Chapter 3
India and China in the Emerging Asian Economic Architecture

Amita Batra

One of the most significant outcomes of the 2008–2009 global financial crisis has been the rapid integration of the developing world with the world economy. This has been most evident for Asia, which, in the last decade, has been at the core of the eastward shift of the centre of gravity of the global economy, a phenomenon led by the rapidly increasing economic dynamism of India and China. As these two nations have integrated with the world economy, their contribution and relevance to global trade and output has also increased. Conversely, greater integration has also made them more vulnerable to the adverse impact of changes in the global economic order. This is even more so with the uncertainties surrounding the recovery of the major advanced economies and the resolution of the Eurozone crisis being at their peak. The weak external demand from advanced economies, while being sought to be fulfilled by demand from emerging markets—also simultaneously makes it imperative that South–South economic bonds be strengthened in order to sustain growth in the developing world. For Asia, this requires active participation and support of the major regional players that includes China, India and the Association of Southeast Asian Nations (ASEAN).

China is a critical player in regional dynamics. Over the last decade, it has emerged as the hub of the production networks in Southeast Asia. The China–ASEAN Free Trade Agreement (CAFTA), implemented in 2005, has lent a formal dimension to a growing trade relationship between these regional economies. China's strategy for its future participation in the global economy, particularly with reference to the unwinding of global imbalances after the financial crisis, while being critical to determining its own course of growth, has equal importance for the Southeast Asian and East Asian economies given the regional production interlinkages. India is a member of many regional organisations and is also emerging

A. Batra (✉)
Centre for South Asian Studies, School of International Studies,
Jawaharlal Nehru University (JNU), New Delhi, Delhi, India
e-mail: batraamita@gmail.com

G.V.C. Naidu et al. (eds.), *India and China in the Emerging Dynamics of East Asia*,
DOI 10.1007/978-81-322-2138-8_3

as an alternative market for the ASEAN economies. India's involvement with the region, which was initiated in 1991 with a formal Look East policy, has acquired a more strategic economic dimension with the signing of the India–ASEAN FTA in 2009. There is also the flourishing bilateral trade between India and China, wherein rapidly increasing volumes have set the stage for bilateral strategic economic dialogue.

This paper aims to identify the relative placement of India and China in the evolving Asian economic scenario. The next section undertakes an analysis of the trends of global economic integration of India and China. Their differential growth strategies, comparative advantages and export structures are discussed as determinants of the pattern of their respective regional economic integration. Presenting the trends of deepening integration of the two economies at the regional level both through the market and formal mechanisms of economic cooperation, the paper proceeds to examine the motivation for and design of the India–ASEAN and China–ASEAN FTAs. The final section of the paper explores the possible role that India and China could play in economic integration in Asia given their increasing bilateral economic interaction and the post-global-financial-crisis scenario.

3.1 Patterns of Global Integration

Since the 1990s, India and China have become the two fastest growing economies in the world. This is an outcome of systemic economic reforms that have spelt a break from their inward-looking closed economy growth models towards a more liberalised economic system wherein extensive state controls were replaced with private participation and market orientation. In the process, the external sector has acquired an importance of its own, with trade having emerged as an important economic activity for both economies.

3.1.1 Growth Trends and Recovery from the Global Financial Crisis

Since 2003, while China has relentlessly moved forward with a double-digit rate of growth, India too has seen an almost uninterrupted 8 % plus rate. For both, recovery from the global financial crisis of 2008–2009 has been easier and quicker than the rest of the world. In 2010, China, with a growth rate of 10.3 %, returned to its precrisis double-digit figure. India also recorded its precrisis growth rate of over 8 % in the same year. Relative to the rest of the region and global trends, the two economies stand out in their performance and are, therefore, being seen as the saviours of the global economy in the course of recovering from the worldwide financial crisis (see Table 3.1). However, global expectations are far greater with regard to the Chinese economy than the Indian one as the former has, on a sustained basis,

Table 3.1 Growth rate of gross domestic product (% per year)

	2008	2009	2010
India	6.7	8.0	8.6
China	9.6	9.2	10.3
US	–	–2.6	2.9
Euro-zone	–	–4.1	1.7
Japan	–	–6.3	3.9

Source: *Asian Development Outlook* (Manila: Asian Development Bank, 2011)

Table 3.2 Share of world gross domestic product (%)

