China and India have a lot to lose in an open conflict. They need some kind of competitive cooperation

It Takes Two to Untangle

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The Chinese Ambassador to the US, Hu Shih, once said, "India conquered and dominated China culturally for 20 centuries without ever having to send a single soldier across her border." But more than half a century after the 1962 war, China is positioning to send its troops across the border in Dokalam. While China-India economic and financial relations have grown considerably, border issues remain unresolved. They may even have worsened as a muscular China asserts its version of sovereignty in the Himalayas, the South China Sea and the East China Sea.

Both China and India have a lot to lose in an open conflict. India needs to keep its focus on economic development as it tries to double its economy from $2.5 trillion to $5 trillion before 2030. China has grown to over $10 trillion, but is now looking outward with its Belt and Road Initiative (BRI) and needs a cooperative India. An open conflict could also coalesce many countries with concerns over China's growing assertiveness, fuelled by growing nationalism at home.

Trade between India and China has grown hugely. It was barely $2 billion in 2001-02. In 2015-16, it exceeded $70 billion. But a huge trade imbalance of almost $50 billion in favour of China reflects India's lack of competitiveness and, to some extent, passive trade and wrong exchange rate policies.

The rupee has appreciated by 15-20% over the last decade in real terms. India's exports to China, mostly raw materials, have been declining since 2010-11 as the Chinese economy slowed down. But Chinese exports into India — mostly manufactures and heavy equipment — have increased rapidly and exceed $60 billion. This is small potatoes for China, whose global exports are around $2,300 billion. But with India poised to grow rapidly, it could be shut out of a lucrative market.

Chinese FDI

Chinese investment in India remains very small. The total Chinese FDI into India is under $2 billion, according to official figures, but could be over $4 billion if investments through indirect routes, such as Hong Kong, are included. India's FDI into China is under $1 billion.

One way to reduce the trade imbalance would be to get more Chinese firms to invest and manufacture in India. This would also support the 'Make in India' campaign. But distrust and political issues keep Chinese investments down. Case in point: India recently rejected a Chinese investment of $1.3 billion in Gland Pharma.

India and China have seen selective cooperation on international issues. India joined the $100-billion Chinese-led Asia Infrastructure and Investment Bank (AIIB) as the second-largest shareholder. India and China are also equal shareholders of the Shanghai-based $50-billion BRICS Bank and a $100-billion contingency reserve arrangement (CRA). India recently joined the Shanghai Cooperation Organisation (SCO), a gathering of China, Russia and Central Asian countries.

But India has not formally joined the BRI, objecting to the China-Pakistan Economic Corridor (CPEC), which has investments in Pakistan-occupied Kashmir (PoK), and is also wary of the Maritime Silk Road with ports in the Indian Ocean ('String of Pearls') which could be used to encircle India. Nevertheless, India has given positive signals on the Bangladesh-China-India-Myanmar (BCIM) road corridor that links Kolkata to Kunming through Bangladesh and Myanmar.

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China faces huge internal adjustments as it tries to rebalance its economy. Its debt-GDP ratio has grown dangerously rapidly from around 150% of GDP in 2008 to around 280% today, as it expanded credit to keep its economy growing in the face of slower export growth. It now takes eight units of credit to generate one unit of GDP, according to the IMF. But this investment credit-led recovery has created enormous excess capacity.

The BRI, with heavy investment in infrastructure links, is seen as a way to utilise some of this excess capacity. But it has huge risks for China and recipient countries as it could create white elephants. Many see it less as an economic project and more a geo-strategic move.

Slowing Economy

India's economy has slowed down, as it has been unable to carry out second-generation reforms in labour and land. The problem of growing non-performing assets has slowed down investment. A bungled demonetisation has also hurt growth. A new goods and services tax (GST) law gave some hope, but a complicated structure and likely implementation problems have reduced its potential benefits.

India recently slapped an anti-dumping import duty on 93 Chinese imports, mostly in the steel sector. It is considering further restrictions in telecom and power. These are seen by some as a sign of an impending trade war between China and India. Shrill nationalist posturing could become a downward spiral, which would hurt both sides.

India must somehow manage an aggressive China without an open conflict, just as Japan and Taiwan keep economic links growing despite contentious issues with China.

China must also learn from Ambassador Hu that in the long run it could win big in India without soldiers, money and knowhow. Some form of competitive cooperation is the way forward for both.

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