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India's Asian trade strategy

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The global context

The year 2016 was a bad one for global economic integration. Two events defined the move towards a new autarky: the vote by a majority of the citizens of the UK to leave the EU on 23 June and the election of Donald Trump to the Presidency of the US on 8 November on an explicit platform of protectionism. One of President Trump's first acts as leader of the US was to withdraw from the Trans-Pacific Partnership, the most ambitious agreement for free regional trade since the abject collapse of the Doha Round of negotiations at the multilateral World Trade Organization (WTO). Global trade is experiencing a period of unprecedented slowdown; indeed, given the contraction in recent quarters, shrinking may be the more appropriate description. India has been reluctant about opening up unabashedly to trade—a legacy of four decades of import substitution and statist policies. The events of 2016 may have led it to consider that the world, usually obsessed with trade creation and trade diversion, was finally coming around to share its preference for trade *aversion*.

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The starkest indicator of India's trade aversion is the country's share of global merchandise exports. At just 1.6 per cent of a US$18 trillion market (Ministry of Commerce and Industry, Government of India, 2016), India trails the EU, China and the US (each of which has about a 13–14 per cent share) by a long distance. The second indicator of India's reluctant attitude towards trade comes from a statistic about intra-regional trade. South Asia is home to almost 1.6 billion people but just 5 per cent of its trade is intra-regional, compared with 55 per cent for the EU and 25 per cent for the Association of Southeast Asian Nations (ASEAN). For Asia as a whole, intra-regional trade is 50 per cent of total trade. Of course, responsibility does not lie with India alone—India's neighbours must share the blame. However, as the largest country and economy in the region, it must accept a greater amount of responsibility for that outcome.

There are two ways for India to interpret the new circumstances. The first is to feel comfortable about the emerging global order on trade and rejoice that there is unlikely to be any pressure from the major advanced economies to sign on to 'big ticket' free trade deals. This would be in line with the trade establishment's long-term defensive view on trade. The second option is to view this global scenario as an opportunity. With just 1.6 per cent of the share of global merchandise trade, India has huge scope to make an improvement in its share of trade, even if the total pie of global trade is stagnant.

There are several reasons why it is in India's interests to opt for the second response. A rapid growth in merchandise trade could not only power India's growth to double digits, but could also provide gainful employment for millions of Indians in labour-intensive industries, which have not been an area of strength for India. It is often argued[2] that India has a large internal market and it need not target international markets. However, the total size of India's economy is around US$2 trillion, whereas the total size of global trade is nine times that; the argument that India can simply rely on internal markets is not convincing.

Apart from necessity, there is also opportunity. China, the world's factory for the last three decades, may finally be ceding some space in manufacturing. There are two factors at work in this trend. First, the rise in real wages is rendering some types of manufacturing uncompetitive in China. Second, the economy needs rebalancing away from an overdependence on exports

2 Former Reserve Bank of India Governor Raghuram Rajan was a proponent of this view (see Rajan, 2014).

towards an orientation towards internal consumption (in many ways, the opposite of what India needs to do). Global manufacturing is looking for alternative destinations. India, with its still-low wage levels, is an obvious alternative but it must realise that it is not the only alternative. Relatively close to home, Vietnam, Bangladesh, Indonesia and the Philippines are competing for the same space. Crucially, this may be the last window of opportunity for India to become a global manufacturing hub. The onset of the 'fourth industrial revolution' posed by automation and artificial intelligence may mean that, two decades from now, manufacturing will have a whole new connotation and an entirely different set of jobs, demanding much higher skill levels. Further, by other measurements, India is not as isolated from world trade as one may think. The share of exports (including manufacturing and services) in India's gross domestic product (GDP) is close to 23 per cent, about the same as China's. Therefore, India has become quite an open economy, even if not entirely by design.   should embrace greater openness.

India's choices

Despite the overwhelming case in favour of greater and freer trade, there are reasons why India may choose not to seize this opportunity. There is genuine concern about the competitiveness of Indian manufacturing should it be opened up to trade. Several sectors of the economy already struggle to compete with imports, particularly those from China. In the one experience that India had with major trade liberalisation, during the economic reforms of 1991, there was little evidence to suggest that manufacturing had received a boost. Instead, there may have been some deindustrialisation in sectors that were totally uncompetitive (see Sharma, 2014). In addition, there is a concern that free trade negotiations inevitably centre around goods, in which India is not so competitive, rather than services, in which India is relatively more competitive. The services that interest India the most, such as information technology services, are heavily dependent on the movement of persons, a subject that is fraught in today's global scenario. Therefore, there are good reasons for the political economy of India being tilted against a more open trade strategy.

