CHAPTER-VI

CONCLUSIONS AND POLICY IMPLICATIONS

6.1 Introduction:

There is now a rich body of literature that analyzes trade liberalization process of the developing economies. Adam Smith (1776) praises the virtues of free trade almost two century ago. Little, Scott and Scitovasky (1970), Balassa and associates (1971) were first multicountry studies of trade regime of developing countries. Some studies find a positive association between trade openness and economic growth (Edward 1992, Dollar 1991, Sach and Warner 1995, Frankel and Romer 1999, Wacziarg and Welch 2008). But Rodriguez and Rodrik (2000) raised doubts about this link because conclusions remained sensitive to difficulties in measuring openness and collinearity of protectionist policies with other poorly executed policies in developing economies. There are studies that find little evidence of a relationship between trade liberalization and economic growth (Agosin 1991, Greenaway and Sapsford 1994, Jenkin 1996, Sarkar and Battacharya 2005). But, Thomas et.al (1991), Weiss (1992), Joshi and Little (1996), have shown that the countries which went for liberalization program have improved their export performance. On the import side also, there is a strong positive impact of trade liberalization on growth of imports and this impact is through the sensitivity of price and income changes (Metso and Vogt 1984, Bertola and Faini 1991). Dollar and Kray (2004) find that the countries that have liberalized have shown acceleration in their real income and there is significant difference in growth pattern of globalised and non-globalised countries.

In view of above, the present study is an attempt to analyze trade reform process of India and China in a comparative framework. The study undertakes comparative analysis of trade reforms of India and China, Structure of trade and impact of trade liberalization on economic growth, export and imports for the period 1970-2012. The major contribution of this study is the detailed discussion on trade policy reforms of India and China.
Further, the success and failure of trade policies is always reflected in trade performance of a country. So we have also analyzed the changing structure of trade, FDI inflows and Balance of payments situation of both the countries. An attempt is also made to capture the impact of trade policy reforms on macroeconomic variable like GDP, exports, imports, trade openness and investment rate of India and China. This chapter presents the major conclusions and policy implications emerging from the study. The chapter consists of three sections, sections 6.2 deals with some major conclusions while section 6.3 presents policy implications.

6.2.1 Major Conclusions: We now turn to summarizing the main findings that follow from our study which are as follows:

(i) Both countries have reduced tariff barriers significantly during the period under study but India’s applied simple average tariff and product wise tariff is higher than China. Tariff restrictions on agriculture products are higher than non-agriculture products in both countries. Non-Tariff Measures have also been reduced gradually as China implemented its commitments to WTO. Import quotas as well as trading rights were discontinued at the end of 2004 while import prohibitions and licensing have been reduced. The administration of import licensing regime has also been simplified. The overall trade restrictiveness index shows that China is more open as compared to India; However, India’s exports face fewer restrictions in partner countries as compared to China.

(ii) Analysis of China’s trade policy shows that these policies are sector specific and gradual in nature and trial and error method has been adopted. For China, trade reforms are a means to achieve development ends. India’s trade reforms are also gradual but the pace is higher as (tariff barriers reduced more speedily after 1990) compared to China. China’s success on export front is reflected by its aggressive pro-export strategy by central authorities, active participation of local government and the presence of Hong Kong and Taiwanese investors looking for a source of cheap labour.
(iii) China adopted geographical targeting by setting up special economic zones and open cities and sectoral targeting as industrial products, textiles, machinery and electronic goods. The special economic zones have contributed in large measure to China’s exports. However, it has not been the case with India. Further, there is a wide range of government incentives aimed at encouraging firms to produce almost exclusively for foreign markets in China. These incentives, which are pure export subsidies, usually take the form of tax rebate that are conditional on firm exporting all or most of the products.

(iv) Attracting export oriented FDI into manufacturing sector has been one of the main purposes of commercial policies of China. China is the largest recipient of FDI and foreign invested enterprises played an important role in export expansion. Moreover, China also promotes outward investment to secure supplies of key raw material such as petroleum and iron ore. India has also allowed foreign investment in all sectors except some sectors due to health and safety considerations. But India has been focusing on infrastructure, power, capital goods and food processing and these sectors do not fall under export activities. As opposed to this, FDI is concentrated in export oriented and high technology manufacturing industry in China. The FDI in India hardly entered export oriented industries and has only been domestic market oriented and not efficiency seeking. However, to some extent export oriented production model is reflected in India’s service sector particularly in software development.

