



What Future for India-China Economic Relations?

Ravi Bhoothalingam

ICS OCCASIONAL PAPER NO. 53

What Future for India-China Economic Relations?
Author: Ravi Bhoothalingam

First published in 2020

© Institute of Chinese Studies, Delhi

Institute of Chinese Studies
8/17 Sri Ram Road, Civil Lines
Delhi 110 054, INDIA
Ph.: +91-11-23938202; Fax: +91-11-23830728
Email: info@icsin.org
Website: www.icsin.org

ABOUT THE AUTHOR

Ravi Bhoothalingam is currently Founder and Chairman of Manas Advisory, a Consultancy practice focusing on Leadership Coaching as well as on business and cultural relations with China, Mongolia and Myanmar. He is Treasurer and Honorary Fellow at the Institute of Chinese Studies, Delhi. He is a B.Sc Hons in Physics from St. Stephen's College, Delhi and holds a Masters degree [M.A. Cantab] in Experimental Psychology from Gonville and Caius College, Cambridge University, when the renowned Sinologist and scientist Joseph Needham was Master of the College. He also holds an AMP from Harvard. Mr. Bhoothalingam served on the Boards of Directors of Dr. Reddy's Laboratories Ltd, Hyderabad, India and Sona Koyo Steering Systems Ltd, New Delhi, India, and has active links in the corporate world, having previously held positions like President, Oberoi Group of Hotels; Head of Personnel Worldwide, BAT Industries plc., London; Managing Director, VST Industries Ltd.; and Director, ITC Ltd. He is a member of the Confederation of Indian Industry (CII) Core Group on China and sits on the Editorial Boards of China Report and World Affairs, two international journals published out of India. His interests cover the history and practice of Confucianism, Sino-Indian business and economic ties, and adventure travel in the remote regions of China. He is a Fellow of the Royal Geographical Society, London.

Contact: sush.ravi@gmail.com

What Future for India-China Economic Relations?

Abstract

India today faces a 'triple whammy': the Covid crisis, the economic downturn and the China challenge. To confront these issues and emerge successful will require a massive and well-considered effort of national mobilisation. The key driver has to be the economic front; only the enhancement of India's "comprehensive national power (CNP)"¹ will provide the resources to meet all three challenges and also achieve India's goals for transformation and prosperity. Meanwhile, China remains the second-largest economy in the world, deeply linked with the global economy. This essay discusses how we might harness China's investments and resources adroitly but carefully to our purpose, somewhat like a sailor out on the high seas in bad weather, who has to tack cleverly from side to side to reach his destination without being blown off course. We consider Sino-Indian economic links in terms of supply and investment chains, products, services, brands and digital offerings in the short, medium and long terms; look at how India's engagement with the rest of the world should evolve, and at enabling factors such as science, technology and finance. A complex web of connections and inter-dependencies then emerges, as do positive and negative incentives that India and the world can apply to change Chinese behaviour. Finally, we pull all these threads together to chart the appropriate course for India-China economic relations.

The conflict between Indian and Chinese soldiers at Galwan on 15 June, 2020 - resulting in the first fatalities along the Sino-Indian border in 45 years - has sent shock waves throughout the country. It is understandable that feelings of sorrow and anger are running high - especially given the barbaric nature of the incident. There are cries for retaliation, and calls for a boycott of Chinese goods - already mooted several months ago in the wake of the Covid pandemic. However, despite some bellicose voices, there seems to be a consensus that allowing the situation to escalate into a general war would be counter-productive and damaging, for both India and China. Some disengagement on the LAC is already under way.

¹ Comprehensive National Power is a Chinese political concept that attempts to build a composite index of national capability comprising military, economic, technological and cultural power
<https://enacademic.com/dic.nsf/enwiki/573205>

Still, the incident marks a watershed in India-China relations. Even in more normal times, it was difficult enough to keep Sino-Indian political issues from influencing economic engagement between the two nations. Going forward, this task will become still more difficult. So, how should India gain greater traction to make Chinese behaviour more amenable to negotiation on outstanding matters? Should India also follow the US example and use economic leverage as an additional tool - in other words - to implement our own version of 'decoupling' from China? This question may not have a binary 'Yes/No' answer, but an exploration of the issues it raises may lead us to a way forward.

The Overall Context

First, we need to place 'decoupling' in the context of India's overall national objective. Since our Independence, Governments of various hues have described that goal in different terms², though the meaning has remained broadly the same: the transformation of India into a modern, prosperous and vibrantly democratic society. Despite changing circumstances, that objective has remained constant and therefore must always guide our deliberations.

Second, India today faces a 'triple whammy': the Covid crisis, the economic downturn and the China challenge. To face these issues and emerge successful will require a massive - and thoughtful - national effort of mobilisation. The key driver has to be the economic front; only the enhancement of India's comprehensive national power (CNP) will enable us to garner the resources to meet all three challenges. That will require many years of rapid and sustained economic and human development. A single-minded focus on this objective, along with staying power and a clear strategy, is needed to reach that goal. There are many elements which constitute that economic strategy, and others³ far more qualified and competent than this writer have spelt out those details. In this essay, our limited scope will be to address the issue of India's future economic relations with China.

