

## INDIA SEEKING OPTIMAL SOLUTION TO “DECOUPLE” FROM CHINA — TURNING TO QUAD FOR INVESTMENT AND ECONOMIC COOPERATION —

Yoji Okano  
Strategic Planning Dept.  
Mitsui & Co. (Asia Pacific) Pte. Ltd.

### SUMMARY

- Relations between India and China have remained tense since 2020. China is adopting a policy that suggests it is not bothered by the friction over the territorial dispute that started the conflict, and India, which has been emphasizing its economic relations with China, is not in a position to take an easy step toward reconciliation.
- India's economic gains from its relationship with China since the Modi government came to power have fallen short of expectations, and the COVID-19 pandemic has further highlighted India's dependence on China and the vulnerability inherent in such dependence. In order to realize a “self-reliant India,” India is shifting its policy to decouple from China, especially in the manufacturing sector. At the same time, expectations are growing for economic cooperation and investment by developed countries, including Japan, the US, and Australia.
- India will avoid a definite deterioration in its relations with China, but will not relax its vigilance, and the amount of Chinese investment it will allow will be limited for the time being. The year 2024, the final year of the Modi administration's term in office is likely to be the target for achieving a path for decoupling from China.

India's relationship with China is often explained from a geopolitical perspective or a perspective that sees it as a dependent variable of the US-China relationship, but India's relationship with China, its largest trading partner, impacts India's economic and industrial policies. This report examines India's relations with China from the perspective of India's economic interests.

### 1. WHERE INDIA-CHINA RELATIONS ARE TODAY

#### 1-1. Amid ongoing tensions with China, India turns toward QUAD

India-China relations have cooled in the wake of the June 2020 clashes in the disputed Ladakh border region, which resulted in casualties (Table 1). While Indian Prime Minister Narendra Modi and Chinese President Xi Jinping held bilateral summits in 2018 and 2019, a meeting has not taken place since 2020<sup>1</sup>. Although the two countries have kept the channels for dialogue between their governments and militaries open, there is no sign of a reconciliation anytime soon.

<sup>1</sup> The year 2020 marked the 70th anniversary of the establishment of diplomatic relations between India and China, and at a summit meeting the previous year, it was agreed that Prime Minister Modi would visit China in 2020 at the invitation of President Xi. However, due to deteriorating relations and the impact of the COVID-19 pandemic, no summit meeting was held, and only congratulatory messages were exchanged between the two leaders and their foreign ministers in April 2020.

**Table 1: India-China relations in recent years**

2017	June	Tensions escalate when the Indian and Chinese troops confront each other in a standoff in the border area of Doklam (the situation is quelled when the two sides reach an agreement in August)
	September	PM Modi attends BRICS summit in China
2018	April	PM Modi visits Wuhan, holds informal summit with President Xi
	November	PM Modi attends trilateral meeting with US and Japan, and also with China and Russia, at G20 Summit in Buenos Aires
2019	June	PM Modi attends trilateral meeting with US and Japan, and also with China and Russia, at G20 Summit in Osaka
	October	President Xi visits Chennai and holds an informal summit with PM Modi (the last bilateral summit as of this writing).
2020	April	The 70th anniversary of the establishment of Indo-Chinese diplomatic ties India, with China in mind, introduces a pre-screening system for direct investment from neighboring countries
	June	Indian and Chinese troops clash in the border-disputed Ladakh region (results in first casualties in 45 years) ⇒ Since then, India has accelerated the introduction of various measures that have led to the exclusion of Chinese companies and products.
	September	Foreign ministers of India and China meet in Moscow during visit for SCO foreign ministers meeting, and agree to take appropriate measures to avoid aggravation of the territorial dispute
2021	July	Foreign ministers of India and China meet in Tajikistan during visit for SCO foreign ministers meeting. The ministers exchange opinions about the situation and pledge to maintain communication
	November	Foreign ministers of China, Russia, and India hold meeting (online, India is host). India expresses support for the Beijing Winter Olympics 2022
	December	China announces that it has given official place names to 15 disputed sites in the northeastern Indian state of Arunachal Pradesh (which China considers to be the southern part of the Tibetan Autonomous Region)

