A new world order?

COVID-19 has exposed global fault lines. Nirupama Soundararajan and Arindam Goswami say it is now the time for India to react economically

The world has changed. The COVID-19 pandemic has unleashed a socio-economic crisis across the globe. Underlying fault lines in economies have been laid bare, and like never before, the robustness and weaknesses of healthcare infrastructure and resources have come to the fore.

Many countries have been forced to re-evaluate their budget spends and their trade strategies. The focus of global trade has shifted from the usual basket of goods and services to pharma and medical products, and counterbalancing the impact of disruptions in global value chains.

The immediate priority of every country has been to brace itself against the impending financial and economic maelstrom that seems to be just around the corner. Countries have been quick to announce economic stimulus and recovery measures as counter measures and provide the much needed relief for affected industries and livelihoods.

Elgin *et al* (2020)[1] have compared the stimulus package developed by different economies on the basis of several parameters, such as, fiscal policy package as a percentage of GDP, interest rate cut as a percentage of pre COVID-19, and monetary stimulus package as a percent of GDP. The United States of America leads the way in monetary terms even though Japan has the largest stimulus package as a percentage of GDP.

While the USA's financial stimulus of USD 2.7 trillion is almost 13.3 per cent of its GDP, Japan's stimulus package worth USD 1.1 trillion is a little above 21 per cent of its GDP. A few of the other major economic stimuli that have been announced are by Sweden (12 per cent of GDP), Australia (10.8 per cent), Germany (10.7 per cent), India (10 per cent), Spain (7.3 per cent), Italy (5.7 per cent), People's Republic of China (PRC) (3.8 per cent), and South Korea (2.2 per cent of its GDP).

However, all these are immediate strategies; any medium to long term strategy would necessarily involve redefining the role of China in their respective domestic economies.

Even before COVID-19, the USA and China trade war had begun. By the time China had locked down Wuhan, global supply chains were already disrupted, causing both scarcity and delays in manufacturing. The current crisis at hand showcased how dependent the world and global supply chains were on China, but the alleged PRC-WHO cover up of COVID-19 and China ostensibly profiteering from the pandemic have not gone down well with many countries, and this has had a direct impact on both trade and geopolitics.

The pressure is on India to react not just politically and militarily to China's role in COVID-19 and to the recent problems at the border, but also to react economically

The USA has delisted Chinese stocks on American bourses and limited flow of their capital into Chinese stocks, initiated action to cut down foreign direct investments (FDI) in PRC, and launched a war against Chinese outward foreign direct investments[2].

Similarly, Japan's Prime Minister Shinzō Abe announced at the 36th *Council on Investments for the Future* at the Prime Minister's Office that Japan will be shifting production bases of high added value products out of the PRC to its home soil[3]. Prime Minister Abe further stated that Japan will also reduce its dependence on China and expand its production bases elsewhere, especially the ASEAN region, for products not falling under the high value product category.

Trade has been affected between China and Australia too, due to Australia's repeated demand for an independent investigation of the source of COVID-19. This has led to China increasing tariff on barley being imported from Australia and banning the import of beef from certain meat plants in Australia. If media reports are to be believed, China is further contemplating targeting other products which are imported from Australia.

Recently, the European Union, known to be one of the largest and long-standing trade partners of China, has initiated several measures to protect local players from possible merger and acquisition by foreign companies[4].

Although, this move is not specifically directed towards China, it came in the light of several businesses overseas being acquired by investments backed by China. The EU has also recently signed the EU-Vietnam Trade Agreement indicating the formers intention of diversifying their supply chain and reducing their dependence on China.

The United Kingdom for its part has reversed its earlier stance of offering a thirty-five per cent stake to Huawei in building their 5G infrastructure and is now contemplating reducing it to zero. Additionally, the UK Government has notified the National Cyber Security Centre to review of *"…the impact of allowing Huawei telecoms equipment to be used in British 5G networks."*[5]

Media reports even suggested that UK has approached the USA with a plan to create a *"D10 club"* of ten democracies which includes South Korea, Australia and India, to lessen its dependence on China for creating an alternative chain of suppliers to deliver equipment for 5G technology[6].

