Economic Policy Social Policy Regional Integration Governance

# CPRG Newsletter

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# INDIA'S FOREIGN ALLIANCE AND POLICY EXECUTION

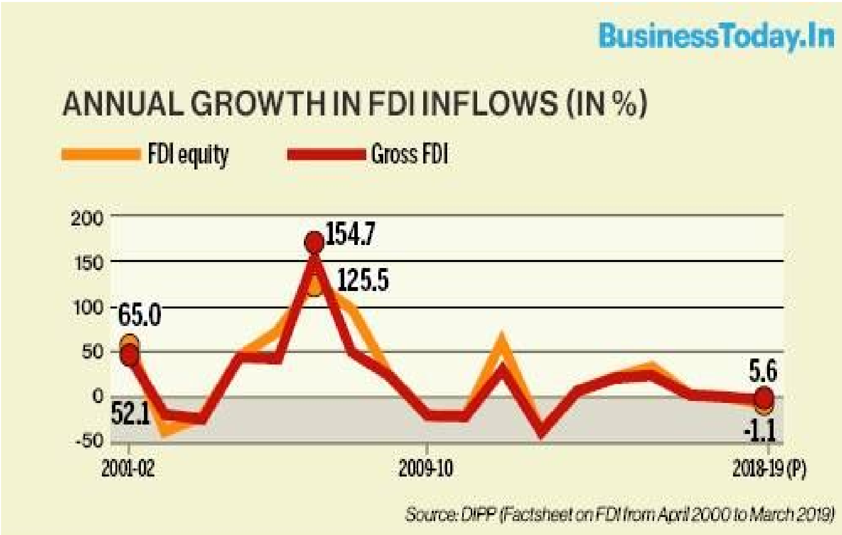
A successful Indian foreign policy, by definition, is one that creates the external circumstances conducive to realizing India's fundamental aims, namely, protecting its physical security and its decisional autonomy, enlarging its economic prosperity and its technological capabilities, and realizing its status claims on the global stage. Attaining these objectives requires New Delhi to engage at three different levels abroad: within the subcontinent and its immediate periphery, the intermediate level of the international system populated by various middle powers, and the core of the system where the great powers reside.

India sees itself as a **stabilizing power** that finds benefit in multiple external engagements, hoping to build momentum for a multipolar world with a multipolar Asia at its core. India's balancing posture and its growing military and strategic capabilities are seen to provide a degree of reassurance against global turbulence and competitive geopolitics.


Source: https://www.youtube.com/watch?v=XIk_LXzUV1Y

In the past few years, India has made progress in facilitating logistics support, increasing maritime awareness, upgrading military exercises, and regularizing strategic dialogues with the US, Japan, Australia, Russia, France, South Korea, Southeast Asia, and others. India is not alone in having a domestic debate about managing China's rise. A combination of approaches will remain in the policy mix of every country. Both the US and India have taken important strides together to advance their strategic partnership in the domain of climate action and policy. However, existing efforts continue to rely mainly on an incremental approach to tackling climate change. Trump also wants to expand the G7 grouping (which China is not a part of) to include Australia, India, South Korea, and possibly Russia, thus making it a G10 or G11, which Mr. Narendra Modi also supported. At the same time, India made another unusual diplomatic play, this time with regard to Taiwan. In an extraordinary move, two Members of Parliament (MPs) — Meenakshi Lekhi and Rahul Kaswan — from the ruling Bharatiya Janata Party (BJP) virtually attended President Tsai Ing-wen's swearing-in ceremony online. Also a recent move worth taking into account regards with Australia.

Under the current FDI policy, a non-resident entity can invest in India except in prohibited sectors/activities under the automatic route that is without requiring Government permission. However, a citizen of Bangladesh or Pakistan or an entity incorporated in Bangladesh or Pakistan can invest only under the Government route, i.e., after obtaining prior Government approval, except that a citizen or entity from Pakistan cannot invest in defense, space, atomic energy, and prohibited sectors/activities. As per the amendment to the FDI policy, any entity or beneficial owner of investment into India or a citizen, based in a country that shares a




Source: https://dipp.gov.in/

land border with India can invest only under the Government route. Also, the transfer of ownership of any existing or future FDI in an Indian entity, directly or indirectly, resulting in the beneficial ownership falling within the above restriction will also require Government approval. The government is likely to extend the existing Foreign Trade Policy by six months to September 30 in the wake of the Covid-19 outbreak.

