

# Trade War: The Future of India China Trade Relations

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## ABSTRACT

*The winds of change due to globalization and free movement of goods, services and capital has taken a huge hit of late due to the trade war between China and USA. USA perceives that it's huge Current Account Deficit (CAD) vis-à-vis China is due to its unfair trade practices, infringement of Intellectual Property Right (IPR) provision by China. The paper seeks to examine what kind of strategy India should adapt in such a scenario, so that its Balance Of Trade (BOT) becomes favourable for it in the long run. After weighing two options, the paper strong argues that India should improve trade ties with China while fostering free trade with other countries. As a viable strategy, it must improve its competitiveness in exports by adopting Industry 4.0 standards and bolster its Special Economic Zone (SEZ) foot print, with a view to make a real mark as global manufacturing hub and improve its value addition by adopting state of art of technologies like AI and factor productivity.*

## 1. Introduction

In the 21st Century, since the Berlin wall broke down in 1989, it has been accepted with opposition that the world has become flat and that the global "playing field" is now in the process of becoming leveled. Following the 'Hindu' Economic Growth rates of 3.5% (Raj Krishna) in India during the 1970s, free trade has become more and more prevalent in the global economy with countries producing those goods in which they have a comparative advantage and facilitating global trade. It has in turn galvanized global economic growth.

As portrayed in 'The World is Flat' (Friedman), there have been three great eras of globalization. The first is one where the driving agent of change was how much brawn a country had and how creatively it could deploy it. The second is one where multinational companies took charge and the third starts in the year 2000 where individuals have found the power to collaborate and compete on a global scale with internet becoming the global that room. Despite China having the largest and perhaps fastest growing economy in the 18th century, the first two phases of globalization were mainly driven by European and American businesses, which is a phenomenon that has left its mark on the economy forever.

Globalization is now rampant, and despite being slowed down by certain periods of trade protectionism. The world acknowledges that it would never have been this prosperous if its effects had been reversed. However, the world now witnesses another setback as President Trump has sparked the latest trade war between the United States of America and China since the imposition of the first round of tariffs in March, 2018.<sup>1</sup>

Despite being an attempt to strengthen the US economy, manufacturing sector, by cutting the trade deficit with China in order to combat what he perceives as their unfair trade practices,<sup>2</sup> Trump's tariffs may be more of a poisoned chalice.

China retaliated with their own tariffs in vengeance, setting off a series of tariff impositions and disrupting the world economy as a whole, thus affecting third-party countries such as India as well.

## 2. Impact on India

India, traditionally an agrarian economy has gradually developed into an open market economy after opening up to global competition.<sup>3</sup> Despite its large current account deficit, India's has one of the world's fastest growing economies with 6.6% annual change in 2017.<sup>4</sup> India has been known for its immense amount of wealth from ancient times and until the establishment of the British Empire. Its trade history reflects that despite the frequent political turbulence during the 12th to the 16th centuries, the country was still prosperous. The political and economic policies followed by the Muslim rulers propagated the growth of towns in various parts of the country. These towns grew into trade and industrial centers which in turn led to the general prosperity, and growth continued on like this until the 18th century. Today, Indian products compete on a global scale, and are recognized internationally.<sup>5</sup> The Indian economy advanced 7.1 percent year-on-year in the third quarter of 2018, well below 8.2 percent in the previous period and market expectations of 7.4 percent. It is the lowest growth rate in three quarters, mainly due to a slowdown in consumer spending amid high oil prices and a weaker rupee.<sup>6</sup> A driving force for this growth was globalization and the ability to trade with other countries, however India has poor inter-regional trade as there is political conflict between large neighboring countries such as China. Despite this, trade in recent years has increased rapidly with thawing grudges in light of the realization

<sup>3</sup><https://investmentopportunitiesinindia.wordpress.com/2011/07/21/indian-economy-a-brief-overview/>

<sup>4</sup><https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG>

<sup>5</sup><http://www.indiatraderpromotion.com/introduction-indian-trade.html>

<sup>6</sup><https://tradingeconomics.com/india/gdp-growth-annual>

<sup>1</sup> [www.china-briefing.com/news/the-us-china-trade-war-a-timeline/](http://www.china-briefing.com/news/the-us-china-trade-war-a-timeline/)

