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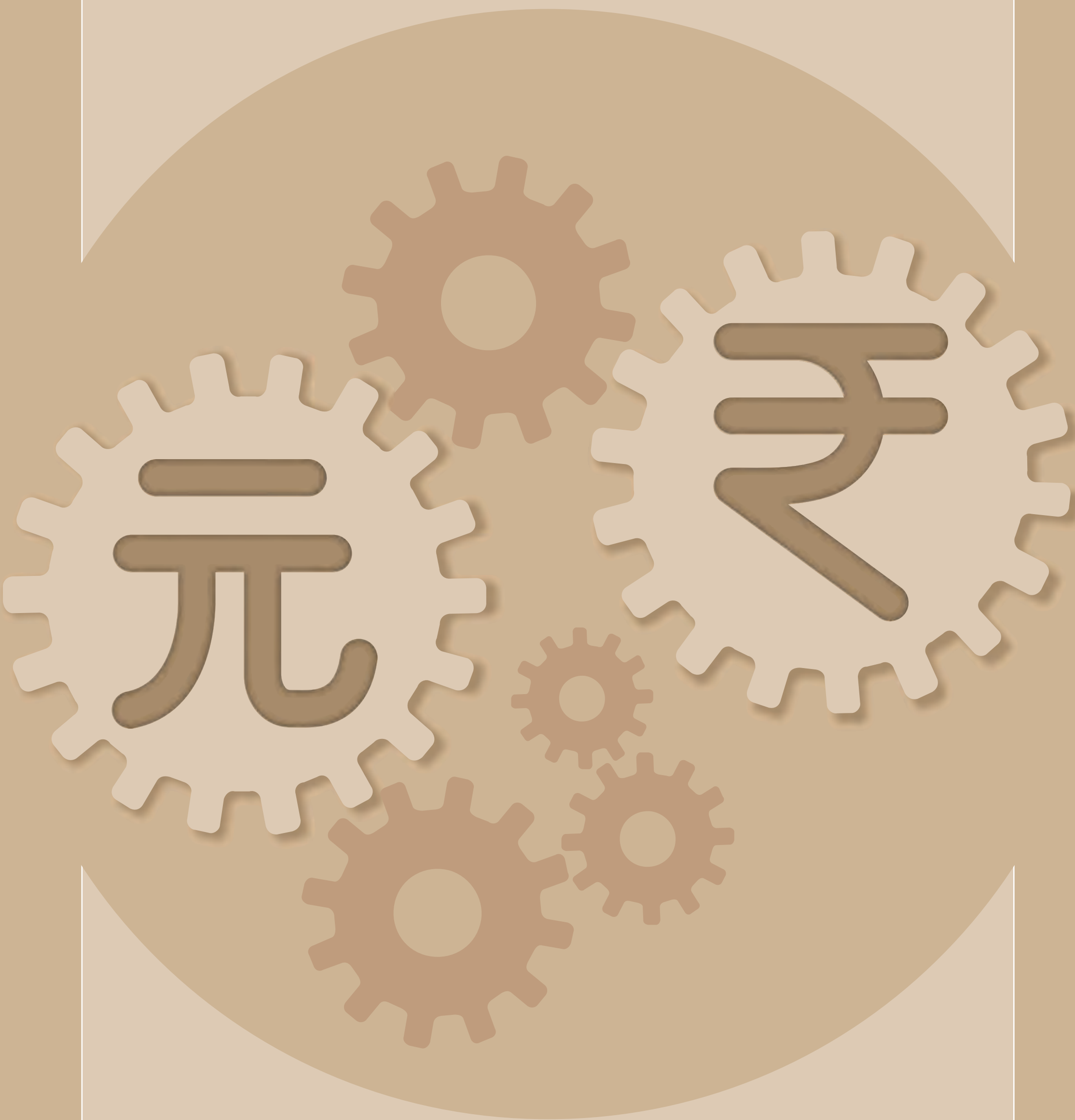
INDIA-CHINA ECONOMIC TIES



THE WAY FORWARD

A Report

23 MARCH, 2016

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Preamble

The China Symposia, developed jointly by the Ananta Aspen Centre, New Delhi and the Institute of Chinese Studies, Delhi, is designed to address key questions about China that arise amongst many of us. The uniqueness of these Symposia lies in the fact that they were conceived as a series of one-and-a-half hour long sessions, spread over a period of six months with the support of India International Centre (IIC). Panels of experts from both India and China were mobilized to initiate in-depth discussions, with the aim of both informing and providing new insights and also provoking general interest and curiosity in the themes selected.