² Indira Gandhi defined it as '*Garibi Hatao*'; the present Government's slogan is the creation of '*New India*'.

³ Refer to the various columns in the *Business Standard* by Shankar Acharya, Pronab Sen and Nitin Desai for a clear exposition of what India needs to do on the economic front.

Third, the Chinese economy is the second-largest in the world and five times the size of ours. It is still growing and is a major player in global trade, investment and areas of growth potential and technological sophistication, with deep linkages with the world economy. Therefore, in order to transform India, we need to harness China's investments and resources adroitly but carefully to our purpose, using both positive and negative incentives. That is no easy task, given the current geopolitical environment and the public mood towards China. Consider a sailor out on the high seas and in bad weather - yet he does not lose sight of his goal. As a skilled sailor, he cleverly tacks from one side to the other to move towards the desired destination. If he sails too close to the wind, he loses speed; if he sails too broad, he is blown off course; if he sails into the wind, he gets becalmed. To relate this metaphor to India's current reality, we need to examine the 'wind'--i.e. the nature of India-China economic connections – within the current global discourse on 'decoupling'.

The Anatomy of 'Decoupling'

Let us briefly review the history and international context of 'decoupling' in its short life of about two years. The issue first manifested itself as a spat over technology, with the US administration accusing China of the consistent use of covert and coercive methods to transfer technology from US firms to China, as also of the outright theft of know-how. Several companies in the US - and elsewhere - supported this move to bring pressure on China to create a more level playing field in their country for the transfer of knowledge and protection of intellectual property. But soon, this quarrel took on a larger dimension, as it morphed into a more general trade-cum-technology war, with President Trump leading the charge for 'fair trade' rather than 'free trade'. Within months, the world witnessed a Sino-US 'trade war', with escalating tariffs and political rhetoric reaching high levels on both sides. Ever since, speculation has been rife that we are heading towards a 'new normal' in global economic relations - where investment, technology and trade links between the two countries are gradually "decoupled". Other regions of the world have since been drawn in, to smaller or greater extents, even whilst the onset of Covid-19 has aggravated the already heated geo-political atmosphere. This background provides some clues as to how India might position itself *vis-à-vis* 'decoupling' from China.

‘Decoupling’ means different things to different people. For the sake of quick understanding, we can examine it in three dimensions: (in) investment/production/supply chains on the one hand, markets/consumer demand on the other, and the supportive elements of science, technology and finance on the third. There are some pitfalls in such over-simplification, but let us leave that aside for a moment and consider the different forms of decoupling, in ascending order of difficulty. The objective is to arrive at a ‘balance-sheet’ of ‘gain versus pain’ for India, which would help us assess the effectiveness of decoupling - or other policies - as a means to influence Chinese behaviour whilst minimising any adverse impact towards attaining our goal.

What *Not* to Do

Before proceeding, it is wise to heed the Hippocratic caution: *First, do no harm*. The immediate responses to Galwan on the economic front by different Government agencies convey varied signals. The show-cause notices to 59 companies who deal in Chinese apps are a good cautionary signal, as they leave the door open for the companies to respond giving reasons as to why their products do not violate India’s ‘sovereignty and integrity’ as per the provisions of India’s Information Technology Act. The resulting enquiry and legal proceedings will be time-consuming; meanwhile, not all the apps have been inactivated. That situation allows for a resolution over a period of time, as appropriate.

However, the delays and hold-ups of Chinese shipments at various Indian ports do not seem to be traced to any clear instructions and harm only Indian importers (the Chinese parties have been paid anyway) and disrupt our production schedules and consumption patterns. Third, the exclusion of Chinese parties from bidding for future Indian road projects⁴, as also the suspension of work on other already-approved China-related projects by some State Governments in the few days after the Galwan incident, may arouse more doubts in the minds of foreign investors. Their grouses already cover infrastructure, logistics, labour laws, slow judicial processes, excessive bureaucracy and what they see as a complex and capricious tax regime. These complaints might be exaggerated, but we must remember that India is still working hard to establish itself as a

⁴ <https://timesofindia.indiatimes.com/business/india-business/no-chinese-company-to-be-allowed-to-bid-for-any-highway-project-nitin-gadkari/articleshow/76739635.cms>

favoured investment destination through initiatives like ‘Make in India’ and ‘Ease of doing business’.

These early reactions by Government can be understood as taken in the heat of the moment. More of the same might provoke retaliation, and thus set off a spiral of escalation on the economic front just when disengagement and de-escalation are in motion in the concerned border areas. The need is for a considered and strategic economic response, for which the following discussion on ‘decoupling’ aims to set the scenario.

