



Calibrating India's Economic Engagement Strategy with China Amidst the Changing Geopolitical Landscape

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Abstract

The trajectory of India-China economic engagement, rooted in a legacy of complex geopolitical ties and asymmetrical economic relations, now stands at a critical juncture amid a changing global order. In this context, Indian Prime Minister Narendra Modi's upcoming visit to China for the Shanghai Cooperation Organisation (SCO) summit carries considerable strategic significance. The thaw in India-China relations offers a timely opportunity to address existing economic imbalances to foster a more balanced engagement, along with reducing external vulnerabilities. Amid these shifting global realities, this policy brief explores three key questions: (i) How can India enhance and diversify its exports to China? (ii) What strategies can reduce its import dependence on China? and (iii) How can Chinese FDI be increased with appropriate guardrails? Drawing on an analysis of export trends and untapped potential, patterns of import dependence, and the evolving trajectory of Chinese investment in India, the policy brief identifies policy pathways to enhance export competitiveness, reduce vulnerabilities from concentrated imports, and channel FDI with appropriate guardrails strategies. It also emphasises the need for stronger institutional mechanisms to address non-tariff barriers and product standards. Together, these measures aim to foster a more balanced, secure, and resilient economic partnership between India and China.

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JEL classification: *F5, F10, F13, F15, F21*

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Nisha Taneja, Sanjana Joshi, Vasudha Upreti and Nirlipta Rath

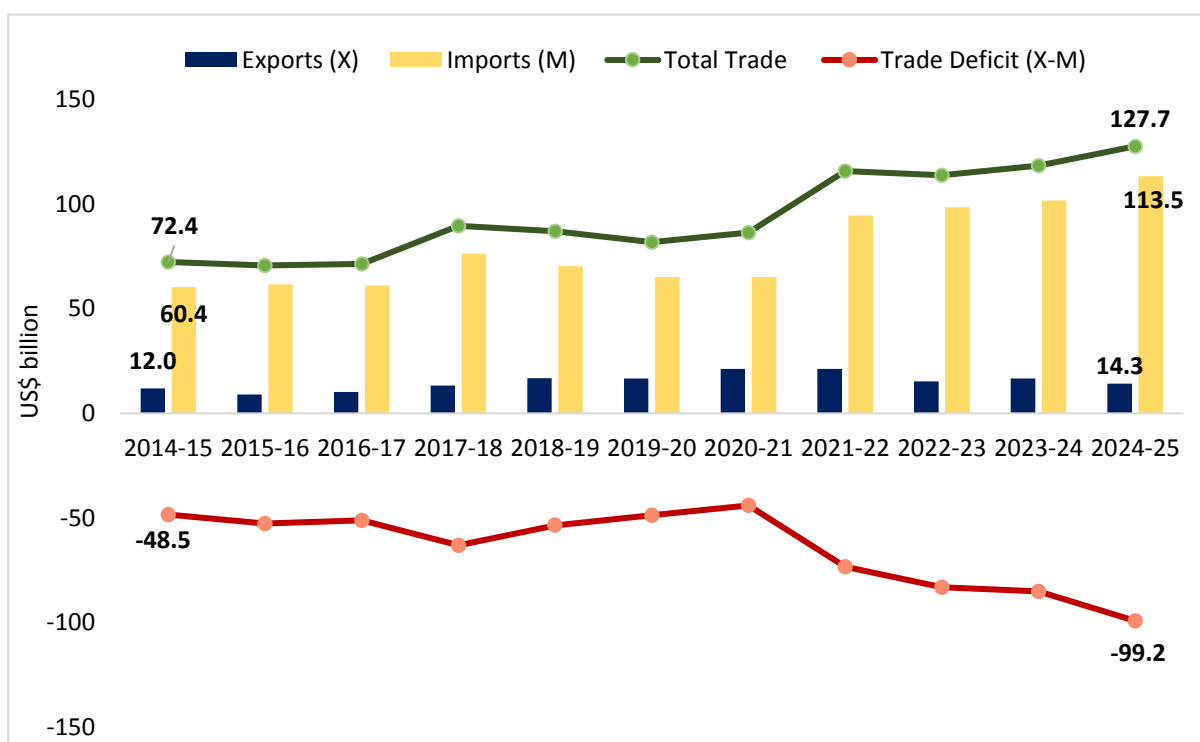
1. The Context

Global trade is in churn with increasing uncertainty and unpredictability induced by shifting geopolitical alliances, national security concerns, and economic nationalism. In this background, Indian Prime Minister Narendra Modi's upcoming visit to China for a summit of the multilateral Shanghai Cooperation Organisation (SCO), for the first time in over seven years, has assumed a great deal of strategic significance. The expectation is that Prime Minister Modi's visit will provide further momentum to India-China rapprochement. In the words of Dr. S. Jaishankar, "Having seen a difficult period in our relationship, our two nations now seek to move ahead".¹ The grounds for this development have been gradually laid since October 2024, when talks took place on complete troop disengagement in Eastern Ladakh, followed by a meeting between Prime Minister Modi and President Xi at the 16th BRICS Leaders' Summit. This progress has been carried over with discussions on advanced cooperation on cross-border trade (through the three designated trading points, Lipulekh Pass, Shipki La Pass, and Nathu La Pass), river data sharing, recommencement of direct flights, easing visa restrictions, and the resumption of the Kailash Mansarovar Yatra.

The bilateral relationship between India and China is among the most complex and dynamic in Asia. Following the Galwan Valley clashes in Eastern Ladakh in 2020, political relations deteriorated sharply; yet, trade between the two countries continued to expand. However, the bilateral trade relationship remains heavily imbalanced. China is India's second-largest trading partner, with total trade reaching US\$ 128 billion in FY25 (Figure 1). However, beneath this resilience lies an imbalance for India. The surge in India's total trade has been driven by soaring imports from China, which peaked at US\$ 113.5 billion in FY25 - increasing by 88 per cent in the last decade. By contrast, exports to China stood at US\$ 14.25 billion in FY25, growing rather sluggishly by only 19 per cent over the same period. Consequently, India's trade deficit with China was US\$ 99.2 billion in FY25 - accounting for 35 per cent of India's total trade deficit and marking the largest deficit India holds with any single country.

¹ WION. (2025, August 19). *India and China need to move ahead after difficult period in bilateral ties: Jaishankar*. <https://www.wionews.com/world/-india-and-china-need-to-move-ahead-after-difficult-period-in-bilateral-ties-jaishankar-1755523404129>

Figure 1: India's exports, imports, total trade, and trade deficit with China (US\$ billion)

