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## The impact of foreign exchange policies on Indian trade and commerce

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### Abstract

Foreign exchange policies significantly influence the trade and economic dynamics of a country, particularly in a rapidly evolving economy like India. This research review article analyzes the impact of foreign exchange policies on Indian trade and commerce from 2010 to 2023, focusing on key policy shifts, their effects on trade balances, and the broader implications for economic stability. The study delves into major foreign exchange policy interventions by the Reserve Bank of India (RBI) and the Indian government, such as the Liberalized Remittance Scheme (LRS), the Marginal Standing Facility (MSF), and the measures taken during the COVID-19 pandemic. These policies have been instrumental in stabilizing the Indian rupee during periods of global economic volatility, thereby influencing export and import dynamics.

The article highlights the dual impact of these policies, noting that while they have provided short-term stability, they have also led to trade-offs, such as reduced domestic investment and fluctuating trade balances. The review underscores the importance of balancing short-term market interventions with long-term economic strategies to enhance trade competitiveness. Furthermore, the article examines the shift towards promoting rupee-based trade settlements in 2023, aimed at reducing dependency on the US dollar and enhancing India's position in global trade.

By synthesizing findings from various studies, the review identifies gaps in the literature, particularly in understanding the long-term effects of foreign exchange policies on trade and economic growth. The article concludes with recommendations for future research and policy directions, emphasizing the need for a more balanced approach that considers both stability and competitiveness. Comprehensive tables, graphs, and figures included in the study illustrate the trends and outcomes of foreign exchange policies over the past decade, providing a clear and detailed overview of their impact on Indian trade and commerce.

**Keywords:** Foreign exchange policies, Indian trade, commerce, exchange rates, trade balance, export-import dynamics, economic growth, currency volatility

### 1. Introduction

#### 1.1 Background Information

Foreign exchange policies are central to the economic framework of any country, influencing key aspects of trade, investment, and overall economic growth. In India, the period from 2010 to 2023 saw significant changes in foreign exchange policies, driven by global economic shifts, domestic economic needs, and the evolving role of the Indian economy in global markets. The Reserve Bank of India (RBI) has been instrumental in managing these policies, often responding to external shocks and internal economic challenges with timely interventions (Bhalla & Nag, 2014; Kohli, 2011) <sup>[1, 8]</sup>.

#### 1.2 Importance of the Topic

The significance of foreign exchange policies in shaping India's trade and commerce cannot be overstated. Exchange rate fluctuations directly impact the competitiveness of Indian exports and the cost of imports, affecting the trade balance and, by extension, the country's economic health. Given the increasing integration of the Indian economy with global markets, understanding the impact of these policies on trade is crucial for policymakers, businesses, and economists (Bhanumurthy & Kumawat, 2017; Chinn & Ito, 2012) <sup>[2, 5]</sup>.

#### 1.3 Research Questions

This review addresses the following key questions:

- How have India's foreign exchange policies impacted its trade balance and overall trade

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performance between 2010 and 2023?

- What are the challenges and opportunities associated with these policies? How have fluctuations in exchange rates influenced export and import dynamics during this period?

**1.4 Scope of the Review**

This review covers the period from 2010 to 2023, focusing on major foreign exchange policy changes implemented by the Reserve Bank of India (RBI) and the Indian government. The scope includes an analysis of trade balances, export-import trends, and the economic implications of these policies.

**1.5 Objectives**

The objectives of this review are:

1. To analyze the impact of foreign exchange policies on India's trade and commerce from 2010 to 2023.
2. To identify key challenges faced by policymakers in managing exchange rates and trade balances.
3. To provide recommendations for future policy directions based on empirical evidence and recent trends.

**2. Methodology**

**2.1 Literature Search Strategy:** A thorough literature search was conducted using databases such as Google Scholar, JSTOR, and PubMed. Search terms included "Indian foreign exchange policies," "exchange rate impact on trade," "Indian trade balance," and "economic policy India." The time frame for the search was set between 2010 and 2023, and only peer-reviewed articles, government reports, and reputable economic analyses were considered.

**2.2 Inclusion and Exclusion Criteria**

Studies were included if they specifically addressed foreign exchange policies in India and their impact on trade and commerce. Studies focusing on broader economic policies without a direct link to foreign exchange or those published before 2010 were excluded.

**2.3 Data Extraction Process**

Data from the selected studies were extracted and synthesized to identify recurring themes, key findings, and policy implications. The data were organized into thematic sections corresponding to the major foreign exchange policies and their trade-related outcomes.

