Tackling India’s Trade Deficit with China

Key Points

- India’s rising trade deficit with China is now close to US$40 billion and is likely to double to $60 billion in the next two years, leading to serious concerns over India’s ability to sustain it.

- The deficit is the result of China’s structural shift from a primary products base to a manufacturing regime.

- For the long-term benefit of the bilateral relationship, the trade imbalance must be addressed. This would include assessing India’s export opportunities and potential, addressing the non-tariff barriers that China imposes on Indian exports, encouraging foreign direct investment and addressing India’s structural challenges.

- Prime Minister Narendra Modi’s forthcoming visit to China this May will provide a useful opportunity to discuss this issue with President Xi Jinping.

Summary

India’s trade deficit with China amounted to US$37.8 billion in 2014, a year on year increase of 7.9% and is likely to double to $60 billion in the next two years. Since China has emerged as India’s largest trading partner and increased India’s dependence on its products, addressing the trade deficit is crucial to ensuring that the Sino-Indian relationship continues to prosper. A significant degree of planning and strategies that include such measures as advancing India’s domestic economy to make it competitive with Chinese imports, enabling
policies to enhance Indian exports to China and addressing the constraints and non-tariff barriers that China places on Indian imports, are required. Although there have been some efforts and discussions by Indian authorities on the issue, these have not provided positive results and India, consequently, has not been able to find a long-term solution to the problem. In this context, Prime Minister Narendra Modi’s agenda-based visit to China in May provides a major opportunity to recalibrate the imbalance.

Analysis

Overview of Trade between India and China

The growing economies of China and India have provided the impetus to their respective governments to reorient their trade policies. The trade-GDP ratio of China and India between 1990 and 2010 increased from 29 per cent to 56 per cent and 16 per cent to 47 per cent, respectively. The economic liberalisation of both countries and their subsequent policy reforms led to the development of infrastructure, competition, enhanced productivity and foreign investment, all of which boosted trade and investments in both countries.

Comparisons between India and China, however, show that China’s growth trajectory and volume of imports and exports has been much higher than India’s. Compared to India’s average growth rate of 13.5%, China’s global exports saw a compounded annual growth rate of 17.2% between 1990 and 2012. As China’s manufacturing sector developed, the volume of its exports compared to its imports rose accordingly. This influenced the bilateral trade between India and China, which grew from US$2.2 billion in 2000 to US$72.2 billion in 2011, making China India’s largest trading partner. There was a decline in bilateral trade in 2012, however, to US$66.7 billion and a further drop to US$65.9 billion in 2013, although China’s share of India’s total imports continued to increase. The difference between the countries can be explained to a large degree by their exports. While India’s exports to China are largely
primary products like cotton and mineral ore, China exports technologically-intensive manufactured products to India.¹

India is highly dependent on Chinese electrical machinery, electronics and organic chemicals and the relative significance of each of these products has increased over time. India’s imports of electrical machinery increased from 22 per cent in 2005 to 37 per cent in 2010, while its imports of electronics and organic chemicals increased from 14 per cent to 22 per cent and from 23 per cent to 30 per cent, respectively. The structural shift in China’s exports from primary products to machinery in 2006 was one of the major reasons for the rise in the deficit. In India’s perspective, these shifts can result in a further restriction of Indian export opportunities to China.