The three symposia explored the dynamic regional and global context of India-China relations, and the changing Chinese domestic situation. The final session in this series critically analysed the future of the bilateral economic relationship between two Asian giants.

India-China Economic Ties: The Way Forward

1. Introduction

Economic ties constitute one of the most crucial areas of the strategic and cooperative partnership between India and China. Both the Asian giants have grown in the post-reform years by increasing their external economic linkages. Currently, India-China trade stands at $70.59 billion, which offers tremendous opportunities for traders and investors of both countries in sectors such as agriculture and food processing, asset management, construction and infrastructure, pharmaceuticals, electronics and information technology, and transport and logistics. Prime Minister Narendra Modi has also highlighted opportunities in railways, smart cities, infrastructure and urban transport for cooperation. For India, there is greater scope for technical and financial collaborations with China in specific "Make in India" sectors like thermal power, renewable energy, railways, construction, ports and media & entertainment.

China's 'rise' has however been a mixed blessing for India. While there are serious concerns generated in some quarters, there has been a welcome increase in a number of sections, which see China's growth as a beneficial opportunity. Arguments in favor of freer access to the Chinese market are being heard more frequently. India–China economic relations have implications not just for bilateral ties but have the potential to shape the economic landscape of the region and the world.

There are stark differences in the developmental process followed by India and China in the last 20 years but the problems at hand for both the countries are alike such as income inequality, gender inequality, rural-urban divide, and unemployment issues. Notably, these problems represent themselves differently in both the economies and in all likelihood, their respective domestic economic developments are likely to affect and/or influence India-China bilateral dialogues. On the regional front, India and China are members of BRICS (Brazil, Russia, India, China and South Africa), Shanghai Cooperation Organization (SCO), East Asia Summit, Basic Groups on Climate Change and G20. The positions of both the countries converge on some issues and diverge on others.

The RCEP (Regional Comprehensive Economic

Partnership) has indeed brought India and China together on a common trade negotiation forum but the agreement has not been concluded yet. India's membership in Asia Infrastructure Investment Bank (AIIB) and the New Development Bank of BRICS, gives it an additional pillar for engagement with China. India's role and influence in these institutions could prove useful in its future negotiations with China.

Geopolitics weighs heavily on India-China bilateral relations thus affecting their economic relations, specially in the following dimensions:

1 Security architecture for Asia.
2 China's strategy for connectivity represented by the Belt & Road Initiative.
3 The new regional financial architecture initiated by China.
4 Military modernization.
5 China's intention to become a major maritime power in Indian and Pacific Ocean.

Following are the challenges that China faces:

1 Demographic changes.
2 Economic slowdown and the hurdles in the rebalancing strategy.
3 Environmental degradation and the problems of sustainable development.
4 Uncertainties in its surrounding areas – particularly in South China Seas .
5 Security issues: China is an untested military power.
6 Vulnerability to events surrounding China, particularly on the western side.

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2.

Contemporary Trends and Dynamics

NEGATIVES

- **Trade Deficit:** In 2015 this amounted to $52 billion - India's trade deficit with China is one-fourth of its overall trade deficit with all countries. In order to reduce this, joint Study Groups and bilateral meetings were set up to facilitate a healthy discussion on both sides. Unfortunately, there is no quick fix to address this issue. Medium to long-term planning is required, which would have to factor some critical issues which are enumerated below.

- **Competitiveness:** Indian firms are not competitive enough on account of significant structural constraints, chiefly the lack of adequate social and physical infrastructure. Indian exports to China essentially comprise raw materials and intermediate goods, whereas Chinese exports to India comprise manufactured goods, mostly power-equipment, telecom products, and a wide range of high-techproducts. India has so far failed to stem this steady rise in the deficit – in fact in 2015, Indian exports to China were worth a mere $10 billion while imports amounted to $62. Further, there are 322 anti-dumping cases filed by India in the WTO, out of which 177 are with regard to China.

