-speed pattern. Services exports grew by about 29 percent over the three years from FY2022-23 to FY2025-26, while merchandise exports grew by about 2 percent. As a result, services moved from about 42 percent to about 49 percent of total exports, and the services surplus rose from US$143 billion to US$214 billion. In FY2025-26 this surplus offset roughly two-thirds of the merchandise deficit of US$333 billion.

6.3 Composition and direction of merchandise trade

Merchandise exports fell by 3.1 percent in FY2023-24, in line with a global decline in merchandise trade that year, and then moved sideways. Electronic goods were a bright spot: their exports rose by about 24 percent to US$29 billion in FY2023-24, which reflects the early effect of the Production Linked Incentive scheme and the relocation of smartphone assembly to India. India's share in world merchandise exports remained near 1.8 percent in 2023, well below its weight in world output.

On the import side, the rise in FY2025-26 was driven by gold and silver purchases and by non-petroleum imports rather than by oil. According to the Ministry's data as reported by commentators, non-petroleum imports grew by about 12 percent in the year, and the trade deficit excluding petroleum and gold-related items also widened. This is consistent with a domestic investment cycle, since gross fixed capital formation grew by 8.2 percent in FY2025-26, but it also illustrates the import intensity of growth.

The direction of trade also shifted. The United States was India's largest export market in FY2023-24, taking about 18 percent of merchandise exports. By FY2025-26, however, the Reserve Bank's annual report records that China had overtaken the United States as India's largest trading partner, reflecting both reduced exports to the US under higher tariffs and India's continued reliance on Chinese inputs. The concentration of import sourcing, particularly in

electronics, machinery and chemicals, is thus an important dimension of external vulnerability.

6.4 Trade policy environment

The policy environment changed substantially. The India-Australia Economic Cooperation and Trade Agreement came into effect in December 2022. The trade and economic partnership agreement with the four EFTA states entered into force on 1 October 2025. The India-UK Comprehensive Economic and Trade Agreement entered into force on 15 July 2026, giving Indian exporters duty-free access to about 99 percent of UK tariff lines by the UK's own account. India and the European Union concluded negotiations on 27 January 2026, with preferential access for Indian exports across most tariff lines, but the agreement still required legal review and ratification and was not yet in force at the time of writing. Agreements with Oman and New Zealand were also finalised in 2026. The cumulative effect of these agreements on trade will appear only gradually.

On the other side, the United States raised tariffs on Indian goods during 2025, with additional duties that at their peak reached 50 percent on a large share of exports. A framework understanding announced in early February 2026 envisaged a lower rate. On 20 February 2026 the US Supreme Court held that tariffs imposed under the International Emergency Economic Powers Act were not authorised, and the administration responded with temporary tariffs under other statutes. Reports as of September 2026 indicate that the US tariff regime applying to India remained unsettled, with a lower baseline rate but with sector-specific duties on items such as steel and aluminium. The practical lesson for the framework is that policy uncertainty in a single large market is a first-order external risk. Separately, the outbreak of conflict in West Asia on 28 February 2026 triggered portfolio outflows and raised shipping and insurance costs.

6.5 External financing and growth outcomes

The current-account deficit stayed moderate despite the widening merchandise gap, at about 1.0 percent of GDP in April to December 2025, because net services receipts and remittances covered most of the shortfall. Foreign direct investment was more volatile: net FDI was about US$28 billion in FY2022-23, US$10.2 billion in FY2023-24, US$1.0 billion in FY2024-25 and US$7.7 billion in FY2025-26, while gross inflows reached US$94.5 billion in FY2025-26, up from US$80.6 billion. The gap between gross and net reflects repatriation and outward investment. Net portfolio outflows of about US$16.5 billion in FY2025-26 added to pressure on the capital account.

Real GDP growth remained strong. Under the earlier series, growth in FY2023-24 was estimated at 9.2 percent. Under the revised series, growth was 7.1 percent in FY2024-25 and
7.7 percent in FY2025-26, led by services, manufacturing and investment. Early data for FY2026-27 point to a rebound in trade: total exports in April to July 2026 were reported at US$316 billion, 13 percent higher than a year earlier, with merchandise exports up 17 percent, though these figures are provisional and the merchandise deficit for the four months was still about US$119 billion.

