



AIC COMMENTARY

No. 37, January 2023

Global Quest for Supply Chain Diversification: Is India Gaining from It?

Pankaj Vashisht* and Oorja Tapan**

New geopolitical construct – “Indo-Pacific” - has gained prominence in policy circles. Though Indo-Pacific is predominantly is a geopolitical construct, it also has a strong economic underpinning which revolves around economic rebalancing or reducing trade dependence on China. This commentary looks into the economic aspects of the Indo-Pacific strategies of leading global players and tries to examine whether or not India is gaining from it.

Introduction

Remarkable economic rise of China has been the most important feature of recent history. Discarding anti-globalisation sentiments, China opened up to foreign trade and investment in 1978. Though it reaped considerable economic benefits of the free trade regime in the 1980s and 1990s, it started taking giant economic strides only after joining the global trading system in 2001. Since then, it has made enormous economic gains to emerge as the nerve centre of global industrial activities. China has become the “world’s factory”. Guided by a well-crafted industrial strategy, it has not only built the largest manufacturing sector in the world but has also gained a massive share in global trade. The economic rise of China has benefited the world through trade-induced welfare gains (Giovanni et al., 2013). However, the welfare gains have also coincided with serious conflicts. Chinese aggressive behaviour in the South China Sea has raised concerns regarding good maritime order rooted in adherence to the established international law and norms (Khurana, 2019). Consequently, a new geopolitical construct –“Indo-Pacific”- has gained prominence in policy circles. Though Indo-Pacific is predominantly a geopolitical construct, it also has a strong economic underpinning which revolves around economic rebalancing or reducing trade dependence on China. Against this backdrop, this commentary looks into the economic aspects of the Indo-Pacific strategies of leading global players and tries to examine whether or not India is gaining from it.

*Pankaj Vashisht is Associate Professor, Research and Information System for Developing Countries (RIS), New Delhi. **Oorja Tapan is a Scholar at Jawaharlal Nehru University (JNU) and was intern at RIS. Views are authors own. Usual disclaimers apply.

High Global Dependence on China

Phenomenal surge in Chinese exports is a well-known fact. During the last two decades, Chinese exports have consistently registered a double digit growth to cross the US\$ 3.5 trillion mark in 2020. With this spectacular growth, China has emerged a key supplier of several products. Its control on global supply of certain products can be gauged from the fact that there are 521 tariff lines at 6-digit level of HS code for which China accounts for more than 50 per cent of global exports (Table1). Apart from these items, it also enjoys more than 30 per cent share in the global exports of another 710 tariff lines. Notably, several of these products are critical for the production of high-tech digital and clean energy systems. For example, with firms' grip on the global supply of several minerals such as rare earth elements, yttrium, gallium, etc. China occupies a prominent position in the value chains of high-performance magnets and several electronic products. Similarly with a very high share in global exports of doxycycline, Vitamin B, Aspirin along with Active Pharmaceutical Ingredients (APIs), China has emerged critical in the global supply chain of pharmaceuticals. Besides, China also enjoys dominance in the supply chain of solar panels, computing equipment, li-ion batteries and many more.

Table 1: Share of China in Global Trade by Tariff Lines

| Sr. No. | Share in Global Trade (%) | Number of Tariff Lines at 6-digit HS Code |
|---------|---------------------------|---|
| 1 | Above 90 | 11 |
| 2 | 80 to 90 | 48 |
| 3 | 70 to 80 | 93 |
| 4 | 60 to 70 | 152 |
| 5 | 50 to 60 | 217 |
| 6 | 40 to 50 | 302 |
| 7 | 30 to 40 | 408 |
| 8 | 20 to 30 | 553 |
| 9 | 10 to 20 | 958 |
| 10 | Bellow 10 | 2644 |

Source: Calculated based on UNComtrade Database

Rebalancing Initiatives

The world woke up to the flip side of overdependence on China, for the first time, in 2010 when in response to a diplomatic row, China stopped the export of rare earth elements (REE) to Japan. Suspension of REE export sent a shock wave to the world, leading to a massive surge in REE prices (Shen et al., 2020). This blatant misuse of control on the supply of critical minerals as a political weapon, forced leading global players to rethink China as a trusted trade

partner. In subsequent years, the terms such as ‘China Plus One’ and ‘Exit China’ started appearing in public discourse and multinationals started looking for business diversification to reduce dependence on China. However, the ‘Exit China’ became most pronounced after the COVID-19 outbreak, which disturbed global value chains and left most of the countries struggling for supply of essential products. During the same time, the leading economic powers adopted the Indo-Pacific construct and spelled out their Indo-Pacific strategies. These strategies unequivocally highlighted supply chain diversification/resilience as one of the prime policy objectives. Subsequently, few countries have announced specific initiatives to achieve the target of supply chain diversification/economic realignment.

Japan has been the most vocal proponent of supply chain diversification. During the last couple of years, it has announced two specific initiatives to reduce dependence on China. First, in 2020, it earmarked a US\$ 2.2 billion financial support package for Japanese corporations operating from China to relocate either back to Japan or ASEAN, India and Bangladesh. It was followed by the launch of a joint ‘Supply Chain Resilience Initiative’ (SCRI) with Australia and India. The SCRI envisages investment promotion events and buyer-seller matching events along with joint trade and investment diversification measures to achieve the objective of economic realignment. The USA has also recently launched the Indo-Pacific Economic Framework to counter China’s regional economic influence. Though IPEF focuses more on formulation and harmonisation of standards, it also envisages achieving supply chain resilience by establishing early warning systems, mapping the critical mineral supply and coordinated diversification measures.

