Delhi Policy Group
Advancing India's Rise as a Leading Power

POLICY BRIEF

The China Factor in India's Economic Security

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PM gives a clarion call for Atmanirbhar Bharat in a virtual address on May 12, 2020. (Source: PIB/Official Website)
Union Finance Minister Nirmala Sitharaman presents the Union Budget 2024-25 in Lok Sabha on July 23, 2024. (Source: News on AIR/Official Website)

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I. Introduction

Navigating trade and economic ties with China has become a challenge for countries worldwide. With the overwhelming concentration of manufacturing in China, it has become the No.1 import partner for over 120 countries. High levels of import dependence, however, carries vulnerabilities for importing countries against unforeseen developments like COVID-19, logistical bottlenecks or natural disasters. Trade dominance by one source of supply also makes them open to pressure. Instances of coercion exercised by China on certain countries for achieving non-commercial objectives have been well documented. Several countries, both developed and developing, have begun to develop de-risking strategies and resilience in their supply chains. Reshoring, near shoring and friendshoring of manufacturing have been actively underway in recent years.

It is China's vast industrial scale and its ability to export products at cheap prices that have made China the world's No.1 exporting nation (US$ 3.38 trn in 2023), with the United States (US$ 2.04 trn) ranking a distant second. But China's push for building this dominance further is now posing an existential threat to prevailing or emerging industrial capacities in other countries in a range of sectors, from chemicals and textiles to metals, processed minerals, machinery, electronics, EVs, solar cells and medical devices. Countries are compelled to impose trade defence measures, even as these are being seen as insufficient.

Travails of Chile and Indonesia

The Huachipato steel plant in Chile announced the suspension of its operations on August 15 and its closure by September, because the anti-dumping duties that Chile had imposed on Chinese steel in April this year were not enough. The 'intensification of Chinese dumping' was blamed for this decision[1].

A protest by workers in Jakarta prompted the Indonesian Minister of Trade, Zulkifli Hasan, to announce in July this year that the government will impose import tariffs of up to 200 per cent on some products from China, particularly

[1] https://www.france24.com/en/live-news/20240807-chile-s-largest-steelmaker-suspends-production-blames-china

textiles, clothing, footwear, electronics, ceramics and cosmetics, to try to protect local businesses and prevent layoffs. But considering the negative impact on the growing trade relationship between the two countries, the Indonesian government subsequently announced that it was setting up a task force to monitor and handle problems related to certain imports[2].

Economic Survey moots greater facilitation of Chinese investments

Meanwhile, India's pre-budget Economic Survey for 2023-24 released in July this year suggested consideration of facilitating foreign investments from China. The Survey felt that to boost Indian manufacturing and incorporate India into the global supply chain, it was inevitable that India plugged itself into China's supply chain. "Whether we do so by relying solely on imports or partially through Chinese investments is a choice that India has to make"[3]. The Survey also pointed out that in response to India's anti-dumping probe against Chinese entities, China has been quietly blocking India's access to solar equipment. Developing countries, the Survey posed, will have to figure out a way of meeting import competition from China while boosting domestic manufacturing capabilities, sometimes with Chinese investment and technology collaboration.

The government signals caution

Commerce and Industry Minister Piyush Goyal, however, made it plain that what was suggested in the Survey was only an idea, and it was not binding on the government. He added there was no rethinking at present to support Chinese investments in the country[4]. Commentaries have continued to appear on this subject, some weighing in support of the idea while others urged caution. It was, for example, made clear that increased investment inflows into the country from China may not necessarily lead to a reduced bilateral trade deficit but could even widen it further[5,6]. Meanwhile, External Affairs Minister Dr. S. Jaishankar also explained that India was not opposed to investments from China per se, even economies like the EU and the US were scrutinising

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[2] https://www.business-standard.com/world-news/indonesia-seeks-ways-to-balance-local-industries-with-high-chinese-imports-124082100255_1.html
[3] https://www.indiabudget.gov.in/economicsurvey/doc/eschapter/echap05.pdf
[4] https://ddnews.gov.in/en/piyush-goyal-confirms-no-change-in-policy-on-chinese-investments/
[5] https://www.thehindubusinessline.com/opinion/should-we-open-the-door-to-chinese-investments/article68502202.ece
[6] https://www.business-standard.com/opinion/columns/simplistic-to-think-chinese-investments-will-improve-india-s-trade-balance-124082801329_1.html

Chinese investments. While this has become a general problem, India also has a special China problem due to border and security concerns[7].

