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# Trade Policy in PRC and India in the New Era of Slower World Growth:

## Challenges and Policy Options

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# Weak External Environment Manifests in Asia's Giants

| GDP Growth (%) | 2011 | 2012f Revised | 2013f Revised |
|---|---|---|---|
| Major industrial economies | 1.2 | 1.2 | 1.3 |
| United States | 1.8 | 2.2 | 2.1 |
| Euro area | 1.4 | -0.4 | 0.2 |
| Japan | -0.7 | 1.7 | 1.6 |
| **Developing Asia** | **7.2** | **6.0** | **6.6** |
| East Asia | 8.1 | 6.4 | 7.0 |
| China, People's Rep. of China | 9.3 | 7.7 | 8.1 |
| South Asia | 6.2 | 5.3 | 6.2 |
| India | 6.5 | 5.4 | 6.5 |
| Southeast Asia | 4.6 | 5.3 | 5.5 |

Source: ADB Asian Development Outlook 2012 Update

# Contents

- With the world economy in the recovery ward, Asia‘s giants under scrutiny as among the few exciting sources of growth

- Lively debate on the giants economic strategies and global impact

- Topical issues:
  - How do the giants compare?
  - What explains the giants rise?
  - Can India close the gap with PRC?
  - What trade issues lie ahead in a turbulent world economy?

- Talk based on Wignaraja (2011 and 2012)

# Messages

- Giants rise impressive. PRC ahead in world trade due to manufacturing. India leads in skill-intensive IT exports.

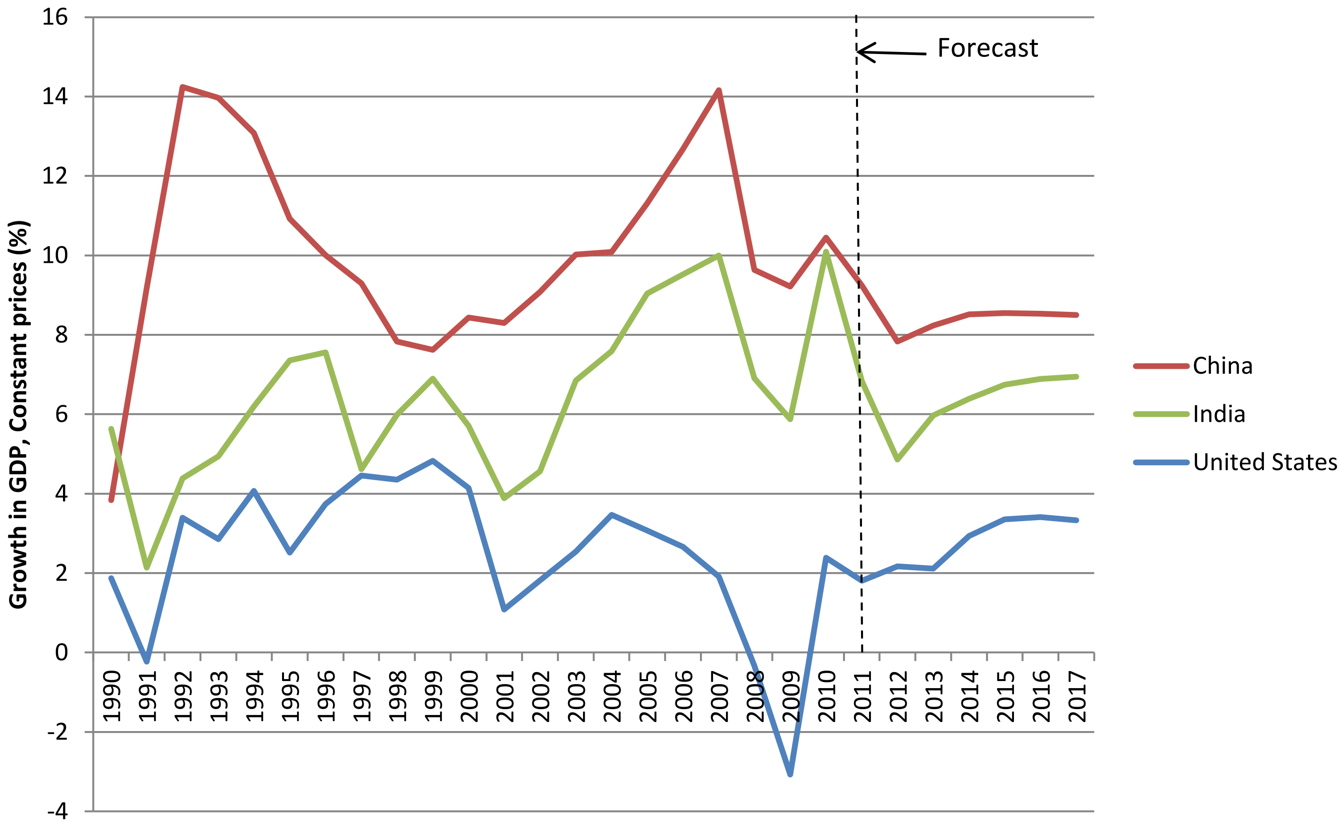
- Why?
  - On balance, initial conditions seem to have favoured PRC.
  - Reform approaches similar but differ in timing, sequencing, implementation and complementary policies.
  - India made reform strides since 2000 but PRC seems more pro-active with first mover advantage.

- PRC likely to remain ahead in world trade in next decade, but India has opportunity to close gap with policies

- Uncertainties lie ahead on trade and growth. How each giant tackles them will ultimately determine performance.

# 1. Comparing the Giants

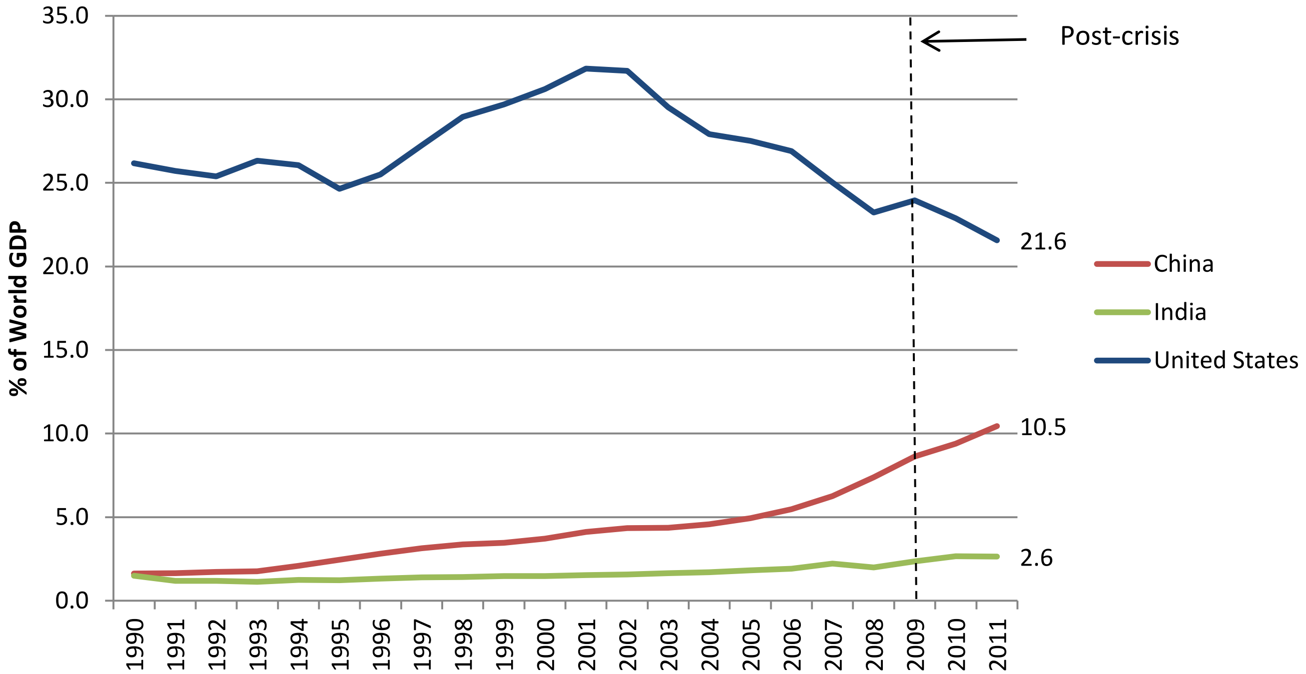
# GDP growth (% per year)




| Year | World Growth (% ) |
|---|---|
| 2006 | 5.3 |
| 2007 | 5.4 |
| 2008 | 2.8 |
| 2009 | -0.6 |
| 2010 | 5.1 |
| 2011 | 3.8 |
| 2012 | 3.3 |
| 2013 | 3.6 |
| 2017 | 4.6 |