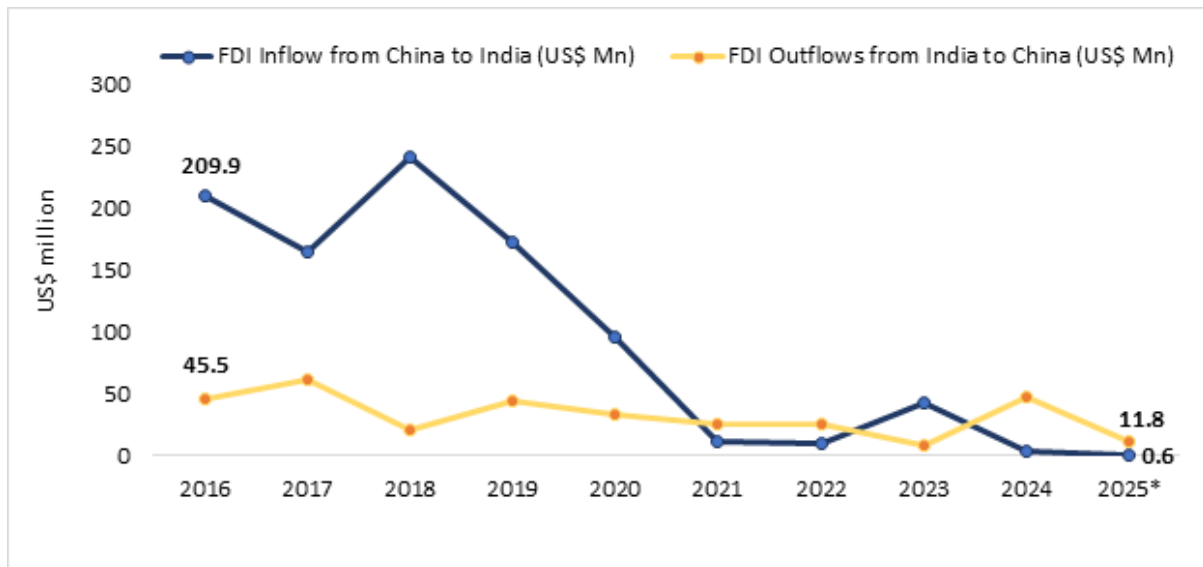


Source: EXIM Data Bank, Ministry of Commerce and Industry

This imbalance is further compounded by persistent structural challenges, as both exports and imports remain prone to significant trade barriers. For instance, Non-Tariff Barriers (NTBs) faced by exporters to China have hindered Indian exports, while China's recent export controls on medium and heavy rare earths have left Indian sectors such as EVs, machinery, electronics, metals, and construction vulnerable, with potential job losses. Due to limited people-to-people and information exchanges, these challenges largely stem from the information asymmetries between the two countries.

FDI inflows from China to India and outflows from India to China have also been low throughout the last decade, reflecting India's cautious stance toward opening its markets to Chinese investment (Figure 2). Between 2016 and 2020, total FDI inflows from China stood at US\$ 886 million. In the subsequent period from 2021 to March 2025, this figure plummeted to just US\$ 68 million, marking a drastic decline. This sharp drop was largely triggered by the Indian Government's action (Press Note 3) that mandated prior Government approval for FDI from countries sharing land borders with India, effectively tightening the investment framework and limiting the scope for new capital inflows, largely from China.

Figure 2: Bilateral FDI trends between India and China (US\$ million)



Source: DPIIT newsletters (FDI inflows) and The Reserve Bank of India (FDI outflows); *Note: The figure showcases FDI outflows to China up to May 2025, while FDI inflows from China are presented up to March 2025

These large economic imbalances in trade and investment flows between India and China need to be revisited against the backdrop of geopolitical developments and the recent thaw in India-China bilateral political relations.

In this policy brief, we focus on three interconnected key questions:

- (i) How can India enhance and diversify its exports to China?
- (ii) What strategies can India adopt to reduce its import dependence on China?
- (iii) How can Chinese FDI into India be enhanced with appropriate guardrails in place?

By examining the evolving trade and investment environment, trade facilitation measures, and bilateral confidence-building initiatives, the policy brief aims to provide actionable policy strategies. We hope that the findings will provide useful inputs for policymakers, industry stakeholders, and strategic planners in shaping a sustainable and mutually beneficial economic partnership with China.

2. India's Exports to China: Current Status and Untapped Potential

This section² analyses the trends and composition of India's exports to China, particularly in terms of the level of skill and technology. The additional export potential of India to China is also estimated, and commodities having untapped potential are highlighted. Furthermore, we examine how tariffs by the U.S. could create potential opportunities for Indian exporters

² This section builds upon and further expands the analysis in Taneja, N et al. (2025)

in the Chinese market. The analysis also identifies the tariff and non-tariff barriers encountered by Indian exporters in the Chinese market, along with key reasons for the rejection of Indian consignments by Chinese authorities.

2.1 Trends and composition

India’s exports to China have shown minimal growth, rising from US\$ 12 billion in 2014-15 to only US\$ 14.25 billion in 2024-25. In 2024, India ranked 34th among China’s import sources, with a share of just 0.7 per cent, far behind Taiwan (8.4 per cent), the Republic of Korea (7 per cent), and the United States (6.4 per cent). Additionally, the composition of India’s export basket to China is characterised by limited diversification, with the top five HS 2-digit categories - mineral products, chemical products, machinery and electronics, live animals and animal products, and base metals constituting about 71 per cent of total shipments in 2024 (Figure 3.a). Alongside this, classification of India’s exports to China by skill and technology level shows that about 68 per cent of India’s exports are resource-based manufactures as well as primary and resource-based agricultural products (Figure 4.a).

Figure 3. a: Share of India’s exports to China at the HS 2-digit level in 2024

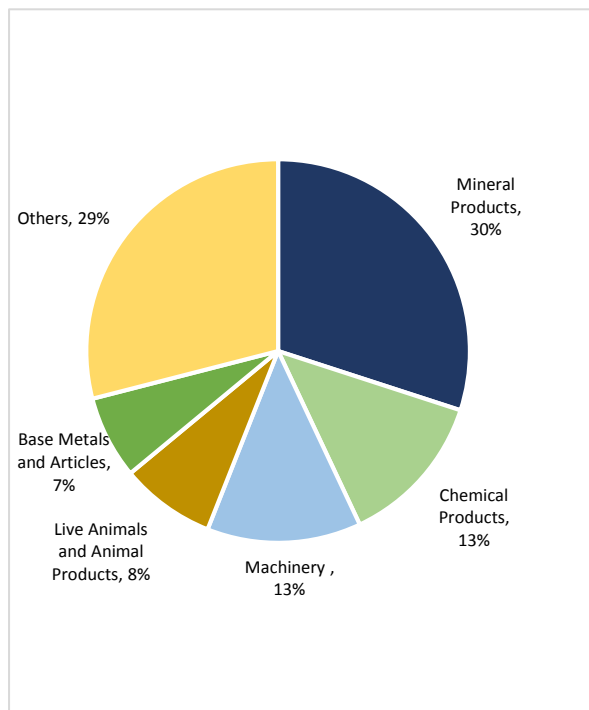
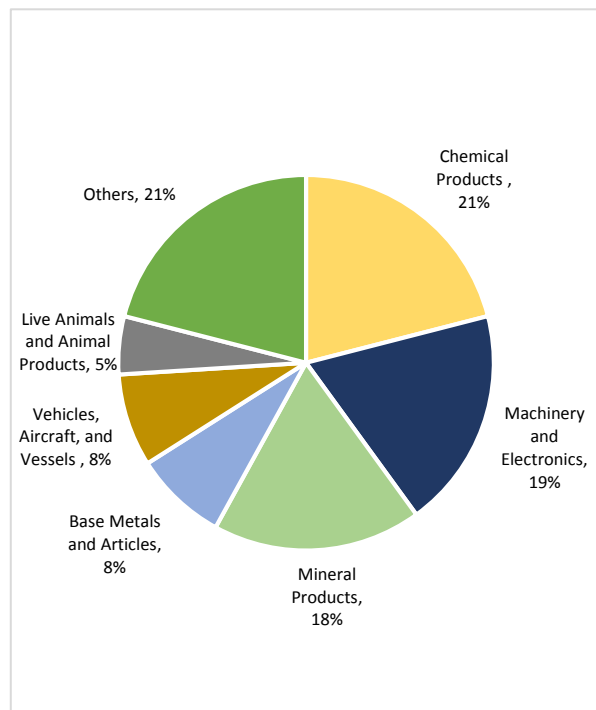


Figure 3.b: Share of India’s additional export potential to China at the HS 2-digit level in 2024



Source: Authors’ calculation using ITC Trade Map

Figure 4.a: Share of India's exports to China as per the level of skill and technology in 2024

