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INDO-CHINA TRADE: TRENDS, COMPOSITION AND FUTURE

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Abstract

India and China are among the oldest civilizations of the world with long history of interaction and relationship. They are the fastest growing economies among the major economies of the world. Both have made rapid progress after liberlisation. One of the major events in international trade and economics is the recent fast growth in the bilateral trade. India has emerged as one of the top ten trading partners of China whereas China has emerged one of the top three trading partners of India. Due to large sige of economies and composition of economies and exports as well as high growth rates and political will from both sides, the bilateral trade will grow further and would have significant impact on global trade and economy.

Key words: India, China, Indo-China trade, trade composition, emerging economies

JEL Classiffication: F14, O53, O57, R11

1. Introduction

China and India are the two fastest re-emerging economies (The Economist 2006). Until the last 19th century, India and China were the world's two biggest economies but they were outsmarted by the steam engine invention and subsequent industrialisation in Europe. Now the circle seems to be complete as we look at the fast growth of India and China in recent years and various projections for future (Goldman Sachs 2003). China's and India's economic growth rates have outperformed world average growth rates for the most part of last fifteen years. China has grown at an average rate of close to ten percent annually during 1990-2007 whereas India has grown at an average rate of six percent annually as compared to world economic growth rate of three percent (Kowalski 2007).Their rapid growth has had a significant impact on world economy (Srinivasan 2006). The story has moved beyond GDP growth rates... the emergence of China and India gives the world an opportunity to experiment and make sure that there is equitable wealth generation (WEF 2006).Together they constitute a big part of global population and geographic area. The two countries now account for 37.5 percent of world population and 6.4 percent of the world output and income at current prices and exchange rates (World Bank 2007).

Chinese phenomenal growth started in late 1970s whereas Indian growth picked up in the early 1990s.The rapid growth started in both countries after the liberalization process. Liberalization has brought foreign competition in various industries and encouraged the domestic companies to become competitive. With liberalization, both countries have also restructured their trade destinations over the years. In general they have used developed countries' market for their export destinations whereas their dependence has gone up for imports from other developing countries (Mohanty, and Chaturvedi 2005). Whereas China is repeatedly mentioned as the 'World Factory' highlighting the contribution of its manufacturing sector, India is increasingly named as 'World Back office' recognizing increasing outsourcing of global services to India. Various studies have projected that these economies will continue to grow and become economic superpowers in next few decades (Goldman Sachs 2007).

India and China are among the oldest civilizations with long history of association. India and China relationships have a long history. Nathu La Pass was the famous silk route. Trading through Nathu La Pass accounted for eighty percent of total border trade volume between India and China in the early twentieth century (Anonumous 2006). Trade ties suffered after Sino-India War of 1962. Visits of Prime Minsters , starting with Indian Prime Minister Rajiv Ghandi in 1988 followed by Chinese Primer Li Peng's visit in 1991 started positive steps for trust building and trade promotion. In 1984, India and China signed a Trade agreement for providing Most Favoured Nation (MFN) treatment. Border trade resumed in July 1992 after a hiatus of more than thirty years, consulates reopened in Mumbai and Shanghai in December 1992 (Economywatch 2005). Trading through Nathu La Pass was suspended in 1962 after the Indo-China War 1962.This pass was reopened after forty-four years of its closure on July 6, 2006. In recent years, the two countries have put in efforts to improve relations and to foster economic ties (TOI 2006, Peopledaily 2008, Chinese Embassay 2008, Indian Embassay 2008). The bilateral trade between the two countries has shown a phenomenal growth and yet there is a lot of untapped future potential. This research paper is an attempt to study the Indo-China trade with focus on recent past and explore potential for future. This paper consists of six sections including the introduction part. The second section takes a quick overview of the performance of Indian and Chinese economies. The third section studies the recent trends in Indo-China trade. Fourth section analyses the composition of Sino-India trade. Fifth section deals with future of Sino-India trade and the last section is conclusion.

