Delhi Policy Group

Advancing India's Rise as a Leading Power

DPG POLICY BRIEF

Outlook and Imperatives for External Trade

Author

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Cover Photographs:

Prime Minister Narendra Modi with US President Joe Biden and Japanese Prime Minister Fumio Kishida at the launch of the Indo-Pacific Economic Framework, May 23, 2022. Source: Website of the Prime Minister of Japan

Jawaharlal Nehru Port, Navi Mumbai. Source: PIB

Commerce Minister Piyush Goyal meeting US Trade Representative Katherine Tai on the sidelines of the IPEF Ministerial in Los Angeles, September 9, 2022. Source: PIB

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Trade trends and outlook

- As per WTO estimates, world merchandise trade could slow down to just 1% growth in 2023, as against an estimated growth of 3.4% in 2022 and 27% in 2021. Uncertainty about global demand at a time of high inflation and elevated interest rates, the continuing war in Ukraine that has made commodity prices unpredictable even as they have softened from peak levels reached earlier in 2022, the prevailing economic sanctions applied against certain economies which have their own ramifications, the continuing COVID-19 pandemic in China, and its impact on economic activity and supply chains worldwide, together make for a difficult world trading environment for 2023. The IMF has warned that a third of the global economy will likely be in recession this year.

- The financial year 2021-22 (hereinafter FY 22) was a good year for India's exports which grew by 45% to US$ 422 bn, breaking off from the level of US$ 300 bn where they had remained stuck for almost a decade. While this growth momentum continued during the initial months of FY 2022-23 (hereinafter FY 23), India's exports have shown steadily reducing monthly growth rates from July 2022 onwards. Thus, while India's total exports for the six month period April-September 2022 showed 17% growth compared to the similar period in 2021, this has already come down to 11% growth for the eight month period April-November 2022.

- Will the performance during the remaining months of FY 23 at least ensure that for the year as whole, the exports will remain in positive territory? Looking at sectors, while refined petroleum products, electronic goods and several agricultural products including rice, sugar and processed agricultural goods have done well so far, textiles including cotton, organic chemicals, plastics, dyes, steel, ore etc., have done poorly. Recent months are also witnessing negative growth trends in the garments, engineering and pharma sectors.

- The Indian government has recently taken some measures including a) extending the benefit of the RoDTEP scheme to cover more items in the chemicals and pharmaceutical sector and iron and steel articles; b) scrapping the export duties on several steel products and some iron ore that were imposed in May 2022 to arrest domestic prices; and c) opening the channel of rupee trade with certain countries. Whether these can revive export prospects in some measure remains to be seen.

- Imports into India have also shown a reduced growth trend as the financial year has progressed, but their growth rates have remained significantly higher than the corresponding export levels. Thus, India's cumulative imports for the eight month period of FY 23 upto November showed a 30% increase from the previous year's level, thanks to steep rises in the imports of coal and petroleum crude, fertilisers, metals, chemicals, plastics, aircrafts, ships and vessels, and edible oil.

- The adverse trade balance on the merchandise account, therefore, after eight months of FY 23 till November 2022, has already exceeded what was a sizeable deficit of US$ 190 bn during the whole of FY 22 . Addressing how to deal with certain non-essential or low quality imports, several of which can well be produced domestically with enhanced quality standards, therefore acquires urgency.

- The toys sector has registered some success. Similar efforts are reportedly underway in the sector of fans. Several more such areas can be targeted with product improvement, strict quality conformance testing, enhancement of scale and competitiveness, and some incentives. Electrical fittings and the after market for vehicle parts, which again attract considerable imports, merit such focus.

- These are quite apart from the efforts being made to boost the country's manufacturing through the PLI schemes launched in 14 areas, setting up of integrated textile parks, and promoting semi conductor manufacturing. There is much at stake in ensuring all of them succeed and contribute also to the country's export effort, as in fact the PLI schemes in the electronics sector seem to be doing in enhancing the export of mobile phones from the country.

- As for export destinations, India's exports to China have declined by 37% so far in FY 23. While this was understandable in respect of sharp reductions in our export of cotton and steel items, in view of domestic constraints in India, the reductions in a wide range of sectors including machinery parts, chemicals and non ferrous metals need closer examination and follow up. Interestingly, the Netherlands has emerged as the third top export destination, after the US and the UAE, and China's ranking has slipped to fourth.

- On the import front, thanks to increases in import of crude, Russia has emerged as the fifth largest source of imports for India after China, the UAE, the US and Saudi Arabia. It will be important for India to keep up the Russian source for energy and other items, providing room for flexibility and limiting expenditure. If some trade gets transacted in Indian rupees, this can also provide outlets for greater Indian exports to Russia that still remain small.

