India and China: Past Trade Liberalization and Future Challenges

Arvind Panagariya
Columbia University

Tokyo Club Macro Conference
December 6-7, 2006

Broad Outline

- Recent Performance
- The Pattern of Trade
- Foreign Investment
- Trade and Foreign Investment Policies
- Looking Ahead
  - National Trade Policies
  - Preferential Trade Area (PTA) Arrangements
  - The Doha Round
- Concluding Remarks

Figure 1: India: Growth Rates During Four Phases

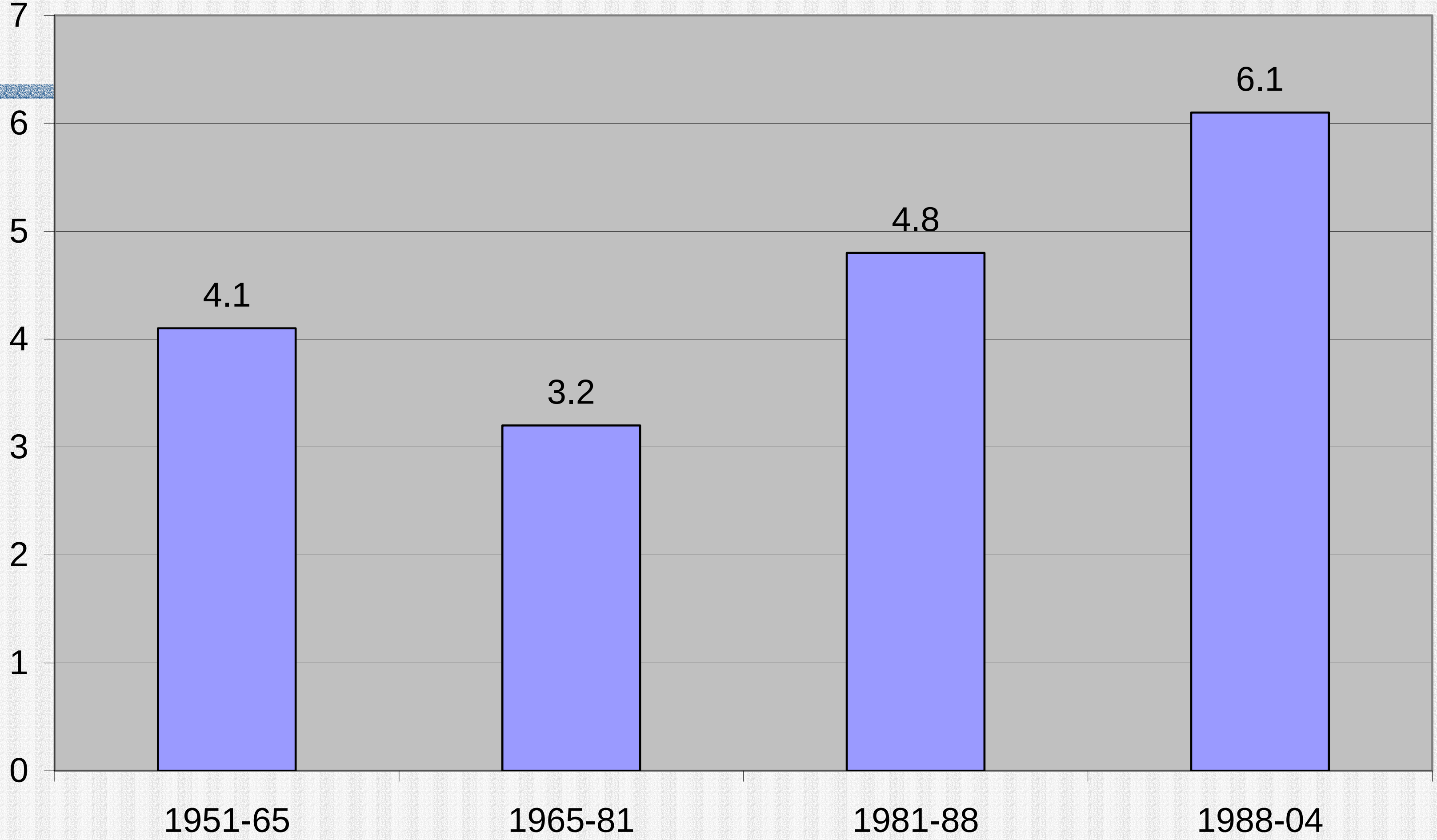
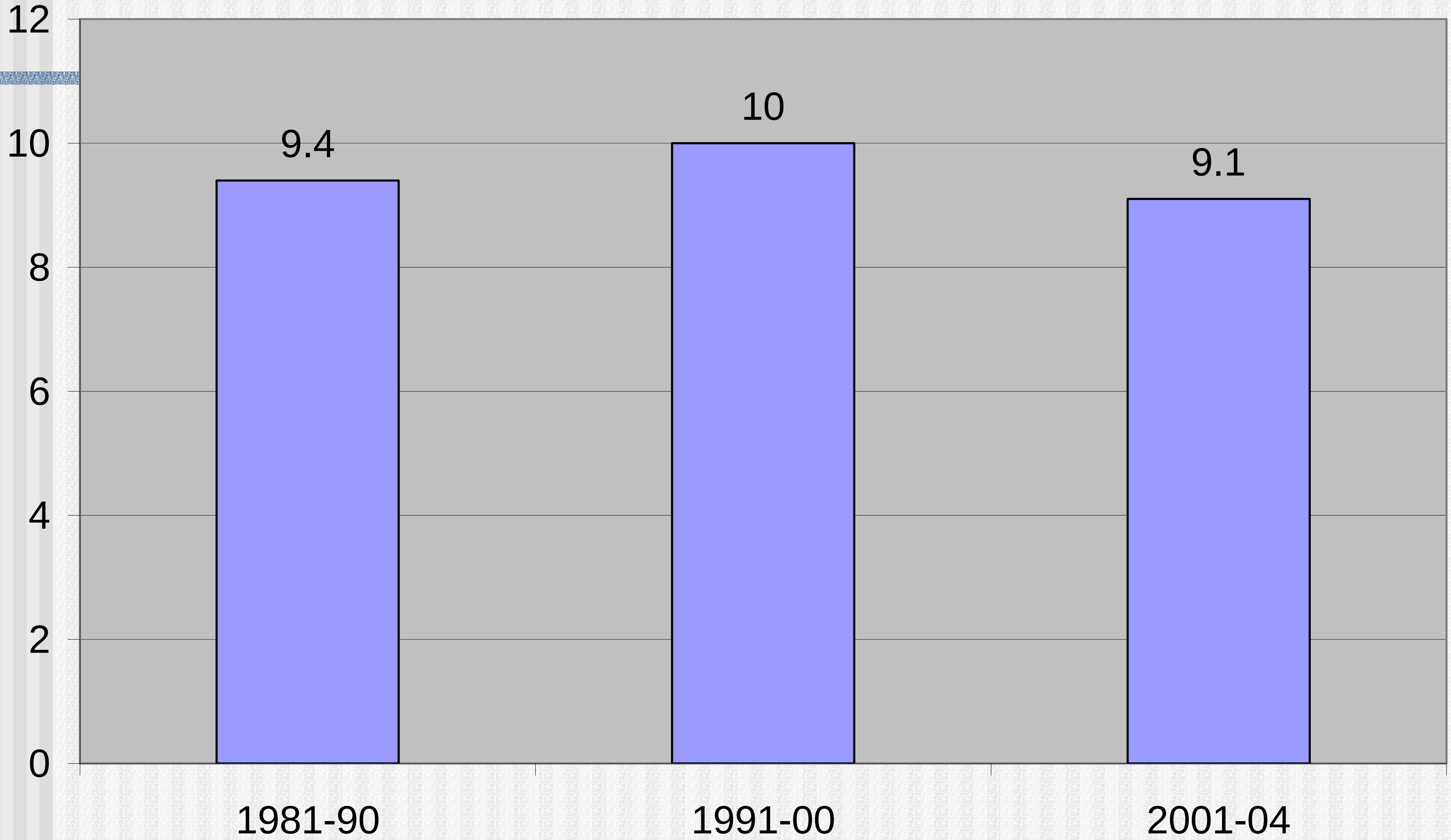