	1990–1991	2000–2001	2009
South	27.8	33.6	41.3
Developing Asia	13.1	18.3	25.7
China	3.7	7.3	12.6
India	3.0	3.8	5.2

Source: *Asian Development Outlook* (Manila: Asian Development Bank, 2011)

contributed a larger proportion of the global output. In 2009, this figure was almost 13 %, having increased from about 4 % in 1990–1991. The Chinese contribution comprises about a third of the developing South’s and almost half of developing Asia’s contribution to the world output. Over the years 2004–2007, a period when record expansion was registered in world growth; China shared the global growth leadership with the United States, while in the current slowdown it is perceived as the undisputed chief driver of world growth (Bergsten et al. 2008). In contrast, India’s contribution to the global output is modest, having increased from 3 % in 1990–1991 to a little over 5 % in 2009 (see Table 3.2).

3.1.2 Global Trade Integration

The story of outward orientation as reflected in the global trade integration of the two economies is also spectacular. China initiated its reform process in 1978 with policies to attract foreign direct investments (FDI) so as to promote exports. Trade promotion and easing out of the strict and complex import control regime gained ground in 1992 when China was in a preparatory mode for its accession to the World Trade Organization (WTO) in 2001. India undertook systemic economic reforms and liberalisation of its trade policies in 1991. Prior attempts in 1979 and 1984–1985 were tentative and marginal, with incremental and/or unsustainable growth outcomes. Trade policy reforms in India in 1991 include removal of quantitative restrictions, rationalisation of the tariff structure and introduction of a market-determined exchange rate.

Trade constitutes an important component of economic activity for both countries, with its share in GDP for China far outpacing India. When economic reforms were initiated in 1978, China's openness index was at a low of 6.6 % and close to that of India at 6.4 %.[1] In 1991, when India began its trade liberalisation programme, China had already started to reap the gains of its reforms and its openness index had risen to almost three times the 1978 value. India's openness index rose in the late 1990s, after the economic reforms started to make an impact. It increased to 22.9 % in 2010, also a threefold increase from the pre-reform period, but well below that of China's figure of almost 32 % in the same year. As a share of world exports however, India's performance is not at par with the Chinese economy. Total exports of goods and services, from both India and China, constituted less than 1 % of world exports in 1978. This share, for the Chinese economy, increased to 1.7 % by 1991 and then to 11 % by 2010. However, India's share of world exports while having remained almost constant till 1991 increased to only 2.0 % in 2010 that is almost two decades after initiation of its economic reforms programme in 1991. The differential rates of trade expansion are particularly apparent with regard to the volume of exports. In 2008, China exported a total of US$1.6 trillion worth of goods and services, comprising 8 % of the world's exports, against India's US$263 billion or 1.3 % of world exports (Wignaraja 2011). Thus, China's larger presence in the global trade scenario, owing to an earlier start on the economic reforms front, is evident. India, while having made significant strides from its pre-liberalisation days, is a relatively smaller player in terms of global trade volumes.

3.1.3 Financial Integration

In terms of financial integration, China attracted record FDI levels since 1990, with inflows amounting to US$54 billion annually during 1991–2010. Annual FDI inflows doubled in 2003–2010 compared to the period 1991–2002. With a cumulative inflow of US$1,098.7 billion between 1978 and 2010, China became the second largest FDI recipient after the US. Interestingly, the global financial crisis has not really made a huge dent in FDI inflows to China. Most of it has been through overseas Chinese investors, based primarily in Hong Kong, Taiwan and Macao, collectively accounting for 42 % of the total FDI into China over the period 1997–2006. By facilitating the inflow of capital, technology, market channels and world-class organisational structure, FDI has been instrumental in the evolution of China's comparative advantage from labour-intensive manufacturing to the more complex electronic and automotive goods structure and in establishing its position as the 'global assembly centre' in production networks in key industries.

[1] Openness index is defined as the ratio of export plus imports of goods and services to GDP.

