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India-China Economic Cooperation

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The legacy of relations between India and China began to change in the 1980s, with the opening of both economies. As long as their relationship was seen through a geopolitical prism, it was easy for both countries to view it as a zero-sum game. With the shift in both countries from an import substitution to an export promotion strategy during the 1980s, the focus shifted gradually to economics. With the acceleration of globalization during the 1990s, the imperatives of global interdependence and an appreciation of the possibilities of mutual gain have also increased. This is particularly so in China, whose share of world trade is now about eight times that of India; they have similar shares of foreign direct investment (FDI) and capital flows. Starting in 2000 these developments led to the establishment of an India-China Joint Study Group (JSG) on accelerating bilateral economic cooperation, of which I was a member as Director and Chief Executive of the Indian Council for Research on International Economic Relations (ICRIER). ICRIER also did a number of background studies for JSG, covering goods and services. After the presentation of this report to the two governments, the two countries formed an agreement for economic cooperation when Premier Wen Jiabao visited India in April 2005. However, the following discussion has nothing to do with that group or the government; these are my personal views.

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I will first review the trade between the two countries and then briefly mention issues connected with comprehensive economic cooperation and a multilateral context.

India-China Trade

In 2004, India was among China's top 20 trading partners, fifteenth in imports, and eighteenth in exports. China was a much more important trade partner for India in 2004, ranking in the top five, second in imports, and third in exports. The details of India's trade with China, from India's perspective, are shown in Table 13.1.

Trends in the export, import, and trade shares are depicted in Figure 13.1. China's shares in India's overall imports and exports have been rising rapidly over the past six years. It is interesting to note that the gap that opened up between the import share and the export share in the middle of the period has now closed.

Figure 13.2 gives the rate of growth of trade as well as the growth of China's share in India's international trade from 1997–98 to 2004–05. The main point is that normally we look at the growth of trade, which for India is somewhat faster than the rise in the trade share of China. That is because India's trade has been growing quickly over this period. But still the trade share has been rising and accelerating over this period at 3.4 percent per annum, as you can see from the bottom line in the figure.

Figure 13.3 depicts the volatility of exports and imports along with the rate of growth of total trade. The figure shows that there is much less 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. The precise degree of volatility is shown in the second column of Table 1, which shows that the coefficient of variation of the export growth rate is double that of the import growth rate.

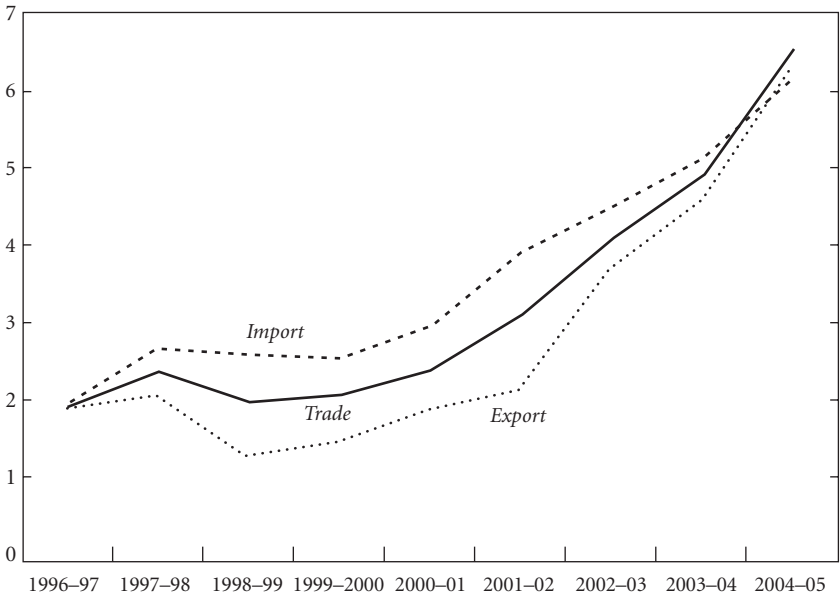
More precisely, the coefficient of variation of exports is 1.2 and that for imports is 0.6. This can bring up a number of hypotheses. One is that India's imports are driven by normal market considerations. In contrast, there is much more implicit or explicit government intervention in China's imports from India; there is an element of government signaling to the socialist/public sector part of the economy. These signals have apparently turned positive over the past few years. This is probably also the reason for the closing of the gap between the import and export shares that had opened up in the middle of the period (Figure 13.1). So perhaps the positive signals from the Chinese government have been partly responsible for this growth in trade.

