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POLICY BRIEF

KEY POINTS

- Trade between India and the People's Republic of China (PRC) has flourished since the two countries liberalized their economies in 1991 and 1978, respectively.
- While Indian exports are mainly primary products, the PRC's exports have evolved to include higher value-added and technologically sophisticated intermediate goods.
- India's lack of export diversification results from lack of manufacturing development, poor industrial infrastructure, rigid labor laws, and relatively limited participation in the global economy.
- To maximize the gains from a free trade agreement (FTA) with the PRC, India should first strengthen its commitment to economic liberalization, address existing trade barriers, and promote industries capable of higher value-added exports.

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DEEPENING INDIA'S SHALLOW EXPORT BASKET[1]

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1. Introduction

As talks of a free trade agreement (FTA) between the PRC and India progress, India has the opportunity to evaluate domestic bottlenecks to export diversification in order to create new trade opportunities. Though India has concluded a number of FTAs already, there is little evidence that these have boosted trade to a significant degree.[2] Would an FTA with the PRC be any different? We suggest that the nature of the bilateral relationship opens the door for an FTA to spur much-needed domestic reform that can unlock India's trade potential.

2. PRC–India Bilateral Trade

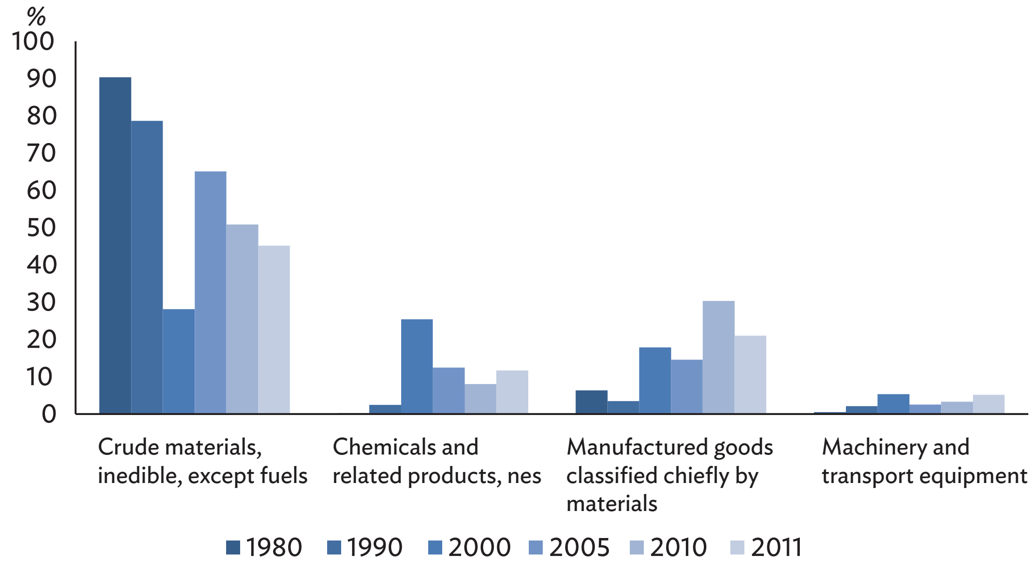
India's bilateral trade with the PRC grew from US$34 million in 2007 to US$70 million in 2011. While these volumes account for a relatively small share of total trade for these economies, the growth trajectories of their economies suggest that bilateral trade will continue to expand. Recent changes in trade flows have been accompanied by ongoing adjustments to the bilateral composition of trade.

An important observation from this decomposition of bilateral exports is that India

[1] This policy brief is part of a series that highlights the competitiveness challenges that Asian countries face in the current economic environment where volatility has increased and trade is increasingly organized into regional value chains. It comes out of issues raised during the Asian International Economists Network (AIEN) Call for Papers Workshop, Trade Competitiveness in a World of Rapid Changes: Challenges and Opportunities for Asia, held at the Asian Development Bank (ADB), Manila on 22 March 2013.

