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TRADE: THE FULCRUM OF INDIA'S GROWTH

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The current geopolitical landscape presents new and exciting opportunities for India. Despite the uncertain global environment, India in 2022-23 surpassed the export target of US $ 750 billion and exports touched US$ 778 billion. Our vast potential has triggered increasing interest, with many countries looking at us favourably for economic partnerships. It is essential we seize the opportunity and foster an environment conducive to trade and investment.

As we look at increasing our share in global trade, the focus should be to embrace technological advancements, improve competitiveness, and move up the value in global supply chain. By nurturing and expanding its capabilities in sectors like pharmaceuticals, automotive and electronics, India can position itself as a reliable and innovative player in high-tech manufacturing exports.

India's service sector exports have proved their mettle, with India's software services and business services making strong in-roads into global markets. Given India's inherent strength, we should look at further diversifying and fully tapping into the potential of this sector.

Even as we embark on our journey to meet the ambitious export target of USD 2 trillion by 2030, we must also move consciously towards ESG compatibility. Embracing sustainable practices will not only enhance our competitiveness but also contribute to a greener and more inclusive future.

The government's focus on infrastructure development and policies supporting the export sector demonstrates its commitment to enhancing domestic capabilities. As we move ahead with strategic global economic partnerships, it will be critical to ensure that these partnerships are beneficial to both , domestic industry and exporters.

Mehul Pandya

MD & CEO,
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The Indian economy has proved to be a testimony of resilience in the face of innumerable challenges. Trade has played a pivotal role in India's growth story so far and remains critical in the journey ahead. With the unfolding of the Amrit Kaal, the nation looks ahead at scaling greater heights of economic growth and prosperity. The present geo-political landscape presents India with an opportunity to establish itself as a global partner of choice. The recent headwinds from the global supply chain disruptions, negative spillovers from geo-political conflicts and the slowdown in global growth have reiterated the need for strategic partnerships with like-minded countries.

While we look ahead at an ambitious trade target, an essential prerequisite is the preparedness of domestic industries to face global competition. India must focus on enhancing its domestic capability by strengthening the infrastructure, improving the ease of doing business and building a conducive regulatory environment. Incentivising innovation through focus on research and development is another critical aspect to increase our competitiveness in the global market.

The government's focus on infrastructure development and various policies aimed at supporting the manufacturing sector, specifically MSME sector are a testimony of the government's commitment to enhance the domestic capabilities. Going forward, the focus must be on benefitting from globalisation without compromising the interests of the weaker sections of the industry.

India's return to the negotiation of free trade agreements after almost a decade is a testimony to the government's strategy of collaboration for growth. The key elements to such collaborations would be to identify synergies in champion growth sectors, debottleneck differences in positions, and explore untapped strategic interests to work together.

Note from
Rajani Sinha

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In an increasingly integrated world, trade can play a very critical role in a country's development. We have seen that exports have been a major driver of economic transformation for some of the Asian economies like Japan, South Korea, China and Thailand. India is in a critical position in the global landscape and is looking at trade and strategic partnerships to unlock its full potential and benefit from globalisation.

India's share in global merchandise exports was at 1.8% in 2022, a minuscule increase of 0.2 pp in the last decade. In terms of composition, technology-related manufactured items dominate India's exports with an average share of 52.8% (2018-22), followed by resource-based manufacturing (34.2%) and primary products (12.5%). However, the share of medium and high-tech manufactured items in India's tech-related manufactured exports remain lower compared to the other economies such as the US, UK, Germany, Japan, China and Vietnam. As per Herfindahl-Hirschmann Index, India's exports are relatively more diversified compared to economies like Bangladesh and the Philippines but are less diversified than US, Germany and China. An analysis of the direction of India's merchandise trade shows that our exports moved away from the advanced economies in the 1990s towards emerging and developing economies. The share of developed economies in India's exports was 49% in 2022, while the share of emerging and developing economies was at 51%.

India is among the top 10 exporters of services globally, with a share of 4% in total services export. The dominance of software services in India's services export basket has continued with a share of 45% in FY23. However, there has been a remarkable shift toward business services, with its share in total services export rising to 24.7% in FY23 from 19.5% in FY13. India's openness in services trade is lower than other major advanced economies across most segments. Reducing the service trade restrictiveness will help to further increase our share in global service exports in the long run, while also boosting the capacities of the downstream industries that rely on services as inputs.

India has set an ambitious target to achieve USD 2 trillion in exports by 2030, with 1 trillion in exports each for merchandise and services. In the past decade, India's merchandise and services exports have grown at a CAGR of 4% and 8.5%, respectively. In order to achieve the aforementioned target, India's merchandise and services exports are required to grow at a CAGR of 12% and 18%, respectively.

As India aspires to take its exports to greater heights, the essential first step would be to focus

on its domestic preparedness and competitiveness. Some pre-requisites for this will include (i) Prioritisation of logistic infrastructure (ii) Increasing the scale of production (iii) Improving the Ease of Doing Business (iv) Focus on R&D to move up the value chain (v) Lowering of import tariff rate and correction of import duty anomalies (vi) Policy support to MSME segment.
India has taken a proactive stance and returned to the table for entering into new trade agreements after almost a decade. India is currently negotiating FTAs with the United Kingdom (UK), European Union (EU) and Canada. Analysis of existing FTAs shows that India has lesser depth in its existing trade agreements with its partners as compared to the trade agreements entered by an economy like the US. Going forward, as India enters into new trade agreements, the focus should be on making these agreements as comprehensive as feasible.

India's past experience holds lessons for negotiating more comprehensive and fruitful agreements for future. In order to fully harness the potential of the New Trade Agreements:

- We need to focus on India's RCA (Revealed comparative advantage) of goods and services. On the merchandise front, India has a revealed comparative advantage (RCA) in intermediate and consumer goods. On the services front, India enjoys a comparative advantage in telecommunication, computer and information services and other business services.

- An analysis based on the trade complementarity index (TCI) shows that India's export basket has high complementarity with import baskets of Italy, Belgium, Germany, Netherlands, Indonesia, France and the UK. However, currently, these countries account for a low share of India's total exports reflecting untapped potential markets.

- Beyond merchandise and services export potential, we should focus on investment opportunities through these FTAs. Foreign investment carries great significance for a country by building its manufacturing capability, facilitating the transfer of new technologies and knowledge transfer.

- There must be a focus on diversifying the modes of services exports. Mode 4 (movement of natural persons) remains more restricted than other modes of services delivery owing to concerns over its implications for the labour markets. Hence, India needs to increase its focus on growing its service trade through other modes i.e. Mode 1 (cross-border supply), Mode 2 (consumption abroad) and Mode 3 (commercial presence).

- We should negotiate for the removal of non-tariff barriers in the form of tariff quotas, technical barriers to trade, antidumping and countervailing duties that pose a major hindrance to accessing the markets in developed countries.

- New generation FTAs are covering issues related to the environment, labour and sustainability etc. International commitments on these issues must be taken only after the domestic regulatory framework is in place, otherwise, these issues might serve as non-trade barriers.

- We need to increase the utilisation rate of the FTAs to reap the benefits arising from the bilateral and multilateral trade agreements. In India, the utilisation rate of RTAs by exporters is low ranging between 5-25% (Asian Development Bank).

- Effective industry consultation is critical for the identification of weaker industry groups which would require some form of initial support to stand the competition arising from increased bilateral trade.