Table 13.1. India's Trade with China

Year	Mean	CV	1996–97	1997–98	1998–99	1999–2000	2000–01	2001–02	2002–03	2003–04	2004–05
Trade (US\$ billion)											
Exports to China			0.6	0.7	0.4	0.5	0.8	1.0	2.0	3.0	5.3
Imports from China			0.8	1.1	1.1	1.3	1.5	2.0	2.8	4.1	6.8
Trade with China			1.4	1.8	1.5	1.8	2.3	3.0	4.8	7.0	12.1
Trade balance	–0.8	–0.5	–0.1	–0.4	–0.7	–0.7	–0.7	–1.1	–0.8	–1.1	–1.4
(percent of trade)	–25%	–0.5	–10%	–22%	–44%	–41%	–29%	–36%	–17%	–16%	–12%
Growth rate											
Export	39%	1.2		17%	–41%	26%	54%	15%	108%	50%	81%
Import	33%	0.6		47%	–1%	17%	17%	36%	37%	45%	67%
Trade	34%	0.8		33%	–17%	20%	28%	28%	60%	47%	73%
Trade share	18%	0.9		27%	–16%	4%	17%	28%	33%	18%	29%
Share in all/total											
Export	2.9%	0.6	1.8%	2.1%	1.3%	1.5%	1.9%	2.2%	3.7%	4.6%	6.6%
Import	3.6%	0.4	1.9%	2.7%	2.6%	2.6%	3.0%	4.0%	4.5%	5.2%	6.2%
Trade	3.3%	0.5	1.9%	2.4%	2.0%	2.1%	2.5%	3.1%	4.2%	4.9%	6.4%

Source: www.dgt.delhi.nic.in, Department of Commerce.

Figure 13.1. China's Share in India's Total Trade
(In percent)

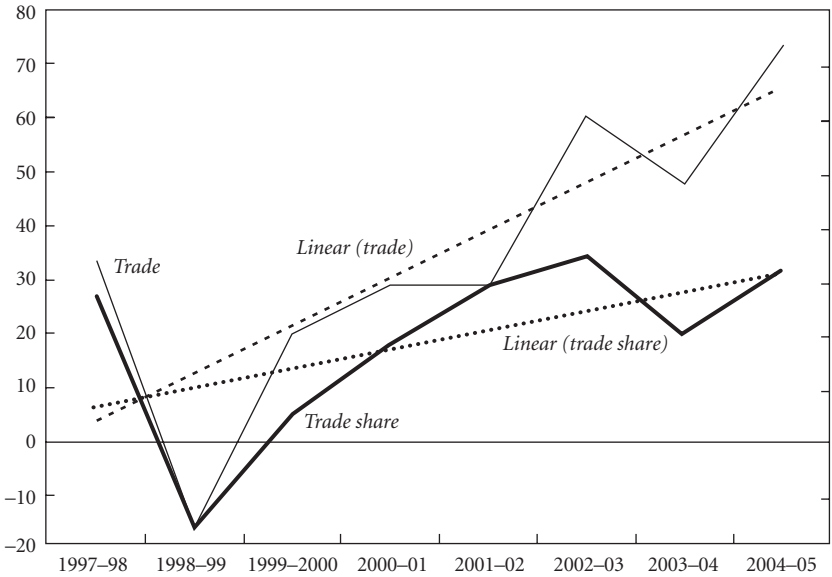


Source: www.dgft.delhi.nic.in, Department of Commerce.

