

Macroeconomic Update: Indian Exports: Loss of Global Competitiveness

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India's exports have declined for six consecutive months since December 2014 with an average decline of 13.85% yoy. The decline was broad-based. Even exports of Manufactured goods trended lower during this time and failed to compensate for the fall in nominal value of commodity exports, which declined due to a huge erosion of global commodity and oil prices. India's exports seem to have become more reliant on global commodity prices in recent years.

In line with global crude oil prices, India's monthly petroleum exports that peaked in July'14 at \$7 billion shrunk to mere \$2.4 billion in May 2015, declining at an average of 52% since the start of the year. Iron ore exports having peaked at \$509.5 million in December 2011 moved from \$129.5 million in April 2014 to \$10 million in May 2015.

It is instructive to take a longer term perspective of export performance (Please see Chart I below). Average export growth has remained almost stagnant since January 2012 after a sharp bounce back from the collapse in the first and second quarters of 2009, induced by the global financial crisis. Export growth since October 2011 (50 months) is much lower than the robust 20% average clocked during the seven year period of April 2002- March 2009. (marginally lower than the 23% rate of growth assumed for the five year period of 2015-16 to 2020-21 in the Foreign Trade Policy announced in early 2015)

Chart 1: India's export growth has been lacklustre since 2012



Source: CMIE data, CRP research

Is the fall in global commodity prices the primary reason for the fall in exports? Does the persistent weakness in exports indicate other structural issues?

The table below indicate that exports from other Asian economies have also suffered due to global demand factors. However, exports from India experience a sharper fall compared to other Asian economies. This perhaps reflects some inherent structural weaknesses that now require to be addressed if export performance is to improve as it must generate the much needed employment opportunities and maintain a healthy external balance.

Table 1: India's export growth has been lacklustre since 2012

% YoY	2014	4Q 2014	1Q 2015	Jan-15	Feb-15	Mar-15	Apr-15	May-15
China	6.1	10.0	10.0	-3.3	48.3	-15.0	-6.5	-2.4
India	0.1	-3.8	-15.4	-9.5	-13.8	-21.3	-14.0	-20.2
Indonesia	-3.7	-8.2	-8.2	-7.7	-16.8	-10.3	-8.5	
Japan	0.4	-6.0	-4.9	2.6	-11.9	-7.8	-7.4	
Korea	0.5	-3.6	-11.3	-1.0	-3.3	-4.5	-8.0	-10.9
Malaysia	6.9	-4.6	-4.6	-8.4	-17.0	-8.8	-18.3	
Philippines	11.2	5.0	5.0	0.0	-3.0	2.1	-4.1	
Singapore	-0.3	-8.0	-8.0	-6.4	-21.6	-7.4	-15.6	
Thailand	-0.3	-0.7	-0.7	-2.6	-6.0	-4.3	-1.7	
Vietnam	13.7	3.8	3.8	17.0	-0.3	8.7	5.6	8.8

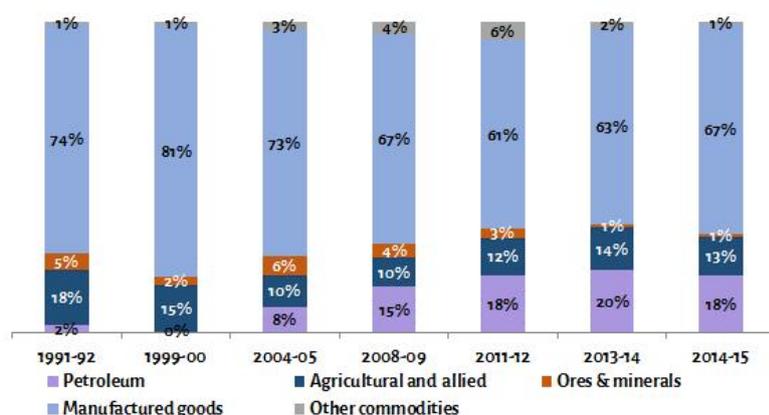
Note: 2014 is the calendar year, 4Q is the period from October to December and 1Q is the period from January to March

Source: HSBC research, CMIE database, CPR research

Composition of India's Export Basket

India's export basket is highly diversified. Manufactured products constitute the largest share – around 67% followed by petroleum products at 18%, agriculture products at 12.5% with Ores and Minerals contributing 1% to total exports.