Focus of this paper

This paper seeks to draw out these issues in some detail, pointing out the vulnerabilities of enhanced dependence on and the threat posed by China's overcapacities. The international backdrop surrounding China's trade and economic dominance is of particular relevance here, as also how the world is seeking to deal with them. Another factor of importance is India's own efforts towards building greater domestic capacities and resilience in collaboration with trusted partners. It thus makes sense that as we move forward, we must try and consolidate this trend further, rather than undermine it. Regulatory oversight acquires particular importance here in ensuring that steps are taken to reduce our dependence risks, and not to elevate them further. However, wherever further trade and investment partnerships can bring gains to the consolidation process domestically and help us move forward on the export front, we should certainly be availing of them.

The intersection between good economics and economic security needs a finely balanced approach.

II. International Backdrop

Several research articles have appeared this year on China's economic dominance and its impact on other economies. Richard Baldwin termed China the world's sole manufacturing superpower[8], considering its 35% share in gross manufacturing output, which becomes a 29% share in value added terms. A Rhodium Group paper drew attention[9] to how China's overcapacity was holding back emerging economies and revealed that even between 2019 and 2022, the import dependence of emerging economies on China had increased. The share of imports seen at HS-6 level in which more than 50% of their imports came from China had gone up from 15 to 20%.

Jay Shambaugh, US Under Secretary for Treasury, who is the US lead for the economic working group between the US and China, has noted[10] that in the first quarter of 2024, China's export volumes rose faster than total export values

[7] https://indianexpress.com/article/india/state-ties-china-calls-investments-from-scrutinised-jaishankar-9543086/
[8] https://cepr.org/voxeu/columns/china-worlds-sole-manufacturing-superpower-line-sketch-rise
[9] https://rhg.com/research/how-chinas-overcapacity-holds-back-emerging-economies/
[10] https://home.treasury.gov/news/press-releases/jy2455

(calculated in US$), rising 11.5% versus 1.5%, respectively, compared to the previous year. Moreover, increases in export volumes were particularly high for electric vehicles (+20%), solar batteries (+30%), and semiconductors (+25%), while overall export prices have fallen significantly since the beginning of 2023.

A team of economists in the European Central Bank has estimated that the Euro area's competitiveness loss has been around 20%. The Real Effective Exchange Rate (REER) of the Euro area vis a vis the Chinese yuan, which is the effective exchange rate divided by a price deflator or index of costs, has gone up from an indexed 100 in January 2021 to 121 this year. This is primarily due to an unfavourable price evolution, considering that the nominal Chinese Yuan-Euro exchange rate has remained broadly stable since 2021. On the other hand, the REER of the EU area excluding China measured 99[11] .

China's overcapacity is attracting political concern

China's 'overcapacity' has also begun to be taken up at political levels internationally. While sectoral overcapacity of China in steel and aluminium was a perennial issue even in the last decade, this time it is more pervasive across sectors. US Treasury Secretary Janet Yellen talked about it during her China visit in April and affirmed[12] that "China is now simply too large for the rest of the world to absorb this enormous capacity". EU Commission President Ursula Von der Layen referred to China's structural overcapacities when she met President Xi Jinping in May in Paris[13]. The G-7 Summit held in June this year in Apulia also made a reference to China's harmful overcapacities in a growing range of sectors.

Why should overcapacities arise in the first place? China's state directed low consumption, high savings and industrialisation push model

China's relatively low consumption ratio (40% as against 50-60% for most other countries) and high savings[14] also generate capital that state controlled banks have used for boosting capacities unrelated to demand. That China's consumption has not grown with its prosperity has become a sore point globally, particularly with local demand now falling further with a continuing property market decline. International pressure on China to boost domestic

[11] https://www.ecb.europa.eu/press/blog/date/2024/html/ecb.blog240903~57f1b63192.en.html
[12] https://home.treasury.gov/news/press-releases/jy2241
[13] https://ec.europa.eu/commission/presscorner/detail/en/statement_24_2464
[14] The WTO Secretariat report for China's trade policy review (July 2024) noted 'China's saving rate continues to be very high by international comparison, mainly due to the importance of precautionary savings. Domestic consumption could be boosted in the long run by reforms in pensions, medical care, and housing, as well as services liberalization'.

demand has not worked. The recently held 3rd Plenum of the Communist Party makes it clear that China will continue to employ industrial policies to further enhance its manufacturing capacities and trade dominance, in particular in strategic industries[15].

Zongyuan Zoe Liu of the Council for Foreign Relations has noted[16] that this policy is not an aberration or a miscalculation. He observes: "According to party orthodoxy, China's economic advantage derives from its low consumption and high savings rates, which generate capital that the state-controlled banking system can funnel into industrial enterprises. This system also reinforces political stability by embedding the party hierarchy into every economic sector. Because China's bloated industrial base is dependent on cheap financing to survive-financing that the Chinese leadership can restrict at any time-the business elite is tightly bound, and even subservient, to the interests of the party". So, this problem does not look like it is going away anytime soon.

