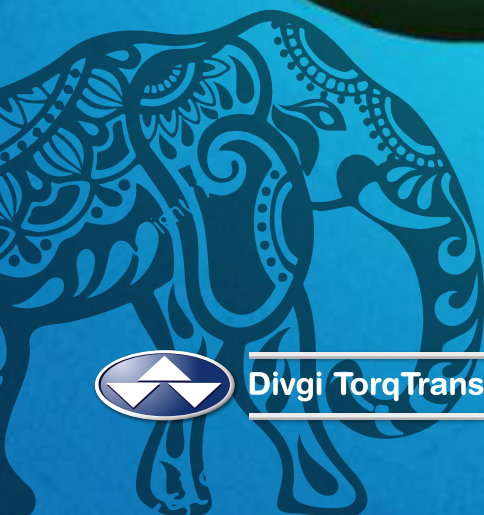


STRATEGY SCAPE

Thought Leadership
Series from
Divgi TorqTransfer
Systems

Will the Elephant and the Dragon Ever Tango?

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ABSTRACT



expensive troop buildup and heightened alert continues along the border and a massive infrastructure build up is taking place on both sides of the border. In short, the standoff continues even after two years with no end in sight.

We argued then that the time had come for the corporate world in India to consider these geopolitical currents very seriously in charting a course for sustainability that is a strategic imperative for companies in the uncharted territory of the new world order that is emerging.

A lot of water has flowed under the bridge since then. In this second paper, we try and revisit what was analysed then and whether actual events in the last two years proved the analysis right or wrong. Using this analysis, the attempt is to further understand current events and propose how the future might unfold and what implication this will have on business risk, business continuity and possible ways to mitigate them.

This is a follow up paper to the one written on July 8th 2020 titled "Decoding China". That paper attempted to make a case for why India's corporate sector needs to draw deep strategic lessons from the military standoff that took place between India and China in eastern Ladakh on the border with Tibet and China, which culminated in a lethal skirmish in which 20 Indian soldiers and unspecified number of Chinese soldiers lost their lives on the night intervening 15 - 16 June, 2020 in the Galwan Valley.

While India countered with equivalent troops and resource build up and even took preemptive action taking tactical initiative and advantage in the Pangong Tso region, over the last two years, India and China have been unable to restore the status quo situation of April 2020 across all conflict points initiated unilaterally by China. Therefore, an extensive and



PART 1

Revisiting Analysis of Previous Paper with Events over the last 2 Years.



We concluded the last paper with an opinion that China would continue to use economic power, military power and political power in their relationship with India and with its other neighbours to deny it its natural growth potential and compete fairly to attain its rightful place in the comity of nations, because India is the only other large nation in the neighbourhood that can deny China its

hegemonic status in Asia. We further concluded that India under the Narendra Modi government seems to have recalibrated its relations with China since their attempt to unilaterally change the status quo of the LAC, just like it did with Pakistan since 2014. The essence of the recalibration can be captured in the positions India has taken, with Pakistan, that Terror and Talks cannot happen

together, and with China that Coercion and Commerce cannot happen together. If India's actions with respect to Pakistan are an indicator, then it appears that India and China are on the threshold of a long unremitting cold war."



A brief note on the pandemic:

The last two years have been tumultuous globally, to say the least. Successive waves of the Covid-19 pandemic repeatedly stalled recovery. Despite the severe setback in India during the second wave in April - May 2021, India has handled the Covid-19 pandemic with admirable dexterity on various dimensions.

- Digital tracking of cases through Arogya Setu.
- Vaccine research and production.
- Fast scaling up of vaccine production capacities in response to 2nd wave.
- Sustained vaccine production by securing sources of raw materials required in the production of vaccines.
- Food support distribution.
- Cash distribution through The Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) financial support while infrastructure was being built as compared to cash dole outs in other countries.
- Vaccination of the world's second largest national population with entirely indigenously produced vaccines with one of the best efficiencies recorded in the world (cost, rate of vaccinations per day, yield between vaccines produced and vaccinations effected).
- One of the strongest economic recoveries of a large economy during FY22

Though the handling of the pandemic may seem to be an unrelated issue to the subject in hand, the lessons learnt from this experience are significant and applicable. India's global standing has been significantly enhanced, the way India stood together resolutely to fight the pandemic and global naysayers who doubted India's ability to handle it. There are many lessons that we can take out of this experience in addressing the risks of the geo-political challenges India faces and Indian businesses face as a consequence.

