

# [The 1980s, the focus shifted gradually to](https://assignbuster.com/the-1980s-the-focus-shifted-gradually-to/)

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Thelegacy of relations between India and China began to change in the 1980s, withthe opening of both economies.

As long as their relationship was seen through ageopolitical prism, it was easy for both countries to view it as a zero-sumgame. With the shift in both countries from an import substitution to an exportpromotion strategy during the 1980s, the focus shifted gradually to economics. With the acceleration of globalization during the 1990s, the imperatives ofglobal interdependence and an appreciation of the possibilities of mutual gainhave also increased. This is particularly so in China, whose share of worldtrade is now about eight times that of India; they have similar shares offoreign direct investment (FDI) and capital flows.

Starting in 2000 thesedevelopments led to the establishment of an India-China Joint Study Group (JSG)on accelerating bilateral economic cooperation, of which I was a member asDirector and Chief Executive of the Indian Council for Research onInternational Economic Relations (ICRIER). ICRIER also did a number ofbackground studies for JSG, covering goods and services. After the presentationof this report to the two governments, the two countries formed an agreementfor economic cooperation when Premier Wen Jiabao visited India in April 2005. However, the following discussion has nothing to do with that group or thegovernment; these are my personal views India-ChinaTrade In 2004, India was among China’s top 20 trading partners, fifteenth inimports, and eighteenth in exports. China was a much more important tradepartner for India in 2004, ranking in the top five, second in imports, andthird in exports. The details of India’s trade with China, from India’sperspective, are shown in Table 13. 1. Trends in the export, import, and tradeshares are depicted in Figure 13.

1. China’s shares in India’s overall importsand exports have been rising rapidly over the past six years. It is interestingto note that the gap that opened up between the import share and the export sharein the middle of the period has now closed.

Figure 13. 2 gives the rate ofgrowth of trade as well as the growth of China’s share in India’s internationaltrade from 1997–98 to 2004–05. The main point is that normally we look at thegrowth of trade, which for India is somewhat faster than the rise in the tradeshare of China. That is because India’s trade has been growing quickly overthis period. But still the trade share has been rising and accelerating overthis period at 3.

4 percent per annum, as you can see from the bottom line inthe figure. Figure 13. 3 depicts the volatility of exports and imports alongwith the rate of growth of total trade. The figure shows that there is muchless variability in India’s imports from China than in India’s exports to China. There is much more fluctuation in the rate of growth of the export trade.

Theprecise degree of volatility is shown in the second column of Table 1, whichshows that the coefficient of variation of the export growth rate is doublethat of the import growth rate. More precisely, the coefficient of variation ofexports is 1. 2 and that for imports is 0. 6. This can bring up a number ofhypotheses. One is that India’s imports are driven by normal marketconsiderations. In contrast, there is much more implicit or explicit governmentintervention in China’s imports from India; there is an element of governmentsignaling to the socialist/public sector part of the economy.

These signalshave apparently turned positive over the past few years. This is probably alsothe reason for the closing of the gap between the import and export shares thathad opened up in the middle of the period (Figure 13. 1). So perhaps thepositive signals from the Chinese government have been partly responsible forthis growth in trade. TABLEFROM ABOVE ARTICLE Thecommodity composition of trade in Table 13.

2 lists India’s top 10 exports toChina and top 10 imports from China. Similarly, Figure 13. 4 depicts theconcentration ratio for exports and imports at the two-digit level by orderingthem from those with the highest to the lowest share and then cumulating theshare.

So, on the horizontal scale, if we look at the number five and track itto the graph, we get the five-product concentration ratio at the two-digitlevel. The bottom line in Figure 13. 4 shows the concentration with respect toimports. The concentration is very high: the top five commodities account foralmost 70 percent of India’s imports from China. The concentration in India’sexports to China is even higher.

The top five exports account for more than 80percent of the exports from India to China. Now we return to Table 13. 2 to seethe list of commodities. The top export from India to China is the two-digitcategory “ ores, slag, and ash” (26) with 52 percent of total export value. Thecategory of salt, sulfur, lime, and cement (25) has another 2. 6 percent ofexport value.

So there is a very high concentration of basic raw materialexports. TABLEFROM ABOVE ARTICLEChina’sShare in India’s Total Trade (In percent) Source: www. dgft. delhi. nic. in, Department of Commerce. Trade Export Import 274 INDIA-CHINA ECONOMICCOOPERATION It seems that this has a more general implication beyond India.

