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The Importance of Trade Policy for Developing Country

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ABSTRACT

Trade policy is a core instrument of macroeconomic management for developing countries. For India—one of the world's largest and fastest-growing economies—trade policy shapes the country's industrial competitiveness, foreign investment flows, employment creation, food and energy security, and integration into global value chains (GVCs). This article examines why trade policy matters for India, reviews historical and recent developments, provides empirical evidence on trade and investment trends, outlines the main channels through which trade policy affects development, discusses current challenges (including trade deficits, import dependence for energy and inputs, non-tariff barriers, and the need for infrastructure), and presents policy recommendations. The analysis draws on recent official data and international research to provide actionable insights for policymakers, business leaders, and researchers.

Keywords: *FDI, Trade policy, Non-Tariff Barriers, Global Value Chain etc.*

Introduction

Trade policy—the set of regulations, tariffs, quotas, trade agreements, standards, and procedures that govern cross-border exchange—matters profoundly for developing countries. Thoughtfully designed trade policies can accelerate structural transformation, raise productivity through exposure to competition and technology, attract foreign direct investment (FDI), create jobs, bolster export earnings, and help finance development priorities. Conversely, poorly designed or unpredictable trade policy can distort incentives, protect inefficient sectors, raise costs for firms and consumers, and leave a country vulnerable to external shocks.

India's policy choices since economic liberalization in 1991 demonstrate how trade policy can reshape an economy. Over the past three decades, India has progressively reduced tariff barriers, opened key sectors to investment, and pursued policies aimed at linking domestic firms to global markets. At the same time, India continues to rely on trade policy tools to protect sensitive sectors, manage balance-of-payments pressures, and pursue strategic objectives such as food security and technological sovereignty. The interplay between liberalization and selective protection underscores why a nuanced, dynamic approach to trade policy is essential for India. [1]

Historical Perspective: Liberalization and Structural change

India's shift from a highly protected, import-substituting economy to one more open to trade and investment began in earnest with the 1991 reforms. Those reforms reduced average tariff rates, relaxed import licensing, and set the stage for greater integration with the world economy (Panigarola, 2008). Since the 1990s, India has experienced a gradual increase in trade openness and a diversification of export baskets: services (notably information technology and business process outsourcing) became leading export earners alongside traditional merchandise exports such as textiles and agricultural goods.

The liberalization decades also illustrate a broader lesson: trade policy alone is not a magic bullet. Complementary reforms improvements in domestic infrastructure, labour and product market policies, education, and governance—determine whether open trade translates into broad-based development gains (World Bank, 2020). In other words, trade policy must be embedded in a coherent national development strategy if it is to deliver sustained benefits [2]

India Recent: Recent Trade and Investment Profile (Empirical Snapshot)

To appreciate the contemporary importance of trade policy for India, it helps to consider recent data:

Table: 1- Indian Trade Summary for FY 2024-2025

Metric	Value (USD Billion)
Exports (Goods + Services)	820.93
Merchandise Exports	437.42
Service Exports	383.51
Imports (Goods +Services)	915.19
Trade Deficit (Overall)	94.26

- **Export and import performance (FY 2024–25):** India's cumulative exports (merchandise and services) for FY 2024–25 were estimated at approximately **US$ 820.93 billion**, a year-on-year increase of about 5.5%, while imports for the same period were estimated at **US$ 915.19 billion** (Ministry of Commerce & Industry / Press Information Bureau [PIB], 2025). Merchandise exports were approximately **US$ 437.42 billion**, and services exports rose significantly, underscoring India's growing services competitiveness.[3]
- **Trade flows during 2024–25 (interim/2025 updates):** Government releases for 2025 show continuing expansion in services exports alongside rising imports, particularly energy and gold, contributing to trade deficits in certain months (Ministry of Commerce; Reuters reporting). For example, the merchandise trade deficit widened sharply in March 2025, driven largely by higher crude oil and gold imports. These shifts highlight India's vulnerability to commodity price movements and the importance of trade-policy tools for macroeconomic stability[4]
- **Foreign direct investment:** India recorded **US$ 81.04 billion** in FDI inflows in FY 2024–25, reflecting an upward trend and signalling investor confidence shaped in part by predictable trade and investment policy frameworks (Press Information Bureau, 2025). The inflows concentrated largely in services, manufacturing, energy, and communications—sectors whose growth interacts closely with trade policy (PIB, 2025).[5]
- **Regional trade agreements and partnership outcomes:** Trade agreements have delivered measurable gains in bilateral trade: after implementation of the India-UAE Comprehensive Economic Partnership Agreement (CEPA), bilateral trade reached roughly **US$ 100 billion** in the years following the agreement, indicating the importance of preferential trade arrangements in expanding market access. Such agreements are part of India's contemporary trade policy toolkit.[6]

These figures illustrate two critical realities: (1) trade and services remain central to India's external earnings and growth prospects, and (2) policy must manage both opportunities (market access, FDI) and risks (commodity dependence, external deficits).[7]

How Trade Policy Drives Development: Channels and Mechanisms

Trade policy affects development through multiple, interrelated channels. Below we examine the most important mechanisms and why they matter for India.