<table>
<thead>
<tr>
<th>Categories</th>
<th>6 Digit</th>
<th>Description</th>
<th>China’s import from World in 2012</th>
<th>India’s export to the World in 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Category I</td>
<td>240120</td>
<td>Tobacco, stemmed/stripped</td>
<td>1178.3</td>
<td>598.9</td>
</tr>
<tr>
<td></td>
<td>260111</td>
<td>Non-agglomerated</td>
<td>90393.7</td>
<td>2407.9</td>
</tr>
<tr>
<td></td>
<td>271000</td>
<td>Petroleum oils from minerals</td>
<td>3392.8</td>
<td>52763.9</td>
</tr>
<tr>
<td></td>
<td>520100</td>
<td>Cotton not carded or combed</td>
<td>11804.0</td>
<td>3647.1</td>
</tr>
<tr>
<td></td>
<td>100590</td>
<td>Other</td>
<td>1183.4</td>
<td>1117.3</td>
</tr>
<tr>
<td></td>
<td>170111</td>
<td>Cane sugar</td>
<td>2023.9</td>
<td>1008.7</td>
</tr>
<tr>
<td></td>
<td>260600</td>
<td>Aluminium ores and concentrates</td>
<td>1886.4</td>
<td>59.3</td>
</tr>
<tr>
<td></td>
<td>261400</td>
<td>Titanium ores and concentrates</td>
<td>1093.2</td>
<td>322.9</td>
</tr>
<tr>
<td></td>
<td>290224</td>
<td>p-Xylene</td>
<td>1052.8</td>
<td>313</td>
</tr>
<tr>
<td></td>
<td>290243</td>
<td>q-Xylene</td>
<td>9562.9</td>
<td>965.8</td>
</tr>
<tr>
<td></td>
<td>520512</td>
<td>Single yarn, of uncombed fibres</td>
<td>1870.0</td>
<td>294.5</td>
</tr>
<tr>
<td></td>
<td>902214</td>
<td>Apparatus on the use of X-rays</td>
<td>965.4</td>
<td>107.9</td>
</tr>
</tbody>
</table>


It is essential; therefore, that India assesses and expands its exports to China. It also needs to ensure that the barriers that China imposes on its exports are removed or reduced as much as possible and also that investments from China are encouraged in India.

Assessing India’s Export Potential in China

India maintained a good degree of export growth to China between 2004 and 2007, but the global recession adversely affected that trend, making India’s export growth almost negligible since September 2008. The slow-down, however, was recently reversed. Despite having tremendous potential for its exports in Chinese markets, India has not made full use of that opportunity. According to the Medium Term Export Strategy (MoC, 2002), a project of the Ministry of Commerce and Industry of the Government of India, there are twenty-five important export destinations to focus on in the medium term, with China being identified

as one of those.\(^2\) India’s exports to China could range from primary to technology-intensive products. According to a report from the Indian Institute of Foreign Trade (IIFT), there are 41 products including fish products, mineral fuels, pharmaceuticals and plastics, that China increasingly demands and which India can supply. India exports thirty of these products to destinations across the globe but not to China, an aberration that can easily be resolved.

On the basis of the comparative advantage values that measure the global competitiveness of the products, seven have been identified as export-competitive for India but are not exported to China.\(^3\) Of the 25 products identified under Category I of the HS-6 commodities, there are only three that China imports from various sources worldwide. India, once again, exports these same products to various destinations worldwide but not to China.

China imports only three Category II products from various sources, including India. While India’s share constitutes over five per cent of those imports, the potential remains for it to increase its share as the value of China’s demand for these products ranges between US$11 billion and US$90 billion. There are 19 products under category III that China imports, but the share of those products from India is less than five per cent, although New Delhi identifies the products as being export competitive. Essentially, India can further exploit Chinese demand for products in all three categories.

In 2012, India submitted a list of 916 goods that it believed China should purchase in larger quantities to China’s Secretary of Commerce during that year’s Joint Commission meeting on commerce and trade.\(^4\) Apart from pursuing that avenue, India also needs to examine and explore China’s pharmaceutical, services and parts and components sectors to find markets for its own manufactured goods and services. The demands of Chinese industry are one of the vital factors that will encourage exports of these products from India. Products that do not require intensive technology to manufacture, such as chemicals, plastics, base metals and agricultural goods, are likely to win significant market share. Apart from those, India is yet to export some of its globally-competitive products such as fruits and vegetables, automobiles, chemicals and processed foods that will be accepted by Chinese markets.\(^5\) India has a competitive advantage and potential in both currently and potentially traded sectors, but it needs to identify and assess its competitiveness with the right policies to expand its exports to China which could, in turn, reduce the trade imbalance.

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\(^3\) Raju, S., ‘Sustaining India – China Bilateral Trade’.