China is now drawing many raw materials from all over the world—from LatinAmerica, Africa, and Asia. Thailand, for example, is a raw materials exporterto China. Indonesia, another raw materials exporter, has seen a surge inexports to China.

I think this is going to be a factor around the world. Atheory that was very prominent in Latin American economist literatureenvisioned countries in the “ center” as an exporter of industrial goods and theperiphery as an exporter of raw materials. I think some element of thatarrangement is emerging with respect to China and other developing countries. The second noteworthy point is with respect to intermediate goods. Thenext-largest exports from India to China are iron and steel, followed byplastics.

There are a number of undifferentiated products, and this, again, hascertain implications for India and for other countries. That is, intermediategoods industries are subject to much cyclical fluctuation. In recent years, thefluctuation has been driven by very high aggregate investment rates in theseproducts. High aggregate investment creates a   Figure 13.

2. TABLE FROM ABOVE ARTICLEdemandfor these commodities, which results in a jump in investment in theseindustries, so the supply rises eventually. Thus, temporary imbalances lead tohigher imports, but these are eliminated by higher supply, and could even befollowed by exports of the same intermediate goods. Figure 13. 3TABLE FROM ABOVE ARTICLEOvertime, perhaps during the next 10 years, all countries, including India, mayface this fluctuation in intermediate goods trade with China. That is, the netdemand for these undifferentiated, intermediate products will sometimes beconverted to net excess supply turning to net exports. Future Potential Beforeexamining the future potential of India-China trade, it is useful to take stockof the existing position from another perspective.

China’s trade with India isless than 1. 5 percent of its trade with the world, whereas India’s trade withChina is over 6 percent of its total trade. Consequently, India’s exports toChina constitute 6. 6 percent of its total exports, whereas they make up only1.

4 percent of China’s imports. China’s exports to India account for 1 percentof its total exports, but constitute 6. 2 percent of India’s imports. This issimply a reflection of each country’s share of world trade, with India’s beingabout 0. 8 percent and China’s about 6. 4 percent.

Figure 13. 4. TABLEFROM ABOVE ARTICLE Thebilateral trade potential is very high, given the size and economic dynamism ofthe two economies. Since 1980, China’s average growth rate has been thehighest, whereas India’s has been the eighth or ninth highest. They are amongthe 10 largest economies in terms of current exchange rates and among the fivelargest in terms of purchasing power parity. They are also neighbors sharing along border, although this border consists of the highest mountain range in theworld; and the sea route between the two countries is long.

Both countries aresignatories of the Bangkok Agreement and already participate in the Asiancurrency union mechanisms. More formally, Dr. Amita Batra at ICRIER has builtan augmented gravity model that provides quantitative estimates of the gapbetween actual trade and trade potential between India and other countries. Itfinds that the potential for trade between India and China is between two and ahalf times and six times the actual trade in the year for which the model wasestimated. The data used were for the year 2002. Some of this potential hasalready been actualized in the subsequent three years to 2005 and is in theprocess of being realized more fully.

There are also a few other relatedstudies by Batra that have been published as ICRIER working papers and areavailable on the ICRIER website (www. icrier. org). These papers, as well as ouranalysis for the India-China study group, show the scope for intra-industrytrade. Both countries are highly diversified economies with very diversifiedmanufacturing structures. Thus, there is considerable scope for intra-industrytrade in intermediate manufactured goods. The share of private consumption inIndia’s GDP is relatively high compared with other emerging economies, whereasthat of China is perhaps the lowest in the world. As consumer goods grow inimportance, there will also be increasing scope for intra-industry trade indifferentiated products and intermediate goods specialization.

There areidentifiable differences in export specialization in the two countries, basedon natural resource endowments, skills, and policy. The most interesting andimportant resource-based difference is in textiles. Given the abundance ofcotton in India, India’s exports are heavily concentrated in cotton textilesand garments, whereas China has a commanding position in textiles and garmentsbased on man-made fibers. An ICRIER study some years ago showed that the twocountries’ exports were largely noncompeting because of this. Among the reasonsfor this divergence in skill development were a highly rigid labor policy fororganized industry, small-scale industry reservations, and exorbitant indirect(excise) taxes on man-made fibers in India.

