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India’s Global Trade - The Need For Value Added Export Incentivization

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A widening gap between services and manufacturing highlights a deeper weakness in India’s global competitiveness.

India's export sector has long been projected as one of the defining success stories of the past decade, marked by resilience, steady expansion, and an increasingly diversified export basket, with total exports reaching nearly $860 billion in FY 2025-26 despite global headwinds. Yet beneath these headline numbers lies a structural challenge: while services exports continue to expand rapidly, manufacturing exports have struggled to deepen value creation, raising important questions about India's long-term position in global trade. These figures have consistently outpaced global trade growth, reinforcing the perception of a system that is both competitive and deeply integrated into the global economy.[1]

Yet, the composition of this growth tells a more complex story and raises a far more fundamental question. In FY 2025-26, services exports touched roughly $420 billion, growing at 8-9%, while merchandise exports stood at about $442 billion, expanding by less than 1%. A year earlier, services exports had grown by over 12%, while goods exports remained largely flat. Over the past five years, services exports have grown nearly twice as fast as merchandise trade, underscoring a structural shift in India’s export engine. While this shift reflects India's growing strength in knowledge-based sectors, it also raises questions about how much value India captures in global trade and global value chains as its export growth becomes increasingly services-driven rather than manufacturing-led.[1]

A key reason for this divergence lies in India’s dependence on duty exemption and deferment schemes such as Advance Authorization (AA), Duty Free Import Authorization (DFIA), Export Promotion Capital Goods (EPCG), as well as frameworks like MOOWR, SEZ, and EOU, all of which are designed to reduce input costs by neutralizing duties on imports. These mechanisms have not only allowed businesses to remain competitive in price-sensitive global markets, but they have also shaped behavior in ways that are less visible but more structural. Recent data indicate that nearly 85% of export promotion scheme utilization is concentrated through AA and EPCG schemes.[2]As global competition

increasingly centers on value creation rather than cost competitiveness alone, this dependence warrants closer examination.

While these schemes have undeniably enabled Indian exporters to maintain price competitiveness and scale up volumes, their pervasive usage also suggests that the underlying basis of competitiveness remains anchored more in cost arbitrage than in value creation. This raises a fundamental concern: India may be exporting more but not necessarily capturing enough of the value embedded in those exports.

Over time, this has created what may be termed an “incentive lock-in effect”, where businesses optimize supply chains and production strategies around fiscal benefits rather than capability building, making competitiveness dependent on policy rather than productivity. This becomes particularly relevant in global trade, where sustained competitiveness is increasingly driven by innovation, localization, and control over strategic supply chains. In practice, the system often rewards efficiency in imports more than in domestic production, making it easier to source components globally than to build them locally. This, in turn, constrains industrial deepening and limits the multiplier effects associated with manufacturing growth.

This dependence also carries external risks. The WTO dispute panel has previously found several of India’s export-linked schemes, including EPCG and other duty-exemption frameworks, to be export-contingent subsidies inconsistent with global trade rules. This highlights the model's vulnerability when it relies heavily on such incentives. While the issue remains contested, it underscores a broader reality: competitiveness built on policy support is not only economically fragile but also institutionally uncertain.

The consequences of this model are visible across sectors. In electronics, one of India’s fastest-growing export segments, domestic value addition remains limited to ~18-20%, indicating that nearly 80% of export value is derived from imported components or external intellectual property. India has effectively become a large-scale assembly base, but not yet a deeply integrated manufacturing ecosystem. The evolution of Apple’s supply chain reflects this reality; while India assembles a growing share of iPhones, high-value components such as chips and display panels continue to be sourced globally, meaning that value capture remains largely outside the country.[3] This reflects a broader challenge within global trade, where the greatest economic gains accrue not from assembly alone but from ownership of technology, design, and intellectual property.

A similar pattern exists in pharmaceuticals: India has earned its reputation as the “pharmacy of the world” through formulation exports yet depends heavily on imports of Active Pharmaceutical Ingredients (APIs), with China accounting for 65–70% of those imports. The COVID-19 pandemic exposed the vulnerability of this model, as supply disruptions triggered cost volatility and production risks.[4]

Even traditional sectors reflect this structural imbalance. India dominates diamond processing but imports ~95% of rough diamonds, while in textiles, a strong domestic cotton base coexists with dependence on synthetics, even as man-made fibers account for the majority of global demand.