China's subsidies are also opaque

The WTO Secretariat Report for China's trade policy review in July 2024 has also taken a negative view about China's subsidy notifications to the WTO[17]. "The two notifications submitted to the WTO during the review period, and the replies provided by China, do not enable the Secretariat to have a clear overall picture of China's support programmes. In particular, the Secretariat was not able to gain deeper insight into the levels of financial support for certain highly traded sectors, such as aluminium, electric vehicles, glass, shipbuilding, semiconductors, or steel. Available commercial databases document important levels of public support for companies in key economic sectors, with a strong concentration in manufacturing, and significant increases in support since 2018. So-called 'Government Guidance Funds' or 'Government Investment Funds' continue to use public resources to make equity investments in industries and activities that the Government considers important. ..., the overall lack of transparency on China's government support may also contribute to debates on what is perceived by some as overcapacity in certain sectors".

[15] The aforementioned report also noted that the structural change that China had previously embarked upon – away from industry and towards services – came to a halt.
[16] https://www.foreignaffairs.com/china/chinas-real-economic-crisis-zongyuan-liu
[17] https://www.wto.org/english/tratop_e/tpr_e/s458_e.pdf

The West finds itself increasingly in direct competition with China

The Western concern about China is evident. While China's earlier dominance in low-end goods did not raise concern, worry them, and was even welcomed with western companies flocking to invest in China as it provided cost effective win-win options, this is now much less the case as China's product coverage has expanded to higher-end items involving direct competition with the West. For example, as per the ECB[18], the number of sectors in which both the Euro area and China enjoy Revealed Comparative Advantage - meaning they export more in these sectors than the world average - has steadily increased in recent years, from around 23% in 2003 to close to 40% in 2022. Even a export major like the Republic of Korea that had a trade surplus with China till 2022 is finding Chinese goods flooding its market with low prices[19]. ROK had a trade deficit of US$ 18 bn with China in 2023, after a span of 31 years.

Derisking and diversification have therefore acquired focus in the West

The supply chain disruptions during the COVID-19 pandemic, and in the immediate aftermath of the Ukraine conflict, demonstrated the risks of relying on concentrated manufacturing locations, as in China. Pure cost efficient arrangements or 'just in time' logistical line-ups are therefore giving way to less risk based options that also factor in 'just in case' scenarios. And China's leveraging its economic muscle to lean on countries to have its way on non-commercial issues is another aspect that has influenced Western decision making. G-7 summits held in Hiroshima (2023) and Apulia (2024) have voiced concerns against such coercion[20].

Industrial policies are now increasingly commonplace

Practically all the G-7 economies have, therefore, introduced industrial policies that help to build domestic capacities and prop up near shoring and friend shoring supply chain possibilities. The Inflation Reduction Act and the Chips for America Act of the US, and the Net Zero Industries Act and the Critical Raw Materials Act adopted by the EU, are some big ticket initiatives even as there other supportive ones. These have mainly focused on EVs, batteries, solar panels, semiconductors and critical minerals processing, but also on other

[18]https://www.ecb.europa.eu/press/blog/date/2024/html/ecb.blog240903~57f1b63192.en.html

[19] 'From steel to kimchi, South Korean exporters face flood of Chinese rivals' by Christian Davies and Song Jung-a, Financial Times, 17 September 2024

[20] The Apulia G-7 Summit Joint Communique inter alia read 'We are not decoupling or turning inwards. We are derisking and diversifyiong supply chains where necessary and appropriate and fostering resilience to economic coercion'. Similar articulations can be found in para 3 of the section on Indo-Pacific in the latest G-7 Foreign Ministers' meeting held in New York on September 24, 2024.

areas. The report submitted by the former Italian Prime Minister Mario Draghi to the EU Commission President Von der Layen earlier this month[21], titled 'The future of European competitiveness – A competitiveness strategy for Europe', has called for the EU to raise investments to the tune of over US$ 800 bn a year to fund rapid reform and stop the EU from falling behind the US and China. This could again spur a whole lot of new initiatives and investments in Europe. Japan is implementing its green transformation package, apart from extending large budgetary allocations for its semiconductor industry.

Investments are already ongoing

As a result of all these legislative and other initiatives since January 2021, private companies have announced nearly US$ 880 bn in new investments in the US, including US$ 410 bn in clean energy manufacturing[22], EVs, batteries and clean power generation. Dozens of companies have also committed to nearly US$ 400 bn in semiconductor investments in the US. Similarly, US based Intel has outlined plans to invest US$ 88 bn in expanding chip research and manufacturing facilities in Europe. Japan has attracted large investments from the Taiwan based TSMC and its own chip maker Rapidus in the last couple of years.