**Challenges and Opportunities in 2020**

It is of fundamental importance that we as a people recognize that the Indian nation faces two existential threats: coercive pressures from neighbors over unsettled boundaries and Islamist extremism. Continuing turbulence in India's North East is becoming another major concern. For India and its foreign policy, the West Asia/Gulf region holds a significant court for strategic, economic, and even domestic political agendas, ranging from migration to energy security. The pandemic has initiated a reverse migration of Indian blue-collar workers as projects in oil-rich States stall, and infrastructure development halts amidst a contracting global economy that some say may be worse than the Great Depression of the 1930s.

The major sovereign wealth funds and other financial institutions in West Asia have been hit hard by COVID-19 as well. Some have seen their real estate and retail portfolios shrink dramatically over the last three months. India is well-placed to attract a significant amount of capital from West Asia and reports of investment by UAE's Mubadala and Saudi Arabia's Public Investment Fund (PIF) are a case in point. The economic reforms announced by the Finance Minister in the week of May 13 bring much-needed clarity to industrial and agricultural policy. A strong, positive message to West Asian investors from New Delhi is now the need of the hour.

According to an OECD index covering 68 countries, India possesses the eighth-most restrictive foreign direct investment (FDI) regime. A Property Rights Alliance trade barrier index calculated for 86 countries ranks India as having the most restrictive trade regime bar. **If India complements its State capabilities with more open trade and investment policies, it could be a major beneficiary of these supply chain realignments and its 'Make in India' strategy would get a jump-start. If it chooses, India could be a winner in a post-COVID-19 world.**

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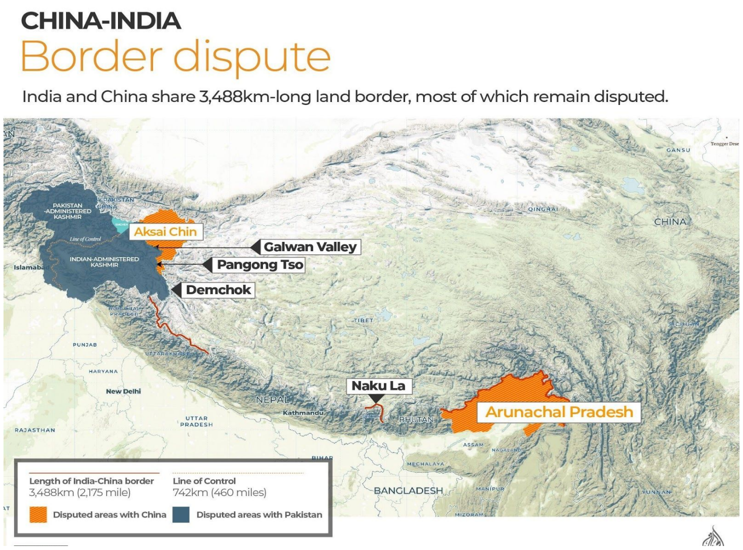
## BEYOND THE SNOW-CAPPED MOUNTAINS: AN INSIGHT INTO INDO-CHINA RELATIONS

The past few days have witnessed escalations at the Line of Actual Control (LAC) between Indian and Chinese forces over a territorial dispute. The materialization of these skirmishes in the form of aggressive action, face-offs and disastrous casualties on both sides of the border (The recent Galwan Valley encounter led to the martyrdom of 20 Indian and 43 PLA soldiers respectively) may be perceived by fence-sitters and naysayers as instances which are few and far between but to critique responses, estimate ramifications and suggest constructive diplomatic action, it is important to understand the historical context. Through this feature, we attempt to throw light on the issues which have persisted since the 1962 Indo-Sino war and also undertake predictive analysis with regards to how a massive escalation would pan out.