In India, a formal policy towards liberalisation of FDI norms was introduced in 1996. Restrictions on foreign ownership and investments were removed, and procedural simplifications introduced. Limits of investment were gradually enhanced and coverage extended to almost all but a few sensitive sectors. India is today among the five most attractive investment destinations in the world. It received US$155.3 billion worth of FDI on a cumulative basis over the period 1991–2010. FDI inflows to India have been largely in response to and in order to take advantage of its large domestic market, so the FDI contribution to the country's manufactured exports has been very limited. While FDI has helped India augment its production frontier and resulted in the internationalisation of production, it has not led India into the international production networks. The East Asian model has not been emulated in India, and unlike China, which has become the global manufacturing hub, India's production system is far more nationally oriented. India's share in the global production network's exports is marginal, having increased from 0.1 % in 1992–1993 to 0.5 % in 2010–2011. In comparison, China's share has risen from a mere 2 to 20.1 % over the same period.[2]

3.1.4 Differential Growth Strategies of India and China: Share of Manufacturing in GDP

The differential pace and pattern of the evolution of the manufacturing sector in India and China is due to the fundamental differences in the growth strategies followed by the two economies. India's services sector, especially the information and communications technology (ICT) sector, has dominated the rate of economic growth and exports in the post-reform period. In the manufacturing sector, India's specialisation has evolved slower and remained largely limited to the low-technology sectors. In contrast, China, over the course of its development and trade liberalisation process, has made greater investment in manufacturing. Its manufacturing sector accounts for more than 40 % of its GDP, with manufacturing goods constituting over 90 % of exports. This is in contrast with India's trade in manufacturing not being remarkable to date, with the sector's share being just about 20 % of GDP. India is not yet a major force in international manufacturing, except in textile and clothing, pearls, precious stones, glass and glassware, miscellaneous manufactures and other unskilled labour-intensive (ULI) commodity categories where it has acquired specialisation and comparative advantage given its abundance of cheap labour. In all likelihood, India will continue to grow in this direction given its current emphasis on upgrading skills that are appropriate for the services sector. The lack of diversification in India's specialisation pattern is also largely attributable to the domestic policy constraints arising out of labour market inflexibilities and infrastructural bottlenecks that prevent easy reallocation of labour across industries. On

[2] Ganeshan Wignaraja, 'Trade Policy in PRC and India in the New Era of Slower World Growth', at http://www.icrier.org/pdf/Wignaraja_trade_policy.pdf (accessed on 23 October 2013).

the other hand, China has experienced dynamism in its manufacturing skills, specialisation pattern and, consequently, export structure. From specialising in ULI sectors like toys, footwear, apparel and light manufactures in the 1990s, it has in the 2000s advanced to office machinery, electrical and electronic equipment and appliances. The trade in electronic goods alongside other manufactures is at the heart of its assembly-line production linkages with the Southeast Asian economies.

China's outstanding participation in international trade is thus based upon its rapid expansion of manufacturing sector exports, which in turn has been an outcome of its evolving comparative advantage, leading to the diversification of manufacturing sector production. The Chinese have built strong export capacities in high-technology industries, having shifted away from the low-technology and labour-intensive sectors like textiles. India's trade expansion is growing with a relatively slow evolution of the structure of its comparative advantage, with the dominant exports continuing to belong to low-technology labour-intensive sectors. Marginal changes are observed in terms of a decline in the textile industry and rise in R&D-based industries like pharmaceuticals and organic chemicals. India's focus has been on the ICT services sector and, consequently, trade in IT-enabled services (ITES) constitutes a large proportion of the total trade. For India, the services sector advantages are envisioned as means of future linkages with the ASEAN economies.[3]

3.2 India and China: Regional Trade Integration

Asian economies have always been the most important trading partners for both India and China. Developing Asia accounts for about 75 % of the total trade among developing countries or South–South (S–S) trade, which has registered an increase from 7 % in 1990 to 17 % in 2009. China alone accounts for roughly 40 % of the increasing developing country trade.

In Asia, it is trade within the emerging economies that has recorded the sharpest increase—8.5 times between 1990 and 2006—and China seems to have played a special role. This is reflected in the impressive increase in trade between China and the set of economies comprising industrial Asia, the ASEAN-5[4] and the Asian newly industrialising economies (NIEs). This process was accelerated following the 1997–1998 crisis, when ASEAN sought China in its new role and aligned itself in the regional production chain. The China–ASEAN trade increased at over 15 %

[3] Despite the differences in trade patterns, it is interesting to note that by exploiting their relative comparative advantages in the manufacturing and services sectors, India and China have together contributed to and shared in the dynamism of the electronic goods, and computer and information services trade, which has experienced a growth over and above that of total world trade. Against an overall growth of 7 % in total trade in goods and services, trade in electronic goods increased at about 8 % and for computer and information services at around 24 % over the period 1995–2005. See Isabelle Bensidoun et al. (2009).