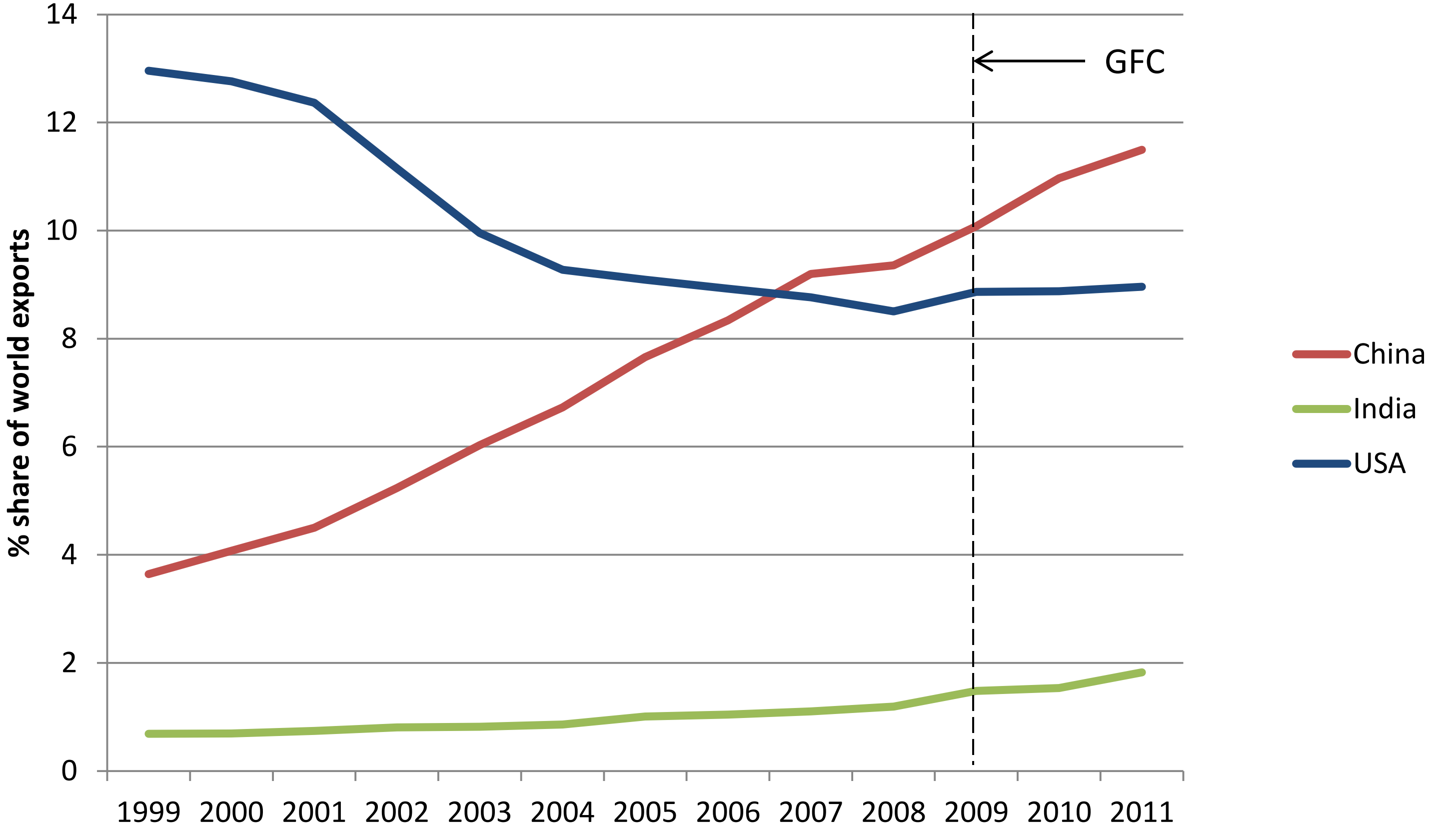
Source: World Economic Outlook Database, IMF

# Share of World GDP




Source: Economic Indicators, World Bank

# Shares of Exports in World Exports




Source: Comtrade

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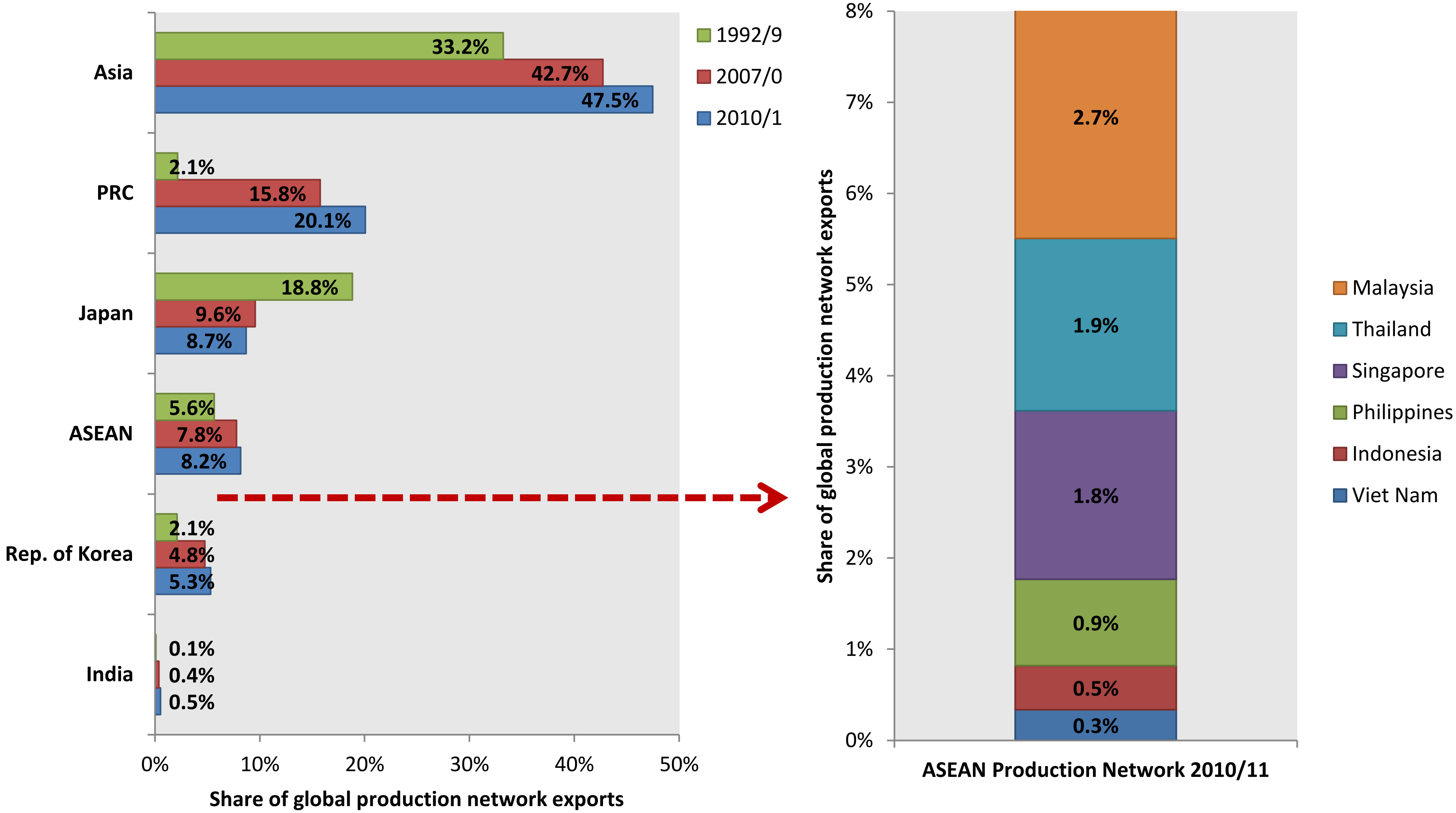
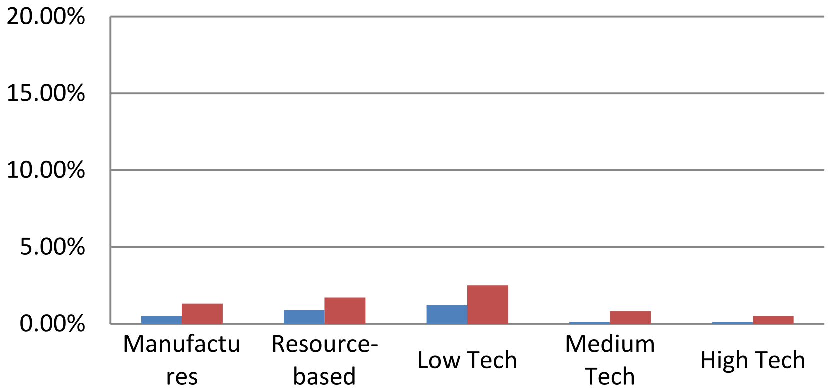
# Participation in Production Networks




