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Deciphering India's Dependency on Chinese Imports

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Abstract

Reducing dependency on imports from China has emerged as a national policy objective for India in 2020. This paper presents a framework that can support decision making in this direction and some techniques to monitor India's progress in this journey. It employs a dataset comprising of 375 product categories at the six-digit HS Code level for which China accounted for 80% or more of Indian imports 2018-19. Analysis on the dataset has been presented through three prisms of dependency - intensity, scale, and criticality. Intensity depicts the urgency with which dependency must be reduced. Scale helps determine whether import substitution through domestic manufacturing is feasible, or an alternative source of imports is preferred. Criticality is a subjective criterion, but pharmaceuticals, electronics, and automotive sectors are significant in the Indian context. The framework and techniques presented in this paper can be adapted for different datasets by altering the filters applied. This paper also highlights areas that deserve further attention.

In 2018, when the US-China trade war commenced, two-thirds of countries (128 out of 190) traded more with China than the United States[1]. The trade war brought into sharp focus the interdependence between two of the world's largest economies. The Covid-19 pandemic exposed vulnerabilities of other countries, entire supply chains and global consumers to China. In tandem with these developments, India's imperative to reduce dependency on imports from China also peaked in 2020. Twenty years of prolific yet unbalanced growth in bilateral trade, a long-standing border dispute which boiled over into a fateful clash in June, and the recent pivot of the Indian Government towards self-reliance have converged to make this a national policy objective.

India's goal of self-reliance embodied in the Atma Nirbhar mission is primarily aimed at domestic goals such as employment generation and increasing manufacturing sector's share in the economy. However, realization of this goal will have global implications due to India's prospects as a large market and investment destination. If India matures as a manufacturing destination it will not only reduce its dependency on imports from China but also emerge as an alternative source of imports for other countries looking to reduce their own dependencies on China, and in the process, impact the balance of global economic power. Additionally, it will open global markets to India, further increasing its own scale and competitiveness, enhancing Indian participation in global value chains, and thus accelerating economic growth. Progress towards such a crucial policy objective is a multi-stage and complex process that deserves robust monitoring to facilitate timely policy interventions.

If India matures as a manufacturing destination it will not only reduce its dependency on imports from China but also emerge as an alternative source of imports for other countries looking to reduce their own dependencies on China

This paper presents a framework that can be used to track India's journey towards reducing dependency on imports from China. It demonstrates this framework by employing a dataset of 375 categories of products at the six-digit HS code level where China accounted for more than 80 percent of India's imports in 2018-19. Rather than merely highlighting absolute figures to demonstrate dependency, this paper takes a step further to dissect the statistics in a manner that

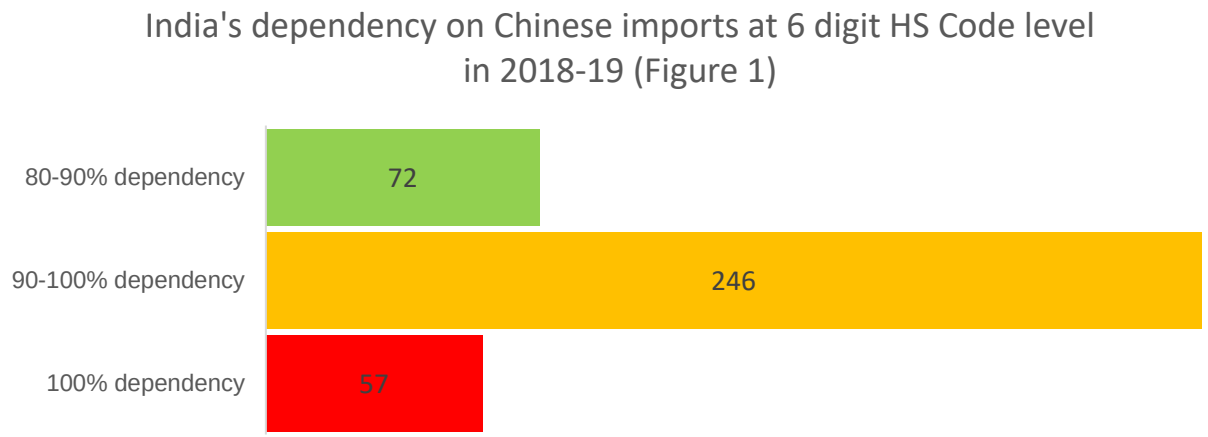
[1] Alyssa Leng and Roland Rajah, Chart of the week: Global trade through a US-China lens, The Interpreter, Lowy Institute (accessed at https://www.lowyinstitute.org/the-interpreter/chart-week-global-trade-through-us-china-lens) on October 3, 2020.