Major Events and Issues Related to Indo-China Relations in the Last 2 Years relevant to the Topic Being Analysed.

1. The standoff at the border continues despite sixteen meetings between the Corps Commanders over the last two years.
2. Status quo of April 2020 that China unilaterally changed has still not been restored.
3. India's firm and repeated stand that relations cannot be normalized unless there is tranquility on the borders, India's interpretation being restoring status quo of April 2020.
4. India's initial response by banning 200+ Chinese apps in India.
5. India keeps China out of 5G roll out in India.
6. India enacts restrictions on foreign direct investments in India by countries that shares a border with India, effectively bringing all Chinese investments in India under scrutiny.
7. India rejects China's vaccine diplomacy and decides to be self-sufficient.
8. India fast tracks deployment of latest 4.5 generation fighters, Rafale squadrons on both Western and Eastern reaches of Indo-Chinese border.
9. India continues massive buildup of infrastructure across the Indo-Chinese border to keep pace with China.
10. India conducts multiple QUAD meetings; five since March 2020-

- formation of QUAD plus, 1st QUAD meeting held in the White House on 24th September 2021 and QUAD Summit held in Tokyo on 24th May 2022 where, among other issues, China and Solomon Islands, and China and Taiwan were discussed.
11. India weans the Maldives away from Chinese influence by a massive relief effort during the pandemic - of food, medicines and trained medical staff under Operation Sanjeevani. This is backed up by a \$500 million Greater Male Connectivity Project in 2021.
 12. India introduces massive 1.97 lakh crore Production Linked Incentive scheme (PLI) under "Atmanirbhar Bharat" on 1st April 2021 that covers 14 sectors of industries to attract investments in India.
 13. India sells BrahMos supersonic naval defense missile system to Philippines in a \$368 million contract signed on the 3rd of February 2022; negotiating the same with Vietnam.
 14. Chinese automotive company, Great Wall, shelve its plan to invest in India after not being able to get approvals from the Indian government. Great Wall sacks all Indian employees without any benefits.
 15. Chinese smart phone companies Xiaomi, OPPO and VIVO under scanner of the Enforcement Directorate of Foreign Exchange

- Management Act (FEMA) violations. Chinese directors flee India.
16. Out of 382 proposals received from China since investment restrictions were enacted, only 80 cleared in the last 2 years.
 17. India's import from China for FY22 surges to \$94.16 billion representing a rise of 44.3% over previous year with India exporting \$21.26 billion to China which was also a marginal increase. However, China's share of imports to India fell from 16.5% to 15.4% with the US taking 1st position.
 18. Sri Lankan economy collapses under debt burden. India extends emergency support with food, medicine, and fuel supplies. India has extended financial support of \$3.8 billion since January 2022, massive corruption in high interest Chinese funded "white elephant" projects being cited as one of the reasons for the collapse.
 19. Pakistan economy also on the brink of collapse with internal political turmoil delaying International Monetary Fund (IMF) bailout. IMF conditionalities also straining relations between Pakistan and China.
 20. India consolidating gains in Jammu and Kashmir (J&K) after abrogation of Article 370, significant infrastructure development and its plan to host the G20 meeting in 2023 in J&K.
 21. China lauds India's neutral stance on

- Ukraine war and supports Indian crude imports from Russia.
22. Indian Prime Minister Narendra Modi continues to demonstrate a robust response to Chinese provocations to Indian sensitivities. Example, wishing the Dalai Lama on his 87th birthday on 6th July 2022.
 23. India, China and Russia collaborate in the recent BRICS summit virtually hosted by China to find an alternative to SWIFT transactions in global trade.
 24. India launches robust "Atmanirbhar" campaign, particularly in the field of defence production, apart from restricting numerous armament systems from imports, thereby increasing local procurement. Various initiatives for local innovation for futuristic systems launched. India makes record ₹13,000 cr. exports in defense equipment in FY22 out of which 70% is from private sector.
 25. China continues to arm Pakistan with naval frigates, J-10 fighters and air defence systems.