*Source: Compiled from UN Comtrade database using methodology from Athukorala (2011)*

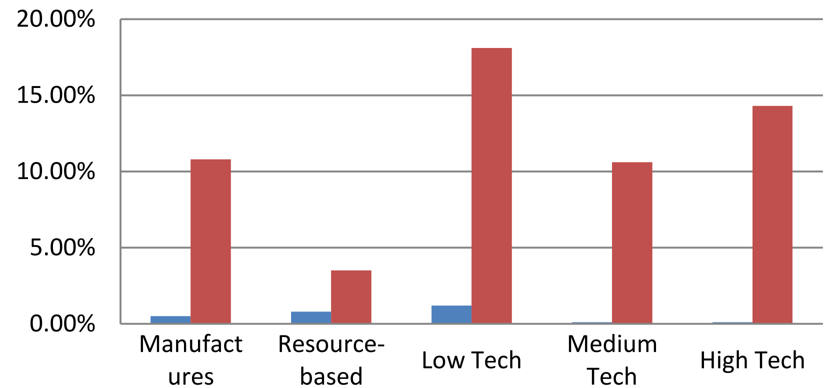
# Export Composition

**Share of World Manufactured Exports - India**




| | Manufactures | Resource-based | Low Tech | Medium Tech | High Tech |
|---|---|---|---|---|---|
| 1985 | 0.50% | 0.90% | 1.20% | 0.10% | 0.10% |
| 2008 | 1.30% | 1.70% | 2.50% | 0.80% | 0.50% |

**Share of World Manufactured Exports - PRC**

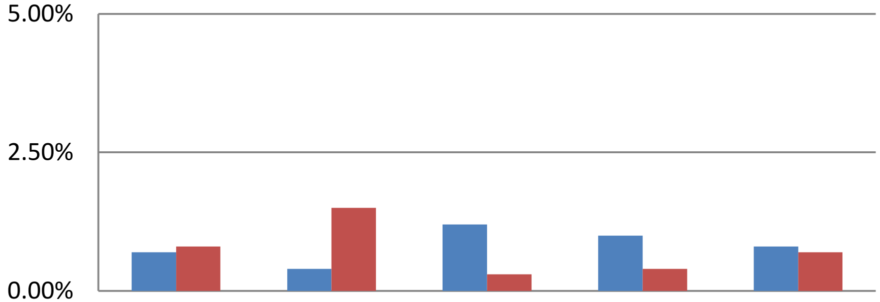



| | Manufactures | Resource-based | Low Tech | Medium Tech | High Tech |
|---|---|---|---|---|---|
| 1985 | 0.50% | 0.80% | 1.20% | 0.10% | 0.10% |
| 2008 | 10.80% | 3.50% | 18.10% | 10.60% | 14.30% |

- Both giants witnessed increasing technological upgrading
- PRC dominated low tech manufactured exports for more than a decade and can be seen as a threat by other high-tech exporters
- India’s progress in exporting high tech products is less pronounced – export growth is based on services

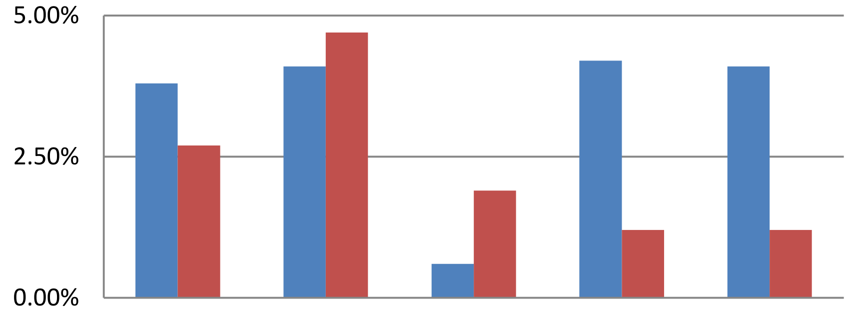
# Which Role do Services Play?

**Commercial Service Export in 1985 as % of World**




| | Commercial services | Computer, communications | Insurance and financial services | Transport services | Travel services |
|---|---|---|---|---|---|
| China | 0.70% | 0.40% | 1.20% | 1.00% | 0.80% |
| India | 0.80% | 1.50% | 0.30% | 0.40% | 0.70% |

**Commercial Service Export in 2008 as % of World**




| | Commercial services | Computer, communications | Insurance and financial services | Transport services | Travel services |
|---|---|---|---|---|---|
| China | 3.80% | 4.10% | 0.60% | 4.20% | 4.10% |
| India | 2.70% | 4.70% | 1.90% | 1.20% | 1.20% |

Source: WDI (2011)

- India is keeping up with China when it comes to IT services
- 4.7% of world share compared to 4.1% of China
- Also in insurance services India is ahead of China (1.9% vs. 0.6%)

# Poverty Reduction

- Both of the giants were successful in reducing poverty in the last 25 years

- Applying 1.25 US$ per day headcount of extreme poverty:
  - PRC: 84.% in 1981 to 16.3% in 2005 (13.1% in 2008)
  - India: 65.8% in 1978 to 41.6% in 2005 (32.7% in 2010)

- But India and China together have 664 million people living on less than 1.25$ a day (2005)

- Rural – Urban inequality is a rising issue

(Source: World Bank (2011))

# 2. Differing Paths to Reform

# Role of initial conditions

1. **Geography:**
   - China: Proximity to fast growing East Asia
   - India: Shares greater ties with Europe (due to legacy of British rule)
2. **Presence of large domestic markets (that allows economies of scale to be exploited)**
   - Although the population is almost identical:
     - China has a domestic market of about $1 trillion
     - India has a domestic market of about $250 – 300 billion
3. **Ample supply of low-cost, productive manpower**
   - Some studies find that labor is more productive in China
   - India's success in IT is based on the exposure to English, decreasing communication costs and the establishment of the Indian Institute of Technology
4. **Institutions**
   - China: Prominent role of Township Village Enterprises (TVEs)
   - India: Small firms in India seem to be severely constrained (e.g. access to finance), consequently only larger firms become exporters

On balance initial conditions seemed to favour PRC

# Reforms - Similarities and Differences

- **Similarities** in reform approaches:
  - Both giants have pursued distinctive reforms and became outward-oriented, market-based economies
  - Both followed a gradual approach (unlike the "Big Bang" in Russia)
  - Both giants had a managed float exchange rate regime and a relatively stable exchange rate
- However, **processes of implementation differ**:
  - Overall PRC was swifter, more coordinated and more credible and also introduced reforms earlier
  - China introduced more comprehensive measures and attracted export-orientated FDI
  - PRC was slower in adopting such a comprehensive FDI framework and at first only restrictions on foreign ownership were altered (SEZ legislation was only introduced in 2005)
  - Nonetheless, surge in FDI flows in the second decade of reforms in India
  - Despite India's efforts and the abolition of import licensing: India's average tariffs for raw materials and machinery remain higher than China's
  - PRC used some industrial policy instruments while India relied more on market forces

# Previous Inward-Oriented Strategies

- **China:**
  - Private sector completely eliminated in 1958 (Great Leap Forward)
  - Quotas and other restrictions led to inefficient capital intensive production by large, state-owned enterprises
  - Fixed and overvalued exchange rate
  - FDI was strictly regulated
  - Commodity trade was solely determined by central planning
  - 1978: Huge and protected manufacturing sector that represents 41% of GDP, exports were stagnant and dominated by primary products
  - Reforms started in late 1970s

- **Similar picture in India:**
  - Import substitution in the 1950s
  - Highly protected and inward-oriented trading regime
  - Significant reforms were not introduced until 1991

# Reforms in China

- Trade and investment reforms to attract FDI in the late 1970's:
  - Law to encourage joint ventures between foreign and local investors
  - Establishment of Special Economic Zones (SEZs) on the Southern coast
  - Tax incentives to direct FDI to SEZs
  - Duty drawback system to ensure duty-free access for all imported raw materials, parts and components for export processing
  - Liberalization of export quotas
  - Stable exchange rate