1. **Market Access and Export – Led Growth**

   Expanding market access through lower tariffs, trade facilitation, and trade agreements allows firms to scale, exploit comparative advantage, and access larger customer bases. For India, services exports (IT, software services, professional services) and certain goods sectors (pharmaceuticals, engineering goods, textiles) have benefited from expanded global market access. Greater exports boost GDP, create jobs, and generate foreign exchange essential for financing imports and development spending (World Bank, 2024; WTO, 2024).[8]

2. **Integration into Global Value Chains and Technology Transfer**

   Participation in GVCs exposes domestic firms to international suppliers, standards, and technologies. This exposure can raise productivity via technology pullovers, managerial know-how, and higher quality standards (World Bank WDR 2020). India has made progress entering certain GVC segments—electronics assembly and parts of the automobile value chain, for instance—but still has scope to deepen integration by reducing trade costs and enhancing domestic capabilities. Policy tools—customs modernization, special economic zones, export incentives, and targeted industrial policy—can facilitate deeper GVC participation.[9]

3. **Attracting FDI and Investment Linkages**

   Predictable trade and investment policy attract FDI, which brings capital, technology, and linkages to global markets. India's rising FDI inflows in FY 2024–25 reflect, in part, reforms to liberalize sectors and simplify regulatory frameworks. Trade policy that reduces uncertainty—through stable tariff regimes, transparent rules of origin, and enforceable trade agreements—increases the returns to foreign investors considering India as an export base or a production hub.[10]

4. **Employment Creation and Structural Transformation**

   Trade-oriented growth can create both skilled and unskilled jobs. Labour-intensive exports—textiles, leather goods, ago-processing—generate mass employment, while services exports create high-skill jobs. By enabling firms to scale and enter export markets, trade policy can accelerate structural transformation from agriculture to manufacturing and services—an essential pathway for broad-based poverty reduction in India (Ahmed & Sengupta, 2020).[11]

5. **Fiscal Space and Balance-of-Payments Management**

   Export earnings provide foreign exchange and fiscal levers. When exports grow, the government has greater capacity to finance infrastructure and social programs without destabilizing exchange-rate pressures. Conversely, large import bills—especially for oil and other essentials—can widen deficits and force policy adjustments. Therefore, trade policy must be aligned with macroeconomic management to avoid persistent external imbalances. The March 2025 widening of India's trade deficit demonstrates this interaction empirically.[12]

Policy Areas of Particular Importance for India

To convert trade potential into development outcomes, several policy instruments deserve special attention.

1. **Trade Facilitation and Logistics**

   Reducing trade costs (time and monetary costs) at ports, customs, and border crossings is often more effective than tariff adjustments. India's ongoing reforms in customs modernization, digital documentation, and port efficiency have the potential to lower these costs significantly. The World Bank highlights that reducing trade costs improves firm competitiveness and GVC participation.

2. **Rule of Origin and Standards Harmonization**

   As India deepens preferential trade agreements, clear and feasible rules of origin and alignment with international standards are necessary to ensure firms can actually utilize preferential tariffs. Non-tariff measures (technical barriers to trade, sanitary and phytosanitary standards) can disproportionately hurt small and medium enterprises (SMEs) unless support is provided for compliance.[13]

3. **Support for MSMEs and Exporters**

   India's import dependence for crude oil and certain fertilizers underscores the strategic dimension of trade policy. Policies to diversify energy supplies, boost renewable energy domestically, and develop strategic reserves help manage external vulnerabilities. Temporary export controls or import liberalization at critical times are policy levers used to stabilize domestic markets.

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5. **Strategy Use of Trade Agreements**

   Bilateral and regional trade agreements (e.g., the India-UAE CEPA) can expand market access rapidly. However, India must negotiate agreements that balance market access with safeguarding domestic policy space to support nascent industries and social objectives. Agreements should be accompanied by adjustment assistance for sectors and workers likely to be displaced. [14]

Challenges and Risk

While trade policy offers opportunities, several challenges complicate the picture for India.

1. **Commodity Dependence and Trade Deficits**

   India's heavy reliance on imported crude oil and certain agricultural inputs makes the country sensitive to global price volatility. The merchandise trade deficit episodes of 2024–25 reflect this vulnerability and emphasize the need for policies that enhance energy diversification and domestic value addition in key sectors.