With domestic capacities coming up, their protection has become a key

The G-7 countries are clearly keen to protect these upcoming capacities from Chinese overcapacities. Securing their workers has also acquired importance. But each Western economy is going about erecting protection in its own unique way. On the face of it, many of these measures seem beyond what the WTO rules may permit. The US has in May this year slapped penal duties ranging from 25% to 100% on a range of imports from China - steel and aluminium items to electric vehicles and batteries - and these duties are coming into force from September 27[23]. Canada has followed suit and its duties, pitched at similar levels and product coverage, will be effective from October 1, 2024[24]. The EU is also soon coming up with its countervailing duties on electric vehicles from China that will be coming up for voting by EU member states

[21] https://commission.europa.eu/document/download/97e481fd-2dc3-412d-be4c-f152a8232961_en?filename=The%20future%20of%20European%20competitiveness%20_%20A%20competitiveness%20strategy%20for%20Europe.pdf

[22] https://www.whitehouse.gov/briefing-room/blog/2024/07/01/building-a-thriving-clean-energy-economy-in-2023-and-beyond-a-six-month-update/

[23] https://www.federalregister.gov/documents/2024/09/18/2024-21217/notice-of-modification-chinas-acts-policies-and-practices-related-to-technology-transfer

[24] https://www.canada.ca/en/department-finance/news/2024/08/canada-implementing-measures-to-protect-canadian-workers-and-key-economic-sectors-from-unfair-chinese-trade-practices.html

before October 30, 2024. The EU is also closely examining subsidies and incentives vis-a-vis other products. Its carbon border adjustment mechanism may also help cover steel, aluminium and a few other items.

Even with the full range of trade toolkit at play, steps are still seen inadequate

The WTO compatibility of several of these measures remains much in doubt. That does not seem to be deterring the developed countries, with the WTO's dispute settlement system presently remaining shackled. They are also employing all available tools in restraining China, particularly in high tech and other sensitive sectors, through investment scrutiny, export controls and other regulatory checks. Even so, a key refrain from the West, which has some validity according to this author, is that global trade rules are not always adequate to protect against China's non-market economy practices.

China too is retaliating

China, meanwhile, is taking retaliatory steps and digging in. President Xi denied during a visit to Paris that there was any overcapacity issue from the point of comparative advantage or global market demand[25]. Chinese Foreign Minister Wang Yi, in his conversation in Beijing with US NSA Sullivan in August this year, also argued that using overcapacity as an excuse to pursue protectionism will only harm global green development and impede world economic growth[26]. China attributes its competitiveness to its industrial scale, efficiency and technology development. But even in April 2020 President, Xi is reported to have said at an internal meeting[27] "We must tighten international production Chains' dependence on China, forming powerful counter measures and deterrent capabilities based on artificially cutting off supply to foreigners".

China has already imposed export restrictions on gallium, germanium, graphite and, most recently, antimony. It is also getting ready with counter measures in case the EU proceeds to impose countervailing duties on Chinese EVs. The EU's agriculture related exports to China - brandy, pork and dairy products - could be at risk. China has also adopted fresh legislation last year

[25] https://english.www.gov.cn/news/202405/07/content_WS66391c1fc6d0868f4e8e6cb6.html
[26] https://www.fmprc.gov.cn/eng/wjbzhd/202408/t20240830_11482159.html
[27] See for example https://www.csis.org/analysis/chinas-new-strategy-waging-microchip-tech-war

that arms it with provisions to retaliate against what are perceived as harmful trade actions[28].

No sign of any let up

It does not appear that this competition and contestation between the West and China will see any early resolution, even as there may be nuanced differences among the Western countries[29]. Risks, therefore, remain high that the gulf between China and the G-7 countries on economic issues may only grow further.

China's own mitigatory manoeuvres

China is trying to mitigate any possible impact by improving its trade ,and economic ties with Australia, New Zealand, some receptive countries in Europe, and also Japan and South Korea. Chinese companies that largely used to invest in extractive industries or infrastructure projects that were part of BRI initiatives are now making investments in manufacturing in ASEAN[30], Turkey, Mexico, Serbia, Hungary and other receptive geographies of a plus one type, that can potentially act as channels for directing trade to Western markets.

Increased Chinese investments make imports from China rise further

There is also the obverse side: investments are also export inducing for home countries. Even otherwise, Chinese companies are fierce competitors in ASEAN'S developing economies, not only in low end items like garments (China is showing no sign of vacating such low end sectors) but also in steel, aluminium, ceramics or glass. With domestic over-capacities in China and cooling demand from real estate, exports have surged further. China's manufacturing trade surplus vis-a-vis ASEAN grew, for example, by 3% as a share of recipient GDP for the ASEAN countries between 2019 and 2023. This was also a period when Chinese investments into ASEAN were rising.