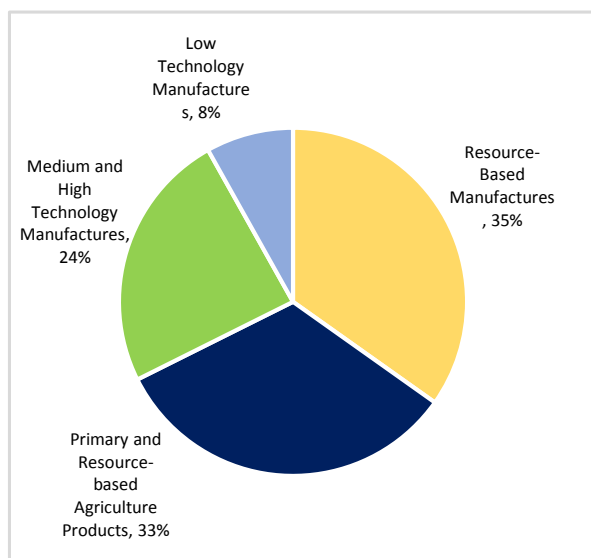
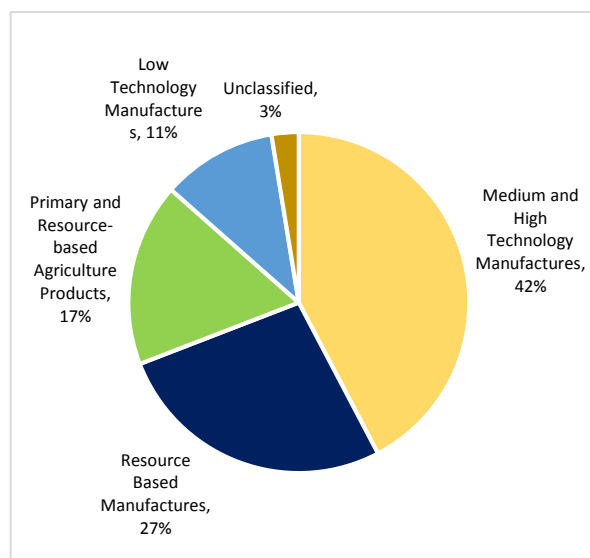


Figure 4.b: Share of India's additional export potential with China as per the level of skill and technology in 2024



Source: Authors' calculation using ITC Trade Map data; Technology classification: UNCTADstat

India's exports to China, being narrowly diversified and dominated by primary and resource-based goods, highlight the need for a concerted action plan that would help diversify as well as upgrade the composition of the export basket to higher technological products. Tapping underutilised export potential with China will not only help narrow the trade deficit but also strengthen India's position amid rising geopolitical uncertainties. The need is now more pressing as recent developments in U.S. tariff measures have left several Indian industries vulnerable in their largest export market. Given this, China offers a timely alternative, with estimates revealing an untapped export potential³ of US\$ 161 billion in 2024, almost ten times the actual export value that year.

The top five categories of products with the highest additional export potential to China are chemical products, machinery and electronics, mineral products, base metals and articles, and vehicles, aircraft, and vessels. Together, these five categories account for 74 per cent of India's total untapped export potential to China (Figure 3.b). Notably, medium and high-technology products constituted 42 per cent of the total additional export potential (Figure 4.b). Given that their current share in India's exports to China is just 24 per cent, this gap highlights the possibility of leveraging better into this segment.

³ Formula for calculating India's untapped export potential with the U.S. (at a disaggregated HS 6-digit level): To assess global competitiveness, we have computed Balassa (1965) revealed comparative advantage for all products exported by India, and selected those items in which India has a Revealed Comparative Advantage (RCA) > 1 $RCA_{ij} = (X_{ij} / X_i) / (X_{wj} / X_w)$ where, X_{ij} represents India's export of commodity j , X_{wj} represents world exports of commodity j , X_i represents the total exports of India, and X_w represents total world exports. Untapped export potential for any globally competitive commodity being exported from India to China is given by: $\text{Min}(IE_x, CI_M) - ET_{IC}$ where IE_x = India's global exports, CI_M = China's global imports, and ET_{IC} = Existing trade between India and China.

At a more disaggregated HS 6-digit level, the top 15 products with the highest additional export potential included oils and preparations, medicaments, telephone sets, aircraft, turbojets, frozen shrimps, and worked diamonds, among others. These top 15 products valued at US\$ 85.7 billion accounted for 53 per cent of India’s total additional export potential to China in 2024 (Table 1). With the likely imposition of additional tariffs by the U.S. on Indian exports⁴, the scope for redirecting some of these products - such as frozen shrimps and gems and jewellery - to China becomes even stronger, positioning it as a viable alternative export market. For instance, the additional export potential of frozen shrimps in China is estimated at US\$ 3.7 billion, yet current exports remain only US\$ 752 million. Similarly, despite an estimated US\$ 3.6 billion export potential in the Chinese market, 36 per cent of India’s worked diamond exports currently go to the U.S., with China accounting for a negligible share.

Table 1: India’s top products with the highest untapped export potential to China at the HS 6-digit level in 2024

HS 6-Digit Product	Description	Current Exports to China (US\$ Mn)	Additional Export Potential to China (US\$ Mn)
271019	Medium oils and preparations	8	20587
300490	Medicaments	71	15111
271012	Light oils and preparations	1209	7449
851712	Telephones Sets	0	6861
880240	Aeroplanes and other aircraft	139	5892
841112	Turbojets	57	4524
30617	Frozen shrimps	752	3629
710239	Diamonds, worked	9	3585
20230	Frozen, boneless bovine meat	0	3557
870899	Parts for motor vehicles	38	3468
711319	Jewellery and precious metals	0	3400
760110	Aluminium, not alloyed	270	3288
854140	Photo semiconductor devices	0	1722
240120	Tobacco	0	1298
290220	Benzene	179	1278
Total of Top 15		2732	85649

Source: Authors’ calculation using ITC Trade Map data

2.2 Market barriers inhibiting exports to China

Realisation of large additional export potential with China has been constrained by several tariff and non-tariff barriers. An analysis of the simple average tariffs (2023) at the aggregated 2-digit level shows varying intensity across sections (Table 2). Among the top sections with the highest export potential, tariffs were 9.8 per cent for ‘Vegetable Products’ and 8.8 per cent for ‘Vehicles, Aircraft, and Vessels’, while Prepared Foodstuffs, Animal or Vegetable Fats and Oils, and Arms and Ammunition also faced relatively high rates. However, these tariffs

⁴ At present, India faces interim tariffs of 25 per cent imposed by the U.S. on certain products, with the possibility of an additional 25 per cent tariff being enforced from 27 August 2025 onwards.

have demonstrated a declining trend across almost all product sections in 2023 as compared to those in 2013 (Table 2).

Table 2: Additional export potential from India to China and associated tariff rates at the section-wise HS 2-digit level

Section	Additional Export Potential in US\$ Mn (2024)	Average Tariff Rates in % (2013)	Average Tariff Rates in % (2023)
Products of the chemical or allied industries	33352	6.89	5.68
Machinery, electrical, and sound equipment	30649	7.44	4.97
Mineral products	29258	3.53	2.49
Base metals and articles of base metal	12942	8.60	6.16
Vehicles, aircraft, and vessels	12700	11.63	8.79
Live Animals; Animal Products	8683	11.65	6.69
Pearls, precious or semi-precious stones and metals	8020	14.58	4.90
Textiles and textile articles	7094	11.77	5.86
Vegetable Products	5266	17.04	9.80
Plastics and articles, rubber and articles thereof	3686	9.49	8.04
Prepared foodstuffs	3297	17.78	10.53
Raw hides and skins, leather, fur skins and articles	1643	12.86	7.25
Optical, precision, and medical instruments	1134	9.31	4.75
Stone, ceramic, and glass products	739	12.65	9.90
Miscellaneous manufactured articles	519	12.31	5.95
Footwear, headgear, umbrellas, walking sticks, etc.	517	18.26	6.25
Pulp of wood or of other fibrous cellulosic material	479	5.75	4.49
Animal or vegetable fats and oils	312	13.27	12.71
Wood and articles of wood	269	5.51	3.74
Arms and ammunition	6	0.00	13.00
Works of art, collectors' pieces and antiques	4	6.50	1.05

Source: Authors' calculations; Information on tariffs data from the WTO database

Although China has progressively implemented tariff liberalisation, the realisation of its untapped export potential remains constrained by persistent Non-Tariff Barriers (NTBs), which continue to pose significant challenges to exporters. According to Indian businesses, China does not permit retesting by third-party laboratories if products fail initial random sampling, making the testing lab's decision final and non-appealable. The recent National

Trade Estimate Report (2025)⁵ published by the United States Trade Representative also highlights key barriers for U.S. pharmaceutical exporters to China, which include restrictive patent examinations, unauthorised disclosure and commercial use of data, slow regulatory approvals, inadequate patent dispute mechanisms, mandatory patent sharing with Chinese partners, and delays in granting patent term extensions. These barriers could also apply to Indian exporters of pharmaceuticals - a sector in which there is a huge potential for Indian exports.