The Dimensions of Decoupling

The most painless way to decouple would be to shift any fresh investment planned in China to other destinations—viz.: if you have three factories there already, do not build a fourth. This makes economic sense, and also follows good risk management practice. Japan - the earliest foreign investor in China - has been doing so quietly for the last five years. Others have since followed. Hence, the shift of investment in garments, leather, toys etc. - low value-added products where the Chinese market is saturated whilst production costs have risen - to destinations like Bangladesh, Cambodia and Myanmar (but not yet to India on any scale). A variant of this decoupling method is to uproot and relocate existing factories out of China. Naturally, this imposes heavy costs and is possible only in very limited cases, since the entire supply chain has to be reorganised as a result.

Note that in neither of the above instances does any ‘reshoring’ necessarily follow - i.e. where the factory is set up instead in India. That would require several other factors to come into play, such as the quality of local governance, transportation, logistics, skills and labour productivity. India needs a comprehensive and consistent set of reforms in these areas to create reshoring possibilities which produce the right employment consequences - a kind of “ease of doing business” programme expanded and deepened manifold. Global investors look for a stable legal, regulatory and tax environment along with an industrial climate that will promote quality, productivity, safety and sustainability; just a squeeze on labour wages or rights will not cut it, nor

will tax exemptions, subsidies and incentives that could be subject to reversal by Government fiat.

What about opting out of supply chains involving China? In 2018, about 28% of global manufacturing was China-based⁵, covering raw materials, intermediates and finished goods. Services come on top of that, all adding up to a big number. Further, international investment into emerging Asian economies in the post-Covid world might well decline as much as 45%⁶. Such global companies as do look towards India might want their own global supply chains alongside and those might well involve Chinese elements. Supply chains in the reverse direction are equally important, since China's growing consumer market and huge purchasing power will attract companies globally. In recent public pronouncements, China has indicated that it will enhance imports with a view to ultimately balancing its trade account. Even if that statement is an exaggeration, it should encourage Indian exporters and makes reforms in our manufacturing environment even more urgent. Equally, we must carefully consider the revised offer to India by the Regional Comprehensive Economic Partnership (RCEP) countries, and negotiate a place in that group. With a looming global recession, this is no time for splendid isolation. We need to be part of vigorous trade and investment chains, regionally and globally.

What can be done (1)?

First, what does seem feasible for India is to establish a mechanism to regulate key Chinese investment or inputs that have strategic or security implications and encourage their substitution by other imports or by domestic Indian firms. Such a list must necessarily be narrow and well-defined or else we are opening the doors wide to misuse and protectionism. As the Prime Minister emphasized, 'self-reliance' does not mean a return to economic autarky and an era of high-cost goods, but a call for India to become competitive at the global level. That is imperative. So, whilst introducing such controls, we must be sharply aware of India's chequered history with industrial regulation and control policy.

⁵ Richter, Felix. February, 18, 2020. <https://www.statista.com/chart/20858/top-10-countries-by-share-of-global-manufacturing-output/>

⁶ UNCTAD World Investment Report, 2020.

For over a quarter-century from the 'Sixties onwards, India suffered the consequences of a '*licence-permit raj*' - a framework of State-led economic controls ostensibly aimed at promoting growth, equity and employment - but which in practice resulted in high prices, a sheltered and uncompetitive industry and modest levels of growth. The economic reforms of 1991 attempted to sweep away this regime and indeed did so, to a limited extent. But protectionist tendencies are still strong in the Indian environment - across political lines and within business circles - and have manifested themselves increasingly in the last few years. And needless to say, the bureaucracy would be delighted to fully regain its earlier powers of intervention and control..... Therefore, any moves to establish a disciplined industrial policy to minimize risk and over-dependence on China in critical areas (5G, robotics, life-saving drugs, for example) will pose enormous challenges. It is feasible, but rather than a simplistic regulatory regime, we need deep and fundamental reforms⁷ in the entire system. Fortunately, the Government today has ample political capital to undertake those structural reforms, and the current crises provide the ideal opportunity. But the results will still take time to appear on the ground.

Second, India must be a strong supporter of globalisation and of multilateral institutions and play an active role in establishing and upholding global norms. We need to be part of both global as well as regional production and supply chains and our voice needs to be heard in international trade circles as a positive and constructive one. But our global weight also depends on our voice in the region. We have already mentioned RCEP. But nearer home, India has neglected its own neighbourhood both economically and politically: intra-South Asian trade is only 5% of its overall trade with the world. And our political relations with neighbours range from the outright hostile to the middling - with Bhutan and Maldives being the exceptions. Like other regions have done - in Europe, Southeast Asia, East Asia and Latin America - we must endeavour to make our neighbourhood an area of opportunity and strength rather than vulnerable points that can be exploited by an opponent.

⁷ See note 3 above.

