

India's Trade Caught in the Middle

Mains: GSIII - Economy

Why in News?

India-U.S. trade talks have stalled amid tariff concerns, while India faces a trade deficit with China and risks to its services exports from AI.

What is the nature of India's external trade challenge?

- **Trade With U.S.A** - India runs a trade surplus with the U.S., particularly in goods.
- **Trade with China** - India has a persistent and structural trade deficit with China.
- India depends on China for several critical imports that are difficult to replace quickly.
- The U.S. trade surplus provides vital foreign exchange earnings.
- Higher U.S. tariffs can reduce Indian exports and increase rupee depreciation pressure.
- The exchange rate depends on the demand and supply of foreign currency.

Demand for dollars increases through:	Supply of dollars comes from:
• Imports of goods and services. • Outward FDI. • Foreign portfolio investment outflows. • External payments and other capital outflows.	• Merchandise and services exports. • Inward FDI and FPI. • Remittances/transfers. • Net factor income from abroad. • External borrowing and deposits.

- **India's exchange-rate mechanism** - India follows a managed float exchange-rate system rather market-determined exchange rate.
 - The RBI intervenes in the foreign-exchange market to manage excessive volatility.
 - When demand for dollars rises sharply, the RBI can sell foreign-exchange reserves to increase dollar supply.
 - When there is excess dollar supply, the RBI can purchase dollars and add to its reserves.
- Persistent intervention, however, can result in depletion of forex reserves.
- This becomes more serious when combined with
 - High crude-oil import costs.
 - A structural trade deficit with China.
 - Capital outflows.
 - Geopolitical disruptions to energy supplies.

How Can AI Affect India's Export Position?

- **Automation of Routine Services** - AI can automate routine coding, customer support and business-process tasks.
 - This may reduce demand for some labour-intensive IT services.
- **Pressure on Services Exports** - Lower demand for traditional IT services can reduce India's service export earnings.
 - This may also reduce foreign-exchange inflows.
- **Changing Global Demand** - Global firms may increasingly prefer AI-based solutions over traditional outsourcing.
 - India may face greater competition from countries with advanced AI capabilities.
- **Need for Skill Upgradation** - India needs to shift from low-value services to AI, R&D, cybersecurity and cloud computing.
 - The workforce must be equipped with advanced digital and AI skills.
- **Opportunity from AI** - AI can also create new export opportunities in software, digital services and technology solutions.
 - India can become a global provider of AI-enabled services.

What are the Challenges in Export Diversification?

- **Market Challenges** - Many Global South markets have lower purchasing power than the U.S.
- Building a strong presence in new markets requires time and investment.
- **Infrastructure Challenges** - High logistics and shipping costs can reduce India's export competitiveness.
 - Manufacturing capabilities remain uneven across sectors and regions.
- **Supply-Chain Challenges** - Sudden changes in export markets can disrupt established supply chains.
 - Excessive dependence on a few suppliers can create new external-sector risks.
- **Skill Challenges** - The shift towards AI and high-value exports requires a highly skilled workforce.
 - Skill gaps may limit India's ability to capture emerging export opportunities.
- **Policy Challenges** - India needs consistent trade and industrial policies to support exporters.
 - Export diversification should be gradual rather than an abrupt shift away from major markets.

What Should India Do?

- **Diversify Export Markets** - India should reduce excessive dependence on the U.S. market.
 - It should expand trade with ASEAN, Africa, Latin America and West Asia.
- **Diversify the Export Basket** - India should move beyond traditional exports and promote high-value products.
 - Electronics, semiconductors, Pharmaceuticals and engineering goods can provide greater export diversification.
 - Renewable-energy technologies and defence equipment can become emerging export sectors.

- High-value digital and professional services can strengthen services exports.
- **Strengthen Domestic Manufacturing** – India should improve infrastructure and reduce logistics costs.
 - Reliable and affordable power, strong domestic supply chains, PLI schemes can support the development of globally competitive industries.
- **Reduce Strategic Import Dependence** – India should develop domestic capabilities in critical sectors.
 - India should diversify import sources, boost domestic production of strategic goods, and ensure no essential supply chain disruptions.
- **Build AI-Resilient Services** – India should develop a workforce with advanced AI and digital skills.
 - Indian firms should focus on developing AI solutions rather than only using them.
- **Use Trade Agreements Strategically** – India should pursue FTAs that provide wider market access for Indian exports.
 - Clear rules of origin can prevent trade-related disputes.

What lies ahead?

- India is caught between a structural deficit with China and dependence on the U.S. market for a crucial trade surplus.
- The emerging tariff and AI challenges make export diversification imperative.
- India should use this moment as a wake-up call to build a broader, more competitive and resilient export ecosystem, while maintaining constructive economic engagement with the U.S. and other major trading partners.

Reference

[The Hindu| India's trade caught in the middle](#)