<sup>2</sup> <https://www.bbc.com/news/world-43512098>

of economic benefits outweighing political hindrances. However, due to the recent trade war, China has been subject to hefty tariffs and the world has seen a shift towards becoming protectionist once again. The tariffs imposed by the U.S. on aluminium and steel to reduce the trade imbalance, take a huge toll on the Chinese economy, as well as that of India and the rest of the world. This war, like most other trade wars will not only have adverse effects on the relationships of U.S. with its trading partners, but the relationships of its trading partners amongst each other as well. China and India being two of the world's largest economies and both having strong ties with the U.S., will witness a drastic change between their relationships depending on economic decision taken by both countries. The aim of this study is to understand the nature of this change and what it would mean for the countries in consideration, which gives rise to the question "How will the trade war affect Indo-China relations and could it lead to a possible improvement in relations between the two countries?"

### 3. Research Hypothesis

Indo-China relations will improve due to the trade war and both countries will stand to benefit in the long-run.

### 4. Methodology

This study will include data from a range of secondary resources including news articles, journals, government reports, reports from intergovernmental organizations etc. as well as primary data such as raw trade statistics.

### 5. Data Collection

#### *Indo-Chinese Relations*

On 1 April, 1950, India became the first non-socialist bloc country to establish diplomatic relations with the People's Republic of China. While, the India-China border conflict in 1962 was a serious setback to ties, Prime Minister Rajiv Gandhi's landmark visit in 1988 began a phase of improvement in bilateral relations.

In terms of economic ties, the relationship between India and China has strengthened greatly in the last few years. Trade volume between the two countries in the beginning of the century, year 2000, had been US\$ 3 billion. In 2008, bilateral trade reached US\$ 51.8 billion with China replacing the United States as India's largest "Goods trading partner." In 2011 bilateral trade reached an all-time high of US\$ 73.9 billion. India-China trade in the first eight months of 2017 increased by 18.34% year-on-year to US\$ 55.11 billion. India's exports to China increased by 40.69% year-on-year to US\$ 10.60 billion while India's imports from China saw a year-on-year growth of 14.02 % to US\$ 44.50 billion. The Indian trade deficit with China further increased by 7.64% year-on-year to US\$ 33.90 billion.<sup>7</sup>

India's goods trade deficit with China appears unsustainable: It was \$63 billion in 2017-18, up from \$51 billion in the previous financial year and \$16 billion ten years ago. That's 60 percent of India's overall trade deficit.<sup>8</sup>

<sup>7</sup>[https://mea.gov.in/Portal/ForeignRelation/China\\_October\\_2017.pdf](https://mea.gov.in/Portal/ForeignRelation/China_October_2017.pdf)

<sup>8</sup>[https://economictimes.indiatimes.com/articleshow/65395955.cms?utm\\_source=contentofinterest&utm\\_medium=text&utm\\_campaign=cppst](https://economictimes.indiatimes.com/articleshow/65395955.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst)

## 6. Effects of the Trade War

### *On India*

Despite not being one of the major participants, India has taken a hit from the trade war. Indian stock markets fell by 0.83% and may plummet further. To worsen matters, India will also have to pay about \$241 million worth of tax to the US. It could impose retaliatory tariffs on other products as that would ensure that the US pays \$238 million as duties for about 30 different types of goods. Nonetheless, this would benefit neither country and worsen political ties whilst at it.

In addition, capital flows will reduce causing the rupee to weaken, which does imply lower levels of investment and negatively affects trader sentiments. However, a depreciated rupee may help India gain export competitiveness. India may become more competitive in products such as textiles, garments and gems and jewelry as it already has a comparative advantage in production for said goods. This may only be possible in the long-run though as China's exports to the US are much more diverse and it's a rather daunting task for India to breach its gap.<sup>9</sup>

### *On China*

Chinese economic growth slowed down to 6.5%<sup>10</sup> following the events of the trade war, implying reduced levels of demand which could be detrimental for the economy. Slowing investment is one of the most significant causes for this as investments contributed to 44% of China's nominal GDP in December 2017. Trader sentiment has been harmed and there has been large dip in consumer and business confidence as a cause of the trade war. To make matters worse, implementing an expansionary fiscal policy is also tough for the Chinese government as mounting levels of debts have arisen, implying that the multiplier effect won't work. In addition, China has a large aging population implying that their dynamics are against them and that there's a limited labour force as well as reduced consumption levels. Although monthly retail sales have been reduced, spending on education and travel have increased to a certain extent<sup>11</sup>.