Markets and Consumers

Does all this imply that China holds all the cards? Not so. When we look at the second type of decoupling - a market/consumer based one - a more nuanced story emerges. The impact of Covid has been stressful for all economies: even in China, with the pandemic under control, production is back to only around 86% of pre-Covid levels⁸, so economic growth for the year may be zero. China is still highly dependent on international trade (38% of its GDP in 2018)⁹ and a global depression looms ahead. Chinese investments abroad face bleak prospects: US interest rates are falling and could turn negative, and infrastructure investments in the Belt-and-Road Initiative (BRI) - always somewhat risky - now seem distinctly dodgy. So, investors and exporters in China should value comparatively stable polities where reasonable returns, large markets and long-term growth prospects are likely. India would certainly qualify as one such destination. It is never a good idea to alienate your customers. Whilst most customers in India are price-sensitive, some are not. If their purchases are discretionary, satisfy emotional or non-essential needs, are highly visible and where substitutes are not too pricy, these customers can be swayed by 'sentiment' or current trends to avoid some Chinese products. A good example is Tourism. The purchase of a holiday overseas (naturally, in a post-Covid environment) is not a decision based only on cost. It also involves the emotional and subjective associations that the destination evokes in one's mind. Tourism is a 'display product' - what others might think of our choice of destination or their reaction when we proudly share our photographs, would weigh in our decision. So, our choice between holidaying in Beijing or Bali, Shanghai or Sydney might well turn on such considerations.

It is difficult to estimate the exact damage this might do to inbound tourism to China or to Chinese exports and/or investments in India. There were around 800,000 Indians travelling to China last year - a tiny fraction of the over 60 million foreign tourists¹⁰ visiting China from across the world. Chinese exports to India are only around 3% of its total exports¹¹. The total

⁸ Trivium China, May 8, 2020.

<https://mail.google.com/mail/u/0/#search/Trivium+86%25/FMfcgxwHNMSHklWITCFjzCenvPdQPmQc>

⁹ World Bank National Accounts Data <https://data.worldbank.org/indicator/NE.TRD.GNFS.ZS>

¹⁰ Excludes visitors from Hong Kong, Macau, Taiwan. <https://www.china-mike.com/china-travel-tips/china-tourism-statistics/>

¹¹ <https://indianexpress.com/article/explained/india-china-trade-ban-explained-6465949/>

stock of Chinese investment in India is difficult to estimate for various reasons but it probably does not exceed around US\$ 17 billion. In the overall Chinese context, these numbers are small and unlikely to provide any leverage to India, even assuming a 100% boycott in all areas.

On the other hand, the short-term (and even medium-term) damage to the Indian economy will be significant. Chinese drug intermediates (APIs) meet about 70% of the need of the Indian formulations industry and to replace those would be both time-consuming and involve economic costs which will pare both the volumes and the thin margins on India's significant generics export business. Chinese intermediates are significant in the auto-ancillary industry which powers a large segment of Indian exports. There are several other areas such as the electronics, medical devices, organic chemicals, cell-phones and telecom sectors within India's production and trade chain which rely on intermediates imported from China. In the short and medium term, therefore, the balance sheet is adverse for India: blunt decoupling *per se* with China does not seem a good idea.

Branding and Intangibles - The Longer View

However, the medium/long term perspective could be different. And this follows our earlier train of thought about Tourism. Imagine the impact on China if a substantial number of tourists around the world forsook Chinese destinations. Increasingly over the last three decades, the non-price values attached to products and services have begun to matter. For example, a small but growing number of consumers are interested in the environmental impact of products, their packaging, waste disposal or methods of production. Similarly, there is a pressure group of 'ethical investment funds' which eschew equity participation in 'sin products' such as tobacco, alcohol, extractive industries, and so on. Hunting of several wild life species has been increasingly banned or strictly limited - take the example of whaling, which was banned for a while internationally and remains severely restricted. (The Hollywood film "*Free Willy!*" had a lot to do with propagating this sentiment globally).

Think of the Aston-Martin, not just a stylish sports car, but the chosen vehicle of James Bond himself. Any person sitting in its driving seat - even in a showroom - would imagine himself in

Bond's place: as rakish, witty and courageous. In a word, irresistible. Branding is the process by which such intangible qualities and values are superimposed on to mere things of utility. In recent years, branding has spread from products to services and now into the digital world. This has implications for China which is creating its own brands in the real as well as virtual space, in the hope that they will become as impactful tomorrow as Pepsi and Toyota are today, with customers all over the world. Inevitably, perceptions about China will rub off on all brands originating in that country. So, how will China's reputation as a country affect its brands in their ability to convey values of trust, dependability, privacy, environmental compliance and ethical labour standards? As Adam Smith showed, there is not such a vast gulf between 'soft' moral values and hard-edged economic efficiency as popularly imagined¹² - it just takes time to connect the dots between them.