A rather palpable sense of angst against the PRC has led to the exit of foreign investors from Chinese soil. Countries are certainly rethinking their supply chains and their dependence on China. This has also meant that a renewed opportunity arises for countries such as Vietnam, Thailand, Taiwan, and India who have been at the forefront in trying to lure these exiting investors with tailor-made policies and the easing of regulations in their respective countries.

During the US-China trade war India did try to attract many businesses exiting China, but with only limited success. This time, India has acted faster and with a more cogent plan. To begin with, the Minister for Commerce and Industry of India, Piyush Goyal, has called upon the Indian Missions abroad to play a more active role in creating export opportunities for domestic players in their countries and highlight India as an active investment destination among foreign investors[7].

They have been further tasked to reach out to heads of foreign companies to take feedback from them which will enable the government to create customised investment policies to attract these companies to set up shops on Indian soil.

Indian state governments are also doing their bit to make their respective states attractive for new investments. Uttar Pradesh became one of the first states to take the lead by conducting video conferencing with a large number of foreign investors, including Japan and the European Business Group Federation, to pull in investors. They highlighted the construction of the Jewar International Airport, expressway projects focused on developing road connectivity, upcoming Defence Park and its proximity to Delhi[8].

The state has also enacted major labour reforms, which had been pending for a while, to provide a stable business environment. Madhya Pradesh, Maharashtra, Gujarat, Rajasthan, Punjab and Himachal Pradesh followed. States are also proactively working towards easing land acquisition, offering competitive rates on electricity, providing tax breaks, and creating single window clearance and approval systems.

While the immediate impact of these changes may not be staggering, it has managed to attract Von Wellex, a premium German footwear brand, and Apple, who has announced its intention of setting up a manufacturing unit in India.

However, for India rethinking her dependence on China is no longer about just COVID-19 or disruptions in supply chains. The recent escalations at the India-China border have altered the two countries' geopolitical relationship. An escalation of this extent that saw casualties on both sides has not happened for many years.

In fact, until recently India and China have been working towards greater cooperation. In trade terms between India and China, India is a net importer. The only commodity in the top ten that India exports to China is organic chemicals. India exported 23.78 per cent of total export of organic chemicals to China.

However, organic chemicals only form 2.67 per cent of India's total export basket. On the other hand, India imports significantly from China. These are mainly petroleum products, iron ore, organic chemicals, electronic components, telecom instruments, iron and steel, and industrial machinery.

In light of recent tensions, the clarion call to reduce India's dependence on China is loud and clear. India must reduce her dependence on China on imports. Geopolitics today is more about economic warfare than conventional warfare. Crippling a country economically is much easier than through military power.

India's dependence on China does not stem from incapability, but from cost. Low cost imports from China have helped reduce cost of manufacturing for India. China undeniably has the price advantage over India and as a result products that can just as easily be manufactured in India are being imported instead. Some classic examples are fireworks, incense sticks, toys, and needles.

India will also have to consider imports from China that enter indirectly. Even if dumping duties are applied to select products from China, they find their way into India's market through other Asian countries. India has to consider all these factors while reconsidering her trade strategy with China.

The task at hand is not impossible. One of the sectors where Indian manufacturing has outshined China's, not just in terms of quality but also market share and market presence, has been in the two-wheeler segment. India's top three two-wheeler companies, Bajaj, TVS and Hero, have managed to steadily oust Chinese competition from India at one point, but also in Africa.

In a similar manner, the Indian pharma sector has also built both capability, scale, and cost competitiveness, which opens up many markets, especially in a post COVID-19 world. Even as countries scramble to work on a vaccine for

COVID-19, the key element is to be able to manufacture volumes for the world that is affordable, and India is poised to assume this responsibility.

