Source : www.indianexpress.com Date : 2020-08-29

INDIA MUST LEVERAGE ITS MARKET TO FORCE CHINA TO SETTLE BORDER ISSUE AMICABLY

Relevant for: International Relations | Topic: India - China

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After the loss of lives of Indian soldiers at Galwan, there have been calls for the boycott of Chinese goods. Counter views have been expressed that the Indian economy is so dependent on China that the costs of taking steps to stop imports would be disproportionately higher for India as most manufacturing in India is dependent on global supply chains where China has a leading role. But this is a fatalistic view. Our dependence can be reduced substantially if there is a national will and resolve to do so.

In the ongoing talks with Beijing it seems that, apart from some token withdrawal, China may not be willing to go back substantially from the areas they have occupied. While diplomatic efforts continue to restore the status quo ante and military deployments have been strengthened to act as a deterrent, the use of military power to get them to move back is a depleting option. So, does India have to accept the status quo and wait for subsequent moves by China along the unsettled border. Agreeing on maintaining peace and tranquillity on the border without movement on a boundary agreement or clarification of the LAC as we have been doing over the past three decades has left space for the Chinese to create border incidents which have now led to casualties. So India needs to get China to seriously negotiate a mutually acceptable boundary agreement.

The size of the Indian market and its potential in the coming years provides India considerable leverage; a leverage we should be willing to use fully. But to use this leverage, Indians, individual consumers as well as firms, have to accept that there would be a period of adjustment in which they would have to pay higher prices. The bottom line that needs to become clear to China has to be that without a mutually satisfactory border settlement and a permanent end to these border incidents, it cannot be business as usual and the Indian market would start shrinking for them. The Chinese have competitive advantage and are integral to global supply chains. But whatever they sell is, and can be, made elsewhere in the world. In fact, most of what we import from China was, is and can be made in India itself. With volumes and economies of scale, the cost of production in India would decline as it did in China.

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The initial focus should be on items which are still being made in India and where imports from China have been increasing. If the RBI were to undo the real exchange rate appreciation, it would be equivalent to an increase in import duties of about 10 per cent. Further, selective imposition of China-specific safeguard duties and use of non-tariff trade barriers should be enough in segments like electrical appliances to let Indian producers expand production and increase market share. The government should also facilitate the flow of finances for expansion and provide technical support for testing, improving quality and lowering costs of production. In critical areas where we are dependent on China for inputs, such as Active Pharmaceutical Ingredients, we need a vigorous approach to procure from elsewhere and have early production in India. The government could provide support for environmental compliance to bring down costs of production. This would create demand for domestic goods and services. The deindustrialisation that trade with China has been causing would get reversed. It would help in the recovery from the COVID-induced recession.

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Then there are strategic sectors where we should reduce vulnerability. Chinese FDI must be subjected to national security scrutiny. The government has made some moves in this direction. In telecom, the UK has just decided that new Chinese participation in 5G would not be permitted and that by 2027 existing Chinese equipment should be phased out. India should take a similar decision. In telecom and power grid management, there is vulnerability from hacking. This is enhanced if the equipment supplier or systems provider would like to embed vulnerability. Fresh participation by Chinese firms should not be permitted in these areas till there is an amicable border settlement.

Subsequently, a view can be taken about phasing out existing Chinese equipment. Chinese firms should not be allowed to participate in bids for all contracts by the central and state governments and their agencies. For instance, the contract for supply of electricity meters in J&K by a Chinese company has serious security implications and should be reversed. Subcontracting to Chinese firms as well as procurement of Chinese equipment by way of government procurement should not be permitted.

Then there are critical products like solar panels and grid storage batteries. In these areas, private investment for manufacturing in India would be triggered by assured government procurement at a commercially viable price with full value-addition in India for five years from commencement of production. The bid process should provide for provision of land, infrastructure and cheap electricity to lower the cost of production. Repeated bids would create a competitive industrial structure. An early transition towards self-reliance would take place.

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The somewhat intractable bit would be the electronic parts supply chain. Every device is likely to have Chinese components. There has been some progress in the last few years in assembly and value addition, especially of smart phones. The government has put in place incentives for greater value addition and phased manufacturing in India. Chinese firms are major players in this space. This need not be disturbed for the present. Chinese profitable investment in India would highlight the importance of the size of the Indian market in the years to come and the advantages of good relations based on a final settlement of the border. It also creates vulnerabilities for the Chinese as the recent ban on apps and popular calls for boycott have demonstrated.

A sustained and graded economic response to the recent Chinese conduct on the border is needed. We should signal India's firm resolve and willingness to bear the cost. China could choose to settle the border amicably and have full access to our market. We could then work together to make this the Asian century. Otherwise, we would still achieve our destiny, but without them.

This article first appeared in the print edition on August 28, 2020 under the title 'Taming the dragon'. Meera Shankar was India's Ambassador to the US and Germany; Ajay Shankar has been secretary, Department of Industrial Policy and Promotion.

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