2. Recent performance of indian and chinese economies

China has been performing quite well during the past few decades. Its GDP has crossed USD 2 trillion mark in 2005 and the GDP growth rate has been more than eight percent in the first years of 21st century. Chinese exports of mass production items have caused serious concern (Mohanty, and Chaturvedi 2005); and studies have predicted that this might contribute to recession in the US (Palley 2004).The performance of China on selected indicators and the changes are shown in Table 1 and Table 2 respectively.

Table 1. China: Selected Indicators (USD billions)

Years Indicators	2000	2001	2002	2003	2004	2005
Exports of goods and services (% of GDP)	23.3	22.6	25.1	29.6	34.0	..
Foreign direct investment, net inflows (BoP, current US$)	38	44	49	54	55	..
GDP (current US$)	1,198	1,325	1,454	1,641	1,932	2,229
GDP growth (annual %)	8.4	8.3	9.1	10.0	10.1	9.9
Imports of goods and services (% of GDP)	20.9	20.5	22.6	27.4	31.4	..
Long-term debt (DOD, current US$)	133	129	120	120	131	..
Merchandise trade (% of GDP)	39.6	38.5	42.7	51.9	59.8	63.8
Net barter terms of trade (2000 = 100)	100.0	100.9	100.5	97.3	91.8	..
Total debt service (% of exports of goods, services and income)	9.3	7.9	8.3	7.4	3.5	..

Source: World Development Indicators 2001, 02, 03, 04, 05, 06, 07.

A big portion of Chinese GDP comes from International Trade and thus the performance of the economy depends to a large extent on the world economy. A slump in world imports shows its effects on Chinese exports and its overall economy. The expansion of international trade has been the key feature of the country's rising prominence in the world economy with average annual growth rates of trade at three times the world rates. Already in 2005 China became the third largest trading nation after the United States and Germany and its contribution to the growth of world merchandise trade over the period 1996-2006 amounted to 20 percent (Kowalski 2007). Looking forward, it is estimated that the China will become the world's top exporter by the beginning of the next decade owing to attractiveness to FDI, a high domestic saving rate, improvements in productivity spurred by reduced internal and external barriers to trade, and a significant surplus of labour (OECD 2005). Overall, Chinese goods exports account for approximately 90% of its total exports, which is substantially higher than the world average at a little over 80%. Its services exports only account for a little less than 10% compared with a world average of 20% (Table 2). All this suggests that China's services exports are still relatively underdeveloped and its integration into the world economy was mainly driven by goods trade (Kowalski 2007).

Table 2. China: Selected Indicators (Percentage change over the years)

Indicators / Years	2000	2001	2002	2003	2004	2005
Exports of goods and services (% of GDP)	..	-3.11	11.21	17.60	14.87	..
Foreign direct investment, net inflows (BoP, current US$)	14.87	15.21	11.45	8.51	2.68	..
GDP (current US$)	2.68	10.54	9.74	12.87	17.72	15.38
GDP growth (annual %)	15.38	-1.19	9.64	9.89	1.00	-1.98
Imports of goods and services (% of GDP)	-1.98	-2.09	10.16	21.25	14.77	..
Long-term debt (DOD, current US$)	14.77	-3.11	-6.28	-0.08	9.12	..
Merchandise trade (% of GDP)	9.12	-2.79	10.99	21.45	15.25	6.75
Net barter terms of trade (2000 = 100)	6.75	0.85	-0.34	-3.24	-5.66	..
Total debt service (% of exports of goods, services and income)	-5.66	-14.41	4.51	-10.99	-52.87	..

Source: World Development Indicators 2001, 02, 03, 04,05,06,07.

Indian economy responded positively to the liberalization process started in 1991 and the growth rates picked up. Table 3 and Table 4 show the performance of India in recent years. Interestingly, the growth in India's economy and trade has been led by services rather than manufacturing. Whereas India has a deficit in balance of trade, it runs a surplus of balance of payments, mainly due to rising services exports. In 1993-2003, India's services exports grew at a compounded annual growth rate (CAGR) of as much as 17.3 percent, which for once is even higher than China's growth rate of 15 percent. Among the major economies of the world, India has the fastest growing services sector exports (Premsingh 2004).