Source: Compiled by MGSSI based on announcements by the governments of India and China, various materials, and news reports

India, meanwhile, is leaning toward the Quadrilateral Security Dialogue (QUAD), a framework for cooperation among Japan, the US, Australia, and India, which it had previously been cautious about. Prime Minister Modi participated in QUAD's first summit meeting (online) in March 2021 and the second summit meeting (held in the US) in September 2021, showing his commitment to cooperate with the US, Japan, and Australia. India has maintained its traditional policy of non-alignment in diplomacy, and while it is not taking part in the movement to contain China, it is building closer ties with the US through QUAD.

## 1-2. Territorial dispute remains unsettled

Tensions between India and China intensified in June 2017 when the two nations' troops faced off in the Doklam district, near the tri-junction border between India, China, and Bhutan. However, as China was scheduled to host the BRICS summit in September 2017, it hurried to resolve the situation, and India responded, resulting in an early reconciliation. In 2018 and 2019, Prime Minister Modi and President Xi visited each other's countries to make a show of their cooperation<sup>2</sup>. The way the two countries managed their dispute was to suppress the territorial issue by seeking a compromise, while promoting economic cooperation and maintaining good relations. For India, its economic relations with China, the world's second largest economy and largest trading partner, are important. However, this holds true only on the premise that China will take restrained action on the territorial issue.

On this point, at least in India's perspective, China has not sufficiently restrained its actions. The number of border crossings by Chinese troops, as ascertained by India, remained at 273 in 2016, 426 in 2017, and 326 in 2018, before jumping to nearly 600 in 2019<sup>3</sup>. In 2020, after the COVID-19 pandemic subsided in China, and conversely, the number of infections surged in India in April, China increased its activities in the Ladakh region, leading to a clash between the two sides in June. At the end of 2021, China announced it had given official names to 15 disputed sites in the northeastern Indian state of Arunachal Pradesh<sup>4</sup>. In January 2022, China enacted the Land Border Act to allow for the establishment of infrastructure facilities necessary for border defense.

<sup>2</sup> Prime Minister Modi visited Wuhan, China, in April 2018, and President Xi visited Chennai, India, in October 2019, and the two held informal summits on both occasions. Prime Minister Modi also participated in the Shanghai Cooperation Organization (SCO) summit held in Qingdao in June 2018. However, in the SCO's statement following its meeting in Qingdao, Russia, Kazakhstan, Kyrgyzstan, Uzbekistan, Tajikistan, and Pakistan were listed as countries that reaffirmed their support for China's Belt and Road Initiative (BRI), while India was not included in the list, indicating India's strong sense of caution toward the BRI.

<sup>3</sup> The Hindu, October 3, 2021

(<https://www.thehindu.com/news/national/chinese-transgressions-testing-india-say-officials/article36808989.ece>)

<sup>4</sup> The region is effectively controlled by India, but China claims sovereignty over the territory, referring to it as the southern part of its Tibet Autonomous Region.

## 2. INDIA'S RELATIONS WITH CHINA FROM THE PERSPECTIVE OF DEEPENING ECONOMIC RELATIONS

### 2-1. COVID-19 pandemic reveals India's dependence on China

On the matter of economic cooperation, before the COVID-19 pandemic, India expected China to reduce India's trade deficit, promote investment in India, and cooperate with each other in key industries. The Five-Year Development Program for Economic and Trade Cooperation,<sup>5</sup> released in conjunction with the first summit between Modi and Xi in 2014, states that the two sides will work together to reduce India's trade deficit, and that China will focus on investment in India, setting a numerical target of \$20 billion over the subsequent five years. Cooperation in priority areas has been discussed at the India-China Strategic Economic Dialogue, which was established in 2010, and at the sixth dialogue in 2019, the last as of today, cooperation was confirmed in the areas of infrastructure, high technology, energy, pharmaceuticals, and others<sup>6</sup> (Table 2).