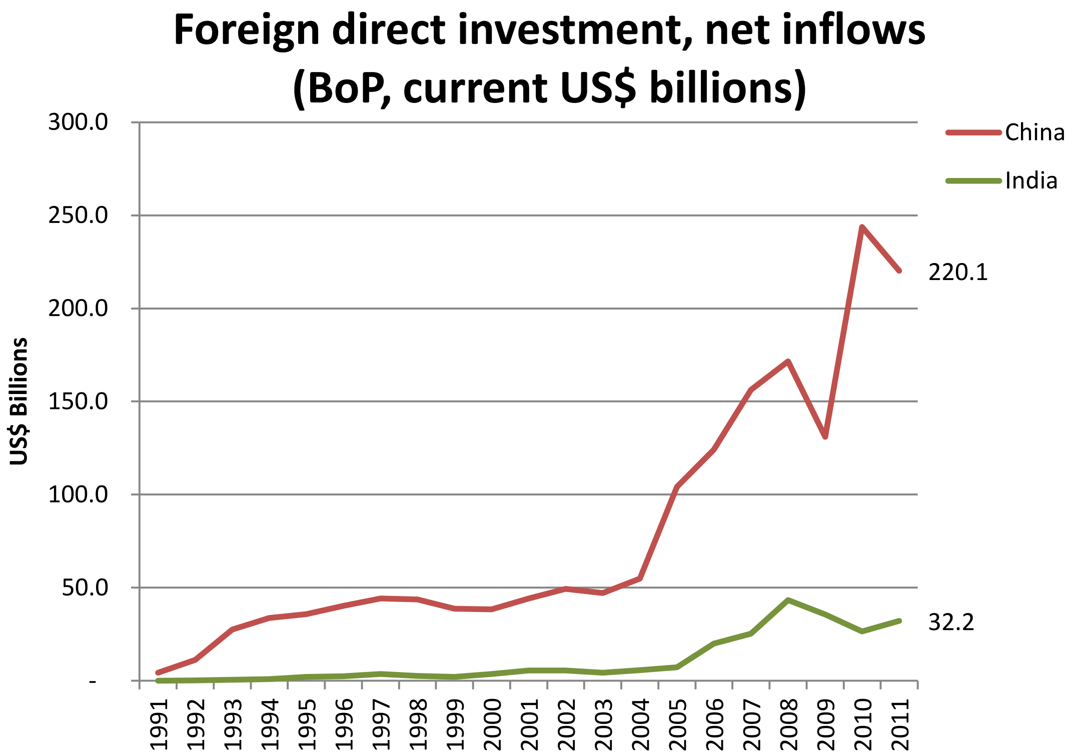
- Import Liberalization WTO Accession and Exchange Rates:
  - 1980's central import planning was substituted by import quotas and licenses (share of imports with quotas fell from 46% to 18 %).
  - More tariff cuts with adoption of socialist market economy in 1992
  - Accession of WTO in 2001: China was part of GATT was a milestone in China's trade integration with the rest of the world

# Reforms in India

- 3 Phases of India's reforms:
  - Inward oriented state controlled policies (1950-1975)
  - Partial liberalization (1976 – 1991)
  - Major reforms starting 1991

- Key points of third phase (post-1991)
  - Import licensing on machinery and raw materials was abolished in 1991.
  - Gradual compression of top tariff rates and at the same time rationalization of tariff structure (reducing number of tariff bands)
  - Depreciated / stable exchange rate
  - Formal FDI policy was adopted in 1996
  - SEZs were established
  - Tariff cuts on non-agricultural products
  - Average tariff rates remain higher than in China's (tariffs on agricultural products in India are double those of China)

# Effects of the Reforms on FDI




Source: The World Bank (2012)

- From 1990 onwards China attracted a record level of FDI
- China became second biggest recipient of FDI
- Positive but lagged increase of FDI in India after 1990
- Through the access to marketing channels, world-class technologies and organizational methods FDI contributed largely to the rise of Chinese exports
- FDI in India more directed towards domestic market
- It seems that Indian policies to attract FDI were not comprehensive enough

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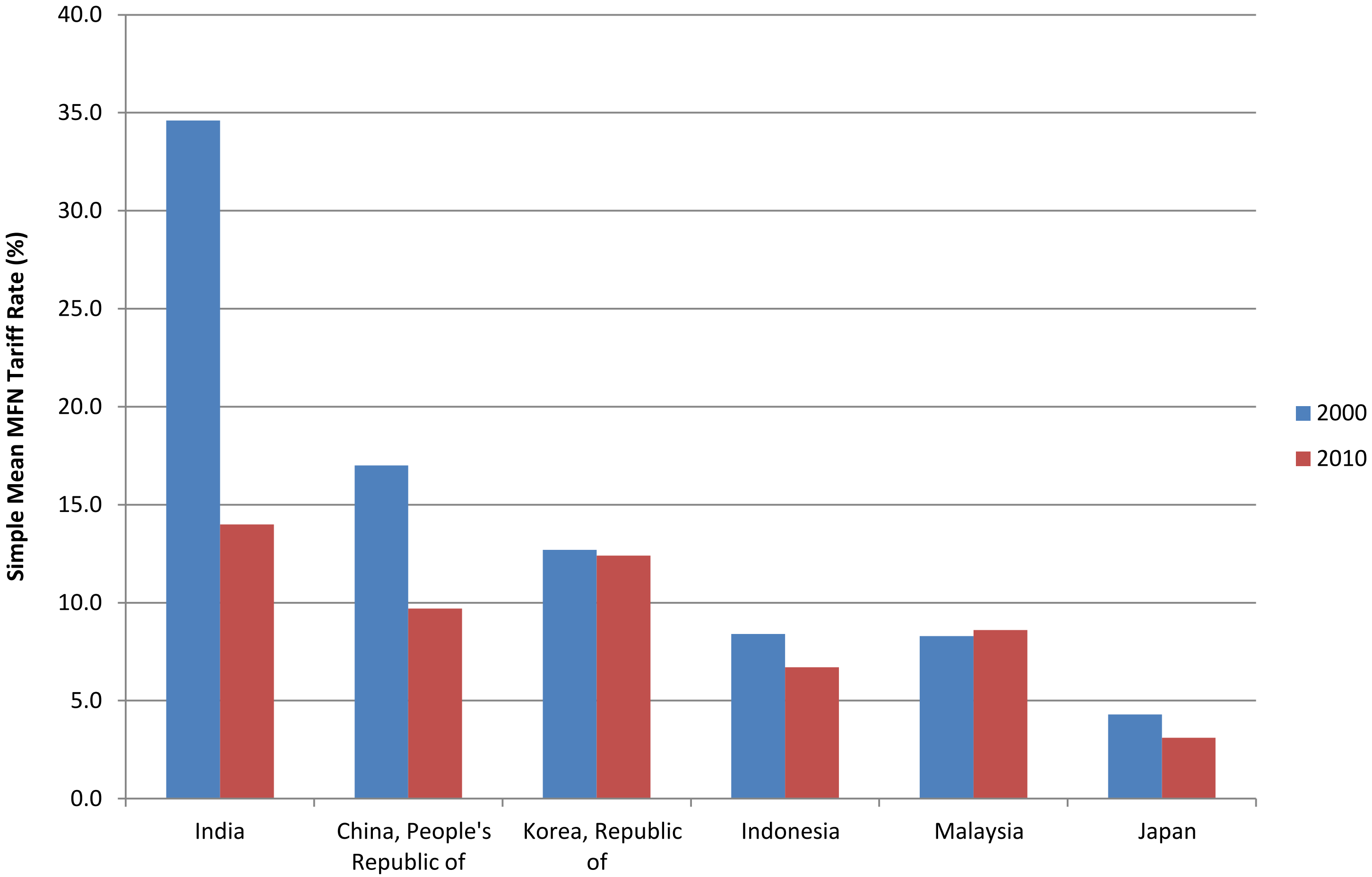
# Simple Mean, MFN Tariff Rate (%) 2000 and 2010




Source: World Bank, World Development Indicators.

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# Non-tariff Barriers Remains An Issue

**Obstacles to Exports Perceived by Japanese Firms, 2011**

| (%) | China | India | Korea | Indonesia |
|---|---|---|---|---|
| High Tariffs | 30.1 | 43.4 | 43.8 | 23.2 |
| Customs clearance procedures (complicated, time-consuming, etc.) | 38.2 | 28.7 | 6.7 | 36.2 |
| Other import regulations (rigorous, different from Japanese regulations, etc.) | 28.5 | 20.6 | 13.3 | 33.3 |
| Responses from importers (collection of proceeds, etc.) | 24.8 | 20.6 | 16.2 | 17.4 |
| Intellectual property rights protection | 27 | 4.4 | 13.3 | 4.3 |
| Import regulations on radioactive materials | 13.8 | 0.7 | 26.7 | 5.8 |
| Local logistics (infrastructure development, transportation networks, etc.) | 7.4 | 40.4 | 1.9 | 21.7 |
| No. of Responses | 747 | 136 | 105 | 69 |

Source: JETRO (2012) : FY2011 Survey on the International Operations of Japanese Firms.