[2] India is currently signatory to the Agreement on South Asia Free Trade Area (SAFTA); Asia-Pacific Trade Agreement (APTA); Bangladesh, India, Myanmar, Sri Lanka, and Thailand Technical and Economic Cooperation (BIMSTEC) Free Trade Area Framework Agreement; Framework Agreement on Comprehensive Economic Cooperation between India and the Association of Southeast Asian Nations (ASEAN); and India–Mercosur Preferential Trade Agreement (PTA). It also has bilateral trade agreements with Afghanistan, Bangladesh, Bhutan, Chile, Japan, the Republic of Korea, Mauritius, Nepal, Singapore, Sri Lanka, Thailand, and the Gulf Council of Cooperation (GCC).

Figure 1: Indian Exports to the PRC by Category (%)



Notes: PRC = People's Republic of China; nes=not elesehwere specified
Source = Calculations based on UN COMTRADE Database, 2012.

exports low value-added products to the PRC and imports high value-added and

technologically sophisticated products from the PRC. Since 2005, India's top exports to the PRC have been ores, cotton, and copper, while leading imports from the PRC have been electrical machinery and equipment, and parts of machinery and mechanical appliances.

In 2011–12, raw materials and intermediate products made up more than 90% of India's exports to the PRC (Dhar 2012). In the bilateral relationship, Indian imports are capital-intensive while exports are mostly intermediate products. Bilateral trade data from 1980–2011 illustrate that India's exports to the PRC are characterized by resource-based and labor-intensive products, and have experienced only limited diversification over time (Figure 1). This shows that India's export of technology-intensive products to the PRC has been well below its potential.

On a positive note, while manufactures are not yet a significant share of India's bilateral export basket, since 2000, exports of such goods have been increasing.

By contrast, the PRC's exports to India have diversified considerably over the past 3 decades. Figure 2 shows the declining share of the PRC's exports in Standard International Trade Classification (SITC) categories 2 and 3 to India since 1980, which are largely crude materials and mineral fuels. Categories 7 and 9 (machinery, transport equipment, and miscellaneous commodities) have increased sharply as a share of total exports to India from 8.6% in 1980 to 45.8% in 2011. This highlights the diversification of the PRC's exports to more value-added and technologically sophisticated products over the years.

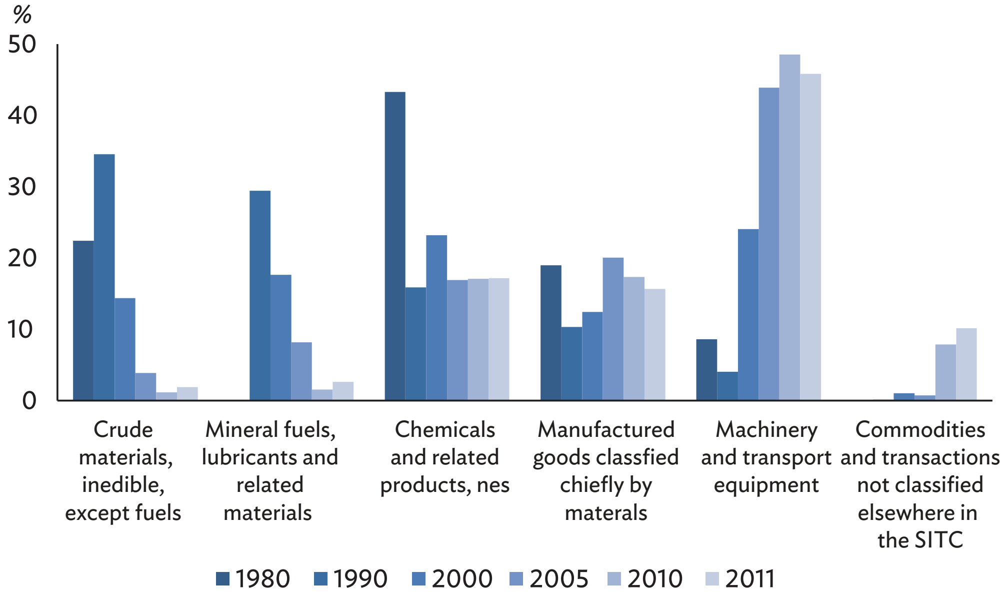
These bilateral trade trends are broadly reflective of both countries' world trade participation as well. The PRC's trade composition shows diversity and dynamism, while India's trade sustains its pattern as well. A critical factor affecting this difference in trade composition has been the implementation of economic reforms in both countries. From 1950 to 1980, the PRC and India each had negligible shares of less than 3% of world exports and imports. Their shares in the world economy increased only after their economies opened up. Yet, the experience of the PRC shows that liberalization alone will not lead to diversification, Srinivasan (2011) points out that the PRC implemented many domestic economic reforms, including reforms of its labor laws, to reap the benefits of liberalization.

