STUDY NOTES · BASIC CONCEPT

What are emerging markets? What is the China+1 strategy?

Indian Economy

27 Oct 2026

What?

Emerging markets are economies that are developing their financial systems, industrial capabilities and integration with global trade and investment. They may offer higher growth opportunities but can also face greater volatility, liquidity constraints and exposure to global capital movements.

Examples often classified as emerging markets include India, Vietnam, China, Brazil, Indonesia and South Africa, although classifications vary by index provider.

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Emerging-market performance is influenced by:

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1. Economic growth and productivity.
2. Inflation and interest rates.
3. Currency stability.
4. Corporate earnings and equity valuations.
5. Export performance and industrial competitiveness.
6. Foreign investment and political or regulatory risks.

There is no single universal ranking of all emerging markets. Rankings differ according to the indicators, weights and time periods used.

What is export competitiveness?

Export competitiveness is the ability of a country to sell goods and services in international markets at attractive prices while meeting requirements relating to quality, reliability, technology and delivery.

It depends on several factors:

Factor	Why it matters
Productivity	More output per worker can reduce unit costs
Logistics	Efficient ports, roads, railways and customs reduce delivery time
Labour skills	Skilled workers support quality and advanced manufacturing
Technology	Automation and innovation improve productivity and product quality
Energy costs	Reliable, affordable power reduces production costs
Trade agreements	Can improve market access and reduce tariff barriers
Regulatory certainty	Predictable rules support long-term investment
Supplier networks	Strong domestic supply chains improve reliability and value addition

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A country can have strong GDP growth driven by domestic consumption but still face weaknesses in export competitiveness. Conversely, an export-oriented economy can record rapid export growth while remaining vulnerable to external demand shocks.

Why has Vietnam emerged as a major manufacturing and export hub?

Quy định tiêu chí doanh nghiệp sản xuất thiết bị điện tử được hưởng ưu đãi thuế thu nhập doanh nghiệp

Vietnam has attracted export-oriented manufacturing, particularly in electronics, machinery, textiles, footwear and other manufactured goods. Its integration into global supply chains has been supported by foreign

investment, industrial clusters and trade agreements.

Important contributing factors include:

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1. China+1 strategy: Companies diversify some production beyond China to reduce concentration risks.
2. Foreign direct investment: Multinational companies establish factories and supplier networks.
3. Trade integration: Trade agreements provide access to several international markets.
4. Manufacturing clusters: Concentrated industrial activity can improve supplier coordination and efficiency.
5. Export-oriented production: Firms produce goods for international markets as well as domestic consumers.

However, Vietnam also faces challenges, including dependence on foreign-invested firms, imported intermediate goods, external demand and concentration in particular export markets.

Vietnam's export success is therefore a useful case study in manufacturing-led growth, not proof that every aspect of its economic model is superior.

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What is the China+1 strategy?

The China+1 strategy refers to companies retaining significant operations in China while developing additional production capacity in another country.

The strategy seeks to reduce exposure to risks such as trade restrictions, geopolitical tensions, supply-chain disruptions and excessive dependence on one production location.

Potential beneficiaries include Vietnam, India, Indonesia, Thailand and Malaysia.

For India, the opportunity lies in attracting investment in electronics, pharmaceuticals, automobiles, renewable-energy equipment, machinery and other sectors.

To benefit, India needs competitive logistics, reliable electricity, skilled labour, efficient customs procedures, predictable regulations and strong domestic supplier networks.

What is Foreign Direct Investment (FDI)?

Foreign Direct Investment is cross-border investment through which an investor establishes a lasting interest and a degree of influence in an enterprise in another country.

Examples include a foreign company establishing a factory, acquiring a strategic stake in a manufacturing business or expanding production facilities.

FDI can contribute to:

1. Capital formation.
2. Employment generation.
3. Technology transfer.
4. Managerial and technical skills.
5. Access to global markets.
6. Development of supplier networks.

However, the benefits depend on the quality of investment, domestic value addition, technology spillovers, employment conditions and links with local firms.