- **Investment:** Chinese investment in India is equally dismal. Though China is India's largest trading partner, out of $200 billion FDI that India has received in the last 15 years, only 10 billion has come from China. This lack of investment can be largely attributed to the trust deficit between the two countries, though Chinese companies are also reluctant to collaborate with Indian infrastructure companies which are heavily indebted.

- **Market Access:** Market access is a huge problem for Indian companies especially in the form of non-tariff barriers. Strict government regulations in China hinder Indian companies from penetrating the Chinese market. However, foreign companies have been able to penetrate this wall. It requires a granular study of Chinese provincial and central regulations and partnerships with local bodies.

- **Knowledge and Information Deficit:** There is a serious knowledge and information deficit between India and China. According to a study conducted by CII Core Group on China, India does not have in-depth knowledge of the Chinese market. This study therefore recommended a Joint industry-government approach. Such a study would address the point made in the previous paragraph to ascertain the knowledge and partnerships required to overcome the non-tariff barriers. A concerted effort must be made to compile this knowledge and information for the benefit of Indian industry and consequently for the government as well. Without such knowledge, no opportunities can be seized.

- **Security Challenges:** Security concerns introduce delays and denials into both investment proposals from Chinese companies and travel to India by their nationals, especially scholars and academics. Since most Chinese companies rely on their think tanks, this is counter productive.

- **Structural Problems:** There are deep structural problems in India's industrial sector owing to under investment. India could learn from China's development experience, whereby the State had focused on large investments in health and education as also in infrastructure development. Additionally, in the present context, State-owned enterprises of China are identifying new areas of investment like biotechnology, renewable energy sources etc.

- **Trade Agreements:** In terms of trade agreements, India's approach is defensive to a considerable extent as it aims to retain the market shares – this needs to be reconsidered.

- **Lack of Coordination:** Strong government- industry coordination is missing in India.

POSITIVES

- **Market Collaboration:** There are numerous opportunities for collaboration between China and India. On the one hand, China is known as the factory of the world, and on the other, India is trying to boost its manufacturing sector by the **"Make in India"** program. This clearly points to the huge potential for joint ventures in the areas of green field investments, technology and SMEs. India is a growing market and it presents a good opportunity for the Chinese economy which can use the potential of Indian market particularly at a time of global economic slowdown.

- **Change in Investment Patterns:** Investments from China to India has increased to $500 million in 2015 – though there is considerable room for more. Somewhat bigger investments have taken place in e-commerce companies. There has also been an increase in microinvestments from the Chinese Small and Medium Enterprises (SMEs) which are looking to leverage the Indian market and eventually start exporting from India. As the Chinese SMEs are losing competiveness in China, they are looking to reverse the trend of declining profits by exploring new markets - Chinese companies are going global now with initiatives like 'Go Global' and 'One Belt One Road'. China is also looking to invest in new areas like financial technology and bio-technology. These are the areas where opportunities are opening up investment on a monthly basis.

- **Climate Change:** On climate change, both countries are facing the pressure to reduce fossil fuel based energy consumption and move towards clean energy. This is one area where collaboration between India and China in terms of R&D technology is wide open, particularly on solar panels where China has a huge competitive advantage.

- **Role of Indian Entrepreneurs:** A new wave of entrepreneurship is emerging in India especially in the field of fine chemicals and in pharmaceutical ingredients, in which China has traditionally been very strong. In the last two years, Indian entrepreneurs have been able to make inroads in some of these markets. [In the context of global supply chains, India will replace China or be the second source for products meant for the FMCG sector.]

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3.

Recommendations

Economic Relations

I) Trade

1. There is a need for a comprehensive strategy to deal with China, for both the Indian private and public sectors, and also the Government. This is because – in many ways – China [when dealing with foreigners] operates as a "system" – i.e. Government and Industry. Indian companies on the other hand are more competitive than cooperative with each other and government is either aloof or in regulatory mode. As a result, Indian companies are more comfortable – and successful – in the West. But they have not invested enough time and energy to understand an even bigger market – China. There is an urgent need to overcome this knowledge and information deficit and create the granular base of data, knowledge and information to generate a new enthusiasm amongst Indian companies, especially the medium and SME sector to do business with China. This requires a joint Industry-Government effort.