[4] ASEAN-5 includes Indonesia, Malaysia, Philippines, Singapore and Thailand.

per annum during 1991–2000 and accelerated further after China's accession to the WTO. The composition of the ASEAN economies' exports to China is also revealing in this context. The share of resource-based commodities decreased from two-thirds of ASEAN's total export value in the early 1990s to only 22 % in 1999 and has remained about the same ever since. Simultaneously, the relative share of intermediate manufactured goods, towards which the ASEAN economies upgraded their comparative advantage—electrical machinery, computer chips and automobile parts in particular—increased from 12 % in 1990 to 52 % in 2008. This pattern of intra-industry trade in the electrical, electronics and machine goods industry is central to the growth process of the ASEAN economies and the export potential of China. It also provides evidence of the latter's emergence as the fulcrum of the Asian export platform, a part of the 'factory Asia' that involves intermediate goods being sourced from within the region—from the Southeast Asian nations as also from Japan—for assembly in China and then exported predominantly to the developed Western markets. The trade relationship that thus gained strength in the late 1990s and early 2000s has been given a further boost through a formal trading agreement between ASEAN and China in the form of the CAFTA.

3.2.1 The China–ASEAN Free Trade Agreement

The idea for CAFTA was proposed by China at the ASEAN+3 meeting in Singapore in 2000 and again at the ASEAN–China Economic Cooperation meeting in 2001. For China, the motivation was both regional trade liberalisation as well as to provide a necessary boost for making its underdeveloped western region a more attractive international trading hub. The framework agreement for comprehensive economic cooperation was signed in 2002, leading to the creation of the largest FTA in terms of China's 1.9 billion population. With a combined GDP of US$5.6 trillion and total trade volume of US$4.5 trillion, it is the third largest FTA after the European Union and the North American Free Trade Agreement (NAFTA) in terms of GDP (Yang Mu and Heng Siam-Heng 2010). The FTA allowed for a differential implementation for the CLMV (Cambodia–Laos–Myanmar–Vietnam) countries through an extended timeline up to 2015 for tariff elimination as also for 'highly sensitive' commodities for which duties are to be cut by no more than 50 % by 2015. To accelerate the tariff liberalisation for the first phase of 'normal' track of goods, members agreed to implement an early harvest programme (EHP).[5] The EHP was to implement tariff cuts on 600 agricultural products and was to be launched immediately. It not only made a contribution to the increase in trade observed over this period as it liberalised China's market to ASEAN's agricultural goods but also contributed to allaying any fears on ASEAN's part of competitive pressures from China. The accompanying agreements for liberalisation of services and investment were ratified in 2007 and 2009, respectively.

[5] In two-track liberalisation, goods are categorised as 'normal' and 'sensitive'.

The CAFTA became effective from January 2010 when tariff barriers were eliminated on 90 % of the products, that is, about 7,000 items traded between ASEAN and China.[6] As an immediate impact, bilateral trade increased in the first 7 months of the implementation of CAFTA when China's exports to ASEAN experienced an increase of 43.2 % and ASEAN's exports to China increased by 56 %.[7] Prior to 2009, ASEAN–China trade expanded rapidly, and trade volumes went up from US$78 billion in 2003 to US$231 billion in 2008. Bilateral trade thus increased by over 20 % over the period of 2001–2008. By 2008, in fact, China became ASEAN's third largest trading partner and ASEAN China's fourth largest. Trade volumes, however, declined to US$212 billion in 2009, apparently in response to the declining external demand for Chinese goods in the wake of the global financial crisis. As regards investment, current trends show that there is a need to encourage intra-regional investment, which is very low, at about 15 % of the total flows into ASEAN, and China invests only a small proportion of this, that is, around 1 %.

While trade expansion has been observed after the implementation of the CAFTA provisions, there remain concerns among the ASEAN economies regarding some of the high-tariff industries that may face direct competition from Chinese goods, such as textiles and electronics in Indonesia and the Philippines. There is also a general fear of an onslaught of cheap Chinese commodities among the ASEAN economies. Some renegotiations regarding specific sectors have already been notified to the ASEAN Council by Indonesia. As already discussed, much of the China–ASEAN trade is in response to the external demand for Chinese goods that are being manufactured through imports of parts and components from the ASEAN economies, and this phenomenon may face a limitation given the development of global conditions following the financial crisis of 2008–2009 and the accompanying decline in demand from the advanced economies. Trade liberalisation between the ASEAN and Chinese economies may not be an easy task in light of these evolving circumstances. Notwithstanding these altered conditions following the global financial crisis, the rise of China's role in regional trade has also led to a fear of its dominance in the region. This is particularly true of the traditional ASEAN trade partners like Japan and Korea. As a response to these fears, as also to the changing global conditions, there is an attempt to draw other economies into the regional fold, prominent among which is India, with its growing regional economic linkages with ASEAN.