The above major events depict a much nuanced relationship between India and China. However, some fundamental shifts since May of 2020 seem likely to remain in play for some more time to come.



Analysis Of These Events In Light Of What Was Concluded In The Last Paper.

1. The border standoff and tensions remain unresolved despite 16 Corps Commanders meeting held in the last two years. China seems to be in no hurry to resolve this. Our analysis of this being a long-drawn-out affair stands vindicated.
2. India has followed through with its position that overall relations cannot be normalized until tranquility on the border is restored, which is, returning to status quo as of April 2020. However, this response has been nuanced to the extent that while investments by Chinese companies in India is under strict scrutiny and in some cases like 5G outright restricted, trade in goods has been allowed to happen.
3. Both India and China vigorously compete for regional influence in the Indo-Pacific and Indian Ocean region. Since May 2020, India's efforts have taken a new trajectory and, in some cases, is neutralising earlier gains made by China; a case in point being Maldives and Sri Lanka. India further ensures that Bangladesh resists China's efforts to tilt its relations in China's favour.
4. India countering China with increased military influence in China's sensitive underbelly, the South and East China Seas and arms sales and security related collaborations with the Philippines, Vietnam, Malaysia, Indonesia, Singapore, South Korea and Japan.
5. India activates multilateral approach to counter China through QUAD participation.
6. The Modi government does not seem to have been lulled into complacency and has kept up its sharp vigil on multiple fronts in its relations with China.



PART 2

Moving Forward



From the analysis made in Part 1, it is evident that India has already recalibrated its relations with China for at least the medium term (the next 5 years). Going forward, the following assumptions are made, which, as of today, seem to be the most likely to happen.

1. Modi government wins the 2024 general elections for another 5-year term till 2029.
2. Xi Jinping is able to hold on to his party General Secretary position for a 3rd term at the minimum. It is very likely that he can get a life term position as well.
3. The Ukraine war gets long-drawn-out.
4. The US - China contest over Taiwan continues to simmer.

With two strong nationalistic leaders with unfettered mandates at the helm of affairs both in India and China at least till 2029, let us analyse how the Indo-China relation is likely to evolve given the background of the last two years as covered in Part 1 and the current geopolitical situation.

The India Story

It is widely expected that the Bhartiya Janata Party (BJP) will further consolidate their national mandate in the 2024 general elections. To what extent this will happen is debatable. In this analysis, we are assuming that the Narendra Modi government gets re-elected with a stronger mandate. In such a scenario, what is likely to happen?

- BJP will try to consolidate the long-term benefits of their policy reforms of the previous terms. It will reinforce its agenda to its core constituency - a resurgent, Atmanirbhar Bharat and counter China's belligerence in trying to contain India with multilateral

alliances till India is capable of countering China on its own on all dimensions of its relationship with China.

- India does not need to choose sides between the West and China in the emerging global order and will emerge as one of the poles in a multipolar world as Dr. S. Jaishankar articulated eloquently recently.
- India's track record, as being the world's largest and most diversified democracy linguistically, ethnically, religiously and culturally, will continue to gain global recognition.
- The Republic of India has achieved and demonstrated to the global community

a model of governance that the less diversified European Union is still struggling at just a level of common currency and economic block.

The Modi government and the BJP have their own strong world view of the position of India in the present comity of nations. Going by the trajectory of the last two terms, it can be expected that the 3rd term of the Modi government will continue in the direction of restoring India's historic position as an important pole in the global order, while not being hegemonic, being counted, consulted, and contributing to the global world order.