Opportunities for India

Growing clamour of supply chain diversification augurs really well for India. Given a strong manufacturing base and large pool of young labour force, India has potential to emerge as a preferred destination for multinationals which are contemplating to shift part of their production out of China to comply with their respective government’s vision of supply chain diversification. Though it's a bit premature to answer if India actually is gaining from the global quest for economic realignment, the early evidence does not paint a rosy picture. Despite some positive anecdotes such as the iPhone coming to India, emerging trends suggest that firms leaving China are not opting for India. The outcome of Japan’s program for ‘strengthening overseas supply chain’ provides clear evidence for this. Japan has been subsidising its firms for shifting base from China to other selected ten Asian countries including India. So far, 113 Japanese firms have availed financial assistance under this program. However, only two

out of these 133 firms have opted for India. Vietnam, followed by Thailand and Malaysia, has emerged as most preferred choice for firms shifting base from China.

Table: 2: Projects Approved under Supply Chain Diversification Support Project

| Country | Round 1 | Round 2 | Round 3 | Round 4 | Round 5 | Round 6 | Total |
|-------------|---------|---------|---------|---------|---------|---------|-------|
| Bangladesh | | | 0 | 0 | 0 | | 0 |
| Brunei | | | | 0 | 0 | | 0 |
| Cambodia | | 2 | 1 | 0 | 0 | 1 | 4 |
| India | | 2 | | 0 | 0 | | 2 |
| Indonesia | 1 | 4 | 5 | 2 | 3 | | 15 |
| Lao PDR | 2 | 1 | 0 | 0 | 0 | | 3 |
| Malaysia | 3 | 3 | 4 | 3 | 3 | | 16 |
| Myanmar | 1 | 0 | 3 | 0 | 0 | | 4 |
| Philippines | 3 | 0 | 4 | 2 | 0 | | 9 |
| Thailand | 6 | 7 | 6 | 3 | 3 | 3 | 28 |
| Timor | | | 0 | 0 | 0 | | 0 |
| Viet Nam | 15 | 6 | 15 | 2 | 2 | 2 | 42 |
| Total | 30 | 25 | 30 | 11 | 11 | 6 | 113 |

Source: JETRO, available at <https://www.jetro.go.jp/services/supplychain/>

Note: Some of the accepted projects are multicounty projects, therefore the country's addition can be higher than the total number of projects reported in the last row.

Way Forward

India, in this 'drift for diversification' has a golden shot at capitalising groupings like the QUAD, SCRI and IPEF to attract global value chains towards its own manufacturing and industrial sector in order to promote the vision of 'Atmanirbhar Bharat'. However, economic gain from ongoing global economic realignment is not automatic. Despite considerable improvement in ease of doing business over the last eight years, India is yet to attract efficiency seeking foreign firms. Substantial challenges stand in the way of India gaining leverage in the "Plus one" diversification model. There is an urgent need to establish India as trusted and efficient supply chain partners. It requires effort on several fronts. First and foremost, infrastructure upgradation is required to reduce logistic cost as India is still ranked below most of its competitors in South East Asia as far as logistics cost is concerned. Speedy implementation of Bharatmala, Sagarmala and PM Gati Shakti National Master Plan could be of great help in this regard. Second, skill shortage needs urgent attention as India is ranked among the top four countries globally facing acute skill shortage. Third, structural reforms are needed for ensuring easy availability of land in mega SEZs. Fourth, India needs to reduce tariffs on intermediate goods which at present is significantly higher than ASEAN economies. Finally, there is a need to address the regulatory constraints. The rare earth element sector is the best example where regulatory constraints are keeping foreign firms away.

References

Giovanni J., A. A. Levchenko and J. Zhang (2014) "The Global Welfare Impact of China: Trade Integration and Technological Change", *American Economic Journal: Macroeconomics*, Vol. 6, No. 3, pp. 153-183

Khurana G. S. (2019): "The Indo-Pacific Idea: Origin, Conceptualisation, and the Way Ahead", *Journal of Indian Ocean Rim Studies*, October-December

About AIC



RIS

Research and Information System
for Developing Countries

विकासशील देशों की अनुसंधान एवं सूचना प्रणाली

Considering the work of the ASEAN-India Eminent Persons Group (AIEPG), and its Report with recommendations for forging a closer partnership for peace, progress and shared prosperity, the Heads of the State/Government of ASEAN and India at the ASEAN-India Commemorative Summit 2012, held at New Delhi on 19-20 December 2012, recommended the establishment of ASEAN-India Centre (AIC), which was formally inaugurated by the Hon'ble External Affairs Minister of the Government of India on 21 June 2013 at RIS. AIC serves as a resource centre for ASEAN Member States and India to fill the knowledge gaps that currently limit the opportunities for cooperation. AIC works with the Ministry of External Affairs (MEA), Government of India and undertakes evidence-based policy research and provide policy recommendations.

AIC Commentary Series Editor: Dr Prabir De, AIC at RIS, New Delhi

Contact us at:

ASEAN-India Centre (AIC)
Research and Information System of Developing Countries (RIS)
Zone-IV-B, Fourth Floor, India Habitat Centre, Lodhi Road
New Delhi – 110003, India
Tel. +91-11-24682177-80
Fax: +91-11-24682173-74
E-mail: aic@ris.org.in
Visit our website at: <http://aic.ris.org.in>

@AIC_aseanindia