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[28] http://en.moj.gov.cn/2023-07/11/c_901729.htm

[29] EU member states approach to investments from China remains varied and there has been a number of greenfield FDI from China particularly in central and eastern Europe.

[30] As per UNCTAD's World Investment Report 2024, the number of greenfield projects announced by Chinese MNEs in 2023 almost doubled compared with 2022, explaining half of the total increase for developing countries. Most of the increase in projects announced by Chinese MNEs were in South-East Asia and concentrated in manufacturing industries, particularly computers, electrical equipment, motor vehicles and other transport.

No doubt, ASEAN countries' exports to Western markets have shown an uptick. But to what extent Western countries may show continued tolerance for such goods with substantial China content remains to be seen.

It is against the foregoing international backdrop that we need to review India-China economic ties, and examine possible ways forward.

III. India - China Trade and Investment ties

India's imports from China continue to rise

India's imports from China have also grown, from US$ 70.3 bn in 2017-18 with a 13.68% market share to US$ 101.75 bn in 2023-24 when the share rose to 15.06%. This trend has continued in the first quarter of 2024-25. India has around 40% or more import dependence in 18 sectors (HS-2 digit level), and in several of them, including organic chemicals, machinery, electronics, synthetic textiles, ceramics and glass, this is rising. At the individual 8-digit level, there are numerous cases of over 70% import dependence.

All this rise is despite India's relatively higher duty levels, and anti-dumping duties applied in respect of certain products. It needs to be clearly understood that these figures underplay the full reality, as some imports are routed via ASEAN countries and Hong Kong, while some also enter through informal border trade channels through neighbouring countries.

The recent rise seen in steel imports into the country from China, with some concern that part of its steel may additionally be getting routed through Vietnam, is an illustration how surplus capacities can exert pressure on the domestic industry and depress prices. The government in India has launched an anti-dumping investigation against Vietnam[31] and is considering some kind of border adjustment duties on increasing steel imports[32]. And not just India, but steel industries from Brazil to Turkey, apart from developed countries, have slapped higher duties or imposed quotas on Chinese steel in the last few months.

India's exports stagnate, with a diminished share

India's exports to China have on the other hand stagnated. The figures for 2023-24 were US$ 16.7 bn, unchanged from 2019-20. But its share in our export

[31] https://www.business-standard.com/economy/news/india-begins-anti-dumping-probe-on-hot-rolled-steel-imports-from-vietnam-124081601611_1.html
[32] https://theprint.in/economy/goyal-moots-idea-of-border-adjustment-tax-suggests-discussion-with-steel-industry/2254949/

basket has been reduced from 5.3% to 3.8%. India's principal exports are iron ore, petroleum products, fisheries and some metals, intermediate chemicals and machinery parts. There are no finished products of any significant scale. Even India's pharmaceutical formulations figure at only US$ 72 mn in exports for such a large market as China.

China's average MFN duties are relatively low at 7%, but more problematical are its non-tariff barriers and opaque procedures.

As for FDI, in India, China ranks 22nd with a cumulative investment of US$ 2.5 bn. Of course, some investments could have also come in through third country channels.

Mutual dependence is fine, but asymmetric dependence has risks

Any significant trade relationship carries a dependence factor. Building inter-dependence among nations was in fact a key driver behind the post World War II economic framework to avoid future wars. But if the trade is asymmetrically skewed, as it is between China and India, when normal relations also don't exist, the dependence becomes a vulnerability that needs to be addressed. India realised, particularly post-April 2020, that over dependence and concentration need to give way to a more secure and de-risked economic environment. The month of April 2020 was indeed a time of grim awakening. India was faced with the COVID-19 pandemic and the accompanying import vulnerabilities, along with a PLA troop build up across our northern borders that also subsequently resulted in the Galwan clash. What has evolved since then is a four pronged framework.

A four pronged framework emerges

Broadly, the set of initiatives that have been launched to address the vulnerabilities India has faced could be grouped under four heads:

- **Keep out risk ridden trade, investment and technologies**: resulted in the banning of several digital applications, prohibition of certain technologies from 5G trials, and introduction of case by case screening of FDI with countries with which India shared borders[33], including China.

- **Strengthening indigenous capacity and competitiveness** : a) Launching of Production Linked Incentive (PLI) schemes in 14 sectors[34]

[33] https://dpiit.gov.in/sites/default/files/pn3_2020.pdf
[34] The Economic Survey for 2023-24 presents some details about progress made under the PLI schemes

ranging from bulk drugs and medical devices to battery making for electric vehicles, and from solar modules to mobile phones and laptops, in all of which import dependency from China was high; b) Initiatives launched in a number of other areas including textiles, footwear, toys etc.; c) Launch of a semi-conductor development programme involving all stages, from wafer fabrication to assembly, testing, marking and packaging as well as design. Five approved projects are at various stages of implementation; d) Boosting mining and processing of critical minerals. After several legal and other preparatory steps, the first composite lithium mining site was awarded last month in the Katghora region of Korba district in Chhattisgarh. India's KABIL company has also secured exploratory and exclusive mining rights for five lithium blocks in Argentina; and e) Strengthening of industrial infrastructure through freight corridors and launch of new industrial cities.

