



# COVID-19 and its Impact on India's FTA Strategy

Amitendu Palit

## Summary

*Over the last one year and more, India has been robustly engaging in free trade agreements (FTAs). The engagement is in marked contrast to the scepticism displayed by New Delhi towards FTAs in the last decade. This paper argues that the far-reaching impacts of the COVID-19 pandemic have been decisive in India shifting to a proactive strategy to engage in FTAs. Imperatives for diversifying sourcing to avoid future supply chain setbacks have encouraged India to financially incentivise local capacities and pursue preferential trade arrangements.*

## Introduction

COVID-19 infections were first detected in the city of Wuhan in the Hubei province of Central China in December 2019.<sup>1</sup> Over the next few months, it spread to Asia, Europe and North America. The pandemic continues to affect lives and livelihoods across the world. However, greater knowledge about the nature of the virus and the availability of vaccines have enabled countries to return to normalcy.

The COVID-19 pandemic has been the most severe public health catastrophe for the world since the Spanish Flu in 1918. It is also one of those exceptional 'black swan' events – developments that are rare and unexpected with significant implications for economies, markets, investments, households and businesses. At the same time, COVID-19 has had profound implications on the global economic order, highlighting vulnerabilities of various economies arising from disruptions in imports and global supply chains. Countries have hastened to respond to the concerns by engaging in a variety of new external economic relationships.

The pandemic has had a profound impact on India's outlook towards engaging in free trade agreements (FTAs). From a high pessimism towards FTAs, best exemplified by the withdrawal from the Regional Comprehensive Economic Partnership (RCEP) comprising the Association of Southeast Asian Nations and its FTA partners (Australia, China, Japan, Korea and New Zealand) in November 2019, India has launched a robust and proactive strategy for new FTAs. Notably, India has already signed FTAs with the United Arab Emirates (UAE) and Australia and is currently negotiating FTAs with the United Kingdom (UK), Canada and the European Union (EU). Talks have also begun on prospective FTAs with Israel and the Gulf Cooperation Council. This paper explores the ways in which the pandemic has been decisive in changing India's outlook on FTAs.

---

<sup>1</sup> Scott LaFee, "Novel Coronavirus Circulated Undetected Months before First COVID-19 Cases in Wuhan, China", UC San Diego Health, 18 March 2021, <https://health.ucsd.edu/news/releases/Pages/2021-03-18-novel-coronavirus-circulated-undetected-months-before-first-covid-19-cases-in-wuhan-china.aspx>.

## Breakdown in Mainland China

COVID-19 caused major disruptions in global and regional supply chains. These disruptions made countries aware of the possibility of not being able to access several essential imports. These imports were necessary for both domestic industrial production as well as final consumption by local populations.

Disruption concerns were particularly high for India following the outbreak of COVID-19 and the consequent shutdown in production in its major sourcing locations, such as China. The anxieties were prominent for pharmaceuticals. With the pandemic forcing Wuhan – a production epicentre for various industrial items, including bulk drugs and drug intermediates – to go into lockdown in early 2020, Indian pharmaceutical producers were perturbed over accessing raw materials to make final dose formulations. In its assessment of the impact of the pandemic in February 2020, the Federation of Indian Chamber of Commerce and Industry estimated local inventories of several common active pharmaceutical ingredients used in many formulations (for example, ampicillin, ranitidine, paracetamol, diclofenac sodium and ibuprofen) to be for only a few weeks.<sup>2</sup> The assessment cast grave concerns over India having enough medicines to tackle the country's looming public health crisis.

The production disruption in China and its attendant implications for India were not limited to concerns over sourcing drug intermediates. It extended to several other products for which India's import dependence on China is critical. These include semiconductor devices, electrical machinery, fertilisers and transformers.<sup>3</sup> Even after production in China recovered by mid-2020 by overcoming the setbacks caused by the first round of the pandemic, it faced periodic disruptions in the months that followed. These included the closure of shipping services at the Ningbo-Zoushan port in August 2021<sup>4</sup> and, more recently in other parts of China due to a renewed surge in COVID-19 cases from early 2022. China's overarching presence in global supply chains as a hub for sourcing and epicentre of shipping routes makes India and the rest of the world heavily vulnerable to production disruptions in the Chinese mainland.

