ISAS Insights

No. 378 – 17 January 2017
Institute of South Asian Studies
National University of Singapore
29 Heng Mui Keng Terrace
#08-06 (Block B)
Singapore 119620
Tel: (65) 6516 4239 Fax: (65) 6776 7505
www.isas.nus.edu.sg
http://southasiandiaspora.org

Bilateral Economic Interests of India and China: Rethinking respective roles in an evolving world economy

China and India are two leading emerging economies of the world today. As neighbouring Asian economies, mutual economic interests of the two nations continue to evolve amidst various developments in the world economy. This insight seeks to address the developments in the India-China economic landscape commenting on possible areas of concentration to maximise mutual benefits going forward.

Deeparghya Mukherjee[1]

The spectacular growth of the Chinese economy over the last few decades has modified the economic power structure of the world. While the western super powers have dominated the world economy for a considerable time, the rise of the Chinese economy maintaining double digit growth rate for more than a decade has established China alongside Japan as two Asian economic powers with greater growth opportunities in China. China is the largest exporter in world economy today ahead of countries like the United States of America (USA) and Germany. It is also the second largest economy in the world ranking after the USA and ahead of Germany and Japan. According to the World Bank, while the USA was a US$18 trillion

[1] Dr Deeparghya Mukherjee is a Visiting Research Fellow at the Institute of South Asian Studies (ISAS), an autonomous research institute at the National University of Singapore (NUS). He can be contacted at isasdm@nus.edu.sg. The author bears responsibility for the facts cited and opinions expressed in this paper.

economy in 2015, China was a US$ 11 trillion economy followed by Japan at US$4 trillion and Germany US$3.3 trillion.

Rising manufacturing costs in the world accompanied with investor friendly infrastructure led to the growth of the manufacturing sector in China. Chinese linkage with production networks of electronic products in Japan and South Korea further facilitated the growth in response to the electronic revolution which required massive growth in production for the US market. Many US companies found it convenient to invest in China and set up production facilities for their products. China further leveraged its linkages in regional production networks of electronic products spanning Japan, Korea and Taiwan. As a major centre for assembly of products, China integrated with the value chains and then moved up to improve productivity and employment benefits.

The Chinese growth story apart from fuelling growth in neighbouring countries as well for the Chinese hinterland is now finding ways to maintain the global growth momentum. While excellent connectivity infrastructure has already been built connecting Chinese ports to the hinterland, Chinese investment in low-income countries across the world has also spiked. As costs of production have increased in China substantially, China is now faced with the problem of maintaining its growth potential and is actively searching for investment opportunities across the region. One also observes a growth in Chinese influence in the Asian region as a central power. China is in disputes with the Philippines and Japan over islands in the South China Sea. Military presence of the Chinese has been observed to grow in the oceans of the region including the Indian Ocean.

South Asia is a relatively less vibrant region as far as international trade and investment are concerned. The countries of India, Pakistan, Bangladesh, Nepal, Bhutan, Sri Lanka, Maldives and Afghanistan have their own sets of advantages. China has shown active interest to invest in these countries to grow trade. China has already helped build ports in several of these countries including Gwadar in Pakistan, Hambantota in Sri Lanka, Marao Atoll in Maldives and Chittagong in Bangladesh.[2] The Gwadar port in Pakistan has recently started operations and the first shipment of Chinese products left the port in mid-November 2016.[3] There are high

[2] See "Chinese Checkers in Sri Lanka Waters" 14th July, 2016 The Tribune (http://www.chinabusinessreview.com/china-and-india-greater-economic-integration/)

[3] See "Chinese Ship Opens New Trade Route via Pakistani Port" 13th Nov, 2016 Bloomberg (https://www.bloomb erg.com/news/articles/2016-11-13/chinese-ship-opens-new-trade-route-via-pakistani-port)

security costs for these shipments which are borne by Pakistan. The port is scheduled to provide easier access for Chinese shipments to Africa and other countries of central Asia and Europe. Of late Chinese submarines have been observed to surface in Pakistani ports although China has continuously denied any possible military angle to its port building initiatives.[4]

