

# **Calibrating Merchandise Trade Portfolio: Need for a Paradigm Shift in India's Trade Policy**

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## **Introduction**

The COVID-19 pandemic and the subsequent lockdowns have resulted in severe supply chain disruptions across countries, impact of which was severe on Indian economy leading to a 7.3% contraction in its real GDP during FY20-21. The mutations of the deadly SARS-CoV-2 virus have been threatening the fragile economic recovery of Indian economy in 2021, further adding to its economic uncertainties. Merchandise exports from India were already constrained by several factors, both global and domestic, thus limiting its role as a major growth factor for the Indian economy in the pre-pandemic era. The spread of the virus added to the already existing woes of Indian exporters for almost a year and half during the pandemic. With the aim of providing stability to exporters during the pandemic, Government of India has extended the Foreign Trade Policy (FTP) 2015-20 for the third time till March 2022.

Despite all odds, Indian exports for the first eight months in FY21-22 have surged significantly, reflecting a good order booking position supported by economic recoveries among major trade partners. Robust export demand mainly for Indian products like engineering goods, petroleum products, pharmaceuticals, chemicals and agriculture products have been driving the export growth post-pandemic. Global demand recovery, supported by ultra-easy liquidity conditions, along with the pent-up demand has made it opportune for Indian exports to grow at record levels. Exports for the first eight months of FY21-22 (April- November) at US\$ 262.5 billion, has been 50.7% and 24.3% higher than exports of the corresponding period of FY20-21 and FY19-20, respectively, meeting almost 66% of the export target for the year (US\$ 400 billion).

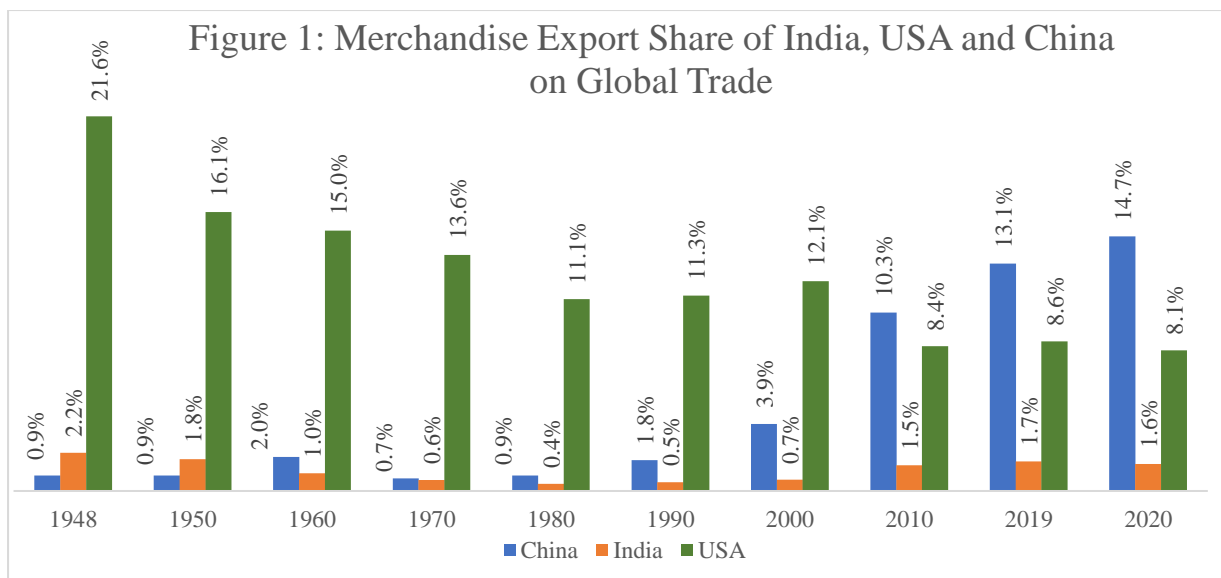
While the global recovery is still not broad based, turnaround in Indian exports is expected to boost economic growth, filling the vacuum created by tepid domestic private consumption as well as investment. Recent events including shortage of containers, delay in shipments amid severe supply chain constraints, shortages of semiconductors, rising prices of inputs including metals, commodities, and food grains, as well as mutations of the virus may act as major deterrents for Indian exports in the coming days.