Source:[https://www.aljazeera.com/news/2020/06/india-china-generals-hold-meeting-defuse-border-standoff-20060610](https://www.aljazeera.com/news/2020/06/india-china-generals-hold-meeting-defuse-border-standoff-20060610)

### Background

Indo-China territorial disputes date back to the "McMahon Line" drawn in 1913 and 1914 to demarcate the areas between British India and Tibet. The line was drawn as part of the Simla Convention which was not officially signed by the Chinese Kuomintang government at the time and has hence not been officially recognized by the communist state. The treaty dictated that the strategically important region of AP state would be within the political boundaries of India, however, China considers it as "South Tibet", a part of the Tibet Autonomous Region.

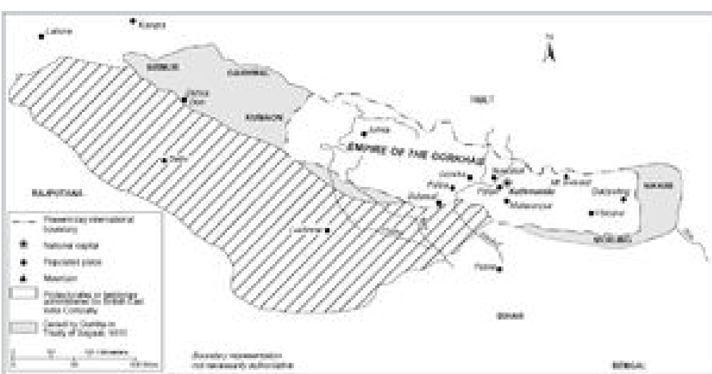
The town of Tawang, which is the second-most prolific Buddhist site and the birthplace of the Dalai Lama, is of special importance to the Chinese government as its occupation would improve its territorial control over Tibet. This disputed area, in addition to "Aksai Chin" (Northwestern Kashmir; administered by China), led to a conflict, colloquially known as the 1962 Indo-Sino war, a war India lost. Since then, in addition to the existing issues, India's firm opposition to the Chinese occupation of Tibet and its formal recognition of the 6th Dalai Lama as its leader has sparked a political conflict directly against Beijing and strained relations even further. Many political theorists speculate that the 1962 war was a conscious effort by China to avoid public scrutiny in the wake of the Cold War, however, those claims have been unfounded. Needless to say, we are at a juncture where Chinese forces are advancing towards territories claimed by India and strong diplomatic action needs to be undertaken to prevent an impending war.

### Indo-Nepal and Indo- Pakistan relations w.r.t China

China's involvement with the Pakistani military, trade, and infrastructure has been strengthened over the years, since the year 1950 when Pakistan was the first country to formally recognize China and maintain diplomatic ties during the isolationist period of the 1960s and 1970s. From the 2010s, this relationship has been affirmed through the OBOR (One Belt One Road) initiative. Similarly, despite being a steady ally of India, Nepal has also been inching towards China for infrastructural, trade, and military support, citing similarities in the political ideology of the ruling party. This is the reason why political researchers state that any military altercation with Pakistan or Nepal would result in the military or intelligence involvement of China. Furthermore, since the countries in question happen to be nuclear powers, widespread destruction is apprehended.

**Indo-Nepal Relations**

It is interesting to understand Indo-Nepal relations from the lens of its respective relationship with China, however, to truly understand the prevalent altercations between the two nations, their relationship must be analyzed independently. The Kalapani region is at the center of this border dispute and has been claimed as Indian territory for the last 60 years. But Nepalese authorities quote the 1815 Sugauli treaty to legitimize its claims over the area. A census for the same was conducted in 1953 and subsequently, parliamentary elections were also held in the area. The land records have been maintained at district administrative offices under the Nepalese government. This spat has further escalated because New Delhi announced a 50 km long construction project along Lipu Lekh in the Kalapani region which has also been disputed land. In November 2019, Nepal announced a new official map which was made public on May 20 and was immediately slammed by New Delhi. These may come across as petty skirmishes regarding a routine land dispute, however, these altercations go way beyond that simple definition. Nepal has always accused India of mingling in its internal affairs and cites this interference as a major reason for the dependence of Nepal's labor force on Indian white-collar jobs. India alleges Chinese involvement with Indian Army Chief Manoj Mukunda Naravane saying Nepal was acting at the behest of "someone else." The repercussions of this diplomatic fallout are still being deliberated.