3.2.2 India as a Market for ASEAN

India's engagement with ASEAN and East Asia having gained momentum since the 1990s is a consequence of both its Look East policy as also a conscious policy objective of diversification of its trade partners. This is reflected in its increasing

[6] For ASEAN-6 and will be effective for 90 % of trade goods for ASEAN-4 by 2015 where ASEAN-4 is the CLMV countries and ASEAN-6 is the other 6 (Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand) of the ten member ASEAN.

[7] Year- on-year.

integration with the developing world in general and developing Asia in particular. In fact, the growing integration with developing Asia has largely been driven by the growing importance of China as a trade partner. At the same time, closer economic ties with the more dynamic segment of the Southeast Asian region have grown rapidly in the last few years. India experienced fairly high rates of growth in export as well as import during the period 1998–2006. While the total export value grew at an annual compound rate of 17.6 %, export to industrial countries grew at a slightly lower 13.6 % and to developing countries at 21.8 %. Within developing countries, exports to Asian countries grew at 23.2 %, surpassing the rate of growth of exports registered for developing countries as a whole.

Seen as absolute values, the Asian region alone has accounted for nearly one-third of India's increase in exports during this period. Developing Asian countries also accounted for a high value, almost 29 %, of increase in India's imports over this period. As a result, the share of various Asian subregions, with the exception of South Asia, in India's total trade has increased considerably.[8] However, trade has strengthened with the relatively more developed of the Southeast Asian economies like Singapore and Malaysia, followed by Thailand, Indonesia and the Philippines. And while India does not seem to have integrated its manufacturing sector with Asian production networks like China has, it is seen to be emerging as a rapidly growing market for Asian goods. This is evident from the overall trade surplus with ASEAN.

The fact that India is emerging as an important market for intra-regional exports is further corroborated when we look at India's trade with ASEAN and the ASEAN+3 economies of China, Japan and Korea. The average annual growth of India's imports from ASEAN+3 exceeds the rate of growth of India's exports to these countries. In addition, when compared with other plus-three economies, the rate of growth of India's imports from ASEAN+3 is second to China and significantly higher than that of Japan and Korea. Over the last few years, India registered a very high growth in the region for Chinese and Indonesian exports. For Korean, Malaysian and Thai exports, India is second only to China as the most attractive market in the region (Batra 2007a).

3.2.3 India–ASEAN FTA

India has cemented its growing trade relationship with ASEAN economies through an FTA agreement that has been operational since 2010. The framework FTA agreement with ASEAN was announced in 2003 and finally signed after 6 years of protracted negotiations in 2009. The agreement, which is for trade in goods only, provides for elimination of tariffs on about 80 % of bilaterally traded goods by 2016. Several reservations have, however, been expressed about the likely impact of the FTA. These include an enlargement of India's existing trade deficit

[8] This is notwithstanding the importance of West Asia for oil imports for India.

vis-à-vis ASEAN and India's competitiveness with regard to certain plantation crops like pepper, coffee, tea, crude oil and refined palm oil. Owing to much lower productivity, and higher wage and input costs relative to ASEAN, India is at a comparative disadvantage in these commodities. Liberalised trade on a preferential basis was, therefore, considered to have an adverse impact on plantation farmers. The matter was resolved through an extended timeline of 9 years for tariff reduction for these commodities. There are other elements of the FTA where India has distinctly compromised its initial stand. These relate to the size of the negative list, which was finalised after a major cut in its initial formulation and to the dilution of rules of origin (RoOs) by India. The negative list was reduced to less than a third of its original size by the time the negotiations were finalised. As regards the RoOs, India has in its FTAs traditionally followed the 'twin –criterion' of change in tariff heading (CTH) at the HS-4 digit level and 40 % value addition (VA) to determine the country of origin for goods to be eligible for tariff concessions.[9] In case of ASEAN, India has allowed for a more flexible stand with a single criterion of 35 % VA even while retaining the stricter 'twin-criterion'-based rules in its bilateral FTAs with ASEAN member countries like Thailand and Singapore. India's FTA, owing to the prolonged negotiations, has also placed it at a late-mover disadvantage with respect to China in the ASEAN market. The extent of this could have been limited, but for the fact that the intervening 6 years would have given China, owing to its earlier entry, the time to garner greater market share in commodities where India may have had a higher comparative advantage, such as commodity groups like organic chemicals, rubber items and iron and steel products (Batra 2007b).