enables prioritization using three prisms – *intensity, scale, and criticality*. It also points towards areas for additional investigations that will enrich the analysis presented here.

Defining the dataset

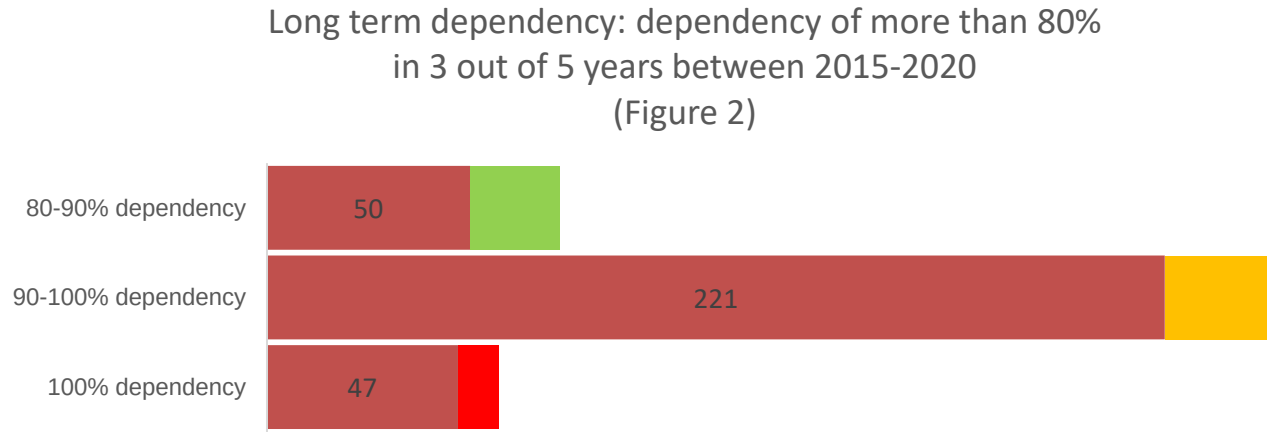
Seasonal demand is an integral part of India's consumer landscape and by extension its thirst for imports from China. Such variations necessitate consideration of trade statistics on an annual (calendar or financial year) basis rather than quarterly or monthly periods to derive meaningful trends. The database maintained by India's Ministry of Commerce publishes trade data monthly using the Indian financial year format[2]. Statistics for 2019-20 are available but the last quarter witnessed Covid-19 disruptions which might have distorted statistics. Hence, 2018-19 makes for an ideal baseline.

In 2018-19, there were approximately 375[3] HS code categories at the six-digit level in which China accounted for 80 percent or more of Indian imports. One advantage of working at the six-digit level is that it captures both intermediates and end products in many industries which would otherwise be more difficult to identify at the eight-digit level. It is certainly possible that a share of imports smaller than 80 percent can be termed as dependency, but it is difficult to argue that 80 percent or more is not dependency. For convenience, this list is further divided into three buckets: 57 product categories where China accounted for 100%, 246 product categories where China accounted for 90-100% and 72 product categories where China accounted for 80-90% of Indian imports (See **Figure 1**).



[2] The public database is available here - https://commerce-app.gov.in/meidb/default.asp
[3] This number could vary slightly depending on the currency, rounding off errors, source of data, etc.

To eliminate product categories with one-off spikes in 2018-19 and confirm long-term dependency, only those categories in which China accounted for more than 80 percent of imports in at least three out of the five years between 2015-16 and 2019-2020 were selected. This filter confirmed long-term dependency to a substantial extent in each of the baskets –47 out of 57 product categories (or 82%) in 100% dependency basket, 221 out of 246 (or 90%) in 90-100% dependency basket and 50 out of 72 (or 69%) in 80-90% dependency basket, thus trimming the list down to 318 categories (refer to **Figure 2**).