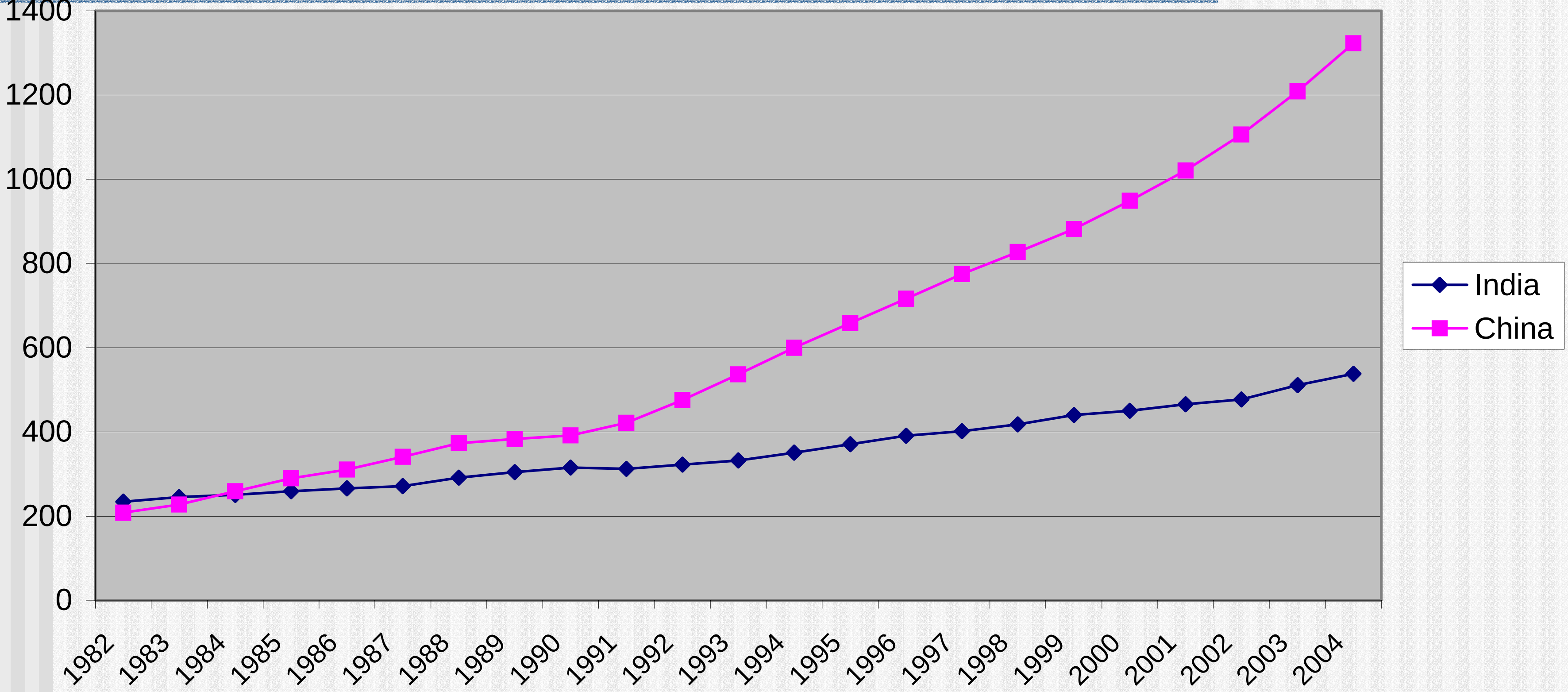
Figure 2: Official Growth Rate in China



Points to Note

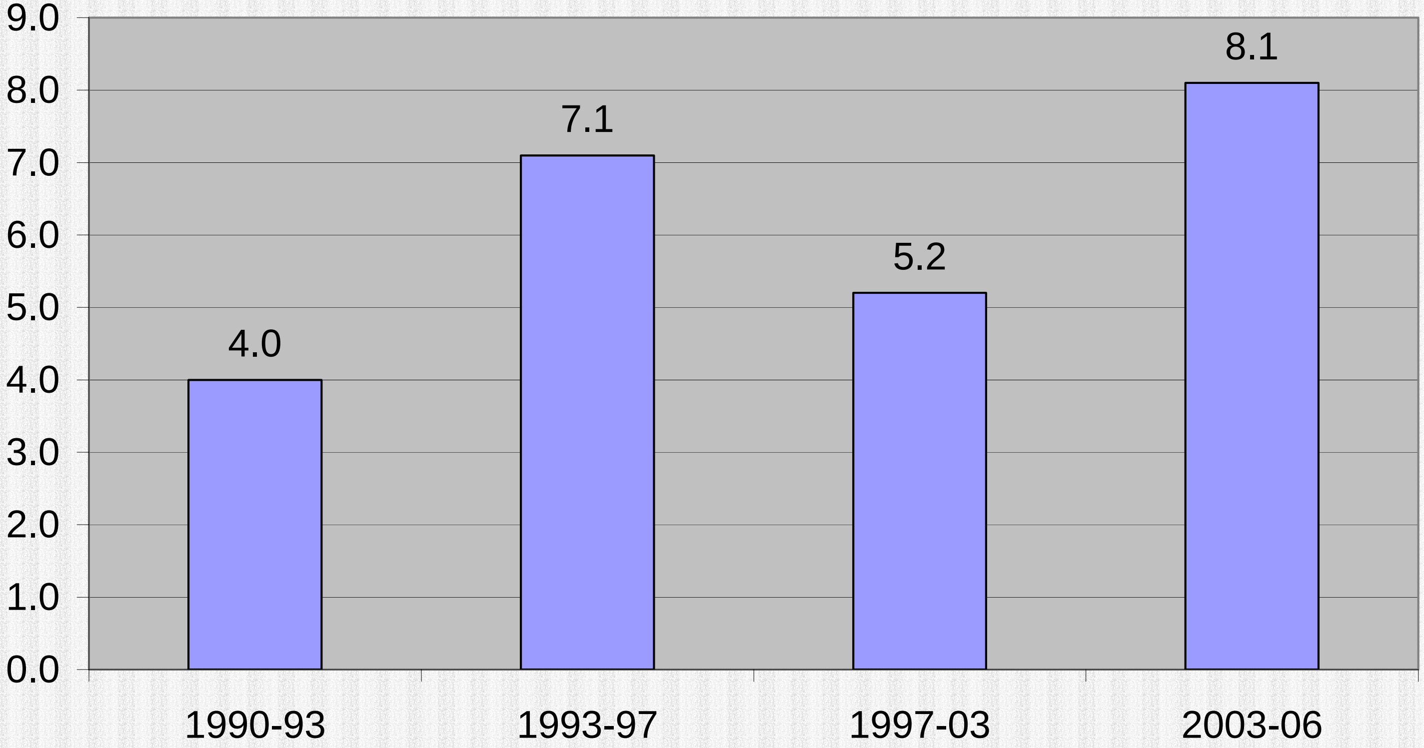
- In terms of the shift to 6% plus growth rate, India is approximately a decade behind China
- Even post-1988, China has grown at least 3% per-annum faster. The gap is higher in per-capita terms.
- This has meant rapidly diverging per-capita incomes in the two countries