A significant question that arises is, if the major advanced economies are turning to protectionism, where will India find the markets for its exports? The answer is relatively simple. Although it is true that the US is becoming more anti-trade, there is no similar evidence that

Europe is. The anti-globalisation sentiment there appears to be centred on immigration. Therefore, opportunities may exist—the UK has already expressed openness towards a free trade agreement (FTA) with India (Press Trust of India, 2017). More significantly, the one engine of the global economy that is still revving, even if at a slower rate than earlier, is East Asia. Many of the global value chains (GVCs) that are critical to global trade are located in this region. India is geographically close to this region. Therefore, India's trade strategy must be an Asian strategy, centred on East Asia and South Asia, which have enormous potential for integration.

However, for an Asian strategy to take shape, India needs to do its homework—quite literally. The first step in an Asian strategy must be to address the bottlenecks in the domestic economy that render Indian industries uncompetitive in the first place. If a domestic strategy is combined with an external strategy, India could make its mark on global manufacturing trade and become a leader for the cause of integration in a world that is moving away from an important source of economic prosperity.

Homework is critical

In a highly globalised world, constructed around GVCs for products, investors, whether Indian or foreign, must choose which location is best to establish their businesses. The difficulty of doing business in India is best summed up by its ranking in the annual World Bank study on the ease of doing business. In the latest (2017) rankings, India comes in at 130 in a list of 190 countries. India has been languishing in the 130s since 2010. A number of competitor countries rank much higher: China, 78; Vietnam, 82; Indonesia, 91; the Philippines, 99; and Sri Lanka, 110. The countries are ranked on a number of parameters, including starting a business, construction permits, obtaining electricity, registering property, paying taxes, obtaining credit, trading across borders, enforcing contracts and resolving insolvency. India fares particularly poorly on some of these indicators; it ranks almost at the bottom (185) in construction permits and its ranking is not significantly better in enforcing contracts and paying taxes (172 for both). Its best performing indicator is obtaining electricity, for which it is ranked 26 (World Bank, 2017a).

However, there is a determined push from the government to improve India's standings in these rankings. Prime Minister Narendra Modi has publicly exhorted his officials to lift India into the top 50 in rapid time. Of course, given the quantum of improvement required in a range of areas, progress may take time. On some indicators, such as resolving insolvency, in which India is ranked at 132, there may be a dramatic upward surge following the legislation introducing a new bankruptcy law. Once the law is codified and put into practice, at least that parameter should experience a sharp improvement.

Factoring in imperfect factor markets

India's lack of competitiveness in manufacturing is not limited to red tape. There are several distortions in critical factor markets—in land, labour and capital—that need to be addressed. Land is a necessary resource for the setting up of industries. Until 2013, land acquisition via eminent domain in India was governed by archaic 1894 legislation, introduced during the period of colonial rule. It can reasonably be stated that the law did not provide adequate safeguards to those whose land was being acquired, whether for industrial use or for the construction of infrastructure so vital to attracting other investment. Unfortunately, the legislation enacted in 2016 that replaced this old law mired the entire process of land acquisition in bureaucracy, delays and unnecessary costs. Given the sensitivity of the political economy to land-related issues (in a relatively poor country, land is often the only major asset for a large number of people) any easing or roll back of the law is fraught and unlikely to be successful. The only way forward is for India's individual state governments to enact their own, more liberal land acquisition laws. Constitutionally, land is a subject that belongs to the state governments. Usually, central government legislation prevails over any state government law. However, in the interest of economic growth, in this particular case, the central government could permit the state legislation to prevail.