2. **Non – Tariff Barriers and Trade Protectionism Abroad**

   While India reduces domestic barriers, its exporters face non-tariff measures in partner markets—antidumping investigations, technical standards, and subsidies by advanced economies. Indian trade policy must include robust trade defence instruments but also diplomatic and technical engagement to remove discriminatory barriers. [15]

3. **Infrastructure and Domestic Supply Constraints**

   Poor logistics, chokepoints at ports, and limited cold-chain capacity raise the cost of exports and reduce competitiveness for perishable goods and high-value manufacturing. Investment in ports, roads, rail, and digital connectivity—aligned with trade policy—remains vital.

4. **Inclusive Distribution of Gains**

   Trade can create winners and losers. Without active labour and social policies, trade-driven structural change can exacerbate inequality and leave certain regions behind. Ensuring retraining programs, social safety nets, and targeted regional development assistance is necessary for socially sustainable trade policy.

5. **Environmental and Sustainability Concerns**

   Global markets increasingly require compliance with environmental and labour standards. India's firms must adapt to green standards, carbon accounting, and sustainable sourcing to maintain market access. Trade policy should therefore be integrated with environmental policy tools and support for green technology adoption.

Case studies: Recent Policy Actions and Outcomes

The India-UAE CEPA (implemented 2022) is an example of how trade agreements can rapidly expand bilateral trade. Reports indicate bilateral trade reached around **US$ 100 billion** post-CEPA implementation, showing how preferential access and reduced trade barriers can boost exports, particularly in merchandise segments such as gems & jewellery, petroleum products, and textiles (Economic Times reporting). The CEPA also illustrates the importance of services liberalization—benefitting Indians in professional and technology services in the Gulf markets.

Make in India and Industrial Policy

The Make in India initiative, launched in 2014, sought to promote domestic manufacturing and attract investment. While outcomes have been mixed across sectors, the initiative combined trade policy with investment facilitation and regulatory reform to create an environment friendlier to exporters and manufacturing FDI. Continued alignment of industrial policy, trade agreements, and export incentives is central to translating such initiatives into higher manufacturing exports and jobs.

Recommendations

Drawing on the evidence and challenges outlined above, the following policy priorities can enhance the developmental impact of India's trade policy.

1. **Reduce trade costs systematically.** Invest in customs modernization, port logistics, and digital documentation to reduce time-to-export and cost-to-export for firms—especially SMEs. Trade facilitation yields large welfare gains at comparatively low fiscal cost.

2. **Targeted support for MSMEs and exporters.** Provide finance, standards-compliance assistance, and export promotion capacity building for micro enterprises and women-led firms to make trade more inclusive. [17]
3. **Deepen GVC participation through inputs and skills.** Encourage backward and forward linkages by improving access to quality intermediate inputs, easing rules of origin where appropriate, and investing in vocational training aligned with export sector needs.
4. **Strategic use of trade agreements.** Negotiate agreements that combine market access with safeguards and adjustment assistance. Prioritize agreements that open services markets and that reduce tariff peaks on manufactured exports.
5. **Energy and input security planning.** Diversify energy sources, build strategic reserves, and incentivize domestic production of critical inputs to reduce the economy's exposure to external commodity shocks.
6. **Green and resilient trade policies.** Link trade policy with climate action—support exporters in meeting environmental standards, incentivize green manufacturing, and attract FDI into low-carbon technologies.
7. **Data-driven, transparent policymaking.** Use high-frequency trade data and stakeholder consultations to calibrate tariff changes and to design contingency measures for external shocks. Transparency reduces uncertainty and encourages investment.

Conclusion

Trade policy is a cornerstone of development strategy for India. When carefully designed and coordinated with domestic reforms—investment in infrastructure, skills, and institutional quality—trade policy can accelerate industrialization, deepen participation in global value chains, attract FDI, and create jobs. Recent data for FY 2024–25 show India's exports and services performance remain robust even as imports of energy and precious metals introduce volatility to the trade balance; these dynamics underscore the need for a nuanced policy mix that balances liberalization with strategic safeguards.

Going forward, India's objective should be to transform trade policy from a narrow tool of tariff setting into an integrated engine for inclusive and sustainable development—one that lowers trade costs, equips firms to meet global standards, leverages preferential agreements strategically, and ensures the gains from trade are widely shared across regions and communities. The evidence from international organizations (WTO, World Bank) and Indian official statistics points to clear policy levers and the urgency of reform; the task for policymakers is to adapt these lessons to India's political economy and developmental priorities

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