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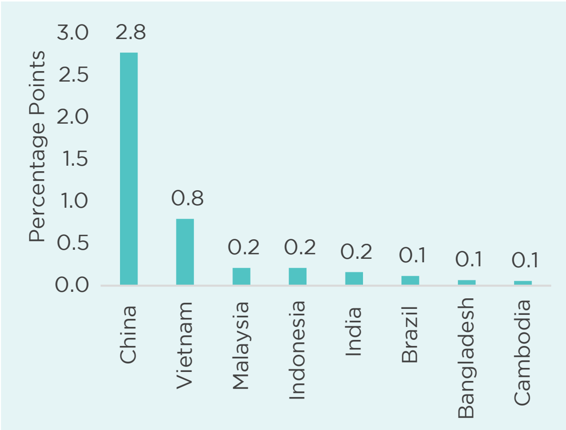
TRADE-THE FULCRUM OF GROWTH IN AMRIT KAAL

I. Overview

Global trade is considered to be the backbone of the international economy. In an increasingly interconnected world, trade acts as a catalyst for promoting efficient production patterns, driving specialisation, fostering technological diffusion and enabling integration into the global value chain. Overall trade plays a crucial role in enhancing the welfare of any economy through growth and productive employment opportunities. Exports have been a major driver of economic transformation for Asian economies such as Japan, South Korea, China, Thailand and Malaysia. In the late 1990s, there was 'hyperglobalisation' that resulted in increased global trade. However, the 2008 Global Financial Crisis, maturing supply chains, and trade tensions in the form of tariff wars led to a period of slow global trade growth termed 'Slowbalisation'. Trade tensions between the two largest economies of the world led to a new wave of protectionism with countries implementing inward-looking policies. Global merchandise exports recorded a CAGR of 1.3% between 2015-20 moderating from 10.2% between 2000-05.

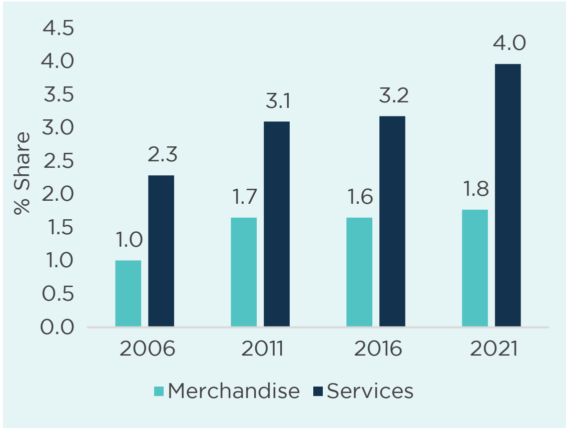
During the last two decades, the Indian economy has grown at an average of nearly 6.4%. In the same period, the contribution of exports (goods & services) to the gross domestic product (GDP) has nearly doubled from 13.7% in FY04 to 23.5% in FY23. Despite the rising share of exports in GDP, India has lagged in meaningfully increasing its share in world exports. India's share in global merchandise exports was at 1.8% in 2022, a minuscule increase of 0.2 percentage points (pp) in the last decade. In the same period, China's share in global exports increased by 2.8 pp to 14.4%. Even for a smaller economy like Vietnam, the share has increased by 0.8 pp to 1.5%. On the services front, global trade has been expanding worldwide on account of continuous technological improvements which have reduced the cost of cross-border exchange and facilitated the growth of new categories of exports. During the last decade (2012-2021), global service exports recorded a CAGR of 3.1%, higher than 2.1% in goods exports. This resilience in global services trade provides an upside potential for economies like India, with large labour force. India's services exports have been the bright spot, with its share in global exports at 4% (increase of 0.8 pp in the last decade).

Exhibit 1: Change in Share of Global Merchandise Exports (Between 2013-2022)



Source: UNCTAD

Exhibit 2: India's Share in World Export of Goods and Services



Source: UNCTAD

II. India's Trade Performance in the Last Decade

A. Composition of Merchandise Trade

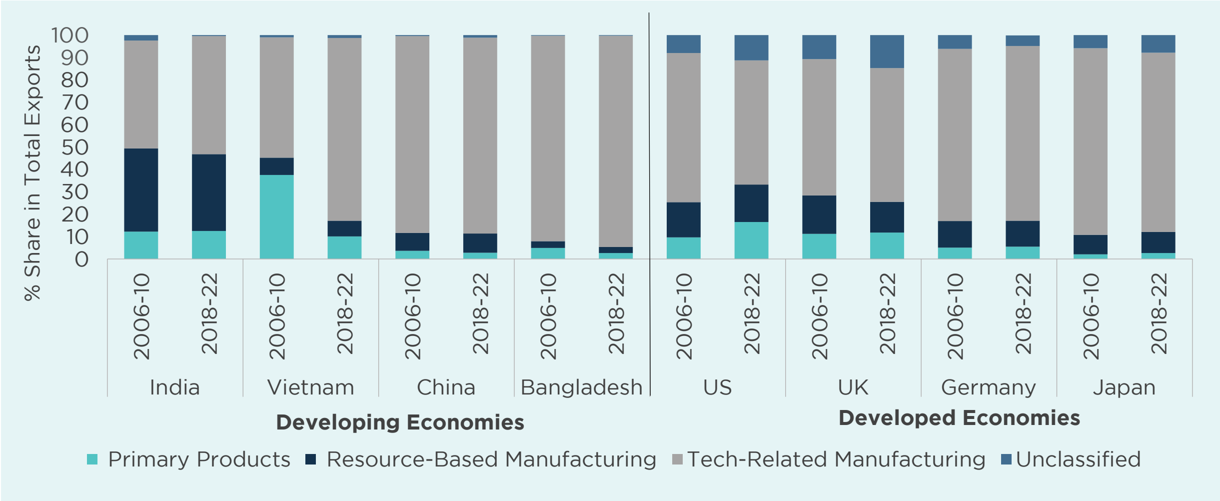
An analysis of India's export basket as per the Lall classification[1] (2000) shows that our export basket is relatively more diversified compared to select developing counterparts (See Exhibit 3). In the recent years, technology-related manufactured items (refer footnote 1) dominate India's exports with an average share of 52.8% (2018-22) followed by resource based manufacturing (34.2%) and primary products (12.5%). In the last decade, while the share of resource-based manufacturing exports dipped marginally, the share of technology-related manufactured items inched up slightly from an average of 48% (2006-10) to 53% (2018-22). The tech-related manufactured items are further classified as per their techonlogical intensity (low, medium and high). For India, the increase in the share of technology-related manufactured items was driven by a rise in the export share of medium and high-tech manufacturing products.

Despite the rise, the share of medium and high tech manufactured items in India's tech-related manufactured exports remain lower compared to the other developed economies such as US, UK, Germany and Japan. Among developing economies, India still lags compared to China and Vietnam in terms of tech-related manufactured exports. China's share of tech manufactured products in export basket is high at 87.5% (2018-2022). Vietnam has made the most notable progress with its average share of tech-related manufacturing exports rising sharply from 54% (2006-10) to 81.6% (2018-22) mainly driven by high-tech manufactured products. Several factors such as trade integration with the world through trade agreements, low import tariffs and measures to boost foreign direct investment supported Vietnam's transformation to complex high-tech manufacturing exports (IMF, 2020). Though Bangaldesh has a high share in tech-manufacturing exports, it is largely concentrated in the low-tech industries such as textile and garment.

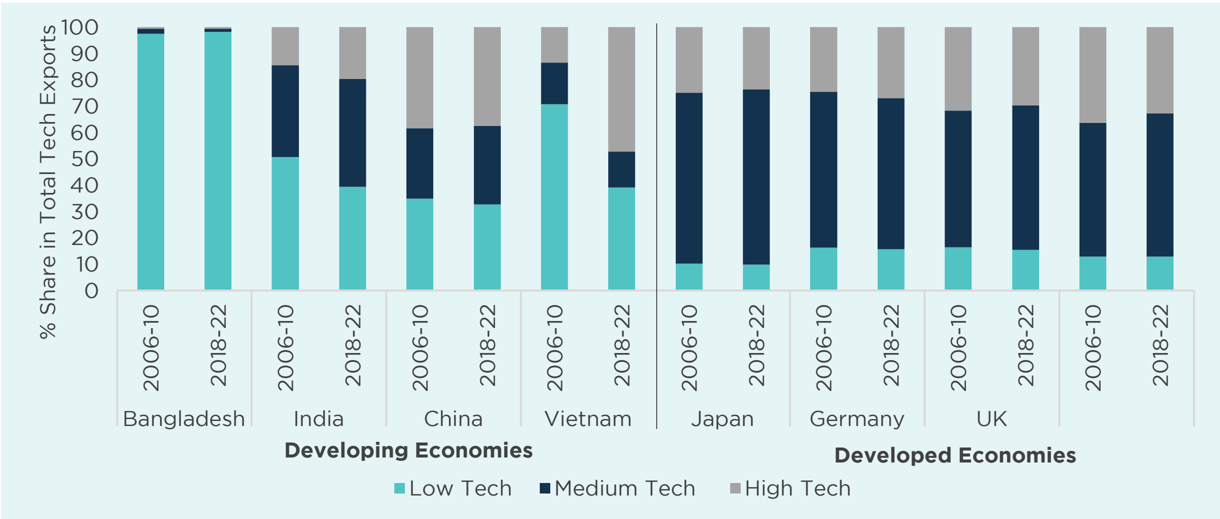
[1] As per Lall classification (2000), exports are classified under three broad categories namely, primary products, resource-based manufactured items and technology manufactured items. Primary products include items such as dairy, agricultural products, crude metals and petroleum etc. Resource based manufactured products include agro-based and other manufactured items such as chemicals, metals, glass etc. Technology-related manufactured products are further classified into low-tech (textiles, garments and footwear), medium-tech (automotive and engineering) and high-tech (electronic and electrical).