Intensity

One simple technique of inferring trade dependency between two countries is to identify products for which the exporting country acts as a dominant source for the importing country. The initial dataset of 375 product categories provides a snapshot of dependency in 2018-19 and the shortened list of 318 product categories represents long term dependency within a reporting period (between 2015-16 and 2019-2020). When China chose to highlight India's dependency or vulnerability, it stated that India imported 92% of computers, 85% of motorcycle components, 82% of televisions and 80% of optical fibres from China in 2018-19[4]. Such snippets of data, while useful to signal dependency, are not sufficient to design policies that are aimed at reducing dependency from the importing country's perspective.

Utility of such data can be vastly improved by combining it with directional trends and drilling down to HS code levels that establish overall value chain dependency of the final product.

[4] Ambassador Sun Weidong cited these statistics in a special lecture titled "India-China relations: The Way Forward" organized by the Institute of Chinese Studies, New Delhi on July 31, 2020. Fact checking revealed some discrepancies possibly due to variance between Indian and Chinese sources, financial year formats, currency exchange rates, etc.

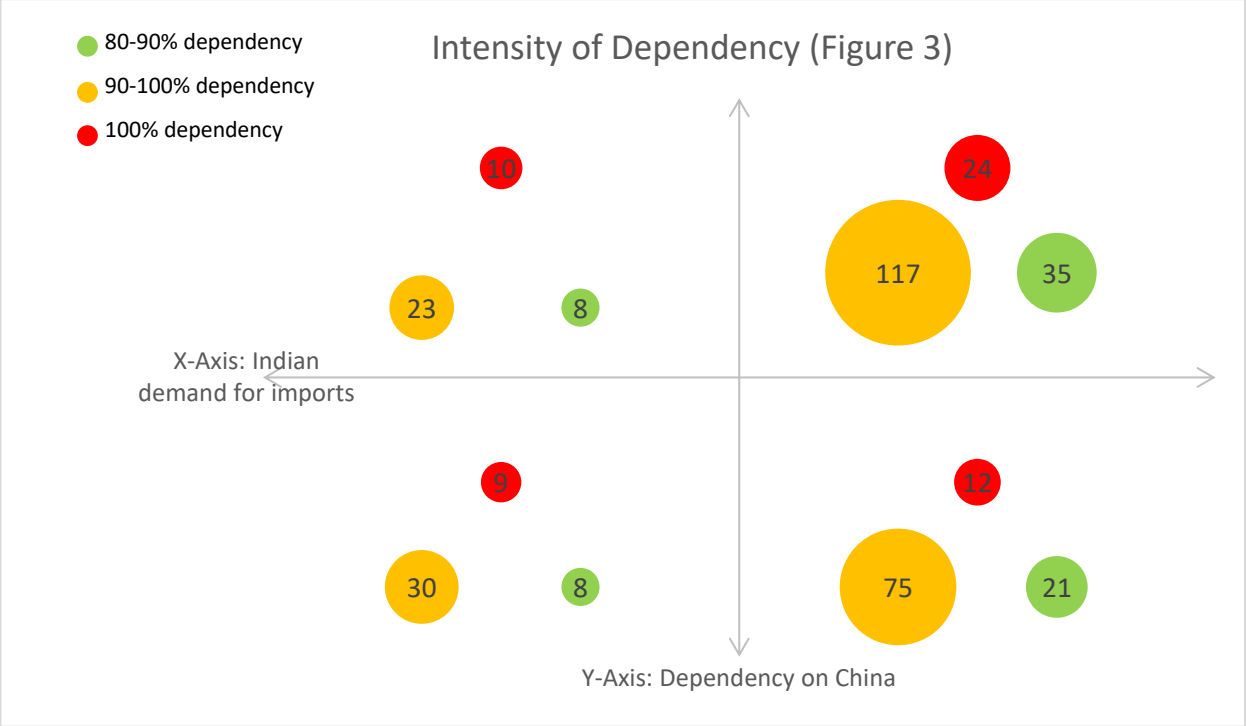
Is India's demand for a product increasing or decreasing? Is dependency on China increasing or decreasing? How are these two trends performing relative to each other? Such information is crucial for prioritization in policy making. It is also counter-intuitive to some extent. For instance, as volume of demand for a category of imports (say televisions) increases, the feasibility of making an investment case to manufacture such products locally in India also improves due to increasing economies of scale. On the other hand, for an essential product where volume of demand is low but stable (such as industrial chemicals) it might be impossible to convince any industry player, whether foreign or domestic, to establish a manufacturing unit in India due to absence of scale. Thus, defining dependency with reference to absolute import volumes alone is inadequate as a methodology. In other words, the "intensity" or urgency of reducing dependency might be greater for a product which is consumed in lower volumes depending on the trend information over a longer reporting period.