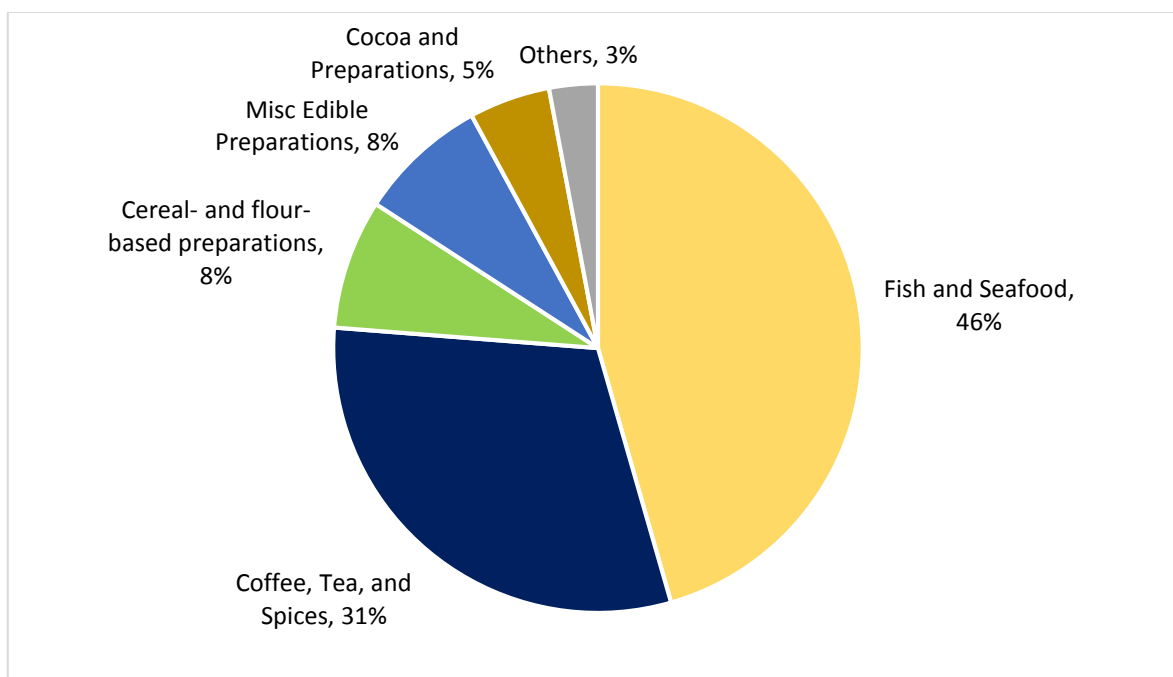
A major impediment that Indian exporters face is the lack of information on regulatory and documentary requirements laid down by Chinese authorities, leading to high transaction costs. This problem is exacerbated by language barriers, as trade-related laws, regulations, and departmental rules are not consistently translated into English. Moreover, sub-central government measures are rarely available in translation, compelling exporters to spend additional time and resources on translation and sourcing information from multiple channels.⁶

On its part, India has difficulty in meeting the product standards laid down by China. India's inability to meet the Chinese product standards is reflected in the number of consignments rejected, particularly in agricultural products. Between 2019 and May 2025, Chinese border authorities rejected roughly 600 Indian food and agricultural export consignments. Fish and seafood accounted for the largest share (46 per cent), followed by coffee, tea, and spices (30 per cent), and cereal and flour-based preparations (8 per cent) (Figure 5). The overall rejections climbed sharply from 2019, peaking at 219 cases in 2021, before recording a steady decline through May 2025 (Table 3). In light of the recent tariff declarations by the Trump administration, and with China emerging as a potential alternative market for Indian shrimp exports, the persistently high rejection rates for seafood in China in recent years are of particular concern.

⁵ The Office of the United States Trade Representative (USTR). (2025, March). *2025 National Trade Estimate Report on Foreign Trade Barriers*. <https://ustr.gov/sites/default/files/files/Press/Reports/2025NTE.pdf>

⁶ Verma, N. (2022). *Non-tariff barriers faced by Indian exporters from their top partner members (EAC-PM Working Paper Series)*. <https://eacpm.gov.in/wp-content/uploads/2023/07/5-Non-Tariff-Barriers-faced-by-Indian-Exporters.pdf>

Figure 5: Distribution of the rejected export consignments from India by China (2019- May 2025)



Source: General Administration of Customs of the People’s Republic of China (GACC) data

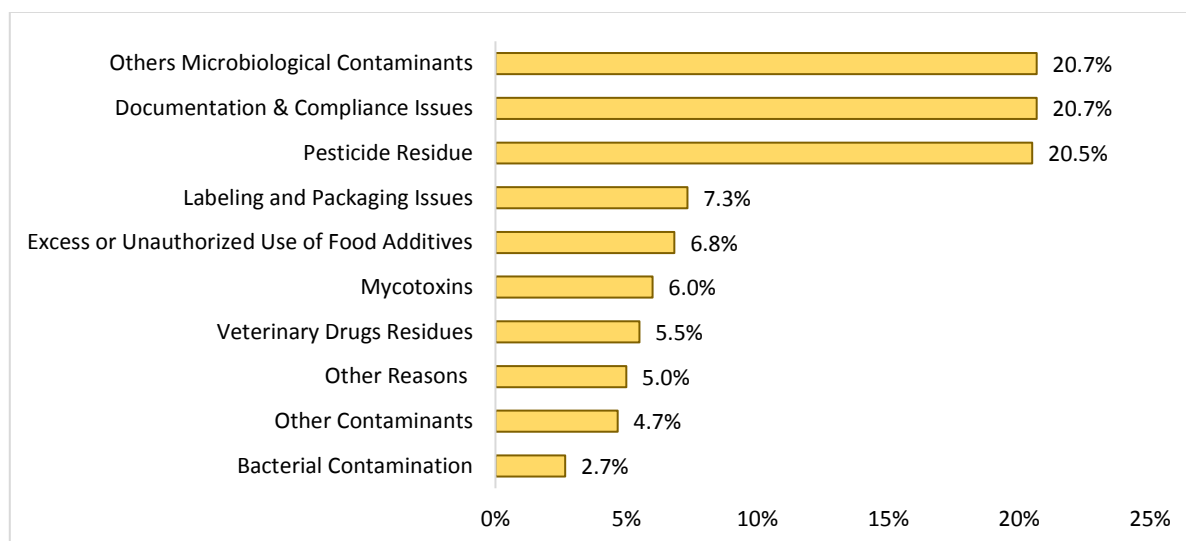
Table 3: Year-wise rejected export consignments of India by China

Year	Fish and Seafood	Coffee, Tea, and Spices	Cereal- and flour-based preparations	Misc. Edible Preparations	Cocoa and Preparations	Others	Total Rejections (Year)
2019	8	30	3	0	1	3	45
2020	22	74	1	1	3	3	104
2021	71	65	34	20	16	13	219
2022	50	6	4	6	0	6	72
2023	45	3	0	0	2	2	52
2024	56	5	2	1	4	4	72
2025 (till May)	26	0	1	2	2	4	35
Total	278	183	45	30	28	35	599

Source: General Administration of Customs of the People’s Republic of China (GACC) data

These rejections were caused by a diverse set of non-compliance factors, primarily due to documentation, compliance issues and microbiological contaminants, each accounting for 20.7 per cent of the total rejection cases (Figure 6). Pesticide residue violations, accounting for 20.5 per cent, were closely followed by issues related to labelling and packaging errors, excess and unauthorised use of additives, and mycotoxin contamination.