Figure 3: Per-capita GDP in India and China at 2000 $US



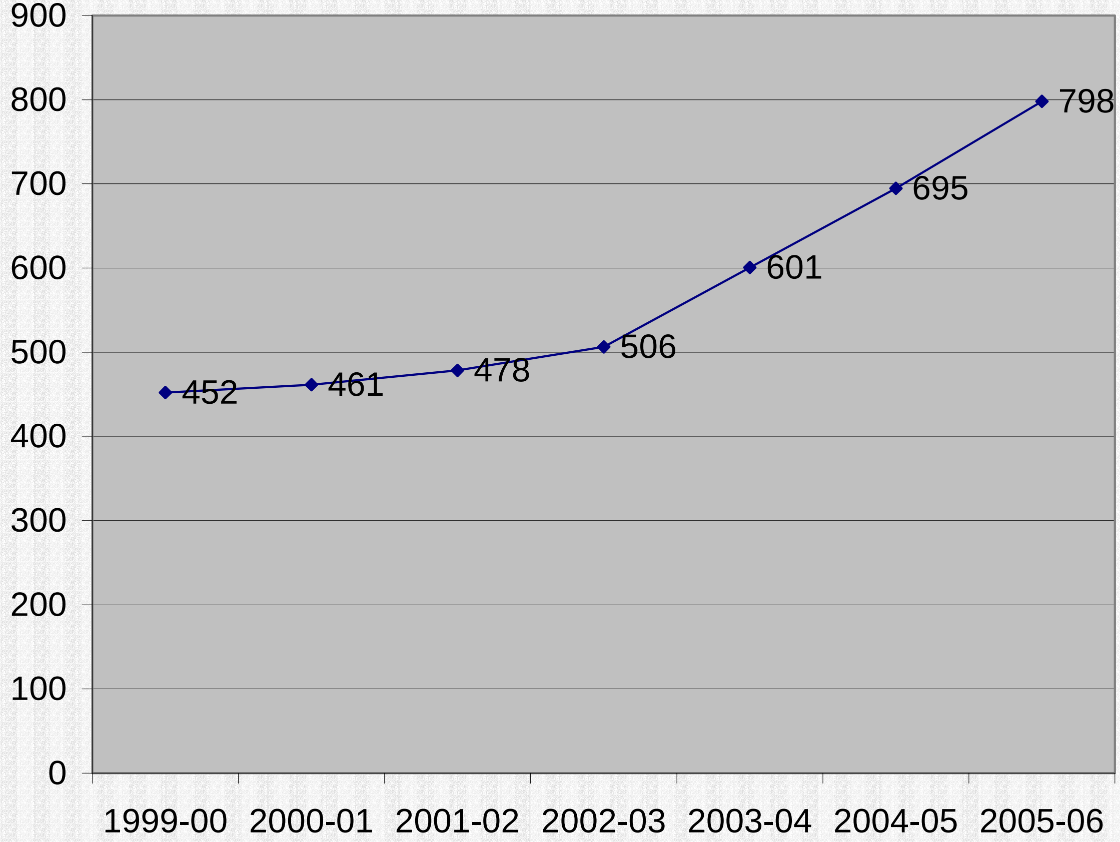
More Impressive Growth in India in the Last Three Years

GDP Growth: Business cycle or a fundamental shift in the growth rate?



Growth in dollar terms has been even more spectacular

Dramatic 16.4% annual growth in the GDP in current dollars in the last three years ($billion)



Salient Features of Growth in India in the Last three Years(1)

- Exports in 1990-91 doubled for the first time in 1999-00. Recently, they doubled in just three years: from $52.7 billion to $102.7 billion
- Services exports have doubled in just two years: from $26.9 billion in 2003-04 to $60.6 billion in 2005-06
- Exports of goods and services as a proportion of the GDP grew from 7.2% in 1990-91 to 11.6% in 1999-00, and to 20.5% percent in 2005-06.
- Trade/GDP ratio rose from 15.9% in 1990-91 to 25.2% in 1999-00 and to 43.1% in 2005-06

Salient Features of Growth in India in the Last three Years(2)

- Foreign investment up from $6 billion in 2002-03 to $20.2 billion in 2005-06. DFI up from $5 billion to $7.8 billion over the same period
- Remittances up from $17.2 billion in 2002-03 to $24.6 billion in 2005-06
- Phone lines up from the *stock* of 5 million in 1990-91 to a flow of 5 million *per month*. 185 million lines as of July 31, 2006
- Sales of passenger vehicles up from 707,000 in 2002-03 to 1.14 million in 2005-06. Total number of vehicles produced in the last three years in excess of *all* registered vehicles in 1990-91

Evolution of Trade Openness

- As measured by exports/GDP ratio, China was already more open than India in 1982
- Over 1982-03, exports/GDP ratio grew rapidly in both countries but it grew much more rapidly in China
- In the early to mid-1980s, exports in both countries grew less rapidly than subsequently (Overvalued exchange rate in India; planning through export targets in China)
- China's share in the world trade grew almost five-fold during this period

Figure 4: Exports of Goods and Services as Proportion of the GDP

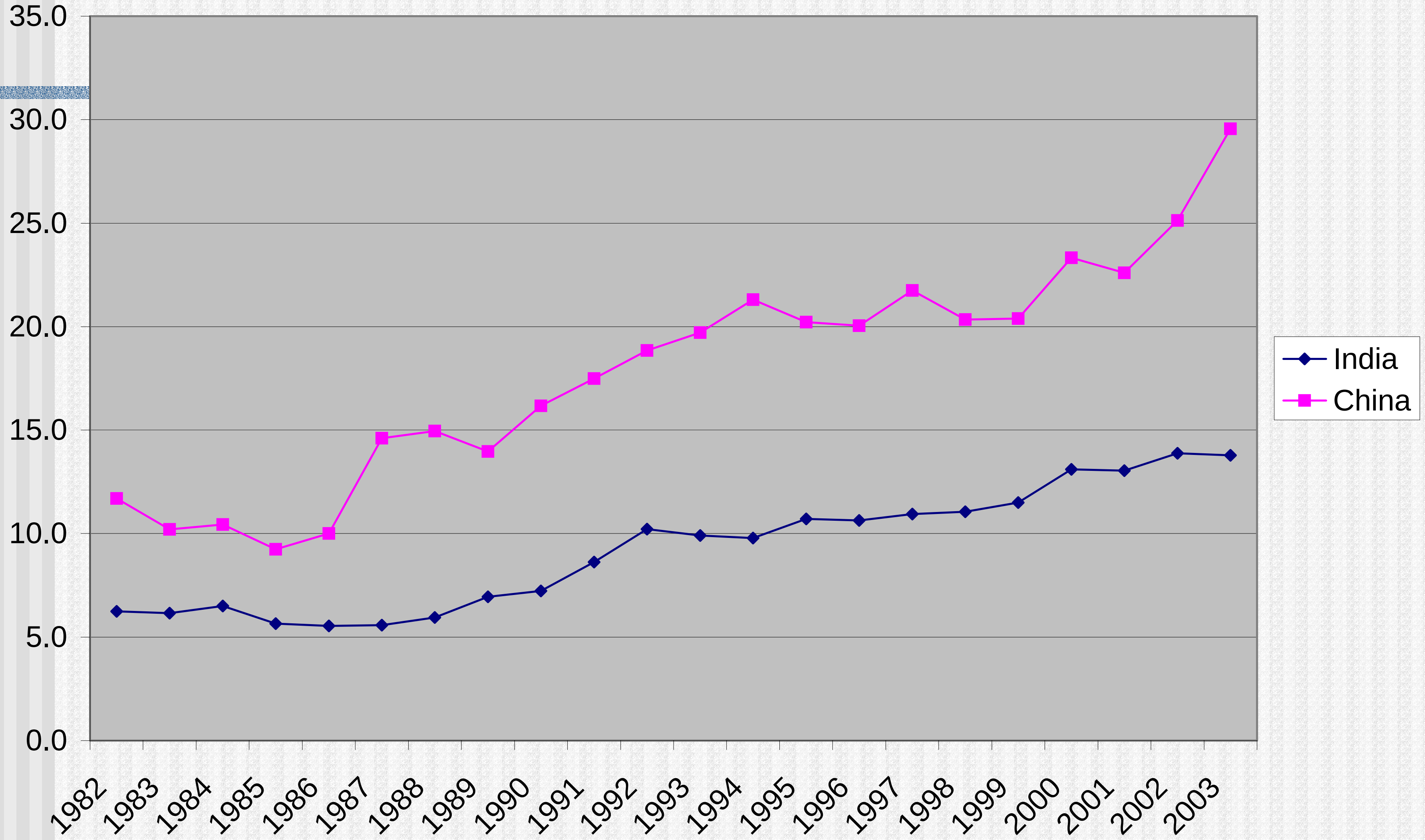
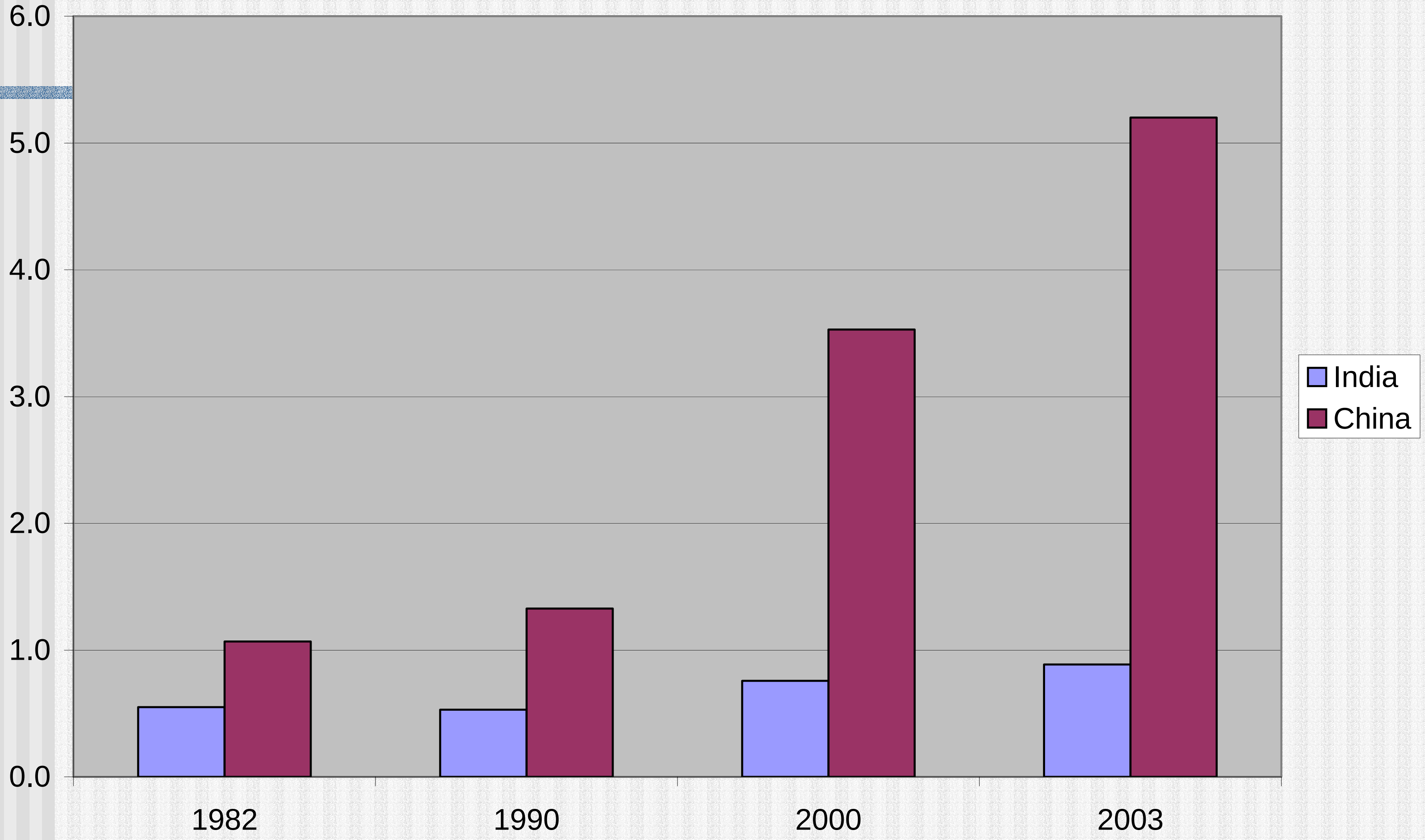