As seen in Chart 2, India is one of the few emerging economies whose share of manufactured goods in total exports has declined continuously over the years - from the high of 81% in FY 1999-00 to 67% in FY 2014-15. Over the same period, the share of Petroleum exports increased as India's refining capacity expanded. The share of ores and minerals exports that increased from FY 1999-00 until 2009, when it started to decline principally due to domestic judicial constraints and unresolved policy issues. The decline in the share of manufacturing products is a regressive trend that needs to be urgently corrected if India does not want to emulate the Russian example of a backward slide to become primarily a commodities exporter. This is specially inimical to employment growth as commodity exports are highly capital intensive.

Chart 2: Change in product composition of export goods (% share)

Source: CMIE data, CRP research

It is easy to see that around 32% (Ores & Minerals, Crude oil and Agriculture products) of India's total exports is directly exposed to global price volatility and the recent decline in nominal value of these exports is directly linked to fall in commodity prices. However, Non-commodity exports where prices have been relatively stable are also declining.

Table 2: India's Top Ten Exports (in FY 2014-15, \$ Bn)

	FY 2014-15	% YoY	% Share of Total
Total Exports in \$ Billion	309.3	-1.8	100.0
Engineering goods	69.4	14.3	22.4%
Petroleum: crude and products	56.5	-10.7	18.3%
Gems and Jewellery	41.0	-0.8	13.3%
Agricultural and allied products	38.7	-9.9	12.5%
Chemicals & related products	32.3	2.8	10.4%
Textiles (ex readymade garments)	18.0	0.1	5.8%
Readymade garments	16.8	12.3	5.4%
Electronic goods	7.2	-17.3	2.3%
Leather & leather manufactures	6.2	7.8	2.0%
Ores & minerals	2.4	-33.2	1.0%

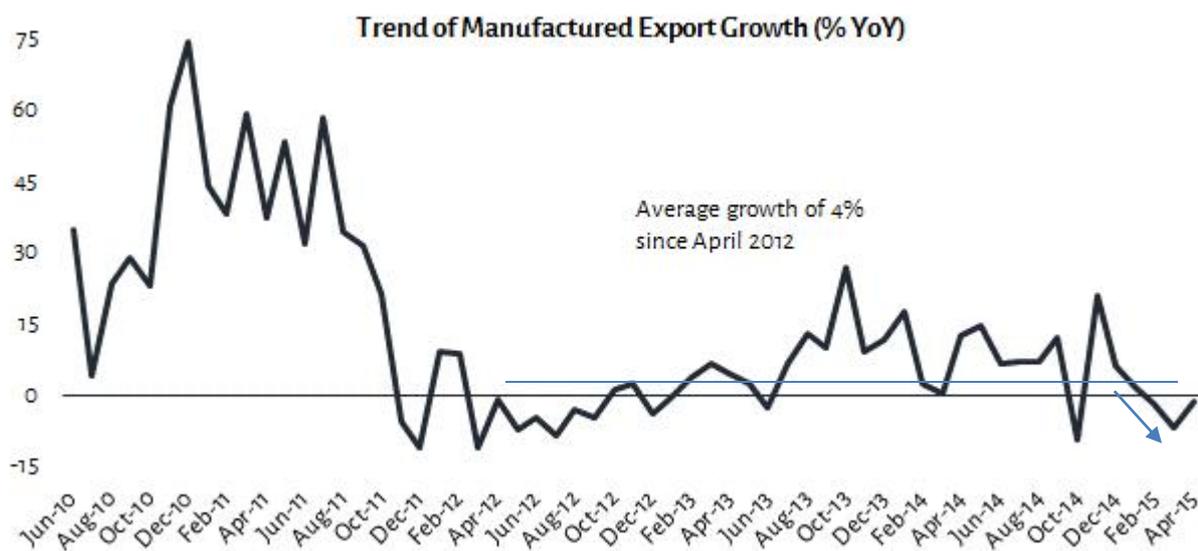
Source: CMIE data, CRP research

A look at the top ten exports products from India indicate that Engineering Goods retain their position as the largest share in exports.

Recent decline in petroleum exports due to sharp fall in global crude oil price has pushed it to fifth place with its share falling to around 11% as on May 2015 from 18.3% last year. It is replaced by Gems and Jewellery as the second largest export product with a share of 13.3%.