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What is Foreign Portfolio Investment (FPI)?

Foreign Portfolio Investment refers to investments by non-residents in financial assets such as shares and bonds without the same degree of managerial control associated with FDI.

FPIs can provide liquidity and broaden the investor base, but their investment decisions may change rapidly when global interest rates, risk perceptions or expected returns change.

Basis	FDI	FPI
Main purpose	Long-term business interest and influence	Financial returns from securities
Typical investment	Factory, subsidiary or strategic business stake	Listed shares and bonds
Liquidity	Generally less liquid	Generally more liquid

Basis	FDI	FPI
Impact	Can add production capacity and technology	Can deepen financial markets and liquidity
Risk	Long-term business and regulatory risk	Market volatility and rapid capital flows

What is currency depreciation, and how does it affect foreign investors?

Currency depreciation occurs when a currency loses value relative to another currency under a market-determined exchange-rate system.

For example, if an investor invests in Indian shares and the rupee depreciates against the US dollar, the investor's dollar-denominated return may fall even if the share price rises in rupee terms.

Currency depreciation can have mixed effects:

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Potential benefit	Potential cost
Indian exports may become cheaper for foreign buyers	Imported oil and machinery become more expensive
Exporters earning foreign currency may benefit	Foreign-currency debt becomes costlier to service
Import-competing domestic industries may gain	Imported inflation may increase
Some sectors may become more competitive	Overseas investors may face lower currency-adjusted returns

The actual outcome depends on the extent of depreciation, imported-input dependence, pricing power, foreign-currency liabilities and the responsiveness of export demand.

What is import cover?

Import cover measures the number of months of imports that a country's foreign-exchange reserves could finance if normal foreign-exchange earnings and inflows were disrupted.

For example, if a country has foreign-exchange reserves of $120 billion and average monthly imports of $10 billion, its import cover is 12 months.

Higher import cover generally provides a stronger buffer against external shocks. However, it does not guarantee currency stability or eliminate risks from capital outflows, external debt or rising import bills.

What is the difference between the current account and capital flows?

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The balance of payments records economic transactions between residents and non-residents.

The current account includes trade in goods and services, primary income and secondary income, such as remittances.

The financial account records transactions involving financial assets and liabilities, including foreign investment.

A country can experience strong export growth but still face external pressure if imports rise sharply, income payments increase or capital flows reverse.

For India, strengthening the external sector requires both export competitiveness and sustainable financing of external transactions.

How can India improve export competitiveness?

India can adopt a multi-pronged strategy:

1. Improve logistics: Reduce freight costs, port congestion and delays in customs clearance.
2. Increase manufacturing productivity: Promote technology adoption, automation and industrial research.
3. Strengthen MSMEs: Improve access to credit, export information, standards certification and global supply chains.
4. Diversify export markets: Reduce excessive dependence on a few countries and products.

5. Enhance skills: Align vocational and technical training with advanced manufacturing requirements.
6. Improve regulatory certainty: Simplify compliance and provide predictable policy frameworks.
7. Expand trade integration: Pursue trade agreements that provide meaningful market access while protecting legitimate domestic interests.
8. Increase domestic value addition: Develop local suppliers and move from assembly towards design, components and higher-value production.
9. Promote innovation: Support research, intellectual property creation and high-technology exports.
10. Strengthen macroeconomic resilience: Maintain credible monetary and fiscal policies and adequate external buffers.

UPSC revision table

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Concept	Key takeaway
Emerging market	An economy with developing financial markets and increasing integration with global trade and investment
Export competitiveness	Ability to compete in international markets through productivity, cost, quality and reliability
China+1	Diversifying production beyond China while retaining some Chinese operations
FDI	Investment involving a lasting business interest and influence
FPI	Investment in financial assets without equivalent managerial control
Import cover	Indicator of the adequacy of foreign-exchange reserves relative to imports
Currency depreciation	Can support some exporters but raises import costs and may reduce foreign investors' returns
Composite tracker	A relative ranking based on selected indicators, not a complete measure of economic strength