- The second aspect is the continued rise in imports from China that are about 18% higher so far in FY 2023. Imports for the whole of FY 23 could, therefore, end up well above the US$ 100 bn mark, considering that in FY 22 they had already totalled US$ 95 bn. This continued growth is also reflected across several sectors including electronics, machinery, organic chemicals, APIs and automotive parts. A diligent process to address possible supply risks should form part of India's corporate strategy, and this should acquire some priority not just among large businesses but also at other levels that needs quiet but active pursuit by industry associations and other bodies.

- Considering the WTO's grim world trade forecast for 2023, it would be necessary to monitor trade trends very closely during FY 2024 to be able to apply remedial measures as and when necessary. The alleged dumping of PCBs from China and Hong Kong is a recent example.

- Exports of commercial services have so far performed better for India in FY23, and rose by 28.82% to US$ 204 bn for the eight month period April-November 2022, compared to the corresponding period in the previous year. Imports too have risen by a similar percentage of 29.35% for this period, reaching US$ 117 bn, but over a smaller base. India's trade on the services side, therefore, shows a higher surplus so far in FY23.

- It remains to be seen if India's services trade, with its predominance of IT and IT enabled services, will escape impact in the expected slowdown/recessionary conditions in FY 24. In any case, it is important that India diversifies its export base, both in terms of the range of services offered and the markets that are now largely confined to certain western economies.

- Overall, to impart fresh momentum at a difficult time, and from a medium term perspective, it would be important for the Department of Commerce to come out with the much postponed EXIM policy, spelling out its vision according due high priority for foreign trade in goods and services in India's overall economic framework. The policy can also detail India's overall approach towards FTAs and other initiatives.

Expansion of India's FTA framework

- India signed two FTAs - one with the UAE and an interim one with Australia - which came into effect on May 1, 2022 and December 29, 2022 respectively. It may be too early to draw conclusions about their impact. There are, however, clear signs of buoyancy in trade in both directions with these countries, that augurs well. Generating greater business promotional activities with these two countries and attracting more investments from them can help consolidate gains.

- Among prospective FTA partners, the negotiations with the UK appear most advanced. Greater focus on market access for each other, and what can help assist in such access, may be more important in these negotiations than allowing intrusive domestic regulatory commitments to gain prominence that would also involve changes on an MFN basis. Concluding such an agreement could also provide a good template for the other ongoing negotiations with partners like Canada and the European Union.

- It would also be necessary to undertake detailed preparations for the review of the ASEAN-India Trade in Goods Agreement for which the scope has recently been agreed. These negotiations should focus on removing existing imbalances in market access commitments, apart from addressing trade facilitation and procedural simplifications.

- Bringing to a satisfactory conclusion the long ongoing FTA review negotiations with the Republic of Korea would be important. The pattern of trade with Japan is also showing changes that would benefit from a review of the India-Japan CEPA. Strengthening trade and economic linkages further with this Quad and Indo-Pacific partner with much mutualities can help in adding depth to this special strategic partnership.

- A word of caution may at the same time be necessary in any presumption that concluding more FTAs would automatically result in a substantial increase in India's exports. All the economies with which India is trying to enter into FTAs, or to hold a review of existing FTAs, already have several FTA partners with deep market access concessions. All that our FTAs with them will do is to give India's exporters a level playing field in those markets. It is absolutely essential to boost India's manufacturing capacities and competitiveness for using such access to benefit. All the initiatives taken - the PLI schemes, the textile parks, semi-conductor manufacturing and so on - will have to be made to succeed. It is opportune that corporates globally are at this time building de-risking strategies for their supply chains. India needs to seize this opportunity in full measure and strive to attract foreign investments in manufacturing.

Resolving bilateral issues with the US and progressing the IPEF

- The US is India's largest trading partner in both goods and services trade, and India enjoys a surplus on both accounts. The bilateral Trade Policy Forum meeting held in November 2021 had raised expectations that the two sides will resolve all pending issues by the middle of 2022. While some related to agricultural products have seen progress, others remain pending. For India, the removal of tariffs on steel and aluminium (imposed by the US under Section 232 of US Trade Act), restoration of GSP benefits, and movement on issues like a totalisation agreement remains important. Consolidating bilateral trade, investment and technology ties, at a time when the relationship on the whole is progressing well, should remain a priority for India in the new year.

- The Indo Pacific Economic Forum (IPEF) launched by 14 countries, including India and other Quad members, in May 2023 has already seen significant progress. Negotiations have commenced on several topics/themes under its four pillars of trade, supply chain resilience, clean economy and fair economy at the Brisbane meeting in December 2022. India will host the next round to be held on February 8-11, 2023 on three pillars (India has not signed up to the trade pillar yet). With the US providing leadership and push, IPEF could develop salience which can bring critical linkages within the region on building resilience in supply chains. IPEF, which is implicitly pegged to reducing dependencies on China, needs to be used to India's advantage. Remaining out of APEC, RCEP and CPTPP, each of which involve several countries in the region, makes it imperative that India must give IPEF the best shot even while retaining policy flexibilities needed for India's development.