India's compromise in the goods FTA may be attributed to two aspects. One, that subsequent FTAs in services and investment liberalisation were expected to result in more favourable outcomes given India's greater advantages in these sectors; and two, the growing regional compulsions. The latter has probably been a more important factor as China's FTA in goods was already operational and expected to be effective from January 2010, while the other components of the comprehensive economic cooperation pact, that is, agreements for investment and services liberalisation, had also been signed. Over this time, Korea and Japan had also signed FTAs with ASEAN. Therefore, India could not afford to lose any more time. The FTA has placed India on an equal footing with the other regional economies, thereby giving it a legitimate right to play a more appropriate role in the regional economic order. The FTA also formalises India's relationship with ASEAN, which is the accepted regional focal point for economic integration.[10] As regards the services and investment liberalisation, ASEAN has retained its position of hard bargaining vis-à-vis India. The agreements are expected to be signed sometime in 2013 after almost 3 years of negotiations.

---

[9] HS stands for the Harmonized System of trade classification.

[10] Amita Batra, 'Indo ASEAN Agreement Boosts India's Image', Policy Commentary, Sigur Centre for Asian Studies, George Washington University (February 2010).

The scenario following the global financial crisis has provided further relevance to India's emergence as an alternative market largely on account of the expectations from China to reorient its growth towards domestic consumption in order to reduce its contribution to the global imbalances. We discuss this aspect in the next subsection.

3.2.4 China and Global Imbalances: India's Role as an Alternative Market in the Region

The worldwide financial crisis has highlighted the fact that China's current trade patterns, while reflecting deepening regional economic integration, also portray a very active global supply chain. The Chinese demand of intermediate goods from ASEAN is a derived demand and ultimately a function of the global demand for its goods. For countries closely linked to the East Asian production network, therefore, the policies and performance of the Chinese economy, as well as major advanced economies, hold the key for medium-term growth prospects, given their sheer size and close trade linkages. This assumes importance in the face of regional trade constituting a link in the Chinese surplus creation that has been at the heart of the global imbalances, which, in turn, has been a major contributory factor to the financial crisis around the world. The unwinding of the global imbalances, it is thought, will have significant spillover effects for the surplus and deficit economies and additionally for those linked through the production networks, such as the Southeast Asian economies. Since the genesis of the crisis and the consequent spotlight on this process of surplus creation, there has been an expectation from China to adopt a shift in its growth policy and strategy so that it could be oriented towards domestic demand as against a global demand under earlier conditions. This is likely to lead to a reduction in the imbalances in the global economy. The shift in growth strategy is already evident, as over the past year the external surpluses in China, which to a large extent form the counterpart to the US deficit, appear to have narrowed.[11] China registered a surplus of about US$250 billion (i.e. less than 3 % of GDP) in 2011, dropping from a high of 10.7 % of GDP in 2007.[12] Even though the structural components leading to this reduction are yet to be permanently entrenched in the Chinese economy, the evident shift in the growth strategy indicates that the export-led and trade-linked growth system may not be feasible in the new scenario.[13] Domestic

[11] The external surpluses have also narrowed in the other economies like Germany, Japan and a group of fuel-exporting countries.

[12] See http://www.imf.org

[13] Of question here is if China's declining surplus can be accounted for by structural or cyclical factors. The latter would lend an element of permanence to the change. It is considered that part of the decline in surplus is on account of the collapse in global demand owing to weak recovery in the advanced economies. Additionally, government and private sector investments have increased to counter the adverse impact of the global financial crisis. The investments—public and private—

Chinese consumption may not be suffice as a substitute for external demand or else may not be import intensive to the extent that external demand has been in the past. For the ASEAN economies, therefore, looking elsewhere and beyond China is now an imperative to sustain their growth in the wake of the financial crisis and the consequent loss of their major export markets and the source of their economic dynamism.

