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For India to Improve its Export Performance, there is a Need For Price Stability

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Improving export competitiveness depends on the government, through prudent fiscal policy, and the RBI, through appropriate monetary policy that maintains price stability.

Representative image. Credit: Reuters/Amit Dave

US President Donald Trump has formally announced the US's withdrawal from the Trans-Pacific Partnership (TPP) agreement signed last year by 12 nations (Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the US and Vietnam) with a combined population of 480 million.

It is a blow to the 11 other members. The US, with its GDP of $18.6 trillion, accounting for 85% of the group's total GDP, would have become the engine of growth and prosperity in the TPP region. The TPP region would have been the largest free trade area with a share of about 40% of world GDP as well as 40% of global trade.

China's ambition

China has already suggested a trade pact, the Regional Comprehensive Economic Partnership (RECP), with a carrot: no environmental and labour protections, which were insisted upon by former US President Barack Obama for TPP. China's RECP will be a larger group, with 16 members, including ten Southeast Asian countries as well as Japan, South Korea, Australia, New Zealand and India.

A well-known Chinese military leader made it clear when he wrote in his blog: "You have your 'America first', we have our 'community of common destiny for mankind'. You have a 'closed country', we have 'one belt, one road'."

China is holding an international conference in May this year that would serve as a showcase of its new Silk Road trade and investment programme. It has renewed its invitation to all, including those who are now deserted by Trump. The world's biggest communist country (GDP $11.4 trillion) has already dislodged Japan (GDP: $4.7 trillion) to take second place behind the US in GDP. It is now aspiring to be the first. It adopted all the capitalistic measures to become number two. Did Deng Xiaoping not say, "It doesn't matter if a cat is black or white, so long as it catches mice"?

With the opportunity it has been handed by Trump, China is eager to complete "the economic integration process of the Asia Pacific" by encouraging free trade. China is aware that it now dominates the world merchandise trade. It ranks number one among the world's exporting countries, accounting for 13.8% of world exports, and ranks number two among importers with 10.6% of world imports. The US, on the other hand, ranks number one among world's importers (13.8% of imports) and number two among exporters (9.13% of world exports).

Although Australia made a brave announcement that the remaining 11 members would go ahead by giving the partnership a new name, TPP 12 minus, and the country's trade minister suggested the inclusion of Indonesia and China into the fold, not many countries see eye to eye. New Zealand is not that enthusiastic. It would also like to consider bilateral agreements.

What should India do now?

The RECP is unlikely to materialise soon as all trade agreements take years to come to conclusion.

In the meanwhile, Indian policymakers have to examine a host of domestic issues that have a bearing on the external sector: exports, imports and trade deficits. India's trade as a proportion of its GDP is shrinking. It was 53.4% in 2008; it declined to 46.8% a year later as a result of the 'great recession'. As conditions improved trade grew to 48.8% in 2014, but global demand conditions began to worsen in 2015 and trade plummeted to 42.1% of GDP. Global trade shrank from 61.0% of GDP in 2008 to 52.6% in 2009, then improved to 60.1% in 2014 and went down to 58.3%, which only proves India is increasingly integrating in the global economy.

Trade in India

Exports as % of GDP
Imports as % of GDP
Trade as % of GDP

2008
24.3
29.5
53.2
2009
20.6
26.2
46.8
2014
22.9
24.1
48.8
2015
19.9
22.1
42.1

However, can we lay the blame of poor export performance on global conditions alone? India's exports as a percentage of GDP have been falling. Imports have also been declining. While one can try to explain away the fall in imports, by attributing it to the decrease in domestic investment by the private sector as reflected in the falling ratios of gross capital formation to GDP and the resultant fall in capital imports, the reasons for falling exports are not that simple.

Most of the factors behind decreasing imports are within our control. We have not been successful in our efforts to diversify our exports into manufactured consumer goods, as has been achieved by China. There is continuing reliance on gems and jewellery, which contribute nearly 15% to the country's exports. There is greater scope for stepping up earnings from drugs and pharmaceuticals, organic and inorganic chemicals, and from engineering goods. There is also a need for looking to new export markets, especially in Africa. Efforts should be directed towards finding new products and new markets. India has done well in one particular area: fuel, oil and oil products. Exports from this category, which were just 5.2% of total exports in 1990 but rose to 20.4% in 2009, are subject to volatility in oil price. Due to a falling trend in oil prices until recently, the share of this category declined to 18.6% of total export earnings. However, rise in oil prices helps only major exporting oil countries. India is not among them.

Price stability for export competitiveness

Commodity diversification and exploration of new markets takes time. In the short term, India can ensure export competitiveness by focusing on its real exchange rate, which is defined as the product of nominal exchange rate expressed as units of foreign currency per one unit of domestic currency and ratio of domestic price index to foreign price index. Given the nominal exchange rate, rise in domestic price level relative to foreign price level makes the real exchange rate rise, which hurts competitiveness. Foreigners have to pay more than before in their currency if the real exchange rate rises. Maintaining or improving competitiveness for promoting exports entirely depends on the government, through prudent fiscal policy, and the monetary authority, through its appropriate monetary policy for maintaining price stability.

The Reserve Bank of India calculates each month what is known as the real effective exchange rate (REER) index covering currencies of 36 trading partners by using the proportion of their exports to total exports as weights, besides the Indian consumer price index (CPI) and 36 countries' price indices.

The Ttable below gives the CPI and REER index numbers. The REER rises as the CPI index rises. Increase in REER signifies decrease in export competitiveness.

CPI, REER and exports

2016	CPI	REER Index
January	126.30	115.30
February	126	112.5
March	126	113.30
April	127.30	113.10
May	128.6	113.30
June	130.1	113.80
July	131.1	114.30
August	131.1	115.7
September	130.9	116.4
October	131.4	116.80
November	131.20	117.9

If India does not control domestic inflation, its export competitiveness will be hurt and exports fall. The latest available trade data (November 2017) reveal that while exports of Australia rose by 23.4%, Indonesia by 21.3%, Vietnam by 16.1%, Thailand by 10.2%, South Africa by 8.5%, Malaysia by 7.1% and South Korea by 2.5%, India's exports rose only by 2.3%.

With dimmed food output prospects due to a poor northeast monsoon, possible drought in the southern states and rise in oil price raising the transport cost component affecting WPI and then CPI, we are heading towards cost-push inflation.

A big fiscal stimulus at this stage will only compound the problem. That will be a challenge for RBI, as well as for exporters.

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