7. Evaluation of Channels and Hypotheses

7.1 Channel-by-channel assessment

Foreign-exchange and balance-of-payments relief is the channel with the clearest support. Services exports, now close to half of all exports, financed a large part of the merchandise import bill, and this allowed the economy to grow above 7 percent without a currency or financing crisis. Capital formation through imported inputs is also supported: the surge in non-oil imports coincided with investment growth of more than 8 percent, and electronics exports show that imported components can be turned into exports when policy and investment align. The technology and value-chain channels are visible in electronics assembly and in the expansion of global capability centres, but domestic value addition in electronics remains modest and the evidence is partial. The scale and competition channel is harder to observe in four years of data. Its operation is more likely to appear in firm-level productivity studies than in aggregate trade statistics.

7.2 Assessment of hypotheses

Table 5: Summary Assessment of Hypotheses

No.	Evidence from FY2022-23 to FY2025-26	Assessment
H1	Total exports up from US$776bn to US$860bn while real GDP growth stayed above 7%; but goods exports almost flat and trade deficit widened.	Partly supported (association, mainly through services)
H2	Services share in exports up from 42% to 49%; services surplus US$214bn offsets about two-thirds of merchandise deficit; services lead GVA growth.	Supported
No.	**Evidence from FY2022-23 to FY2025-26**	**Assessment**
H3	Non-oil, non-gold imports and investment grew together; electronics exports rose with imported components.	Supported, with limited domestic value addition
H4	Merchandise deficit rose to US$333bn; gold and electronics imports drove FY26 import growth; US tariff shocks and the West Asia conflict hit flows.	Supported

Source: Author's assessment based on Sections 6.2 to 6.5. These are interpretive judgements, not statistical tests.

Taken together, the evidence is consistent with the conditional view of the literature. Trade contributed to growth where complementary conditions were present: skills in the case of services, and policy support plus investment in the case of electronics. It contributed less where those conditions were weaker, as in labour-intensive goods exports facing high tariffs abroad.

8. Challenges and Limitations

- A stagnant goods-export base: merchandise exports were roughly US$440 billion in FY2022-23 and again in FY2025-26, so goods exports did not contribute to growth in this period.
- A widening merchandise deficit: imports of energy, gold and electronics keep the deficit large, and in FY2025-26 it reached US$333 billion.
- Exposure to tariff and policy shocks in major markets, especially the United States, whose rules changed several times between 2025 and 2026.
- Import concentration and supply-chain risk, particularly reliance on China for inputs, which grew as China became the largest trading partner.
- Volatile capital inflows: net FDI fell to US$1 billion in FY2024-25 and portfolio flows reversed sharply in FY2025-26.
- Services-led growth is skill-intensive and absorbs less low-skilled labour than manufacturing exports.
- Data limitations: figures are revised, the GDP series has a new base year, and four annual observations do not allow formal econometric testing.

9. Policy Implications

- Turn new agreements into trade: provide exporters, especially small and medium enterprises, with information, certification and trade finance to use the UK, EFTA and EU agreements.
- Revive goods exports by lowering logistics costs, rationalising tariffs on imported inputs so that exporters are not penalised, and improving customs and port efficiency.
- Deepen value-chain participation in electronics and other sectors by encouraging domestic component production and raising local value addition.

- Diversify export markets and import sources to reduce dependence on any single country, including through the pending EU agreement.
- Reduce energy and gold import dependence through renewable energy, energy efficiency and policies that channel household savings to financial assets.
- Sustain services leadership with investment in skills, digital infrastructure and higher-value professional and technology services, and negotiate mobility and services provisions in trade agreements.
- Keep macroeconomic stability and a flexible exchange rate to absorb external shocks, and strengthen FDI inflows that bring technology and not only capital.

10. Conclusion

This paper developed a conceptual framework in which foreign trade affects India's growth through technology transfer, capital formation, scale and competition, foreign-exchange relief and value-chain integration, subject to domestic conditioning factors and external risks. Applied to the post-2022 period, the framework fits the evidence. Trade supported growth chiefly through services exports, which financed a large merchandise deficit, and through imported inputs that supported investment. Goods exports, however, stagnated, the overall trade deficit widened, and external shocks, notably in United States tariff policy and in West Asia, exposed the limits of the model.

India's growth will increasingly depend on whether new trade agreements can revive goods exports, whether domestic manufacturing can capture more of the value in global supply chains, and whether import dependence in energy, gold and electronics can be reduced. Further research should apply the framework to quarterly and monthly data as longer post-2022 series become available, and use sector and state-level analysis to test the channels formally.

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