Source : www.livemint.com Date : 2020-07-14

ASIA’S TWO BIG ECONOMIES WILL BOTH LOSE AS THEY DECOUPLE

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Foreign Capital, Foreign Trade & BOP

The border clash between the two nations has snapped ties that could have spelt greater value for both

For two years in a row, India’s biggest trading partner has been the US and not China, and this is based on merchandise trade only, i.e. without including India’s impressive export of software services. More encouragingly, India’s trade surplus with the US has been rising and its trade deficit with China falling for three consecutive years. As of March, India had a current account surplus of $28 billion with the US, inclusive of net software exports, and a $48 billion deficit with China. In all likelihood, this trend would have continued were it not for the disruption of covid-19 and the fatal military clash in Galwan Valley. Despite thorny border issues spanning decades, several tense standoffs, including most recently for 72 days at Doklam, there hadn’t been fatalities for nearly 50 years. An eyeball-to-eyeball confrontation at the border has always been defused before it could get nasty. But after the incident of 15 June, in which 20 Indian as well as an unspecified number of Chinese soldiers were killed in eastern Ladakh, the mood on bilateral trade has soured. Chinese imported cargo is languishing at ports, as clearance is either denied or delayed. This is hurting Indian importers that have already paid for the cargo. India’s export consignments face similar hurdles in China. Various confirmed orders to Chinese companies for road construction or for supplies to the Indian railways stand cancelled. India has also banned 59 Chinese apps, despite their user base in India of over 200 million.

Even before Galwan, India changed its policy on select foreign investment, aimed primarily to curtail equity money flowing in from China. This adversely affected at least a dozen startups, which crucially depend on venture capital funding from China. Due to the changed law, Chinese investors have to now apply through our consulate, and at the time of writing this, there is word that almost 100 applications await approval.

How did we get here? Such a rapid deterioration in commercial relations was not anticipated even six months ago. For nearly two decades, trade growth has been vigorous, although skewed in China’s favour. In 2001, India was ranked 19 as an export destination for China. This rank rose to 6 in 15 years, clearly showing the growing importance of the Indian consumer to Chinese producers. Bilateral trade was within the target of $100 billion. Indian entrepreneurs began sourcing more and more from China, mainly for the huge cost advantage as compared to Europe or America. In 1999, only 5.8% of India’s imports came from China, but that climbed to 41% by 2015. Much of the capital expenditure for India’s fast-growing telecom and power sectors, including solar power, was sourced from China, and in some cases funded by loans from Chinese banks. Imports of intermediate goods included chemicals, electronics, and textile fibre and fabrics, while those of consumer products spanned a wide variety, from gadgets to Ganesha idols.

Most tellingly, India’s dependence on sourcing active pharmaceutical ingredient (API) from China also increased dramatically. APIs are crucial imports required for India’spharmaceutical industry, which exports generic drugs. These low-cost generics help keep healthcare costs low for India as well as its trade partners. Today, more than 68% of APIs are imported from China. The import dependence in other sectors is as follows: In electronics 45%, in capital goods including machinery 32%, in organic chemicals 38%, in furniture 57%, in fertilizers 28%, and in automotive parts 25%. Nearly 80% of compressors used in products like air conditioners are imported from China, as are 95% of motors used in washing machines.

It would be unwise to see the trade relationship only through the lens of import dependence. In certain categories like specialty chemicals, pharmaceuticals and auto ancillaries, India's exports were improving. There was also ongoing bilateral dialogue to bridge the deficit. The trade deficit was partly offset by rising capital inflows. The present value of Chinese investment in India is about $8 billion, but there is scope for much more. Even 1% of Chinese foreign exchange reserves invested annually in Indian infrastructure projects can practically wipe out India's trade deficit. This would be investment in a variety of non-sensitive sectors, with no threat to national security.

Alas, all these bright prospects have evaporated after Galwan. When President Xi Jinping took office eight years ago, he had outlined five proposals to improve Indo-China relations. These included maintaining strategic communication, harnessing each other's comparative advantage in trade, strengthening cultural ties, expanding coordination in multilateral fora, and accommodating each other's core concerns. Dialogue and engagement was supposed to be the cornerstone of the relationship.

But in the past two years, China's increased aggression, not just in Ladakh and Doklam, but elsewhere in the South China Sea, Hong Kong and the Indo Pacific, has diminished the prospects for healthy growth of trade between the two Asian neighbours. With high tension, it is becoming untenable to keep geopolitical issues apart from economic and trade relations, no matter how mutually advantageous the latter may be. The decoupling may be gradual and not total. But the mutual enthusiasm for dynamic economic, strategic and cultural ties has cooled off, at least for the foreseeable future. Unless cooler and wiser heads prevail, that promise will remain unfulfilled—nay, be betrayed.

Ajit Ranade is an economist and a senior fellow at The Takshashila Institution, an independent centre for research and education in public policy.

END