This kind of branding is important enough with physical products, but even more so with the growing presence of virtual products and services in the digital domain. Chinese apps, virtual platforms and communications networks like WeChat will have to compete against the likes of WhatsApp and Facebook. Later on, when 5G applications like driverless cars, home services, telemedicine and many other similar offerings come to the marketplace, the role of the intangible but influential values mentioned earlier will become even more important. They will also encompass areas like stronger customer rights, ability to enforce contracts, obtain legal recourse even against the State, protection of data and privacy, independence of regulatory systems, anti-trust and monopoly controls, and so on. Consumers will then make their choice and the Chinese will have to compete with the world on these factors as well. Price will certainly be a factor, but not necessarily the deciding one. The possible impact of intangibles - applied on a global scale - is similar to what we said about Tourism earlier, and not one that China can afford to ignore.

What can be done (2)?

India needs to send out a clear message - where we welcome foreign investment, and where we do not - whether from China or elsewhere - based on risk, impact and employment potential. It is not desirable to do so on a geographical basis - by naming the country or even by thinly

¹² See Adam Smith, 1759. *The Theory of Moral Sentiments*

disguising such a reference (viz. ‘any country that shares a land boundary with India’)¹³. Apart from being discriminatory, this is an invitation to retaliation. Moreover, in these days of complex corporate structures, establishing beneficial ownership or the source of true management control can tie up capital in endless legal wrangles.

It is also self-defeating. When inward investment sources are thin on the ground (as mentioned earlier) why turn away willing investors in non-critical areas? Take mergers and acquisitions, for example. Why stop a Chinese investor from taking over a distressed Indian company in, say, the garments, toys, chocolates or leather sectors? It will save jobs, conserve already invested capital, maintain production and preserve Indian resources for better use elsewhere.

In terms of markets and branding, India must throw its weight behind strengthening global rules in terms of market access, environmental standards and data protection laws with clear parameters to distinguish acceptable variations in specified circumstances. That will make it easier to hammer out a global consensus and see whether China is willing to be part of it. If not, it will make it easier for global economic pressure on China in areas like tourism and branding. Naturally, India must be clear about its own ability and willingness to abide by these standards as they emerge. We shall say more about this in the following section.

Whilst on the subject of branding and intangibles, we must note that India possesses considerable cultural capital as well as ‘soft power’ – a concept popularised by Joseph Nye¹⁴. But have we done enough to mobilise this asset in creating a public perception of our civilisation in the minds of the Chinese people? Correspondingly, have the Chinese done likewise? In both countries, there is widespread ignorance of the other’s history and culture, so the answer to both questions is clearly ‘No’. People-to-people ties have remained at minuscule levels for many years. As a result, the discourse between India and China remains far from multi-dimensional, and is thus over-influenced by the changing course of bilateral political and economic relations. Whilst tangential to the main thrust of this essay, this point is important and deserves attention separately, since public perceptions matter, whatever be the nature of Government in each country.

¹³ Press Note 3 of April 17, 2020

¹⁴ See his *Soft Power: The Means to Success in World Politics* ([Public Affairs](#), 2004).

Science, Technology and Finance

Science, technology and finance are three bare necessities to support innovation and growth in any system of production of goods and services. Whilst science provides the basic design of the system, technology (in its wider meaning) may be likened to a machine/market network that can generate and supply a variety of products and services, with finance as the fuel that keeps it all running smoothly. So, any discussion on decoupling must consider how these elements will respond in the emerging situation. Since India is not significantly connected to the global arena as a defining player in any of these areas, the paragraphs below will briefly cover their global impact on China.

Science has always been an enterprise which has drawn on civilisational advances from around the globe. Even today - in the midst of the Covid crisis and widespread suspicion of China's omissions and commissions - there is strong cooperation by scientists of all nationalities in finding a cure and a vaccine. Science thrives in an atmosphere of cooperation-cum-competition; it is sometimes difficult to discern the difference. Though China has a great story to tell about its advances on the technological front,¹⁵ its progress in fundamental research in the natural sciences has been modest. China still requires connectivity with the global scientific establishment if its future progress is not to be slowed. And there lies the rub. The current mood in the US militates against sharing scientific research findings in critical STEM (Science, Technology, Engineering Mathematics) areas with Chinese scientists or even with research students in the US. So, a 'decoupling' with the US in science - even if limited - will not portend well in China.

In technology, China has some selling points. The Deng economic strategy post-1979 relied on putting money into the hands of the poor rural masses and monetizing that demand through the production of cheap consumer goods. Over time, China moved up the value chain, offering that same population - in sequence - affordable consumer durables, electronic items, cell phones, and the like. Digital products and services followed and apps are the latest *avatar*. Chinese entrepreneurs - aided by their State-capitalist economy - were able to create the technologies to produce and distribute these items at affordable prices on a mass scale and over a long period.

¹⁵ See this writer's essay *Can China become a global leader in Innovation?* Book chapter 13 in *China at a Turning Point*, ed. Manoranjan Mohanty, Pentagon Press, India, 2019.