The commodity composition of trade in Table 13.2 lists India's top 10 exports to China and top 10 imports from China. Similarly, Figure 13.4 depicts the concentration ratio for exports and imports at the two-digit level by ordering them from those with the highest to the lowest share and then cumulating the share. So, on the horizontal scale, if we look at the number five and track it to the graph, we get the five-product concentration ratio at the two-digit level.

The bottom line in Figure 13.4 shows the concentration with respect to imports. The concentration is very high: the top five commodities account for almost 70 percent of India's imports from China. The concentration in India's exports to China is even higher. The top five exports account for more than 80 percent of the exports from India to China. Now we return to Table 13.2 to see the list of commodities. The top export from India to China is the two-digit category "ores, slag, and ash" (26) with 52 percent of total export value. The category of salt, sulfur, lime, and cement (25) has another 2.6 percent of export value. So there is a very high concentration of basic raw material exports.

Figure 13.2. Growth Rate of India's Trade in China
(In percent)

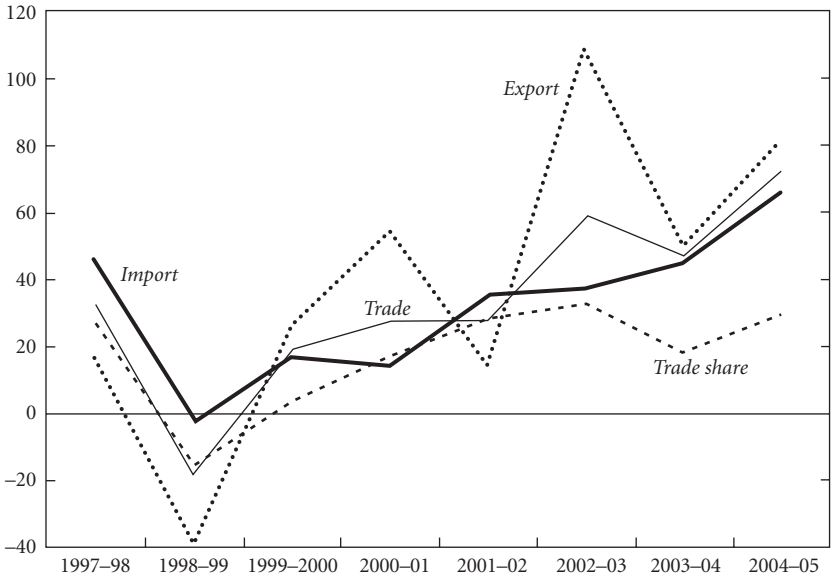


Source: www.dgft.delhi.nic.in, Department of Commerce.

It seems that this has a more general implication beyond India. China is now drawing many raw materials from all over the world—from Latin America, Africa, and Asia. Thailand, for example, is a raw materials exporter to China. Indonesia, another raw materials exporter, has seen a surge in exports to China. I think this is going to be a factor around the world. A theory that was very prominent in Latin American economist literature envisioned countries in the “center” as an exporter of industrial goods and the periphery as an exporter of raw materials. I think some element of that arrangement is emerging with respect to China and other developing countries.

The second noteworthy point is with respect to intermediate goods. The next-largest exports from India to China are iron and steel, followed by plastics. There are a number of undifferentiated products, and this, again, has certain implications for India and for other countries. That is, intermediate goods industries are subject to much cyclical fluctuation. In recent years, the fluctuation has been driven by very high aggregate investment rates in these products. High aggregate investment creates a

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(In percent)



Source: www.dgft.delhi.nic.in, Department of Commerce.