In achieving these goals, they may have to demonstrate shades of a hard state, especially with respect to Jammu and Kashmir and its handling of a stronger neighbour like China who has the diametrically opposite goal of containing India. Answering a question at a recent seminar celebrating India's 75th anniversary as to what India's focus will be in the next 25 years, India's Minister of External Affairs, Dr. S. Jaishankar articulated, "It will be building of capacity, capacity and capacity".

A difficult neighbour in the form of Pakistan is an older challenge India faces. China blatantly disregards India's red lines by investing in Pakistan Occupied Kashmir, while calling out Indian actions in the Indian state of Jammu and Kashmir. India, since the 2020 clashes, has been responding in equal measure. The deployment of Tibetan special forces to severely constrain Chinese forces locally and making these facts universally public was to signal to China that the game of perception can be played both ways. A de-nuclearised and severely economically impoverished Pakistan is China's nightmare in their regional strategy. And

this is precisely India's goal.

India has also not shied away from flexing its capacity building in the Andaman and Nicobar Islands by stationing Air Force squadrons with the capability to choke the Malacca Straits. India is further consolidating its capabilities in the Indian Ocean Region by what is called the "Double Fishhook" strategy. The first fishhook is a string of military bases on the eastern side of the Indian Ocean ending at the American Naval base at island of Diego Garcia. The second fishhook is the string of bases on the western side of the Indian Ocean skirting continental Africa and again connecting Diego Garcia. This level of assertiveness by India on multiple dimensions is new to China.

The China Story

Xi Jinping's quest to retain power may not be an easy one. Even as he most likely retains power for a 3rd term, there is likely to be serious discontent from other senior politburo members as some reports indicate from the so-called Shanghai

Group. China also faces some serious internal problems like the real estate bubble, massive debt of provincial governments and massive debts of its high-speed rail network that are leading to a credit bubble. The recent mass run on small county banks and mass people's movement to stop paying mortgage payments are pointers to the stressed credit situation in China. Increased civil unrest due to its zero tolerance Covid-19 response policy has also been reported. The cost of China's internal security apparatus is reported to rival its defence spending. Another challenge China could face is food security. It has always hovered on the threshold of being secure in food and has heavily depended on food imports. Its ability to outbuy food in the global markets, as it has been doing in the recent past, may get restricted if there is a global food shortage driven by the prolonged war in Ukraine and many food growing countries start restricting exports of food. Even a single seasonal flood in China could make the situation severe. These internal problems are likely to tempt Xi Jinping to manufacture external events that unite the country with nationalistic fervour. Unifying Taiwan has long been Xi Jinping's desire to leave as his legacy. However, if he secures a 3rd term or a life term position as General Secretary, it is likely that he will bide his time for an opportune moment. China may prefer to weaken Taiwan's democratic institutions from within through corruption and even targeted assassinations. For this to work, China will need time and also have to dissuade other strong players globally and regionally from supporting Taiwan's democratic independence and try to isolate them and attempt the unification without any military action. The Ukraine war demonstrates that it is one thing to be able to attack a weaker country but to be able to retain and occupy territory in today's military tactics and strategy is extremely difficult. Military action on Taiwan might also unite the rest of the world against China causing serious internal unrest within China because of external isolation. China's geography with a single hemmed in Eastern seaboard works against China's interest in a long-drawn conflict with major powers of the world.

For this unification without military action to work, China would want to keep India distracted and hemmed in in its own



India's "Double-fish hook" military bases strategy

South Asia and Indian Ocean regions. By keeping constant pressure on the Indian government at the border below an escalation threshold, then makes a plausible strategy to keep India distracted at its own borders and maintain a financial drain on India, thus limiting its ability to interfere in the South and East China Sea.