2. In addition to the current asymmetric – and unsustainable - trade between India and China, there is also a lack of focused coordination within both government and industry which cannot be blamed entirely on political differences or geopolitics, and consequently, lack of preparedness. India does not have as many products to offer to China. At present, India is not a major trade partner of China. There is an urgent need to build knowledge as to where India's comparative advantage lies. One possibility could be to set up a task force as mentioned above, (unpublicized), to closely monitor China's strategy, agenda, and actions

and coordinate between the government and business.

3. In order to address the issue of trade deficit with China, there is a need for India to introduce deep structural reforms. This includes higher public investments in social and physical infrastructure.

4. The current slowdown of the Chinese economy and the inevitable complexities in the "rebalancing," could provide opportunities as well as challenges for India. It is essential to understand the nature of the slowdown. One major underlying factor of the "rebalancing" is the over-capacity of Chinese industries. On a positive side, the offshoring of Chinese manufacturing, particularly in high-value areas like innovation, will throw up many opportunities for India, as China promotes consumer spending.

5. Another area where we witnessing an upsurge is the E-Commerce sector- many Chinese e-commerce companies are interested in replicating the Alibaba model in India. China is looking for direct participation at the E-commerce sector. This should be expeditiously explored.

6. In an increasingly economically interdependent world, regional organizations and trade blocs are playing an important role. There is an opportunity for India to explore alternative trading agreements with China, in order to create a different and harmonized set of regulations. India can take advantage of the Chinese state capacity and competitive regulations.

7. There are interesting insights to be drawn from China's economic and political relationship with Japan, which has flourished despite many political and historical issues. High levels of trade and investment, large numbers of student exchanges and steadily increasing numbers of tourists, have gone alongside with the political differences. This shows that vibrant economic relations can coexist with poor political relations.

8. **Tourism:** The current state of Sino-Indian tourist exchanges can only be described as pathetic. Annually, less than 100,000 Chinese travel to India and about 700,000 Indians go to China. From two populous nations, whose combined outbound travellers number 100 million every year, this is unacceptable. India must launch a serious drive to attract Chinese tourists and provide Mandarin speaking tourist services for them. Our languishing tourism business will receive a much-needed fillip.

II) Investment

9. There are numerous advantages to be gained from Chinese investment in India's infrastructure sector especially in the industrial corridor. India relies heavily on ODI assistance from Japan and other countries. China can step into this, and convert the trust deficit to productive use. The 2016-17 Indian budget figures cuts on import duties for raw materials and intermediate goods in manufacturing, particularly consumer goods, durables and electronics. This is a huge opportunity for China to export to India. Many Chinese firms may bring in investment and set up bases in India. This could address the huge trade deficit and even create opportunities for exports to third

countries. Vietnam has followed a similar path. However, India needs to change things on the ground to attract Chinese investments.

10. The institutional distance between India and China needs to be bridged and this can be only be addressed by increasing the opportunities to work together and getting familiarized with each other socio-economic environments. Many people in China are not aware that India is one of the few destinations where Chinese companies are listed faster than their domestic market.

11. Chinese Corporate sector is more global in its outlook and is willing to invest in India. This should be actively pursued – in both, manufacturing and investment.

12. **Supply Chains:** China is trying to integrate India into its supply chain, which will help Chinese companies to re-brand themselves. An example for this can be seen through the popularity of Xiaomi phones in India. Many Chinese companies are setting up supply chains that will help them to set up their own brands. It is seen as a political as well as economic move. However, in terms of value chains, Chinese companies are ahead of India. Careful planning is needed so that these trends do not fuel more competition rather than cooperation between the two countries.