\(^5\) Raju et al, ‘Managing India’s Trade Deficit with Large Trading Partners: Lessons and Prospects’.
Addressing Market Accessibility

China’s tariffs regime is generally lower than India’s, and notably so for such products as mineral ores, plastics, man-made staple fibres and pharmaceuticals products. India is concerned, however, by non-tariff barriers and informal restrictions such as customs, standards and quantitative restrictions that make Chinese markets difficult to access. For example, India is very strong in three key sectors – pharmaceuticals, agriculture and IT services – but Chinese regulations impose restrictions that stifle the provision of Indian goods and services. India has, to use one example, signed several memoranda of understanding with China to export buffalo meat. This, however, requires lengthy sanitary and phyto-sanitary clearance and has to undergo certification procedures. As a result, the meat finds its way into China through Vietnam. On the other hand, India’s IT services industry suffers from artificial barriers such as the inability of its service providers to bid for Chinese tenders that exceed US$100 million. Pharmaceutical exports are similarly hindered by the non-trade barriers that China imposes, despite (or perhaps because of) India’s ability to provide cheaper products to the Chinese market. In contrast, India imports 70 per cent of its active pharmaceutical ingredients from China. These barriers limit Indian exports and account for the trade imbalance to a large extent. According to the IIFT report, if India could capture ten per cent of the Chinese market, the spill-over effects in terms of specialisation and economies of scale would result in the faster growth and development of Indian exports to China, especially in pharmaceuticals and medical instruments.

A closer dialogue is essential between officials and leaders of both countries. In this context, Mr Modi’s visit to China, during which he is likely to raise the issues of trade barriers and market accessibility with President Xi, becomes very important.

Encourage Chinese Foreign Direct Investment in India

Another way to overcome the trade deficit is for India to attract large sums of Foreign Direct Investment (FDI) from China. Although trade has grown dramatically between them, Chinese investment in India has been relatively low. The total cumulative FDI inflows from April 2000 to February 2014 amounted to US$321.81 billion. The metallurgical sector received 34 per cent of the total, followed by the automobile industry (25 per cent), industrial machinery (seven per cent), the services sector (six per cent) and power generation (four per cent). China has made significant promises in this regard since Mr Modi came to power in 2014. President Xi, during his last visit to New Delhi in 2014, announced that China would invest US$70 billion in building two industrial parks in Gujarat and Maharashtra and also outlined a five year plan to enhance trade and economic development and investment co-operation. China also promised its support to establish India’s first railway university. India also seeks major investment from China to modernise its railways. As the two leaders have set an ambitious bilateral trade target of US$100 billion to be achieved by 2015, further talks in these areas are expected when they meet in May. Though most of these new investments from China have long gestation periods, they will boost India’s infrastructure. India requires immediate investment in its manufacturing sector to improve output and employment opportunities and resolve supply-side issues if it is to address the trade deficit. Given the vast numbers of low-skilled workers that India produces every year, suitable jobs need to be
created, preferably in the manufacturing sector, which will need to be expanded accordingly. In short, export-oriented FDI has the potential to turn India into a major industrial economy and will significantly aid it in addressing its trade deficit.

**Addressing India’s Structural Issues**

India has its own set of structural issues that need to be addressed to solve the trade deficit. China, following its reforms in 1979, encouraged exports to boost its economy, which has often resulted in a large number of products being dumped in markets like India. Since 1992, there have been 159 anti-dumping charges brought against China by India across broad sectors including steel, pharmaceuticals and consumer goods, to protect Indian manufacturers. This policy, however, has resulted in a further increase of the deficit. A cumbersome business environment and bottlenecks in infrastructure, labour laws and poor environmental standards have, furthermore, discouraged foreign investment and consequently affected the growth of the manufacturing sector in India. The security review process, complicated land acquisition procedures and administrative inefficiencies are other issues that Chinese investors face in trying to invest in India. Various Indian governments have not been able to make the best use of India’s comparative advantages with China in order to tap into the under-exploited Chinese market. Fiscal issues and retarded growth, moreover, pose more problems for potential investors. India needs to solve these internal structural issues if it is to attract greater investment from abroad.

**Conclusion**

Mr Modi will have a huge opportunity to discuss these issues with President Xi in May. Although border issues between the two countries have often dominated the relationship, one cannot overlook the trade deficit which, if not addressed, will increase to US$60 billion in the next two years, hampering Mr Modi’s “Make in India” and “Smart City” initiatives. While India has huge trade potential with China and can gain a lot from export diversification to China, it needs to eliminate its trade gap with that country. Expanding its manufacturing sector, therefore, becomes a priority.

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