# Geopolitical realities after Covid-19 and implications for the Indian economy

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Content



10 October 2020

2662 words

## Introduction

The outbreak of the SARS-CoV-2 virus and the disease it causes has consequences for domestic and foreign policies countries all over the world. The crisis will further deepen the rift between China and many, if not most OECD-countries. These geopolitical shifts will have a significant effects on manufacturing. Policymakers will be willing to shed a little efficiency to reduce dependence on China. Therefore, the current crisis will result in new opportunities for many economies, but some will of course benefit more than others. India will most probably belong to the major beneficiaries of the coming new form of globalization.

China today is a different state than before Xi Jinping gained power in 2012. Xi was appointed General Secretary of the Communist Party in 2012 and, with the exception of Mao Zedong, has shaped China's domestic and foreign policy more substantially than any of his predecessors. At the 19th Congress of the Party in 2017, Xi stressed during his three-and-a-half-hour speech that in his first term of office, China had stood up and become both rich and powerful. In contrast to the forty years since Mao's death, Xi, for the first time repeated the slogan that Chinese policy could solve the problems of humanity (Economy 2018, p. 60). Xi has thus abandoned the dividing line between domestic and foreign policy and is relying on exporting the CCP's political values throughout Asia and the rest of the world (Economy 2018, p. 69).

Today, countries all over the world are politically concerned about the increasingly authoritarian stance that Xi and the ruling CCP are asserting. Many observers have spotted the ugly face of Chinese communism, and for countless observers, Xi's "Chinese Dream" is a nightmare. The suppression of political freedoms and the brutal use of concentration camps to "re-educate" religious minorities have thus far been overlooked dimensions of the dire human rights situation in China. The world is once again confronted with a rising authoritarian power.

**The new Cold War**

30 years after the end of the Cold War, the world is once again confronted with a conflict between two major powers. The expectation that the collapse of the USSR would mark the beginning of a harmonious world marked by fruitful co-operation have proven to be too optimistic. The main driver of the new Cold War is of course China. The American President has raised the level of attention to the issue, but he has not created it. The main driver for the new Cold War is the Chinese government under the leadership of Secretary General Xi Jinping.

In many countries, the perception of China has changed significantly over the past two years. Previously, changes in China's foreign policy under Secretary General Xi Jinping had long been ignored. Once leaders realized that Xi had radically altered his policies, governments initially struggled to find an appropriate response to China's aggressive foreign diplomacy and international trade policy. This inertia has disappeared. Whilst the Trump administration was the first to tighten its policy, other governments have followed suit. Today, even most European governments – long reluctant to confront Beijing - have changed their policies vis-à-vis China. In March 2019, the European Commission published a document which explicitly branded China as a "systemic competitor" (European Commission 2019; Berkofsky 2020, p. 100).

While many of the long-term effects of the SARS-CoV-2-crisis are not clear yet, the pandemic will lead to a departure from established trade and production patterns. The reason for that change will be political rather than microeconomic. The rivalry between the United States of America and the People's Republic of China will intensify, given the devastation that the virus has caused. The US will not forget China's contribution to the emergence of the crisis. Today, there is bipartisan support for a tough stance on China in the American political system. The corporate world may not share all the political concerns of President Trump, but they will not resist a reorienting of the US's economic policy and consequential relocation of production from China to other economies.

In the United States, President Trump enjoys remarkable support for his 'tough on China' policies. The perception of China by US citizens has shifted significantly in recent years. According to a survey conducted by the Pew Research Center between 3 March

2020 and 29 March, 2020, two thirds of US citizens surveyed have a negative opinion of China with only a quarter of Americans having a positive opinion. Today, nine out of ten Americans surveyed view China as a threat, including 62 percent who see it as a significant threat.[1]

The negative perception of China in the United States is not the exception, but the norm, at least in OECD-countries. In a survey taken in 14 countries by the Pew Research Center in summer 2020, 71 percent of Germans had an unfavorable view of China, up from 56 percent one year earlier. Despite Germany's above average dependence on exports to China, the German population scored exactly the median of 9 European OECD-countries.[2]

Interestingly, perceptions of China were most negative in Sweden, a small country with a population of a little over 10 million people, i.e. about half of the population of Beijing. Sweden is home to the Chinese-owned car manufacturer Volvo and used to be known as a very open society. But Sweden had also been exposed to what "The Economist" called "Shotgun diplomacy". In November 2019, the Chinese ambassador to Sweden, Gui Congyou, threatened the Swedes: "We treat our friends with fine wine, but for our enemies we have shotguns."[3]

Statements like these have backfired all over Europe and have contributed to a revision of the benefits of relations with China. For manufacturing companies outside China, this may be a welcome development. If policymakers continue to deemphasize economic efficiency and prefer production outside rather than in China, this would be positive for producers, if negative for consumers. That being said, even consumers are increasingly sceptical about dependence on China, partly due to the ongoing bullying tactics of Chinese politicians and diplomats.