## Not just China

The understanding that India must diversify the sourcing of critical imports to avoid adverse impacts of future disruptions was driven home by the realisation of exigencies that can arise even with respect to sourcing from countries other than China. Such exigencies could arise

---

<sup>2</sup> Amitendu Palit, "COVID-19, Supply Chains and Dependence on China: The Indian Perspective", in Korea Economic Institute of America; and "Questioning the Pandemic's Impact on the Indo-Pacific: Geopolitical Gamechanger? Force for Deepening National Identity Clashes? Cause of Shifting Supply Chains?", Joint U.S.-Korea Academic Studies, 2021, Volume 32. [https://keia.org/wp-content/uploads/2021/07/KEI\\_Joint-US-Korea\\_2021\\_FINAL\\_DIGITAL.pdf](https://keia.org/wp-content/uploads/2021/07/KEI_Joint-US-Korea_2021_FINAL_DIGITAL.pdf)

<sup>3</sup> Export-Import Data Bank (Annual), Department of Commerce, Ministry of Commerce and Industry, Government of India.

<sup>4</sup> "China's zero-COVID policy is so strict that it shut down a whole shipping terminal after just one case", CNBC, 12 August 2021. <https://www.cnbc.com/2021/08/13/chinas-zero-covid-strategy-to-disrupt-shipping-as-ningbo-zhoushan-port-shuts-.html>

from natural calamities and political events. Globally, supply chain vulnerabilities were noticed on several occasions before the onset of COVID-19. The Fukushima earthquake in Japan (2011) and heavy flooding in Thailand (2011) caused sourcing problems for several supply chains. More natural calamities, such as Hurricane Sandy on the east coast of the United States (US) [2012] and Hurricane Maria in Puerto Rico (2017), created widespread turbulence in the functioning of supply chains. Moreover, political events with far-reaching significance, such as the imposition of economic sanctions on Iran (2018) and the implementation of Brexit (2019), severely impacted supply chains. Regionally, the trade war between the US and China that began in 2018 from the US' imposition of unilateral tariffs on Chinese exports to the US, and retaliatory tariffs by China on US exports, have led to the reshoring of production within East and Southeast Asia, with concomitant impacts on supply chains.

Supply chain fissures caused by natural disasters and political events highlight sourcing dependencies and their adverse implications, as much as pandemics like COVID-19 do. In this respect, the lessons from COVID-19 were not limited to the shutdown of factories in Wuhan. As the pandemic spread beyond China, more instances arose of countries, including India, staring at prospects of major interruptions in imports. A significant part of these is related to the supply of semiconductors. Supplies of semiconductors, popularly referred to as chips used in a variety of electronic products, have been badly affected due to disruptions in production in key chip producing locations such as Taiwan, Japan, South Korea and Malaysia during the later waves of the pandemic in 2021.<sup>5</sup> The chip shortages have wide-ranging effects on the production of many industries that contribute significantly to national industrial output and employment, such as automobiles, industrial and consumer electronic items and household appliances.

After the onset of COVID-19, India, like all other countries, has been experiencing high demand for an array of electronic products (for example, laptops, tablets and smartphones), the adoption of work-from-home practices and digital delivery of education and retail services. A global shortage of chips affects the production of these items in demand; consequently, the ability of Indian industries and consumers to adapt to the new conditions. As the demand for automobiles and several other electronic devices remain high, the chip shortage and resultant supply constraints are also pushing up prices of these items.<sup>6</sup> In this respect, the semiconductor supply shortage is an example of how COVID-19 has prolonged sourcing problems across the world, in contrast to natural disaster-related setbacks, from which supply chains could recover much faster.

## **Diversifying Sourcing: Self-reliance and External Trade**

The consequences of the pandemic have made it essential for India to explore options to reduce sourcing dependency. It has adopted two strategies in this regard.

---

<sup>5</sup> "Here's what the global chip shortage is all about", *Techwire*, 3 November 2021, <https://techwireasia.com/2021/11/heres-what-the-2021-global-chip-shortage-is-all-about/>.