# 3. Can India Close the Gap with China?

Challenges and Opportunities

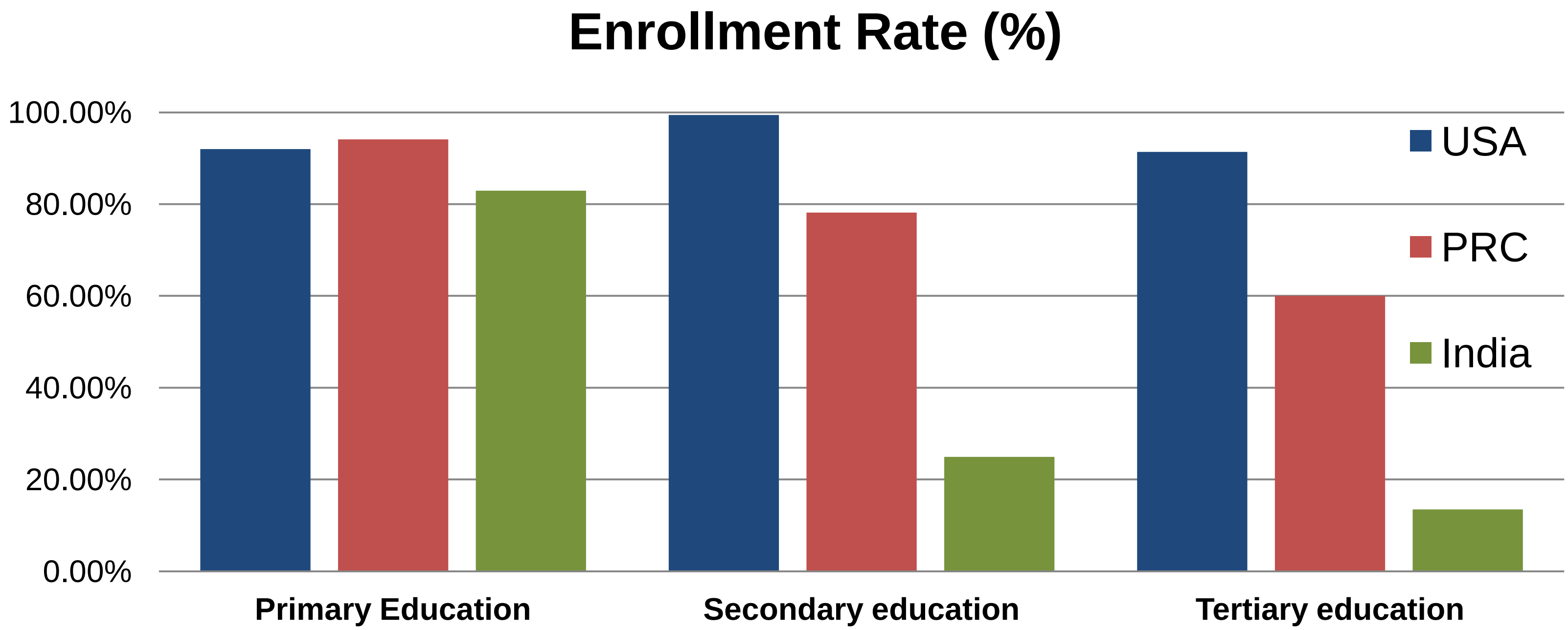
# 1. Demographics

- Argument by “The Economist”: Demographics and Democracy will help India to overtake PRC
  - India’s population will grow faster than PRC’s
  - India assumed to overtake PRC in terms of % of population that is working age in the next twenty years
- ADB’s projections on demographics confirm this view

| Indicator | Years | PRC | India |
|---|---|---|---|
| Working age population rate (%) | 2011 to 2020 | 71.6 | **69.4** |
| | 2021 to 2030 | 66.7 | **67.4** |

- **However**, additional fundamentals such as education, technology and infrastructure may also play a role

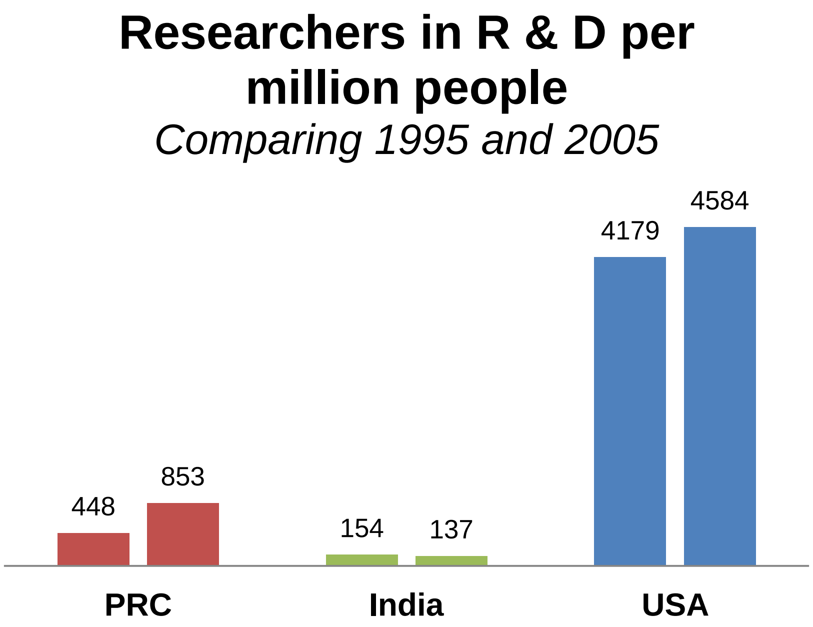
# 2. Education

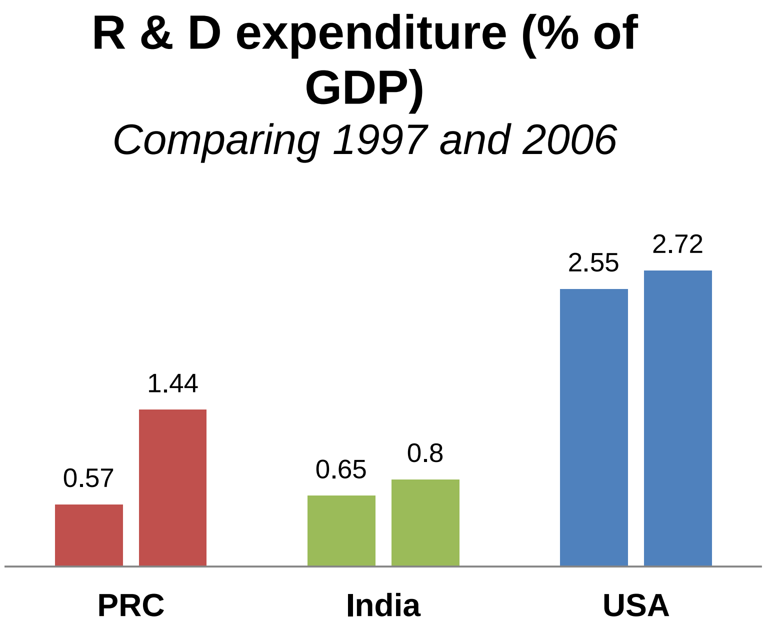



- Difficult to adapt workers with little formal education to advanced production processes and techniques.
- Lack of basic education can therefore become a constraint on business development.
- Long term, investment in basic education is essential

Sources: Human Development Report 2011; Global Competitiveness Report 2011

# 3. Technology



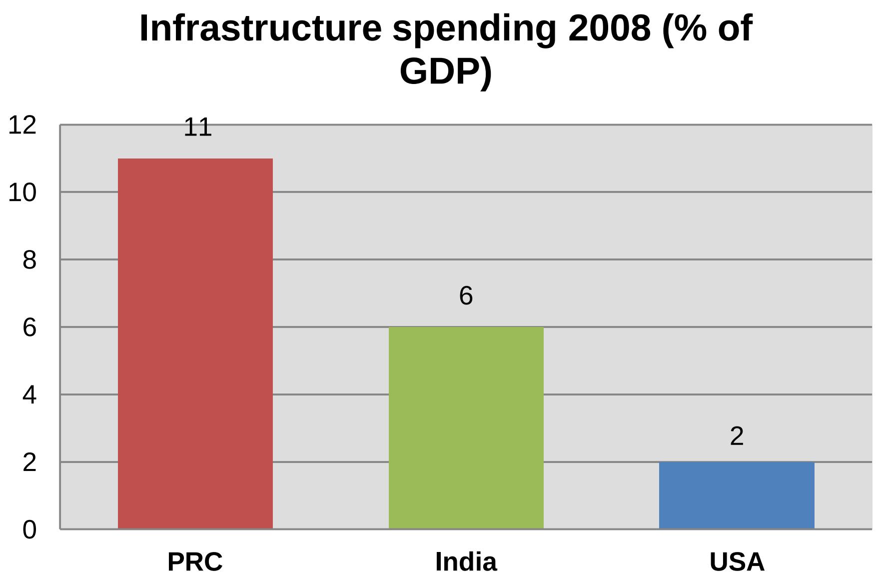

- PRC's R&D expenditure (relative to GDP) more than doubled in the last decade whereas India's R&D spending stagnated
- Also reflected by the number of researchers