Exhibit 3: Commodity Composition of Exports-Select Economies

Panel A: Overall Export Composition



Panel B: Composition of Tech-Based Manufacturing Exports



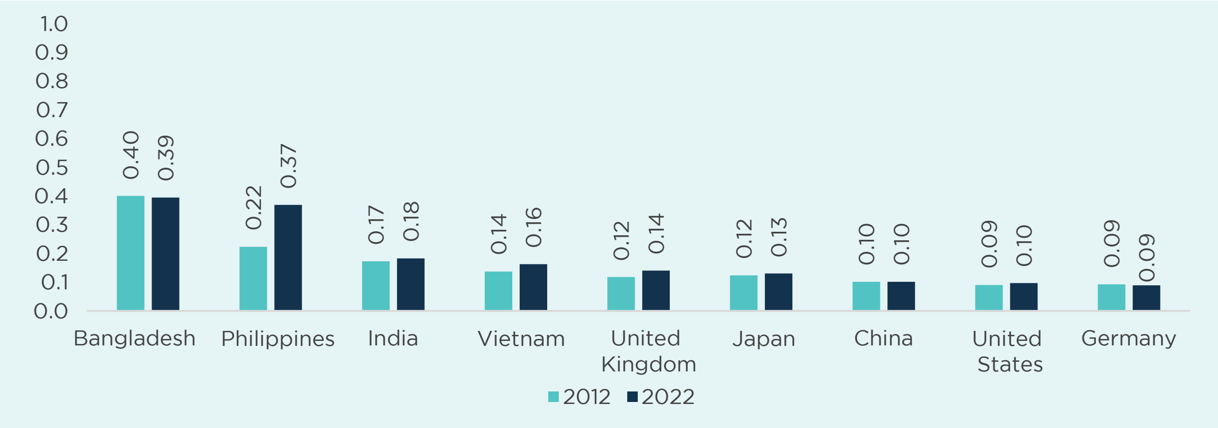
Source: CareEdge calculation based on UNCTAD data (SITC, Rev 3)
Note: Primary products include items such as dairy, agricultural products, crude metals and petroleum etc. Resource based manufactured products include agro-based and other manufactured items such as chemicals, metals, glass etc. Technology-related manufactured products are further classified into low-tech (textiles, garments and footwear), medium-tech (automotive and engineering) and high-tech (electronic and electrical).

Building Resilience through Export Diversification

Export diversification is important from the perspective of building resilience towards global trade shocks as concentration on a few products is likely to exacerbate the transmission of negative spillovers from global economic uncertainties and demand shocks. Empirical evidence suggests that economies with high product concentration such as Bangladesh, Philippines, Sri Lanka and Cambodia experienced a greater export loss as global demand weakened amid the coronavirus pandemic (Bangladesh Bank, 2022). Product concentration measured by the Herfindahl-Hirschmann Index[2] shows the extent to which a country's exports are concentrated on a few products. The index shows that India's exports are relatively more diversified compared to economies like Bangladesh and Philippines, but is less diversified than US, Germany and China. Going ahead, not only must India focus on expanding its current export basket but also concerted efforts are required to upscale to high-end tech manufacturing exports.

[2] The index takes a value between 0 to 1, where 0 indicates a homogenously distributed export pattern among a series of products whereas an index of 1 is indicative of high concentration on a few products.

Exhibit 4: Product Concentration Index- Exports

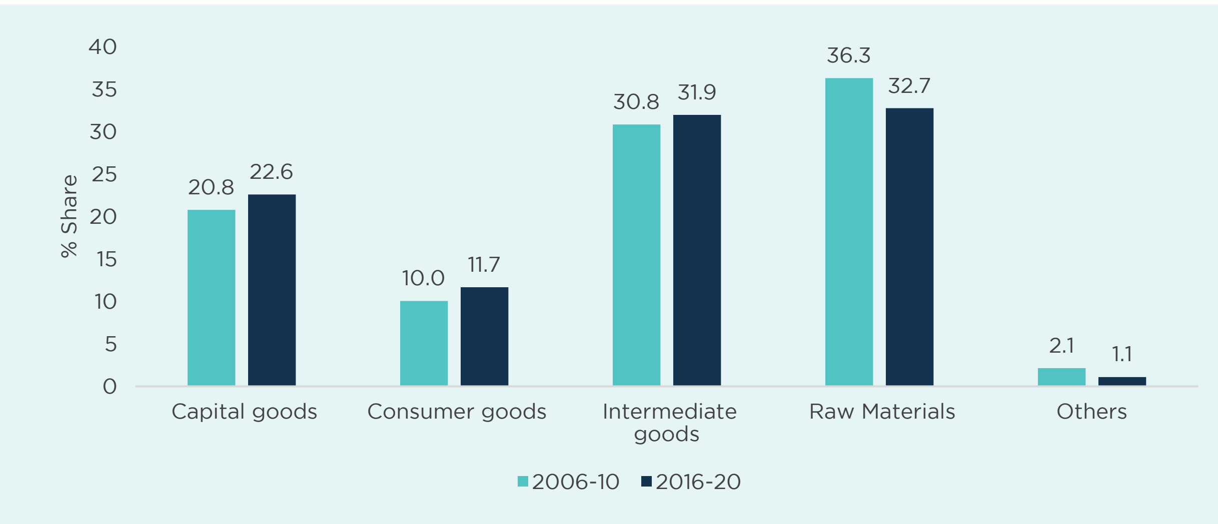


Source: UNCTAD; Note: Concentration index represents the Herfindahl-Hirschmann Index

Boosting Exports through Enabling Imports

The manufacturing sector is the backbone of an economy's overall economic progress and benefits greatly from imports of key inputs which are used by the downstream industries. Thus, the formulation of sound import policies is crucial for boosting domestic manufacturing capacities. India's import basket is dominated by raw materials with a share of 32.7% (2016-20) followed by intermediate goods with a share of 31.9%. The other import categories are capital and consumer goods with a share of 22.6% and 11.7%, respectively. The share of capital goods imports has inched higher in the recent years. Given the criticality of capital goods for moving up the value chain, the government had formulated the Export Promotion Capital Goods (EPCG) Scheme to prioritise the imports of capital goods to enhance the quality and competitiveness of India's exports. The EPCG scheme facilitated the import of capital goods for pre-production, production and post-production stages at zero customs duty. Going ahead, trade policies must be formulated taking into consideration the importance of key imports for the domestic industries.