Figure 6: Share of exports of goods and services in the world market



India: Patterns of Exports

Item	2003-04	2004-05	2005-06P
I. Primary products	**15.5**	**16.2**	**16.0**
II. Manufactured goods	**76.0**	**72.7**	**69.9**
A. Leather and manufactures	3.4	2.9	2.6
B. Chemicals and related products	14.8	14.9	14.1
C. Engineering goods	**19.4**	**20.8**	**21.0**
1. Iron & steel	3.9	4.7	3.4
2. Manufacture of metals	3.8	4.1	4.1
3. Machinery and instruments	4.3	4.5	4.7
4. Transport equipment	3.1	3.4	4.4
D. Textile and textile products	**20.0**	**16.2**	**15.6**
1. Cotton yarn, fabrics, made-ups, etc.	5.3	4.1	3.8
6. Readymade garments	**9.8**	**7.9**	**8.2**
E. Gems and jewellery	**16.6**	**16.5**	**15.1**
F. Handicrafts (excluding handmade carpets)	0.8	0.5	0.4
G. Other manufactured goods	1.0	1.0	1.1
III. Petroleum products	**5.6**	**8.4**	**11.2**
IV. Others	2.9	2.7	2.9

Pattern of Exports: Factor Intensities

- Haphazard in India
  - Software (skilled-labor intensive)
  - Gems and jewelry (semi-skilled-labor intensive)
  - Apparel (unskilled-labor intensive)
  - Textiles; Petroleum and petroleum products; and Iron & steel (capital intensive)
- Coherent in China
  - Apparel, textiles, toys, footwear, sports goods in 1990s
  - Office machinery, telecommunications, electrical machinery, apparel currently
- China more specialized by the stage of production

