India can emerge as the new export powerhouse if it enhances its foreign trade ecosystem

Let's Be a Jolly Good Export


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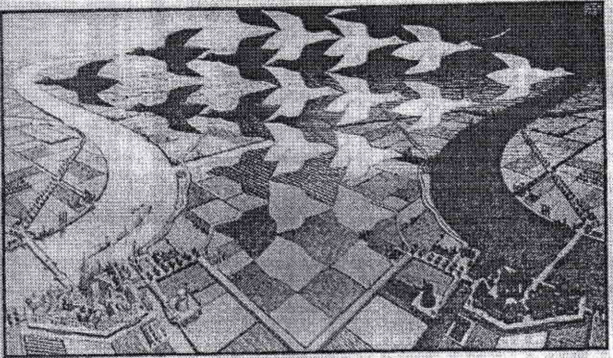

Making outflows fly

India is rising in the ranks of global trade. Between 2010 and 2020, its global export share stagnated below 1.8%. But since 2021, its goods exports have held up much better than other economies in Asia. Its global export share has reached 2.6%, much higher than Vietnam's 1.5%, and only slightly below South Korea's 2.7%. Although it is still trailing far behind China, India is beginning to punch its weight in global exports.

So, what's happening? There are five structural shifts:

▶ Geopolitics: Since the US-China trade war, MNCs have intensified their search for manufacturing alternatives to China. China's share in US imports has slid by 2.5 percentage points to 15.5% since end-2019. Its Asian peers, including India, have benefited from this shift. India's share of US imports has risen from 2.3% to 2.7% over the same period. In absolute terms, India's share is still small. But there is considerable room to grow, given the large scale of production that India offers.

Some other economies, like Vietnam, have already won a larger share of the shifting supply chains. This is partly due to long-standing preferential access that Vietnam enjoys in the US market — it signed a free trade deal way back in 2000 — which India does not.

▶ Offshoring of services: India already has an established business model for (offshored) IT service exports. The surge in labour costs in developed markets and a global push to digitisation during the pandemic meant a host of other services — financial, business, research, consulting, etc — are increasingly being offshored to India.

In FY2021 and FY2022, combined fixed FDI into financial and business services rose to $45.6 billion, much higher than the $25.6 billion into manufacturing. This surge in investment has led to a rapid expansion of global capability centres (GCCs), a market expected to reach $85 billion from an estimated $40 billion currently. This also marks a welcome diversification in India's service export basket. Business services, for example, have had a stronger run than IT services in recent quarters, keeping aggregate services exports resilient.

▶ Make in India: GoI has focused on infrastructure build-up via record budgetary allocations to capex, alongside production-linked incentive (PLI) schemes to boost manufacturing and exports. Some of it is already yielding results. India's mobile phone exports, for example, have spiked in the last two years.

▶ Exchange rate management: RBI has probably actively pursued a depreciated nominal effective exchange rate (NEER) to support manufacturing and exports. This is evident from the continuous decline in NEER in recent years, simultaneous to the rise in forex reserves. In fact, RBI has not allowed the rupee to appreciate, although external headwinds that led to the currency's decline in 2022 have receded.

This shift in RBI's forex policy is not surprising. Policymakers have considered stable, undervalued exchange rates as necessary (if not sufficient) tools in the policy arsenal to support manufacturing and exports in the early phases of growth and industrial development.

▶ Trade deals: Unlike the four other structural forces already playing out, a greater focus on trade deals, which will lead to greater gains in the medium term, may not be showing up in the data yet. But it will be a vital cog in the wheel.

For about a decade since 2011, India did not negotiate a single trade deal with any major economy. It is also the same period when its share of global exports stagnated. Preferential market access is undoubtedly vital to export ambitions. New Delhi has made a good start with the India-UAE Comprehensive Economic Partnership Agreement (CEPA) and the India-Australia Economic Cooperation and Trade Agreement (ECTA) coming into force last year. It still needs to put a lot of diplomatic effort in this direction.

For perspective, Vietnam's numerous trade deals bestow it preferential access to more than 80% of global GDP. For India, this metric is only about 20-25%. India has much lower labour costs than other major Asian economies and, more importantly, offers scale with its large labour force. In the past, these were insufficient to attract MNCs into export-oriented investments. But the structural forces discussed above have cast India in a new light.

The structural boosts to exports are still at a nascent stage and have a considerable way to go. Take the supply chain diversification out of China. For every 1% gain in US import share, India can add an estimated $30-40 billion to its annual exports. Thanks to 'Make in India', global electronics giant Apple is looking to increase India's production share to 40-45% by 2027, up from less than 5% currently. For perspective, Apple's iPhone sales in 2022 reaped $206 billion in revenues.

For India to emerge as the new export powerhouse, it needs to enhance the whole foreign trade ecosystem. Isolated boosts won't cut it. It needs increased preferential access via free trade deals with more countries, stable and competitive exchange rates, improving infrastructure and policy support for manufacturing, and continued supply of inputs like labour with required skills will all be indispensable. From here on, much depends on whether policymakers can maintain the momentum.

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