NEW MARKETS FOR OLD

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The Anglo-Indian relationship has always been strong. But, as the effects of the global downturn reverberate on both sides, how is the trade dynamic changing? What role will British businesses continue to play?

India's rapid economic growth has been unconventional. While China placed emphasis on the manufacture and export of goods, India focused instead on the provision of services, notably in the field of business process outsourcing. India's experience in moving straight from an agrarian to a service economy is unique for a large country.

Given its economic structure, it comes as no surprise that India punches below its weight in terms of its contribution to global merchandise trade flows. Although exports tripled between 2002 and 2007 to $153bn, this was still only one-eighth of the value of China's exports, and less than two per cent of the world total.

In marked contrast with China, India habitually runs a large trade deficit, with the shortfall on goods reaching a whopping $119.1bn in the 2008-09 fiscal year. This means that India's imports were covered to the tune of just 59 per cent by its exports. Oil and jewellery hold the key to the country's burgeoning deficit. Last year's surge in the price of crude oil to close to $150 a barrel caused the value of oil imports to jump to $93.2bn in the year to March 2009, representing 32 per cent of all imports.

The trade position has also been undermined in recent years by Indians' long-standing love for all that glitters. With the price of gold rising to historically high levels in the past few years – in common with many other commodities – imports of gold, precious stones and jewellery more than doubled in the three years to 2006-07, when they accounted for a sixth of the total.

Looking east

The strong and sustained growth of Asian economies in the past decade has helped to reshape the geographic pattern of India's trade, with these countries growing in importance both as markets and as suppliers. The corollary is that mature industrial economies now feature much less prominently. Imports from those countries shrank from 57 per cent of the total in 1990 to 33 per cent in 2007, while their share of India's exports fell from 55 to 41 per cent. Meanwhile, India's trade with other Asian countries (excluding Japan, Australia and New Zealand) has exploded, increasing over the same period by a factor of 15. By 2007, they accounted for close to 30 per cent of both exports and imports.

> "The strong and sustained growth of Asian economies has helped to reshape the pattern of India's trade"

Against this background, it's hardly surprising that the UK's importance as a trading partner has diminished. In 2007-08, the UK ranked sixth as an export market, and a lowly 18th as a supplier of goods. Britain's share of India's imports has more than halved since 1990, although this experience is by no means unique among developed economies.

The biggest change in India's geographical trading pattern is the rapid growth of China as an export market, despite a long-running border dispute. China now accounts for nearly nine per cent of India's goods exports (compared with under two per cent in 2000 and 0.1 per cent a decade earlier), and ranks third, behind the US and UAE.

Photography: **Photolibrary**

Mending fences

While trade with China and other Asian countries (especially entrepot centres such as Singapore, Hong Kong and the UAE) has expanded rapidly, India still does little business with its immediate neighbours. Trade between South-Asian nations has been hampered for decades by border disputes, political rivalries and religious differences. The South Asian Free Trade Area (SAFTA) was established in 2006, with the aim of removing tariffs between members by 2016, but the obstacles are considerable.

In 2007, exports of goods from India to other SAFTA countries totalled just $7.5bn (mostly to Bangladesh and Sri Lanka), while imports were worth just $1.8bn. Although trade is now expanding at a healthy pace, SAFTA countries account for just over two per cent of India's merchandise exports and imports. In particular, Indo-Pakistani trade is paltry (given the size of the two economies), with the total bilateral flow amounting to just $1.2bn in 2007.

India: major trading partners 2007-08

Export markets	US$bn	%
US	20.7	12.7
UAE	15.6	9.6
China	10.8	6.6
Import suppliers	**US$bn**	**%**
China	27.1	10.8
US	21.0	8.4
Saudi Arabia	19.4	7.7

Source: Government of India: Dept of Commerce

Tilting in India's favour

Britain's loss of market share in India has been accompanied by the disappearance of the traditional surplus on trade in goods. From the UK's perspective, trade with India first went into deficit in 1998, and has been that way since 2003. But having soared to over £800m in 2007, the shortfall narrowed to just £324m last year.

The movement in India's favour isn't just another symptom of Britain's declining manufacturing base; it also reflects India's expanding product range. A case in point is the rapid development of India's oil refining capacity. Shipments of refined petroleum products to all countries in 2007-08 amounted to $28.1bn, more than 17 per cent of the total. This puts it well ahead of precious stones and jewellery as India's largest export earner. In 2008, India's refineries shipped products to the UK worth £350m, having sent only negligible amounts earlier in the decade.