### *India's Options*

1. Follow in the footsteps of the US, in order to maintain relationships and also fill in the gap that China created
2. Improve ties with China and engage in Free trade with the rest of the world

## 7. Evaluation of First Option

Recognizing that the United States is India's largest trading partner, and has strong political, security and energy ties, it would be in India's best interests to maintain these relationships (Brief on India-U.S. Relations). Talks between officials of both countries have witnessed the will to strengthen economic ties once again after the raise in tariffs on Steel and Aluminum from the US; as a result there has been a significant 128% increase in aluminum scrap imports from the US to India (Mazumdar). India currently has a large trade surplus with the United States with a record high of \$23 billion by the end of

<sup>9</sup> <https://yourstory.com/2018/08/us-china-trade-war-impact-india>

<sup>10</sup> <https://www.forbes.com/sites/kenrapoza/2019/01/14/china-is-losing-the-trade-war-in-nearly-every-way/#721465277f03>

<sup>11</sup> <https://www.cnbc.com/2018/09/24/trumps-trade-war-threatens-chinese-economy-china-already-has-cracks.html>

2017, and so would benefit from a bilateral free trade agreement with the US so that it can keep this up. With export promoting policies and an increase in output, India might even be able to fill the gap that has been left by China.

However, this would invoke America to demand uninterrupted market access as India is a big market for heavily subsidised American goods such as farm and dairy as well as technology and pharmaceuticals amongst others as America would prefer to export finished products rather than shift manufacturing abroad. In addition, despite having certain advantages in managing American IT firms and short-term communication services, India would be restrained in terms of exports as it's likely that the US will allow access subject to various prerequisite conditions, including quotas and minimum wages for workers. The US may not be prepared to sign a completion agreement with India for protecting the rights of short-term IT and other services providers who divide their working career between two or more countries (Kanth). All in all, there's a large possibility that engaging in trade with the U.S. will significantly harm domestic industries and agriculture.

### 8. Evaluation of Second Option

Despite being longstanding economic and strategic rivals, as of recently, relationships have been thawing without any hitches. China has made it easier for India to export rice, removed import duties on anti-cancer drugs and agreed to share data that predicts river flows between the two countries during the flood season perhaps in an attempt to strengthen bonds. In addition, due to the higher tariffs on Chinese products, it may turn to India so that products may be finished and exported from there instead as India has a much larger capacity than Vietnam and Bangladesh<sup>12</sup>. As China can't afford to be fighting wars on to different fronts, it would be wise for them to build a healthy relationship with India which would be mutually beneficial.

However, there are many possible obstacles to be faced before they become best buddies. One of these is the large and growing trade gap between both countries that has touched \$63 billion thus far, due to imports of heavy machinery, telecom equipment, home appliances etc.<sup>13</sup> Better trade relations could make India worse off despite current campaigns to increase domestic production. Another barrier would be the latest border dispute, something that Sino-Indian relationships have been categorized by for years. India has also been one of the only members that has chosen not to endorse China's Belt and Road initiative, making this another sore spot in their relationship.

### 9. Way Forward

India should focus on itself and improving export competitiveness, and engage in export promoting policies as well as increase output. Under present circumstances, with a large current deficit and rapid economic growth, India would benefit from engaging in free trade rather than implementing protectionist measures and blocking China out with the U.S. Considering that China has been welcoming of Indian exports

as numerous delegation-level talks have been held to push India's exports to China to address the over USD 51 billion trade deficit. India should also take a leaf out of China, by adapting Industry 4.0 standards, like introducing AI techniques and robotics into manufacturing. The SEZ experiment of India was based on the Chinese success, in order to propel exports and become a global manufacturing hub. India will profit enormously out of China's experience and experimentation for investing in high skill jobs. Trade imbroglio between USA and China can be a real trade opportunity for India to improve its global share in exports.

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