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CHINA/INDIA: Warming Trends in Economic Relations

Summary

1. Sino-Indian economic relations are gradually improving, although the two countries will probably remain relatively minor trading partners in the foreseeable future. In conjunction with efforts towards normalization of relations, China and India signed the first trade agreement in close to 30 years in August 1984 and a proposal was made to increase two-way trade more than ten-fold to US \$1.0 billion by 1990. Closer relations will be supported by both nations' broader political goals and their newly pragmatic approach to trade liberalization. Nonetheless, growth in bilateral trade is likely to be slow because their export products are primarily competitive. The expected increase in Sino-Indian trade will not greatly threaten Canadian exports, although there could be some minor trade displacement.

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CHINE-INDE: Les relations économiques ont tendance à se réchauffer

Résumé

1. Les relations économiques sino-indiennes s'améliorent petit à petit, quoique les deux pays resteront probablement l'un pour l'autre des partenaires commerciaux relativement mineurs dans l'avenir prévisible. L'entente commerciale signée par la Chine et l'Inde en août 1984 était la première à intervenir en tout près de trente ans et il a été proposé de décupler les échanges commerciaux pour les porter à 1 milliard de dollars (É.-U.) d'ici 1989. Le resserrement des relations sera étayé par les vastes objectifs politiques des deux nations et le nouveau pragmatisme de leur ligne de conduite vis-à-vis la libéralisation des échanges. La croissance du commerce bilatéral n'en sera probablement pas moins lente, leurs produits d'exportations se faisant concurrence. L'augmentation prévue du commerce sino-indien ne représente pas une grave menace pour les exportations canadiennes, même s'il risque d'y avoir certains déplacements commerciaux mineurs.

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Report

2. Economic relations between India and China have gradually improved in recent years following a virtual absence of trade in the 15 years after the 1962 border war. In conjunction with efforts to normalize relations, total bilateral trade grew from some US \$2 million in 1977 to close to US \$60 million in fiscal year 1983-84. This growing trend, however, has been somewhat erratic; bilateral trade actually dropped by over 50 per cent following its peak of US \$145 million in 1982-83. In August 1984, the two countries signed the first trade agreement in almost 30 years in order to promote greater economic ties. This agreement provides for reciprocal most favoured nation status, allowing both partners to enjoy at least as favourable tariff preferences as those accorded to any other country. A goal has been proposed to increase bilateral trade to US \$1.0 billion in three to five years and discussions are currently underway to increase the exchange of market information. (CONFIDENTIAL)

3. The agreement specified a number of potential items for bilateral trade, although no commitments were made and no specific volume goals were set. The list of possible exports from India to China included coffee, tobacco, raw cotton, iron ore, steel, sheet glass, construction

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materials, light engineering goods, scientific instruments, transport equipment and consulting services (especially for civil and industrial engineering and thermal power plants). Identified potential exports from China to India included cereals, edible oils, pharmaceutical products, coking coal, raw silk, non-ferrous metals and engineering goods.

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4. The recent bilateral trade agreement does not particularly signal a change in India's foreign economic policies. In the later years of Indira Gandhi's rule, India was relatively pragmatic in pursuing economic co-operation with Western, Soviet Bloc and Third World countries alike, even in the face of some political differences. Such economic pragmatism is likely to become even more evident under the new government of Rajiv Gandhi and his business-oriented advisors. India can ill afford to ignore potential sources of foreign trade earnings from China or any other country at this point. Its rising current account deficit, combined with an anticipated drop in bilateral and multilateral concessional aid, will probably present India with considerable foreign exchange difficulties throughout the balance of the decade. On the other hand, this ongoing shortage of foreign exchange will also make the government

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somewhat cautious in removing import restrictions on trade. Moreover, while the new government favours trade liberalization in principle, this process will continue to be slowed by powerful commercial interests seeking protection as well as by influential advocates of import substitution and self-sufficiency.

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5. China has also stressed the need for economic pragmatism in its foreign relations and the Sino-Indian agreement is indicative of the government's increasing unwillingness to allow political differences to undermine economic relations. China's current "open door" foreign trade policy has led to a considerable increase in multilateral trade, with a large growth in imports in 1984. Further import increases should be supported over the next several years by China's substantial foreign exchange reserves of some US \$16 billion (at the end of 1984) and by its relatively low debt service ratio. At the same time, exports probably will continue to expand under China's aggressive export marketing policies, although there could be some slowdown in world demand. Developing countries such as India should see some increase in their exports to China,

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but they are unlikely to be the major beneficiaries of China's expanding economic relations. Industrialized countries will continue to have a comparative advantage in producing the advanced technology and capital goods that constitute an important part of China's import demand.