There is a similar problem (and solution) in the vexed domain of labour laws. India's labour laws, drafted in the early years of independence, provide a great deal of protection to incumbent labour, but have created perverse incentives for industry to use capital in a country where labour is abundant. The statutes of the labour laws (there are several) make it nearly impossible to 'hire and fire'. That is why labour-intensive industries have never really taken off in India. Worse, the size of the formal sector (in which workers obtain benefits including pension contributions and insurance) is small. Only an estimated 10 per cent of the entire workforce is in the formal sector. Informal workers account for 60 per cent of the workforce in the organised sector. That proportion has not registered much change even 25 years after economic liberalisation, which, given that labour laws have remained untouched, is hardly surprising. The vested interests of incumbent labour will not make reform easy in New Delhi; the mere mention of labour reform the 2000–01 budget speech caused enough of a storm that the topic has not been mentioned since. However, as in the case of land, India's federal structure gives state governments the right to make their own labour laws. Some states, most notably Gujarat, have recently amended their labour laws, increasing the specified threshold on the number of workers above which the labour laws apply. Such reform by some states may eventually induce a competitive response from other states and result in a race to the top.

India's capital markets are its most reformed factor markets. In particular, significant changes were made in the market for equities, which has resulted in the development of robust stock markets, an important source of corporate finance and an instrument of corporate governance. However, the banking system continues to dominate the financial sector. State-owned banks control 70 per cent of all lending. The private sector has more efficient banks, but their market shares trail well behind the public sector banks. India has been slow to liberalise the banking space—too few private banking licences have been given in the past two and a half decades. However, the digitisation of banking and the arrival of payments banks could alter the landscape.

The building blocks of infrastructure

India's infrastructure woes are well known and well documented. What matters for competitive industry and efficient trade is excellent connectivity. India's record on roads, railways and ports, the three most critical pillars of a connectivity network for trade, is poor, especially in comparison to its closest competitors, even in nearby Asia. A full detailing of India's infrastructure woes would require a separate paper. Here, we focus on a handful of key infrastructure quality indicators to illustrate how India compares with (and trails behind) many of its competitor nations. The World Economic Forum's (2016) Global Competitiveness Report for 2015–16 presents some stark numbers for India. Overall, on the aggregated infrastructure index, India's rank is 81, well below most of its competitor countries in East Asia and in the emerging economies: Malaysia, 24; Russia, 35; China, 39; Thailand, 44; Mexico, 59; Indonesia, 62; Sri Lanka, 64; South Africa, 68; Brazil, 74; and Vietnam, 76. On the quality of roads, India ranks 61, ahead of Indonesia, 80; Vietnam, 93; and Brazil, 121; but below Malaysia, 15; Sri Lanka, 27; South Africa, 34; China, 42; Thailand, 51; and Mexico, 54. On the quality of port infrastructure, India ranks 60, ahead of Russia, 75; Vietnam, 76; Indonesia, 82; and Brazil, 120; but lower than Malaysia, 16; South Africa, 36; China, 50; Thailand, 52; Mexico, 57; and Sri Lanka, 58. On the index of air transport infrastructure, India ranks 71, which is below South Africa, 14; Malaysia, 21; Thailand, 38; Sri Lanka, 45; China, 51; Mexico, 55; and Indonesia, 66; but above Vietnam, 75; Russia, 77; and Brazil, 77. India slips to near the bottom of the pile vis-à-vis its competitors in the quality of electricity supply, in which it ranks 98. Out of the major emerging economies, only South Africa, ranked 116, is lower than India.

In some domains, including electricity, perverse policy incentives are a great hindrance to competitiveness. India has long followed a policy of cross-subsidies in the pricing of power or electricity, with industry being charged higher tariffs to cross-subsidise the agriculture sector. In China, by comparison, industry receives concessional tariffs. The high cost of power for productive manufacturing renders it uncompetitive. In railways, India has a long history of cross-subsidising passenger tariffs by charging higher rates for freight. The outcome of this policy is that 65 per cent of India's freight moves on trucks via highways and roads, with only 35 per cent moving by rail (World Bank, 2017b). This is the precise opposite of the scenario in most major economies, as road is much slower than rail. Thus, the perverse rail cross-subsidisation reduces the competitiveness of those engaged in trade and has other negative externalities, including congestion and pollution.