Manufactured Goods Exports

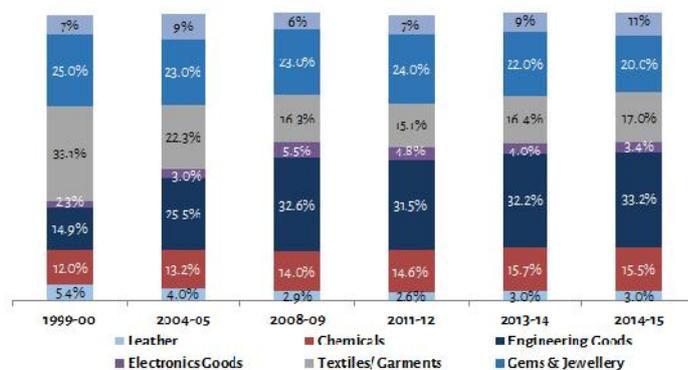
Manufactured exports have been clocking a low single digit growth rate since 2012 after the robust 23% yoy growth during the boom period of 2003-2008 (same rate as assumed in FTP 2015). They have worryingly suffered a decline for four successive months during February to May 2015.

Chart 3: India's Manufactured Goods Export Growth Has Been Lacklustre Since 2012

Source: CMIE data, CRP research

Within manufactured products, the composition has undergone a significant change from traditional, labour-intensive products like Textiles and ready-made garments, Leather and Gems & Jewellery to more modernized, mechanized engineering goods like automobiles, auto parts, capital goods and cotton and polyester yarn.

Chart 4: Change in composition of Manufactured goods exports



Source: CMIE database, CPR research

Share of traditional exports like 'Textile (including Ready-made Garments)' and 'Leather' products has come down from 33% and 5% in 1999-00 to 17% and 3% respectively in 2014-15.

The fall in share of Textile was taken up by 'Engineering goods' as its share more than doubled from 15% to 33% during that period.

'Engineering goods' and 'Gems & Jewellery' are the two top segments within manufactured goods accounting for 53% of total manufactured goods exports.

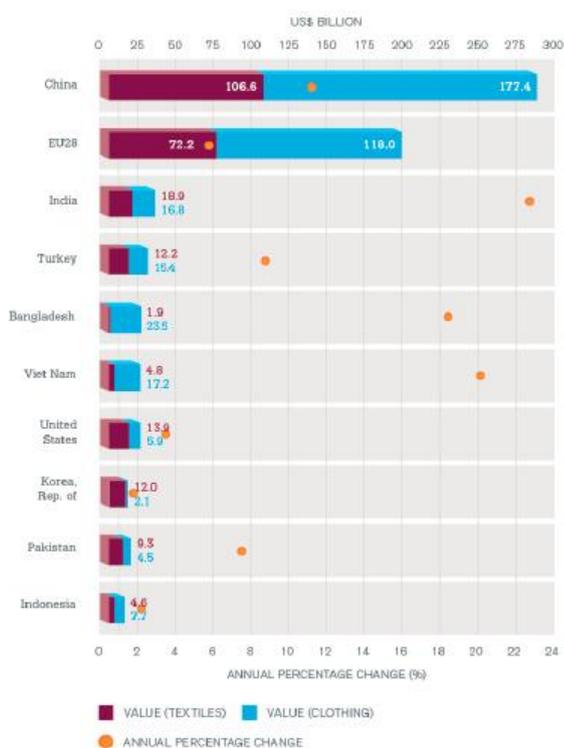
TEXTILES

Share of Textile exports (including Ready Made Garments, RMG) in India's total exports has declined considerably since the 90s.

Despite being the third largest textiles exporter, India's share is a mere 6% of total world exports (in 2013) while the top exporter China accounts for a huge 35% of the total global market share.

In Ready-made Garments or Clothing exports, Bangladesh has surpassed India to become the third largest Clothing exporter of the world with a share of 5%, perhaps because of its duty free access to Canadian and European (including UK) markets. India ranked just below Bangladesh but was far behind China which accounted for a whopping 40% of global clothing exports. The silver lining is the Middle East market where India's clothing exports increased by 53% annually in the last year.