Figure 6: Distribution of rejected food & agri-exports by China from India, by cause (2019- May 2025)



Source: Authors' calculations using the GACC data

While India's exports to China remain heavily concentrated in primary and resource-based goods, there is a considerable untapped potential for expansion into higher-value segments. The recent thaw in diplomatic relations presents a timely opportunity to recalibrate this trade dynamic. At the same time, addressing NTBs should remain a central priority, both bilaterally and domestically. Many of these barriers stem from limited people-to-people contact and information asymmetries between the two countries.

3. India's Imports from China

This section⁷ reviews the growth of India's imports from China over the past decade and their product composition. It highlights the major import categories, the extent of India's dependence on China for specific items, and the share of uncompetitive imports within India's import basket.

3.1 Trends and composition

India's imports from China have grown sharply - from US\$ 60.4 billion in 2014-15 to US\$ 113.5 billion in 2024-25. This surge has made China India's largest import partner, accounting for roughly 16 per cent of India's total import basket, while positioning India as China's sixth-largest export destination.

Chinese imports into India span a far more diverse and technologically advanced segments, including machinery and electronics, chemical products, base metals, plastics and articles thereof, as well as textiles and textile articles (Figure 7.a). Notably, 75 per cent of India's imports from China comprised high and medium-technology manufactures (Figure 7.b).

⁷ This section builds upon and further expands the analysis in Taneja, N and Upreti, V (2025)

Figure 7. a: Share of India's imports from China as per the HS 2-digit in 2024

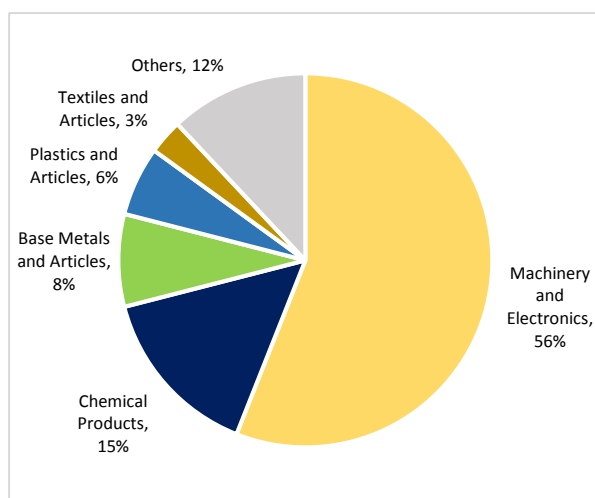
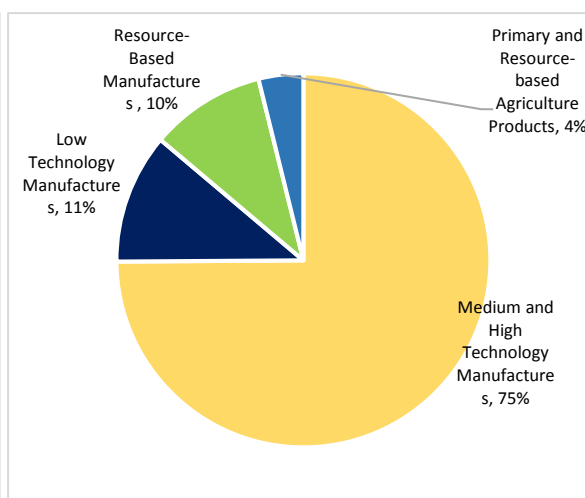


Figure 7.b: Share of India's imports to China as per the level of skill and technology in 2024



Source: Authors' calculation using ITC Trade Map data; Technology classification: UNCTADstat

Key imports at the disaggregated HS 6-digit level include parts of telephone sets, data-processing machines, electronic integrated circuits, and photosensitive semiconductor devices, among others (Table 4). Notably, India relies heavily on China for these top import items, with items such as data-processing machines accounting for 80 per cent of India's total global imports and penicillin imports making up 91 per cent of the country's global supply.

In fact, in 2024, there were around 562 products for which India's imports from China accounted for 80 per cent or more of its total imports of that product from the world. These high-dependency items represented about 16 per cent of India's total imports from China, valued at approximately US\$ 16 billion.

Table 4: India's top import products from China and their share in world imports in 2024

Product	India's Imports from China (US\$ Bn)	India's Imports from the World (US\$ Bn)	Share in World Imports
Parts of telephone sets	7.1	13.7	52%
Data-processing machines	4.7	5.9	80%
Electronic integrated circuits	4.6	14.7	31%
Photosensitive semiconductor devices	3.6	4.8	76%
Lithium-ion accumulators	2.1	2.8	75%
Electronic integrated circuits as memories	1.6	4.2	39%
Electronic integrated circuits (excl. memories)	1.4	4.3	33%
Parts of automatic data-processing machines	1.2	2.8	41%
Static converters	1.1	2.0	56%
Machines and mechanical appliances	1.1	2.1	50%
Polyvinyl chloride	1.0	2.6	38%
Antibiotics (excl. penicillin and their derivatives)	0.8	0.9	85%
Preparations based on titanium dioxide	0.7	1.1	62%
Penicillin and its derivatives	0.7	0.8	91%

Source: Authors' calculation using ITC Trade Map data

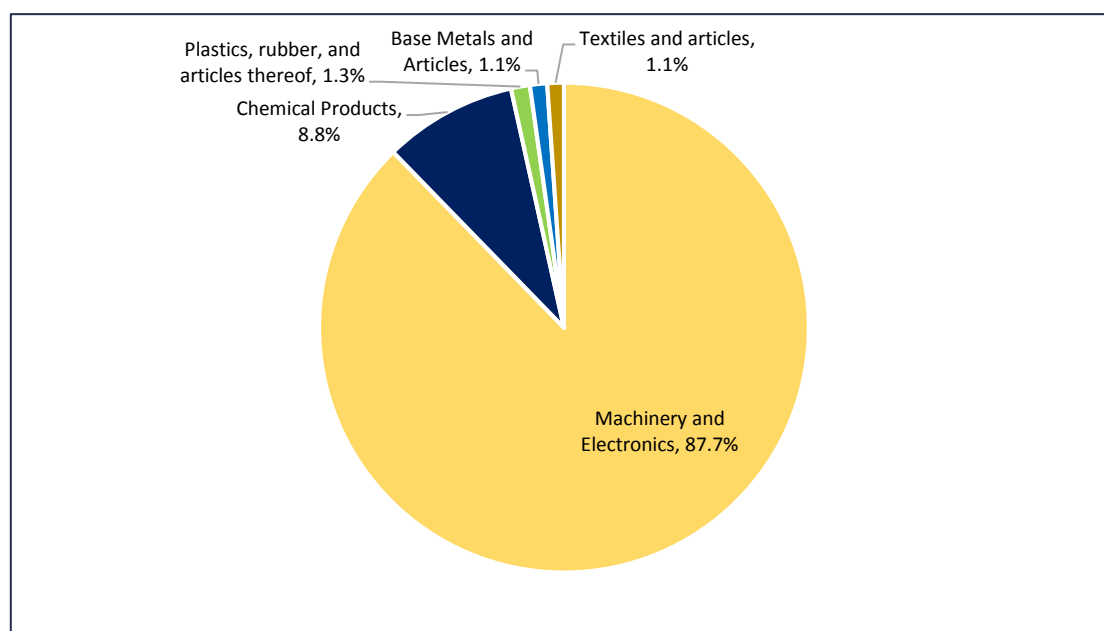
Such heavy dependence on Chinese imports raises critical concerns about India’s industrial reliance across key sectors such as manufacturing, infrastructure, automobiles, renewable energy, telecom, and pharmaceuticals, amplifying vulnerability to supply chain shocks and worsening trade imbalances.