India and China have developed their unique positions in the world economy and are poised to lead the economic growth in the world in the new millennium. As two rising economic powers the bilateral economic relations would be most important in shaping their mutual economic horizons. However, India's economic relations with China cannot be viewed in isolation. The political climate of the region and political relations between the two countries continue to influence the bilateral economic engagements. Since 2014, there have been multiple efforts by the Indian establishment to work more closely with leaders of neighbouring South Asian countries as well as reach out to the world better through multiple state visits by the Prime Minister to various countries inviting investments into India to help kick start the manufacturing sector of the country increasing employment of the semi-skilled and unskilled labour force. The government has also pioneered the "Make in India" initiative to this end to invite investors to invest in India. China has not been an exception to this. The Indian prime minister was warmly treated in China during his visit in May 2015. However, China has recently blocked India's bid to enter the prestigious Nuclear Suppliers' group (NSG). It has also blocked India's demands to declare Maulana Masood Azhar as a terrorist at the United Nations.[5] Maulana Masood Azhar is one of the key accused in various terrorist activities in India and had been released by terrorists who had hijacked an Indian Airlines flight from Kathmandu to Delhi back in 1999.[6] Multiple cross overs by the Chinese Army in the border areas of Leh and Ladakh have also been noticed.

As one of the few economies growing at above 7% today, India is a lucrative market for investment for China, which has experienced lower growth in the recent past. Chinese investments in India are on the increase. Although foreign investments from China are increasing it is doing so at a slower rate being influenced by security concerns of India given

---

4 See "Aware of Chinese Submarine Deployment at Balochistan's Gwadar port: Navy chief" 2nd Dec, 2016 The Tribune (http://www.tribuneindia.com/news/nation/aware-of-chinese-submarine-deployment-at-balochistan-s-gwadar-port-navy-chief/331339.html)

5 See "China Again sides with Pakistan, blocks UN move to ban Masood Azhar" 31st Dec, 2016 The Economic Times(http://economictimes.indiatimes.com/news/defence/china-again-sides-with-pakistan-blocks-un-move-to-ban-masood-azhar/articleshow/56256016.cms)

6 See "Hijacking of Indian Airlines Flight 814" (http://cdm.syr.edu/wp-content/uploads/2014/10/Indian_Airlines_Hijacking_ExecSummary.pdf)

China's political stand at the international level. The Chinese have expressed interest in investing in India on multiple fronts. However, investment approvals to Chinese investors cannot be granted without an eye on India's security concerns and thus the investments from China into India have yet to see major growth.

Looking at the Chinese investments in India first, a rise in the incidence of joint ventures and take overs of Indian start-up companies by Chinese companies is noticeable. Major Chinese companies investing in India include Shanghai Automotive Industry Corp., Chint Group, Dingshen, Shanghai Electric Company. Major sectors with Chinese investments include automobiles, metallurgical ndustry, Eeectrical equipment and power.[7] Although not one of the top most foreign investors in India, Chinese investments have touched US$1.24 billion in terms of FDI stocks.[8] States like Maharashtra, Gujarat, Andhra Pradesh and Tamil Nadu with better investment and business climate are major target destinations for Chinese investments. Prospective benefits of existing investment commitments include the creation of 3000 jobs by the Dingshen manufacturing investments. China Fortune Land Development (CFLD) are scheduled to assist in building 10 industrial parks. A growing Chinese presence in the Indian e-commerce sector with substantial stakes of Ali Baba in Indian ecommerce companies (like PayTM) is easily observed.[9]

There are various areas where Chinese investment may play a key role in building India's potential. Specifically, skill development, building of smart cities, the digital India initiative, infrastructure projects , industrial parks, collaboration in building railways infrastructure are some of such areas.

Amongst Indian investments in China, there is a predominant presence of Indian IT firms in China. Companies like TCS, Wipro and Infosys have grown their operations in China over time creating employment for Chinese skilled personnel.[10] Investments by Indian companies in the automobile sector may also be noticed easily. Mahindra & Mahindra (M&M) Ltd., India's leading agricultural equipment company and the world's third-largest tractor

---

7 See "China and India: Greater Economic Integration" (http://www.chinabusinessreview.com/china-and-india-greater-economic-integration/)

8 See "Chinese Investments in India increased six times: Report" 24th May, 2016, The Economic Times (http://economictimes.indiatimes.com/news/economy/foreign-trade/chinese-investments-in-india-increased-by-six-times-report/articleshow/52418055.cms)