## **Need for a Paradigm Shift in India's Trade Policy**

Merchandise exports from India which was a meagre US\$ 17.7 billion in 1991 started picking up after rigorous Liberalization reforms and recorded US\$ 275.5 billion in 2020. However, the exports from India, in the last decade have remained almost stagnant. On the other hand, India's imports which were US\$ 23.6 billion in 1992, recorded a much faster growth to reach US\$ 368.0 billion in 2020, reinstating India's potential as a target market by global trading nations. Thus, along with the benefits of liberalization, India also has been a victim of the globalization process. To meet the ambitious export target of USD 1 trillion by 2030, a multipronged strategy focusing on promotion and support of domestic production for exports for India along with targeting new markets and products are required.

Reviving exports growth in the wake of rising Protectionism and Non-tariff measures by countries remain a huge challenge going forward. India's major export and import markets being developed economies, have already reached a high growth trajectory, and are currently witnessing a general and simulated slow down, resulting in falling demand, further hindering India's exports and export led growth. This has resulted in India's trade deficit growing bigger every year, limiting its high growth potential. Moreover, India's over dependency on a few products and fewer markets had a sharper adverse impact on country's international trade revenue.

Further, even after three decades of liberalization, India's share in global exports remained below 2%, which is very low compared to China (14.7%) and the US (8.1%). The success of Chinese reform measures and supporting policies in international trade arena is clearly visible from the below chart. From a 0.9% share in global exports in 1948, today China is contributing 14.7% to global exports (Figure 1).



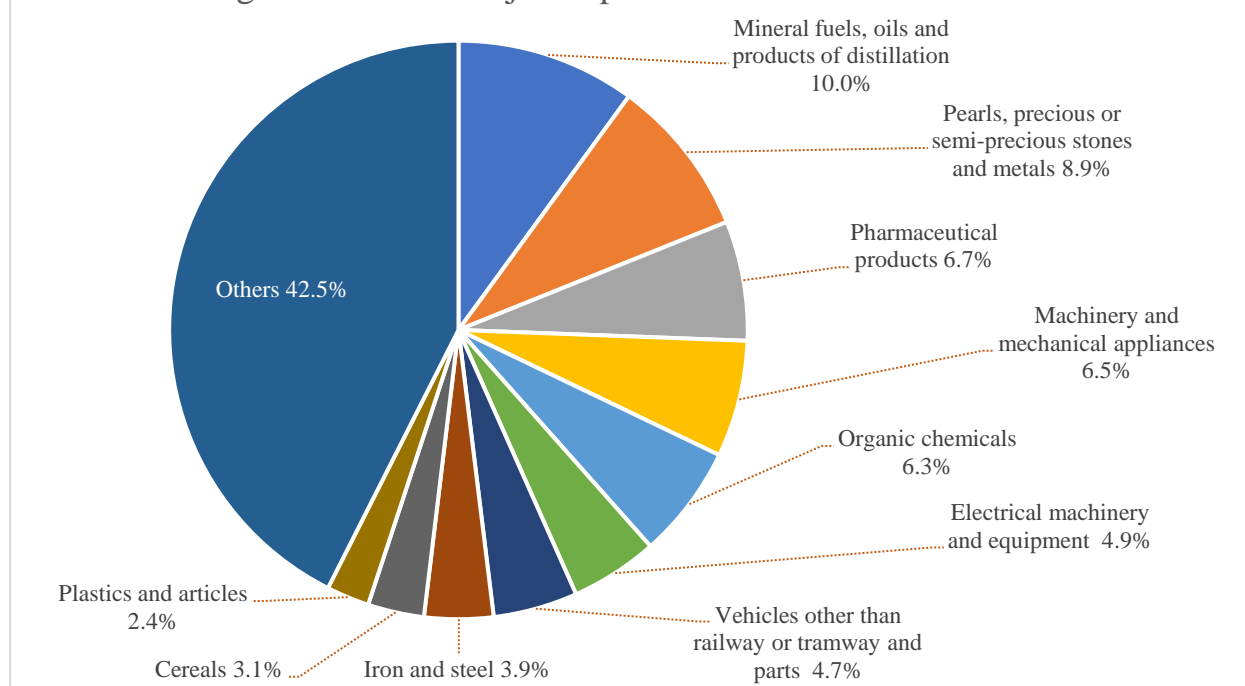
*Source: World Trade Organisation*

## Where is India Lacking?

India's exports today constitute only 11% of its GDP, which evidently indicates that India's much praised export led growth strategy is not a major success unlike Germany, Japan, East and South-East Asian peers. Moreover, India's export system is heavily dependent on imported production inputs. A major drawback of Indian system is its limited production competitiveness in many of the inputs necessary to produce India's major export products. Not so cheap labour compared to Bangladesh, Cambodia, Vietnam and Sri Lanka, logistic deficiencies due to inefficient supply chains, limited capacity creation, issues related to availability of high skilled labour to manage high technology production process, increased import costs, etc. are some of the other factors holding back Indian exports.