One of the indirect consequences ofthe rigid labor policy has been a greater use of educated labor and highervalue-added niche products in India. There are also differences in skills, because of either cultural or historical development. In the case of generalskills, India has a comparative advantage in the English language and indealing with multiethnic, multireligious workforces. These strengths couldenable a clear advantage in industries such as advertising and entertainment. China has developed a lasting advantage in labor-intensive mass manufacturing, based on the virtual absence of labor laws for the FDI export sectors, thesingle-party system of government, and the organization and management of thesocialist investment system. There are also differences in sector-specificskills.

India has developed, over the past half century or more, skills inengineering/automobiles, specialty chemicals, and pharmaceuticals. China, bycontrast, has developed over the past 25 years skills in consumer electronics, telecommunications, and other consumer durables. On the other hand, China andIndia are similar in that the labor force in each country has strong math andscience skills. The ICRIER studies also identified at the two-digit andsix-digit levels a list of commodities with the greatest export potential fromIndia to China and vice versa. Among the former are agriculture and alliedproducts, iron and steel and articles thereof, nuclear reactors, boilers andmachinery, man-made steel fibers and man-made filament yarns, organicchemicals, and cotton. Among the categories that have potential for exportsfrom China to India are nuclear reactors, boilers and machinery, organicchemicals, silk, and electrical and electronic equipment. Nuclear reactors andboilers and machinery appear in both lists and indicate the potential forintra-industry trade.

Barriers and Constraints To realize the full potential ofIndia-China trade, remaining barriers and constraints have to be relaxed. Theseinclude customs rules and procedures, standards, certification and regulatorypractices, nontariff barriers, and rules of origin. Some of the problems thathave arisen with respect to customs valuation are (1) the use of a minimumreference price instead of the World Trade Organization–sanctioned transactioncost method; (2) a variation of customs valuation across ports, resulting inadditional costs to exporters; and (3) a lack of clarity in guidelines andprocedures relating to imports for exporters. Though some of these things applyto all trade, there are some changes that may be more acute in a bilateralcontext that would lead to an increase in India-China trade. Thus there is aneed to evolve a mutual consensus on customs valuation, clarify guidelines, facilitate uniform documentation across ports, and increase the efficiency ofhandling at ports and customs. An existing mechanism, the India-China CustomsCooperative Group, can be used for this purpose. To illustrate, variationacross ports creates special problems for small exporters.

For a largeexporter, like the United States to China, these problems are minor; but if youhave many small exporters, as we have in India-China trade, these variationscreate additional costs for both sides. Similarly, there are problems relatedto imports for exporters. This may be very simple for, as an example, tradersin Taiwan Province of China or Hong Kong SAR, but not for those in India.

Weneed more clarity and guidelines. Also, there are certain problems related tostandards, certification, regulatory practices, rules, and regulations in termsof national treatment and accessibility. The Chinese language poses a problemfor Indian traders, because most Indian trade is in English. It is difficultfor them to keep up with the Chinese regulations. This situation creates anextra problem for Indian traders that could be easily remedied if the rules andregulations were published and updated regularly, preferably in English, thelanguage of international commerce. The certification process, including withrespect to sanitary and phytosanitary standards (SPS), also involves delays andhigh costs. SPS requirements generally exceed what is necessary to protectconsumer health.

India has a great interest in certain agriculturalcommodities, the standards for which need clarification. Certain otherstandards related to commodities such as granite are not available. Harmonization of technical and agricultural standards would greatly facilitateIndia-China trade.

Certain nontariff barriers (NTBs) are also hindering thegrowth of trade between the two countries. There are problems related to tariffquotas, preshipment inspection, and definitions of rules of origin. Forexample, there are NTBs on automotive parts and components, and a tariff-quotaon agricultural products. These barriers need to be eliminated. A preshipmentinspection agreement between the two countries could help reduce NTBs andrelated barriers. Problems relating to rules of origin can be sorted out byagreeing on clear definitions. This in turn could result in smoother movementof goods between the two countries.

Removal of these constraints and barriersin a spirit of cooperation and mutual accommodation will set the stage for aquantum jump in economic cooperation between the two countries. Next StepsGoing forward, from a global perspective, everybody knows that China has beenthe fastest-growing economy, averaging 9. 5 percent for the past 25 years, butnot many people know that India has been the eighth- or ninth-fastest-growingeconomy over the past 25 years. This is because many people think that India’sreforms started in 19