<sup>6</sup> "Global semiconductor shortage dampening festive spirit for consumer electronics, auto firms", *The Times of India*, 6 October 2021, <https://timesofindia.indiatimes.com/auto/news/global-semiconductor-shortage-dampening-festive-spirit-for-consumer-electronics-auto-firms/articleshow/86812845.cms>.

The first strategy is to curb import dependence by developing indigenous capacities. Becoming self-reliant is an appealing option as it would lower the costs of unforeseen disruptions in imports. However, achieving self-reliance from a situation of high import dependency is a formidable task.

India's import dependencies arise from various factors. Foremost among these is the high cost of producing import substitutes at home. High local costs encourage cheaper imports – a reality that cannot be changed within months, even years. For a country like India, which does not enjoy efficiencies in production across a range of manufacturing items, imports have been more necessities than choices. The necessities extend to raw materials and components for use in industrial production and products for final consumption. The wide-ranging dependency is evident from the diverse composition of India's import basket – ranging from crude oil, fertilisers, organic chemicals, drug intermediates, semiconductors, automobile parts and components, electrical and non-electrical machinery, laptops, smartphones, televisions, solar energy modules and household appliances. It is impossible to develop sufficient local capacities for replacing imports of all these items in a short time.

India has decided to augment local capacities by financially incentivising domestic production. The strategy comprises the award of production-linked-incentives (PLIs) for several industries. PLI beneficiaries will receive financial incentives for incremental sales from local capacities. The PLIs were first announced in the Union Budget for Financial Year 2021 and 13 PLI schemes were notified at different points in time beginning from March 2021.<sup>7</sup> The largest PLI scheme – for manufacturing semiconductors – was the latest to be announced in January 2022.<sup>8</sup> These schemes aim to “boost domestic manufacturing in sunrise and strategic sectors, curb cheaper imports and reduce import bills, improve cost competitiveness of domestically manufactured goods, and enhance domestic capacity and exports.”<sup>9</sup>

The objectives of the PLI schemes – much as they are geared towards enhancing domestic capacities and producing import substitutes – can hardly afford to overlook the importance of engaging with external markets. Indeed, this is where the second strategy of reducing sourcing dependence becomes critical. Since the PLI schemes will take time to achieve their objectives, it is important to ensure that the concentration of sourcing among a few locations does not affect the ability to access imports. A focus on the financial incentivisation of local capacities for substituting imports must proceed along with the emphasis on locating alternative external sources of supplies. The two objectives cannot be pursued in mutual exclusion. The importance of an active FTA engagement policy becomes vital in this regard for obtaining access to multiple markets.

---

<sup>7</sup> “Status of Production-Linked Incentive Schemes”, *Press Information Bureau*, 7 April 2021, <https://www.pib.gov.in/PressReleasePage.aspx?PRID=1710134>

<sup>8</sup> “With Rs 76000 crore PLI scheme, India set to action its semiconductor fab vision”, *The Economic Times*, 12 January 2022, <https://economictimes.indiatimes.com/small-biz/sme-sector/with-rs-76000-crore-pli-scheme-india-set-to-action-its-semiconductor-fab-vision/articleshow/88848107.cms>

<sup>9</sup> “Global semiconductor shortage dampening festive spirit for consumer electronics, auto firms”, *The Times of India*, op. cit.

## Pushing Local, Bridging Global

India is not alone in efforts to reduce sourcing dependency and build self-reliance in a post-COVID-19 scenario. Encouraging local production through a variety of incentives has been a top priority for the Joe Biden Administration in the US.<sup>10</sup> Japan has been offering incentives for more local investments in order to strengthen domestic supply chains.<sup>11</sup> Similar measures have been announced by Australia.<sup>12</sup> The goal of self-reliance is also at the core of China's 'dual-circulation' strategy unveiled in the aftermath of the COVID-19 pandemic.<sup>13</sup>