The obvious solution to perverse pricing is for the government to stop administering prices. Currently, there is more reason to be optimistic about a change in the power sector than in railways. In the power sector, several state governments have privatised distribution companies, which are more likely to price according to market factors. However, the electricity regulators have not always played an independent and neutral role in the matter of tariff policy. Making them genuinely independent could finally rationalise pricing in electricity. In railways, in which there is no private participation at all, rationalisation of tariffs requires great political will because it would mean an increase in passenger tariffs and a reduction in freight tariffs. The current government of Prime Minister Narendra Modi has carried out the first increase in passengers' fares in over a decade, but more remains to be done to get prices right.

GST and the single market

India has not just been reluctant about free and open trade outside its borders. Within its own borders, India deliberately avoided creating an architecture for a single market until about a decade ago, when it began to consider the idea of a goods and services tax. India has long had a complex system of indirect taxes under which the union government and 29 state governments levy a variety of taxes, often cascading in their effect. These include excise duties, value-added tax and the notorious *octroy*, which is a tax levied as goods cross from one state to another. This bevy of indirect taxes, which are far from uniform in their application, have hobbled the free and efficient movement of goods. The gains to internal trade and to economic efficiency from the reform of such a complex system are huge.

A well-designed GST, which would yield significant gains to the economy, should contain the following features: a single rate, a reasonably low rate and no exemptions. The GST as implemented in India in July 2017 satisfies none of these criteria. India's GST has been launched with four rates from 5 per cent to 28 per cent with several exemptions. The problem with multiple rates for different goods and exemptions for certain goods is that they encourage unproductive rent seeking, as interest groups spend resources lobbying for a favourable tax slab for their good. The problem with a rate that is set too high is that it encourages evasion, a perennial problem in India, given its history of high tax rates.

Introducing legislation in favour of the GST involves a constitutional amendment, which requires approval not just in the two houses of parliament, but also in a majority of state legislatures. Several of India's states, particularly those that are production hubs, were concerned that a shift in the levying of tax from the factory gate (in the old system) to consumption (under the GST) may lead to revenue losses. States wanted some protection of revenues, which explains their insistence on leaving alcohol and tobacco out of the remit of the GST, so that they could levy their own taxes on these high revenue-yielding items. In the end, some compromise between the union government and the state governments was necessary and it is likely that India's GST will begin with four rates, ranging from single-digit up to 28 per cent, and several exemptions.

It is estimated that the current incidence of indirect taxes on goods totals about 27 per cent. By comparison, most goods will see a reduction in rates under the GST. Significantly, the interstate border levy, or *octroy*, will be abolished, eliminating bottlenecks at state borders, as goods-carrying vehicles will no longer have to make long stops to fill out tax papers. The savings in fuel costs and time are not trivial. Moving forward, there is a commitment to lowering rates, reducing the number of exemptions and reducing the number of slabs (tax thresholds), once the uncertainty about the GST and tax collection sorts itself out in a few years. In the meantime, even in its current form, the GST will be a major improvement on the existing system that will increase the competitiveness of India-based manufacturers and, eventually, boost overseas trade.[3]

Fix the parts before the whole

It would be evident to any observer of the Indian economy that the list of reforms to be undertaken domestically, whether on regulations, infrastructure or taxes, will take a long time to be implemented in the context of India's competitive democratic system. It would be unwise and unrealistic for India to wait until every domestic reform to improve its competitiveness is undertaken before it opens up to trade. If anything, a greater opening up to trade could help push through domestic reforms. That said, it may be more realistic and feasible to create two or three economic zones, in which a speedier implementation of reforms may be possible. However, in a democratic federal polity, it is likely to be difficult to follow a China-style special economic zone policy. In China, certain regions along the coast were developed as a priority, while interior regions waited their turn. India's union government would find it difficult to favour some regions over others—it does so only in exceptional cases, where geographical terrain is a hindrance to economic activity—particularly if the prioritised regions were the already more prosperous areas along the coast.

3 A study conducted by the think tank National Council of Applied Economic Research (NCAER, 2009) for India's Finance Commission analysed the benefits of a GST for growth and trade.

However, India's federal polity can be leveraged to speed up reforms in some areas of the country.[4] State governments have considerable autonomy under the constitution to draft their own laws. In the case of politically sensitive reforms, such as land acquisition laws and labour laws, it makes eminent sense for state governments to take the lead. There is some evidence of this already. At least five states, among them Gujarat, have made local labour laws more flexible.[5] Some states have chosen to liberalise land laws creatively, by opting for solutions like land leasing (see Panagariya, 2016b) and land pooling, rather than blanket land acquisition. As long as the union government does not 'run roughshod' over what states do legislatively, reform can take place outside the politically charged atmosphere of New Delhi. The government of Prime Minister Modi is committed to cooperative federalism, under which the union government works with state governments as equal partners. It is also committed to competitive federalism. If some states reform, thereby attracting investment and jobs, other states may be forced to follow a reformist path by their demanding electorates.