Source: WDI (2012)

# 4. Infrastructure

| | **USA** Rank (out of 142) | **PRC** Rank (out of 142) | **India** Rank (out of 142) |
|---|---|---|---|
| Overall infrastructure | 14 | 48 | 84 |
| Quality of roads | 20 | 54 | 86 |
| Electricity supply | 33 | 59 | 110 |

Source: World Economic Forum – Competitiveness Report 2012-2013




- India must invest in infrastructure to
  - improve connectivity,
  - enter supply chains
  - promote regional integration
  - promoting multi-modal infrastructure
- Potential is high
  - 25 out of the 50 fastest growing cities in Asia are in India - 8 in PRC*

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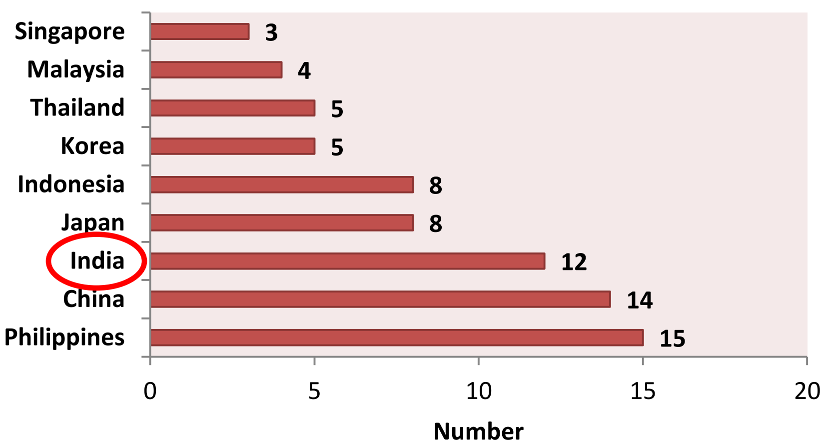
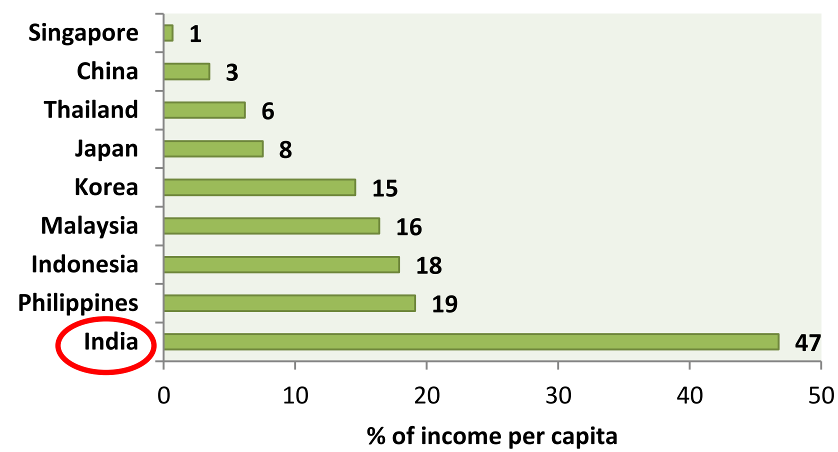
# 5. Cost of Doing Business

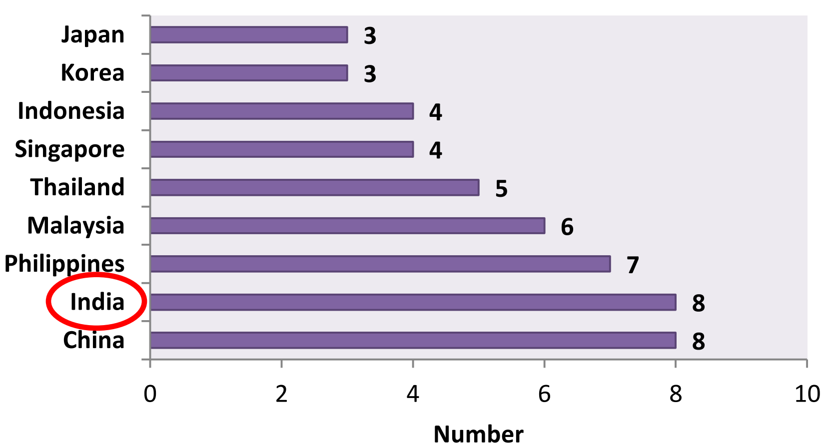
a) Procedures to start business, (number) 2011