- **Forging supply chain collaborations with friendly partners:** a) Entering into cooperation as part of Quad initiatives as well as bilateral and trilateral initiatives with the other three Quad members; b) Joining 14-member India-Pacific Economic Forum (IPEF), which includes supply chain and clean economy pillars; c) Becoming part of Minerals Security Partnership; and d) Joining the India-Middle East- Europe Economic Corridor initiative.

- **Entering into more FTAs with select partners:** After a pause of almost a decade on new FTAs signed by India, and India also deciding in 2019 not to join RCEP, India has concluded FTAs with Mauritius (2021), UAE (2022), limited FTA deal with Australia (2022) and EFTA (2024). FTA negotiations with the UK and Oman are reportedly at an advanced stage. Negotiations continue on a FTA with the European Union, review of the ASEAN-India Trade in goods Agreement, and upgrade of the agreement with Australia, among others.

Future direction of India-China trade and economic ties

Against the background already described, and in the light of the ideas put forward in the Economic Survey and the ministerial level caution, the question arises how to move forward on the difficult India-China economic relationship. Domestically, ramping up India's manufacturing, ensuring greater value addition in India's exports, making India even more competitive on business and trade facilitation, and implementing the foregoing four point framework in a missionary mode, are crucial[35]. An economically stronger India carries currency in dealing with China. Economic strength also enables greater room for arriving at what could be truly mutually beneficial solutions.

China has, however, never shown any interest in addressing the steep asymmetry between India's imports from China and India's exports to that country. Vague arguments about different industrial structures in the two countries do not offer satisfactory answers. If India can export billions of US dollars worth of pharmaceutical formulations to the US and EU markets, there is no adequate explanation as to why our exports of these products to a mega market like China should be only US$ 72 million. Adequately addressing this steep imbalance would be a good way to start, if there is any interest for a reset on China's part.

In the meanwhile, it is also important to have clarity about how to address trade and investment regulatory aspects vis-a-vis China that come up from time to time. Gaining a deeper understanding of India's import dependence with respect to China would be a necessary pre-requisite to start. Second would be to have a better appreciation of trade remedial measures necessary in order to provide our producers a level playing field to compete and not face unfair competition from subsidised state driven overcapacities or dumping of goods. Third would be the evolution of some internal guidelines and guardrails for dealing with proposals for investment by Chinese companies in India, even if they will be dealt with on a case by case scrutiny basis.

Studying India's import dependence vis-a-vis China

Imports from China can broadly be classified into four categories that are not entirely mutually exclusive.

a) **Industrial imports of machinery, intermediates, components, accessories and metal items from Chinese producers that are used as inputs by Indian manufacturers**: Imports of several of these items are substantial. They include the set of 14 items in which PLI schemes are currently operational, including those relating to clean energy sectors. Further analysis will be required to examine the vulnerability risks for other

[35] At a time when India's Aathmanirbhar Bharat programme was announced in May 2020 by Prime Minister Modi with further elaboration subsequently this author had written a brief on June 30, 2020 as to how the several new initiatives can be implemented with also a boost to trade. See https://www.delhipolicygroup.org/uploads_dpg/publication_file/aatma-nirbhar-bharat-abhiyan-and-the-trade-factor-1840.pdf

products (see Box 1), and if they are also deemed critical then tweaking or adding more products to the PLI platforms may be necessary.

Box 1: Examining Dependency in Trade

Examining 'dependency' of products falling particularly under categories a) and d) mentioned in the adjoining text could begin by looking for those over the 40% threshold (for certain strategic items like steel, it can be argued even a 25% threshold requires an alert). In competition literature, a market share of 40% is regarded as 'presumptively dominant' and a share of over 70% as 'presumptively monopolistic'. Admittedly, competition is examined at a firm level. However, for a country like China where state level interventions in the market are commonplace, this will not be an incorrect approach for analysis. Fair competition will require that such dominance needs to be curbed through greater domestic production, appropriate incentivisation or other forms of protection. Alternative suppliers will need to be encouraged who can supply the items at competitive prices. FTAs can explored with partners who can bring such benefits under the easier market access the FTA will provide.

Amit Kumar of Takshashila Institute has also developed a framework[36] to assess concepts of product dependence: when it turns vulnerable, and when the vulnerability in turn can become critical or strategic. Factors include import share, scope for alternate supply at competitive price, and whether the product is amenable for domestic production within a reasonable time or carries a long gestation period. It would also depend on how any disruption in supply could affect the population, and the nature of utility the product has for the people at large.