This strategy was described by the late management guru C.K.Prahalad as ‘finding the treasure at the bottom of the pyramid’. Poverty eradication thus became not just morally desirable but also a source of corporate profit!

As a result, within a generation or so, huge numbers of Chinese people moved out of poverty and many of them including their businessmen and entrepreneurs retain memories - and what is more, knowledge - of the techniques applied to achieve that result¹⁶. These methods result in lowering the unit costs of production and distribution along with greater execution speed. These are valuable learnings for other nations on the development path and so it is no wonder that the Belt-and-Road Initiative (BRI) is predicated largely on this foundation. However, (for entirely different reasons), the infrastructure initiatives of the BRI are have hit serious obstacles, so the Chinese hope that its new *avatar* - the ‘Digital Silk Road’ - might have better prospects.

At the same time, there are clear risks to adopting Chinese technology. We have already mentioned several of them earlier in our discussion on branding. In addition to those, possibly the most significant risk is the consequence of becoming tied into systems driven by Chinese standards. This applies particularly in the digital domain, where adoption of a certain master-standard makes it inconvenient and costly to switch to alternative products, though those remain theoretically available. (For a commonplace though minor example, think of the costs of switching from Apple to Android systems or vice versa). Above all, the magnitude of the perceived risk does not have to depend on a ‘smoking gun’ being discovered i.e. a component or part within a Chinese-supplied system, which is directly linked to mischief or ill-intent. The risk-confidence balance as assessed by Governments - in which public perception will play a part - is sufficient and this is most often a political rather than technical decision. Competitors can also intervene to talk up these issues. These complex facets of digital systems are very important for investors to unravel: as they bet on the future of different technology domains, they need to take a view of how those domains might evolve and direct their investment accordingly. This brings finance into the picture.

¹⁶ It is for this reason—to cut gestation periods and costs—that Indian digital commerce companies have tied up with Chinese investors.

There is a clear debate within US financial circles today about the merits and demerits of technological decoupling with China. One side of Wall Street would favour stifling of emerging Chinese competition in that domain (think Huawei, for instance). But given the dense and complex inter-connections in the China-US supply and production chains, others - even within the same firm or Company - might be hurt as a result. There is a certainty in the immediate pain but the gain lies in the future and is thus only a probabilistic outcome. Since the US is a vibrant free-market economy where stock prices and valuations determine corporate behaviour, deliberate and concerted corporate action in a certain direction is difficult to orchestrate by the State, unlike in China. But this debate is still evolving, and can gather momentum depending on multiple factors.

China needs to worry about the probability of such a financial sector assessment turning adversarial to its interests. Finance is the bedrock of scientific and technological innovation. Thousands of start-ups - where innovation first occurs - rely on venture capital funding, for which the USA is still the predominant source. There is then the entire dollar-backed international monetary and institutional framework which remains the principal fuel for world trade and which will take cues from the actions of the US markets and the Fed. The Hong Kong situation further complicates matters for China. Strangulation - sudden or graduated - of the flow of finance capital into its high-tech areas is definitely a risk that China must factor into its calculations.

But this is also a game of poker. The men (predominantly) in the Wall Street brokerages are also keenly aware that there could be the possibility of a deal to be cut with China. They have no great pretensions or fundamental ideological positions about China or even the Chinese Communist Party. They just want the heat off the competitive battle - it is really all about market share, profits and not ideology. Rather than poker, perhaps these brokers are playing chess not *weiqi*, the Chinese 'board game of surrounding'¹⁷ (better known by its Japanese name 'Go'). Chess is all about striving for a clear result—a check-mate; a stalemate or draw is treated as an unsatisfactory conclusion. But *weiqi* is all about gaining market share - domination of the market rather than extinction of the opponent. Businessmen are well aware that any decline in China's

¹⁷ See this writer's article '*What Chess and Go tell us about India and China's Strategic Thinking*' in *The Wire*, December 19, 2018. <https://thewire.in/world/india-china-strategy-chess-go>

growth - let alone its collapse - will affect the global economy adversely. So, they might switch to *weiqi* rules, and the game then turns on the pressure that can be exercised to reach the minimum market share acceptable to both the Chinese and the US sides. This is razor's edge stuff! But is Xi Jinping playing *weiqi*? Or has he done a cultural swap and adopted chess for his strategic guidance?

What can be done (3)?

India would do well to step up its investment in R&D and aim at higher scientific productivity and innovation emerging from her considerable pool of S&T manpower. Also, to engage more strongly with global innovation centres - countries like South Korea, Japan, Singapore and Switzerland - which have a high ratio of patents to population.

In technology, the choices vis-à-vis Chinese technology are relatively easy to make in both the critical/security areas and in non-critical sectors. It is in the grey zone in between that careful analysis is required to arrive at solutions that are both secure and cost-effective. Perhaps a variety of 'hybrids' could be considered for such areas - if technically feasible - where suspect Chinese technology is confined to 'the periphery' but not to 'the core'.