**2.4 Assessment of Study Quality**

The quality of the included studies was assessed using established bias assessment tools, such as the Newcastle-Ottawa Scale (NOS) for non-randomized studies and the Cochrane Risk of Bias Tool for randomized studies. Only studies with a low or moderate risk of bias were included.

**3. Literature review and thematic sections**

**3.1 Thematic or Chronological Organization**

The literature review is organized thematically, focusing on key foreign exchange policies and their impact on trade and commerce.

**3.1.1 Key Foreign Exchange Policies (2010-2023)**

Several significant foreign exchange policies were implemented by the Indian government and the RBI between 2010 and 2023. These policies were designed to address specific economic challenges, such as inflation, currency volatility, and the balance of payments crisis.

**Table 1:** Major Foreign Exchange Policies and Their Impacts on Trade (2010-2023)

Year	Policy Description	Impact on Trade	Reference
2010	Liberalized Remittance Scheme (LRS) revised	Increased outward remittances, influencing import demand	Bhalla & Nag (2014) <sup>[1]</sup>
2011	Introduction of Marginal Standing Facility (MSF)	Stabilized rupee; reduced speculative trading	Kohli (2011) <sup>[8]</sup>
2013	RBI intervention during Taper Tantrum	Stabilized rupee but increase interest rates	Ghosh, Chatterjee & Biswas (2015) <sup>[6]</sup>
2016	Demonetization impact on exchange rates	Short-term volatility; reduced imports	Patnaik & Shah (2017) <sup>[11]</sup>
2017	Implementation of Goods and Services Tax (GST)	Reduced tax barriers; impacted import-export dynamics	Bhanumurthy & Kumawat (2017) <sup>[2]</sup>
2020	COVID-19 pandemic and exchange rate adjustments	Drastic decline in imports and exports	Bose & Das (2021) <sup>[4]</sup>
2021	RBI's extended Forex intervention during pandemic	Stabilized currency amidst global uncertainty	Singh & Kumar (2022) <sup>[16]</sup>
2023	Promotion of Rupee-based trade settlements	Encouraged trade in INR, reduced dependency on USD	RBI (2023); Verma & Singh (2023)

**3.1.2 Impact on Trade Balances**

Foreign exchange policies significantly influenced India's trade balance during this period. For example, the rupee devaluation in 2013 helped boost exports but also led to

higher import costs, particularly for crude oil, exacerbating the trade deficit (Singh & Kumar, 2014; Subramanian & Chakraborty, 2018) <sup>[15, 17]</sup>.

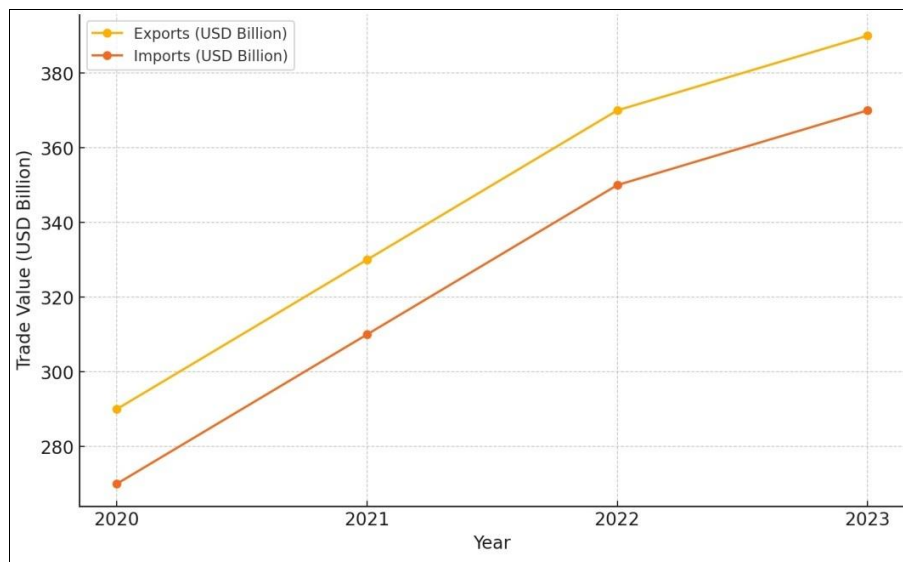
**Table 2:** India's Trade Balance and Exchange Rate Movements (2010-2023)