3. Global Trade Patterns of the PRC and India

A look at the participation of India and the PRC in world trade offers some insight into the progress the PRC has made and the challenges that India still faces. Panagariya (2012) and Srinivasan (2013) have argued that the PRC's exports showed greater "dynamism" than Indian exports during the 1980–2010 period. In particular, the progression of manufactured exports over time exemplifies the divergence in export performance between the two countries.

From 1980 to 2010, manufactured products (SITC categories 6, 7, and 8) accounted for more than 50% of total exports for each country. The PRC's export share increased from 57% in 1984–90 to 86% in 2001–04. In addition, during these years, the PRC's export pattern shifted from miscellaneous manufactures (SITC 8) to machinery and transport equipment (SITC 7). The PRC has emerged as a major exporter of manufactured goods: from a relatively small share of 1% of the global total in 1980 to about

Figure 2: Indian Imports from the PRC by Category (%)



Notes: PRC = People's Republic of China; nes= not eleswhere specified
Source: Calculations based on UN COMTRADE Database, 2012.

11% in 2011. The import patterns of the PRC and India show machinery and transport equipment (SITC 7) to be prominent imported goods in both countries, accounting for approximately 40% of total PRC imports from 1980 to 2010, and roughly 20% for India over the same period.

India also reported an increase in manufactured exports' share of total exports between 1984 and 2004 from 55% to 62%, though unlike the PRC, this does not indicate a move toward more technologically sophisticated capital-intensive products. In addition, India's share of the global manufactured goods trade increased considerably less between 1980 and 2011: from 0.6% to only 1.6% (World Trade Organization 2012).

There are two basic reasons for the differences in the export patterns of these two countries over time. The first is the focus of the reforms each country has implemented. In the PRC, reforms have been initiated to take advantage of trade liberalization as part of its WTO commitments (Panagariya 2007). Second, while Indian reforms were industry-based, it focused more on economic reforms as opposed to manufacturing sector development. The reforms implemented in the 1980s reduced license controls in some industries and initiated exchange rate reforms (Panagariya 2004, Ahluwalia 2005). The 1990 reforms focused on domestic industrial policy, private investment in the industrial sector, trade and exchange regimes, and foreign investment regulations (Srinivasan and Tendulkar 2003). These actions improved the investment environment generally, but did not aim to take advantage of specific trade opportunities.

4. The PRC–India FTA and the Way Forward

Given India's growing bilateral trade with the PRC, the proposed PRC–India FTA can be used as a tool to address some of the issues discussed above that hold Indian industry back, including the lack of policy support and a poor business climate. There are two sectors in particular where FTA-based reforms can have an important impact on India's bilateral trade composition.

The pharmaceuticals sector is an important sector for consideration. A memo issued by the Government of India in 2011 highlighted trade barriers faced by Indian corporations. These include regulatory requirements around clinical trials and the process of registering new drugs, which can take up to 10 months in the PRC compared with only 90 days in India (Sharma 2012). These are issues that can be addressed bilaterally.

Similarly, in the information technology (IT) services sector, a 2011 memo issued by the Indian government highlighted improvements in trade with the PRC while also noting that barriers continued to exist. These include rigid certification requirements in bidding for government-sponsored IT projects (Sen 2012).

If India is to use this potential FTA as an opportunity to deepen its export basket, the time is now for India to review its trade structure and related policies. India needs to adopt a conscious policy of encouraging value-added exports, particularly to the PRC. As most of India's trade basket consists of raw materials and intermediate goods, India needs to promote high-end manufacturing, which requires concomitant economic reforms in labor markets and other domestic areas.

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