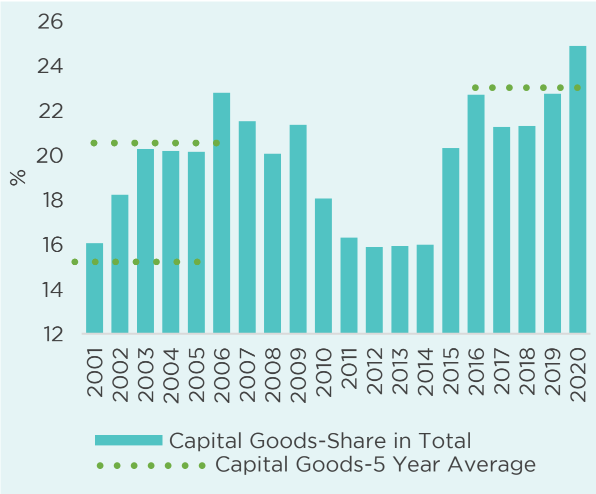
Exhibit 5: Composition of India's Imports



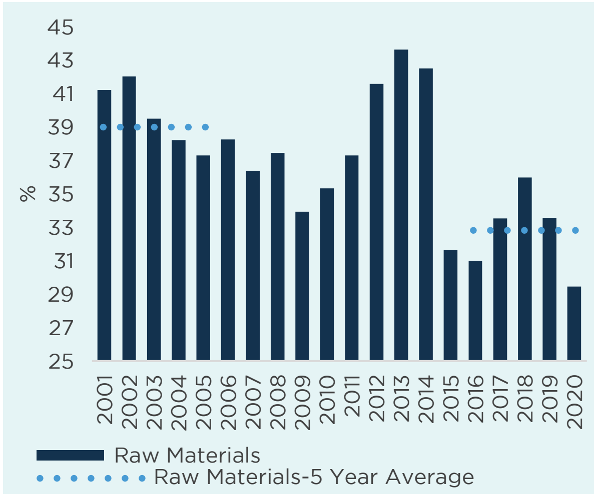
Source: WITS

Exhibit 6: India's Import Composition- Trends in Select Commodity Groups

Panel A: Capital Goods



Panel B: Raw Materials



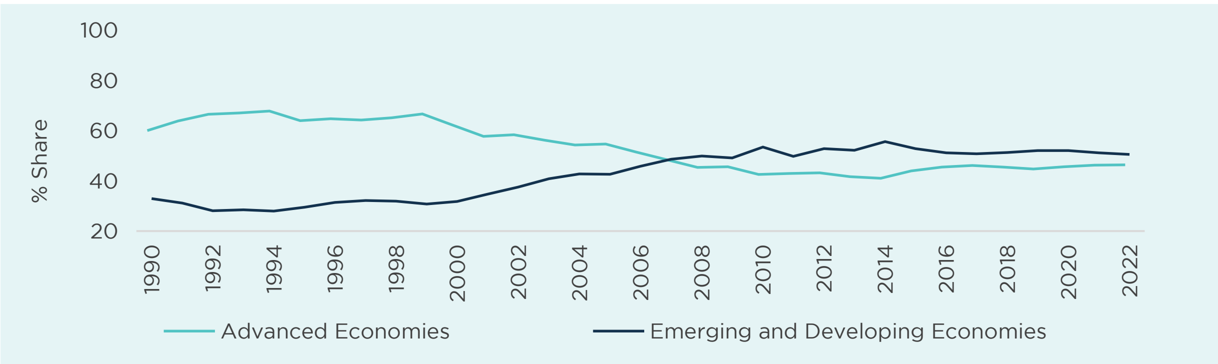
Source: WITS

B. Direction of Merchandise Exports

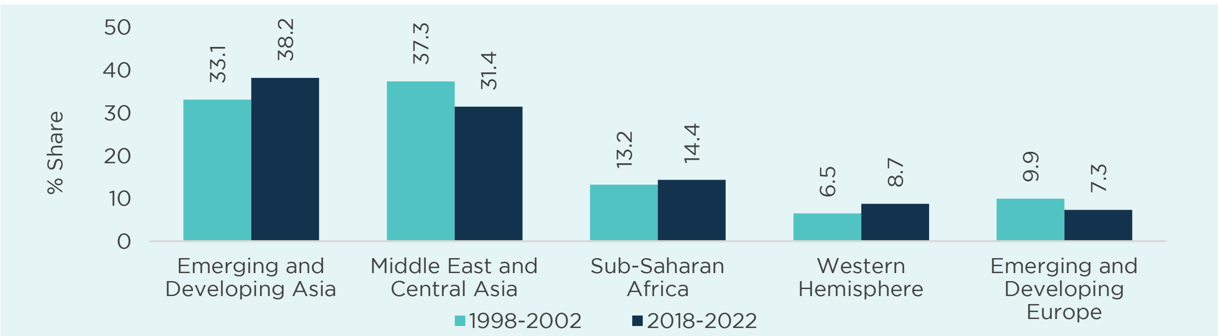
India's exports are well distributed between advanced and developing/emerging economies. An analysis of the direction of India's merchandise trade shows that our exports moved away from the advanced economies in the 1990s towards emerging and developing economies. The share of developed economies reduced to 48.8% in 2022 from 62.4% in 1990 while the share of exports to emerging and developing economies increased to 50.6%. India's slowing exports to the advanced economies can be attributed to the demand slowdown in India's key export destinations following the 2008 global financial crisis. Among the emerging and developing economies, Middle East and Asian economies (China, Bangladesh, Nepal, Malaysia, Indonesia & Vietnam) are India's top export destinations. Whereas, among advanced economies, US and Euro area are the key markets.

Exhibit 7: Direction of India's Merchandise Exports

Panel A: Exports to Advanced & Emerging Economies (Share in Total)



Panel B: Share of Exports Within Emerging & Developing Economies



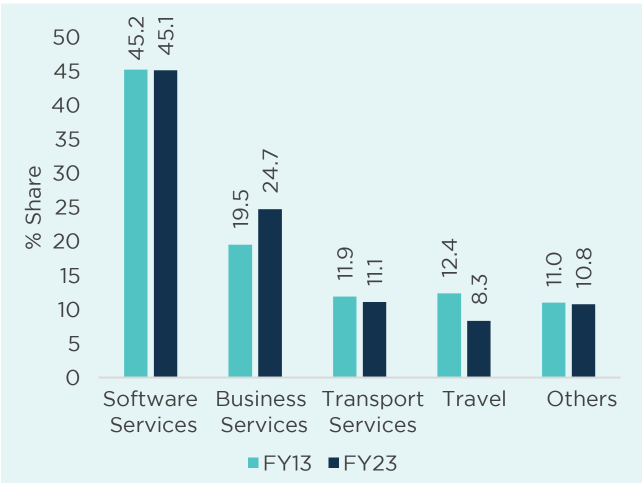
Source: Direction of Trade Statistics, IMF

C. Services

India has emerged as a key player in the world's services trade with its services exports having grown at a CAGR of 8.5% in the last decade. As of 2021, India is among the top 10 exporters of services globally. The country's share in global services export has risen by nearly 0.8 pp in the last decade to 4%. In comparison, some of the developed economies have a high share in global services exports such as US (13%), UK (6.9%) and Germany (6.2%).

With regard to services export basket composition, the dominance of software services in India's services export basket has continued with a share of 45% in FY23. Also, in the last decade, there has been a remarkable shift toward business services with its share rising to 24.7% in FY23 from 19.5% in FY13. To achieve the indicative target of services exports of USD 1 trillion by 2030, services exports basket needs to be further diversified with a focus on other business services in which India has immense potential. The government has identified 12 champion sectors in services for promoting their development and realising their potential. These include Information Technology & Information Technology enabled Services (IT & ITeS), Tourism and Hospitality Services, Medical Value Travel, Transport and Logistics Services, Accounting and Finance Services, Audio Visual Services, Legal Services, Communication Services, Construction and Related Engineering Services.

