India-United States Bilateral Trade
Trade deficit: Myth and reality

Trade deficit on its own is not a bad thing. Even India suffers from a trade deficit with the rest of the world. In 2016, in terms of goods trade, the United States' trade deficit with India was US$22bn – a mere 2.7 per cent of total US trade deficit of US$798bn with the world that year.

However, trade deficit has to be seen in a scientific manner. In 2011 – as per the latest data of OECD-WTO Trade in Value Added database – in value added term, the United States' trade deficit with India that year was only US$4.8bn, which was less than one-third of its trade deficit with India in that year in terms of gross value of trade. This is also argued by Robert Lawrence in his short policy paper "Five Reasons Why the Focus on Trade Deficits Is Misleading" in which he categorically stated that more than 60 percent of United States trade merchandise imports are capital goods or components and parts rather than finished goods. The current perspective of Trump Administration on trade deficit is fundamentally flawed as it fails to recognise the reality of value chain led trade in which imports are critical for the growth of exports.[1]

1. Introduction

1.1 India and the United States of America have a longstanding "*economic and strategic partnership"* shaped by a diverse range of factors such as deep-rooted democratic values and convergence of interests on bilateral, regional and global issues. They have acted as push factors to an ever-expanding economic and strategic relationship between the two countries and also for making significant improvement in bilateral trade.

1.2 Bilateral trade continues to flourish without any major anticipated upheavals in the upward trajectory except for one supposedly contentious issue of trade deficit from USA's side. This could potentially eclipse the ambitious bilateral trade target of US$500bn by 2025. This could also have a spill over effect on other better-managed bilateral issues such as strategic and security cooperation.

1.3 In this context, this Note analyses the bilateral trade relations between India and the United States from a domestic value added perspective by making a comparison of trade balances obtained from gross as well as from value added trade in goods.

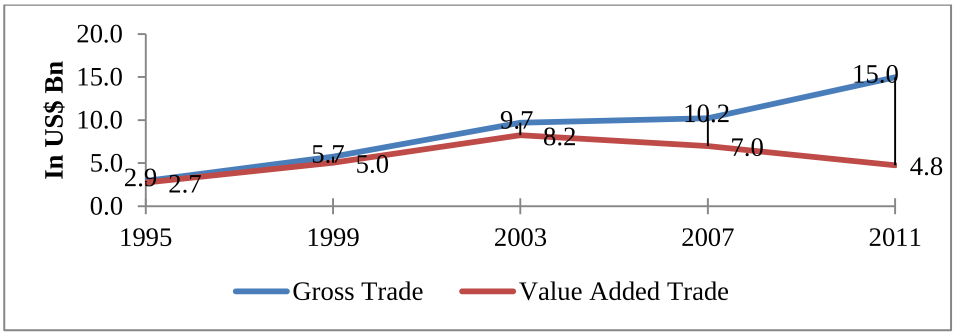
2. India's Trade Surplus with the United States

2.1 In 2016, India has traded US$62bn worth of goods with the United States. Out of this, US$42bn was its exports and US$20bn was imports from the United States, leading to a trade surplus of US$ 22 bn. Indian trade balance with United States in gross and value added terms over 1995-2011 is represented in Figure 1. Data for this analysis is taken from the OECD-WTO (Organisation for Economic Cooperation and Development, World Trade Organisation) database on trade in value added (TiVA). This data (in value added trade) is available till 2011.

2.2 In 1995, India's trade surplus with the United States – in both gross and value added terms – were almost at the same level (US$2.7bn and US$2.9bn, respectively). Thereafter, both expanded at an increasing rate till 2003. After this, India's trade surplus with the United States in terms of gross value went on increasing but the same in terms of value added went on declining. In 2011 (as per the latest available data), while in terms of gross value of trade India's trade surplus with the United States was US$15bn, in terms of value added trade it was US$4.8bn.

[1] Robert Z. Lawrence, 'Five Reasons Why the Focus on Trade Deficits Is Misleading, Peterson Institute for International Economics.

Figure 1: Indian Trade Surplus with the United States in Gross and Value Added Term



Source: OECD-WTO TiVA database

2.3 In other words, in 2011, India's trade surplus with the United States was three times less when the trade is looked at in value added term. This trend is expected to continue and one can make a reasonable assumption that while in recent years India's trade surplus with the United States in gross value term has increased (from US$15bn in 2011 to US$22bn in 2016), there may be even less surplus in value added term as compared to that in 2011.

2.4 This means that, as compared to India's exports to the US, there is much more domestic value addition in US exports to India. This is not surprising because India's exports to the US are mostly primary and/or finished products, with little or low value addition. On the other hand, much of US exports to India are of high-value, technology-intensive products having strong backward as well as forward linkages at the domestic level itself through research and development, sophisticated packaging, etc. In short, while the US products are at the backward as well as forward ends of a value chain, India's products are mostly in the middle of a value chain.

2.5 Besides the value added argument, Robert Lawrence has put more weight on current account, which includes trade in services and net earnings from investing and working abroad along with the goods trade. Furthermore, the United States should recognise that trade agreements can never produce bilateral trade balance. In a trade agreement, some countries will have trade surplus and some will have deficit. Renegotiations of NAFTA on the assumption of eliminating trade deficit by the United States is deeply flawed and squarely opposed to fundamental principles of free trade agreement, which is based on efficient allocation of resources and competition

3. In lieu of conclusion

3.1 The current noise in bilateral trade flows between India and the United States in terms of India's surplus/US' deficit does not reflect the true nature of their trade scenario as it does not recognise the reality of value chain led trade. Our analysis counters a popular argument that India has a large trade surplus with the United States.

3.2 The underlying logic to the bilateral trade relationship goes beyond what is reflected in gross trade figures. On the one hand, the United States must consider that its efforts to improve the power equilibrium in the Indo-Pacific region as well as to shape a new global economic and political order cannot be fulfilled without a significant role for India. On the other hand, India should also recognise that its economy stands at a potentially transformative threshold and requires the United States as a trusted partner, which is an important source of capital, a host of skilled workforce, a source of technology and strategic support, and a growing market.

3.3 This is critical for India's economic imperatives and for it to become a pivotal power in the Indo-Pacific region. Enhanced bilateral trade between these two partners can help fulfill these objectives and that should be looked at the partnership value that trade can bring *per se* as against bogging us down to a pointless debate on trade surplus/deficit.