Figure 1: Top Six Exports of India

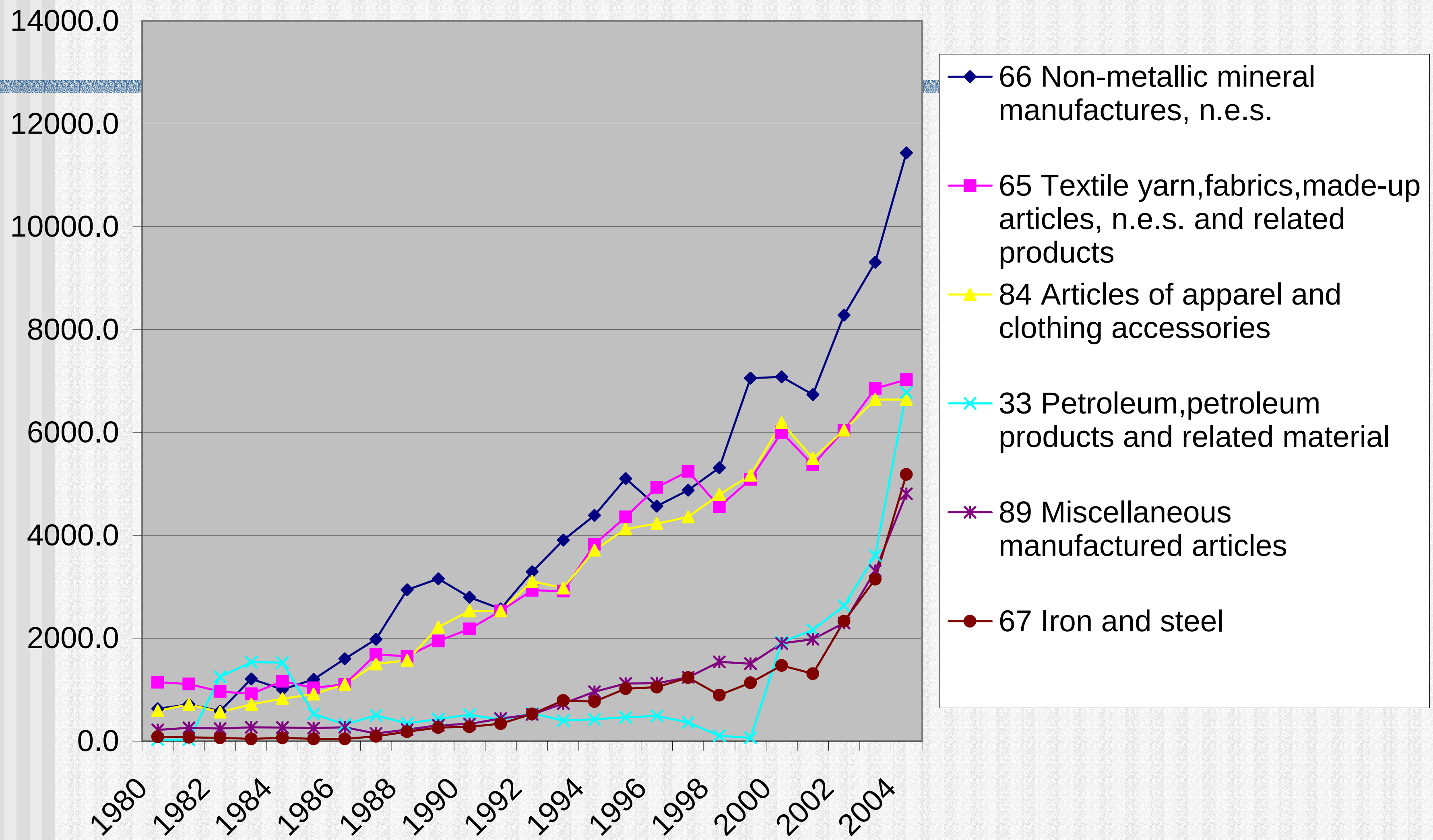


Figure 9: Top six exports of China

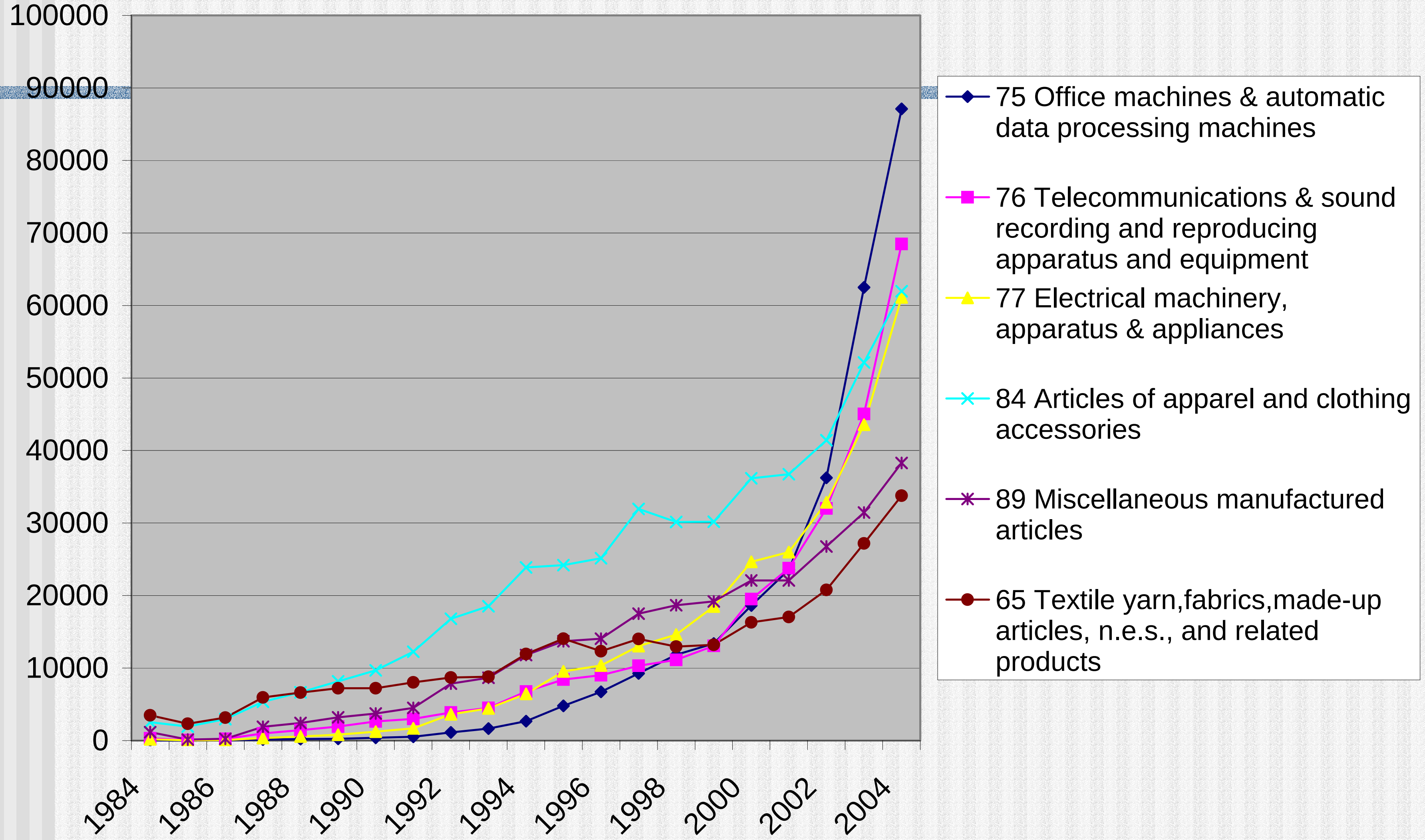
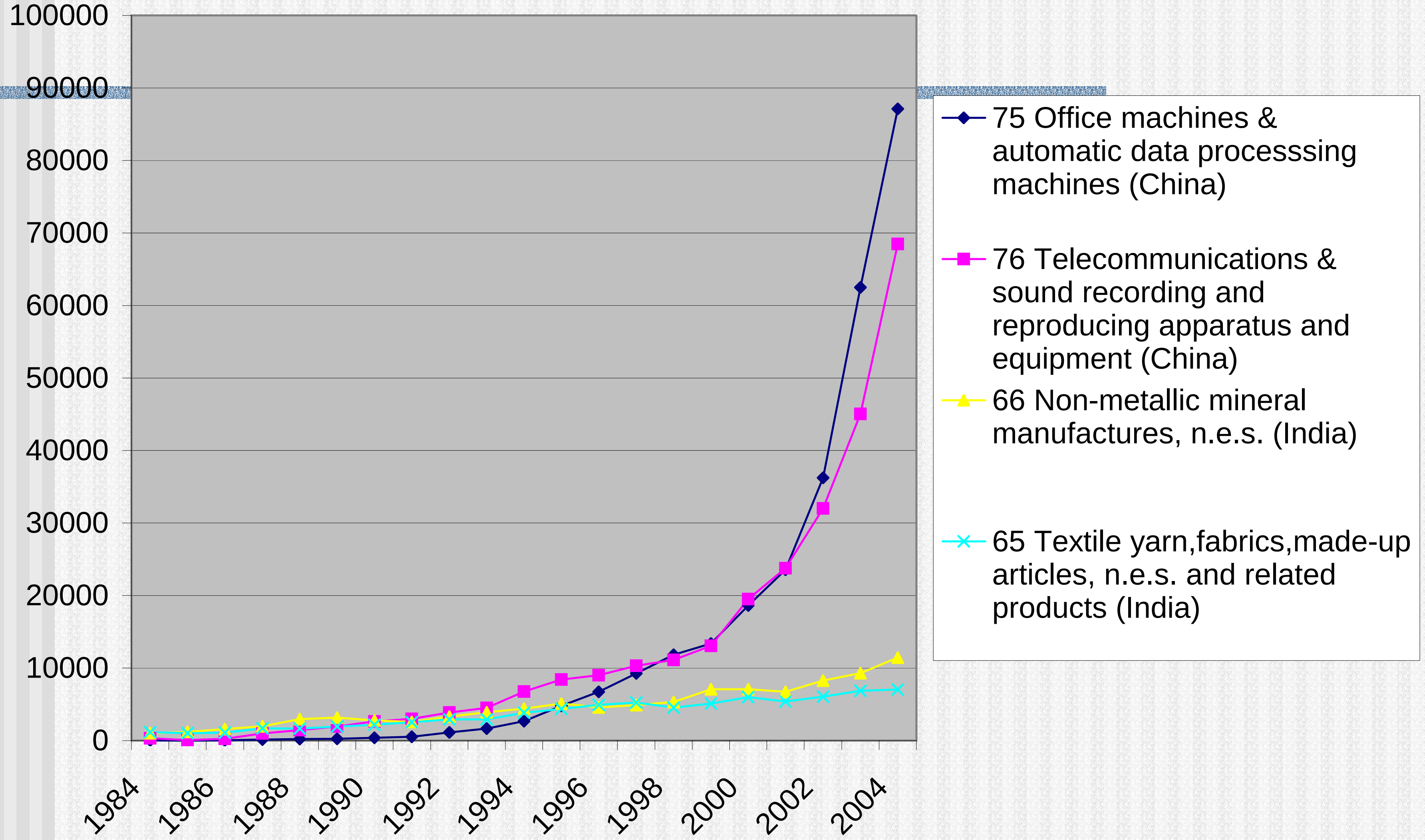