Moreover, a good number of major Indian export products are not having a high share in global imports. It may be noted that India's top 10 export products accounted for 57.5% of India's total exports in 2020 (Figure 2). India has very limited presence in some of the major globally traded items such as electronics (Indian exports accounting for 0.5% of global imports), machinery (0.8%), and transport products (1%).

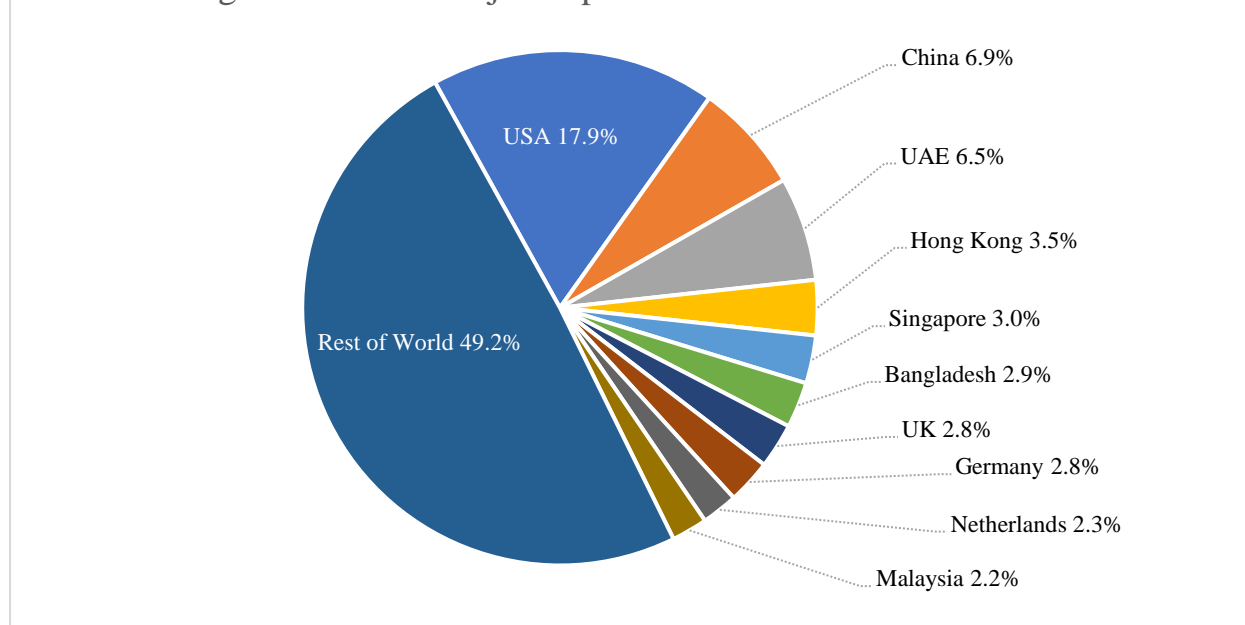
Figure 2: India's Major Export Products in 2020



Source: UN COMTRADE statistics

In addition, India's top ten export markets accounted for 50.8% of India's exports in 2020 (Figure 3). This clearly highlights the concentration risk in India's international trade.

Figure 3: India's Major Export Destinations in 2020



Source: UN COMTRADE statistics

## Export Diversification is the Key

An analysis on India's export concentration using UNCTAD's Export Product Concentration Index for last 25 years is carried out to investigate whether a large share of India's exports is accounted for by a small number of commodities or if its exports are well distributed among many products. As a higher concentration index shows a sign of low export diversification with consequent economic vulnerabilities, its evolution through time gives important signals of changing productive structure of a country. Below table shows the merchandise product concentration index for exports of India vis-à-vis its peers and economic regions for last 25 years.