(v) Another important feature of China’s trade reforms is that they have been supported by administrative reforms. Decentralization of administrative system was introduced at three levels as right and responsibilities were transferred to local authorities from central government to encourage local state owned companies to develop internal trade linkages. China also developed trade related regulatory and international law system. All these reforms smoothened the process of international trade by bringing Chinese trade practices more in line with international standards. But Indian administrative system is still not fully adapted to an open free market
economy, so in absence of proper governance, institutional and regulatory system and transparency, the reforms did not work to the optimum.

(vi) China’s objectives regarding foreign trade policies are more qualitative in nature. China has used its trade and foreign investment policies actively to meet its industrial and development goals. For example China has utilized foreign capital to improve industrial structure, and technological capabilities by encouraging FDI into new and high technology industries, modern services and agriculture. Its trade policy is a combination of import substitution and export promotion policies by encouraging export of those labour intensive industries in which it has comparative advantage; and promoting development of those capital and technology intensive industries in which it does not have a comparative advantage. India’s trade policies objectives are more quantitative in nature such as to double India’s share in global merchandise trade within five years (Foreign Trade Policy 2004-09) and to accelerate export growth to 25 percent by 2020.

(vii) Both nations have managed floating exchange rate system. However, China does not allow its currency to float and therefore, must make large scale purchases of dollar to keep exchange rate within certain target levels. Although the Renminbi (RMB) has appreciated against dollar in real terms about 40 percent since reforms were introduced in July 2005, some analysts contend that it still remains highly undervalued. China’s undervalued currency make its exports less expensive and imports more expensive than would occur under a floating exchange rate system.

(viii) Our analysis shows that maximum growth in trade/GDP ratio (Trade Openness) has taken place during the post WTO period in China. It is deeply involved in fulfilment of its WTO commitments and its accession agreement is most comprehensive and complex in character. China has used the WTO as an important instrument to bring about critical domestic reforms in many areas. In dispute settlement area it has played a constructive role through sincere efforts to resolve disputes before they need to go to formal adjudication in the system. China’s thirteen years are marked by its compliance with WTO commitments, cautious approach in using its rights and
avoiding confrontation with trading partners. India is the founding member of WTO and supports multilateralism at international level but its compliance to WTO has been limited and restricted.

(ix) A major difference of trade policies of India and China is that Chinese trade policies have been dominated by export-promotion policies and simultaneously by import restrictive policies. On the other hand, India’s trade liberalization policy has been much less unidirectional. The 1980s were more dominated by export promotion policies while 1990s and 2000s saw more emphasis on import liberalization. Further import liberalization policy in India is sequential and cautious. In India import duties on capital goods were lowered in the mid-1980s, followed by lowering of import duties on raw material and intermediate products in 1990s and eventually import duties were lowered for consumer goods in 2001. The impact of these policies is reflected in exports, imports and balance of payments trends of India and China.

(x) Our analysis of trade outcomes of both economies shows that in 2013, China was the largest exporter of merchandise trade in the world with a share of 11.8 percent in comparison to India’s share of 1.7 percent with 19th ranking in world merchandise exports. China was the fifth largest exporter of service trade in the world with a share of 4.4 percent closely followed by India with 3.3 percent share in world’s service trade and sixth rank in 2013. Ninety four percent of China’s exports were manufactures and only six percent were primary products in 2012, whereas in India forty percent exports were of primary products and 60 percent exports were of manufactures in 2012.

(xi) China’s major exports were machinery and transport equipments, office and telecom equipments, electronic and office equipments and telecommunication equipments in 2012. India’s major exports were fuel and mining, agriculture exports, chemicals, machinery & transport equipments and textiles in 2012. Fuel and mining which includes ores and other minerals and non ferrous metal had highest share in India’s exports (21.6%) whereas China is second largest importer of these products which indicate the
cautiousness of Chinese leadership towards building reserves of this category. China is also a leading exporter of textiles while India is at second position in 2012. However, China’s trade volume of these products is seven times higher than India’s volume. In 2012, China’s main imports were fuel and mining, Chemicals, office and telecom equipments, Machinery and transport equipments and agriculture products. In 2012, India’s main imports were fuel and mining, Chemicals, Machinery and transport equipments, agriculture products, office and telecom equipments.