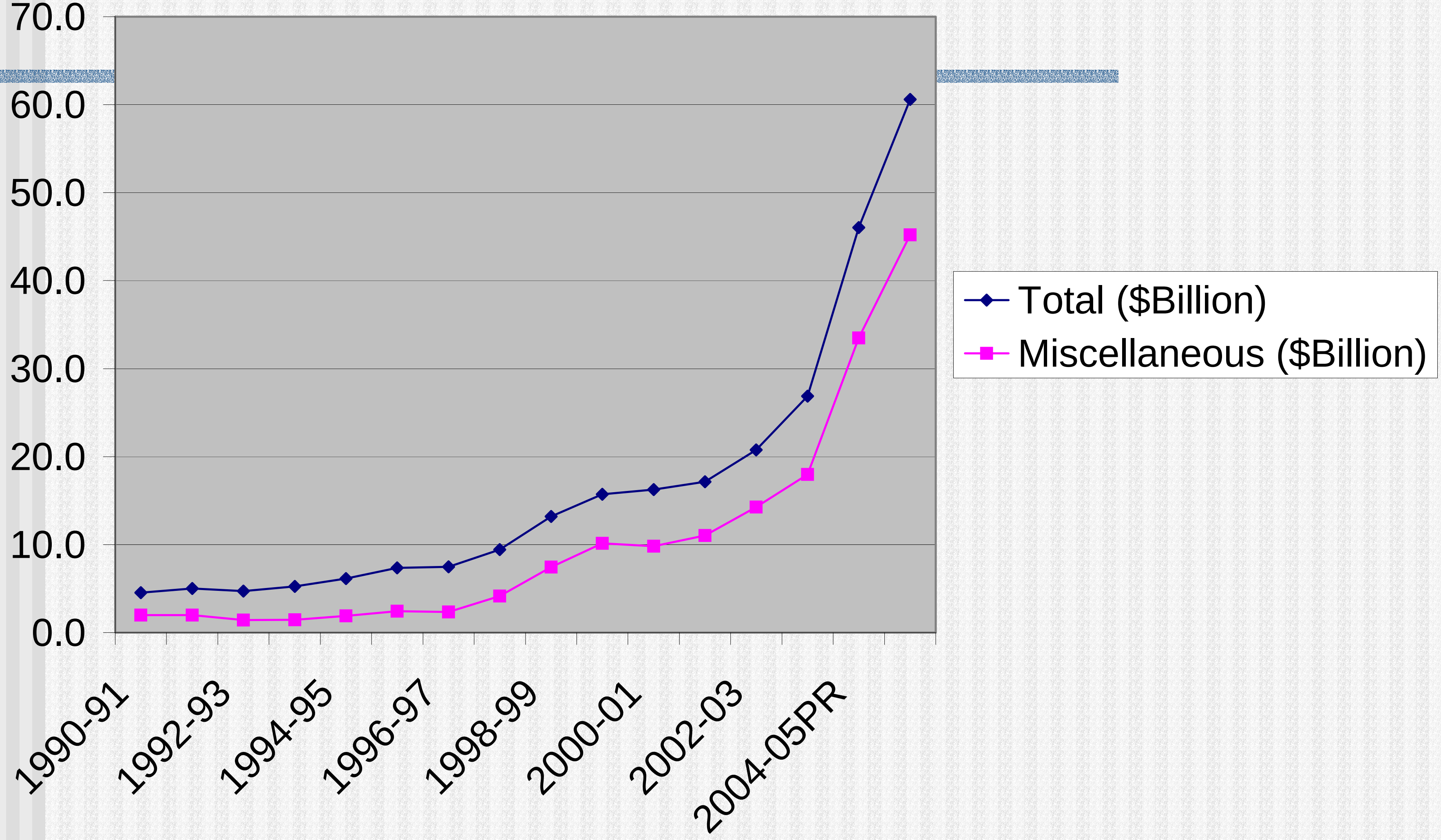
Figure 10: Top two exports of each of India and China



Merchandise Imports

- China's imports have been concentrated in machinery and transport equipment (SITC 7)—46% during 2001-04.
- In India, SITC 7 accounts for only 19% imports
- Mineral fuels and lubricants (SITC 3) account for 31 percent of India's imports
- The structure of imports also points to a very capital intensive production structure in India