Across sectors, the pattern is consistent: exports are scaling, but domestic value chains are not deepening. India has successfully integrated into global value chains, but a larger share of value creation continues to reside outside its borders. The challenge now is to move from participation to greater ownership within those value chains. However, strengthening domestic value chains is not solely a question of policy or production. It also depends on the capabilities of the workforce that supports them. It also depends on the capabilities of the workforce that supports them. India’s challenge is therefore not limited to supply chains

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alone; it is also embedded in the system’s capabilities, particularly its workforce.

India possesses a significant demographic advantage, with nearly two-thirds of its population in the working-age category, offering one of the largest labor pools globally. It also produces approximately 1.5 million engineering graduates every year, reflecting the scale of its talent base. Yet this quantitative strength masks a qualitative gap: only about 4-5% of the workforce has received formal vocational or technical training, limiting the availability of industry-ready skills required for modern manufacturing.[5]

This mismatch between scale and skill has allowed the services sector, particularly IT and knowledge-based industries, to thrive, but has constrained manufacturing, which depends on deeply embedded technical capabilities and mid-level skilled labor.

The experience of leading trading economies offers useful lessons. Their success was not built solely on export growth, but on increasing domestic value addition, technological capability, and control over critical segments of global value chains.

In contrast, China focuses on deepening large-scale manufacturing and the localization of supply chains, while South Korea leverages state support to build globally competitive giants such as Samsung and Hyundai through technological upgrading and branding. Germany relies on precision engineering, skilled labor, and tightly integrated supplier networks.

In each of these cases, incentives served as a transitional tool for capability building rather than a permanent foundation for competitiveness, highlighting that the key difference lies not in whether incentives are used, but in what they are used to build. China, for instance, initially relied heavily on tax rebates and export incentives to scale manufacturing, but progressively shifted its focus toward domestic value addition through localization policies and ecosystem development. South Korea followed a different but equally instructive path: early state support for large industrial groups was closely linked to export performance and technological upgrading, with subsidies gradually phased out as companies became globally competitive.

The result is a clear maturity gap: India has scale, but not yet depth; talent, but not fully translated capability.

At a structural level, export competitiveness can be understood from three dimensions: cost, capability, and value capture. India’s current model remains strong on cost, moderately positioned on capability, and weakest on value capture.

This is reflected in macro indicators: manufacturing value-add remains around 12–13% of GDP in India, compared to about 25% in China, while investment in R&D is just ~0.6% of GDP, far below China’s ~2.5%, thus limiting innovation-led growth.[6]

The policy challenge, therefore, is not to withdraw support abruptly, but to change what drives competitiveness. Output-based frameworks such as RoDTEP represent a step in this direction, as they neutralize embedded costs without distorting sourcing decisions, even though they may not replicate the immediate cost advantages of input-linked duty exemptions. Over time, India's export incentive framework must increasingly reward domestic value addition, localization, and innovation, shifting towards a model of value-added export incentivization rather than one focused primarily on export volumes.

Businesses, too, must move beyond cost arbitrage and adopt capability-building through dual-sourcing strategies, investments in design and intellectual property, progression from OEM to branded exports, and selective backward integration in critical inputs.

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India's export story has delivered scale, but it now faces a defining test. As technology, intellectual property, and resilient supply chains increasingly shape global trade, the ability to retain value within domestic ecosystems will determine long-term competitiveness. The policy challenge is therefore not simply to increase exports, but to encourage greater domestic value addition, innovation, and capability building. In global trade, the winners are not those who sell the most to the world; they are those who own the most of what they sell.

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[1] Ministry of Commerce & Industry

[2] Directorate General of Foreign Trade Statistics Division

[3] Ministry of Electronics & IT

[4] Ministry of Chemicals and Fertilizers : Department of Pharmaceuticals

[5] Ministry of Skill Development and Entrepreneurship

[6] data.worldbank.org