It is also noteworthy that national initiatives to develop industrial self-reliance have not been accompanied by efforts to disengage from external trade. While continuing to focus on the interests of American workers as the core element of its external trade policy, the Biden administration has focused on expanding trade engagement with major trade partners, such as the EU, Japan, Canada, Mexico, India and the Indo-Pacific region.<sup>14</sup> Japan has ratified the RCEP and plays an active role in steering the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP). The CPTPP – comprising 10 Asia-Pacific economies (Australia, Brunei, Canada, Chile, Japan, Malaysia, New Zealand, Peru, Singapore and Vietnam) – has received formal applications from the UK, China and Taiwan for membership. Besides ratifying the RCEP and working with Japan on the prospects of the CPTPP, Australia has also inked bilateral trade agreements with Indonesia and several Pacific Island economies since the onset of COVID-19.<sup>15</sup> India and Australia have just concluded the Economic Cooperation and Trade Agreement on 2 April 2022. China too has been engaged in furthering its external trade relations by ratifying the RCEP and applying for membership in the CPTPP.

## Concluding Thoughts

The COVID-19 pandemic has made it abundantly clear that developing internal capacities to reduce sourcing dependencies cannot be followed without robust engagement in external trade. Meaningful trade relations are essential to overcome any supply interruptions that future episodes of the pandemic, or similar unanticipated setbacks, might produce.

---

<sup>10</sup> "Executive Order on Ensuring the Future is Made in All of America by All of America's Workers", The White House, 25 January 2021, <https://www.whitehouse.gov/briefing-room/presidential-actions/2021/01/25/executive-order-on-ensuring-the-future-is-made-in-all-of-america-by-all-of-americas-workers/>

<sup>11</sup> "Incentives related to investment in Japan", Japan External Trade Organisation (JETRO), [https://www.jetro.go.jp/en/invest/support\\_programs/incentive/](https://www.jetro.go.jp/en/invest/support_programs/incentive/)

<sup>12</sup> Investor Updates, Australian Trade and Investment Commission; <https://www.austrade.gov.au/international/invest/investor-updates/2021/new-incentives-to-encourage-investment-in-australia>

<sup>13</sup> "What we know about China's 'dual circulation' economic strategy", *Reuters*, 16 September 2020, <https://www.reuters.com/article/china-economy-transformation-explainer-idUSKBN2600B5>

<sup>14</sup> "Testimony of Ambassador Katharine Tai Before the House Ways & Means Committee Hearing on the President's 2022 Trade Policy Agenda", Office of the United States Trade Representative; <https://ustr.gov/about-us/policy-offices/press-office/speeches-and-remarks/2022/march/testimony-ambassador-katherine-tai-house-ways-means-committee-hearing-presidents-2022-trade-policy>

<sup>15</sup> The Pacific Agreement on Closer Economic Relations Plus (PACER Plus), comprising Australia, New Zealand, Samoa, Tuvalu, Kiribati, Tonga, Solomon Islands, Niue and Cook Islands, was signed on 13 December 2020. See "Australia's Free Trade Agreements (FTAs)", Department of Foreign Affairs and Trade (DFAT), Australian Government.

For a country like India that has large import dependencies, efforts to diversify sourcing necessitates engaging in new trade agreements. The advantages of FTAs lie in the reciprocal preferential accesses that parties to these agreements enjoy. For India, the new FTAs concluded with the UAE and Australia, and the ones being negotiated with the UK, Canada, and the EU, offer it opportunities of engaging in preferential trade with some of its most vital economic partners.<sup>16</sup> These FTAs can provide India with considerable prospects in the diversification of sourcing, securing investments for building local capacities and creating more opportunities for its exports.

. . . . .

Dr Amitendu Palit is a Senior Research Fellow and Research Lead (Trade and Economics) at the Institute of South Asian Studies (ISAS), an autonomous research institute at the National University of Singapore (NUS). He can be contacted at [isasap@nus.edu.sg](mailto:isasap@nus.edu.sg). The author bears full responsibility for the facts cited and opinions expressed in this paper.

---

<sup>16</sup> Amitendu Palit, “India’s New and Robust FTA engagements”, Institute of South Asian Studies (ISAS) Brief No. 870, 5 October 2021, <https://www.isas.nus.edu.sg/papers/indias-new-and-robust-fta-engagements/>.