Exhibit 8: Compositional Change in Services Export Basket



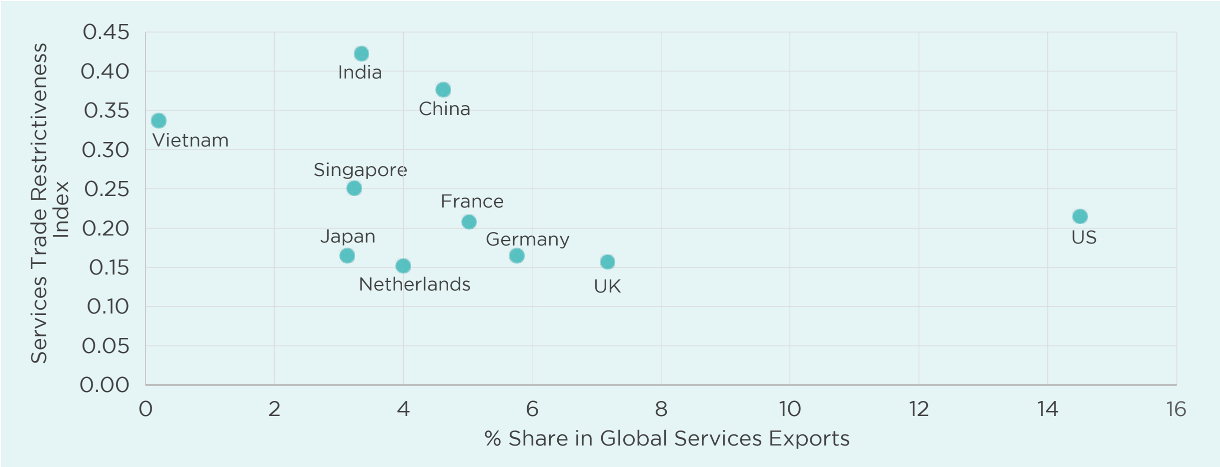
Source: RBI

Along with diversification of the services export basket, there must be focus on diversifying the modes of services exports. Services exports are done through various modes namely Mode 1 (cross-border supply), Mode 2 (consumption abroad), Mode 3 (commercial presence) and Mode 4 (movement of natural persons). Given India's demographic dividend in midst of ageing population globally, it has been a proponent of Mode 4 of services exports in its trade agreements. Liberalising the movement of natural persons through mode 4 would not only boost prospects of India's service exports but would also prove to be a favourable deal for our trading partners lacking the required skill set. However, Mode 4 remains more restricted than other modes of services delivery owing to concerns over its implications for the labour markets. Given this scenario, India needs to increase its focus on growing its services trade through other modes even while paving the roadmap for liberalising services trade through Mode 4.

While the tremendous potential in India's services exports has been highlighted in recent times of slowing merchandise exports amidst global slowdown, it is important to note that domestic services sectors have high restrictions for foreign entry. High barriers in the domestic service sectors act as an impediment, particularly in downstream industries where services are used as inputs. Such restrictions to liberal services trade limit the overall competitiveness and economic performance of the domestic industries. Moreover, economic theory suggests that 'a tax on imports is a tax on exports' implying that high restrictions domestically may be unfavourable for services exports in the long run. OECD estimates Services Trade Restrictiveness Index (STRI), an evidence-based tool that collects information on services trade restrictions across 22 major services sectors. The STRI index takes value between 0 & 1 where 1 denotes completely closed sector for trade. A country's share in global services exports is closely linked with the extent of restrictiveness in the domestic services sector. Economies with high services trade restrictiveness index (STRI) are seen to have a lower share in global services exports.

India's openness in services trade is lower than other major advanced economies across most segments. Reducing the services trade restrictiveness will help to further increase our share in global services exports in the long run, while also boosting the capacities of the downstream industries that rely on services as inputs. However, we need to cautiously evaluate this move so as to not hamper the domestic services industry.

Exhibit 9: Services Trade Restrictiveness Index (2022) & Share in Global Exports (2012-2021)



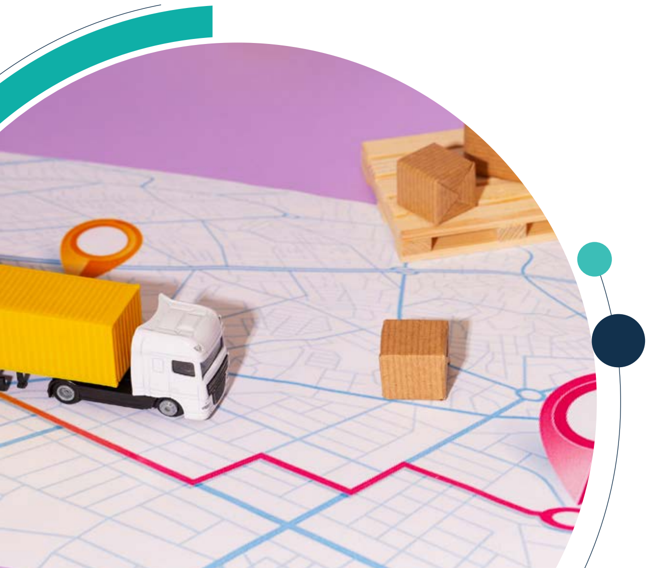
Source: OECD & UNCTAD

III. Roadmap for India's Exports

India has set an ambitious target to achieve USD 2 trillion exports by 2030, with 1 trillion exports each for merchandise and services. In the past decade, India's merchandise and services exports have grown at a CAGR of 4% and 8.5%, respectively. In order to achieve the aforementioned target, India's merchandise and services exports are required to grow at a CAGR of 12% and 18%, respectively. As India aspires to take its exports to greater heights, the essential first step would be to focus on its domestic preparedness and competitiveness. In the World Economic Forum's Global Competitiveness Index[3] (2019), India ranked at the 68th spot, lagging in terms of other economies such as the US (2nd), Japan (6th), Germany (7th), UK (9th), Malaysia (27th), Thailand (40th) and Indonesia (50th). To strengthen the domestic industry and bolster export competitiveness the following aspects require policy attention:

1. Logistics:

A country's logistic infrastructure is a vital prerequisite for fostering international trade. India's logistic costs as a percentage of GDP are estimated to be in the range of 14-18%, much higher in comparison to the global benchmark of 8%. The Economic Survey (2017-18) highlights that a 10% decrease in indirect logistics cost has the potential to boost exports by around 5-8%. India ranked 38th in the World Bank Logistic Performance Index[4] (2023) improving from its earlier rank of 44th in 2018. While India's performance has improved in recent years, it still ranks much lower in comparison to other economies like Germany (3rd), Japan (13th), the United States (17th) and China (19th). India has taken steps to address the underlying issues of the logistics sector by implementing the National Logistics Policy with a vision 'to develop a technologically enabled, integrated, cost-efficient, resilient, sustainable and trusted logistics ecosystem'. Going ahead, the continued prioritisation of logistic infrastructure remains the key to reducing costs and boosting domestic competitiveness.



[3] The Global Competitiveness Index is built on twelve pillars namely institutions, infrastructure, ICT adoption, macroeconomic stability, health, skills, product market, labour market, financial system, market size, business dynamism and innovation capability
.
[4]The World Bank's Logistic Performance Index (LPI) measures dimensions such as the efficiency of customs and border management clearance, quality of trade & transport-related infrastructure, the competence of logistic services, ability to track and trace consignments, competitiveness in the pricing of international shipments, timeliness of shipments reaching consignees.

2. Increase Scale of Production and Improve Ease of Doing Business

Policy measures targeted at improving the scale of production will help us benefit from economies of scale thus reducing the cost of production and making our exports competitive. Domestic policies such as the 'Make in India' initiative and the Production Linked Incentive (PLI) scheme are a testimony of India's commitment to reforms. Improving the Ease of Doing business and an atmosphere of policy certainty are other critical factors that will attract and retain investment in the manufacturing and export sector. India occupied the 63rd spot in the Global Ease of Doing Business Ranking (2020), scaling up from its earlier rank of 77th (2019). India was among the economies recording the most notable progress in the global rankings. Going forward, continued and targeted policy action remains the key to eliminating the domestic structural challenges and leveraging the full potential of investments.