One technique to solve for intensity of dependency is to plot two trend lines: one representing volume of India's demand (X-axis) and the other representing China's share in Indian imports (Y-axis), both on year-to-year basis, over a reasonable period of five years to eliminate distortions and produce a relatively stable trend. The results of such comparison can be organised into four quadrants: **Class A** where volume of Indian imports is increasing and percentage value of China as a source is also increasing; **Class B** where volume of Indian imports is increasing but percentage value of China as a source is decreasing; **Class C** where volume of Indian imports is decreasing and percentage value of China as a source is also decreasing; and **Class D** where volume of Indian imports is decreasing but percentage value of China as a source is increasing.

Class D Indian imports are decreasing but dependency on China is increasing	**Class A** Indian imports are increasing and dependency on China is also increasing
Class C Indian imports are decreasing but dependency on China is also decreasing	**Class B** Indian imports are increasing but dependency on China is decreasing

Creation of such intensity quadrants in each of the dependency baskets revealed the following distribution[5] (see chart below and **Figure 3**):

Dependency Baskets	*No. of product categories*	*Distribution of product categories*			
		Class A	*Class B*	*Class C*	*Class D*
100%	57	24	12	9	10
90<100%	246	117	75	30	23
80<90%	72	35	21	8	8



Depending on one's choice of assumptions, certain general conclusions can be drawn from the above:

a) Reducing dependency in Classes A and B where Indian imports are increasing is more urgent than Classes C and D where Indian imports are decreasing;

[5] Data for atleast one year was missing for two product categories in 100% basket and one in 90-100% basket so the sum of the product categories across classes A, B, C, D in these baskets do not add up to their actual totals.

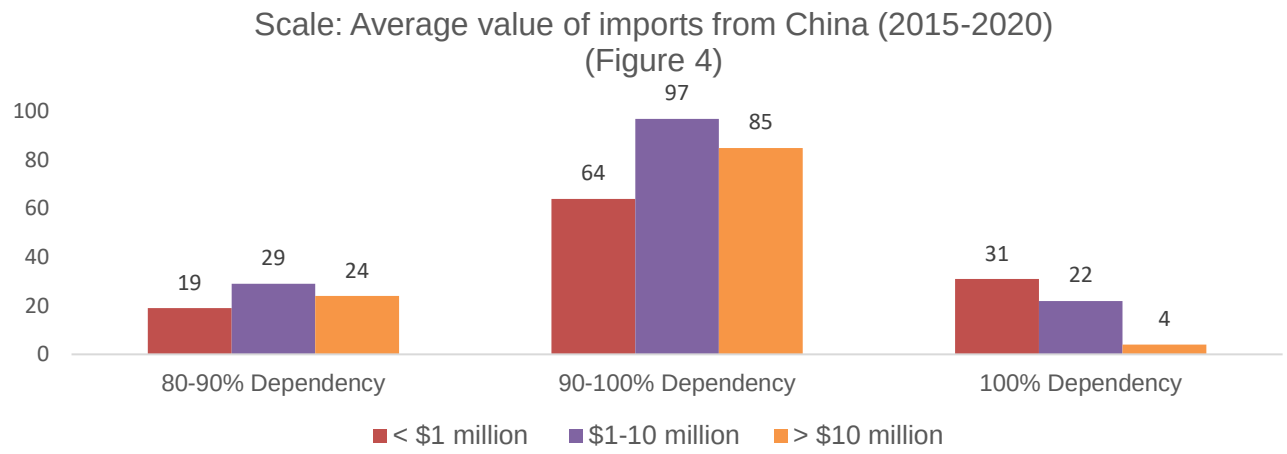
b) Domestic manufacturing will be more feasible in Class A where increasing demand will ensure economies of scale and increasing dependence on China also indicates lack of alternative sources;
c) Alternative sources will be easier to find in Classes B and C where dependence on China is already decreasing; and
d) Reducing dependency in Class D will be toughest since India's demand is decreasing making it difficult to make a case for local manufacturing and dependency on China is increasing due to lack of alternative sources.