How Effective Will 'Decoupling' be in Changing China's Behaviour?

The discussion so far reveals three clear trends. *First*, India's own decoupling from China will have very limited effects on that country but will exact a disproportionate price from India, at least in the short/medium term. *Second*, the impact on China will be greater depending on how widely and consistently 'decoupling' from China is implemented around the world, and that will take some time as individual countries make their own assessments. *Third*, intangible/digital products, high technology and finance will be the areas where the pressure will be most felt by China. India and other countries can accelerate this process by supporting multilateral institutions like the WTO and WHO in their unenviable task of establishing (and in WTO's case, enforcing) globally-accepted rules and norms of behaviour.

How effective will this process be? Some in China are already uneasy that their Government has pushed the envelope too far in terms of aggressive posturing and worry that the outcomes, especially in technology and finance, will impede that country in achieving its economic and social goals in the wake of the damage inflicted by the pandemic. This anxiety can only increase if India is added to the growing list of countries who are wary if not suspicious about China's intentions and practices across several fronts. All businessmen are conscious that the present must be used to build the future, so they watch and assess emerging trends for their good or ill. Chinese businessmen and even some sections within the Chinese Communist Party (CCP) are no different, though they may not be vocal about their views. After all, we are looking for nothing as dramatic as a regime change or a collapse of the CCP. Rather, for the Chinese to feel sufficient pressure to ask themselves: 'when we are on the edge, why push our luck and risk both present and future?'

Could such pressure stem out of a growing realisation that two promises made by the Party to the Chinese people might be in danger of unravelling? The first promise was made by Mao Zedong from the ramparts overlooking Tiananmen Square on October 1, 1949 when - to the huge crowd gathered below - he declared: "*China has stood up*". The meaning was clear: under the leadership of the CCP, the new-born Peoples' Republic of China would ensure that never again would the Chinese people suffer such pain and shame as inflicted upon them by foreign powers during the "century of humiliation" after the Opium Wars. The second is more of an implicit contract - often called one of 'performance legitimacy'¹⁸ - between the Party and the people, where the Party ensures a steady increase in national economic and social development in return for the people accepting the supremacy of the Party and overlooking its over-reach and its blemishes.

Will such a combined effect of an attack on China's national self-esteem along with a hit on its real economic growth propel a policy rethink? Nationalistic regimes around the world - both democratic and authoritarian - have shown scant regard for external opinion. History's judgement on the efficacy of economic sanctions is also bleak. So far, only in the case of South Africa and Myanmar have sanctions 'worked', and that too after a long interval. But one assumes

¹⁸ Jon-Jon Lam, January 10, 2013. *Performance Legitimacy: An Unstable Model for Sustaining Power*, <https://www.china-mike.com/china-travel-tips/china-tourism-statistics/>

that the CCP also possesses a keen eye for self-preservation and therefore assesses all risks accordingly. So, how will the CCP assess the risks?

Recent Chinese history provides examples of both types - of ignoring the risks as well as of prompt mitigation. In the first category, the madness and chaos of the Cultural Revolution lasted a long ten years¹⁹, wreaking enormous damage in China's social fabric. Today in China, that period is mourned as one that led to a 'lost generation'. On the other hand, there are three other examples nearer our time, where the Party reacted quickly and decisively to avert threats that it felt could mobilise extensive and very adverse public reaction. The first was the milk adulteration scandal of 2008²⁰, the second was the counterfeit and adulterated medicinal drugs racket²¹ during the past decade, and the third was the air pollution problem, particularly in Beijing²².

Today, Covid-19 already poses a challenge to the Party. The above-mentioned technological and financial pressures on China may well begin to manifest themselves in the future and gather momentum if there is a fair measure of coordination across several countries. The global trends and mood will become clearer as time passes. Fifty years separate us from the days of the Cultural Revolution and since then China has grown richer, and older. Would that affect its tolerance for risk and hardship? Will China cut a deal? The jury is still out...

Conclusion

This journey to deconstruct the meaning of 'decoupling' has led us through many twists and turns. In our conclusions below, we pull the various threads in this essay together by making six basic points.

First, to recall our opening remarks regarding the overall context, India must build its Comprehensive National Power to realise our goals to transform the nation.

¹⁹ The Great Proletarian Cultural Revolution (GPCR) lasted from 1966 to 1976.

²⁰ Huang, Yanzhong: Forbes.com, July 16, 2014, *The 2008 Milk Scandal Revisited*, <https://www.forbes.com/sites/yanzhonghuang/2014/07/16/the-2008-milk-scandal-revisited/#7f76cd624105>

²¹ <https://www.cnbc.com/2018/08/06/chinas-growing-drug-scandal-is-having-a-ripple-effect-around-the-worl.html>

²² <https://www.bbc.com/news/world-50287565>

Second, the boundary question with China will not be resolved through war. Skirmishes can only change the tactical positions on the ground. Ultimately, negotiations will determine the result, and for success in that process, the state of India's CNP relative to China will be a material factor.