There could be more parameters inserted in developing such a framework, including availability of technology, the length and complexity of the supply chain involved in making the product, and so on. There could also be sectoral complexities. Finetuning the framework to the China context would also be important. Once such a well formulated framework becomes available, internal evaluation of the nature of vulnerability of each product needs to be undertaken on the basis of the Harmonised System Code of classification, at least at the 6-digit level. The resulting output can form the basis for further domestic action.

Source: Author

[36] 'Defining Dependence-induced Vulnerabilities in Asymmetrical Trade Interdependence: A Conceptual Framework' a paper by Amit Kumar of Takshashila Institute, 2023.

b) **Imports into India of products made by third country companies in China (termed foreign invested enterprises):** These cover a range of products including machinery, electrical and electronic gadgets, precision instruments, medical devices, automobile OEM parts and even certain consumer items. Such foreign entrepreneurs may be amenable to locate manufacturing units in India if offered them attractive investment opportunities and, if necessary, by allowing some of their Chinese vendors for parts to also set up units after due vetting.

c) **Imports of China made consumer items which are relatively low priced, some of doubtful durability or quality:** Such items - electrical fittings, after market products for autos, cycles and parts, locks and door fittings, blankets, plastic items, toys, umbrellas, crackers and even idols for worship - used to be made in India in industrial hubs but have been outsourced substantially over a period of time. Their revival in India, as in the case of toys or fans on which some progress has been made, needs to be under taken seriously. The newly announced 12 industrial cities could focus on some of them. Scaling and standardisation would be important. Imparting necessary skills through some of the internship and skilling programmes announced in the budget could also assist in establishment of such units.

d) **Goods which are smart and can connect to the Internet, other networks, and devices capable of data storage:** Risks to data security and data privacy become added concerns particularly for products that become part of critical infrastructure, be it power equipment or port mounted cranes or even connected vehicles. Unless their 'smartness' can be modified with domestic software and other capabilities, they will remain a risk. Already certain apps and technologies have been banned. This category of goods again needs examination for possible domestic manufacturing, or for sourcing from trusted partners.

Will reduction of India's MFN tariffs be right in the current context?

India's MFN tariff average is about 17% overall and 13.5% for non-agricultural products,[37] which is somewhat high compared to several other developing countries, including the ASEAN countries. Finance Minister Nirmala Sitharaman announced in her 2024-2025 budget speech that the government will undertake a comprehensive review of the rate structure over the next six months to rationalise and simplify it for ease of trade, removal of duty inversion

[37] https://www.wto.org/english/res_e/statis_e/daily_update_e/tariff_profiles/IN_E.pdf

and reduction of disputes. While this is welcome, any substantial reduction will need to keep in view the need for protection against subsidised imports, or those pushed into India because of overcapacity in the source country. While lower tariffs will be good to promote domestic competitiveness, this can also be done through the FTA route, particularly as our FTA portfolio gathers more partners and could potentially involve deeper concessions as it appears to be presently poised.

Do we have adequate tools for ensuring timely trade remedies?

India has largely been relying on launch of anti-dumping and anti-subsidy measures to protect its domestic industry from dumping and subsidisation. As per the latest notification of India to the WTO, there are 53 products on which anti-dumping duties are currently in force[38] on imports from China. There are also four products on which countervailing duties are in force[39] in lieu of subsidies granted by China.

Levy of anti-dumping and countervailing duties involve lengthy investigation processes following complaints from producers who account for a significant share of producers. Investigating subsidisation by China also becomes complicated in view of the opaque nature of their subsidy programmes.

However, in a situation where a country has overcapacities and can quickly offload products in foreign markets in large volumes and with low prices, traditional trade remedy measures may be inadequate to cope. For example, faced with a flood of steel imports from China, Brazil has earlier this year imposed a tariff rate quota on certain steel items, and those imports higher than the quota will face a 25% additional tariff. Of course, the US and Canada have already imposed high tariffs on several goods from China. These are not strictly based on dumping or subsidisation investigations but also involve economic security and other considerations under their domestic laws. And when these other countries raise their tariff walls, the diversion threat of Chinese goods to the Indian market only gets further elevated.

India will need to carefully monitor how other countries are responding to the China overcapacity threat and look for possible options in its own case. India's Athmanirbhar efforts, undertaken with considerable resources to reduce its dependence, including through the PLI and other capacities it is creating

[38] https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=q:/G/ADP/N391IND.pdf&Open=True
[39] https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=q:/G/SCM/N414IND.pdf&Open=True

should not get thwarted by unfair competition from state driven overcapacities and dependence creation strategies of third countries.