<b>Table 1: Merchandise Product Concentration Index for Exports</b>							
<b>Country/Region</b>	<b>1995</b>	<b>2000</b>	<b>2005</b>	<b>2010</b>	<b>2015</b>	<b>2020</b>	<b>% Change 1995-2020</b>
Bangladesh	0.33	0.38	0.38	0.41	0.41	0.40	21
Brazil	0.09	0.09	0.09	0.15	0.13	0.18	100
China	0.07	0.08	0.11	0.11	0.10	0.10	43
<b>India</b>	<b>0.14</b>	<b>0.15</b>	<b>0.13</b>	<b>0.16</b>	<b>0.12</b>	<b>0.10</b>	<b>-29</b>
Indonesia	0.14	0.13	0.13	0.16	0.14	0.12	-14
Hong Kong	0.09	0.11	0.15	0.20	0.25	0.32	256
South Korea	0.15	0.16	0.16	0.15	0.15	0.18	20
Malaysia	0.18	0.22	0.19	0.16	0.17	0.24	33
Mexico	0.12	0.14	0.14	0.15	0.12	0.14	17
Russia	0.26	0.28	0.35	0.37	0.32	0.26	0
South Africa	0.11	0.14	0.14	0.14	0.12	0.16	46
Vietnam	0.20	0.24	0.23	0.11	0.19	0.18	-10
BRICS	0.06	0.06	0.08	0.08	0.08	0.07	17
ASEAN	0.13	0.18	0.14	0.13	0.11	0.13	0

Source: UNCTAD Stat

Compared to 1995, the merchandise product concentration index for Indian exports moderated from 0.14 in 1995 to 0.10 in 2020, implying India's little effort towards product diversification. At the same time, the index for countries including China, Brazil, Hong Kong, Malaysia, Bangladesh, South Africa etc. have gone up, showing the unique trade strategy of these economies in enhancing export revenues by focusing on major export products. In case of India the combined share of top 5, 10 and 15 merchandise export items have seen a rising trend since 1995 indicating that though India has been able to achieve a fall in the export concentration index by inclusion of additional products in the export basket, the share of major export items have not changed much. While China is one of the largest contributors to global exports with a share of 14.7%, its strategic position in the global trade is unique which is evident from its low concentration index (0.10), one of the lowest among peers.

Moreover, share of high value technology intensive products in India's export basket remain much smaller compared to China. As per the UNCTAD, 44% of Indian exports in 2020 belonged to primary products and resource-based manufactures, 43.2% belong to low and medium technology products, and 12.4% are high technology manufacture exports. India ranks 43<sup>rd</sup> in the Economic Complexity Index (ECI) 2019 out of 130 countries ranked by Harvard University, based on the complexity of the products that it exports, while China ranked 16<sup>th</sup>.

## **Conclusion and Future Expectations**

India's high export orientation in a few large trading partners and a few products preclude its ability to fully offset any sharp decline in exports. India needs to diversify its trading partners, both export markets and import sources, and find alternate high value products, due to scale, complementary economies and spreading risk. India may explore targeted geographies and product specific strategies. Exploring opportunities in new markets in Africa, South-East Asia and Latin America through strategic investments, where receptiveness towards non-Chinese trading partners is more important and needs to be explored further.

Additionally, India may aim at diversifying its import suppliers. Products having high import orientation from few countries, especially China need to be diversified. The policy needs to ensure that product or market concentration of India's trade should not go beyond specific levels. Promoting efficacy of States in exports and exploring hitherto unexplored products are added areas to be considered for long term export growth.

COVID-19 has brought about a new world order. Businesses that have been earlier benefitted from economic inter-dependence by cross-border supply chains, especially from China were affected badly due to the recent supply chain disruptions resulting in piling up of inventories, limited raw material supply and reduced demand. There have been indications that several national governments are encouraging their businesses to move out of China and set up factories in other economies with greater ease of business and cost effectiveness. The prolonged US-China trade disputes have also resulted into a shift in the operation base of several companies from China to South-East Asian Economies such as Vietnam. The recent pandemic has further compelled the multinational companies for relocating their base to a country where production is not only cost effective, but also offers a huge market in case of occurrence of similar calamities. For instance, Vietnam, a major textiles producer and apparel exporter do not have enough resources for textile production as it produces limited cotton, and its production is mostly supported by cotton imports from a few key partners. Moreover, Vietnam with a population of 95.5 million hardly provides a domestic market to balance out

the impact of a crisis like the current COVID-19 pandemic, which affected both raw material supply to and export of textile products from the country. On the other hand, India with a population of near to 1.4 billion with median age at 28 has the advantage of a large market to counter the impact of a similar crisis.

The situation demands for a drastic realignment of India's trade strategy, considering the strategic retreat from globalization and implementation of inward, rather than outward-looking economic policies by trading countries. India need to ensure the ongoing export momentum and focus on trade diversification agenda. It is very much imperative for India to explore significant reforms in trade policies including diversification of export products as well as destinations, increased domestic production, land and labour law reforms, speedy environmental clearances, and setting up alternative payment mechanisms, among others in its new FTP 2022-27.

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