Table 3. India: Selected Indicators (USD billions)

Indicators / Years	2000	2001	2002	2003	2004	2005
Exports of goods and services (% of GDP)	13.2	12.7	14.5	14.8	19.0	..
Foreign direct investment, net inflows (BoP, current US$)	3.6	5.5	5.6	4.6	5.3	..
GDP (current US$)	461.3	478.3	506.1	600.7	694.7	785.5
GDP growth (annual %)	4.0	5.3	3.6	8.3	8.5	8.5
Imports of goods and services (% of GDP)	14.1	13.6	15.5	16.1	21.0	..
Long-term debt (DOD, current US$)	95.6	94.8	100.7	107.6	115.2	..
Merchandise trade (% of GDP)	20.4	19.6	20.9	21.4	24.9	28.2
Net barter terms of trade (2000 = 100)	100.0	97.8	88.6	80.6	75.9	..
Total debt service (% of exports of goods, services and income)	14.5	11.7	14.8	18.9	..	..

Source: World Development Indicators 2001, 02, 03, 04,05,06,07.

India's recent economic dynamism has led many to compare it with China and to expect a similar dramatic insertion in world markets. However, India's trade expansion is much less impressive. Its share in world trade has first declined steadily since the beginning of the 1970s to around 0.5% at the beginning of 1990s and then rose steadily to just above 1% currently. The compound annual growth rate of India's exports of goods and services for the 1990-2005 period was 14%—well above the world average growth of 6%. In particular, in the last five years Indian exports have increased at around 18-20% per annum—three times the rate of world trade growth. Yet, these significant increases reflect to a large extent a relatively low base; India's contribution to the growth of world merchandise trade over the period 1996-2006 amounted to a mere 2%, as compared to 20% in the case of China (Kowalski 2007). Despite India being relatively abundant in skilled labour and capital, its manufacturing trade is highly concentrated in low-technology goods and the share of high-technology manufactured goods in its total exports has barely changed since the mid-1990s and remains under 5%, as compared to 30% for China (Kowalski 2007).

Table 4. India: Selected Indicators (Percentage change over the years)

Indicators / Years	2000	2001	2002	2003	2004	2005
Exports of goods and services (% of GDP)		-3.42	13.88	1.79	28.28	.
Foreign direct investment, net inflows (BoP, current US$)	3.6	5.5	5.6	4.6	5.3	..
GDP (current US$)	461.3	478.3	506.1	600.7	694.7	785.5
GDP growth (annual %)	13.07	32.30	-31.23	128.11	2.99	0.03
Imports of goods and services (% of GDP)	0.03	-3.41	13.76	3.56	30.64	..
Long-term debt (DOD, current US$)	95.6	94.8	100.7	107.6	115.2	..
Merchandise trade (% of GDP)	7.07	-3.70	6.62	2.22	16.49	13.31
Net barter terms of trade (2000 = 100)	13.31	-2.17	-9.41	-9.04	-5.89	..
Total debt service (% of exports of goods, services and income)	-5.89	-19.14	27.02	27.28	..	..

Source: World Development Indicators 2001, 02, 03, 04, 05, 06, 07.

3. Recent trends in Indo-China Trade

Indo-China trade has grown very fast during last few years as shown in Table 5. After studying Indo-China trade over the years few trends emerge. First, after adjusting for partner GDP (i.e. bilateral trade divided by the trading partner's GDP) India's trade with China is greater than that with Japan, the US or the entire world (Gupta 2008). Second, China is one of top three trading partner of India whereas India is one of top ten trading partners of China. Further, China's trade is increasing much faster with India out of its top ten trading partners and same is the case with India. Third, the trade balance is in China's favour consistently over the years, which may be a cause of concerns to policy makers in New Delhi.