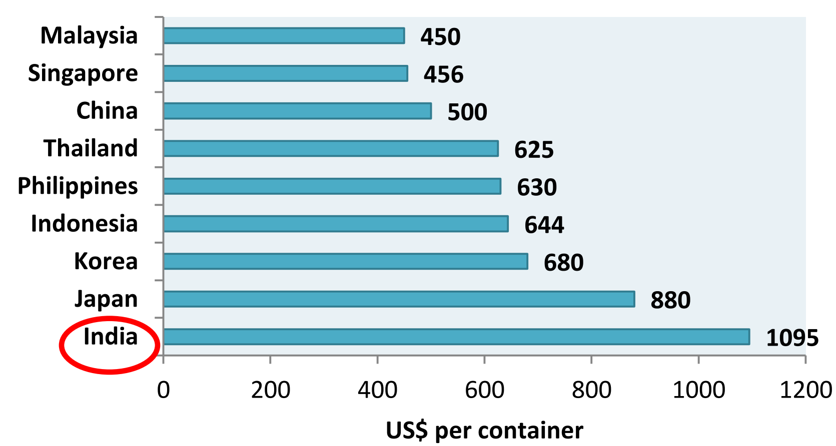

b) Cost to start business, (% of income per capita) 2011




c) Documents required for export, (number) 2011




c) Cost for export, (US$ per container) 2011




*Source: World Bank (2012), Ease of Doing Business Report*

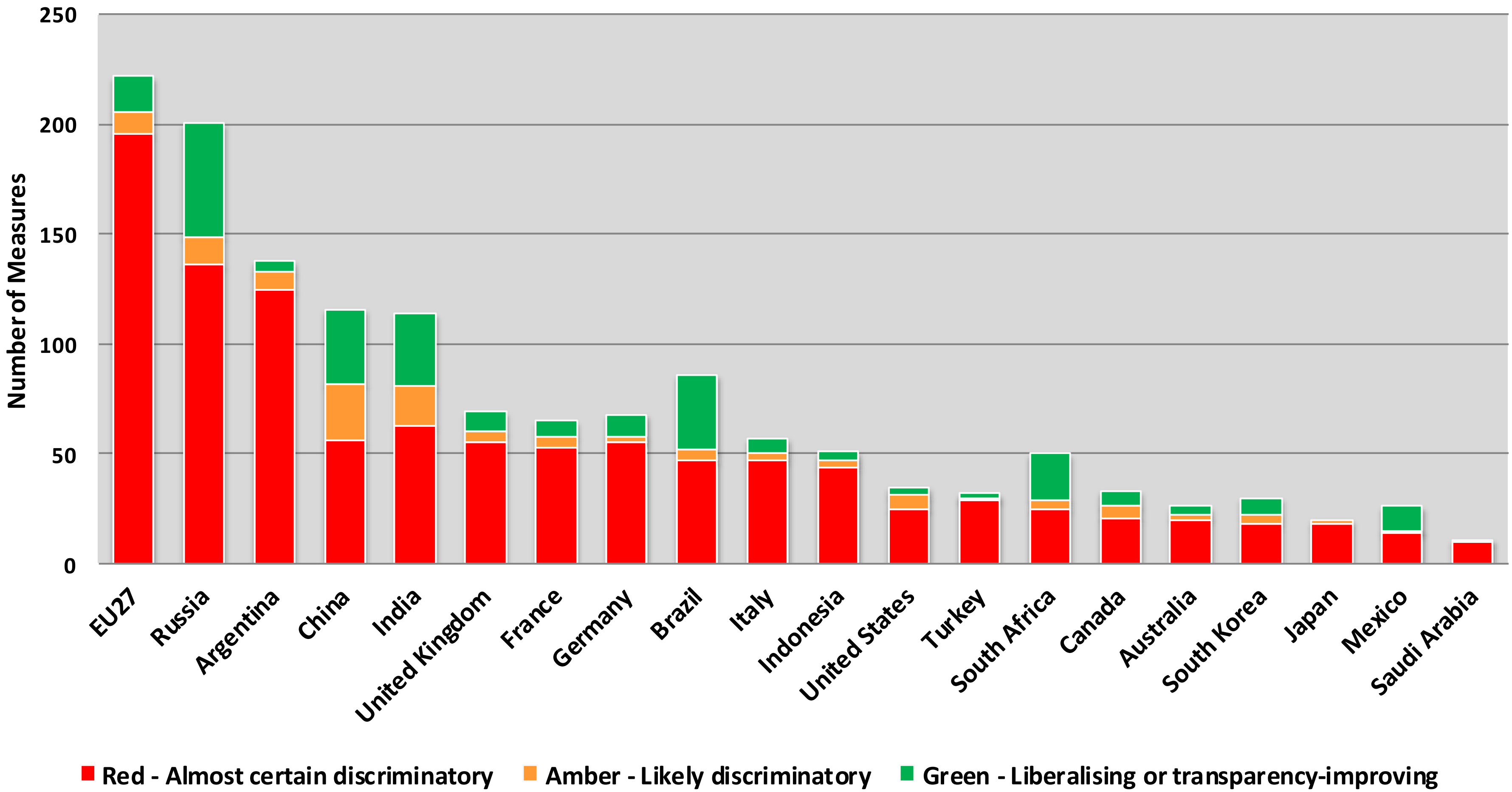
# Regulations

- PRC – Proposed reforms under the new government
  - Change the growth model from that of an export and investment-led model towards higher value manufacturing and increased domestic consumption
  - Promote reform of the political structure
  - Strengthen social development via better education, more secure jobs, more satisfying incomes, more reliable social security, more sophisticated medical services, more comfortable housing, and finer environment

- India – Recent reforms
  - India is open for business
    - new regulations allow foreign direct investment from abroad of up to 51 percent in multi-brand supermarkets, up to 49 percent in aviation, up to 71 percent in broadcasting and up to 49 percent in parts of the power industry
  - More reforms needed to increase India's competitiveness

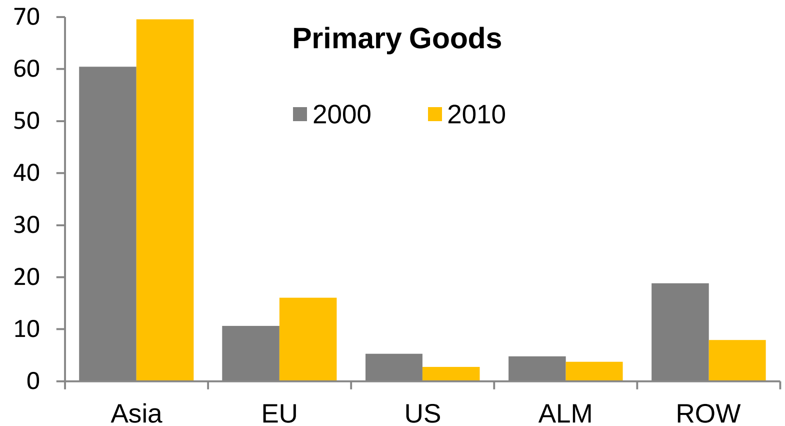
# 4. New Era of Slow Growth: Trade Policy Challenges

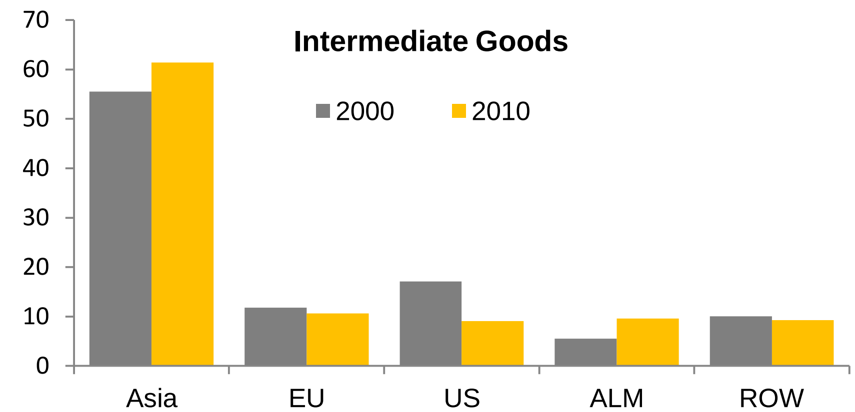
# 1. Rising Protectionism: which G20 countries are protecting?