**Table 2: Contents and agenda of the Five-Year Development Program for Economic and Trade Cooperation between India and China (2014), and the 6th Strategic Economic Dialogue (2019)**

Five-Year Development Program for Economic and Trade Cooperation between India and China (2014)	Trade	<ul style="list-style-type: none"> <li>Eliminate trade imbalance (reduce India's deficit with China).</li> <li>Promote the entry of Indian products into the Chinese market.</li> </ul>
	Investment	<ul style="list-style-type: none"> <li>Encourage Chinese companies to invest in complementary industries where they have strengths (machinery, electronics, communications, home appliances, automobiles, pharmacy, pharmaceuticals, textiles, plastics, chemical engineering, industrial parks).</li> <li>Improve the investment environment in India.</li> <li>China to invest \$20 billion over the next five years</li> </ul>
	Others	<ul style="list-style-type: none"> <li>Promote various mechanisms for further discussion and facilitation of dialogue.</li> </ul>
Sixth India-China Strategic Economic Dialogue (2019)	Policy coordination	<ul style="list-style-type: none"> <li>Collaborate in innovation and investment in the fintech sector.</li> </ul>
	Infrastructure	<ul style="list-style-type: none"> <li>Chennai-Bangalore-Mysore railway F/S, Delhi-Agra high speed rail feasibility study</li> <li>Identify new projects.</li> </ul>
	High technology	<ul style="list-style-type: none"> <li>Collaborate in AI, high-tech manufacturing, and next-generation mobile communications.</li> <li>Pursue technology innovation, digital partnerships, data governance, and related policies.</li> </ul>
	Resource conservation & environmental protection	<ul style="list-style-type: none"> <li>Discuss and review progress in water management, waste management, low-cost construction technology, water damage control, air pollution control.</li> <li>Explore potential for cooperation in waste power generation, sewage sludge treatment, etc.</li> </ul>
	Energy	<ul style="list-style-type: none"> <li>Cooperate in renewable energy, clean coal technology, smart grids, smart meters, EVs, energy storage solutions, etc.</li> <li>Conduct research on efficiency of solar power generation.</li> </ul>
	Pharmaceuticals	<ul style="list-style-type: none"> <li>Promote cooperation for India's generic drugs and China's APIs</li> </ul>

Source: Compiled by MGSSI based on Indian government materials

However, the results in terms of trade and investment before the COVID-19 pandemic were not satisfactory to India. The country's trade deficit with China increased from US\$23.8 billion in 2010 to US\$44.8 billion in 2014, and further, to over US\$50 billion in 2015-19<sup>7</sup> (Figure 1). Although investment by Chinese companies has increased markedly compared to previous years due to the emergence of large-scale projects in the cell phone, automotive-related, and digital sectors, the total amount of investment for 2014-19 was US\$2 billion, only one-tenth of the stated target of US\$20 billion (Figure 2).

Moreover, the COVID-19 crisis of 2020 highlighted India's structural dependence on and vulnerability to China. Looking at imports in 2020, India's imports from the rest of the world fell 23.2% year on year due to the economic slowdown and logistics disruptions, while imports from China fell only 14.0% year on year, supported by demand

<sup>5</sup> Website of India's Ministry of Commerce and Industry:

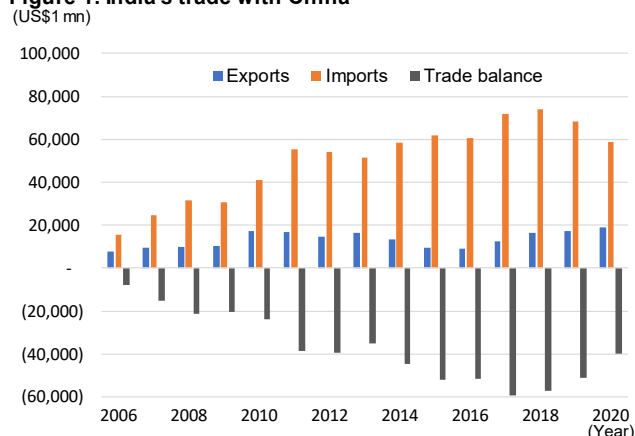
[https://commerce.gov.in/wp-](https://commerce.gov.in/wp-content/uploads/2020/05/MOC_636156057952507552_Five_Year_Development_Plan_Commerce_18_9_2014.pdf)