The map as per the 1815 Sugauli treaty.
Source:https://www.loc.gov/collections/country-studies/about-this-collection/

**Conclusion:**
It is fair enough to say that the complexity of India's relationship with its Himalayan neighbors ought to be understood. From a purely objective perspective, a massive escalation would affect all parties involved and will also result in widespread destruction due to deemed nuclear status and economic fragility.

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**THE INDIAN TRADING SECTOR: IMPACT OF COVID-19 AND BORDER DISPUTES**

Since the liberalization in 1991, India has developed an increased interconnectedness with the global economy. Since the past 30 years, India has been recognised as one of the rising nations amongst the emerging economies. India has shown a consistent growth of more than 6% in the past decade with the help of business-friendly policies, and has become one of the key contributors to global economic growth.

The following graphs display the movement of multiple economic factors during the 2008 financial crisis and the COVID-19 pandemic. It can be observed that the behavior of the pandemic in terms of economic impact is similar to the financial crisis of 2008.

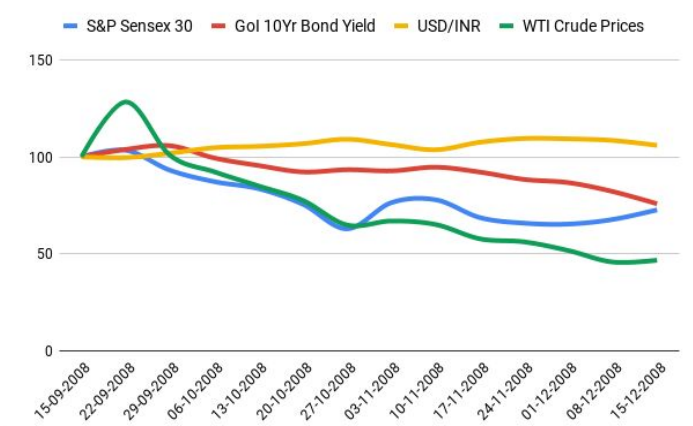


*Fig: Global Financial Crash (2008)*

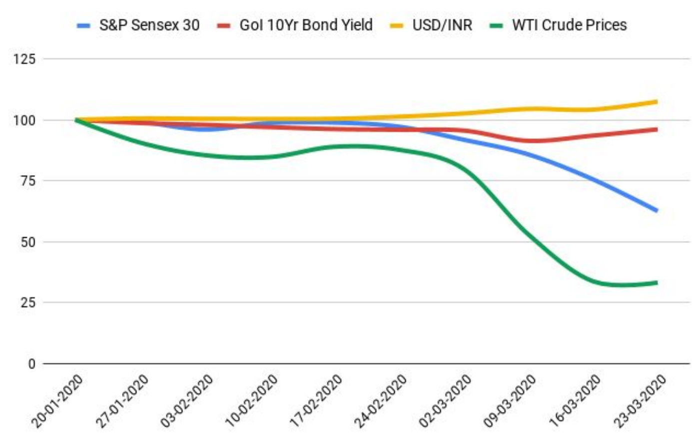


*Fig: COVID Pandemic (2020)*

The GDP of India has stoops as low as sub-2.5% according to Moody's and it is safe to pronounce the state of the country as a "Minsky Moment" in other words a state which exhibits a major, sudden decline of asset values and symbolizes the end of the growth phase of economy. The Indian export sector is highly likely to be affected and continue to remain subdued in the months to follow.

In the last financial year, the Indian export business was stressful, however, the outbreak of COVID-19 has further aggravated the export numbers to as low as 15-20% as per the estimates. The coming months are likely to show a further contraction in these numbers given reports of cancellations from main markets like the United States and Europe. ALong with this, the suspension of manufacturing due to the lockdown has affected the exports during the second as well as some of the third quarter of 2020.

