Can China be the Vent?

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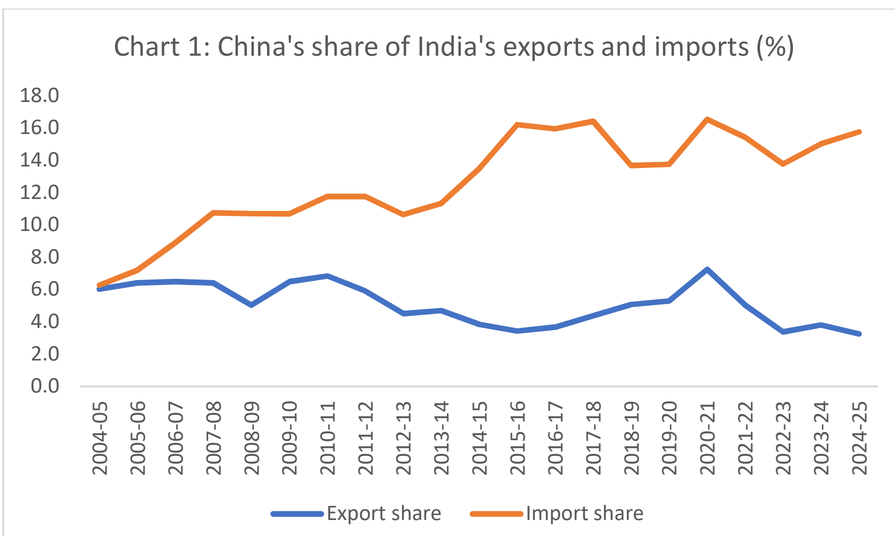
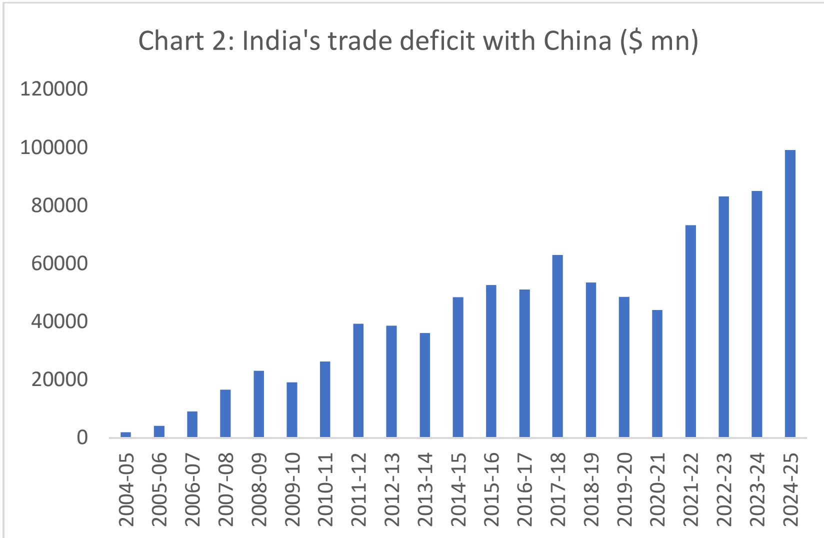
Trump's tariff aggression and the imposition of tariffs aggregating 50 per cent on most imports from India, have had one significant outcome. Neighbours India and China are now willing to talk to each either, pointing to a thaw in the relationship following the clashes in the Galwan Valley in 2020. In the new environment, not only have talks between the two countries revived, but Prime Minister Modi has chosen to travel to the Shanghai Cooperation Organisation summit and meet with President Xi Jinping.

There are two factors that seem to play a role in driving India's stance of compromise and dialogue with a country considered for long as the primary 'enemy'. One is the desire to send out a signal to the Trump administration, through rapprochement with a 'rising' China, in the hope that this will force the US to rethink the punitive tariffs it has imposed on the country. The other is to seek in China the alternative market for the Indian goods that the tariff hikes will definitely keep out of the US, so as to prevent any deterioration of India's balance of payments.

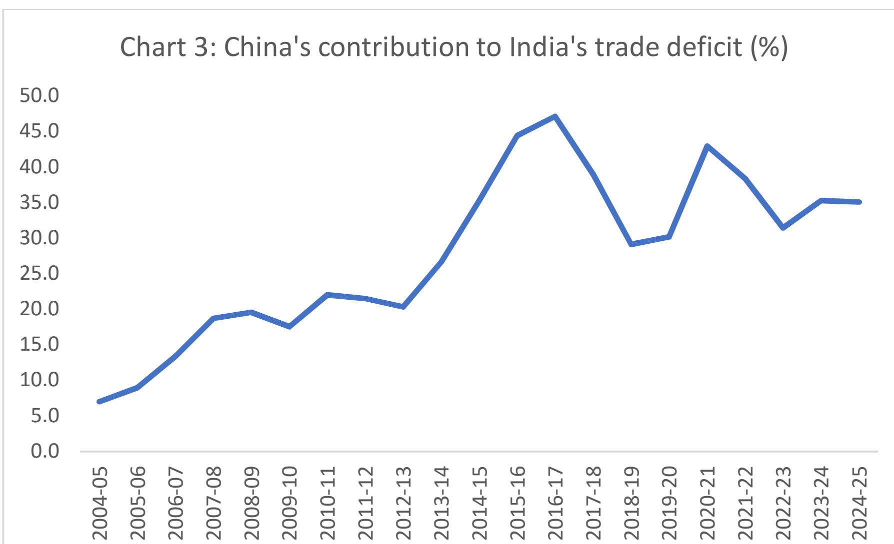
If the post-tariff hike decline in India's exports to the US is to be compensated with exports to other regions, a large part of that increase would have to be directed at the largest of these markets, which is China. India's effort at improving relations with China is clearly motivated by that objective. But that objective is not easy to realise.