India ranks third among the world exporters in Textile and Clothing segment taken together in 2013, as reported in latest WTO report. The highest growth was clocked by India at 23% as seen in the chart below. Viet Nam increased its share in world exports and overtook the United States in 2013 as the sixth-largest exporter of textiles and clothing.

Table 3: India is one of the top exporters of Textile and Ready-made Garments in the world (as in 2013)**Textile**

	Rank	Value (\$ Bn)	Share in World Exports			
			1980	1990	2000	2013
China	1	107	4.6	6.9	10.4	34.8
EU	2	72	-	-	36.7	23.6
India	3	19	2.4	2.1	3.6	6.2

Clothing (Ready-made Garments)

	Rank	Value (\$ Bn)	Share in World Exports			
			1980	1990	2000	2013
China	1	177	4.0	8.9	18.3	38.6
EU	2	118	-	-	28.7	25.6
Bangladesh	3	24	0.0	0.6	2.6	5.1
India	6	17	1.7	2.3	3.0	3.7

Source: WTO statistics, CPR research

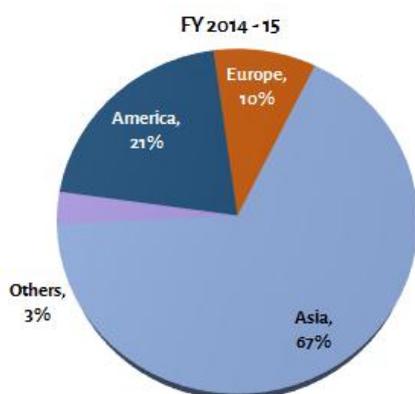
Within textiles exports from India (excluding RMGs), the share of yarns and fabrics, which are increasingly becoming automated and absorb smaller number of workers, has increased to about 86% of the total textile exports. *These are effectively commodity exports as both yarn and fabric do not have the benefit of branding that permits higher unit value realization. India has apparently lost market share in labour and skill intensive RMG, thereby causing employment losses in this sector.* Labour intensive exports like carpets have seen their share decline to a mere 8% in line with ready-made garments.

In the textile sector, therefore, there is a clear need for policy intervention to reverse this trend towards lower labour intensive exports. A possible way forward would be to replace the capital subsidy paid under the Technology Up gradation Fund with a labour related subsidy for the export units. This would have to be done in a WTO compatible manner.

Gems and Jewellery (G&J)

India exported G&J worth \$41 billion in the year 2014-15 as against \$24.8 billion of Transport equipment, \$16.8 billion of machinery, \$8.7 billion of Iron & Steel and \$2.4 billion of Ores & minerals – making it one of the top foreign exchange earner.

India is the world's largest diamond cutting and polishing centre and exports 95% of the world's diamonds, according to statistics released by the Gems and Jewellery Export promotion Council (GJEPC).

Chart 5: Destination of Gems and Jewellery exports

India exports Gems and Jewellery mostly to Asia (67% of total) with UAE accounting for 29.9% (vs. 4% in 1990-91) and Hong Kong 29.5% (vs. 14% in 1991-91). Interestingly, exports to UAE have tripled and that to HK doubled since FY 2007-08.

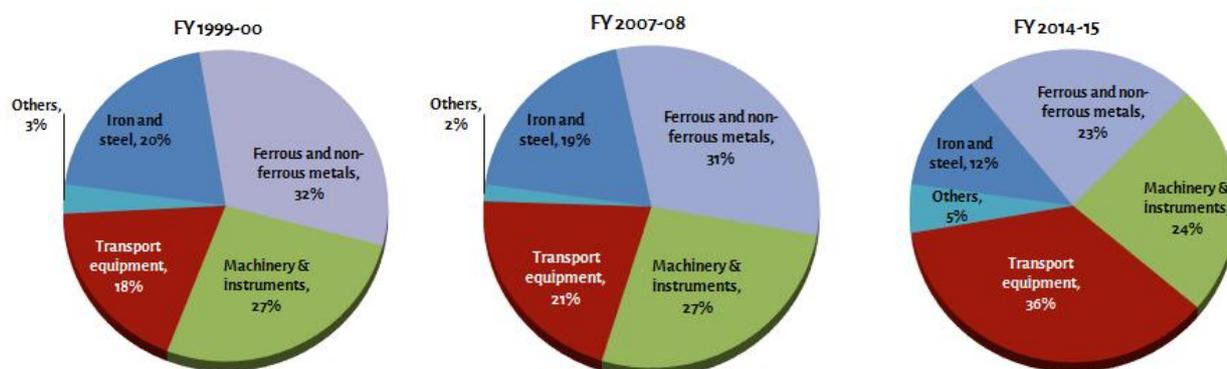
On the other hand, share of exports to US and Europe has declined. Share of exports to Europe was 24% of total in 1991-92 which came down to 9.5% in 2014-15.