Nonetheless, India's exports to the UK are by and large still concentrated in lower value-added basic manufactures. Clothing remains by far the largest category, accounting for nearly one-fifth of exports last year. The ending of the Multi-Fibre Arrangement in

PERSPECTIVE: GEETA GOPALAN

Now an independent financial services consultant and an advisor at mobile banking specialist Monitise, Geeta Gopalan was with Citigroup for 20 years, in India, the UK and the US.

The fundamentals of the UK-India trade relationship are strong. Importantly for UK companies, while growth rates are falling in most other parts of the world, there is still growth in India.

Any negative effect of the recession on trade has been offset somewhat by the opportunities created by the depreciating pound. The UK export sector has become more competitive. There are still companies out there with a strong balance sheet and, as traditional markets look less attractive, they will seek out new markets like India in which to grow and expand.

Sectors in which UK exporters could do well in the long term include the excellent engineering design services sector. While there is less demand domestically during the recession, India is desperate for these kind of design capabilities.

The oil and natural gas sector is another growth area in India, one in which the UK has a tremendous talent pool. Companies such as Cairn Energy are a great example of the success that energy companies can have in India. Aerospace, core infrastructure and financial services may also present opportunities. India's banking sector is seeing good growth and, subject to the Reserve Bank of India approval, UK financial sector professionals and banks could really make their mark in India.

The government will play a part in how the trade relationship develops, but less so than it did. While many sectors are still state owned, as the economy continues to divest, the situation can only get better for potential investors.

PERSPECTIVE: CAIRN ENERGY

Edinburgh-based oil and gas exploration and production company, Cairn Energy Plc, has been active in India and South Asia for over 15 years. Since the discovery of the world-class Mangala field in 2004, the company has focused on developing the main oil fields in the Rajasthan desert. Cairn is now set to deliver first oil from the Mangala field later this year, followed by the Bhagyam and Aishwariya fields. The Mangala find, the largest of the 25 discoveries in Rajasthan, is the biggest oil find in India for more than 20 years. Once on-stream the fields will be responsible for at least 20 per cent of India's domestic oil production. According to engineering and operations director Phil Tracy, who is also chairman of the Rajasthan Project Review Board, "Building strong, open and lasting relationships with all stakeholders has been integral to Cairn's success on the Indian sub-continent. We've worked closely with local communities in Rajasthan, inviting farmers to help level the site for the processing terminal and have established an Enterprise Centre to promote local economic development."

Cairn India was floated on the Bombay and National Stock Exchanges in January 2007. Along with the creation of an experienced management team committed to investing in the country, this has further strengthened relationships with the Government of India and the State Government of Rajasthan, while allowing others in India to become stakeholders in the company.

Vital business goals have only been achieved through partnering with host governments and by establishing key alliances. "The secret", says chief executive Sir Bill Gammell, "is to understand you are a guest in a country."

Cairn has responded to the current economic downturn by focusing on the delivery of its core projects. "The decision to develop the Rajasthan fields in a phased manner has provided Cairn with greater operational flexibility," says Tracy. "It has also allowed the initial focus to remain on the export infrastructure." The successful five per cent placing of shares in March 2009 strengthened Cairn's equity capital base and provided the company with enhanced operational and financial flexibility.

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2005 (which offered protection to textile producers in developed countries) also shifted the balance in favour of Indian producers.

Despite losing ground as a supplier of goods to India, Britain's market share is still more than in many other distant developing countries, such as China and Brazil. Although tempting to ascribe this to the vestigial connections of empire, it is another reflection of India's huge demand for jewellery and gold and Britain's role in trading these products.

In 2008, precious stones and metals made up more than two-fifths of Britain's exports. This was boosted last year when gold and similar physical products were given "safe haven" status, as a result of volatility in the currency markets and the crisis in the global banking system.

The remainder of shipments from the UK to India are dominated by machinery and transport equipment, valued at £1.1bn in 2008, or about a quarter of the total. The largest identifiable products within this diverse category were aircraft, aero-engines and their parts.

A heavy hitter in services

As the contribution made by services to India's economy has climbed, so has its ability to generate surpluses on its transactions with other countries. Sales of services reached $87.7bn in the 2007-08 fiscal year (slightly more than half that earned from exports of goods) and the net position after deducting purchases of foreign services yielded a surplus of $37.6bn. In addition to these commercially traded services, the economy benefits from remittance payments worth more than $40bn, sent home by Indians living and working abroad.

The gamut of activities that go under the general banner of business process outsourcing (classed in India's official statistics as software) earned $40.3bn in 2007-08, almost double their value two years earlier. But the global recession has now stalled the growth of services income, with receipts stagnating in the final quarter of 2008.