One scenario of the past that India should study is how her economy coped post Pokhran II sanctions, which was one of India's most challenging times. The nuclear tests in Pokhran in 1998 were considered as a defiance to the nuclear proliferation initiatives by the USA. While *"the Buddha smiled"* on India, many countries were simply not amused!

Leading the pack of countries imposing sanctions was the USA, who evoked the Glenn Amendment and imposed a whole series of sanctions on India in the form of withdrawing aid, blocking access to credit, ending all defence deals, and expressing objections to any kind of financial assistance that would be provided by multilateral organisations[9].

Morrow and Carriere (1999)[10], on analysing the impact of the sanctions on the Indian economy, concluded that, *"… sanctions had a marginal—but not negligible—effect on the nation's economy."* An investigation conducted by the US International Trade Commission (1999, Investigation Number – 332-406)[11] came to a similar conclusion.

They computed that the total cost of sanctions on India was USD 1.5 billion, while the cost to the USA was USD 161 million and *"…increasing perception of US companies as unreliable suppliers."*[12] There are two potential learnings for India.

The pressure is on India to react not just politically and militarily to China's role in COVID-19 and to the recent problems at the border, but also to react economically. Domestic demands have been to reduce, if not completely stop, Chinese investments in Indian companies and re-assessing existing investments, to alter the terms of trade including a ban on imports from China, and to re-evaluate various bilateral treaties India has with many countries to review any indirect imports from China.

The hope is that these initiatives will drive up manufacturing in India, a core priority of the incumbent government's *Make in India* initiative. The government's own e-marketplace, GEM, has already made it mandatory for their vendors to state the origins of the product, ostensibly to track the kind and volumes of imports from China in terms of both final products and components. It is expected that this may be extended to all other forms of retail in India.

There is much debate on how India must react economically vis-à-vis China. India's micro, small and medium enterprises are already worried about how any ban on imports will affect their production lines and drive up costs. There is also concern over whether India can build scale in production for certain commodities that have not quite been part of India's production basket. This is where India's two potential learnings from the US sanctions could come in useful.

India imposing any kind of restriction in part or whole on Chinese imports and/or investments almost tantamount to self-imposed sanctions. As harsh as the phrase may sound, the first lesson for India is that this may not be as bad as perceived, if one goes by how easily India was able to do post the US sanctions.

The second lesson, and a far more important one, is to realise why India was only marginally impacted. One of the reasons why India was able to weather the severe sanctions was its strong services sector[13]. The late 90s and early 2000 was the golden age for information technology in India, which saw the rise of the Indian IT industry. Several Indian IT companies such as Wipro, HCL, TCS was were leading suppliers of software and tech support to major international companies, including ones in USA, with a rapid growth in their operation. Even leading tech companies in the US were supported by emigrant engineers from India.

Moreover, cheap labour and a large English-speaking population resulted in India becoming a major hub for the services industry, especially BPOs, KPOs and backend operations of major American and European companies. Most importantly, the USA and its allies had deprived themselves of a large consumer market and therefore lost precious market share to their Asian competitors.

Lesson two for India is that she needs, this time, not one, but a couple of champion sectors in which she can stand her own and contribute more than China to the globe.

Other factors that India has to keep in mind while reconsidering her economic relationship with China is not just the quantum of restrictions, but also for how long these can be imposed. The two aforementioned studies that analysed the impact of American sanctions on India also noted that they probably didn't have a huge impact as expected because they were only implemented for a relatively short duration.

Good foreign policy and geopolitics mandates that India does reduce her dependence on China. However, any move to this effect will have to be carefully calibrated and well executed, while being fully aware and prepared of the consequences for the Indian economy.

Anything short of that will end up being as much as an embarrassment as the Glenn Amendment sanctions were for the USA, since it didn't quite result in the expected outcome, which was for India to feel the heat. India must resist knee-jerk policy reactions and take the time to react wisely rather than brusquely. ■

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