Source: CMIE database, CPR research

India has a competitive advantage in G&J sector and it is a success story of labour intensive exports. Much more focused policy initiative should be given to this sector, including setting up of new clusters with R&D and design facilities to further boost our market share. Recently, China has been increasing its imports of Gems & Jewellery with the rise in its household disposable income. India should try and penetrate this market.

Engineering Goods

The 'Engineering goods' is the largest export segment of India by share. The export of 'Engineering Goods' almost doubled since FY 2007-08 to \$69 billion in FY 2014-15 (it increased 12 times from \$5.7 billion in FY 2000-01).

Chart 6: Change in composition 'Engineering goods' exports

Source: CMIE database, CPR research

India's export of 'Iron & Steel' has moved down significantly since FY 2007-08 as export growth of these items remained stagnant or very low. However, India was ranked 8th among the top exporters in 'Iron & Steel' segment with a share of 2.8% in world exports in 2013. It has also managed to increase its share from 0.9% in 2000.

Table 4: Top exporters of 'Iron & Steel' and 'Automobile products' in the world (2013)

Iron & Steel							Automotive products						
	Rank	Value (\$ Bn)	Share in World Exports					Rank	Value (\$ Bn)	Share in World Exports			
			1980	1990	2000	2013				1980	1990	2000	2013
EU	1	169	-	-	47.1	37.1	EU	1	656	-	-	49.8	48.7
China	2	55	0.3	1.2	3.1	12.0	Japan	2	152	19.8	20.8	15.3	11.3
Japan	3	39	20.1	11.8	10.4	8.6	USA	3	135	11.9	10.2	11.7	10.0
India	8	13	0.1	0.2	0.9	2.8	India	11	11	-	0.1	0.1	0.8

Source: WTO statistics, CPR research

On the other hand, 'Transport Equipment' (including cars and auto components) export from India has been growing at an average of 23% in last seven years and increased its share in India's total exports from 21% in FY 2007-08 to 36% in FY 2014-15 (from \$7 bn to \$24.8 bn during that time). 'Transport Equipment' are exported primarily to Asian countries with Sri Lanka and UAE accounting for about 24% of total transport equipment exports. India has increased its share in world export of 'Automotive products', according to WTO report and was ranked 11th among top exporters in that segment in 2013.

The success of automobile sector has some directly relevant lessons for other sectors. Government of India had liberalised the automobile industry in 1991 and created the Auto Policy in 2002 to attract foreign direct investment (FDI) into the sector. The policy allowed automatic approval of foreign equity investment of up to 100% for the manufacture of automobiles and auto components. According to the Department of Industrial Policy and Promotion (DIPP), the industry has attracted FDI worth US\$ 12.4 billion during the period April 2000 to February 2015. Several car makers including foreign manufacturers like Honda, Renault, Nissan, Ford, Fiat, Volkswagen etc. are building new capacity in India dedicated partially or exclusively for exports. Car makers are making India an export hub for markets such as Africa, Latin America and the Middle East. The Automobile Mission Plan of the government for the period 2006–2016 states: "to emerge as the destination of choice in the world for design and manufacture of automobiles and auto components with output reaching a level of \$145 billion; accounting for more than 10 per cent of the GDP and providing additional employment to 25 million people by 2016." India is expected to improve its world market share in this segment going forward.

The directly relevant lesson of other sectors is to make them attractive for FDI and take active steps to attract export oriented FDI in sectors where India can be integrated with global production networks or where the domestic market offers sufficient demand for exploiting economies of scale.

