



Does the U.S.-China confrontation present a commercial opportunity for India?

The U.S.-China confrontation started with a trade skirmish in 2018. It has now progressed to conflict on a number of fronts – blaming China for the Covid-19 worldwide crisis and retaliation for China’s destruction of Hong Kong freedoms being among the latest.

Prominent advisors to President Trump advocate complete economic disengagement from China. Trump seems to be listening, and the U.S. Congress is growing more supportive of the President’s hostility toward China. By contrast, the U.S. relationship with India seems to be growing stronger. Trump conducted a visit to India that apparently met the goals of both Prime Minister Modi and President Trump.

Modi acquiesced to Trump in lifting a ban on Indian export of drugs that the President wrongly indicated could help in the fight against Covid-19. Trump says the two leaders continue to talk directly to each other. According to my colleague at CSIS, Rick Rossow, U.S.-India trade and investment figures seem to be defying gravity in remaining on an upward path. Strategically, the relationship continues to strengthen. The U.S. conducts more military exercises with India than any other non-NATO country.

The data seem to indicate there is room for vast increases in U.S.-India economic engagement if some portion of U.S.-China trade and investment can be transferred to India. China exported \$452 billion worth of goods to the U.S. in 2019 and had some \$117 billion of direct investments from the U.S. as of the previous year. By contrast, Indian goods exports to the U.S. were only \$58 billion in 2019 and the stock of investments \$46 billion as of 2018.

As the confrontation between the U.S. and China grows more acute, there has been speculation that Chinese exports to and investments from the U.S. could be shifted to India.

Now that the U.S. is revoking Hong Kong’s special status under U.S. trade and investment laws, there has been further speculation about the ability of India to pick up financial business previously conducted from Hong Kong.

Is it to India’s advantage?

The opportunity for India and the U.S. is real. However, the probability of such a shift actually occurring is dependent on a number of key factors.

On the trade front, protectionism raises its ugly head in the U.S.-India relationship just as does in the U.S.-China relationship. U.S. advocates of economic disengagement from China certainly are not advocating engagement with India.

Rather, their perspective is “Make America Great Again” by producing in the U.S. goods and services previously sourced from other countries. This includes products sourced from India, and the many points of economic contention between the U.S. and India bears witness to this perspective.

Trump, with his penchant for wrongly viewing trade balances as akin to a company’s profit and loss statement, certainly isn’t going to make importing from India easier without a corresponding willingness of India to import more from the U.S.

This is his “Art of the Deal” in which wringing maximum concessions from the other party is the goal in any negotiation. Not only has Trump’s Republican Party turned away from free trade but a growing number of Trump’s Democratic opponents agree with him on trade protectionism.

As for India, the recent trade policy of the Modi government is not encouraging. “Make in India” and now “Atmanirbhar Bharat” (“Self-Reliant India”) have been accompanied by a large number of protectionist measures.

These include local content and localisation requirements as well as increased tariffs. Indian investment policy is a bit more encouraging with raising caps on foreign direct investment and allowing increased participation of the private sector in areas previously reserved to the government.

But, in the present atmosphere, increasing Indian exports to the U.S. to a level enjoyed by China will not occur unless India further opens its markets.

The great conundrum

There is also the question of how much of the Trump threat of economic disengagement from China is real and how much of it is for U.S. domestic consumption in an election year. Even in the midst of what seems to be the greatest U.S.-China confrontation since Nixon went to China in 1972, both sides have taken pains to point out that the so called "Phase I" trade deal is still intact and proceeding.

Disengagement will also be difficult because China holds \$1.11 trillion of U.S. debt, the second most of any nation, and many U.S. corporations are heavily dependent on profits from their Chinese operations.

This drive for profitability brings us to a well-recognised list of fundamental challenges to the ability of India to significantly increase its share of U.S. imports and investments.

U.S. corporations are not going to increase their imports from India unless they can make money on the transactions. Even though India enjoys certain cost of labor advantages, there are many who still consider India a relatively high cost source for export goods. Besides, much of the investment by U.S. companies in China has not been for export, but as a means to exploit the Chinese domestic market.

For the Indian market to be as attractive as that of China is a long-term proposition. If the U.S. and China actually do disengage, U.S. companies may look to India for growth, but will fight to protect existing investments made to serve the Chinese market.

Allied to the question of cost is the issue of quality. When it comes to goods, India still lacks a reputation for quality. It makes no difference if goods, whether they be auto parts or medical equipment, are inexpensive if they cannot be depended on for quality. India seems to have solved this problem for software and information technology enabled services.

Hopefully, the same can be done for Indian manufactured goods. Dependability is also a requirement for exponentially increased Indian exports

to and investments from the U.S. Many Indian enterprises are infamous for their tendency to regard a contract as only a starting point for renegotiation.

This is true not only for export/import contracts but also major investments. The legacy of contracts that change with changes in government at the federal and state levels dies hard. The vaunted advantage of India over China in regard to the rule of law often evaporates in the face of court slowness and the willingness to defer to governments in contractual matters.

Under Modi, India has made great strides in the ease of doing business. However, China still outranks India by far. Indian labor laws, land tenure and business termination reforms are works in progress. India has yet to approach China achievements on infrastructure, especially for transportation. These are vital factors for acquiring exponentially increased direct investment from the U.S.

In the age of the Covid-19 pandemic, public health becomes an all-important issue in deciding on manufacturing investment decisions. It remains to be seen whether the Modi government measures to control the virus will work.

Suffice it to say that plans for shifting U.S. supply chains and investments from China to India simply will not occur unless the Covid-19 virus can be brought under control. Domestic unrest and prospects for war are also factors that raise fears of the instability that businesses hate in making decisions about trade and investment.

Conclusion

There is economic opportunity for India in the fallout from the U.S.-China confrontation. However, to take advantage of this opportunity, India must with renewed seriousness open up to a host of policy and production issues that have long challenged its place in world trade and investment. A shift from China to India will not occur simply because of U.S.-China confrontation.

Such a shift is made more difficult by the present pandemic and fears of instability. India cannot accomplish such a shift through its efforts alone. India and the U.S. both need to be reliable and steady partners who understand the importance of economic underpinnings for a strong and growing relationship between the world's two greatest democracies.

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