[content/uploads/2020/05/MOC\\_636156057952507552\\_Five\\_Year\\_Development\\_Plan\\_Commerce\\_18\\_9\\_2014.pdf](https://commerce.gov.in/wp-content/uploads/2020/05/MOC_636156057952507552_Five_Year_Development_Plan_Commerce_18_9_2014.pdf)

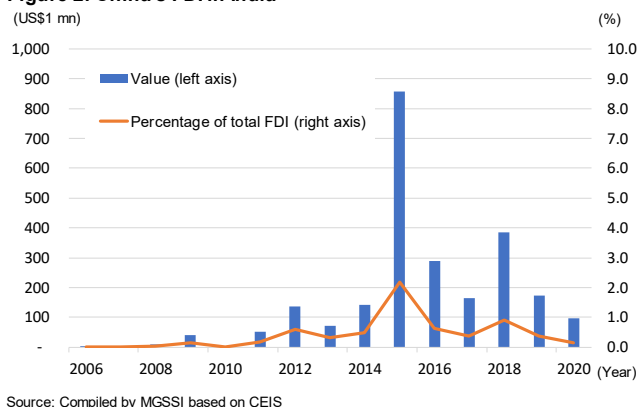
<sup>6</sup> The India-China Strategic Economic Dialogue was established in 2010 with the participation of NITI Aayog, a policy advisory body in India, and the National Development and Reform Commission of the People's Republic of China (NDRC). The dialogue has been held six times from 2011 to 2019. The sixth dialogue was held in New Delhi in September 2019.

(<https://pib.gov.in/PressReleaseDetail.aspx?PRID=1584574>)

<sup>7</sup> The deficit has been declining since 2018, partly due to accelerated local production of cell phones by Chinese companies in India. However, India's dissatisfaction and deep sense of caution about its deficit with China can be seen in the fact that the biggest factor in India's decision to opt out of the Regional Comprehensive Economic Partnership (RCEP) was its concern that its deficit with China would expand again if it joined the RCEP.

**Figure 1: India's trade with China**

Source: Compiled by MGSSI based on International Trade Centre materials

**Figure 2: China's FDI in India**

Source: Compiled by MGSSI based on CEIS

for electronic components and cell phones. In 2019, India's imports from China as a percentage of its total imports grew to 16.0% from 14.3%. In India's trade with China in 2021 (January-November), imports jumped 51.2% to US\$78.9 billion (exports rose 24.3% to US\$21.5 billion), and the deficit widened further to US\$57.3 billion. This was due to the expansion of imports of personal computers, electronic components, semiconductors, chemicals, pharmaceuticals, and other products for which demand was growing in India. The rapid increase in imports from China of artificial respirators, oxygen concentrators, and other products for which supply shortages became serious in the second wave of COVID-19 after April 2021 was also widely reported at the time.

Although the COVID-19 pandemic was also an opportunity for India to increase its presence as the "world's pharmacy," its dependence on imports from China for approximately 70% of its active pharmaceutical ingredients (APIs) was also seen as a problem from an economic security perspective. At the 2019 Strategic Economic Dialogue, the two sides confirmed the promotion of collaboration between India's generic drugs and China's APIs, but the atmosphere is no longer conducive to possible collaboration in these important areas. At the annual meeting of the Confederation of Indian Industry in August 2021, India's Minister of External Affairs Subrahmanyam Jaishankar said that the COVID-19 pandemic had revealed Indian manufacturing industry's vulnerability of external dependence and stressed the need to resolve this<sup>8</sup>.

From India's perspective, the economic benefits it has gained from China since the Five-Year Plan agreed to in 2014 have fallen short of its expectations. In the wake of the COVID-19 pandemic, India has become more concerned about promoting economic ties that could further deepen its dependence on China, with which it has territorial disputes.