The growing intersection between trade and decarbonisation efforts

- The European Union is steadily moving towards introduction of its carbon border adjustment mechanism (CBAM) from 2026 onwards, to prevent carbon leakage, which will initially apply to seven areas of manufacturing - cement, fertilisers, iron and steel, electricity, aluminium, hydrogen and some downstream areas - which can subsequently extend to other products. This will effectively require exporters to the EU to be paying a carbon tax for their export of these items, based on emissions embedded in them, reduced only by any carbon credit that may have been paid for by the producer in the country of origin. In essence, therefore, the EU measure requires every producer exporting to the EU, to adhere to EU's own carbon pricing norms for meeting its commitment towards reducing GHG emissions by 55% by 2030 compared to the 1990 levels. Members of the BASIC forum, including India, have expressed grave concerns about the EU proposal as far back as 2021.

- The US is following a different protectionist tack of its own. The Inflation Reduction Act passed by the US Congress in August 2022 permits a wide range of incentives for producers of electric vehicles, energy efficient appliances, lithium batteries etc., and for consumers undertaking home improvements or installing heat pumps, all of which are meant to contribute towards the country's decarbonisation efforts. But all these incentives or tax credits are conditional on local manufacturing with North American content, and in certain cases like batteries for the raw material to be sourced from countries with an FTA with the US. The EU, UK and the Republic of Korea, among others, have raised concerns about the US move.

- Efforts to meet decarbonisation targets, laudable as they are, are now clearly coming embedded with protectionist elements shielding or providing incentives to their domestic industry. The WTO compatibility of such measures is much in doubt. More importantly, as in the case of EU's CBAM , which can impact some of India's exports like steel and aluminium, there are two additional aspects that merit consideration. First, CBAM gives credit for market based carbon prices paid in the exporting country but it does not consider any comparable emission reduction costs that can arise from regulatory measures. Second, it does not provide for equity by applying the principle of common but differentiated responsibilities.

- Rather than each country pursuing such measures in a unilateral manner, is there scope for coming to an agreement internationally on what can be deemed equivalent measures for meeting each country's commitments? Could India take the initiative, during its G-20 chairmanship, a forum in which all significant actors are represented, to initiate discussions on this important issue? Alternatively, could India attempt to arrive at some equivalence agreement with the EU as part of the ongoing FTA negotiations? Clearly, the issue needs urgent attention.

WTO reform

- It is unclear to what extent WTO reforms, including those of the WTO's dispute settlement mechanism, will be actively pursued this year at a time when the economic and geopolitical environment appears far from conducive. The Biden Administration has strongly rejected the recent WTO panel ruling against the additional duties on steel and aluminium items imposed by the Trump administration on national security grounds, and has made it clear it does not intend removing these duties. Sectorally targeted industrial policies are also being adopted by the trade majors, be they related to semi-conductors or to climate related products and services. Export controls have witnessed a resurgence. Amidst all this, is there any prospect of developing consensus on reforms to the WTO whose fundamental principle is of non-discrimination?

- India will need to actively monitor developments on this front and continue building coalitions on issues of interest to it at the WTO, particularly considering that the EU has been calling for the WTO's 'root and branch reform'. Issues like food security (public stockholding for food security purposes) remain important for India, as also how a 'developing country' may be defined. But on certain issues like investment facilitation or services regulation, on which plurilateral talks have been taking place, India can be more forthcoming. Overall, the prospects for any breakthrough during the coming year appear bleak.

Concluding note

- Prospects for continued growth in goods trade in 2023 do not appear bright at present. Few sectors like petroleum products, electronics, and certain agriculture items may show positive trends, depending on prevailing prices. India will need to make every effort to suitably assist its exporters to meet the challenge.

- India's services trade appears better positioned.

- It would be important to come out with India's long postponed EXIM policy.

- India should continue to actively pursue ongoing FTA negotiations with select partners and prepare well for the FTA review with ASEAN, while also taking forward reviews with Korea and Japan.

- Building manufacturing capacities and competitiveness have to remain in focus. Initiatives launched, including the PLI schemes, need to succeed.

- Holding the next Trade Policy Forum meeting with the US, and trying to resolve pending bilateral trade issues with India's top trade partner, will be important.

- India needs to work on using IPEF to its advantage.

- Decarbonisation initiatives by developed trade majors to meet climate targets are being made with protectionist content. Can India utilise its G-20 chairmanship to initiate discussions on addressing equivalence? Or should India pursue this with the EU under the ongoing FTA negotiations?

- Prospects for any breakthrough in WTO reform during the year appear bleak. However, India will need to closely monitor developments on this front.

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