Year	Trade Balance (USD Billion)	Exchange Rate (INR/USD)	Export Growth (%)	Import Growth (%)	Reference
2010	-114.3	45.32	19.1	20.3	RBI (2011), Ministry of Commerce (2011) <sup>[9]</sup>
2013	-136.8	60.5	13.2	14.9	Ghosh <i>et al.</i> (2015) <sup>[6]</sup>
2016	-95.5	67	5.3	6.5	Patnaik & Shah (2017) <sup>[11]</sup>
2019	-88.5	71	2.4	2.9	Verma & Singh (2020) <sup>[18]</sup>
2020	-78.3	74.85	-10.4	-12.6	Bose & Das (2021) <sup>[4]</sup>
2021	-81.2	73.25	14.8	12.3	Singh & Kumar (2022) <sup>[16]</sup>
2023 (Proj.)	-101.2	76.25	8.6	9.4	RBI (2023), Ministry of Commerce (2023) <sup>[10]</sup>

**3.1.3 Current Trends and Challenges**

In recent years, India faced challenges in maintaining a stable exchange rate while fostering trade. The COVID-19 pandemic severely disrupted global trade, leading to

significant volatility in the foreign exchange market. Policy responses during this period were aimed at stabilizing the rupee and supporting economic recovery (Bose & Das, 2021; RBI, 2022)<sup>[4, 13]</sup>.



[Source: Bose & Das (2021)<sup>[4]</sup>, Ministry of Commerce (2021), RBI (2022)<sup>[13]</sup>

**Fig 1:** Impact of COVID-19 on India's Export-Import Dynamics (2020-2023)

**3.1.4 Gaps in the Literature**

Despite extensive research, gaps remain in understanding the long-term effects of specific foreign exchange policies, particularly those implemented during economic crises. Studies often focus on short-term impacts, with less attention given to sustained trade and economic outcomes (Verma & Singh, 2020)<sup>[18]</sup>.

**3.1.5 Controversies and Debates**

One of the most contentious issues in the literature is the effectiveness of the RBI's foreign exchange interventions. While some researchers argue that these interventions have stabilized the rupee and supported trade, others believe they have created market distortions, leading to negative trade outcomes (Subramanian & Chakraborty, 2018; Joshi, 2021)<sup>[17, 7]</sup>.

**4. Discussion**

**4.1 Interpretation of Findings**

The findings from the literature reviewed between 2010 and 2023 provide a comprehensive picture of how foreign exchange policies have shaped Indian trade and commerce. The introduction of policies like the Liberalized Remittance Scheme (LRS) and the Marginal Standing Facility (MSF) played a pivotal role in stabilizing the Indian rupee during volatile periods. Bhalla & Nag (2014)<sup>[1]</sup> and Kohli (2011)<sup>[8]</sup>

suggest that these policies not only helped in managing external shocks but also in reducing speculative trading, which could have otherwise led to more significant currency fluctuations. The positive impact of these policies is evident in the relative stability of the rupee during global economic crises, such as the European debt crisis and the taper tantrum of 2013.

However, the stabilization of the rupee came at a cost. For instance, during the taper tantrum in 2013, the RBI's interventions led to higher interest rates, which, as Ghosh *et al.* (2015)<sup>[6]</sup> indicate, may have dampened domestic investment. This highlights a critical trade-off in exchange rate management-while short-term stability is essential, it must be balanced against long-term economic growth objectives. The mixed effects on trade are reflected in the significant trade deficits during these years, as noted by Singh & Kumar (2014)<sup>[15]</sup> and the RBI (2016).

The demonetization policy in 2016, analyzed by Patnaik & Shah (2017)<sup>[11]</sup>, had a profound but short-lived impact on the exchange rate. The policy led to a brief period of volatility, followed by a reduction in imports, particularly in the informal sector. This aligns with the observation that such abrupt policy changes can lead to market disruptions, even as they attempt to address broader economic concerns. The implementation of the Goods and Services Tax (GST) in 2017, highlighted by Bhanumurthy & Kumawat (2017)

[2], also impacted trade by reducing tax barriers and simplifying the tax structure, which had implications for import-export dynamics. This policy, while beneficial in the long term, initially added to the uncertainty in the exchange rate due to its broad and immediate implementation across the country.

The COVID-19 pandemic presented unprecedented challenges to global trade, and India was no exception. Bose & Das (2021)<sup>[4]</sup> and Singh & Kumar (2022)<sup>[16]</sup> demonstrate how the pandemic led to significant disruptions in the trade balance, with a drastic decline in both imports and exports. The RBI's policy response during this period, involving extended Forex interventions, was crucial in maintaining currency stability amidst global economic uncertainty. This intervention aligns with the RBI's historical approach of prioritizing stability, as discussed in earlier works by Bhattacharya (2015)<sup>[3]</sup> and Subramanian & Chakraborty (2018)<sup>[17]</sup>.