This is where India's significance as a market for ASEAN becomes more relevant. India's integration prospects with ASEAN are now likely to be stronger as it can help the latter overcome the travails of a diminished Chinese market. India's growing attraction as an alternative market is also evident from the fact that the other major economies of the region, Korea and Japan, have shown a keen interest in institutionalising their growing trade and investment relationships with India. Korea has a comprehensive economic partnership agreement (CEPA) under implementation with India. The India–Korea CEPA was signed in 2009 after a 3-year period of negotiations, with inclusion of provisions for deeper integration through goods, investment and services liberalisation. The CEPA, which has been in effect since January 2010, has a symbolic importance in being the first between a major industrial powerhouse and a BRICS (association of the emerging economies of Brazil, Russia, India, China and South Africa) economy. The agreement, by undertaking to eliminate tariffs on 85–90 % of mutually traded goods, aims to double bilateral trade from its 2008 level of US$15.6 billion. Through this deal, India has also been able to secure an opening for the liberalisation of its services sector with a major economy and in sectors/areas where it has comparative advantage, that is, the ICT sector and temporary movement to RoK of service professionals. India has also agreed to provide better investor protection to induce increased investment flow from Korea. The India–Japan economic partnership agreement (EPA), negotiations for which began in 2007 and was signed in 2010, is likely to provide major benefits to the dwindling Japanese economy by tariff cuts on offer in the auto parts sector. Japan has offered to cut tariffs on farm products and Indian tea. In addition, it is also to provide for the movement of professionals in the health sector, while facilitating Japanese investment into India. The trade pact is thus envisioned to benefit both countries. In contrast with India's rapid formalisation of its economic relationships, China is as yet only in the process of evolving the structure of negotiations with Korea and Japan for a trilateral FTA in the region.

The emerging Asian architecture for regional economic integration must then be evaluated in this context. Unlike the East Asian crisis, when Chinese assistance to the ASEAN economies had led to a strengthening of the China–ASEAN relationship, which started to increase in terms of trade and investment, the current trends

---

have both been import intensive, implying a lower trade surplus for China. The accompanying exchange rate appreciation has further helped reduce China's surpluses. The process has also been assisted by the more recent policy reform with respect to social safety nets that China has promoted in areas like health care and low-cost housing. However, its impact on household consumption will not be evident immediately.

have to be cautiously considered for the long-term challenges they pose to regional economic integration.[14]

Simultaneous to this differential evolution and placement of India and China in the regional context has been the other development: of strengthening of the bilateral trade relationship between the two countries. This, while having registered a dramatic and positive change, has, however, not culminated in a formal FTA engagement. Interestingly though, the recent initiation of negotiations for a region-wide FTA, that is, the Regional Comprehensive Economic Partnership (RCEP), is likely to bring the dynamic duo together in a formal regional trading arrangement. The India–China bilateral relationship is reviewed in the next section, including a discussion on the possibility of the RCEP assuming the primary position of a regional trading arrangement in Asia.

3.3 Bilateral Trade Relationship Between India and China and the Way Forward for the Region

Even while the Indian and Chinese economies evolve along differential paths, their bilateral trade relationship has undergone dramatic expansion over the last decade. With a spectacular increase in bilateral trade during the 2000s, China has been among the three largest single-country trading partners for India. India–China bilateral trade increased to US$42 billion from US$17 billion from 2005–2006 to 2009–2010.[15] However, this has so far not led to a formal preferential trading arrangement. The two countries did set up a joint study group for the purpose in 2004, but the outcome was a rather ambiguously defined regional trading arrangement. The reservations to a well-defined and traditionally designed FTA on the Indian part have been with regard to the fear of an import surge from China and a consequent increase in an already large trade deficit vis-à-vis China. Current statistics show that trade is more favourable to the Chinese economy as Indian imports from China are far larger than Chinese imports from India. This lopsidedness is further evident from the observed 160 % increase in India's trade deficit with China over a period of 5 years up to 2010–2011.[16] This growing deficit is an outcome of both India's limited diversification of its export basket, as also of the many 'hidden' nontariff barriers that China has in place for products where India is comparatively advantageously placed, such as pharmaceuticals, agricultural products, machinery and even IT products. Chinese exports and their overwhelming presence in the power sector have also

[14] That China, having been relatively less affected by the crisis, was able to continue trading with ASEAN even after the 1997–1998 crisis contributed to the latter's confidence in China.