Apart from reforms in factor markets such as land and labour, state governments can also play an important role in the speedier implementation of infrastructure projects. Although the funds for infrastructure may need to come from New Delhi, implementation can be made more efficient locally through quicker clearances and easier regulations at the state level.

Therefore, in India, rather than pursuing a centrally created special economic zone in the manner of China, the way forward appears to be giving more autonomy to states to push reforms, which will be supported by the union government. States like Gujarat, Andhra Pradesh, Maharashtra and Tamil Nadu, which are already the main centres of industry, have shown evidence of pushing forward at the state level, irrespective of what happens in New Delhi. That way, at least some progressive states can take a lead and breakaway from the vicious cycle of perverse policies and poor implementation that afflict India's overall competitiveness. This would provide a perfect platform for a more aggressive Asian trade strategy.

4 For a full exposition on the potential of coastal employment zones in India, see Panagariya (2017).

5 See NITI Aayog Vice Chairman Arvind Panagariya's blog on the subject of labour laws and state governments (Panagariya, 2016a).

South Asia first

The logical beginning of an Asian trade strategy for India should be in its immediate neighbourhood. Regional trade agreements have long been used as an engine to power growth. The global multilateral system, typified by the General Agreement on Tariffs and Trade and the WTO, has always moved slowly and, sometimes, not at all. In contrast, regional initiatives aimed at opening up trade have flourished in almost every part of the world. The EU was an early starter and remains the model for a common market, if not for a currency union, but the North America Free Trade Agreement (NAFTA), ASEAN in East Asia and Mercosur in Latin America have also had reasonable degrees of success. In South Asia, the South Asia Free Trade Agreement (SAFTA) was signed in January 2004 between eight countries in the region: India, Pakistan, Bangladesh, Sri Lanka, Nepal, Bhutan, the Maldives and Afghanistan. The aim of SAFTA was to reduce customs duties in the region to zero by 2016. Needless to say, that goal has not been achieved. Political tensions between India and Pakistan, the two biggest countries, have derailed aspirations for an economic union in the region. India has made more positive moves than Pakistan, at least in bilateral relations. India granted most-favoured nation status to Pakistan in 1995, but Pakistan failed to reciprocate, effectively rendering SAFTA a non-starter.

Fortunately, India has pushed ahead with alternative sub-regional arrangements in South Asia, which may have more potential to succeed than SAFTA. One such initiative involves Bhutan, Bangladesh, India and Nepal (BBIN).[6] In June 2015, the member nations signed a motor vehicle agreement,[7] with restrictions on and delays for vehicles of a member country driving on the other member countries' roads. A similar agreement had been proposed earlier under the South Asian Association for Regional Cooperation (SAARC) framework, which included Pakistan, but it did not come to fruition. A motor vehicle agreement is a crucial prerequisite for efficient trade, especially overland trade, between neighbouring countries.

6 On the opportunities and challenges of BBIN, see Pal (2016).

7 For a news report on the implementation of the motor vehicle agreement, see Law (2015).

Along with BBIN, a second vehicle for India's South Asian strategy is the Bay of Bengal initiative for multisector technical and economic cooperation (BIMSTEC). BIMSTEC has seven member states, five of which (India, Nepal, Bangladesh, Sri Lanka and Bhutan) are in South Asia and two of which (Myanmar and Thailand) are in South-East Asia, although in the geographical vicinity of South Asia. BIMSTEC was founded in 2004 but it has gained a renewed momentum recently (see ENS Economic Bureau, 2016), particularly since India moved to its proactive 'Act East' policy.[8]

The China obstacle

If Pakistan has long been the hurdle for a proactive South Asian strategy, then China is the elephant in the room when it comes to India's (East) Asian trade strategy. It is well known that India has a fraught political relationship with its northern neighbour. The two most populous countries in the world fought a war in 1962. Since then, the two countries continue to have a prickly relationship involving temporary border incursions because of a disputed border. China has made a territorial claim over the North-East Indian state of Arunachal Pradesh, which has ancient links with Tibet, but India considers the state its territory. China's implicit and explicit diplomatic and military support for Pakistan, against what India perceives as its interests, is an added political irritant to the bilateral relationship. The bilateral relationship between China and Pakistan is only growing stronger. China's massive investment in an economic corridor through Pakistan that will link China's relatively underdeveloped western region to a port (Gwadar) on the Arabian Sea is a sign of ever deeper engagement.