Scale

Scale is an important determinant for feasibility of manufacturing activity. The Indian Government has recently amended criteria used to classify enterprises as medium, small and micro as part of the Atma-Nirbhar Bharat Abhiyaan Economic Package[6]. Based on these revised criteria, enterprises with an annual turnover of less than INR 100 Crores will qualify as medium enterprises making them eligible for incentives. In other words, an assumption can be made that a domestic manufacturing firm seeking to substitute itself as a source to meet demand in a product category where annual Chinese imports are currently valued at approximately $ 10 million (INR 74 Crores) will be viable. Ofcourse nothing prevents larger enterprises from manufacturing products that have higher demand. Hence, product categories can be characterised as 'high' volume if their average annual import value over the 2015-2020 period exceeds $10 million. The application of this rule leads to a conclusion that 113 product categories (4 in 100% dependency basket, 85 in 90-100% dependency basket and 24 in 80-90% dependency basket) correspond to the scale required for medium enterprises in India or higher so dependency can be reduced through domestic manufacturing (See **Figure 4**). Whereas those product categories with average volumes lower than $10 million can only be explored by small and micro enterprises or perhaps be imported from alternative sources.

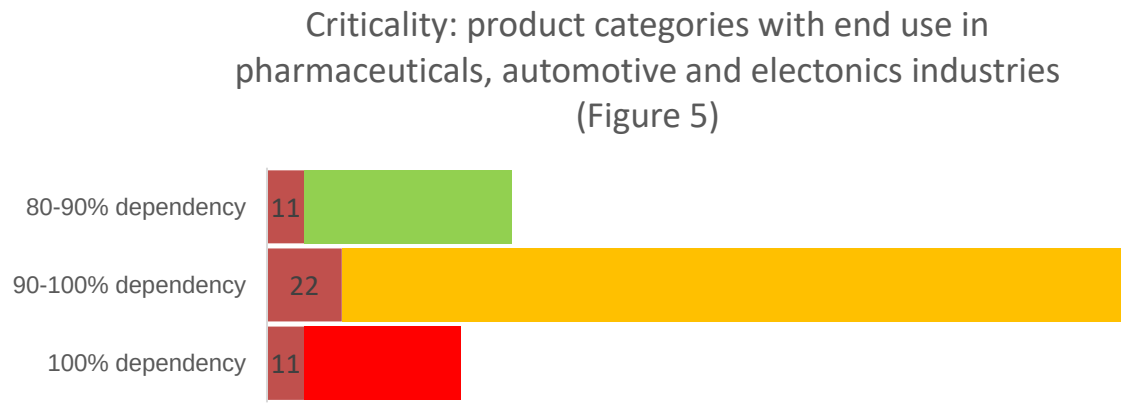
> It is necessary to re-classify product categories based on their end uses rather than their description in the HS Code classification tables.

[6] https://pib.gov.in/PressReleseDetailm.aspx?PRID=1623601



Criticality

Unlike intensity and scale which are founded on absolute data, criticality is a subjective criterion. It can have different meanings depending on the context. At the national level it might involve security or military considerations, or it can mean criticality of certain inputs for specific industries. For the present purpose it simply means potential to cause significant disruption to Indian industry and consumers. Hence, it is necessary to re-classify product categories based on their end uses rather than their description in the HS Code classification tables. Such an exercise can lead to an extent of overlap between industries insofar as dual-use products are considered. Subject to this limitation, three industries emerge as critical from the dataset under consideration - pharmaceuticals, electronics and automotive. They account for 11 out of 57 (or 19%) of product categories in the 100% dependency basket, 22 out of 256 (or 9%) in the 90-100% dependency basket and 11 out of 72 (or 15%) in the 80-90% dependency basket (see **Figure 5**).