India has managed to diversify its exports basket but has failed to claim a large market share in any product category. Its share in total global exports in various segments remains low even in segments where it is one of the top ten exporters. A detailed study of the manufactured exports indicate that capital and skill intensive groups like Engineering goods (machinery, transport equipment) and Chemicals have performed better in terms of export penetration and volume growth. But unskilled labour intensive segments like Garments (RMG) and Leather have performed poorly. This is in contrast to the general perception that India has a competitive advantage in unskilled labour intensive industries due to availability of cheap labour as well as huge demand for such products from developed markets. An urgent corrections is called for and policy measures required to reverse this trend.

Structural Impediments for Export Performance

India has diversified its export destination from developed economies to others in the last decade. In 2000, more than 50% of India's merchandise exports were going to key developed markets (DMs) like USA, Euro area, UK, Canada, Australia and Japan (as seen in Chart 10). But a decade and a half later, the situation has dramatically changed. Now only a third of our exports go to these developed markets and 71% of our exports go to various emerging economies with 49% going to Asian economies.

Recent fall in commodity prices explain some weakness in export growth but that is only part of the story. In terms of exports by destination, exports to the US have become the key support to overall exports since last couple of years, in line with the gradual recovery of the US economy.

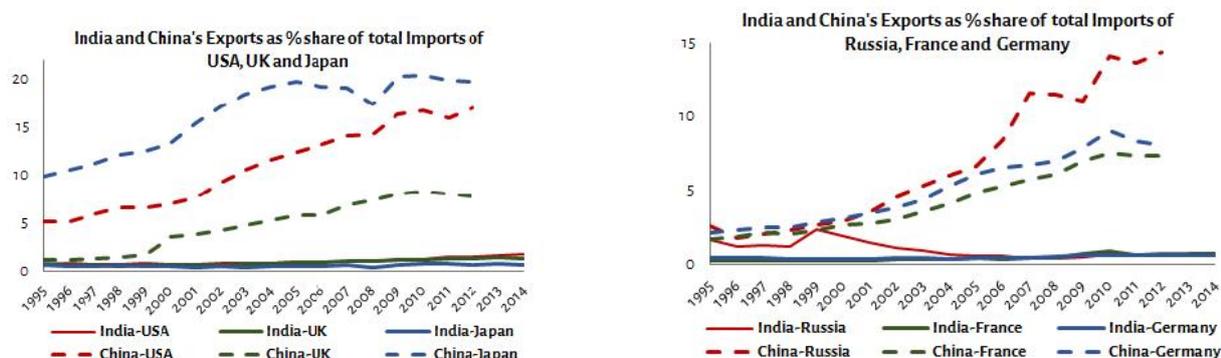
However, exports to Europe have contracted sharply in FY 2014-15. It is convenient to think that the sharp fall in the currency euro is responsible for this as exports to Euro area in nominal terms is reported in US dollar. There might be some truth in it as euro is down nearly 20% yoy against the US dollar. But a recent report by HSBC stated that exports in volume terms from Emerging Asia to Euro area has remained flat since last year with slight downward movement in recent months. So, exports to Euro zone has remained slow due to structural reasons other than the falling currency. Interestingly, export growth to China has been moderating since FY 2002-03 and finally contracted last fiscal. Fall in commodity prices as well as slowing demand from China are both responsible for this.

India Failed to Improve The Share of its Exports in Developed Economies Unlike China

Charts below show India and China's exports as a share of total imports of major developed economies. India's share of export to USA and UK improved from a mere 0.7% in 1995 to only around 1.5% in 2012 while that of China increased to 17% and 8% respectively (from 5% and 1% in 1995 respectively). India's export to Russia actually went down while that to France and Germany remained flat. However the share of China's export to these economies took off since 2000.

India failed to improve its market share in its existing markets in Developed Economies while it diversified into other emerging markets. This is a purely defensive response and does not auger well for our future export performance because advanced economies will continue to have by far the largest share in global imports for the foreseeable future.

