Our Dependency on China didn't Happen Overnight*

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In the wake of the India-China conflagration at the border, the worst in more than five decades, the fault lines of India’s economic relationship with its northern neighbour are now wide open. Amidst the demands for boycotting Chinese products and investments, the Government of India finds itself in a bind, given the sheer dependence of the Indian economy on China.

This dependence did not happen in a hurry; it took China the good part of the past decade and a half to slowly but surely dominate India’s market for telecom and electronics products, the backbone of government’s Digital India mission. More important is India’s dependence on China for the Active Pharmaceutical Ingredients (APIs), which have helped the Indian generic manufacturers to provide cheap medicines. China supplies more than 90 per cent of the APIs for several antibiotics and vitamins, which implies that India does not have an alternative source for meeting its API requirements.

Dependence on a single country for critical products in such a large measure can never be a right strategy, especially for a country like India. This situation, therefore, needs to change, but it can happen only through the adoption of policies that can help a transition to a new normal. India’s policy makers must reflect on what they should have done, but did not, during the past decade and a half.

In 2003-04, Chinese products had relatively minor presence in India’s import basket totalling just less than $3 billion and India’s trade deficit vis-à-vis China was less than $1 billion. In the next five years, India’s imports from China increased to $32.3 billion, and the trade imbalance jumped to $23.1 billion. China continued to expand its market in India, increasing it to $76 billion in 2017-18. With India’s exports stagnating for reasons explained below.

Trade deficit

India’s trade deficit with China was a massive $63 billion in 2017-18, or nearly 40 per cent of its overall trade deficit. In the past three years, the trends have shifted somewhat, as imports from China have declined to $65 billion in 2019-20, and exports have increased to $16 billion. But this does not imply a decrease in imports from China, as imports from Hong Kong have increased.

What explains this sustained expansion of imports from China? Fast-tracked trade liberalisation resulting in the lowering of average import duties on industrial products from 33 per cent in 2000 to below 9 per cent in 2008 is one factor. India also had to remove all the quantitative restrictions on imports, such as import licensing, in 2001. An expansionist China was thus provided an opportunity.

Faith in marketplace

The second development was the decision by the governments of the day to desist from taking any significant measures to prepare the industrial sector for an open economy. Instead, policymakers had decided to repose complete faith in the ‘magic of the marketplace’.

Their target was to reduce import duties to the level of those in the East Asian region. But what India’s policymakers refused to see was that these economies had adopted well-honed industrial policies, which enabled their industries to not only face import competition in increasingly open economies, but to also become globally competitive in the process.

There was no lack of advice on the urgent need to shore up the industrial sector. In 2006, the National Manufacturing Competitiveness Council advised the government to take prompt measures to raise the share manufacturing in the country’s gross domestic product (GDP) to at least 23 per cent within a decade. Thereafter, successive governments unveiled the National Manufacturing Policy in 2011 and Make in India in 2014, with the singular objective of strengthening the manufacturing sector, but ironically, the share of manufacturing in GDP has remained stuck between 15 and 17 per cent.

Import liberalisation

What is inexplicable is that despite the body blow being suffered by the domestic manufacturing industry because of being thrust into import competition without requisite preparation, successive governments have been deepening the process of import liberalisation through free trade agreements (FTAs).

India’s three major FTAs, with the Association of South East Asian Nations (ASEAN), Korea and Japan, have resulted in the increasing trade deficit, almost entirely because its exports have remained sluggish, while imports have expanded because of market opening. In recent years, there was a strong push from within the government to join another FTA, the Regional Comprehensive Economic Partnership (RCEP), which includes China.

Academics and activists had cautioned about the adverse consequences of eliminating import duties on a large number of products, thus enabling China to expand further at the expense of the domestic manufacturing industry. When the Prime Minister was finally persuaded from joining the grouping in November, the response of the officials was that this was a “missed opportunity” for India. Today, the country would have been left to rue the day it would have joined RCEP.

Besides offering lower tariffs to Chinese imports, RCEP would have also impacted the government’s ability to scrutinise foreign investors from China, a policy that it had introduced in April this year. RCEP includes an investment agreement, which limits the autonomous policy space of the participating governments to regulate investments.

Deregulating FDI

The Government of India had unilaterally given up scrutinising foreign investment in 2017 by significantly deregulating the Foreign Direct Investment (FDI) regime, which it did by disbanding Foreign Investment Promotion Board (FIPB). The liberalisation of FDI policies that began in the 1990s, and which gained momentum in the previous decade, was yet another nail in the coffin for the manufacturing sector. Companies already weakened by adverse import competition, became easy targets for foreign investors. This was evidenced by the steeply increasing cases of takeovers of Indian entities in recent years.

The scale of Chinese investments in India is unclear, as official agencies from China and India give widely varying numbers. While the Department for Promotion of Industry and Internal Trade puts the figure at over $2 billion, the China's official agencies have put the figure at $8 billion. But as in case of trade, Chinese investors have a dominant position in India's unicorns that are also an integral part of the gig economy. These entities, some of which are staring at a ban, have often been lauded by the government as having the potential to address India's unemployment problems.

With the government now emphasising on self-sufficiency, it could take lessons from an essay that John Maynard Keynes had written at the height if the Great Depression, bearing the same title: "Ideas, knowledge, science, hospitality, travel these are the things which should of their nature be international. But let goods be homespun whenever it is reasonably and conveniently possible, and, above all, let finance be primarily national."

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