Table 5. Indo-China Trade (USD million)

Year	India's Export To China	Rate of Growth	India's Imports From China	Rate of Growth	Total Trade	Growth of Total Trade	Trade Balance
1994-95	254.3		761.04		1015.34		-506.74
1995-96	333.2	31.03	813.19	6.85	1146.39	12.91	-479.99
1996-97	615.32	84.67	757.55	-6.84	1372.87	19.76	-142.23
1997-98	718.94	16.84	1120.7	47.94	1839.64	34.00	-401.76
1998-99	427.06	-40.60	1096.47	-2.16	1523.53	-17.18	-669.41
1999-00	539.41	26.31	1288.27	17.49	1827.68	19.96	-748.86
2000-01	830.03	53.88	1494.92	16.04	2324.95	27.21	-664.89
2001-02	955.19	15.08	2043.33	36.68	2998.52	28.97	-1088.14
2002-03	1980.61	107.35	2799.29	37.00	4779.9	59.41	-818.68
2003-04	2962.92	49.60	4063.96	45.18	7026.88	47.01	-1101.04
2004-05	5,615.88	90.04	7,097.98	75.12	12,713.86	81.41	-27,981.49
2005-06	6,759.10	20.36	10,868.05	53.11	17,627.15	38.65	-46,075.19
2006-07	8,287.48	22.61	17,447.01	60.53	25,734.49	45.99	-59,341.43

Source: Monthly Statistics of Foreign Trade of India – DGCI&S, Govt. of India and Commerce Ministry, Govt. of India.

4. Composition of Indo-China trade

The composition of Indo-China trade is given in Table 6 and Table 7. Indian major exports to China mainly consist of primary goods as shown in Table 6. The top three Indian exports are iron ore; primary and semi-finished iron and steel; and, plastic and linoleum products.

Table 6. Major Indian Exports to China (USD million)

Name of the Commodities	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05
Iron Ore	87.77	81.43	130.16	207.56	409.37	825.74	2084.43
Prim. & semi-fin.iron & steel	4.72	3.59	26.4	11.02	491.02	577.25	488.74
Plastic & linoleum products	6.28	25.36	103.11	141.95	177.92	306.44	438.9
Processed minerals	16.99	11.56	15.24	23.4	87.58	99.99	230.85
Inorg/org/agro chemicals	22.28	39.32	60.01	48.84	88.89	83.96	217.91
Other ores & minerals	39.93	65.47	73.15	113.81	154.3	128.88	192.48
Drugs, pharma.& fine chem.	42.68	46.01	58.56	80.37	93.02	102.53	106.33
Machinery & instruments	9.17	11.72	19.72	11.36	32.47	73.5	98.14
Residual chem. & allied Prod	6.42	8.5	11	16.75	21.45	33.89	76.77
Non-ferrous metals	0.1	0.08	17.99	2.85	21.2	43.53	65.42
Marine products	51.51	87.81	116	85.19	118.39	89.08	65.38
Cotton yarn fab madeups etc	40.73	56.05	71.54	75.06	64.04	74.11	64.92
Electronic goods	4.08	9.24	20.66	15.9	22.82	42.31	44.53
Castor oil	17.19	31.95	13.83	7.08	1.64	8.93	40.89
Oil meals	32.64	9.69	8.29	4.22	3.67	17.28	35.81
Finished leather	3.32	4.02	8.41	12.7	15.84	21.65	30.5
Manufactures of metals	3.79	1.41	10.57	11.5	32.31	27.9	28.95
Ferro alloys	2	0.54	0.15	4.54	3.93	6.2	28.44
Dyes, intermediaries etc	3.41	3.31	8.59	11.29	20.08	66.2	18.63
Gems & jewelry	1.27	0.31	0.17	0.66	2.08	9.73	18.45
All Commodities	427.06	539.41	830.03	955.19	1980.61	2962.92	5344.88

Source: Monthly Statistics of Foreign Trade of India – DGCI&S, Govt. of India and Trade and Balance of Payment Statistics – CMIE, July 2005

Chinese major exports to India mainly consist of manufactured goods as shown in Table 7. Top three Chinese exports are electronic goods ; coal, coke and lubricants; and, organic chemicals.