Until the late 1990s, Britain enjoyed a services trade surplus with India. But, like the trade in goods, this has turned into a persistent deficit in recent years, standing at £143m in 2007. However, these transactions remain worth little more than a tenth of those in merchandise. It may come as a surprise that Anglo-Indian services trade is, in fact, dominated by travel and tourism, rather than IT services.

Nonetheless, the deficit that has evolved in recent years is clearly due, in part at least, to the long-standing enthusiasm of UK firms for offshoring and outsourcing. Much of the expenditure by British firms on offshoring, however, is not captured by the trade statistics, with in-house operations (as opposed to work outsourced to Indian firms) classed as foreign direct investment.

Recession takes its toll

The impact of the global recession on India's exports has been heavy, but less severe than in many other countries, including Japan and China. In March, the value of exports was down by 15.3 per cent in rupee terms from last year. But, for the whole of the 2008-09 fiscal year, the value of goods shipped overseas was still 3.4 per cent to the good compared with the previous year.

The trade deficit could well shrink now that oil prices have settled at a lower level. Indeed, while the value of imports surged by 29 per cent for the whole of the 2008-09 fiscal year, by March they were falling in line with exports. In terms of merchandise trade between Britain and India (services data will not become available for some time), the loss seems to have been borne almost entirely by the former. Use of monthly data can be misleading, as the trend in trade flows is often erratic. Nonetheless, it seems highly significant that in the first two months of 2009 the UK's exports to India were more than 37 per cent down from the same months of last year, while imports from India were virtually unchanged. These figures may hint, on the one hand, at the resilience of demand for clothing, textiles and footwear by British consumers, and on the other at dislocations in the pattern of trade in diamonds and precious metals.

Trade with India: top sectors by value in 2008

UK imports	value £m	% of total
Clothing and clothing accessories	843	19.8
Refined oil products	350	8.2
Textiles	310	7.3

UK exports	value £m	% of total
Non-metallic mineral products	945	22.9
of which: Pearls and precious stones	933	22.6
Silver and platinum	743	18.0
Metal waste and scrap	319	7.7

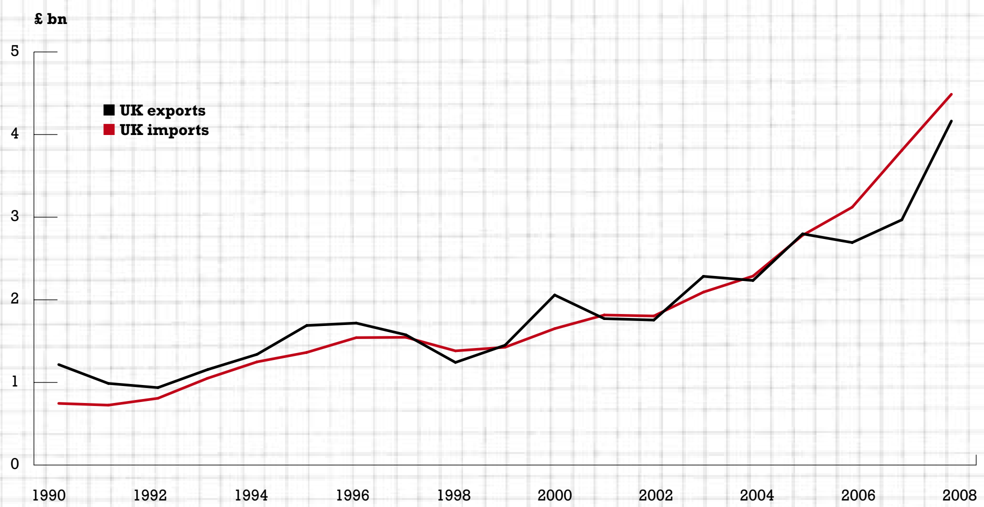
Source: HM Revenue & Customs

UK-India trade in services 2007

	UK exports		UK imports		Balance
	£m	% of total	£m	% of total	£m
Banking	109	26.6	20	3.6	89
Computer services	39	9.5	281	50.8	-242
Advertising & market research	1	0.2	8	1.4	-8
Management consultancy	9	2.2	4	0.7	4
Petroleum, chemical & pharmaceutical industries	19	4.6	8	1.4	10
Film & television	35	8.5	2	0.4	33
Consulting engineering	74	18.0	6	1.1	68
Manufacturing industries	46	11.2	27	4.9	19
Total	**410**		**553**		**-143**

Source: ONS

Turning tide: imports take over



Britain enjoyed a services trade surplus until the late 1990s but, as with goods, this has turned into a persistent deficit. In 2007 this stood at £143m.

Source: ONS

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