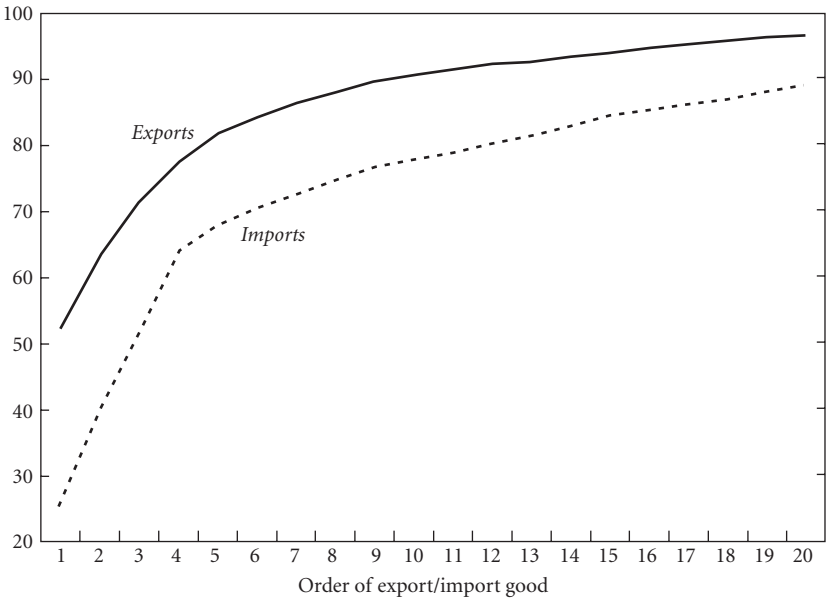
demand for these commodities, which results in a jump in investment in these industries, so the supply rises eventually. Thus, temporary imbalances lead to higher imports, but these are eliminated by higher supply, and could even be followed by exports of the same intermediate goods.

Table 13.2. Composition of India-China Trade

India's Top 10 Exports to China			India's Top 10 Imports from China		
HS	Commodity	Share	HS	Commodity	Share
26	Ores, slag, ash	52.1%	85	Electrical machinery and parts	25.6%
72	Iron and steel	11.5%	84	Nuclear reactors, boilers, machinery	14.8%
39	Plastic and articles	7.4%	27	Mineral fuels, oils, and waxes	12.0%
29	Organic chemicals	6.5%	29	Organic chemicals	11.7%
28	Inorganic chemicals, compounds	3.9%	50	Silk	4.3%
25	Salt, sulphur, lime, cement, etc.	2.6%	71	Pearls, stones, jewelery	2.2%
3	Fish and aquatic invertebrates	1.9%	28	Inorganic chemicals, compounds	2.1%
84	Nuclear reactors, boilers, machinery	1.8%	72	Iron and steel	1.8%
52	Cotton	1.5%	59	Textile fabrics, industrial textiles	1.5%
74	Copper and articles	1.2%	54	Man-made filaments	1.5%

Source: www.dgft.delhi.nic.in, Department of Commerce.

Figure 13.4. India's Import and Export Concentration of Trade with China
(Cumulative share, in percent)



Source: www.dgft.delhi.nic.in, Department of Commerce.

Note: Sorted on year 2004–05.

Over time, perhaps during the next 10 years, all countries, including India, may face this fluctuation in intermediate goods trade with China. That is, the net demand for these undifferentiated, intermediate products will sometimes be converted to net excess supply turning to net exports.

Future Potential

Before examining the future potential of India-China trade, it is useful to take stock of the existing position from another perspective. China's trade with India is less than 1.5 percent of its trade with the world, whereas India's trade with China is over 6 percent of its total trade. Consequently, India's exports to China constitute 6.6 percent of its total exports, whereas they make up only 1.4 percent of China's imports. China's exports to India account for 1 percent of its total exports, but constitute 6.2 percent of India's imports. This is simply a reflection of each country's share of world trade, with India's being about 0.8 percent and China's about 6.4 percent.