Third, China will remain as a major global economic player. Along with both the above propositions, this means that India's economic engagement with China must continue, but must be carefully strategized and executed to serve those goals. This essay indicates some relevant approaches for evaluation towards building that strategy.

Fourth, India must engage with the rest of the world and mesh its overall strategy within an atmosphere of openness to trade, investment, technology and finance so that self-reliance is born out of building our own strengths and capabilities.

Fifth, these are difficult tasks to undertake, for both our Government and people. Only one other country - Vietnam - has managed to retain and enhance a vibrant economic relationship with China amidst a live maritime boundary dispute and the traumatic experience of having suffered fatalities in skirmishes with China²³ within the last 50 years. Perhaps, we can take a leaf out of their book.

Finally, to create that single-minded focus towards reform and rapid growth, the social compact between our Government, industry, labour and society at large, must change. The fruits of enterprise and labour must be shared more fairly, moving our society towards greater equity and equal opportunity, visibly apparent through practice. Divisive issues that can create serious distraction must be put aside. Fraternity and social coherence are values to be cherished in any case, but it is worth remembering that they are also conducive—*inter alia*—to a scientific orientation, increased productivity, and the creation of a manufacturing culture. Japan and Germany - countries which rose from the ashes of destruction after 1945 - are striking examples of what it takes to recover and prosper after a global disaster. India too needs that same

²³ Vietnam fought a brief land war with China in 1979, with sporadic maritime skirmishes continuing through parts of the 1980s. Fatalities resulted on both counts.

determination. Fortunately, our Government today can mobilise that spirit through the huge public support that it enjoys and therefore is well placed to implement a comprehensive reform and growth plan to propel India into the future.

Galwan is ‘a watershed moment’ in India-China relations. It could also be the moment when India finally takes the path to become ‘the uncaged tiger’²⁴, to create true growth and prosperity for all its people, and take its rightful place in the world.

Acknowledgements

I am very grateful to Dr. Shankar Acharya and Ms. Syeda Imam for having read the first draft of this essay and offering their perceptive comments. The responsibility for the views expressed, of course, remains mine.

²⁴ See a special Report titled “*A Survey of India: Caged*”, *The Economist*, May 4, 1991

ICS OCCASIONAL PAPER *Back Issues*

ICS Occasional Papers showcase ongoing research of ICS faculty and associates on aspects of Chinese and East Asian politics, international relations, economy, society, history and culture.

Issue No/ Month	Title	Author
No. 52 July 2020	Student Mobility for Higher Education: The Case of Indian Students Studying Medicine in China	Madhurima Nundy and Rama V Baru
No. 51 June 2020	Analyzing China's Mediator Role in MENA - More than Just a Global Responsibility?	Jayshree Borah
No.50 May 2020	Launch-On-Warning and China's Nuclear Posture	Samanvya Hooda
No.49 May 2020	US-China Rivalry: A Strategic Moment for India?	Sujan R. Chinoy
No.48 May 2020	COVID-19, China and Anatomy of Fang Fang Phenomenon	Hemant Adlakha

PRINCIPAL SUPPORTERS TO ICS RESEARCH FUND

TATA TRUSTS



MINISTRY OF EXTERNAL AFFAIRS
GOVERNMENT OF INDIA



INDIAN COUNCIL OF
SOCIAL SCIENCE RESEARCH

GARGI AND VIDYA
PRAKASH DUTT FOUNDATION



JAMNALAL BAJAJ
FOUNDATION

PIROJSHA GODREJ FOUNDATION

ICS PUBLICATIONS



A short brief on a topic of contemporary interest with policy-related inputs



Platform for ongoing research of the ICS faculty and associates



Authored by the faculty, also emerging from research projects and international conferences



Draft paper of ongoing research

ICS JOURNAL



In its 56th year, *China Report* is a refereed journal in the field of social sciences and international relations. It welcomes and offers a platform for original research from a multi-disciplinary perspective, in new and emerging areas, by scholars and research students. It seeks to promote analysis and vigorous debate on all aspects of Sino-Indian relations, India-China comparative studies and multilateral and bilateral initiatives and collaborations across Asia.

China Report is brought out by Sage Publications Ltd, New Delhi.

Editor
Associate Editor
Assistant Editor
Book Review Editor

Sreemati Chakrabarti
G. Balachandirane
Rityusha Mani Tiwari
Vijay K Nambiar



INSTITUTE OF CHINESE STUDIES

8/17, Sri Ram Road, Civil Lines,
Delhi 110054, INDIA
T: +91 (0) 11 2393 8202
F: +91 (0) 11 2383 0728

<http://www.icsin.org/>
info@icsin.org



twitter.com/ics_deihi



facebook.com/icsin.delhi



in.linkedin.com/icsdelhi



soundcloud.com/ICSIN



youtube.com/ICSWEB



instagram.com/icsdelhi