Table 7. Major Indian Imports from China (USD million)

Name of the Commodities	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05
Electronic goods	161.46	178.22	244.56	385.19	812.16	1384.44	2069.19
Coal, coke & lubricants	108.2	146.04	261.34	263.43	175.61	221.5	780.19
Organic Chemicals	163.54	178.71	181.02	242.38	326.42	474.06	606.66
Non-electrical machinery	48.92	53.04	60.49	72.14	105.69	184.38	424.43
Electrical machinery	20.6	28.58	46.34	59.98	72.3	101.7	211.23
Medical & Pharm products	71.27	73.05	70.32	105.26	150.25	185.26	192.8
Other tex yarn, fab, madeups		20.5	34.75	46.89	75.97	107.66	172.95
Silk yarn & fabrics		12.81	17.27	32.2	52.23	105.2	156.52
Non-ferrous metals	52.27	49.01	41.89	54.53	46.23	86.82	145.13
Silver		20.16	8.3	94.41	121.21	58.42	138.62
Iron & steel	20.44	30.75	7.53	14.52	9.24	31.65	136.21
Inorganic chemicals	62.72	53.2	48.37	59.66	69.25	104.46	131.22
Silk raw	48.31	87.44	95.66	122.9	106.96	113.7	123.34
Non-metallic mineral mnfs.	7.42	10.24	14.65	30.24	44.42	64.58	121.12
Manmade filament/spun yarn/waste		12.38	9.84	17.32	56.05	82.61	115.78
Metaliferrous ores & metal scrap	8.5	11.26	19.65	14.52	28.46	63.96	102.99
Professional inst, optical goods etc.	18.85	23.37	23.38	55.31	80.49	90.01	99.32
Transport equipment	3.49	8.45	6.62	9.06	22.15	13.16	88.5
Manufactures of metals	12.04	15.38	17.77	31.14	32.69	55.34	88.07
All commodities	1096.47	1288.27	1494.92	2043.33	2799.29	4063.96	6768.92

Source: Monthly Statistics of Foreign Trade of India - DGCI&S, Govt. of India, and Trade and Balance of Payment Statistics – CMIE, July 2005

The trade composition as discussed above and shown in Table 6 and 7 supports the presence of strong complementarities between the two economies having similar factor endowments but well differentiated economic structures (Boillot and Labbouz, 2006)

5. Future of Indo-China trade

Looking at the economic size and growth rates there is huge scope for further growth in Indo-China trade. The scatter plot of the data reveals that there is an exponential growth of trade in the given time series. Moreover the coefficient of determination for a linear regression equation comes out to be low (R^2 = .680 and adjusted R^2 = .654) strongly suggesting a non-linear trend in the time-series. Performing a non-linear regression analysis upon the given data and plotting it shows that there is a better fit of the estimated curve. In addition the R^2 and adjusted R^2 values, both, are considerably high suggesting a good fit of the model. ANOVA statistics also substantiate the appropriateness of the model considered. The trend lines of exports as well as imports also exhibit a similarity in distribution and are given as non-linear regression equation given as equation (2) and (3). Growth rates of exports and imports are highly spiked and import growth rates exhibit a weak linearity (R^2=.064), but as the data is highly skewed (skewness = 2.18) normality of the growth rate of imports is doubtful.

Non-linear Regression Equations

Y_{Tot_trd}= 7624.038681 -3671.088981X+ 392.699657X^2 ……………. (1)

R^2 = .95301 Adjusted R^2 =.94446 Standard Error 2652.60028

F = 111.54171 Signif F = .0000

$Y_{Exports}$ = 1799.83 -895.02 X + 108.264 X^2 …………………………… (2)

R^2 = .979 F = 258.64 Signif F = .0000

$$Y_{Imports} = 5824.21 - 2776.1\ X + 284.436\ X^2 \ldots\ldots\ldots\ldots\ldots \quad (3)$$