Monitoring progress

The techniques described above can be used to monitor India's progress in reducing dependency on imports from China in the following manner:

a) Prima facie dependency – this will reveal number of product categories in which China accounts for more than 80% of India's imports. Any dip from the level of 375 in 2018-19 will be an improvement. Due to seasonal demand in certain categories an annual check will be better suited for this technique than on quarterly basis.
b) Long-term dependency – data from a rolling period of five years (or 20 quarters) can be used for this technique which filters only categories where China accounts for more than 80% of imports in three out of five preceding years. Again, any dip from the current level of 318 will be an improvement.
c) Dependency buckets – this technique can be applied to either of the two datasets described immediately above. As the number of categories in 100% dependency bucket decreases it is likely that the numbers in 90-100% and 80-90% buckets will increase. However, any sign of a product category moving in the opposite direction will indicate that dependency on China is increasing.
d) Intensity of dependency – If incentives for import substitution are effective then categories from Class A will move into Class C.
e) Alternative sources - If viable alternative sources to China are found categories will move from Class A into Class B.
f) Vulnerability check - Class D should be monitored closely since China might exert economic pressure on India through economic blockades in such categories where domestic manufacturing is not feasible and alternative sources are difficult to find.
g) Scale – The effectiveness of Atmanirbhar policies at least insofar as imports from China are concerned will be determined by the number of SMEs or larger companies, domestic or foreign, which start or expand their manufacturing capacity in product categories where average value of imports exceed US$ 10 million. There are 113 product categories which might be suitable for such opportunities.
h) Criticality – Since this is a subjective criteria progress can only be monitored against industry-specific policies. It is likely that pharmaceuticals, electronics and automotive sectors will receive special policy attention so offtake numbers under respective incentive schemes should translate to corresponding reduction in dependencies.

Areas for further work

The framework, analysis and techniques presented above are based exclusively on trade data. As demonstrated above, they can collectively serve as a call for action or be used independently to monitor progress. Development of a multi-pronged strategy to reduce dependency on imports from China will require further layers of analysis. Some of these are highlighted below:

1. Standards – Quality standards are an indispensable tool to ensure optimum utilisation of domestic manufacturing capabilities and reduce dependency on imports from China. The Bureau of Indian Standards (BIS) has issued more than 25,000 quality standards for products and services but only 150 of them are mandatory[7]. Standards for 370 products are being devised to ensure items that can be locally produced are not imported[8]. The toy industry which imported US$ 1.4 billion worth of products in 2018-19 (China is the largest source) and comprises of 4000 domestic micro, small and medium enterprises is likely to become the first test case under this head. India decided to implement quality standards (with effect from September 1, 2020) after a shocking 67% of imported items failed quality tests in 2019. The HS Code classification does not reveal distinctions between products within the same category that cater to distinct markets or consumer groups. Automotive components are a powerful illustration. India is home to leading global players in the two-wheeler industry with impressive manufacturing capabilities. Yet China accounted for 83.08% of India's imports of Motorcycle parts and accessories (HS Code 871410) in 2018-19. This is mainly on account of a strong preference among distributors in the "after-market" segment for imported products which are cheaper because of lower quality. If uniform standards are enforced for both OEMs and after-market players, the demand for imports will automatically reduce. A comprehensive study of standards undertaken in conjunction with industry will reveal many more possibilities of a similar nature.
2. Global value chains – India's aim to attract global value chains will necessitate identification of industry linkages that can be used to reduce dependence on Chinese imports through backward integration. Multinational groups in which Indian subsidiaries import intermediate products from their sister companies in in China can be incentivised to make additional

[7] Rituraj Tiwari, Govt asks BIS to prescribe standards for imported goods to curb non-essential Chinese imports, https://economictimes.indiatimes.com/news/economy/policy/govt-asks-bis-to-prescribe-mandatory-standards-for-imported-goods/articleshow/77135890.cms?from=mdr