(xii) Direction of trade changed substantially in both India and China for the period under study. Share of EU, USA and other developed nations has declined in total trade whereas trade with developing countries has increased in both nations. However, China has emerged as one of the most important trading partners of India in recent years. China is exporting nearly 70 percent of its exports to Asia. Share of developing economies is increasing in India’s exports.

(xiii) China’s service exports were US$ 208.2 billion with 8.5 percent share in total exports in 2012. Service imports of China were US$ 330.2 billion with 15 percent share in total imports. In 2013 India’s total service exports were US$ 153.0 billion with a share of 33 percent in total exports and service imports were US$ 127.8 billion with a share of 22.8 percent in total imports.

(xiv) China is having a continuous trade surplus on its balance of trade whereas India is facing trade deficit on its balance of trade account. One of the major reasons for this is that in China, the growth rate of exports has always been greater than the growth rate of imports but in India the growth rate of imports has been always greater than exports growth rate. China’s international reserves were US$ 3332.9 billion in 2012 and India’s international reserves were US$ 271.5 billion. This means China’s reserves are 12 times higher than that of India’s international reserves.

(xv) Foreign Direct investment is increasing in both India and China but China is able to attract five times higher FDI than India. China’s FDI inflows in 2012 were US$ 121.0 billion in comparison to India’s FDI inflows of US$ 25.5 billion.

(xvi) Unlike India, China’s real GDP growth rate improved immediately...
after economic reforms from 5.9 percent during 1970-80 to 10.2 percent during 1981-1990. India’s GDP growth rate was 4.4 percent during pre-reform period (1970-90) and 6.8 percent after reforms (1991-2012). Further China’s growth rate of GDP is higher than India during the entire period under study. Interestingly China’s exports grew at a higher rate 17.6 percent during the pre-reform period (1970-80) and compared to the post reform period (1980-2012). India’s export growth rate was 5.7 percent during 1970-90 which improved to 13.7 percent during the post reform period. On imports side, China has a higher growth rate of imports during pre-reform and post-reform periods, 17.5 and 15.3 percent respectively compared to India where the growth rate of imports was 7.1 percent during 1970-90 which increased to 14.0 percent in the post reform period. Further China’s exports growth rate is higher than imports growth rate during the reform period whereas in India imports growth rate is higher than exports growth rate, this has serious implications for balance of trade.

(xvii) A comparison of pre and post liberalization growth of GDP, exports and imports of two countries shows that for China only GDP growth is statistically significantly different between the two periods. The growth of exports and imports not statistically significantly different for China. However, for India growth of GDP, exports, imports are statistically significantly different for the pre and post liberalization periods.

(xviii) An analysis of trade openness shows that China (7.6) was less open than India (11.23) in early 1970s but was on a better footing vis-à-vis India in 1978 with its openness 1.61 times higher than India. China doubled its openness between 1986 and 1997 but it is post 1999 period wherein China achieves maximum growth in trade openness which may be the result of China’s entry into WTO. However, China is more vulnerable to international disturbances as global recession have reduced its openness from 71.5 percent in 2007 to 63.9 percent in 2012. India’s openness started increasing steadily though slowly after trade liberalization. However, it is only after 2003, that India has been able to increase its openness significantly from 30.3 percent to 55.6 percent in 2012. It took China 18 years to double its openness index from 18 percent in 1978 to 35 percent in 1996 but India succeed in doubling
it in 12 years from 14.3 percent in 1991 to 29.4 percent in 2003. The most important determinant of trade openness ratio of China is the removal of non-tariff barriers and declining tariff rate whereas for India population growth rate has negatively affected the trade openness ratio.

(xix) Phase wise analysis of trade policy reforms shows that for China GDP, trade openness and investment rate improved in all phases except 1979-1992 period for China. Highest growth in these variables was achieved during post WTO period 2001-2012. In case of India, during partial liberalization phase (1981-90) there is a slight improvement in GDP and investment rate but very insignificant increase in trade openness ratio. The maximum improvement in these variables has been achieved in fourth phase(2006-2012) which is SEZ policy phase of India.

