Xi's visit to redefine Indo-China business ties

But India needs to fix its manufacturing ecosystem to tap the full potential

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Although India and China are often lumped together as the two largest and most populous emerging economies in Asia, there are many differences in their development models. China has been an export-driven economy that has achieved early success in labour-intensive manufacturing sectors. India began with a development model based on import substitution but later moved to an economic environment where many controls were liberalised. The contrast in the evolution of the two economies is evident in economic indicators such as GDP, savings, investments and current account balances.

It is apparent that the economies of China and India display different characteristics and hence their strategic requirements are different. For China, it is important to rebalance the economy away from excessive investment by slowing down overall GDP growth. The Chinese government has explicitly stated that it would like to move towards a more domestic consumption driven economy and depend less on exports.

The imperatives for India are quite the reverse—it needs to increase investment and exports. At the same time, it needs to enhance domestic capacity across sectors in order to curtail imports. Since the needs of the two economies are complementary, the two governments need to work towards rebalancing the flow of trade between them. The business communities of the two countries need to cooperate to enhance investment across borders.

Trade between India and China has seen rapid and unbalanced growth since 2008. Bilateral trade crossed $65 billion in 2013. Chinese imports have grown sharply relative to Indian exports resulting in a record deficit of $35 billion in 2013. India has emerged as one of the key markets for China, growing at a faster rate than the country's other trading partners, except Vietnam. Today, India's imports from China continue to be dominated by high-skill and technology-intensive manufactured products and exports by primary commodities. In addition, China is undertaking about $60 billion worth of projects in India which further exacerbates the trade deficit. This economic engagement model between India and China is unsustainable and needs to be restructured.

It is in this economic backdrop that President Xi Jinping will be making his maiden visit to India this week. It is expected that his visit would include a strong business focus.

About 100 Chinese companies have presence in India, in sectors ranging from iron & steel to IT and hardware manufacturing.

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On the flip side, China has presented itself as a good location for business for Indian IT companies. Several Indian IT companies have invested in China to cater to their clients in Asia-Pacific region. Indian manufacturing companies, especially in the automotive sector—both in OEM and component space—are investing in China to take advantage of the large domestic Chinese market.

Indian industry, however, faces challenges in China due to the policy environment. These include issues such as the long period taken to register Indian drugs to non-tariff barriers like the absence of mutual recognition agreements on harmonisation of conformity assessment procedures. It is expected that both governments would look into ways of expanding Indian presence in China and encourage Chinese investments in India.