3.2 Uncompetitive imports from China

Another key concern regarding the long-term sustainability of India’s trade balance with China is the dominance of uncompetitive imports in India’s import basket.⁸ A product imported from China can be considered uncompetitive when its per-unit import price is higher than that offered by at least one of India’s top three alternative supplier countries for the same product.

In 2024, out of the top 50 imported products from China, around 23 were uncompetitive, 8 of which belonged to the top 15 itself. For instance, among these uncompetitive products is Penicillin, which India imports from China despite being available at 15 per cent lower prices from Hong Kong and 36 per cent lower from the UAE. Likewise, smartphones imported from China cost about 35 per cent more than those sourced from Vietnam. These uncompetitive imports - mainly machinery, electronics, and chemicals - were worth nearly US\$ 30 billion, or two-thirds of the import value of the top 50 products (Figure 8).

Figure 8: Distribution of India’s top 50 price-uncompetitive imports from China at the section-wise HS 2-digit level in 2024



Source: Authors’ calculation using ITC Trade Map and UNCOMTRADE data

⁸ Mohanty, S. K. (2014, July). *India-China bilateral trade relationship*. <https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/PRsicBT130613.pdf>

The persistence of such uncompetitive imports despite available cheaper alternatives can be attributed to China's strategic export practices. China is known to offer deferred payment options, low-interest financing, and technical cooperation arrangements to make its exports more attractive to importing countries. For this purpose, the China Export and Credit Insurance Corporation - Sinosure⁹ - plays a proactive role by offering credit insurance to Chinese exporters, covering the risk of non-payment. Under specified terms and conditions, it can bear up to 100 per cent of the risk amount, providing a significant advantage to exporters by enabling deferred payment arrangements. This, in turn, enhances the competitiveness of Chinese products, even when their unit costs are higher.

The sharp rise in India's imports from China - more than doubling over the past decade and concentrated in high and medium-technology sectors - remains a major concern for the country, particularly due to the heavy reliance on top import items that constitute a substantial share of India's total imports of these products from the world. Many of these imports are also uncompetitive, sustained by China's strategic financial practices. Curbing this dependence - especially on uncompetitive imports - should remain a critical strategic priority.

4. Chinese Investment Flows into India

This section¹⁰ examines the trajectory of Chinese investment inflows to India over the past decade, with a focus on trends, sectoral composition, and the policy framework shaping these inflows. It reviews how investment patterns evolved before and after the introduction of DPIIT Press Note 3 (2020)¹¹, highlighting the trends in both automatic and government approval routes. The section also discusses India's shifting policy stance towards Chinese FDI in recent years and its implications for key sectors such as manufacturing, electronics, and retail.

4.1 Trends and composition

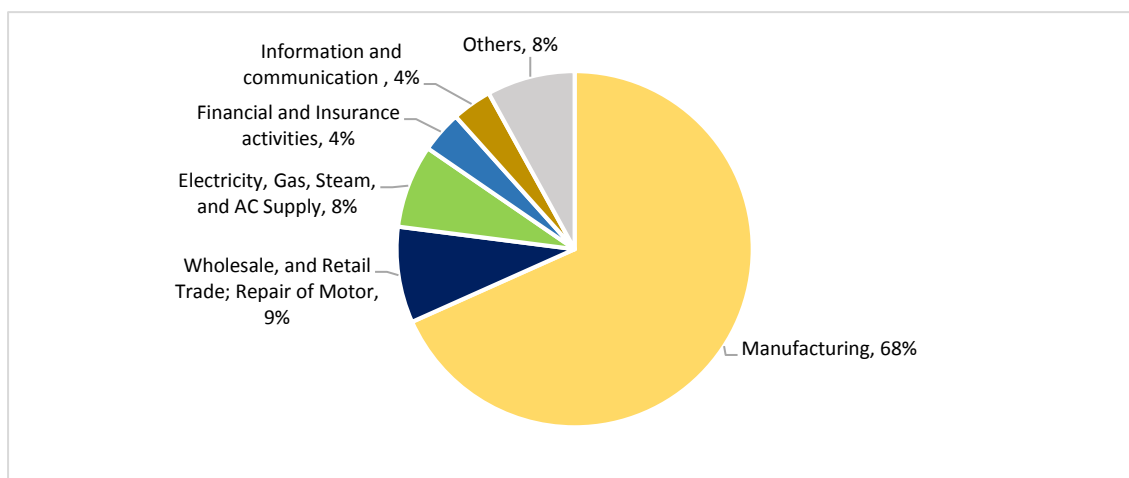
While imports from China to India have grown significantly over the past decade, Chinese investments in India have declined and remained well below their potential. Between 2016 and March 2025, India received about US\$ 954 million in FDI from China, with inflows falling from US\$ 210 million in 2016 to just US\$ 3.7 million in 2024. Over two-thirds of these investments went into manufacturing (Figure 9), led by motor vehicles (18 per cent), electrical equipment (17 per cent), and computers & electronics (14 per cent).

⁹ Newell, D. (2024, January 8). *How to deal with Sinosure as an importer*. <https://www.globaltrademag.com/how-to-deal-with-sinosure-as-an-importer/>

¹⁰ This section builds upon and further expands the analysis in Taneja, N and Upreti, V (2025)

¹¹ Department for Promotion of Industry and Internal Trade, Ministry of Commerce & Industry, Government of India. (2020, April 17). *Press Note No. 3 (2020 Series)*. https://dpiit.gov.in/sites/default/files/pn3_2020.pdf

Figure 9: Distribution of FDI inflows from China to India to various industries as per the NIC 2008 section-wise classification (2016-March 2025)

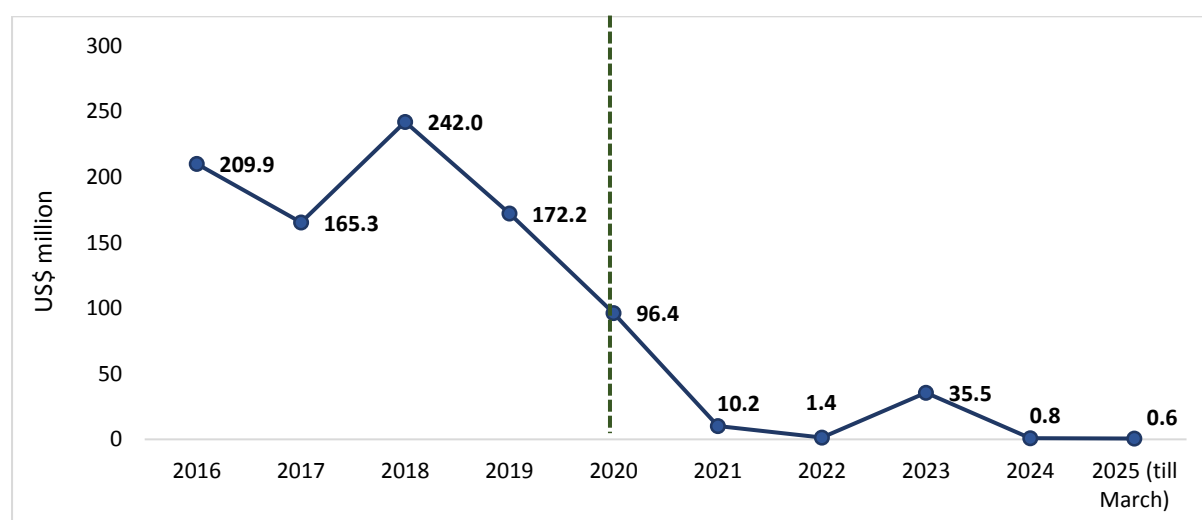


Source: Authors' calculations using FDI data from DPIIT newsletters and classification from NIC 2008

Prior to 2020, China was not subject to any specific restrictions on inward investment into India. Therefore, during this period, Chinese FDI into India occurred almost entirely via the automatic route, amounting to approximately US\$ 886 million between 2016 and 2020 (Figure 10), while inflows through the government route were negligible, around US\$ 0.2 million (Figure 11).

