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TRADE AND INVESTMENT

UKaid
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Managing India's Trade Deficit with Large Trading Partners: Lessons and Prospects

- *India has been running high trade and current account deficit since early 1980s*
- *Current account deficit is unsustainable and requires effective management.*
- *India has high trade deficit with China, South Korea and Indonesia*
- *High trade deficit leads to higher interest rate, inflation, debt and lower economic growth (IMF, 2002)*

India's trade deficit increased from $161 billion in 2011 to $192 billion in 2012 but declined to $153 billion 2013.

Import management, export incentives, introduction of GST, bi-lateral agreements with concerned countries. building up domestic capacity and domestic standards will increase export and reduce trade deficit.

Is trade deficit bad?

If in a country like India growing fast, the demand for raw material and intermediate goods is high it can cause high trade deficit. However, if trade deficit becomes chronic structural, financing become difficult making them unsustainable after a point in time.

High Trade deficit: the negative Impacts

High Trade deficit leads to higher currency volatility, high interest rate, and higher debt accumulation. High interest rate reduces investment and thereby economic growth

Why Study on China, South Korea and Indonesia

China, South Korea and Indonesia are India's major trading partners in Asia with whom India is facing a high non-oil trade deficit.

Targeting trade deficit with above three countries would reduce India's trade deficit by $45 billion.

India's Trade Deficit: Some Facts

India's trade deficit increased from 43 billion in 2005 to 192 billion in 2012. However, it has declined to 153 billion in 2013.

Trade deficit as ratio of GDP increased from 5.2 per cent in 2005 to above 10 per cent in 2012 and declined to 8.2 per cent in 2013.

Current Account deficit as ratio of GDP increased from 1.2 per cent in 2005 to 4.9 per cent in 2012 and declined to 2.6 per cent in 2013.

Cause of rise in Trade Deficit: The recent rise in trade deficit is due to slowdown in export growth due to moderate demand from western countries and increase in gold imports. Weak manufacturing sector is the another reason for low exports.

Direction of Trade

India has a relatively balanced trade with European Union (EU) and favourable trade with the US. However, India has been running high trade deficits with oil producing countries and other countries such as China, Switzerland, Japan, South Korea, Taiwan, and Indonesia.

During 2007 and 2013, the negative trade balance has increased for these countries, the highest being in China followed by Korea, Indonesia, Japan and Malaysia. Dumping is also an issue with both China and Indonesia.

China as trading partner: China is India's largest trading partner with total trade amounts to $68 billion in 2013. Indian exports to China last year totalled $17.03 billion and imports totalled $48 billion, leaving total trade deficit of $31 billion.

India's export is dominated by primary products and imports are dominated by capital goods or intermediate goods and generally highly technology intensive

The reason for low penetration into Chinese market is due to high tariff and non-tariff barriers faced by India on these products and preferential treatment given to the competing countries. Dumping and high and growing trade deficit with China has also compelled the Government of India to put India-China FTA on the backburner. There is also stiff resistance from the Chambers of Commerce for the India-China FTA due to fear of injury to domestic industry.

South Korea as trading partner: Bilateral trade between India and South Korea stands at $17.5 billion in 2013. India's export to South Korea stands at $6.2 billion and imports totalled to $11.3 billion. India has trade deficit of $ 5.2 billion

India's export baskets to South Korea is more diversified but dominated by traditional labour intensive products and imports mainly capital goods and intermediate goods.

The prevalence of large amount of tariff and Non-Tariff Barriers (TBT/SPS) and the preferential trade agreements granted to some of the trade partners of South Korea limits India's export.

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Factors Affecting India's exports

India's export to China, South Korea and Indonesia is hampered by imposition of various tariff and Non-Tariff barriers (TBT/SPS) and preferential trade agreements granted to some of the trade partners.

Export strategy for increasing exports

By identifying high export growth oriented products and focusing on these products India can reduce trade deficit.

Policy Recommendation for reducing trade deficit

Negotiations with China, Korea, Indonesia; Export Incentives; Eliminating the inverted tax system; Introduction of GST; Improving the domestic manufacturing capacity; Greater Participation in Global Production Networks; Upgrading manufacturing technology and encouraging FDI from China into export oriented areas.

India's Export Strategy

China: There are 22 products at 6-digit level where demand is expanding in China and India has supply capability. The products broadly fall in agricultural, mineral, chemical, pharmaceuticals, metals electrical and non-electrical machinery, automobile parts and medical instruments.

Korea: There are 40 export potential products, for which Korea has demand and India has supply capabilities. These products fall under primary products like meat, fish, minerals, cotton, fibre and sophisticated items like machinery, iron & steel, aluminium etc. Proper implementation of the India-Korea CEPA would also help in bringing down the trade deficit.

Indonesia: There are 84 products that Indonesia source from abroad and India has supply capabilities. These products fall under primary products like Coffee, tea, mate and mineral fuels, oils & product of their distillation and sophisticated items like ships, boats and floating structures, organic chemicals etc.

General Policy Recommendations

Negotiations with China/Korea/Indonesia: To make the trade more balanced India should press above countries to reduce the tariff and non-tariff barriers to trade. If the bias against India is removed, it can offer identified potential products to China at a competitive prices.

Export Incentives: India should Include identified high export potential products in market linked focus products scheme (MLFPS). Under this scheme, government incentivise export of products that have high employment intensity in rural and semi urban areas, to offset infrastructure inefficiencies and other associated costs involved in marketing of these products at 2% duty credit of FOB value.

Eliminate the inverted tax system: Take measures to eliminate the inverted tax system where the finished product lands at lower duty than the components.

Introduction of GST: GST brings transparency. If the principle that only goods and services are to be exported not taxes then introduction of GST, exports will be zero rated. This means all taxes including state taxes like VAT, sales tax, purchase tax, octroi, turnover tax, and electricity duty will be refunded and add to export competitiveness.

Image courtesy of khunaspix at FreeDigitalPhotos.net

Improve the domestic manufacturing capacity: The labour productivity analysis of China and India reveals that Indian industry is far behind the Chinese industries. However, India is doing better in the Electrical and Non-Electrical Machinery sectors. Also there are wage differences between India and China, providing India some advantage to beat its lagging industrial productivity with respect to China.

Greater Participation in Global Production Networks: China and Korea are in the forefront of global production networks, which are largely driven by Multinational corporations (MNCs). Indian can follow similar strategy provided basic infrastructure facilitates and conducive business environment is there.

KPP is a South-South cooperation programme promoting knowledge sharing in the areas of Food Security, Resource Scarcity and Climate Change; Health and Disease Control; Trade and Investment; and Women and Girls. KPP is funded by the Government of UK's Department for International Development (DFID) and managed by a consortium led by IPE Global Private Limited under its Knowledge Initiative. The main objective of KPP is 'Gathering and uptake of evidence on issues central to India's national development that have potential for replication in LICs and impact on global poverty'.

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