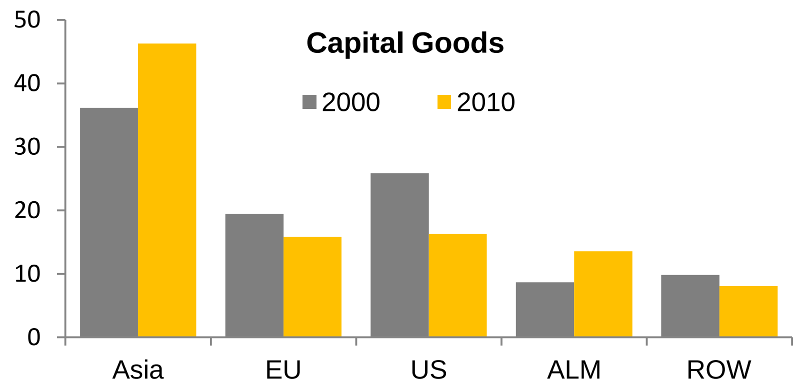


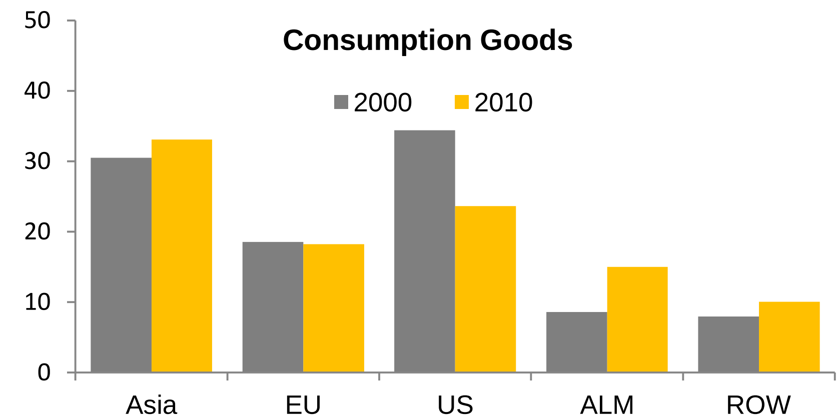

*Source: 11th Global Trade Alert report, www.globaltradealert.org*

# 2. Shifting Destination of Asia's Exports by Stage of Production (% of total): More Asian Demand



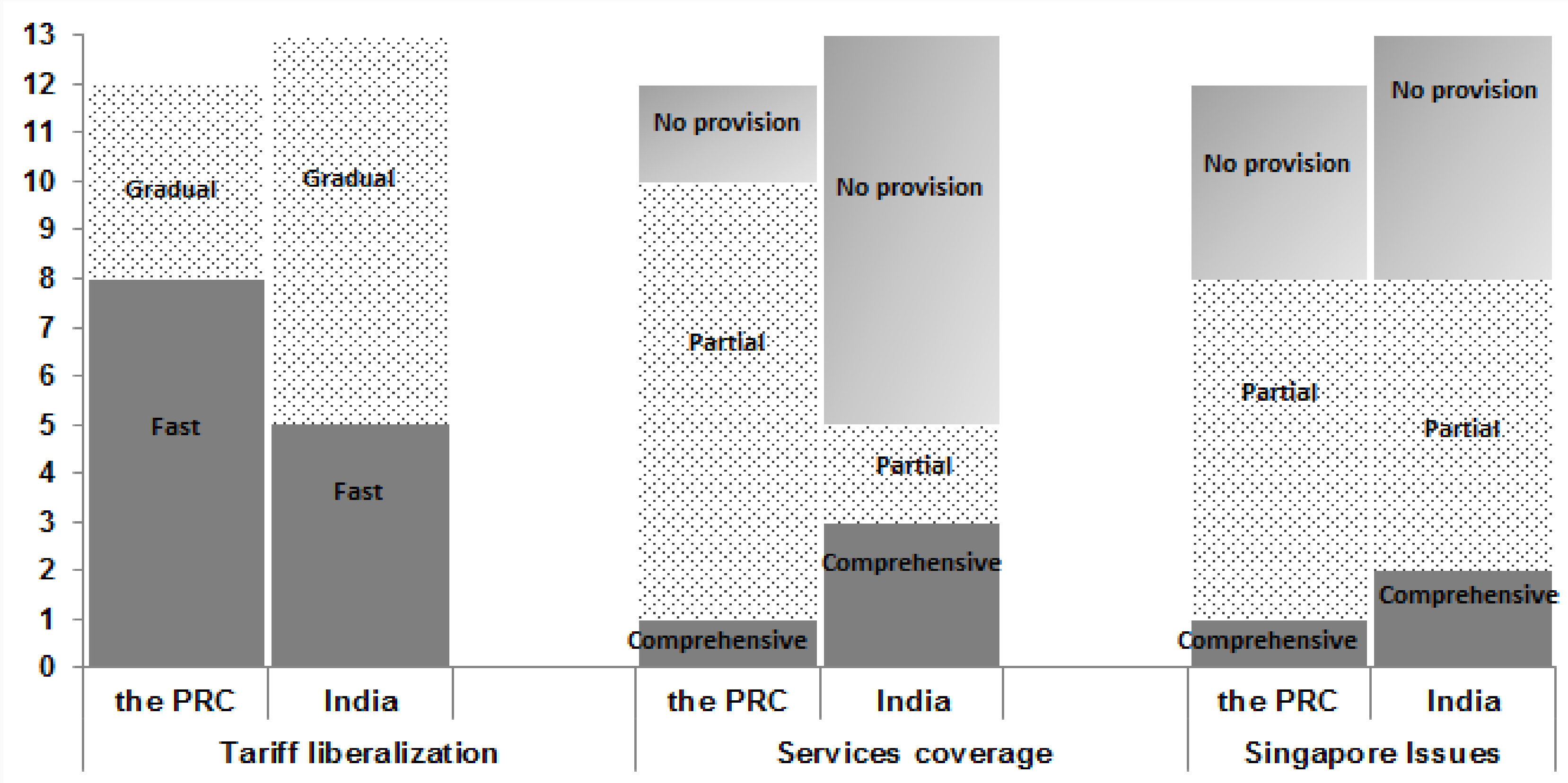




*Source: ADB Asia Economic Integration Monitor July 2012*

# 3. More Comprehensive FTA-led Regionalism

- Both giants pursue bilateral/regional FTAs alongside WTO multilateralism
- Concerns expressed by some:
  - Limited coverage of FTAs and vague formulations compared to FTAs in the Americas or Pacific
- Using economic evaluation criteria to examine FTA quality:
  - Mixed Picture: out of 23 FTAs of the giants 10 are WTO-compliant on goods liberalization and 3 are comprehensive in services coverage
  - China accelerated its steps to FTA negotiation after its accession to the WTO in a recognition of the importance to integrate into the world. India speed up its negotiation from 2007
  - The targets of India’s FTAs are more geographically diverse, including both developing countries and developed countries. But China focus on the Asian, Pacific and latin America countries, most of which are developing countries.
  - China’s FTAs seem better in goods liberalization (e.g. China – NZ FTA that eliminates 35% of tariffs with immediate effect)
  - China’s FTAs seems better in service coverage (7 of China’s FTAs cover partial liberalization in services

# Depth of FTAs in the China and India as of February 2012




*Source:* Author's updates based on Wignaraja (2011 and 2012).

# RCEP and TPP – Salient Features

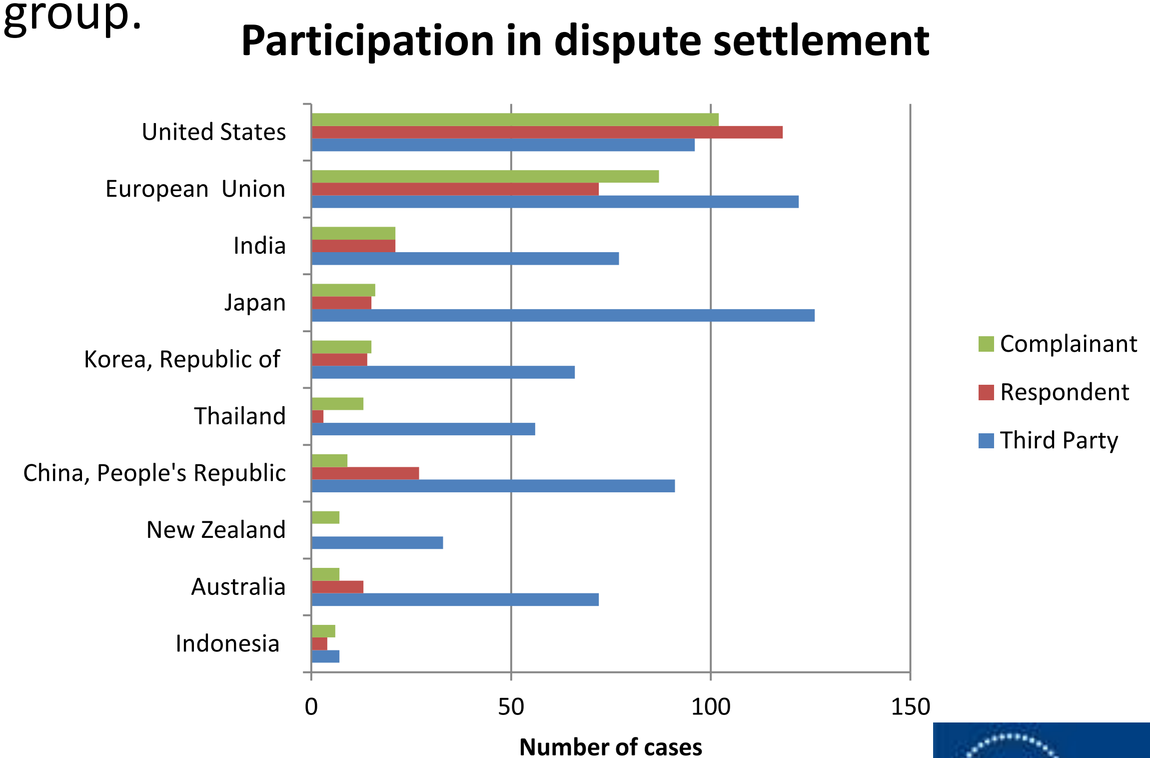
- **RCEP**
  - Negotiations launched in November 2012
  - Focus: trade in goods, services trade and investment
  - Limited openness allows developing countries to join
- **TPP**
  - Negotiations to expanded P-4 membership started in March 2010
  - Comprehensive coverage of new trade issues e.g. intellectual property, government procurement, competition, labour and the environment
  - High degree of openness and hence limited membership

# 4. Strengthening Global Trade Rules

- India is a original member of the WTO, while China joined in the WTO in 2001.
- Both are active in WTO trade negotiations and this has fundamentally altered the dynamics of WTO negotions
  - In the current Doha Round negotiation, they provide leadership for developing countries to strengthen their position on agriculture and NAMA negotiations
  - Have a reputation for not wishing to include Singapore issues into the negotiation package
- Both China and India are important to the future of the WTO
  - Selection of new WTO Director-General
  - Finding an orderly conclusion of the Doha Round,
  - Shaping the post- Doha WTO agenda
  - Fostering WTO reforms

# Frequent Users of the WTO Dispute Settlement Mechanism

- The active participation of giants also reflect their frequent use of the WTO's dispute settlement mechanism
- Even though the giants have not participated in as many trade disputes as the US and EU, they are top users among the developing country and Asian country group.




Source: WTO 2012

# 5. Committing to Plurilateral Agreements

- Plurilateral Agreements focus on the specific sector and are agreed by a group of members, e.g. the Information Technology Agreement
- Regarding the plurilateral agreements in the Annex 4 of the WTO (Civil Aircraft Agreement and the GPA), neither of them are the members. But China has announced early time of the year it join the negotiation of the GPA.
- As to the ITA (Information Technology Agreement), both of them are parties.
- Even though plurialteral agreements are concluded among a group members, given the economic significance of the two countries in extensive issues.

# Summary

- Giants rise impressive. PRC ahead in world trade due to manufacturing. India leads in skill-intensive IT exports.
- Why?
  - On balance, initial conditions seem to have favoured PRC.
  - Reform approaches similar but differ in timing, sequencing, implementation and complementary policies.
  - India made reform strides since 2000 but PRC seems more pro-active with first mover advantage.
- PRC likely to remain ahead in world trade in next decade, but India has opportunity to close gap with policies
- Uncertainties lie ahead on trade and growth. How each giant tackles them will ultimately determine performance.

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