Table 1: India's Ranking on Dimensions of the Logistic Performance Index

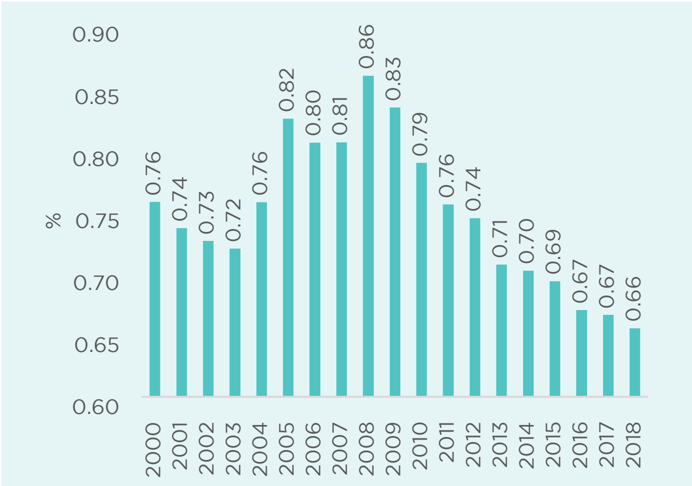
	2018	2023
Overall Rank	44	38
Customs	40	47
Infrastructure	52	47
International Shipments	44	22
Logistics Competence and Quality	42	38
Timeliness	52	35
Tracking and Tracing	38	41

Source: World Bank

3. Focus on Research & Development to Move Up the Value Chain

India needs to not just embed itself in the global value chain but also move up in the value chain. Hence, it becomes critical to increase our focus on R&D. India's gross domestic expenditure on research and development (GERD) as a percentage of GDP was at 0.66% in 2018. This compares poorly to that of US (3.01%), China (2.14%), Japan (3.22%), Germany (3.11%). Other developing economies like Brazil (1.17%) has shown a relatively better performance than India. In India, spending on R&D is steered mainly by the government as against countries like the US, Japan and South Korea where the business sector assumes a greater role. Thus, incentivising private sector participation could hold the key to promoting R&D in the country.

Exhibit 10: India's Gross Domestic Expenditure on R&D as a Percentage of GDP



Source: UNESCO Institute for Statistics

4. Lowering of Tariff Rates and Correction of Duty Anomalies

As India moves towards integrating itself into the global value chain, it needs to cautiously reduce its import barriers. While broadly lowering the import duty barrier will result in increased competition for domestic manufacturers, it will also result in access to cheaper raw materials and reduce the overall cost of production for domestic manufacturers. According to the WTO Tariff Profiles 2023, India's average most favoured nations (MFN) applied tariff rate was 14.7% for non-agricultural products, much higher when compared with that of other developed and developing economies. Also, India needs to correct the inverted duty structure in specific cases, where inputs or raw materials are taxed at higher rates than finished products. This hurts the competitiveness of Indian manufacturers making domestic products more expensive than imported finished products. Thus, correcting duty anomalies is key to attracting investments in the manufacturing sector and improving India's export competitiveness. Sectors that are high export-intensive or have a high export potential must be prioritised when correcting the inverted duty structure anomaly.

Table 2: WTO Tariff Profiles 2023: Non-Agricultural Products

	Simple Average	
%	Bound Tariff Rate	MFN Applied Tariff Rate
India	36.0	14.7
Indonesia	35.5	7.9
South Korea	9.8	6.5
China	9.1	6.4
United Arab Emirates	12.7	4.6
United States	3.2	3.1
United Kingdom	4.1	2.9
Japan	2.5	2.4

Source: WTO; Note: Most Favoured Nations (MFN) tariffs are normal non-discriminatory tariff charged on imports (excludes preferential tariffs under free trade agreements and other schemes or tariffs charged inside quotas), Bound tariff is the maximum MFN tariff level for a given commodity line, Applied tariff is the actual duty at which imports take place.

5. Policy Support to MSMEs:

Micro, Small and Medium Enterprises (MSMEs) play a critical role in steering India's economic development and employment. MSME manufacturing constitute a share of around 37% of India's manufacturing gross value output (FY20) and specified MSME-related products accounted for 45% of our overall exports (FY22). Despite the important role of MSMEs in domestic output and exports, they are faced with difficulty in sourcing raw materials and capital at an effective cost. Domestic policies and incentives require a special focus on the needs of this critical segment to help grow our overall exports. Revision of the MSMEs definition, Emergency Credit Line Guarantee Scheme (ECLGS) is a testimony of the government's emphasis on this crucial sector.

IV. Push for Foreign Trade Agreements

India has taken a proactive stance and returned to the table for entering into new trade agreements after almost a decade. The current global landscape presents a valuable opportunity for India to not just promote exports and embed itself in the global value chain but for establishing strategic economic partnerships. In the evolving global scenario, foreign trade agreements are becoming increasingly crucial for boosting trade relations, investment flows, facilitating technology transfer and skill movement. Presently, India has 13 Free Trade Agreements (FTAs)/Regional Trade Agreements (RTAs) and 6 Preferential Trade Agreements in force. India is also currently negotiating FTAs with trade partners such as the United Kingdom (UK), European Union (EU) and Canada.

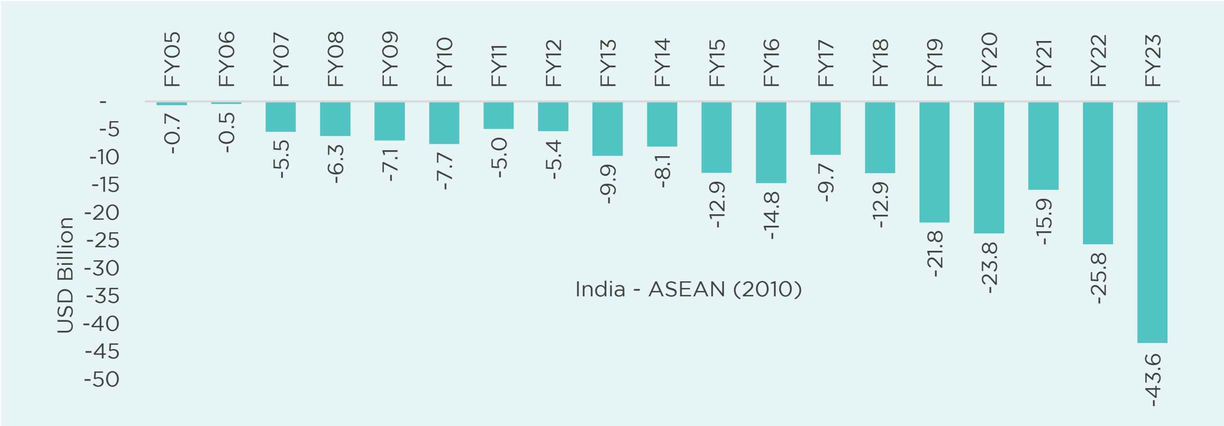
Past experience suggests that India's trade deficit with important FTA partners like Japan, South Korea, and ASEAN widened after entering into the trade agreements. This could be attributed to the fact that Indian exports are income-elastic and less price elastic in nature due to which they benefit less from any tariff reduction/elimination.

Other reasons for such performance with FTAs could be the asymmetry in tariff structure, low competitiveness of the domestic manufacturing sector, delays and administrative costs associated with rules of origin and non-tariff barriers. Moreover, India's utilisation rate for regional trade agreements is seen to be low in the range of 5-25% (Asian Development Bank). Low FTA utilisation rate points to the inability of the industry to reap the benefits arising from the bilateral and multilateral trade agreements.

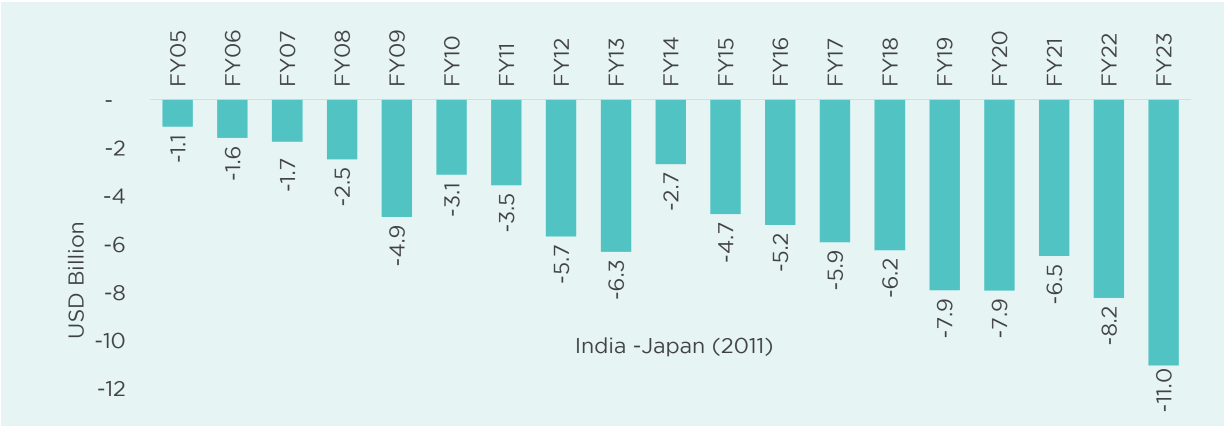
India's worsening trade balance with its FTA partners must not just be viewed from the lens of cheaper imports posing a threat to domestic producers, but it is crucial to recognise the importance of these imports for the downstream industries using them as intermediary inputs. In this context, it is crucial to take into consideration the nature of our economy, its production patterns, level of industrial development, reliance on imported inputs, etc. Going ahead, India's past experience holds lessons for negotiating more comprehensive and fruitful agreements.