The bilateral trade potential is very high, given the size and economic dynamism of the two economies. Since 1980, China's average growth rate has been the highest, whereas India's has been the eighth or ninth highest. They are among the 10 largest economies in terms of current exchange rates and among the five largest in terms of purchasing power parity. They are also neighbors sharing a long border, although this border consists of the highest mountain range in the world; and the sea route between the two countries is long. Both countries are signatories of the Bangkok Agreement and already participate in the Asian currency union mechanisms.

More formally, Dr. Amita Batra at ICRIER has built an augmented gravity model that provides quantitative estimates of the gap between actual trade and trade potential between India and other countries. It finds that the potential for trade between India and China is between two and a half times and six times the actual trade in the year for which the model was estimated. The data used were for the year 2002. Some of this potential has already been actualized in the subsequent three years to 2005 and is in the process of being realized more fully.

There are also a few other related studies by Batra that have been published as ICRIER working papers and are available on the ICRIER website (www.icrier.org). These papers, as well as our analysis for the India-China study group, show the scope for intra-industry trade. Both countries are highly diversified economies with very diversified manufacturing structures. Thus, there is considerable scope for intra-industry trade in intermediate manufactured goods. The share of private consumption in India's GDP is relatively high compared with other emerging economies, whereas that of China is perhaps the lowest in the world. As consumer goods grow in importance, there will also be increasing scope for intra-industry trade in differentiated products and intermediate goods specialization.

There are identifiable differences in export specialization in the two countries, based on natural resource endowments, skills, and policy. The most interesting and important resource-based difference is in textiles. Given the abundance of cotton in India, India's exports are heavily concentrated in cotton textiles and garments, whereas China has a commanding position in textiles and garments based on man-made fibers. An ICRIER study some years ago showed that the two countries' exports were largely noncompeting because of this. Among the reasons for this divergence in skill development were a highly rigid labor policy for organized industry, small-scale industry reservations, and exorbitant indirect (excise) taxes on man-made fibers in India. One of the indirect consequences of the rigid labor policy has been a greater use of educated labor and higher value-added niche products in India.

There are also differences in skills, because of either cultural or historical development. In the case of general skills, India has a comparative advantage in the English language and in dealing with multiethnic, multireligious workforces. These strengths could enable 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, the single-party system of government, and the organization and management of the socialist investment system. There are also differences in sector-specific skills. India has developed, over the past half century or more, skills in engineering/automobiles, specialty chemicals, and pharmaceuticals. China, by contrast, has developed over the past 25 years skills in consumer electronics, telecommunications, and other consumer durables. On the other hand, China and India are similar in that the labor force in each country has strong math and science skills.

The ICRIER studies also identified at the two-digit and six-digit levels a list of commodities with the greatest export potential from India to China and vice versa. Among the former are agriculture and allied products, iron and steel and articles thereof, nuclear reactors, boilers and machinery, man-made steel fibers and man-made filament yarns, organic chemicals, and cotton. Among the categories that have potential for exports from China to India are nuclear reactors, boilers and machinery, organic chemicals, silk, and electrical and electronic equipment. Nuclear reactors and boilers and machinery appear in both lists and indicate the potential for intra-industry trade.

Barriers and Constraints

To realize the full potential of India-China trade, remaining barriers and constraints have to be relaxed. These include customs rules and procedures, standards, certification and regulatory practices, nontariff barriers, and rules of origin.

Some of the problems that have arisen with respect to customs valuation are (1) the use of a minimum reference price instead of the World Trade Organization-sanctioned transaction cost method; (2) a variation of customs valuation across ports, resulting in additional costs to exporters; and (3) a lack of clarity in guidelines and procedures relating to imports for exporters. Though some of these things apply to all trade, there are some changes that may be more acute in a bilateral context that would lead to an increase in India-China trade. Thus there

is a need to evolve a mutual consensus on customs valuation, clarify guidelines, facilitate uniform documentation across ports, and increase the efficiency of handling at ports and customs. An existing mechanism, the India-China Customs Cooperative Group, can be used for this purpose.