However, despite this policy openness, various non-policy barriers constrained investment flows. As highlighted by Taneja et al. (2015)¹², examples of such barriers included mutual trust deficits, visa hurdles for Chinese nationals, and Chinese state-owned enterprises' focus on natural resource sectors like oil, gas, and coal.

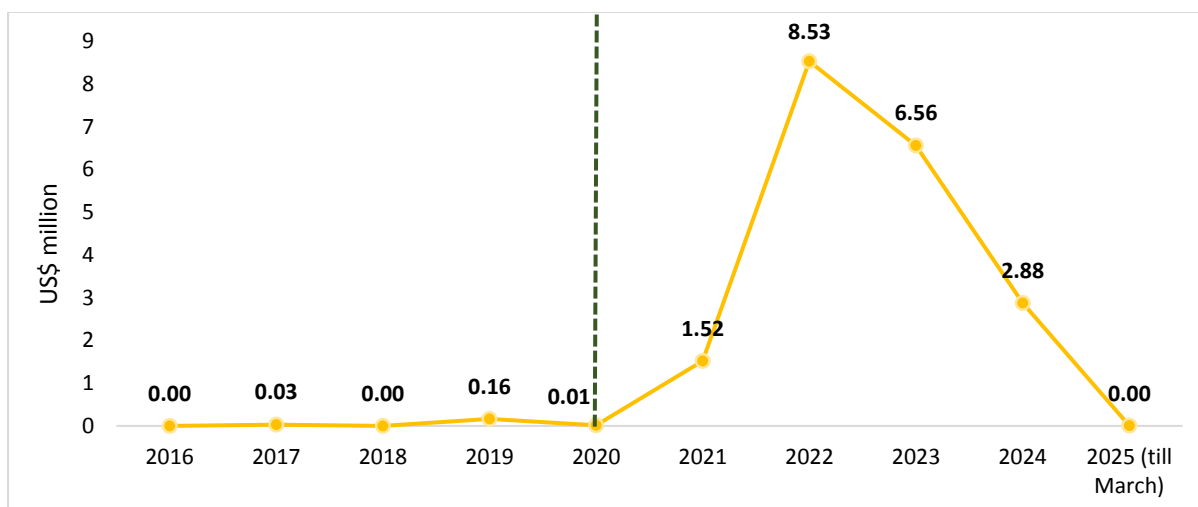
Figure 10: India's FDI inflows from China over the years (US\$ million) via the automatic route



Source: DPIIT newsletters

¹² Taneja, N., Wadhwa, D., & Bimal, S. (2015, July 11). *India's trade deficit with China: How to bridge the gap?* <https://www.epw.in/journal/2015/28/commentary/indias-trade-deficit-china.html>

Figure 11: India's FDI inflows from China over the years (US\$ million) via the government route



Source: DPIIT newsletters

A major turning point for FDI inflows to India came in April 2020 with the introduction of the Press Note No. 3 (PN3) by DPIIT, which altered how FDI inflow from countries bordering India is treated. The PN3 mandates that any investment originating from countries sharing a land border with India - including China - or where the 'beneficial owner' of the investment is based in or is a citizen of such countries, must receive prior government approval. Before this change, investors from these countries (except Pakistan and Bangladesh) could invest in India largely through the automatic route, facing minimal restrictions unless operating in sensitive sectors.

As stated in the official text of the note, PN3 was introduced to "curb opportunistic takeovers/acquisitions of Indian companies due to the COVID-19 pandemic," seemingly in an immediate response to the growing concerns over predatory Chinese capital acquiring stakes in Indian firms, triggered by the People's Bank of China's decision to increase its shareholding in HDFC Bank from 0.8 per cent to 1.0 per cent. Coupled with China's history of strategic acquisitions in the U.S. and Europe, which led several countries to tighten their own FDI norms, these developments influenced India's decision to introduce stricter screening of investments.

The situation was further intensified following the clashes between the countries in Galwan Valley in June 2020, prompting India to take further steps to restrict Chinese investment in India, such as rejecting several high-profile investment proposals, including one from electric vehicle manufacturer BYD.

This policy overhaul had a marked effect on both the volume and route of FDI inflows. From 2020 onwards, FDI through the automatic route declined sharply from US\$ 96.4 million in 2020 to just US\$ 0.64 million in 2025 (till March) (Figure 10). Meanwhile, FDI through the

government route, which had remained nearly dormant earlier, began to show some activity, peaking at US\$ 8.53 million in 2022 (Figure 11). This shift not only rerouted investments through the government approval channel but also led to the exit of several investors who had previously relied only on the automatic route.

4.2 India's shifting approach to Chinese FDI

While the PN3 restrictions remain in force, Indian discourse has recently shown a softening in stance towards Chinese investments. The Economic Survey of India 2023-24 set the tone for this shift in approach, vouching for attracting China's FDI into India's manufacturing sector stating how a complete decoupling from Chinese supply chains may not be a viable option for India due to China's deep integration into global supply chains, and the significant share of intermediate and capital goods sourced from China that are critical for sustaining India's manufacturing capacity. Hence, a more pragmatic approach would be to reduce overdependence on imports by encouraging greater Chinese FDI in India's manufacturing sector. In addition to providing essential capital, these investments will enhance India's manufacturing capabilities and support the "Atmanirbhar Bharat" initiative by fostering a more conducive environment for domestic manufacturing.

This policy shift has also started influencing government actions, particularly in the electronics and automobile sectors, where Chinese investments are now receiving faster security clearances from the Indian authorities. While blanket clearances remain limited, joint ventures (JVs) with Indian firms are being increasingly facilitated. For instance, in 2024, approvals were granted to the Micromax-owned Bhagwati for a JV with Chinese manufacturer Huaqin and to Dixon Technologies for acquiring a stake in Ismartu India, a subsidiary of China's Transsion Holdings. Similarly, the JV between India's JSW Group and China's SAIC Motor to produce electric vehicles under the MG brand also received approval.

Beyond electronics, easing measures are also evident in retail. Shein, the Chinese fast-fashion giant banned by India in 2020, is re-entering India via a partnership with Reliance Retail, which will fully control the Shein India Fast Fashion application. The return was cleared only after scrutiny by key ministries and requires regular government-approved cybersecurity audits.

Despite historically low Chinese FDI inflows and the further decline caused by the introduction of the PN3 in 2020, the present context offers a pivotal window for a strategic reset for inviting Chinese FDI into India. With policy discourse increasingly recognising the role of Chinese capital and technology in advancing India's manufacturing ambitions, it is time for India to move beyond ad-hoc approvals. A predictable, transparent, and well-defined framework is the need of the hour - one that safeguards national interests, protects security, and bolsters domestic industrial capacity.

5. Way Forward – Economic Engagement Strategies

At this current pivotal juncture in India-China relations, it is essential to adopt targeted strategies that not only address existing barriers to trade and investment but also balance economic engagement with the imperatives of national security.

