Can the Economic Lever Nudge China?*

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In a surprise move, the Indian government has decided to ban the use of 59 Chinese apps, some of which like Tik-Tok and UC browser are extremely popular in India's consumer digital space. According to The Wall Street Journal, quoting estimates made by Sensor Tower, the 59 banned apps were the target of 4.9 billion downloads in India since January 2014, including 750 million so far in 2020. The move was widely interpreted as being part of India's response to the disturbing developments along its border with China, and as a means to pressure China, even as India strengthens its military positions and negotiates for the restoration of the status quo.

India, of course has not presented this as an act of economic retaliation to evidence of incursion by China into its territory. Rather, it has justified it as means of preventing the companies owning these apps from undermining the sovereignty and integrity of the country, and of "stealing and surreptitiously transmitting users' data in an unauthorized manner to servers which have locations outside India." Given allegations of close links of Chinese companies to the government at home and even the People's Liberation Army, the action appears to be part of a larger security response to a perceived threat from a neighbor whose influence in the region has increased significantly.

In fact, for some time now, and for what appear to be larger strategic considerations, the government has put China's economic and trading presence in India under watch. Allegations of dumping or aggressive behavior of Chinese investors and contractors have been common. This has more recently translated into very specific policy action, with occasional imposition of anti-dumping duties and of non-tariff barriers in the form of quality control orders or other regulations. In April, for example, foreign direct investments originating in neighbouring countries were taken off the automatic approval list, even where permitted. "An entity of a country, which shares land border with India or where the beneficial owner of an investment into India is situated in or is a citizen of any such country, can invest only under the government route," the release from Department of Promotion of Industry and Internal Trade announced. Specific government permission, and therefore monitoring, was made mandatory. Given the relative importance of investment inflows from India's neighbours, it was clear that this was directed at Chinese investors, private and official, that were seen as picking up equity in Indian companies at discounted prices as growth slowed and the Covid-induced economic crisis struck.

But now comes evidence that such defensive economic action will be widened, to include offensive measures. Besides banning popular Chinese Apps that have overwhelmed India's digital space, despite India's claim of being a software power, reports have it that the government is planning to dissuade private telecom operators and state-owned telecommunication companies MTNL and BSNL not to purchase hardware from Chinese firms (especially Huawei and ZTE) to upgrade their networks. Chinese players are also to be kept out of Indian highway projects, including participation through the joint venture route. While these and similar measures are being discussed in the corridors of government, 'track-2' efforts seem underway outside government, with a campaign for boycott of Chinese goods and for policies that impose restrictions on imports from China. As of now the emphasis is on appealing to popular patriotism, with the government facilitating a boycott by requiring e-commerce firms to publish country of origin on all the goods sold through their web marketplace.

These economic responses in the face of growing diplomatic and military tensions have raised a number of questions. One is whether these moves are merely symbolic or would actually hurt China enough to encourage it to hold back, engage in negotiations on border issues and arrive at a settlement acceptable to India. Another is whether India too would lose as a result of these measures, and whether the cost of deploying such instruments would hurt an economy that has clearly lost momentum. The answers to these questions would determine whether, together with the announcement of the Atmanirbhar (self-reliant) Bharat drive, these responses targeted at China would put India on a trajectory that reverses the trade liberalization and open economy agenda adopted by successive governments since 1991. That trajectory would possibly be supported by sections of business that are looking for protected spaces in the domestic market.

Though the ban on apps would not immediately significantly hurt the profits of Chinese firms, it would check their advance to dominance in a market that is being seen by all as being the next frontier digital market (after China), given the size and demographic profile of its population, and the low levels to which data costs have been pushed by cut-throat competition. The result has been proliferating ownership of smartphones, increase in internet use and the growing popularity of e-commerce. According to Byte Dance Ltd, which owns Tik-Tok, that app was being used by at least 120 million Indians every month. While those numbers were yet to translate into revenues and profits, the potential is immense, especially given the collateral advantage that these so-called tech firms have in collecting and collating data. Moreover, Chinese giants like Alibaba and Tencent have been investing heavily in Indian start-ups, betting on their success and the returns from appreciation of equity values that was expected to bring. So, if kept out of India’s digital market, Chinese firms are likely to be significant losers.

That being said, the loss of an Indian presence would not be the end of the world for all Chinese firms, which have grown to global scales based on business at home, have strong control over the large home market, and have other jurisdictions to diversify into. It affects more the likes of Huawei, which was banking on becoming the word leader in 5G technology, and which is being kept out on security grounds from many developed country markets. Absence of Chinese firms in India’s internet space would also not hurt China’s economy much, though its mercantilist ambition, already being thwarted in the US and elsewhere, would suffer a minor dent. Even if the fortunes of ‘tech’ firms are seen as influencing China’s strategic stance, it is unlikely that loss of the Indian market would force the Chinese government to bend on what it declares to be issues of national sovereignty and integrity.

For India, extending its economic response to the military stand-off to include trade in goods is the challenge. There is reason why the government chose the internet arena to launch its China offensive. Given the structure of merchandise trade between India and China, it is far more difficult for India to counter China there. The sharp spike in India-China trade over the last decade or so has seen India’s imports from China rising much faster than its exports to that country. The net result is that in 2019-20, when slowing growth brought down imports from China, India ran a deficit of $48.7 billion in its trade with China, which, adding exports and imports, totaled $81.9 billion. When growth in India was better and trade buoyant, its China-trade deficit stood at $63 billion in 2017-18 and $53.6 billion in 2018-19.

This deficit, it could be argued, strengthens the case for trade sanctions against China, as that would bring down imports and reduce the shortfall relative to exports. But India's imports reflect not just China's competitiveness in the Indian market vis-à-vis domestic and third country suppliers. It is also indicative of India's dependence on China, not just for cheap final products, but crucial and reasonably priced intermediates and capital goods. China accounts for close to 15 per cent of India's exports, and is an important supplier in areas such as mobile phones, telecom, power, and pharmaceutical intermediates. Two categories of imports, "Nuclear Reactors, Boilers, Machinery & Mechanical Appliances" and "Electrical Machinery, Telecom Equipment, Audio & Video Recorders" account for 50 per cent of imports from China, and "Organic Chemicals" for another 12 per cent. Close to 50 per cent of India's electronics imports originate in China, with that dependence rising to around 66 per cent in the case of pharmaceutical ingredients. India's dependence on Chinese supplies is not just large, but also heavily concentrated.

These imports are not all easily substituted from other sources. The consequences of such dependence were experienced recently. Thus, when the Covid pandemic shut down production facilities in China, drug prices rose in India and producers expressed concerns about shortages of crucial intermediates. Together with delays in customs clearance of imports from China in recent times, critical drugs such as blood-thinner Heparin are in short supply and have turned more expensive, so much so that the National Pharmaceutical Pricing Authority (NPPA) has allowed a one-time price increase of 50 per cent in the ceiling price of Heparin injection used in treatment of those infected with Covid-19.

All this suggests that a sudden reduction in imports from China can be disruptive, and is likely to influence government thinking, leaving aside the possibility that China would appeal against what it considers discriminatory protection against its goods at the WTO. So, while the military and diplomatic stand-off would be difficult to resolve, using economic weapons to temper China's stand would not be easy either. In that sense, the presence of Chinese firms in a relatively inconsequential area such as mobile apps was for the India government an easy and convenient lever to use. Finding more such levers could prove difficult.

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