Exhibit 11: India's Trade Deficit Widens with Major FTA Partners

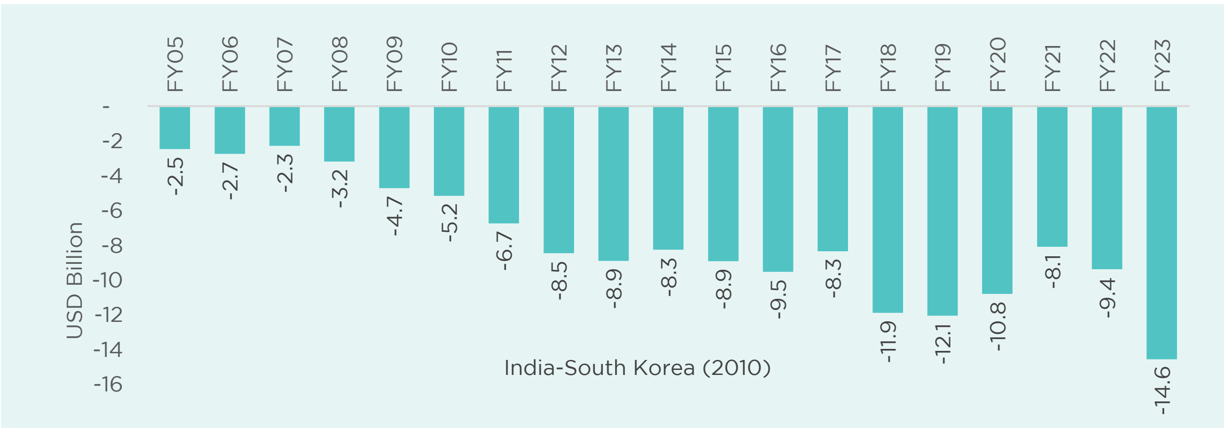
Panel A: ASEAN



Panel B: Japan



Panel C: South Korea



Source: CEIC

Depth of India's Trade Agreements

With the increase in the number of trade agreements worldwide, greater emphasis is being placed on the content of these agreements. The content of trade agreements is becoming critical from the perspective of effective integration in the global value chains. We have attempted to study the depth of trade agreements based on the World Trade Organisation (WTO) methodology which evaluates depth in terms of the 'WTO+LE provisions'[5]. These provisions fall under the current mandate of the WTO and are already subject to some form of commitment in WTO agreements when legally enforceable. The data reveals that India's trade agreements with South Korea, Singapore and Japan have greater depth compared to the others (Refer Exhibit 12). Data also shows that the trade agreements entered into by the US have greater depth when compared to the trade agreements entered by India (Refer Exhibit 13). Going forward, as India enters into new trade agreements, the focus should be on making these agreements as comprehensive as feasible.

Exhibit 12: Depth of Trade Agreements-India

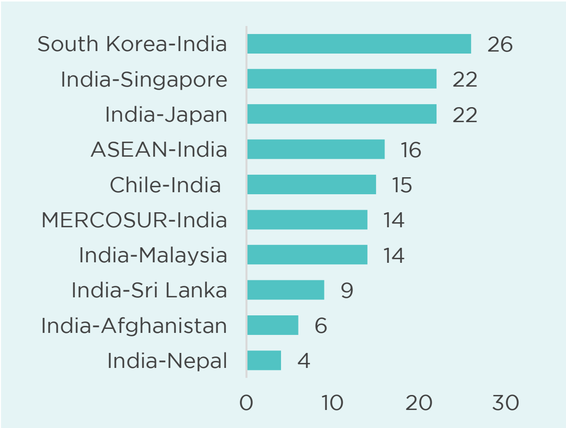
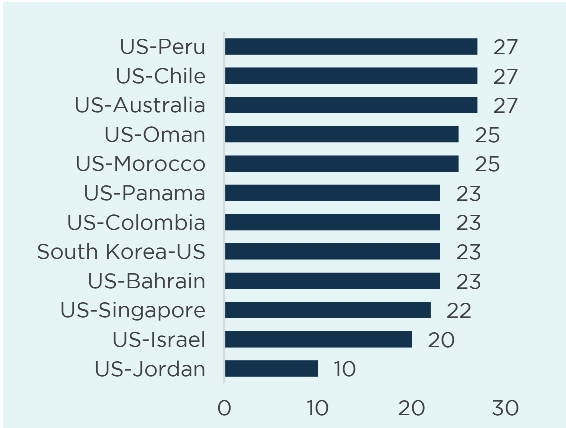


Exhibit 13: Depth of Trade Agreements-US



Source: CareEdge calculations based on World Bank data; Note: Higher score signifies greater depth with highest score being 28.

Ways to Harness the Potential of New Trade Agreements

1. Focus on Revealed Comparative Advantage (RCA) of Goods & Services

The theory of comparative advantage propounded by David Ricardo is critical for the production and export patterns in any economy. The theory states that a country must specialize in exports of those goods that it can produce more efficiently compared to the rest. The revealed comparative advantage (RCA) index is a crucial indicator for quantifying a country's comparative advantage in exports of select goods or services.

The RCA index is defined as the ratio of two shares. The numerator represents the share of a country's total exports of commodity 'x' in its total exports. The denominator is the share of world exports of commodity 'x' in total world exports.

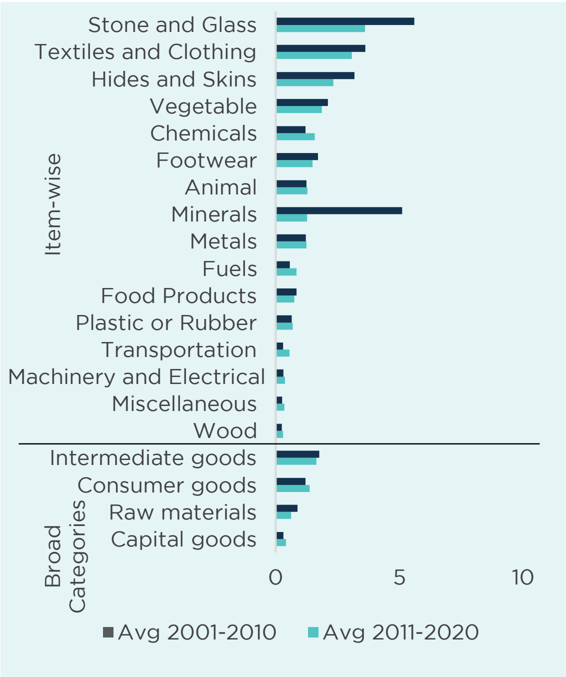
$$RCA = \frac{X_{ij}}{\Sigma X_{ij}} \Big/ \frac{X_{wj}}{\Sigma X_{wj}}$$

Where Xij represents country i's exports of commodity j and w represents world exports. If RCA is greater than 1, it is interpreted that the country has a comparative advantage in exports.