China's strategy to encircle India in its neighbourhood, that some analysts call the "String of Pearls" strategy, currently seems to be failing. Sri Lanka is now expected to keep a balance tilted in favour of India as it will require emergency relief as well as India's goodwill to secure a bailout package from the International Monetary Fund (IMF). Bangladesh has consistently resisted going against India's interests in favour of China. While

Pakistan remains the only client state, its precarious financial position has caused a strain in its relations with China. The toppling of the Imran Khan led Pakistan Tehreek-e-Insaf (PTI) government is seen as a West initiated move within Pakistan and in China. Pakistan needs the IMF bailout package to get multilateral funding without which Pakistan will collapse like Sri Lanka. China alone cannot keep Pakistan economically viable. With Saudi and Indian interests coming in alignment, Pakistan's options will remain challenged. With the political class in Pakistan torn between Western and Chinese pressure, for China to use Pakistan as a proxy to put pressure on India is, for the moment, diminished to a certain extent. This leaves China with the only option of increasing the pressure on the Indo-Chinese border.

The recent air sorties that the People's Liberation Army Air Force (PLAAF) is conducting on the Indo-Chinese border could be a result of this.

Despite the noises of protest China makes on India restricting Chinese investment in India, I think China is comfortable with the current status quo; allow India to restrict Chinese investment into India to the extent India can while allowing goods to be traded to China's advantage.

Taking all this into account, it seems China will be in no hurry to normalise ties with India soon. In fact, it is in their interest to keep it on the boil, albeit under a certain threshold level in a long-drawn-out contestation. **China might only start normalising its relationship with India after its goal of unification of Taiwan is met.** By that time, they will need India for their longer-term objectives. China's skewed demographic challenges of a fast-aging population bulge, unbalanced sex ratio and one of the lowest current fertility rates of 1.31 births per female (2.1 being considered as the sustainable ratio) pose serious challenges for China's long-term future. If China is to transition into a high technology, automation driven economy, they will need India's market to be a sustainable economy.



So, will the Elephant and the Dragon Finally Ever Tango?

What most analysts overlook, with the world still being largely Western centric, is that the present contestation between India and China could be one of the most defining events for humanity going forward. Together, they are the fastest growing economies representing a massive 36.5% of the global population. If they collaborate, Western dominance is history. If they contest and compete, which seems to be the evolving reality, the near future will be full of uncertainties.

The global sourcing story will be another dimension of competition between India and China as India puts its best talent and resource to work to create an alternative to China and China works equally hard to retain its position.

Another aspect for the world community to observe is that the India China contestation is between an areligious authoritarian regimen with a fairy

homogenous population in China verses a deeply religious diverse democratic population in India.

How the interests of the current global powers align to shape the future of humanity is anybody's guess. But, for the moment, it seems unlikely that India and China will be able to normalise their bilateral relations to the level before April 2020 in the foreseeable future. At a bilateral level, one can expect vigorous contestation, just below a threshold of it escalating into a military conflict. However, loose collaboration in multilateral fora cannot be ruled out where certain national interests align.





CONCLUSION

The way geopolitics is currently evolving, the idea of globalisation seems to have run its course. Fault lines in the forms of governance of countries, that was brushed under the carpet in the heydays of globalisation are getting starkly exposed as communist authoritarian regimes once again compete with Western liberal democracies for regional and global hegemony. The future of global trade may get fractured in politically aligned trade blocks.

India's strong domestic market, that many global rating agencies and analysts predict to be a beacon in an otherwise gloomy global forecast, will be a key tool in India's toolkit in managing China's expected belligerence against India. Given the military asymmetry between India and China, India will be forced to play the commerce card in managing its relationship with China.

This, along with the geopolitics driven global trade realignment, may force India to decouple its economy with China faster than we think even if it impacts its growth to a certain extent.