However, politics is not the only reason for a tense relationship between India and China. There is an economic dimension that has gained prominence in the last 15 years, as India has developed a highly skewed bilateral trade relationship with China. This is arguably a bigger hurdle to reducing barriers to trade than the political tensions that exist between the two countries. Consider this statistic: in 2000–01, India's trade deficit with China was under US$1 billion, but in 2008–09, it was US$22 million.

8 For the details of the policy, see the official Government of India statement (Ministry of External Affairs, Government of India, 2015).

In 2015–16, India's trade deficit with China had risen sharply to a massive US$53 billion. China's accession to the WTO in the early 2000s and its massive export expansion thereafter saw it build surpluses with several major economies. India was no exception. In India's case, it is not just the size of the deficit that is noticeable, it also the quality. India's imports from China are overwhelmingly higher value-added manufactured goods, while India's exports to China are largely lower value-added raw materials, mostly minerals. This situation is perhaps a reflection of China's superior competitiveness in manufacturing.

However, what the trade relationship does not reflect is India's comparative advantage; China's non-tariff barriers restrict the export of goods and services in which India is competitive. China maintains non-tariff barriers on a number of agricultural products from India, including regulatory requirements that restrict the import of pharmaceuticals from India. In the realm of services, regulatory restrictions inhibit the export of entertainment products from India and visa regulations make it difficult for Indian information technology service providers to export their services to China. Thus, India has good reasons to be exasperated with China and to be reluctant about opening up to trade. India is open to the import of manufactured goods from China (largely because of its commitments to multilateral trade agreements), but China is not open to importing goods and services in which India is competitive, and restrictions are permitted on the movement of these goods (agriculture and pharmaceuticals) and services (entertainment and information technology), even under multilateral trade agreement regimes.[9]

From India's perspective, the situation is worsened by the very limited amount of foreign investment received by India that could aid in financing the trade deficit in a sustainable manner. Between 2000 and 2014, Chinese investment in India totalled just US$400 million, a tiny fraction of the trade deficit. Of course, some of the blame for this situation can be ascribed to India, which has, from time to time, raised barriers to Chinese investment in sectors such as telecommunications, citing security concerns. In other situations involving Chinese investment, such as in the case of power projects, India objected to the use of Chinese labour instead of local labour. Needless to say, all the factors that deter investment in manufacturing in India apply to all investors, whether Indian, Chinese or

9 In 2010, India issued a démarche, a strong diplomatic notice, to China on the barriers to trade for Indian goods. See Nayyar (2010) for more detail.

from elsewhere. Nevertheless, compared with the foreign investment that India has received from the advanced economies in the last 15 years, the quantum received from China is small.

The East Asia (minus China) strategy

Given its vexed relationship with China, is it worthwhile for India to attempt to develop a sub-East Asian strategy (minus China), just like the sub-South Asian strategy (minus Pakistan) it has been moving ahead with? The challenge is that, when it comes to open trade, India has similar problems with the ASEAN countries as it does with China. The India–ASEAN FTA, which became operational in 2010, has evoked serious concern from Indian manufacturers. The automobile industry, particularly the automotive components industry, has found it difficult to compete with manufacturers based in Thailand. A study by one industry group, the Associated Chambers of Commerce and Industry of India (ASSOCHAM, 2016), suggested that, since the signing of the FTA, India's exports to ASEAN have remained virtually stagnant, whereas imports have grown by 33 per cent. None of this is entirely surprising because India's problems at home are at the root of its uncompetitiveness. If those problems, described in earlier sections of this chapter, are addressed, then India's competitiveness on trade will improve vis-à-vis ASEAN and China. As the trade deficit with ASEAN is nowhere near the alarming level of that with China, it makes sense to maintain an already open trade arrangement with ASEAN and use that pressure to improve domestic policies and infrastructure. In addition, the India–ASEAN relationship does not come attached with the political baggage of the China–India relationship. On the contrary, India could leverage the real tensions that some ASEAN countries (e.g. Vietnam) have with China to gain greater economic concessions for the member countries in return for a political alliance that could counterbalance China.