To illustrate, variation across ports creates special problems for small exporters. For a large exporter, like the United States to China, these problems are minor; but if you have many small exporters, as we have in India-China trade, these variations create additional costs for both sides. Similarly, there are problems related to imports for exporters. This may be very simple for, as an example, traders in Taiwan Province of China or Hong Kong SAR, but not for those in India. We need more clarity and guidelines.

Also, there are certain problems related to standards, certification, regulatory practices, rules, and regulations in terms of national treatment and accessibility. The Chinese language poses a problem for Indian traders, because most Indian trade is in English. It is difficult for them to keep up with the Chinese regulations. This situation creates an extra problem for Indian traders that could be easily remedied if the rules and regulations were published and updated regularly, preferably in English, the language of international commerce.

The certification process, including with respect to sanitary and phytosanitary standards (SPS), also involves delays and high costs. SPS requirements generally exceed what is necessary to protect consumer health. India has a great interest in certain agricultural commodities, the standards for which need clarification. Certain other standards related to commodities such as granite are not available. Harmonization of technical and agricultural standards would greatly facilitate India-China trade.

Certain nontariff barriers (NTBs) are also hindering the growth of trade between the two countries. There are problems related to tariff quotas, preshipment inspection, and definitions of rules of origin. For example, there are NTBs on automotive parts and components, and a tariff-quota on agricultural products. These barriers need to be eliminated. A preshipment inspection agreement between the two countries could help reduce NTBs and related barriers. Problems relating to rules of origin can be sorted out by agreeing on clear definitions. This in turn could result in smoother movement of goods between the two countries.

Removal of these constraints and barriers in a spirit of cooperation and mutual accommodation will set the stage for a quantum jump in economic cooperation between the two countries.

Next Steps

Going forward, from a global perspective, everybody knows that China has been the fastest-growing economy, averaging 9.5 percent for the past 25 years, but not many people know that India has been the eighth- or ninth-fastest-growing economy over the past 25 years. This is because many people think that India's reforms started in 1992 and that India has been lagging by about a decade. The fact is that India's reforms started around the same time as China's (1980), but its average growth rate has been slower (Virmani, 2005). The East and Southeast Asian economies that have grown faster than India during the past 25 years are likely to slow during the next decade. India, in contrast, has been on a rising growth rate trend since the reforms of the 1990s. It is therefore likely to be among the five fastest-growing economies (if not among the top three) along with China. It will become one of the primary global growth drivers by the end of the decade along with China. By 2010, it is likely to be the fourth-highest contributor to world GDP growth after the United States, China, and Japan. The possibilities for trade and economic cooperation between China and India will therefore continue to expand.

Once the identified barriers are removed (hopefully in a year or two), we should be in a position to start discussing a comprehensive economic cooperation agreement. Given the high reinvestment, "vent for surplus" approach of the socialist-owned part of China's economy, a free trade agreement is likely to benefit China more than India. So there has to be a trade-off. I think both sides need to recognize that you cannot have these special agreements unless both sides can balance the gains and losses. There are already some special losses to certain manufacturing sectors such as toys. However, India expects some gains in the services sector. The agreement has to be a comprehensive one that includes trade in both goods and services.

Another area of economic cooperation that is very important for the future of Asia is that Indian and Chinese economic cooperation be embedded in an Asian context. India and China have either framework agreements or ongoing discussions for a Free Trade Agreement/Common Economic Partnership Agreement with the Association of Southeast Asian Nations (ASEAN), Japan, and Korea. We have to harmonize these by developing an East Asian community in which ASEAN, China, Japan, and India are equal partners. In December 2005, there was a meeting of the East Asian Economic Community, in which both India and China were involved. China's attitude toward Indian inclusion will be closely watched by people in India and Asia as an example of its general approach to hegemonic competition versus mutually beneficial cooperation.

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