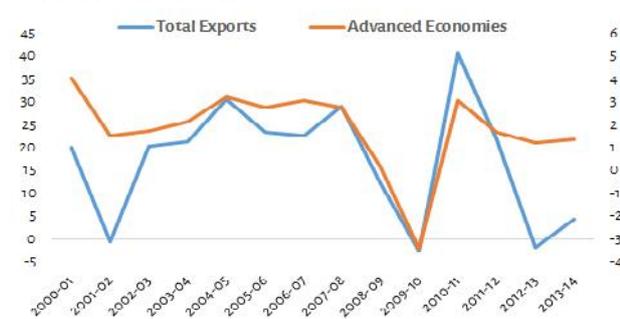
Chart 7: Comparison of India and China's Export Share in Total Imports by Major Developed Markets



Source: WTO statistics, CMIE, CPR Research

Excessive diversification of India's export, both in terms of products and destinations, has made our exports sensitive to global growth and so the export growth closely tracks the global growth.¹

Chart 8: Movement of export and GDP growth of advanced economies



Source: IMF database, CMIE, CPR Research

The chart 13 plots India's export growth and GDP growth of advanced economies. The two lines almost move in sync with a sharp plunge during financial crisis when our exports declined along with global demand.

However, since 2011, the two lines diverged - India's exports remained weak while global growth stabilised. This is due to huge diversification of our export destination and a decline in market shares in advanced economies.

Reasons for Weakness in Exports

In the table below we try to compare some key supply side variables during the boom period of 2004-2008 and the post crisis period of 2010-2014.

Table 5: Comparing the two periods 2004-2008 and 2010-2014

Loss of Competitiveness

	2004-2008 (Average)	2010-2014 (Average)
REER (Export weighted 36 currencies)	103	111
Real Rural Wage Growth (% YoY)	-0.6	10.7
Road Length in Km/Day	8.4	6.9
Telecom Subscriber Base Growth (% YoY)	41.1	11.7
Core Sector growth (% YoY)	5.8	5.6
Gross Electricity Generation	6.0	5.9
Peak Power Deficit	13.6	8.4

Source: CEA, CMIE, CPR research

- ❖ It is easily seen that there was some productivity loss during the post-crisis period. Real rural wage rate was growing at high 10.7% compared to almost flat growth during the boom period.
- ❖ Rupee appreciated in real term during the second period.

¹ It is found that GDP growth of USA (or advanced economies) had much higher influence on India's export during the earlier period of 2000 to 2006 with a correlation coefficient of 77% which reduced to 33% from 2006 to 2015. So, the recent pick-up in US growth has failed to lift our exports. On the other hand, the correlation with growth rate of Emerging and Developing Asia has increased in recent times. The correlation coefficient in recent period has increased to 78% from 60% in earlier period (2000-2006) making growth rate of China and other major Asian economies' much more influential on our exports. With the change in our export destination in last decade with higher share to Asian economies, it is obvious that demand from China will impact export growth.

- ❖ Infrastructure growth slowed down in the latter period when measured by proxies such roads constructed in Km per day, growth in telecom subscribers, core sector, electricity generation and peak power deficit as proxies for infrastructure sector. We find that infrastructure constraints were there even during the boom period. However, the evidence is not very conclusive because the core sector growth and increase in electricity generation remained almost the same during both the periods.
- ❖ Slower global demand growth combined with loss of global competitiveness due to higher wage growth, stronger rupee and infrastructure deficit had an adverse impact on Indian exports since 2012.
- ❖ India has managed to reverse few of the key supply side weaknesses. Rural wage growth that peaked at 21.5% YoY in August 2011 has decelerated sharply and averaged at around 5% in recent months. There is a greater push to ease infrastructure bottlenecks with higher public expenditure particularly in roads, railways and ports.

Conclusion:

- **India has managed to diversify its exports but with mixed results. It has failed to claim a large market share in any export product category in the world. It does not have depth in any export product or any market.**
- **A detailed study of the manufactured product exports reveal that unskilled labour intensive segments like Textile and Leather have performed poorly despite the fact that India has a competitive advantage and there is a huge demand for such products from developed markets.**
- **India needs to identify the sectors where it has the natural competitive advantage and focus sharply on providing necessary infrastructure and skills for these sectors.**
- **These sectors can also lead India's effort to integrate with global production networks which depends critically on availability of adequate infrastructure and ability to attract export oriented FDI as in the automobile industry.**
- **Some macroeconomic factors like an appreciated Rupee and rise in real wages have hurt export performance. This can be compensated by replacing capital related subsidies with labour and employment related promotion activity to reverse the trend of rising capital intensive exports.**
- **The evident inability to increase our share in global markets in general and in advanced economy markets in particular points sharply to the need for a thorough review of the working and performance of export promotion councils and other agencies like FIEO, STC and MMTC.**