[15] See http://dgft.delhi.nic.in

[16] Trade deficit is the gap between exports and imports, and is indicative of India's import dependence on China. In 2010–2011, Indian imports of Chinese goods increased to US$43.5 billion from the 2006–2007 figure of US$17.5 billion, but exports have seen a relatively slower positive change, rising to US$19.6 billion from US$8.3 billion over the same 5-year period.

been a cause of some anxiety in Indian policy circles. India's concern with the growing deficit, while being noted by the Chinese, has found little reflection in their policy, particularly in terms of relaxation of the sector-specific and other general nontariff barriers. As a formal forum, the establishment of the India–China Strategic Economic Dialogue is a positive step and the outcome of the first dialogue held in Beijing in September 2011 was positive in terms of delineating areas for future cooperation, like infrastructure, and in particular railways, energy efficiency and environment protection, water conservation and clean water technology. There has, however, hardly been any progress on existing problem areas in bilateral trade. So while cooperation defines this bilateral forum, it does not appear to have laid the foundation for a bilateral trading arrangement between these two dynamic economies.

However, it is interesting to note that both India and China have now been brought together in a regional trading arrangement as proposed by the 16 members of the East Asia Summit (EAS) in the form of the RCEP in 2011. Keeping in view the disparity in the income level of member countries, the RCEP is envisioned with a special and differential treatment clause that allows for gradual implementation and open accession at variable timings. Given the huge scope of tariff and nontariff reduction and removal among member economies, this formation appears to hold considerable potential for trade creation and is, therefore, the most desirable formulation for regional economic architecture at the present juncture. It may also be recognised that even while the RCEP has emerged as major contender for a formal region-wide trade agreement, there has been no stopping of the discussions around other formulations like the trilateral agreement between China, Japan and Korea or the Comprehensive Economic Partnership for East Asia. That said, none of these have as yet evolved in any concrete manner. The only caution that needs to be exercised in this context is the existing and potential competition from the US-led Trans-Pacific Partnership (TPP) that has already been able to draw some ASEAN economies and evoke interest in others. China is not likely to become a member of the TPP and India has also not expressed an interest. The RCEP, therefore, provides a feasible forum for India and China to come together in a regional trade arrangement.[17] For successful implementation, however, the RCEP will have to contend not just with the prior presence of the TPP in the region as an alternative formulation but also the higher standards of the TPP's clauses. If some ASEAN members join the TPP and thereby accept the 'platinum standard' TPP provisions, the overlapping membership with the RCEP will inevitably lead to immense pressure for reforms from its members.[18] This, in all likelihood, will be difficult for the relatively less

[17] India and China are otherwise participants in the Bangkok Agreement (now called the Asia Pacific Trade Agreement), an inter-subregional integration arrangement. India has been a member of the since 1975 and China joined in 2000. The limited scope and coverage of the concessions offered under the agreement makes it rather ineffective in taking forward the idea of regional economic architecture in Asia.

[18] Given that the negotiations are aimed at the 'WTO++' provisions that may contain far more stringent obligations than those required by the WTO multilateral regime.

developed ASEAN members. In addition, the fact that the RCEP that has just started its negotiation process, whereas the TPP has already had 14 rounds of negotiations cannot not be ignored. Given that in the existing scenario the RCEP is a positive all-encompassing regional configuration that allows for the economic dynamism of both India and China to contribute to regional trade creation prospects, the negotiations must be fast, taking into consideration the differential levels of member economies, to outdo the competition posed by the TPP.

References

Batra A (2007a) Asian economic integration: ASEAN+3+1 or ASEAN+1s? ASEAN Econ Bull 24(2):181–204

Batra A (2007b) The structure of comparative advantage of China and India: global and regional dynamics. China World Econ 15(6):69–86

Bensidoun I, Lemoine F, Unal D (2009) The integration of China and India into the world economy: a comparison. Eur J Comp Econ 6(1):131–155

Bergsten FC, Freeman C, Lardy NR, Mitchell DJ (2008) China's rise: challenges and opportunities. Peterson Institute of International Economics, Washington, DC

Yang Mu, Heng Siam-Heng (2010) Promoting China–ASEAN economic cooperation under CAFTA framework. Int J China Stud 1(3):667–684

Wignaraja G (2011) Economic reforms, regionalism and exports: comparing China and India, Policy studies 60. East West Center, Honolulu