(xx) Finally, the relation between economic growth and trade has been analyzed through Granger Causality Test. There is a unidirectional causality from GDP to Exports of India at 2nd lag but bidirectional causality between GDP and exports at 4th lag. There is no causality between GDP and Exports of China at second lag but bidirectional causality at fourth lag. There is unidirectional causality from GDP to imports for both India and China at 2nd lag and bidirectional causality at 4th lag. This implies that in both India and China, exports do not promote GDP, however imports induce growth in short run. But exports promote GDP in long run in both countries which implies that exports contribute to economic growth after a particular level of development reached in a country. Our study is also in conformity with Attri V.N. (1996) and other studies in the field.

6.3 Policy Implications of the study:

Foreign trade plays a very important role in growth promotion of a country. But it also increases the vulnerability of the reforming economy to turbulences in the world economy. It is argued that domestic demand based growth model can reduce dependency on other markets which may become volatile given the current economic scenario. China’s economic integration level is very high, that’s why Chinese leadership in now focusing on increasing domestic demand for growth acceleration. China is facing various imbalances in its economy; that’s why trade policy reforms should be seen in
the context of necessary domestic reforms. Some of the urgently required reforms are revaluation of Renminbi to something approaching market determined levels, restructuring and privatization of SOEs and state owned banks, financial sector reforms to deepen capital markets and turn saving into more productive investments, secure private property rights including legal title to rural land, deregulation of internal trade to create a more integrated domestic market, market pricing for a range of inputs (land, water and other natural resources) and better provision of public services (health, education, pensions and social security). All these reforms would help rebalance growth and make China less reliant on exports and capital intensive polluting production and more reliance on services and domestic consumption. Indian economy is more balanced in this regard but slow on reform front. But reliability of India is more in international market, China is often blamed for dumping, manipulation of statistics and unfair trade.

The important policy implications that emerge from this study are as follows:

(i) In conformity with the theory of liberalization, as discussed in the literature of economics, the study of the two countries proves a link between trade liberalization and higher and faster economic growth. But, the pace of economic growth seems to be a function of consistent economic reforms in other sectors of the economy. This is what explains the difference of growth rates in China and India. In China, the process of liberalization has been more realistic and comprehensive and its implementation has been excellent vis-à-vis India.

(ii) This implies that the country embarking on the process of liberalization should focus on credibility of economic reforms, good governance and right order, speed and sequencing of trade reforms. Otherwise the reform process may fail as in case of south cone countries in Latin American in early 1970s.

(iii) Trade Policy whether “general” or “sector – specific” may not lead to growth. In order to arrive at any concrete statements on impact of trade policy overtime, one should revert to dynamic macroeconomic models, such as distributed lag models which would enable economists to find out about the strength and impact that trade policy might have on the rate of growth. This should be a line of research to be followed in the
future. However the study leads to the conclusion that trade openness in the long run has a positive impact on output growth i.e. capital accumulation and total factor productivity (TFP) growth. This is more true in case of China than India.

(iv) Further, it is evident from the study that if trade policy leads to the removal of anti-export biased environment in the country as in case of China, then export orientedness increases and so does the volume and value of exports. It has happened in China whereas in India, its success has been restricted. This implies that pragmatic and comprehensive trade policy is an effective tool for accelerating economic growth. But study does reveal that if (trade – policy) is not the only determinant of economic growth.

(v) The study reveals that since the introduction of liberalization in China and India, their macroeconomic performance has significantly improved. This is true in case of China to a greater extent. In China, the annual growth rate of real GDP has been ten percent on an average during the post reform period; whereas it has been seven percent in case of India. Similarly, the exports and imports also grew at exceptionally high rates. The momentum could not be maintained in both the countries due to different reasons. We are not going into the details of causes of decline of GDP, exports and imports growth rates. The study finds unidirectional causality from GDP to exports and GDP to imports in both countries after certain lag (s). The absence of causality from exports (imports) to GDP needs to be further investigated.

In view of the above, it may be inferred that the process of liberalization (trade- liberalization) does contribute to high economic growth under certain favourable conditions. The process should be implemented in such a way as to avoid or minimize the imbalances in the economy which did not happen in case of China. In India, the imbalances have not occurred. The major policy implication of the present study is that countries should follow a cautious, credible, comprehensive and pragmatic trade liberalization policy relevant to specific country conditions.