9 See "Led by Alibaba Group, More Chinese Investment Continues to flow into Indian Startups" 4th Jan, 2017 Forbes(http://www.forbes.com/sites/suparnadutt/2017/01/04/led-by-alibaba-group-more-chinese-investment-conti zznues-to-flow-into-i ndian-startups/#645bbb5ab26f)

10 See "Infosys marks largest investment outside India, in Shanghai" (http://inchincloser.com/infosys-marks-largest-investment-outside-india-in-shanghai/)

manufacturer, entered into joint venture (JV) in China in 2008. M&M has a 51 percent stake, while its partner, Yancheng Tractor Factory, China's third-largest tractor manufacturer, holds the remainder. M&M owns 80 percent of its first JV in China, which was with Jiangling Motors Corp., Ltd. In February 2008, a consortium of two Chinese companies- Xingxing Group Co., Ltd. and China Minmetals Corp; and two Indian companies- Kelachandra Group and Sigma Minmet Ltd. formed a JV, Xindia Steel Ltd., to invest $2 billion in an iron ore pellet plant in India.[11]

Looking at the bilateral trade between India and China, one easily notices a phenomenal increase mainly riding on increased Indian imports from China. The India-China bilateral trade which was as low as US$ 2.92 billion in 2000 touched US$ 41.85 billion in 2008, making China India's largest trading partner in goods. By 2015, Sino-Indian bilateral trade stood at US$70.4 billion. Of this, India's exports to China were $ 8.86 billion whereas China's exports to India were $ 61.54 billion. Thus, in 2015, India's trade deficit stood at US$ 52.67 billion.[12] This amounts to about half of India's total trade deficit with the world and has been a major concern for India not only because of increased trade exposure to a single country but also due to the way Chinese goods are dominating the Indian markets. Demands of industrial lobbies for increased protectionism have not met with much success as both India and China are members of the World Trade Organisation (WTO). Undue discriminatory treatment by either country to protect their own industries would lead to appeals by their trade partner and WTO's decision would have to be honoured in such matters. Hence, lowering India's trade deficit with China could occur either by developing expertise to export better into Chinese and other world markets or building expertise gained from Chinese investments in the country to develop world class products trying to become a part of production networks of various products and moving up the value chain to contribute in the higher value added segments of the network.

However, in chalking a path for maximising mutual economic benefits of China and India one needs to keep in mind the recent developments in the world trade and investment scenario. Recent developments in world politics have added focus to the future of trade deals. The future of the largest trade deal; namely the Trans Pacific Partnership (TPP) seems less than bright with a prospective withdrawal of the USA. This has left the Regional Comprehensive

[11] See "China and India: Greater Economic Integration" (http://www.chinabusinessreview.com/china-and-india-greater-economic-integration/)

[12] See "India's trade deficit with China jumps to $53 Billion in 2015-16" 1st August, 2016 The Economic Times (http://economictimes.indiatimes.com/news/economy/foreign-trade/indias-trade-deficit-with-china-jumps-to-53-billion-in-2015-16/articleshow/53492853.cms)

Economic Partnership (RCEP) as the most important trade deal which is under negotiation in the Asian Region with ASEAN+6 (i.e. ASEAN countries plus India, China, Australia, South Korea, New Zealand and Japan) as the members of the deal. The renewed focus on RCEP is of key importance to both India and China. The negotiating agenda should focus on maximising mutual benefits through greater market integration. Value chain integration in sectors like automobiles, electronic equipment should be facilitated through appropriate negotiation on rules of Origin (ROO) and intellectual property rights issues.

India and China are slated to grow as two economic powers of the Asian region in this century. India's competitiveness in services and China's in manufacturing complement mutual growth. A number of economic opportunities may be exploited mutually with greater prospective benefits. Chinese investments in India have increased significantly in the wake of relaxed FDI norms along with the "Make in India" initiative. Chinese investments should improve India's infrastructure and manufacturing potential in key sectors like automobiles, electrical and electronic equipment. India in turn should use China's investor friendly regime to invest and reap benefits in the service sectors as well as automobiles and information technology sectors. Trade deals in the Asian region like the RCEP and other bilateral trade and investment agreements should be appropriately negotiated and exploited to harness the potential of the economies.

. . . . .