[5] Depth of trade agreements is evaluated on the basis of provisions related to (1) Tariff liberalisation & elimination of non-tariff measures on industrial goods, (2) Tariff liberalisation & elimination of non-tariff measures on agricultural goods (3) Customs, (4) Elimination of Export Taxes, (5) Sanitary and Phytosanitary Measures, (6) Technical Barriers to Trade, (7) State Trading Enterprises, (8) Antidumping, (9) Countervailing Measures, (10) State Aid, (11) Public Procurement, (12) TRIMs, (13) GATS, (14) TRIPs. A provision is assigned a score of 0 if the provision is not mentioned in the agreement or is not legally enforceable, 1 if the provision is mentioned, is legally enforceable but is explicitly excluded by dispute settlement provision and 2 if the provision is mentioned and is legally enforceable. Given the 14 provisions which can be assigned a score from 0 to 2, the highest score that a trade agreement can be assigned is 28.

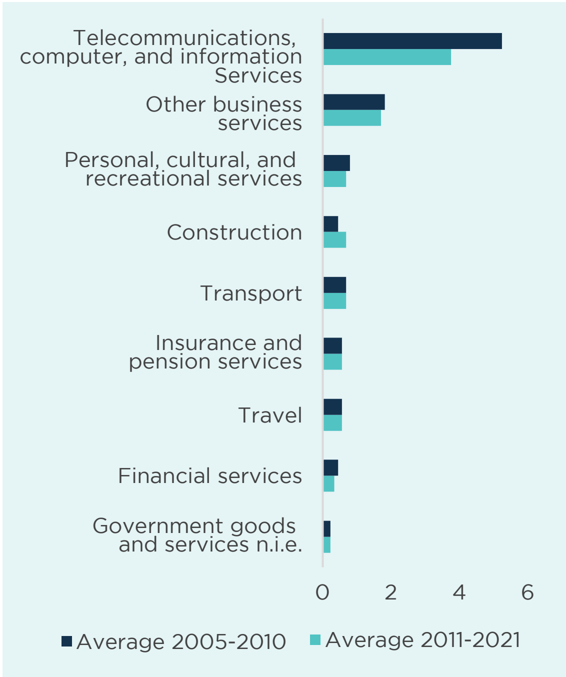
On the merchandise front, India has a revealed comparative advantage (RCA) in intermediate and consumer goods while it has relatively less RCA for capital and raw materials. An item-wise analysis shows that India has a comparative advantage in the export of items such as stone & glass, textiles & clothing, chemicals, minerals and metals. Hence, India must specifically focus on the items in which it has a comparative advantage. On the services front, India enjoys comparative advantage in telecommunication, computer and information services and other business services (that includes R&D, consulting and trade-related services). India has relatively lower RCA in other service categories. India needs to improve its competitiveness in other service categories to enable diversification of service exports.

Exhibit 14: Revealed Comparative Advantage-Merchandise



Source: WITS

Exhibit 15: Revealed Comparative Advantage-Services



Source: CareEdge Calculation based on UNCTAD data

2. Focus on Trade Complementarity with the Partners

The trade complementarity index measures the degree to which the export pattern of one country matches the import pattern of another. A high degree of complementarity reflects favourable prospects for a successful trade arrangement.

Trade Complementarity (TC) between countries k and j is defined as:

$TC = 100 (1 - \text{sum}|m_{ik} - x_{ij}|/2)$

Where x_{ij} is the share of good i in total exports of country j and m_{ik} is the share of good i in total imports of country k. The index is 0 when no goods exported by one country are imported by the other and 100 when the export and import shares of the two countries show an exact match.

An analysis based on the trade complementarity index (TCI) shows that India's export basket has high complementarity with import baskets of Italy, Belgium, Germany, Netherlands, Indonesia, France and UK. However, currently these countries account for a low share of India's total exports reflecting untapped potential markets. (Refer Table 3). Going forward, the aspect of trade complementarity holds great significance from the perspective of expanding exports into overseas markets.

Table 3: India's Export Trade Complementarity

	% Share in India's Total Exports (2022-23)	Trade Complementarity Index (2020)
United States	17.4	64.3
United Arab Emirates	7.0	65.9
Netherlands	4.8	71.6
China	3.4	59.5
Singapore	2.7	53.7
United Kingdom	2.6	69.3
Saudi Arabia	2.4	67.1
Germany	2.3	70.4
Hong Kong	2.2	39.9
Indonesia	2.2	72.4
Belgium	2.0	76.9
Italy	1.9	80.3
France	1.7	70.6
Malaysia	1.6	63.7
South Korea	1.5	64.8
Vietnam	1.3	59.1
Japan	1.2	67.9

Source: CareEdge Calculation Based on WITS Data, CMIE

3. Capitalise on Investments and Technology Transfer

Beyond merchandise and services export potential, we should focus on investment opportunities through these FTAs. Foreign investment carries great significance for a country by building its manufacturing capability, facilitating the transfer of new technologies and knowledge transfer. This helps in the creation of an enabling environment in which innovation is incentivised and domestic competitiveness is enhanced. Thus, the aspect of investment remains critical in the formulation of a comprehensive trade agreement. However, due attention must also be attributed to enhancing the domestic infrastructure and overall ecosystem to absorb and capitalise on foreign investments.

4. Negotiate Removal of Non-Tariff Barriers

Non-tariff barriers in the form of tariff quotas, technical barriers to trade, antidumping and countervailing duties pose a major hindrance to accessing the markets in developed countries. Compliance to non-tariff barriers and the resultant increase in the cost of production adversely impacts domestic exports. On one hand, there is a need to strengthen the domestic production processes to ensure adherence to global standards. While on the other hand, trade negotiations must have a special emphasis on the reduction/elimination of the non-tariff barriers that increase the cost of compliance with trade agreements.

5. Watchfulness Around the New Age FTA's

New generation FTAs are moving beyond the scope of trade-related issues to cover issues related to environment, labour and sustainability etc. Taking binding commitments on these new issues in the proposed FTA's which are being negotiated by India, may hamper the country's exports in the future. International commitments must be taken only after the domestic regulatory framework is in place, otherwise, new non-trade issues might serve as non-trade barriers weighing on exports. Meanwhile, we need targeted policies to enable us to move towards ESG compatible goals.

6. Increase the Utilisation of Trade Agreements

The utilisation rate of RTAs by exporters is low ranging between 5-25% (Asian Development Bank). Low FTA utilisation rate points to the inability of the industry to reap the benefits arising from the bilateral and multilateral trade agreements. Several factors such as the difficult Rules of Origin (RoO) clause, weak industry consultation, high cost of compliance, cumbersome procedures and lower awareness have prevented FTAs from becoming the preferred route of trade. These aspects should be looked into to enable the economy to fully benefit from the FTAs. Exporters need to be educated to take advantage of such agreements. There are also needs to be an effective redressal system to take care of foreign buyers and Indian exporters grievances.

7. Engage in Effective Industry Consultation

The key to successful trade agreements lies in understanding the viewpoints of the key stakeholders by engaging in effective industry consultation. Effective consultations will aid in a better understanding of the interests and concerns of several industry groups. This approach is critical for the identification of weaker industry groups which would require some form of initial support to stand the competition arising from increased bilateral trade. Given our high import tariff, we will be giving much more in terms of duty reduction. Hence, it is important to understand how prepared our industries are for duty free/reduced duty competition. These consultations will help in identifying sectors that need to be ring-fenced.

V. Way Forward

India is on the path to becoming a developed nation by 2047 with emphasis on exports as an important driver of economic growth. Our economy holds tremendous potential to turn the ambitious target of USD 2 trillion exports by 2030 into a reality. Keeping in view the target of a manifold increase in India's goods and services exports, the government recently unveiled the New Foreign Trade Policy (FTP) 2023. The new trade policy adopts a dynamic approach based on 4 pillars: Incentive to remission, export promotion through collaboration, ease of doing business and focus on emerging areas. The prospects of gains from trade are particularly immense for our economy with an enormous sectoral potential along with the large untapped labour endowment. As we move towards the ambitious target, there is an urgent need to improve our domestic preparedness to enable us to increase our share in global trade. The government's policy push for supporting the export sector and commitment toward establishing new economic partnerships through new trade agreements are steps in the right direction. As we negotiate the new FTAs it will be critical to ensure that the agreements are comprehensive and enable strategic partnerships. As India tides through uncertain waters in midst of a challenging global economic scenario, sustained policy support remains critical for boosting India's exports.

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