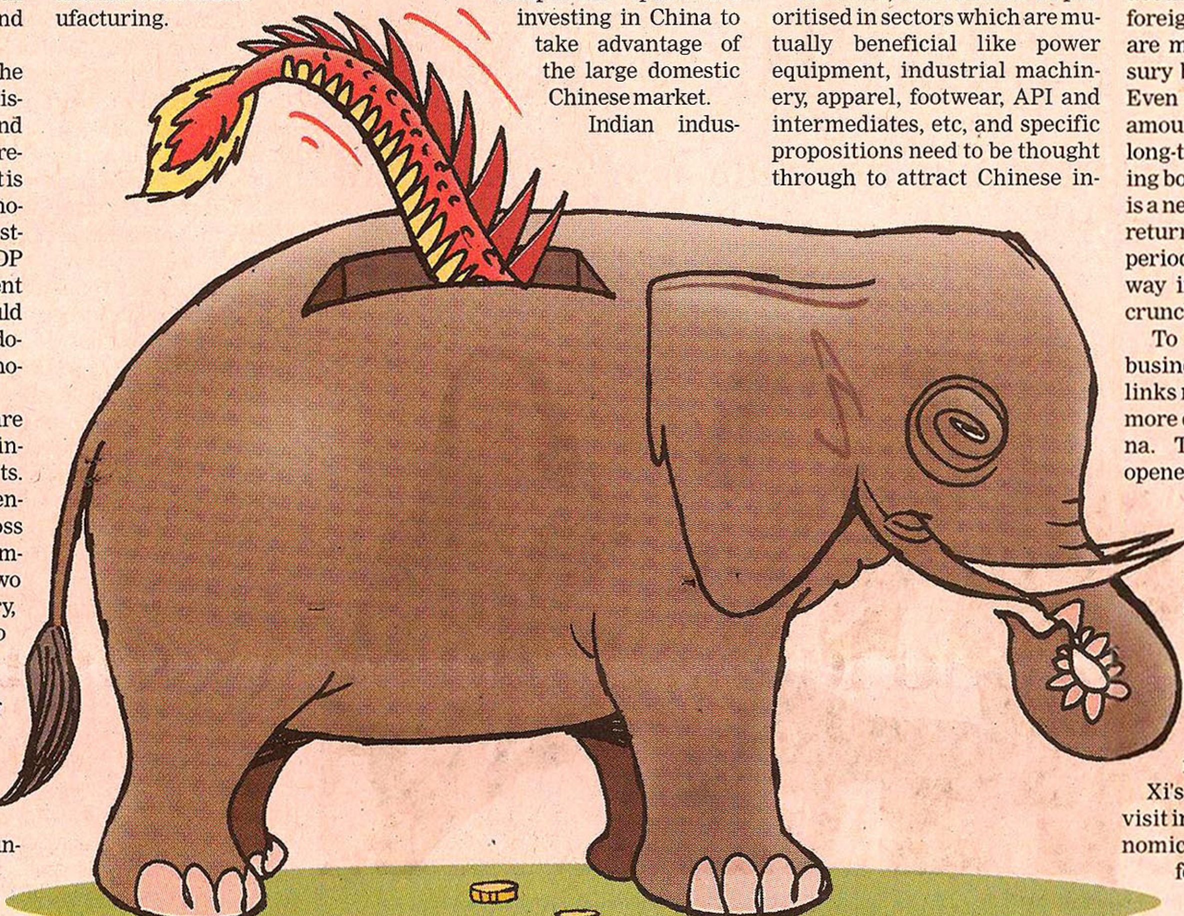
In order to promote Chinese investment in India, the two countries have agreed to set up two Investment Parks for Chinese manufacturing companies. The Indian industry believes that this would be the right way to step up manufacturing investments in India and help Chinese companies leverage our cost-competitive environment and skilled workforce. This also works well with the government's overall objective to promote the manufacturing in India.

However, these need to be prioritised in sectors which are mutually beneficial like power equipment, industrial machinery, apparel, footwear, API and intermediates, etc, and specific propositions need to be thought through to attract Chinese investment in these sectors. The states will play a crucial role in this process.

In addition, to realise the full potential of this proposal, there is some groundwork required on India's part. Substantial changes are required to the manufacturing ecosystem in India to make it globally competitive and attract MNC production networks in the ASEAN region for leveraging Indian manufacturing for exports to China and the world. In addition, India will need to have policies and infrastructure directed towards export oriented manufacturing and create Chinese Investment Parks, possibly as JVs with their Industrial Park developers, given the specific needs of Chinese investors. Vietnam is a good example to emulate in this regard, especially in electronics and footwear.

The infrastructure sector is another area where India and China can work together. China has about $3 trillion in accumulated foreign exchange reserves which are mostly invested in US treasury bonds and some EU bonds. Even if a small fraction of that amount were to be invested in long-term infrastructure financing bonds in India—even if there is a need to give an assured rate of return in reminbi over a 20+ year period—it would go a very long way in alleviating the resource crunch being faced in this sector.

To encourage more Chinese business and tourists, direct air links must be increased between more cities across India and China. The overland route was opened up with border trade arrangements but lack of infrastructure is a challenge. An economic corridor through Bangladesh and Myanmar to south-western China has been proposed. It is hoped that this proposal will receive a further boost during this visit. Indian industry is confident that President Xi's visit would be a landmark visit in terms of the bilateral economic relationship and we look forward to the outcomes.



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