$R^2 = .925$ F = 67.78 Signif F = .0000

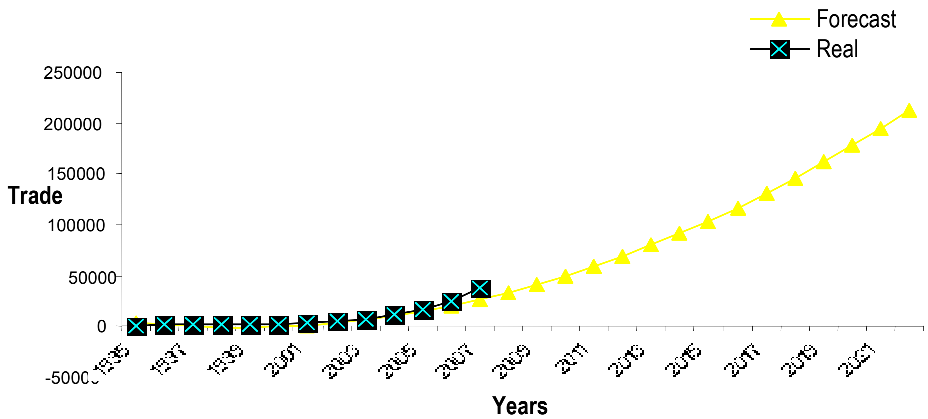

Figure 1. Indo-China Trade

The regression analysis reveals that the total trade of the country will increase in quadratic proportions, and in the years to come one can expect more and more bilateral trade to follow between China and India. The projection for the year 2008 onwards is given in Table 8 and Figure 1. Total trade between India and China can be expected to become 8 to 10 times of the level it was in the year 2007. Even if the growth rate in India-China trade slows down to 25% annually (a conservative projection) from the current rate of over 50%, bilateral trade between them will be almost $75 billion in 2010 and $225 billion in 2015, i.e., as large as China-US trade just three years ago (Gupta 2008).

Imports from China are larger than the exports and the growth based on the regression annalysis reveals that it would remain higher in the coming years. Differentiating Equation 2 and 3 we get:

$dy/dx_{export} = -895.02 + 216.528\ X$, $dy/dx_{import} = -2776.1 + 568.872\ X$

we can observe that coefficient of X in dy/dx_{export} is less than dy/dx_{import}.

India can expect the deficit in balance of trade to accompany the growth in trade. The mean growth rates of exports is higher than that of imports (39.0638 and 34.0215) suggesting that if India can substantially increase the export growth rate the problem of deficit in balance of trade can be taken care of. The total trade can also be expected to fluctuate, as it can be seen in a number of occasions in the given data that there are minor fluctuations as in the year 2002-03.The analysis of the variables under consideration suggests that the growth of trade in the initial years have been low, but in the coming years this can rise sharply. As the larger portion of the total trade is comprises of imports from China, in the long-run this can prove to be detrimental to the balance of trade between the countries.

Table 8. Future India-China Trade (Estimated)

Year	**Trade(USD million)**
2008	33197.93
2009	40915.13
2010	49417.73
2011	58705.73
2012	68779.13
2013	79637.92
2014	91282.12
2015	103711.7
2016	116926.7
2017	130927.1
2018	145712.9
2019	161284.1
2020	177640.7
2021	194782.7
2022	212710.1

India and China are two fastest growing economies with huge exports growth rates and roughly one third of humanity. India and China are major developing countries and our strategic relationship has global significance (President Hu 2006).As their economies keep growing further and as the current bilateral trade is a small fraction of the trade potential, the trade between these two economies is one of the most important aspect of twenty-first century international trade and it will have significant impact on global trade and economy. It is more and more essential for developed countries to adapt to the emergence of these two Asian giants, and, to do so, the developed countries must target their demand more (Boillot, and Labbouz 2006).

6. Conclusion

India and China are the two fastest growing economies among the major economies of the world. Both countries have shown remarkable growth after liberlisation process. One of the recent and more important aspects is the bilateral trade between the two countries. The bilateral trade has grown remarkably in the last six-seven years. Today China is one of the top three trading partners of India whereas India has become one of the top ten trading partners of China. Looking at the size of the economy, composition of economy and exports and growth rates, there is a lot of untapped potential for bilateral trade growth. This bilateral trade will have significant impact on the global trade and economic scenario.

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