Figure 4: Services Exports of India



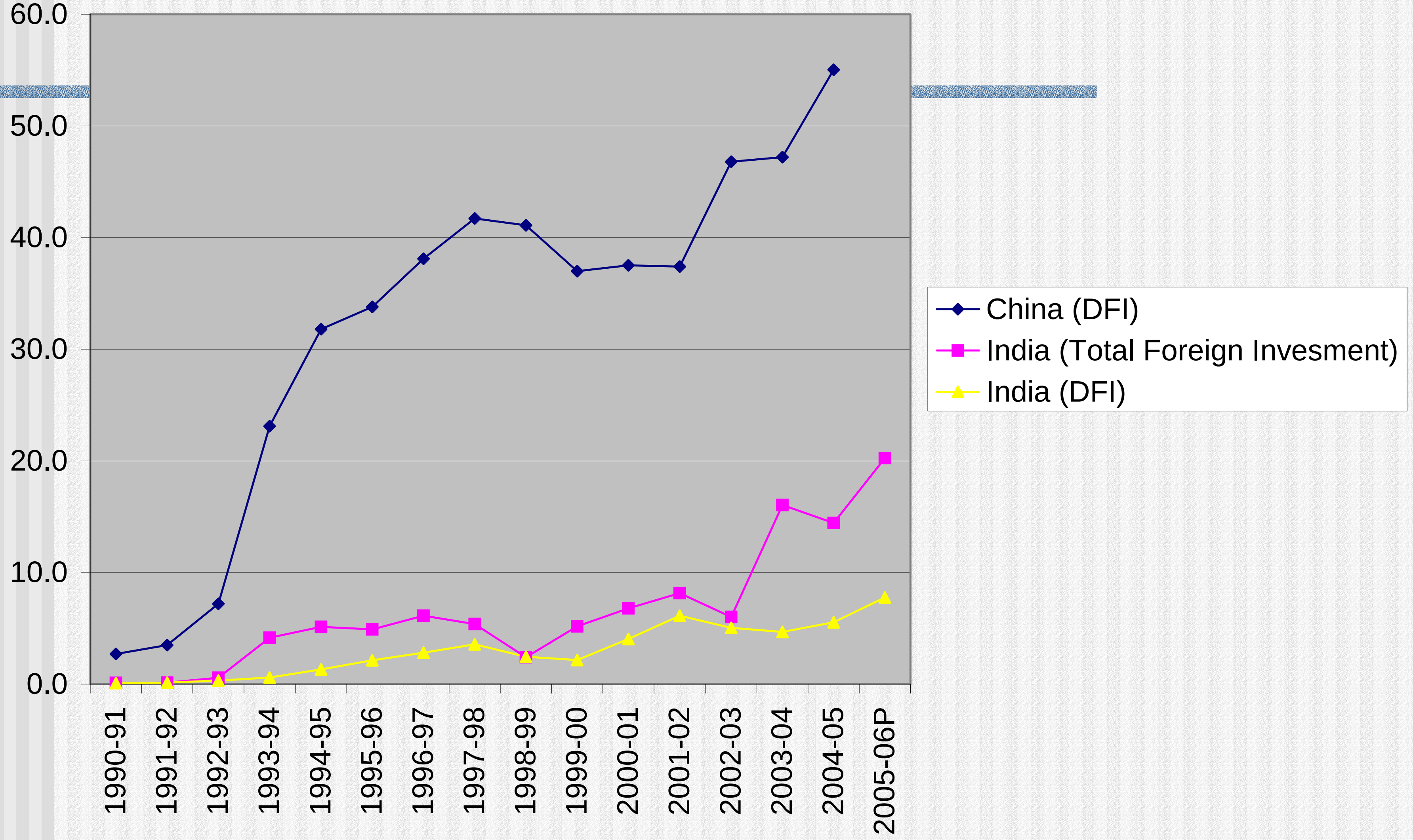
Composition of Software Exports

Year	IT Services ($Billion)	ITES-BPO ($Billion)	Total Software ($Billion)	Growth in Total Software	Share of BPO in Software
1	2	3	4 (=2+3)	5	6
1995-96	0.8		0.8		
1996-97	1.1		1.1	45.9	
1997-98	1.8		1.8	59.9	
1998-99	2.6		2.6	47.8	
1999-00	3.4	0.6	4.0	52.4	14.3
2000-01	5.3	0.9	6.2	56.9	15.0
2001-02	6.2	1.5	7.6	23.0	19.6
2002-03	7.0	2.5	9.5	24.8	26.2
2003-04	9.2	3.6	12.8	34.1	28.1
2004-05	13.1	4.6	17.7	38.3	26.0
2005-06	17.3	6.3	23.6	33.3	26.7

India's Software Exports ($billion)

Year	IT Services	ITES/BPO	Total Software
1995-96	0.8		0.8
2000-01	5.3	0.9	6.2
2003-04	9.2	3.6	12.8
2004-05	12.0	5.2	17.2

Figure 5: Foreign Investment ($Billion)



Prasad and Wei on DFI into China from 1998 to 2004

- “Table 2 shows that about two-thirds of these flows have been going into manufacturing, with real estate accounting for about another 10 percent. Within manufacturing, the largest identifiable share has consistently gone to electronics and communication equipment. The share of manufacturing has risen by almost 15 percentage points since 1998, largely at the expense of the shares of utilities, construction, transport and telecommunication services, and real estate. Since the industries with declining FDI shares are largely focused on non-traded goods, the evolution of this pattern of FDI seems to be consistent with the notion that these inflows have been stimulated by China’s increasing access (both actual and anticipated) to world export markets...”

India: Composition of DFI, 1991-2005

Item	$Billion	Percent
Electrical Equipments (incl computer software)	4.9	16.0
Transportation Industry	3.1	10.3
Services Sector	3.0	9.8
Telecommunications	2.9	9.5
Fuels (Power & Oil Refinery)	2.5	8.3
Chemicals (Other than Fertilizers)	1.9	6.2
Food Processing Industries	1.2	3.9
Drugs and Pharmaceuticals	0.9	3.1
Cement and Gypsum Products	0.7	2.5
Metallurgical Industries	0.6	2.1
Consultancy Services	0.4	1.5
Miscellaneous Mechanical & Engineering	0.5	1.6
Textiles (Includ Dyed, Printed)	0.4	1.4
Trading	0.4	1.2
Paper and Pulp including paper product	0.4	1.2
Hotel & Tourism	0.3	1.0
Glass	0.3	0.8
Rubber Goods	0.2	0.8
Commercial, Office & Household Equipment	0.2	0.8
Industrial Machinery	0.2	0.7
Machine Tools	0.2	0.5
Other	5.2	17.0
Total	30.5	100.0

Trade Policy in the mid 1970s

- ALL trade centrally controlled in both countries
- India
  - Licensing
  - The “Red Book” of allowed imports and their quantities issued every six months
  - Canalization
- China
  - Centrally controlled FTCs directly under the Ministry of Foreign Trade

Liberalization in the 1980s: India

- Scope of “canalized” imports reduced
- Open General Licensing (OGL) expanded: 30% imports freed up by 1990
- East-Asian style export incentives in the second half of the 1980s
- More than 30 percent real depreciation of the rupee in the second half of the 1980s
- Tariffs raised to mop up the quota rents

Liberalization in the 1980s: China

- End to the central monopoly: Multiplication of FTCs at provincial and local levels and by line ministries (>5000 FTCs by 1988) and conferral of trading rights on larger enterprises
- Special Economic Zones and Open Cities
- Joint venture status with 25% foreign investment. Direct trading rights to the JVs
- FX retention rights to FTCs and enterprises
- depreciation (RMB 1.5 per dollar in 1979; 2.8 in 1981; 3.7 in 1986; 21% devaluation in 1989; 8.7 in991)
- Licensing (46% imports in the late 1980s), canalization, tariff hikes (avg.: 43% in 1985)

Comparing India and China

- China was more open in the 1980s
  - Default regime in India: Licensing; actual user and domestic availability conditions (except OGL)
  - In China: No restriction on the companies authorized to trade except for products subject to canalization or licensing
  - Overvalued exchange rate in India in the first half of the 1980s
  - Foreign investment regime far more open in China (esp. in the SEZs and open cities)

1990s and Beyond: India

- End to licensing in capital and intermediate goods in 1991; in consumer goods in 2001
- Highest industrial tariff down from 350 percent in 1991 to 12.5 percent currently
- Agriculture: Very high tariff equivalents (bound at 100 to 300 percent)
- Services: On balance more open now than China (exceptions: distribution services and insurance)
- DFI: Negative list approach; only a handful of sectors with sectoral caps below 51 percent.

1990s and Beyond: China

- Scope of licensing reduced: by 1997, only 5% of the tariff lines under licensing
- Average industrial tariff down from 43% in the late 1980s to 40% in 1993, 23% in 1996, 15% in 2001, and 9% by 2006 under the WTO entry conditions
- Agricultural tariff: 15% under entry conditions
- Substantial liberalization of services under the WTO entry conditions (including distribution and insurance sectors)

Why India Lags Behind China

- Trade openness is not the major factor: in industry and services India is almost as open as China
- Domestic policies are the key factor
  - Small-scale industries (SSI) reservation
  - Business houses with $27 million or more in assets limited to 19 “core” capital-intensive industries (list expanded in the 1980s)
  - Foreign investment limited to 40% in most cases
  - Labor market rigidities
  - Infrastructure (power is the biggest constraint)

Looking Ahead

- National Trade Policies
- Bilateral Agreements
- Multilateral Negotiations: The Doha Round

National Trade Policies

- Further compression of tariffs
- Eliminating tariff peaks: automobiles (new and used)
- Agriculture (liberalization with other reforms in the area)
- Trade facilitation
- Contingent Protection (Anti-dumping)

Trade Facilitation

Transaction	Location	Norm
Air Freight	Delhi Airport	
Export	2.5 days	Less than 12 hours
Import	15 days	Less than 12 hours
Containerized Sea Freight	Mumbai	
Ship Waiting Time	3-5 days	Less than 6 hours
Export Dwell Time	3-5 days	Less than 18 hours
Import Dwell Time	7-14 days	Less than 24 hours