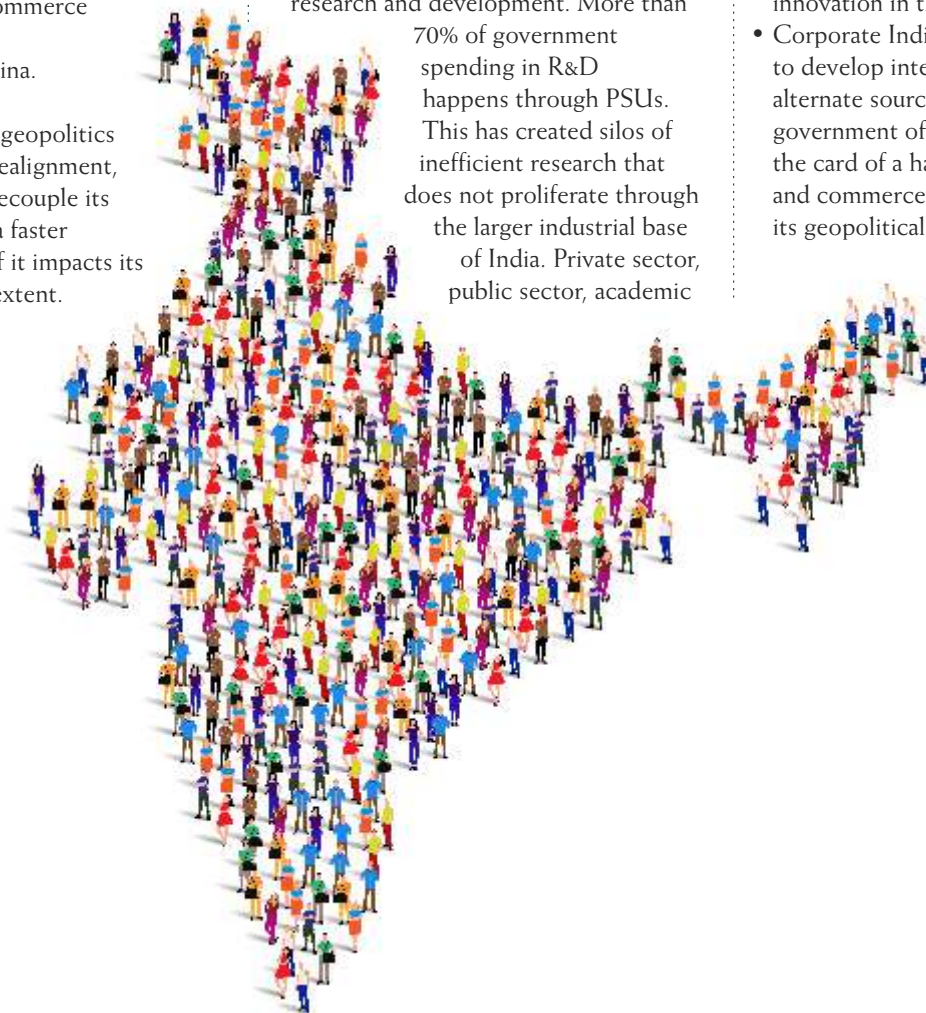
What India as a Country and Corporate India do to address this

- Build capacities across the board in all dimensions of its economy with a missionary zeal. The Aatmanirbhar Bharat mission is a step in that direction.
- It is not sufficient just to relocate manufacturing to India. India needs to develop and sustain an ecosystem for research and development, innovation, and knowledge-based value addition in India. The Prime Minister's clarion call from the ramparts of the Red Fort on India's 75th Independence Day of "Jai Vigyan" and "Jai Anusandhan", (victory through science, technology and innovation) seems to have come out of this realisation.
- Just like the PLI scheme, the government has to seriously incentivise research and development. More than

70% of government spending in R&D happens through PSUs. This has created silos of inefficient research that does not proliferate through the larger industrial base of India. Private sector, public sector, academic

institutions, national laboratories academic institutions - national laboratories need to collaborate on thrust areas to develop a vibrant innovation ecosystem. The government instead of spending money on R&D in PSU silos, should develop a system of grants to such collaborative efforts between private sector, academic institutions and national laboratories. This could attract further funding from other sources, sharpen the edge of the research subject and bring in efficiencies of program management, industrialisation and bring the outcomes of the R&D work to market fruition more efficiently, the biggest spin-off benefit being, developing a culture of research, development and innovation in the society.

- Corporate India would be well advised to develop internal capacities and alternate sources to China should the government of India be forced to play the card of a hard decoupling of trade and commerce with China to manage its geopolitical and security imperatives.





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