History provides some lessons. The evolution of trade relations between India and China suggest that relative competitiveness has been shifting in China's favour. This is reflected in the fact that while India's dependence on imports for imports from China has increased over time, it has not been able to make inroads into China's markets. As Chart 1 shows, over the last two decades the share of imports from China in India's total imports has risen significantly. On the other hand, the share of India's exports directed to China has stagnated for some time and then declined. The "strengthening" of trade relations between the countries has mainly been driven by rising imports from China into India.



The result has been a long-term rise in India's deficit in trade with China (Chart 2). While that deficit appeared to be on the decline just before and after the COVID years, it has, interestingly, spiked after clashes between troops of the two countries in the Galwan Valley in 2020, which otherwise worsened relations between the two countries. The deficit with China, which was close to $100 billion by 2024-25, rose from 7 per cent of India's total deficit with all trading partners to a high of 47 per cent in 2016-17. Though it declined subsequently, trade with China still accounted for as much as 35 per cent of India's aggregate trade deficit in 2024-25 (Chart 3).



What is noteworthy is the nature of India's trade dependence on China. As Table 1 illustrates, India's exports to China principally consisted of minimally processed primary products, excepting for organic chemicals. On the other hand, India's imports from China consisted largely of machinery and equipment, especially for the electronics industry (Table 2). Thus, India's trade with China reflects starkly the inadequate development of its own manufacturing sector, despite long years of emphasis on boosting manufacturing production. A feature of that inadequate development is India's open production cycle in which domestic manufacturing production remains dependent on imports of machinery and sophisticated intermediates from abroad. This is not surprising. China has registered major advances on the technological front, while India has struggled to advance despite much promise.

Table 1: Shares in total of India's principal exports to China (%)

	Ores, Slag & Ash	Mineral Fuels, Mineral Oils & Pdt	Organic Chemicals
2004-05	53.8	0.3	10.6
2005-06	53.9	0.3	12.7
2006-07	46.9	1.4	9.6
2007-08	59.3	1.6	11.7
2008-09	53.4	1.3	7.6
2009-10	49.5	0.9	8.8
2010-11	32.3	5.7	7.3
2011-12	26.8	6.9	7.5
2012-13	14.8	2.7	9.8
2013-14	11.0	7.5	7.7
2014-15	4.5	11.8	10.5
2015-16	6.1	7.9	11.0
2016-17	16.6	8.4	11.5
2017-18	9.8	12.2	19.9
2018-19	7.9	19.0	27.0
2019-20	16.2	15.1	26.7
2020-21	23.4	5.8	18.6
2021-22	13.7	10.5	16.6
2022-23	12.3	17.1	17.0
2023-24	26.5	8.8	13.4
2024-25	16.8	11.5	15.1

Table 2: Shares in total of India's principal imports from China (%)

	Nuclear Reactors, Boilers, Machinery & Mech App	Electrical Machinery & Equip & Parts	Organic Chemicals
2004-05	14.8	25.0	11.6
2005-06	19.9	25.5	12.1
2006-07	18.6	24.3	9.8
2007-08	17.8	28.1	8.8
2008-09	17.0	30.8	8.7
2009-10	20.0	31.4	9.8
2010-11	17.7	27.3	8.9
2011-12	18.3	25.6	7.9
2012-13	19.2	26.8	9.5
2013-14	18.5	27.9	10.6

2014-15	16.8	27.7	10.5
2015-16	17.1	32.0	9.8
2016-17	18.1	35.9	9.2
2017-18	17.7	37.5	9.3
2018-19	19.0	29.3	12.2
2019-20	20.4	29.3	12.2
2020-21	21.4	31.2	13.8
2021-22	21.0	32.0	13.2
2022-23	21.5	28.0	13.5
2023-24	22.1	30.8	11.3
2024-25	22.9	33.5	10.1

The implications of these trends are obvious. Increased aggregate trade between the two countries could widen the already large deficit in India's trade with China, with more imports rather than enhanced exports. It could also displace some domestic production, which would add to the adverse effects on domestic economic activity of the Trump tariffs. Given that context, trade cannot be the principal basis for strengthened relations between the two countries in the near future. Even if China makes some concessions, the resulting benefit to India is unlikely to be a major contributor to that strengthening. On the other hand, a worsening deficit could lead to discontent on the Indian side. If relations have to strengthen, geopolitical factors and the need to stand up to Trump could be the more important factors—at least for India.

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