It is estimated that India would display signs of recovery by the fourth quarter of 2020. An article by the Economic Times stated that a policy paralysis in this situation along with the global trade slowdown could negatively affect the Indian exports in the near future. However, as soon as the global economies begin to revive in the medium to long term, some of the following key factors would contribute to the recovery of the Indian export business:

- The holiday season (Christmas) in the EU and the US has previously shown to boost the demand in these countries which in turn acts as a stimulus for Indian exports.

- The Indian exports might gain some benefit from the weak rupee against the dollar as soon as the global trade gets moving again.
- The excessive interconnectedness of the Indian export market to the global value chains supported by India's leading position as an exporter of agricultural, pharmaceutical and other essential commodities would further promote the demand especially after the pandemic, thus, increasing the exports.
- Finally, other factors like the traditionally low crude oil prices accompanied by the significantly low lending rates from the Reserve Bank of India could support this growth in the coming quarters.

The Monetary Policy Committee (MPC) in one of its recent announcements declared some relaxations in the Cash Reserve Ratio (CRR) along with a significant cut in the repo rate of 75 basis points in an attempt to enhance liquidity in the market. A three-month moratorium on the existent loan payments was also announced. Even though these measures are causing temporary relief to the markets, it is necessary to be cognizant of scenarios that one might face in the coming months.

Apart from the COVID-19 crisis, the ongoing Indo-China border crisis might not immediately affect the trade relations of the two nations, according to a report by The New Indian Express. Nevertheless, if the situation becomes adverse, there is an increased chance of negative changes in the bilateral relationships. President of the Federation of Indian Export Organisations, S.K Saraf said, "I do not see any impact on the bilateral trade relations due to the current border tensions between the two key trading partners," There are massive trade opportunities for both the countries' businesses to expand in each others' markets. Biswajit Dhar, the economics professor at Jawaharlal Nehru University explained that due to heavy dependence of India on the Chinese market for several critical products such as Active Pharmaceutical Ingredients (APIs), India should refrain from putting any trade restrictions on China. There are no available alternative markets for these products and India would not be able to import from elsewhere immediately. An increase in the import duties and tariff would simply add a burden on the domestic consumers. Finally, he recommended promoting domestic manufacturing of critical products as a solution to such a crisis. As per the report, "India's exports to China stood at **USD 15.54 billion during April-February 2019-20**, while imports aggregated at **USD 62.38 billion** during the same period. Exports and imports in 2018-19 were **USD 16.75 billion and USD 70.32 billion** respectively".

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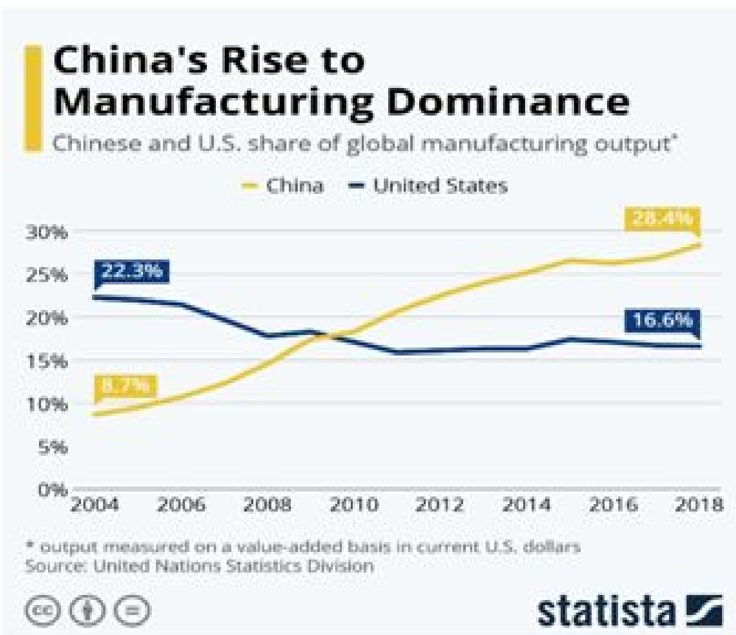
## HOW CAN INDIA BECOME AN ALTERNATIVE CENTER OF ECONOMIC POWER

COVID-19 has exposed the world economy's over-dependence on China. According to the United Nations Statistics Division, China's share in global manufacturing output climbed from 8.7% in 2004 to 28.4% in 2018. Due to this dominance, the world has faced supply chain disruptions during the ongoing pandemic. Coupled with growing hostility towards China because of their negligence, which led to the pandemic in the first place, the world is now looking to diversify its supply chains and move their enterprises outside China. This is a golden opportunity for India to become a global manufacturing hub. With concerted efforts, India can replace China as a world power if they capitalize on this exodus.