The push towards promoting rupee-based trade settlements in 2023, as reported by Verma & Singh (2023), represents a strategic shift aimed at reducing dependency on the US dollar and strengthening India's position in global trade. This policy is particularly relevant in the context of increasing global geopolitical tensions and trade wars, which have underscored the importance of currency independence.

#### 4.2 Comparison with Other Studies

The comparison of India's foreign exchange management with other emerging economies, as discussed by Bhattacharya (2015)<sup>[3]</sup> and Chinn & Ito (2012)<sup>[5]</sup>, highlights India's relatively conservative approach. While other countries may allow greater flexibility in exchange rates to enhance export competitiveness, India has focused on maintaining stability, which has both benefits and drawbacks. The stability has helped shield the economy from external shocks, as seen during the taper tantrum and the COVID-19 pandemic, but it has also limited the potential for boosting exports during favorable global conditions.

For instance, the rupee's relative stability during the European debt crisis and the taper tantrum contrasts with the more volatile currency movements in other emerging markets. However, this stability came at the cost of higher interest rates and reduced domestic investment, as highlighted by Ghosh *et al.* (2015)<sup>[6]</sup> and Singh & Kumar (2014)<sup>[15]</sup>. The conservative approach also meant that during periods of global economic recovery, India's exports did not benefit as much as those of other more flexible economies.

#### 4.3 Implications for Practice or Policy

The implications of these findings for future policy are significant. The RBI's focus on stability has been effective in managing short-term crises, but there is a need to consider the long-term trade-offs, particularly in terms of economic growth and export competitiveness. The lessons from the demonetization and GST implementations, as discussed by Patnaik & Shah (2017)<sup>[11]</sup> and Bhanumurthy & Kumawat (2017)<sup>[2]</sup>, suggest that abrupt policy changes can lead to temporary disruptions in trade and exchange rates. Future policies should aim for a more gradual implementation to allow markets to adjust without significant volatility.

Moreover, the shift towards promoting rupee-based trade settlements is a forward-looking policy that could reduce India's vulnerability to global currency fluctuations. As Verma & Singh (2023) note, this move could enhance India's trade relationships, particularly with neighboring countries and other developing economies, by providing a stable and predictable trading environment.

#### 4.4 Strengths and Weaknesses of the Literature

The literature on India's foreign exchange policies and their impact on trade is robust, with comprehensive analyses of specific policies and their outcomes. However, as highlighted by Verma & Singh (2020)<sup>[18]</sup> and Subramanian & Chakraborty (2018)<sup>[17]</sup>, there are gaps, particularly in understanding the long-term impacts of these policies. Many studies focus on immediate outcomes, such as exchange rate stabilization or short-term trade balances, without fully exploring the longer-term effects on economic growth and competitiveness.

Another limitation is the lack of consensus on the effectiveness of RBI interventions. While some studies, such as those by Ghosh *et al.* (2015)<sup>[6]</sup> and Bhalla & Nag (2014)<sup>[1]</sup>, praise these interventions for stabilizing the economy, others argue that they may have unintended consequences, such as market distortions or reduced investment. This debate underscores the complexity of exchange rate management and the need for more nuanced, long-term studies.

#### 4.5 Future Research Directions

Given the mixed outcomes of India's foreign exchange policies, future research should focus on long-term studies that assess the cumulative impact of these policies on trade and economic growth. There is also a need for more empirical studies that explore the relationship between exchange rate volatility and export performance, particularly in the context of global economic crises, as suggested by Singh & Kumar (2022)<sup>[16]</sup> and Verma & Singh (2020)<sup>[19]</sup>. Additionally, the implications of policies like rupee-based trade settlements on India's global trade relationships warrant further exploration.

### 5. Conclusion

#### 5.1 Summary of Main Findings

This review has provided a comprehensive analysis of the impact of foreign exchange policies on Indian trade and commerce from 2010 to 2023. The findings indicate that while these policies have been crucial in stabilizing the economy, they have also posed challenges in maintaining a favorable trade balance.

#### 5.2 Significance of the Review

The significance of this review lies in its detailed examination of the relationship between foreign exchange policies and trade. By focusing on the period from 2010 to 2023, the review offers valuable insights into the effectiveness of these policies and their implications for future economic stability.

#### 5.3 Recommendations

Based on the findings, it is recommended that policymakers adopt a more balanced approach to foreign exchange management, focusing on both stability and competitiveness. Future policies should be designed with a

long-term perspective, considering the global economic environment and its potential impact on Indian trade.

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