Figure 12: Key Strategies



5.1 How can India enhance and diversify its exports to China?

- i. **Prepare an Export Diversification Strategy:** India should adopt a targeted approach to diversify its export basket to China, moving beyond primary and resource-based goods to expand into medium and high-technology products such as telephone sets, aircraft, turbojets, motor vehicle parts, and photo-semiconductor devices. Such diversification would enhance export value and competitiveness while narrowing

the trade deficit, leveraging India's substantial untapped potential in China's market. Given the tariff and policy uncertainties in the U.S. market, India could consider redirecting some exports - such as frozen shrimps, cut and polished diamonds, jewellery and precious metals, telephone sets, and motor vehicle parts - to China, where they hold additional export potential, thereby mitigating risks and unlocking new growth opportunities.

- ii. **Establish a Bilateral Mechanism to Address NTBs:** Identifying and addressing NTBs is essential to improving market access for Indian exporters to China. An impactful step in this direction could be the creation of a joint India-China task force of trade and technical experts, which would facilitate the sharing of trade-related information and identify, monitor, and resolve NTBs through regular consultations, technical cooperation, and early resolution of disputes.
- iii. **Improve Transparency:** To reduce the transaction costs arising from language-related issues, China could be urged to comply with WTO-designated languages for all official trade communications. Similarly, to address the issue of arbitrary product rejections during random sampling, China can be encouraged to establish a transparent, efficient, and accountable third-party laboratory testing mechanism. This would provide Indian exporters with an opportunity to appeal such decisions and ensure fairer compliance procedures.¹³
- iv. **Improve Product Standards:** On its part, India should simultaneously work towards upgrading its domestic systems, particularly in cases where product rejections stem from quality-related issues. Strengthening internal quality infrastructure will not only enhance export competitiveness but also help reduce vulnerability to unjustified non-tariff measures.
- v. **Enhance Exchanges to Bridge Information Gaps:** Initiatives to enhance information exchange and reduce prevailing asymmetries between the two countries are essential to laying the groundwork for a more balanced trade relationship. The Indian government's recent decision to reinstate tourist e-visas for Chinese citizens is a positive step in this direction, as it will facilitate business interactions, foster partnerships, and enable greater information sharing.¹⁴ India and China are already on track to promote greater people-to-people exchanges, including arrangements for the resumption of direct flights, enhanced media and think-tank interactions, and other platforms for cultural and professional exchange. Continued proactive efforts to broaden these channels will be critical for building trust, improving mutual understanding, and creating the enabling environment needed to address market access barriers.

¹³ Verma, N. (2022). *Non-tariff barriers faced by Indian exporters from their top partner members (EAC-PM Working Paper Series)*. Retrieved from <https://eacpm.gov.in/wp-content/uploads/2023/07/5-Non-Tariff-Barriers-faced-by-Indian-Exporters.pdf>

¹⁴ Saha, S. (2025, July 25). *India reopens e-visas for Chinese tourists: What it means for travel, culture and business*. <https://www.ndtv.com/travel/india-reopens-e-visas-for-chinese-tourists-what-it-means-for-travel-culture-and-business-8947975>

5.2 What strategies can India adopt to reduce its import dependence on China?

- vi. Reduce Import Dependence through Targeted Chinese FDI:** While India's high and growing dependence on Chinese imports raises serious concerns about industrial reliance and strategic autonomy, a complete decoupling from Chinese supply chains is unlikely to be viable. This is due to China's deep integration into global value chains, particularly its large share of intermediate and capital goods that are critical to sustaining India's manufacturing capacity. A more pragmatic strategy, therefore, is to gradually reduce overdependence by encouraging targeted Chinese FDI in India's manufacturing sector, particularly under the Production Linked Incentive (PLI) scheme. By incentivising Chinese firms to set up factories in India, domestic production capacity can be scaled up, local supply chains strengthened, and value addition retained within the country. This approach holds particular promise for high-dependence sectors, such as electronics and technology products and components, automobiles and auto-components, and pharmaceuticals, where localisation of production can substantially cut the import bill while fostering technology transfer and job creation.
- vii. Diversify Imports:** Complementing this, a strategy of import diversification could be adopted for uncompetitive imports from China, achieved by gradually shifting towards more price-competitive suppliers, and exploring new source countries by creating an enabling environment to facilitate imports from these markets. For instance, products like smartphones and telephone sets can be sourced at a much cheaper price from Hong Kong and Vietnam, flat panel display modules from South Korea and Hong Kong, and penicillin from countries such as Hong Kong and the UAE.
- viii. Bilateral Mechanism to ease Imports of Items Subject to Chinese Export Controls:** China's April 2025 export controls on critical medium and heavy rare earths - including samarium, gadolinium, terbium, dysprosium, lutetium, scandium, and yttrium - require exporters to obtain licenses and declare control numbers at customs. For India, which depends on Chinese supplies for its defence, electronics, clean energy, and EV sectors, these restrictions could disrupt supply chains and raise costs. It may be noted that exports are not banned but only require a license, which creates an administrative burden on importers and exporters. This issue can be dealt with by setting up a bilateral mechanism that would address information asymmetries, reduce delays, and facilitate transactions.

5.3 How can Chinese FDI into India be enhanced with appropriate guardrails in place?

- ix. Revisit Press Note 3 and Establish Guardrails based on Global Experiences:** The PN3 remains one of the biggest obstacles to advancing India-China economic ties. Alongside causing a decline in Chinese investments into India since 2020, PN3 contains several ambiguities in its text, such as the scope of the term 'beneficial

owner' and its interpretation under varying thresholds in Indian laws. Overall, PN3 has created an unwelcoming environment for investors, with the reliance on the government route further adding significant administrative bottlenecks. In this context, the best way forward for India would be to incorporate lessons from other countries' regulatory experiences and establish clear guardrails to safeguard national security.

Several countries have adopted guardrails to protect FDI from flowing into vulnerable sectors. For instance, the USA, Australia, Germany, and Italy designate sensitive sectors - such as defence, critical infrastructure (energy, transport, communications, healthcare), advanced and emerging technologies (AI, semiconductors, biotechnology, cybersecurity), and critical minerals - for enhanced scrutiny. Australia goes a step further by exercising "call-in" and "last resort" powers to reassess previously approved investments if national security risks emerge, a safeguard India could also consider.

Drawing from such global practice, India could use safeguards for foreign investments in sensitive sectors like defence, telecommunications, infrastructure, and emerging technologies, while simultaneously permitting and even encouraging higher equity inflows through the automatic route in non-strategic areas such as manufacturing. For instance, for China, India could allow up to 49 per cent equity participation in non-sensitive sectors - higher than the 24 per cent proposed by NITI Aayog. At the same time, for sensitive sectors, institutional safeguards such as post-approval reviews, a central registry of foreign ownership, conditional approvals (e.g., restrictions on board representation, mandatory technology transfer clauses, periodic compliance audits), and inter-agency coordination should be built into the system.

- x. **Establish an Inter-agency Committee:** Complementing this could be the establishment of a centralised inter-agency committee, with representation from key ministries and departments - such as the Ministry of Home Affairs, Department for Promotion of Industry and Internal Trade (DPIIT), Ministry of Electronics and Information Technology (MeitY), Department of Telecommunications, Ministry of Information and Broadcasting, and the National Security Council Secretariat (NSCS). This body would streamline approvals, assess national security risks, and oversee investments involving sensitive personal data - similar to the Committee on Foreign Investment in the United States (CFIUS).

5.4 Additional Pathways

- xi. Revive MoUs to Deepen Economic Cooperation** - The recent improvement in India-China diplomatic relations provides a strategic window to revive the signing of MoUs and agreements, particularly in the sphere of economic cooperation. In the past, both countries have actively engaged through MoUs, dialogues, programmes, and formal agreements, reflecting a shared commitment to strengthening trade and investment ties through structured and institutionalised cooperation.

Rekindling the cooperative spirit of 2013-2019, an era marked by a flourishing of bilateral engagements, can help address persistent trade and investment imbalances while creating structured channels for dialogue, investment, and sectoral partnerships. Reinstating such institutional mechanisms will therefore be critical in advancing a more stable, predictable, and mutually beneficial economic relationship.

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