Source: [Statista]

However, the situation is complicated. These firms are looking at Vietnam, Thailand, and Taiwan as better alternatives despite India's huge demographic dividend. Between April 2018 and August 2019, 56 companies relocated from China, but only three came to India. Despite our advantages, we have a lot of structural issues we need to fix.

Land acquisition and labor regulations are very stringent in India. Investors often have to negotiate with a lot of small land-owners to obtain land. The process is very time-consuming and cumbersome. Labour laws also deter companies from relocating to India. India's legal framework, in this regard, is very archaic and discourages large-scale manufacturing. Firms tend to operate as small enterprises to escape the purview of these regulations. But without obtaining scale, competing in the world economy is very difficult.

While the government is looking to consolidate all the labor codes into just four codes and make compliance easy, it has not announced any major land acquisition reforms yet. In May, the government, however, announced that it is creating a 462,000 hectares land pool to aid companies moving out of China to acquire land easily. We need to make the process easier through legislative intervention.

Two other areas of focus must be power sector reforms and commercial contract enforceability. In the power sector, India produces about 365 gigawatts of electricity as of October 31, 2019. This is enough to meet the country's demands. However, corruption, theft, inadequate infrastructure, and mounting debt are some reasons why electricity distribution in our country is in shambles. The government recently announced the privatization of all distribution companies (DISCOMs) in the Union Territories. It is looking at Public-Private partnership in the states. Electricity distribution must be primarily privatized. The government must look to spend its money on improving the infrastructure, like setting up smart meters to prevent theft, instead of constantly bailing out inefficient DISCOMs.

While India ranks high on the Ease of Doing Business, it ranks very low on Commercial Contract Enforceability (163/190). Change in state governments often leads to the canceling of previous projects, and existing contracts are not honored. Court disputes take years to reach a conclusion (1445 days on average). India must set up an expedited system of solving commercial disputes, possibly looking at ADR methods like the NHAI has recently done. The government must frame a law to prevent state governments from canceling contracts after the investments reach a particular stage and penalize them if they do.

Needless to say, education forms the bedrock of economic growth in this technology-intensive era. In this aspect, India needs to overhaul its traditional education system to make it more research-oriented. It should be devised to raise people's productivity and creativity and promote entrepreneurship and technological advances. Focus on "skill development" is also of utmost importance. The government is planning to introduce a re-skilling fund as part of the labor code to enable laid-off workers to invest in skill-development so that they remain relevant in the job market.

Another causative factor behind economic growth is healthcare. India has traditionally grappled with health issues, which have not only affected its human capital but also have curated blemished perceptions about it. Hence, India needs to create an environment where citizens are cognizant about healthcare and have equitable access to affordable health coverage with a focus on precautions and preventions. Early diagnosis and minimum quality of care must be assured by a booming and sustainable ecosystem harboring both public and private players. Weaker labor laws are not enough if the labor force is malnourished or wasted.

India must also aim to cut down on its imports by providing viable alternatives here. Recent steps like coal liberalization and financial incentives for producing raw materials for the pharmaceutical industry are in the right direction. While these are targeted towards specific sectors, giving effect to the reforms mentioned above will automatically create a conducive environment for correcting our trade deficit. Solving these major structural problems can help India become an economic superpower and replace China's centrality in the world economic order.

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The **Centre of Policy Research and Governance (CPRG)**, India strongly believes that in the 21st century an India deprived of gainful opportunities, necessary for the flourishing of a young and emergent India, will prove to be an impediment in the development of human capital and preservation of global security. CPRG thus works towards providing gainful opportunities in an effort to promote the involvement of young people in policy making and politics.

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