[8] Shruti Srivastava, India plans to impose strict rules and tariffs on Chinese imports, https://economictimes.indiatimes.com/news/economy/foreign-trade/india-plans-to-impose-strict-rules-and-tariffs-on-chinese-imports/articleshow/76618641.cms

investments in India to increase backward integration and reduce reliance on imports. Electronics, electrical appliances, and capital equipment are some sectors where such a strategy will bear fruit. This has a higher chance of success than incentivising importers of products from Chinese companies that might be recipients of subsidies from the Chinese government. Bulk drugs are an example in this category.

3. Tariff policy – India has already imposed anti-dumping duties on imports of 97 products, countervailing measures on 3 products and safeguard duty for 1 product from China[9]. products from China. Such protection might inhibit expansion of domestic manufacturing capacity and cause long term dependency. The chemical industry is a prime example This problem is further accentuated in sectors where absence of large players makes it difficult for Indian industry to initiate anti-dumping investigations. A plan of action that encourages Indian government agencies to commence suo motu investigations coupled with robust plans to improve competitiveness of Indian players for products deemed critical is a must.
4. China's advantage – Sectors in which China has a global monopoly or an inherent advantage need special attention. Electric vehicles are an appropriate illustration although at a nascent stage of development in India. Such industries need tailor-made incentives to ensure India does not develop new sources of dependency.
5. Nuanced FDI policy – India has relied excessively on liberalisation of sectoral limits for foreign ownership as a tool to attract FDI. More recently several States have abolished application of labour laws in a bid to attract FDI. Scale of investment and generation of employment are the most common indicators used while disbursing incentives to foreign investors. Multiple States often compete for the same FDI projects resulting in sub-optimal results at the national level. This points to a need for a more nuanced approach towards FDI. China has experimented with a variety of FDI strategies across regions and industries to ensure domestic industry thrives alongside foreign investors. Such models deserve in-depth examination to distil lessons for India if attempts to wean away potential investors away from China are to succeed.
6. Ease of manufacturing – India's recent success in improving its World Bank rankings for ease of business must be furthered through a more granular focus on easing bottlenecks in the manufacturing sector. Rejuvenation of Special Economic Zones and creation of public manufacturing infrastructure must be initiated on the back of a comprehensive satisfaction survey among current players which are unable to scale.

[9] As on July 10, 2019, as per response provided by Ministry of Commerce in response to a parliamentary question. Accessed here (https://dipp.gov.in/sites/default/files/lu_2743.pdf) on October 12, 2020.

7. Trade diversion – it is highly likely that imports from China will be re-routed through intermediate jurisdictions such as Vietnam, Hong Kong, etc. A more focussed study in this area will reveal the scope for such trade diversion and possible counter measures.

Conclusion

The fact that China accounts for more than 80% of Indian imports in 375 product categories is cause for concern albeit not entirely unexpected. The silver lining to this finding is that 113 of these might have sufficient demand to make them attractive for SMEs or larger enterprises which seek to meet demand through domestic manufacturing. Alignment of Atma-Nirbhar policies towards these goals should be possible in a gradual manner. By combining the intensity and scale techniques described above it is possible to formulate some general recommendations as below:

Class	***Volume***	***Possible Action***
A	High	Domestic manufacture needs to be prioritised
	Low	Explore alternative sources before domestic manufacturing
B	High	Actively reduce imports from China
	Low	No urgent action required
C	High	Actively reduce imports from China
	Low	No urgent action required
D	High	Actively reduce imports from China
	Low	Actively reduce imports from China

These general recommendations can be further refined after undertaking investigations indicated above. Regardless of the factors that drive prioritisation within Indian policy making or pace at which India reduces its dependency on imports from China it is imperative that a permanent monitoring mechanism is established to measure periodic progress towards the national objective of reducing dependency on imports from China. Without a concrete framework to measure progress, this nation building exercise might risk being hijacked by mercantile interests that have abetted and benefited from India's growing dependency on China over the last two decades.

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The views expressed here are those of the author and not necessarily of the Institute of Chinese Studies.

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