The significance of continued engagement with ASEAN also lies in penetrating some of the GVCs that are centred in Asia. As much of the global trade occurs within these value chains—from which India is largely excluded—ASEAN can help India gain a foot in the door. As China slows down and rebalances its economy away from exports to domestic consumption, some of the businesses that are based in China may move out to ASEAN and South Asian nations. India needs to compete to attract that investment. At any rate, it cannot afford to be out of the value chain. A defensive insular strategy will lead to exclusion.

India must also explore opportunities and synergies with some of the less developed ASEAN countries, particularly the Cambodia, Laos, Myanmar and Vietnam (CLMV) grouping. Interestingly, these four countries are geographically contiguous to India's east (the order of closeness is Myanmar, Laos, Cambodia and Vietnam) and, in many ways, they are India's closest neighbours within ASEAN (along with Thailand). The government of India is actively pursuing investment and trade opportunities with these countries in areas in which complementarities may be greater than competition (and, therefore, more palatable politically). The government has proposed setting up special purpose vehicles to aid investment in the region.[10] The fact that the region has an important geographical link with India's most backward north-east and eastern regions makes engagement a win–win for both sides.

Conclusion

India has a long history of trade with nations near and far, but, in the last 70 years, when India has been a modern, independent country, this relationship with trade has ceased. As a result of the effects of colonialism and the adoption of a broadly statist economy in the 1940s and 1950s, India veered onto a path of import substitution and trade aversion. In fact, this was the case in most post-colonial economies in the developing world. However, unlike the East Asian 'tiger' economies of Singapore, South Korea and Taiwan, which changed course in the 1960s and early 1970s, and China, which changed course from the late 1970s, India has continued to resist trade. It has persisted with a failing import substitution strategy and missed out on an opportunity to catch up through export-oriented growth. The major economic reforms of 1991, which included significant trade liberalisation, hardly led to an embrace of free trade. An uncompetitive manufacturing sector, protected through decades of socialism, was not able to stand up to competition from open markets. While its manufacturing sector remains unable to compete with the best in the world, India will continue to be reluctant

10 For a detailed study of India's engagement with the CLMV countries, see Das (2015).

about freer trade. Therefore, it is imperative that the factors that render Indian manufacturing uncompetitive are urgently addressed. India must begin by doing its homework on the appropriate strategy and reforms. However, a strategy that focuses on setting the right basic conditions for manufacturing—whether through simplifying the rules for conducting business, factor markets reform, tax reform or a focus on infrastructure development—should not be confused with an import substitution strategy. Although India has a big domestic market, the global market will always be much larger. It must make 'Make in India' for the world.

Therefore, India must enhance its engagement with open trade, even during the process of resolving its domestic problems, which will not be solved overnight, but will yield gradual improvements. Indian manufacturing has to become a part of the GVCs that are core to the manufacturing processes and, indeed, to trade. Given the global environment, which has lurched towards protectionism at least in the advanced economies of the West, the logical way for India to pursue a trade strategy is through Asia, the one region of the world that is still growing reasonably fast. India could begin by opening up to the South Asian region, minus Pakistan, and maintaining an open engagement with the East Asian region, without being overly concerned about China. The politics of this strategy are important, as the economies and countries in the Asian region seek a counterweight to China's power. India should also begin to more seriously explore the potential in larger regional arrangements, such as the Regional Comprehensive Economic Partnership. It should insist that other countries take steps to liberalise their services sectors, particularly those sectors that require the movement of natural persons, a comparative advantage for India.

The nature of the global economy—including manufacturing and trade—may undergo a fundamental change as the fourth industrial revolution comes to fruition in a decade or two from now. This means that India has a narrow window to finally catch up on manufacturing as we understand it today. It also means that India needs to get its house in order (i.e. undertake domestic policy reforms) before the onset of that revolution. A proactive Asian trade strategy could help to achieve that goal, which, in the long run, may be more critical than simply raising exports.

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