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6. Closer relations in general between India and China would serve each side's broader political goals: promotion of regional stability, improved status in the Non-aligned Movement and enhanced impact in North/South circles. Closer contacts would also help de-emphasize mutual suspicions (i.e. India's concerns about China's links with Pakistan and China's suspicion of India's link with the USSR) while providing leverage to reduce related problems. China believes Rajiv Gandhi is the only Indian leader that could improve Sino-Indian relations. India seeks to broaden its contacts without imperilling its advantageous relationship with the USSR. Both China and India aim to limit superpower presence and impact in Asia and the Indian Ocean.

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7. The two countries may also hope that improved economic relations will provide openings for settlement of their ongoing border disputes. The last round of bilateral

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talks in September 1984 made little progress toward settling border delimitation issues, but did advance exchanges in scientific and cultural areas. Neither side expected much progress prior to the planned Indian general elections and now Mrs. Gandhi's assassination and the elections have further delayed plans to resume discussions. Nonetheless, even if bilateral problems could be speedily resolved, China and India would remain rivals for regional pre-eminence, for Third World influence, for hard-won overseas markets and for concessional development financing.

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8. Although continued improvement in Sino-Indian economic relations can be expected, the two countries are likely to remain relatively minor trading partners for the foreseeable future. The proposed two-way trade goal of US \$1 billion by 1990 is equal to only about 2 per cent of China's current total trade and is less than 4 per cent of India's trade. Even this goal may be difficult to achieve within the suggest time frame, given that the two countries have a very limited ability to meet each other's import needs. Because India and China tend to excel in the production of many similar primary products and labour-

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intensive manufactured items, they will probably continue to be primarily export competitors rather than trading partners. Growth in bilateral trade will probably also be constrained by the unwillingness or inability of India and China to provide concessional import financing. At present, both countries place a very high priority on obtaining favourable financial arrangements when they are choosing foreign suppliers.

(CONFIDENTIAL)

9. Even in those areas where Sino-Indian exports are complimentary, infrastructural constraints will continue to add to the costs of bilateral trade. China and India will, for the most part, find it difficult to take advantage of their common border to conduct trade because of insufficient transport capacity. China has indicated that there is some potential for India to supply inputs for Tibet's economic development, but China's major industrial markets and producers are in the south and north-east. In addition to the problem of the natural barrier of the Himalaya Mountains, transportation bottlenecks prevent China from shipping goods across country and most bilateral trade must be conducted by sea. While improvements in the transportation sector are expected to be a priority in China's Seventh Five Year Plan (1986-90), investment will be

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insufficient to alleviate these constraints. As a result, the locational comparative advantage of Sino-Indian traders will continue to be lower than many of their South Asian competitors. (CONFIDENTIAL)

10. Although both countries would like to increase their exports of manufactured goods and technological services, primary and semi-manufactured products will probably continue to be the mainstay of Sino-Indian trade in the future. India is particularly protective of its manufacturing industries and China likes to depend on its domestic industries to satisfy its demand for manufactures wherever possible. India and China have been more willing to open their doors to high technology imports, but both are primarily interested in the most advanced systems and techniques from Western industrialized nations. Nonetheless, India contends that its indigenous technology for the operation of many industrial and thermal power plants is particularly cost-efficient for countries like China that are rich in labour resources but often lacking in capital and infrastructure. However, even if the Chinese support this contention, Indian manufactures will have to be very price competitive for the Chinese to consider importing them. (CONFIDENTIAL)

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11. There are prospects for some improvement in Sino-Indian economic relations quite apart from developments in bilateral trade. Indian engineers in particular have been searching for new business opportunities in China. Officials from both countries have also been discussing the possibility of establishing more joint ventures; at present, there are only three small-scale joint operations.

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12. There has been some speculation that India and China may form a tea "production union" to co-ordinate foreign sales and to exert greater influence on world tea prices by jointly managing export supplies. There is little doubt that such a union would exercise considerable control over tea prices given that the two nations provide over half of the total world tea production. It is less clear, however, that either country would have much to gain from such a union; although slumping demand for tea in the Middle East markets has precipitated a recent 25 per cent drop in international tea prices, sales in other areas of the world remain strong and tea prices are still high by pre-1984 standards. Moreover, India has already placed significant restrictions on its tea export volume to help provide for

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increasing domestic demand. Production unions appear even less desirable in other fields where India and China are major competitors; both export large quantities of fabrics to the West and light engineering goods to Third World countries, but their combined market shares for these items are too small to give them substantial control over world markets.

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13. Although Sino-Indian trade is expected to remain relatively small, any increase could result in more competition for other trading partners. While Canada's exports to China and India are largely dissimilar to those currently traded between the two countries, Canada could potentially supply some of the products set out in the trade agreement, such as steel, iron ore, coal, tobacco and some manufactures. Nonetheless, the expected increase in Sino-Indian trade will not greatly threaten Canadian exports and any trade displacement is likely to be minor.

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