## 2-2. Pushing for a "self-reliant India" by decoupling from China

In May 2020, the Modi government announced its "Self-reliant India" campaign to overcome the COVID-19 pandemic and to promote the economy going forward. Focus of promotion of domestic industry are on the manufacturing sector, and the government has made clear its renewed emphasis on the "Make in India" promotion program that it has been pursuing. At the core of the program is the PLI<sup>9</sup> scheme that assumes production of the target items (Table 3) will expand by providing subsidies to promote domestic production and exports. Many of the items covered by the scheme are those in market segments where Chinese products have a strong presence, so if the scheme proves effective, India will make progress in its decoupling from China. Even outside the manufacturing sector, the government has taken steps to exclude Chinese companies and brands, including in areas that have been the focus of the India-China Strategic Economic Dialogue (Table 4).

<sup>8</sup> Mint, August 13, 2021 (<https://www.livemint.com/news/india/pandemic-exposed-lack-of-basic-manufacturing-in-india-jaishankar-11628780810284.html>)

<sup>9</sup> Production Linked Incentive Scheme

**Table 3: Targets of Production Linked Incentive (PLI) Scheme**

Mobile phones	Air conditioners, LEDs	Electronic components	Communication network equipment
Photovoltaic modules	Advanced chemistry cell batteries	Chemical & industrial textiles	Specialty steel
Automobiles/automotive parts	Medical equipment	Pharmaceutical intermediates	Pharmaceuticals
Food			

Source: Compiled by MGSSI based on government materials

**Table 4: India's measures toward decoupling from China**

Trade	Stricter customs clearance inspection of imports from China
	Ban on imports of air conditioners using refrigerants, and restrictions on imports of televisions and tires
Investment	Adoption of a pre-screening system for investments by Chinese companies (results in delays in the existing investment plans of several Chinese auto companies)
Other	Exclusion of Chinese companies from government procurement and bidding projects
	Stricter inspection of power equipment made in China
	Eliminating Chinese companies and Chinese-made equipment from the telecommunications sector
	Ban on smartphone apps of Chinese companies
	Establishment of a fund for the domestic production of active pharmaceutical ingredients

Source: Compiled by MGSSI based on various materials, news reports

For India to become self-reliant, attracting foreign investment is essential, but India has taken a tough stance on China by introducing a pre-screening system for Chinese investment in April 2020<sup>10</sup>. Since then, there has not been much news about new investments by Chinese companies, thereby existing investment plans have also been affected. The Chinese automaker Great Wall Motor was planning to acquire General Motor's plant in India by the end of 2020, but as of January 2022, investment approval had not been granted<sup>11</sup>. Changan Automobile had been in the process of selecting a site, but has reportedly abandoned its plan to advance into the market. In addition, in the PLI certification of air conditioner parts announced in November 2021, foreign companies such as Daikin and Johnson Controls Hitachi Air Conditioning were selected, while Chinese companies such as Midea and Haier were not selected. The reason for this is that the investment itself needs to pass a preliminary review before the PLI review<sup>12</sup>. This demonstrates India's current understanding with respect to its relations with China is that the best solution for a self-reliant India is not to deepen economic relations, but to decouple from China<sup>13</sup>.

While on the contrary, India has high hopes for QUAD and the Japan-Australia-India framework, which have given impetus to the strengthening of economic ties, especially since 2020 (Table 5). The priority areas of vaccine production, infrastructure development, climate change response, key technologies (semiconductors, 5G, etc.), and supply chain resilience are all areas in which investments in and support for India can be expected. For the general manufacturing industry as well, which is not closely related to economic security, India has high expectations of investment from developed countries, such as Japan, the US, and South Korea. Local governments in India are competing to attract investment. For India, the leaning toward QUAD is not only a security arrangement, but also a move in anticipation of economic and industrial benefits.

<sup>10</sup> The system requires prior approval for direct investment from bordering countries, but it is essentially a measure taken with China in mind. In January 2022, it was reported that regulations may be eased for investments where the equity interest is small.

<sup>11</sup> The Economic Times, January 12, 2022 (<https://economictimes.indiatimes.com/industry/auto/auto-news/great-wall-motors-extends-gm-plant-term-sheet/articleshow/88844747.cms?from=mdr>)

<sup>12</sup> NNA Asia, November 5, 2021, "Incentives for four Japanese companies in air conditioners: Manufacturing promotion program targets Daikin and others"

<sup>13</sup> Considering India's weak industrial competitiveness and trade structure, it is possible to point out the difficulty of reducing its dependence on China. However, given the current state of relations between India and China, the external environment, and the history of the relationship, it should be emphasized that India is rather increasing a sense of crisis due to the difficulty of reducing its dependence on China, and its expectations are rising for investment from and economic cooperation with developed countries, such as Japan, the US, and Australia.

