Client: IIFT	Date: 12th September ,19
Publication: Mint	Page: 14

India should rid its trade policy of outdated priorities

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The government's aim to propel India towards a $5 trillion economy by 2024-25 requires us to pay our trade policy special attention. At present, the total value of India's imports plus exports is around $700 billion, which is about 40% of the country's gross domestic product (GDP). If this 40% proportion is to be maintained, total trade will have to increase to about $2 trillion by then, of which at least $1 trillion would have to come from exports. This would require a substantial change from the country's current thinking on trade policy.

The main change necessary is not to think of trade policy as merely a means to promote exports, but to look simultaneously at the issues of exports, imports, and foreign direct investment (FDI).

There are a number of reasons for this. For one, exports can no longer be isolated from imports today, as almost 80% of world trade is intra-industry trade. This needs a little explanation. In the mid 20th century, it was easy to classify products as exports or imports, and further as agriculture, manufacturing or services exports or imports. However, the growth of intra-industry trade since 1980 or so implies that countries simultaneously export and import items of the same industry group. Countries now import an item, add value to it, and export a related item. One example is that of gems and jewellery, and precious stones. India imports both diamonds and gold, adds value by transforming these into jewellery, and exports this to the world. This kind of simultaneous export-import is characteristic of almost all traded items. Hence, trade policy must look at both imports and exports, and not only at exports. One implication is that the challenge is not of simply attaining $1 trillion worth of exports, but of achieving $2 trillion in world trade.

Second, it is also becoming extremely difficult to separate the export of services from that of commodities. India is a leading player in the world market in products that are very intensive in the use of IT services. Electronic items are probably the best example of this. In 2015-16, these items constituted about 3% of our exports and 6% of imports. India today is a net importer of electronic items that have a substantial IT component. The issue here is how the export of information technology enabled services (ITeS) in domestic electronic manufacturing can be enhanced so as to export more value-added electronic products. This also implies that looking at exports in isolation would be inappropriate.

Third, today trading countries are trying to move up the export ladder by moving from low-cost labour-intensive items to higher value-added technology-intensive products. Countries such as China (in recent times), South Korea, and Japan have done this successfully. The link with trade policy here is that technology is acquired slowly through learning from technology leaders. At present, many of these technology leaders are foreign transnational corporations (TNCs) whose presence in an economy is reflected in FDI figures, since they bring in investment from overseas once they enter a market. Another aim of moving up the technology ladder is to establish the country's position in international value chains, often called global value chains (GVC). A GVC traces an entire production cycle, which could range from the export of inputs to intermediate manufacturers abroad and the import of the components thus made, to the assembly of the final product for shipment to other markets.

In an era of global value chains, we need to focus on exports, imports and FDI simultaneously

An aspect of these GVCs is that the processes are linked vertically through the medium of global firms, and Indian firms are no exception to this. It is often not recognized that not all TNCs are global giants. There are examples of mid-sized firms in places such as Taiwan, Japan, and South Korea that export goods and services.

The ascendance of GVCs means that TNC investments, which usually take the form of FDI, tend to result in the dominance of intra-firm trade at the global level. Today, FDI is just another way of doing trade. This is clear from the fact that there is almost a one-to-one correlation between a country's exports/imports and inflows/outflows of FDI.

So, a third element of trade policy is to recognize the interlinkages outlined above by associating itself with FDI policy. Currently, in India, separate government departments define trade policy and FDI policy, and this is not very efficient.

The short point is that one cannot look at trade policy in isolation. The country has to recognize that it has three elements: trade in commodities (imports and exports), trade in services, and FDI. We need to look not only at trade policy, but also at the link between trade policy and FDI, as these are two sides of the same coin. To this, if we add the fact that trade in commodities and services are increasingly inter-related, it is clear that achieving India's implied export goal of $1 trillion by 2024-25 calls for a more holistic approach to trade policy.

The overall issue is that trade policy still has an overhang from the policy framework of the 1980s, under which the primary objective was to somehow increase India's exports while imports were kept under control by trade licences. This system led to an overemphasis on export policy, ignoring issues of imports and FDI.

My argument here is that in the current global scenario, this approach is an anachronism and needs a rethink, given the changing nature of world trade and the existence of global production networks.