India could, therefore, consider developing an economic argument that if a country has already reached a dominant share in the imports of a particular product of, let us say over 30% for the previous couple of years, then the importing country should have the ability, without resorting to an investigation, to limit further imports beyond the previous year's levels, at the applicable level of duty (effectively a tariff rate quota) for providing fair competition.

There could also be other options, but these will obviously need careful examination which must include consideration of possible retaliatory measures.

While India and the EU are at very different levels of development and face different issues and concerns, it is still instructive for those implementing India's foreign trade and investment policy to note the key principles for trade policy that the Draghi Report has set out. Excerpts may be seen in Box 2.

Box 2: Key principles for trade policy in a European Industrial Strategy

Given below are some extracts from the recently submitted report by former Italian Prime Minister Mario Draghi to the EU Commission President Ursula Von der Layen on key trade policy essentials to be pursued as his suggested industrial strategy for the EU is taken forward for implementation:

a) **The era of global trade governed by multilateral institutions looks to be passing and the EU's trade policy is already adopting to this new reality:** In June 2023, the EU adopted a new Economic Security Strategy, furnishing itself with a range of instruments to deal with dumping, respond to coercion and address distortions caused by foreign subsidies within the EU, as well as adopting tools to address technology leakage and sanctions.

b) **Trade policy needs to be fully aligned with industrial strategy:** Trade policy should be based on careful, case by case analysis, rather than on generic stances towards trade. In some cases, the EU should use its trade policy arsenal to keep barriers low, in others to level the playing field, and in yet others to secure critical supply chains. When it comes to increasing security and reducing dependencies, the EU must ensure access to critical resources and protect supply chains. This may require securing preferential trading arrangements with key partners and guaranteeing critical supplies, including through offtake agreements and investment in production facilities abroad.

c) **To avoid the pitfalls of protectionism, trade policy should be governed by some principles:** Firstly, measures should aim to distinguish between genuine innovation and productivity improvements abroad which are beneficial to Europe, and state sponsored competition and demand suppression which lead to lower employment for Europeans. Second, tariffs should avoid creating perverse incentives that undermine European industry, and therefore need to be consistently assessed across all stages of production (tariff inversion is to be avoided). Finally, trade measures have to be balanced against consumer interests.

d) **There should be enhanced coordination in EU's FDI decisions:** EU should strengthen its investment screening mechanism. At present FDI screening is a national competence resting with member states, who are only required to exchange notifications and information. This fragmentation prevents the EU from leveraging its collective power in FDI negotiations and complicates the formulation of an FDI policy. Co-ordination is important for the emergence of joint ventures in strategic sectors and ensuring that EU companies retain relevant knowhow and can drive the next wave of innovation.

Source: Author

How must India deal with investment proposals?

The government of India has made it clear that it is not against all investments from China. At the same time, the current case by case scrutiny appears likely to remain in place for the foreseeable future. Two types of investment proposals may merit some priority consideration in this context. One is Chinese companies coming in as part of a MNC ancillary set-up, that can in turn facillitate the MNC's substantial investments in India. The other could be an Indian company forming a joint venture with a Chinese partner, with some technology and knowhow brought in by the latter and a pathway for progressively increasing domestic content.

In respect of such proposals, it makes sense for developing certain broad internal guidelines and guardrails, supplemented by some sectoral ones, to ensure that that there is coherence, consistency and speed in decision making on them. Similarly, guidelines in terms of the grant of visas for technicians and other professionals will also need finalization, to ensure clarity and timely approvals.

However, as already mentioned, even as investments in local manufacturing can help reduce imports of that item, the total import levels may not necessarily decline and could even increase, as in the case of ASEAN countries. Investments must not further elevate India's import dependence. This is an overall aspect that needs to be necessarily kept in view while according approvals for Chinese investments.

IV. Conclusion

Just as other countries are fashioning their trade, investment and industrial strategies to meet the challenges arising from China's pursuit of state driven global economic dominance through subsidisation, overcapacities and economic coercion methods, India too is evolving its own game plan. In India's case, there are also additional dimensions of concern arising from the border problem and tensions along the LAC.

The post April 2020 framework that India has adopted, with an emphasis on Athmanirbhartha, spans a wide canvas and needs to be effectively implemented, even as further details need fleshing out. Wherever further adjustment or strengthening is required, this must be undertaken.

This paper has attempted to fill in certain details that can help in navigating the India-China bilateral trade and economic ties in the present difficult environment. There could be others. A key overall objective is to try and reduce dependence risks and, most certainly, not elevate them further. Implementation will succeed only if there is greater convergence of viewpoints in pursuing this overall approach, not just among India's policy makers and implementing officials, but across the entire spectrum, from academia to business and industry.

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