Anti-dumping: 1995-05

Figure 6: Anti-dumping Initiations

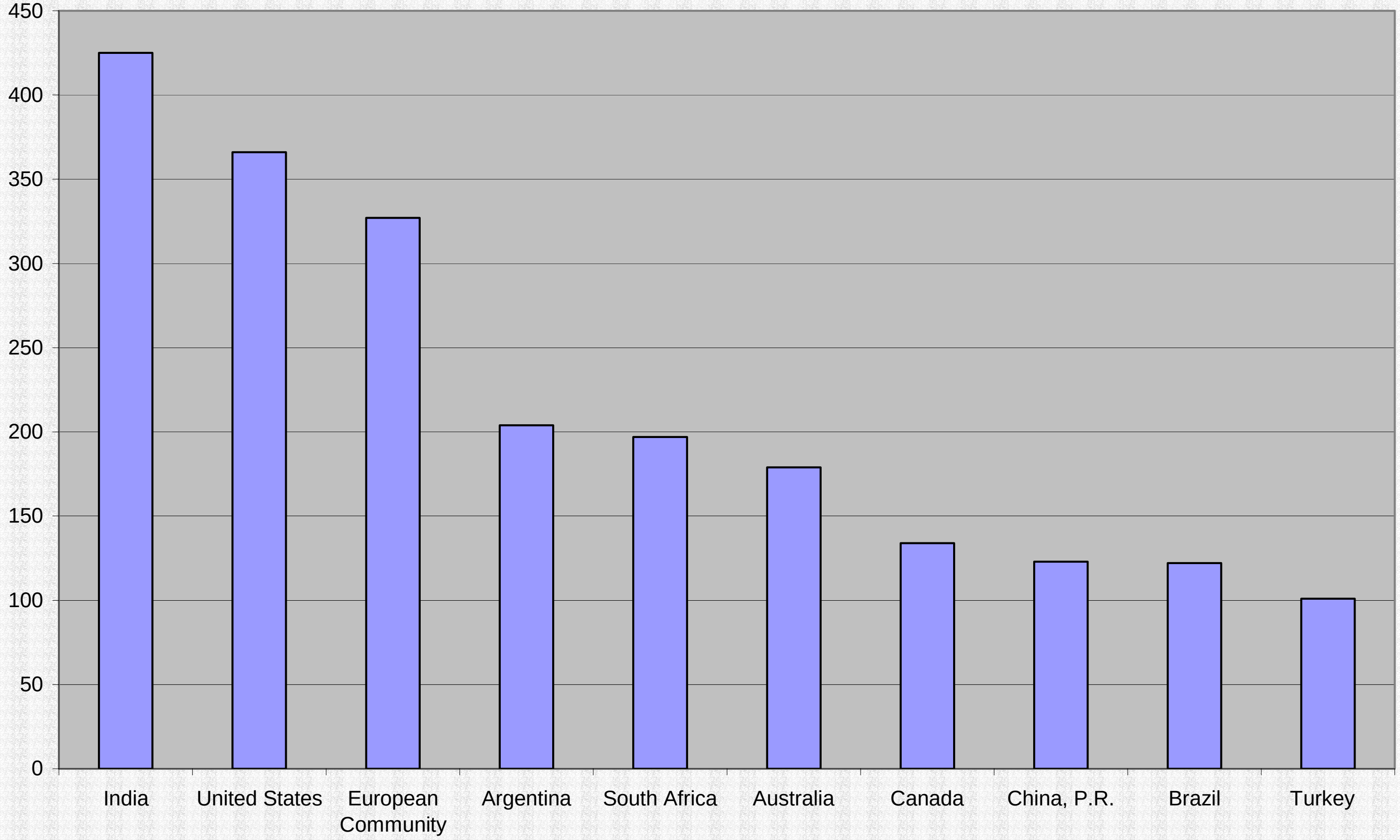
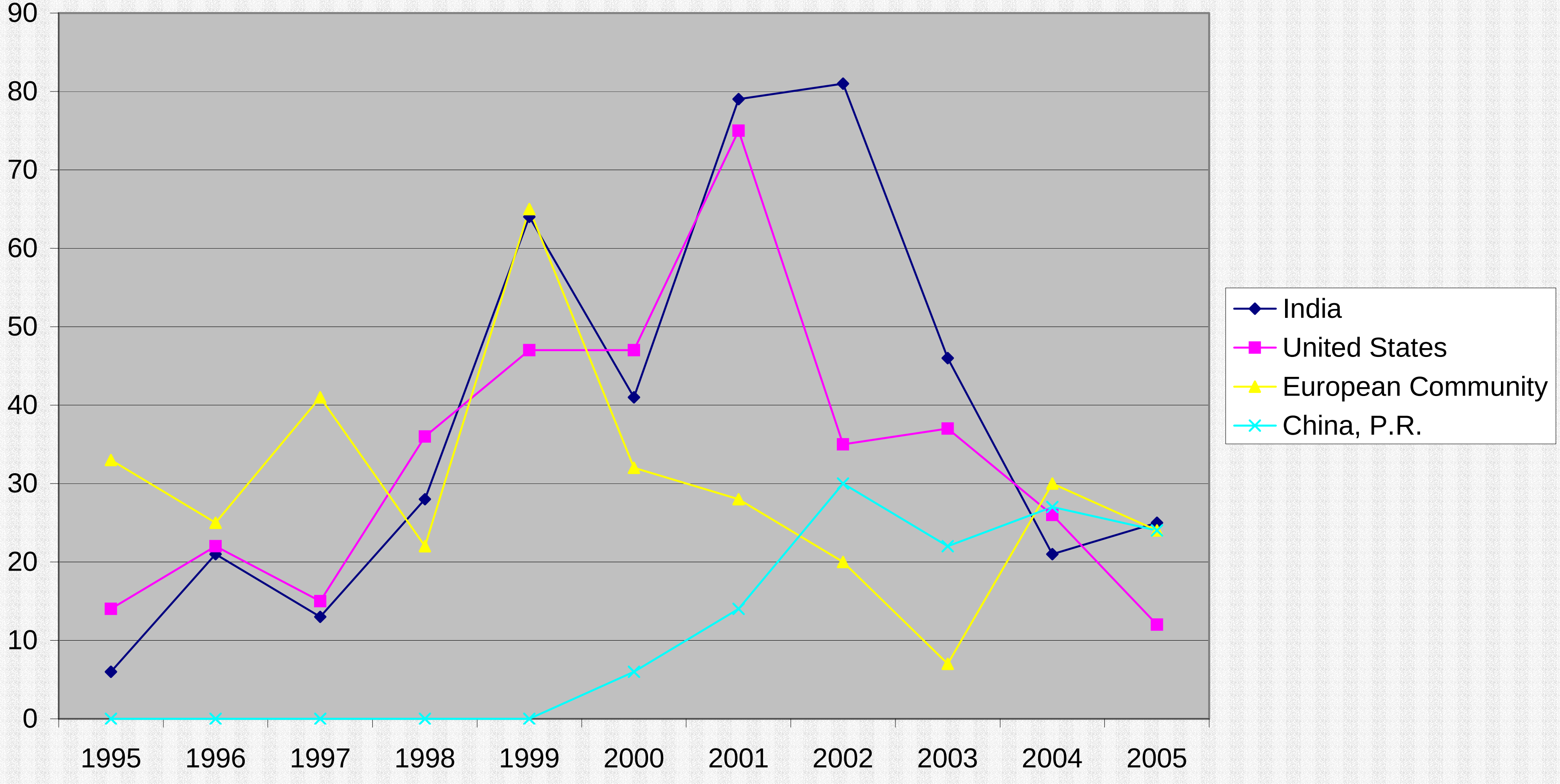


Figure 7: Annual Anti-dumping Initiations: Top Three and China



Preferential Trade Agreements

- Discriminatory: Trade diversion versus trade creation
- Rules of Origin
- Sectoral exclusions
- Spaghetti Bowl

India’s PTAs

Existing	Ongoing	Under Study and Consideration
Bangkok Agreement	Indo-ASEAN CECA	Gulf Cooperation Council (GCC)
Global System of Trade Preferences (GSTP)	South Asian Free Trade Agreement (SAFTA)	China
SAARC Preferential Trading Agreement (SAPTA)	BIMSTEC (Bay of Bengal Initiative for Multi-Sectoral Technical & Economic Cooperation)	South Korea
India-Sri Lanka FTA	India - MERCOSUR PTA	Japan
India - Thailand FTA		Malaysia
India Singapore Comprehensive Economic Cooperation Agreement (CECA)		Pakistan
Indo-Nepal Trade Treaty		Southern African Customs Union (SACU)
India-Mauritius PTA		Egypt
India-Chile PTA		Israel
		Russia
		Australia

An India-China FTA?

- If India and China insist n taking the bilateral road (not recommended), best to have a bilateral with each other
- Given Chinese competitiveness, less scope for trade diversion in India
- Can serve as the focal point for the other Asian countries and pry open the EU and NAFTA to Asia from which they have diverted trade
- Promote an alternative template

Doha Round

- India has taken a hard line on agricultural liberalization—large number of special products, special safeguard
- Liberalization in agriculture by India will be good—in a liberalized regime, Indian agriculture is likely to be competitive
- Some sectors may emerge as successful exporters, pressure for agricultural reforms (land titles, private mundies etc.) will increase

Thanks You and That is All