13. **Entertainment industry:** There is a general lack of interest on the part of the Indian Industry to explore the Chinese market – but given the constraints, it is important to identify areas which can easily attract Chinese investments like tourism, media and entertainment and other soft services. There are many possibilities in the entertainment industry as China, despite being a highly regulated market, still emerges as the second largest movie market in the world. In 2015, three Indian movies were commercially released in China. Both countries also signed the co-production of movies and there is likelihood for more Indian movies to enter the Chinese market.

14. **Reciprocity:** There is a need to focus on reciprocity as there must be a two-way negotiation between India and China. As India promotes investments from China, similarly China must also support India's investment in the Chinese domestic market.

15. The world economy is slowing down. China is looking to vitalising its domestic demand. India should also try to revive domestic demand. In the process of transition, investment and infrastructure are two areas where both the countries can collaborate. Given the significant demand for cheaper medicines and drought-resistant crop varieties in both the countries, public sector research institutions in China and India must cooperate and collaborate with each other to find creative solutions to common problems.

16. Indian Industry must actively lobby in China and Indian representatives must regularly and actively participate in reform related consultative meetings in China to protect, promote & preserve Indian interests.

17. In order to understand China better, India requires a large pool of Mandarin-knowing China experts, also versed in Chinese history and culture. The urgent

need of the hour is to establish China-focused institutions that will encourage larger numbers of students to specialize on China.

18. OBOR (One Belt One Road Initiative) is a huge project for China involving trillions of dollars across many countries with geo-political challenges. India so far has not endorsed the OBOR initiative, but given its credibility in the region, India's participation could help reduce the geopolitical tensions and bring in other multilateral institutions to support and promote the connectivity projects.

19. Both RCEP and the Trans-Pacific Partnership (TPP) will drastically reduce transaction costs and move towards trade facilitation and standards harmonization. On TPP, Chinese position has evolved from hostility to that of an open mind. Joining TPP will bring reforms internally in China. India must cooperate with China to formulate or devise regulatory standards that are more amenable to Indian and Chinese domestic environment. India needs to quickly move towards establishing the National Trade Facilitation Committee (NTFC), which will act as a link between the private sector & the government. This requires sustained coordination and cooperation between the Indian Industry, Ministry of External Affairs & Ministry of Commerce.

20. China is shifting its focus from low-end manufacturing to a service-based economy. India, which traditionally enjoys an upper hand in the service sector, must negotiate a cooperative agreement with China that will open up Chinese markets for Indian goods in exchange for Indian services. As far as trade negotiations with China and other countries are concerned, India must shed its defensive posture as it only results in retention and not expansion of market share.

21. India must push harder to join APEC which serves as a "best practices" body wherein members collaborate in improving trade standards and facilitation. As a business driven organization, it serves as a much better platform in facilitating interactions between businesses across borders. India can work with other countries to improve standards and procedures.

22. Bilateral relations between India and China changed for the better after Prime Minister Narendra Modi's visit to China. PM Modi's visit with top business leaders in Shanghai was a step in the right direction. Similar steps should be taken to build market confidence. During his visit, PM Modi conveyed a clear message that Chinese investment is welcome in India. After PM's visit, India received many concrete investment proposals from Chinese companies.

23. India needs to concentrate on its exports. There is a need to select certain brands which will do due diligence and promote Indian business - not only in China, but also in other countries. India needs to emulate the East Asian countries in bringing about a closer coordination between government and industry. Given the lack of understanding and asymmetry of knowledge, we need policy inputs and prescriptions. Indian industry as a whole and the Indian government need to form a new compact to address this issue.

24. With increasing trade and investments volume, apparently a large number of business disputes are arising with other countries. India has also filed many anti-dumping cases against China in the WTO. Cooperation between industry and trade chambers can play a constructive role in this regard.

25. Lastly, India must re-examine its stand on China's One Belt One Road (OBOR) initiative. India's participation in this project will result in improved connectivity within Asia and the Indo-Pacific littoral. It must be noted that the OBOR is a collaborative and participatory initiative that focuses on greater connectivity through infrastructure development, essentially and to begin with, financed by China. It is pertinent for India to participate in wide-ranging consultations with Beijing. A quid pro quo approach could be explored, whereby India commits to be the security provider for Chinese interests in the Indian Ocean region and China in turn does the same for Indian interests in East and South China seas.

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