**Table 5: Overview of the Quadrilateral Security Dialogue (QUAD)**

COVID-19	<ul style="list-style-type: none"> <li>• Launch of the vaccine partnership</li> <li>• Production support by Indian pharmaceutical giant Biological E</li> </ul>
Infrastructure	<ul style="list-style-type: none"> <li>• Promoting quality infrastructure development in the Indo-Pacific region</li> <li>• Leveraging both public and private funds</li> </ul>
Climate Change	<ul style="list-style-type: none"> <li>• Promoting the greening of marine transportation</li> <li>• Promoting decarbonization through clean hydrogen partnerships, etc.</li> </ul>
Key & emerging technologies	<ul style="list-style-type: none"> <li>• Semiconductors: Ensuring supply chain security through joint initiatives</li> <li>• 5G: Launching Track 1.5 dialogues to create diverse and resilient ecosystems</li> <li>• Next-generation information and communications, artificial intelligence: Launch of individual groups to contribute to technology standardization</li> <li>• Biotechnology: Conducting surveys on trends in advanced biotechnology, etc.</li> </ul>
Cybersecurity	<ul style="list-style-type: none"> <li>• Launching initiatives to improve the resilience of critical infrastructure</li> </ul>
Space	<ul style="list-style-type: none"> <li>• Sharing of satellite data for the protection of the earth and oceans</li> <li>• Collaboration for the promotion of mutually beneficial space utilization and technologies</li> </ul>

Source: Compiled by MGSSI based on Japanese government announcements, etc.

## OUTLOOK FOR THE FUTURE

### 3-1. While avoiding decisive confrontation, maintain China decoupling policy

India does not want its relations with China to deteriorate to the point of impeding its economic development. There are still areas where India can cooperate with China in the international arena. These include support for multipolarity and multilateralism in international relations, as well as climate change response and trade rule-making, in which both countries participate as “developing” countries<sup>14</sup>. Serving also as important channels are multilateral frameworks, such as the Russia-India-China (RIC) trilateral grouping, BRICS, and Shanghai Cooperation Organization, in all of which both India and China are members.

However, given the bilateral territorial dispute, China's support for Pakistan in the conflict, and China's growing influence in neighboring countries, India's wariness of China is unlikely to diminish. Both countries are planning to develop infrastructure in border regions, and the possibility of a recurrence of clashes with casualties like those that occurred in 2020 cannot be ruled out. Even if India were to strike a compromise with China, while selectively accepting investments by Chinese companies in manufacturing and other sectors where there are fewer security concerns and greater job creation, in reality, it will likely continue to reduce its dependence on China.

### 3-2. The year 2024 is considered the next milestone

It is important to keep 2024 in mind in the time frame for measuring the achievement of India's efforts to decouple from China. The year is also the final year of the second Modi administration's term in office and a year of general elections. The directions for economic cooperation under the frameworks of QUAD and the Japan-Australia-India alliance were almost fixed in 2020-21. India will now determine whether or not these frameworks will actually bring benefits to its country. If the scale and speed of Western investment and economic cooperation do not meet expectations, India may reshape its economic partnership with China<sup>15</sup>. As the application of the PLI scheme began successively for individual products from 2020, some degree of success or failure will be visible by 2024.

In 2024, the US presidential election will be held. If former President Donald Trump were to return to office, it could destabilize US-India relations. In China, the National Congress of the Communist Party of China will be held in the fall of 2022. That should be sufficient time to reassess if there is any change in its diplomatic stance, including its response to the territorial dispute.

<sup>14</sup> India is aligning itself with China in these areas because it is in its own national interests, not because it wants to cooperate with China.

<sup>15</sup> The timing of this adjustment may not wait until 2024, in view of India's desire to stimulate investment from the West.