[1] Pew Research Center: U.S. Views of China Increasingly Negative Amid Coronavirus Outbreak, April 2020.
[2] The nine countries are: Sweden, Denmark, the United Kingdom, Netherlands, Belgium, Germany, France, Spain and Italy. Pew Research Center: Unfavorable Views of China Reach Historic Highs in Many Countries. 6 October 2020, available at https://www.pewresearch.org/global/2020/10/06/unfavorable-views-of-china-reach-historic-highs-in-many-countries/
[3] The Economist, How Sweden copes with Chinese bullying, 20 February 2020.

For the corporate sector, the negative perception of the People's Republic of China is quickly evolving into a reputational risk. Producing in China for markets elsewhere carries the risk of consumer backlash. Whilst many people may hitherto have been indifferent to the origin of the products they buy, the aggressiveness of China's foreign policy is resulting in a closer scrutiny of the place of production. Of course, such activities will not be a mainstream activity, but for large corporation the risk of being shamed as a supporter of a totalitarian state is real. Consequently, there will a relocation of production elsewhere.

**Is de-coupling possible?**

European companies have been actively expanding their business with China for years, and recently, they managed to reduce the trade imbalance. In 2018, member countries of the European Union imported goods worth 400 billion euros from China and exported a little over half of that amount to China. Exports from EU countries to China grew faster than Chinese exports to Europe between 2008 and 2018. European exports to China grew from 78.3 billion euros in 2008 to 209.9 billion euros in 2018, an increase of 268 percent. Chinese exports were already high in 2008, at 249.1 billion euros, and have since risen by 58.5 percent to 394.7 billion euros.

It is not surprising that Germany has higher exports to China than any other country in the European Union. But it is astonishing that in 2018 Germany recorded exports of 93.7 billion euros and has higher exports to China than the next eight European countries combined. German exports to China totalled 92.9 billion euros in 2018. In 2018 Germany exported four and a half times as much to China as to France. These figures demonstrate why Germany's policy towards China is much more cautious than France's. Germany is more vulnerable to Chinese coercion. Significantly, almost half of France's exports to China are Airbuses – an irreplaceable good for China.[4]

[4] Eurostat: EU-28 exports to and imports from China, available at https://ec.europa.eu/eurostat/statistics-explained/index.php?title=File:EU-28_exports_to_and_imports_from_China_by_product_group,_2008_and_2018.png

At the same time, China is not irreplaceable. Germany does more business with the four Eastern European economies Poland, the Czech Republic, Hungary and Slovakia than with China. Merely two percent of jobs in Germany depend directly or indirectly on exports to China.[5] Whilst decoupling will have costs, it is not impossible.

**The re-organization of supply chains**

Supply chains will be re-organized also because the dependence on China turned out to be a major problem in 2020. Globally, the high level of dependency on China became evident when the country initiated its lockdown in response to COVID-19 at the end of January 2020. South Korean manufacturers Hyundai and Kia had to suspend production because they lacked components from China. In Japan, Honda and Nissan were forced to scale back production. The British manufacturer Jaguar Land Rover reportedly flew parts from China to Britain in suitcases to maintain production.[6] Manufacturers will shift their preferences from “just in time” to “just in case”.

There will thus inevitably be a reorganization of supply chains after the current crisis has ended, and the current dependency of OECD countries on China will be reduced. Whilst strategic goods may enjoy priority, there will be a tendency to prioritize non-Chinese sources. Until 2020, many politicians and citizens were unaware of the outsized role that China plays in the provision of major components as well as medical equipment and pharmaceuticals. Once the effects of the high degree of dependency on China became clear, calls for a restructuring of supply-chains were raised. Mathias Döpfner, Chairman of the German media house Axel Springer, has called for “forceful decoupling” from China (Small 2020, p. 10).

The French finance minister, Bruno Le Maire, has claimed that European countries should reduce their dependence on China and has labelled this a process of strengthening the “sovereignty in strategic value chains”. He named the automotive, aerospace, and

[5] The Economist: Germany’s China policy: Out of date. 18 July 2020, p. 24.
[6] Economist Intelligence Unit: Country Report Italy, 16 April 2020. p. 39.

pharmaceutical industries as examples.[7] Europeans, however, do not use the term “decoupling” but rather prefer the milder and less confrontational expression “diversification”. The effect, however, is the same.

This re-organization of supply chains as well as production does not mean that companies from OECD-countries will no longer produce in the People’s Republic. In the future, many companies will follow a pattern that has been labelled as China + 1: Production in China for the Chinese market, production elsewhere for the rest of the world.

Finally, it is not just politics that drives companies out of China to other countries. China has become too expensive. Between 2000 and 2016, real wages rose by 400 percent. Whilst this development is of course excellent for Chinese citizens, it makes manufacturing there less attractive. Of course, this is what globalization is all about: Once an economy has developed and its citizens enjoy a higher standard of living, this results in higher costs and makes producing in other economies more attractive. The Cold war and Covid-19 accelerate this process, but would have occurred anyway, at least to a degree.

**How India will benefit from the new globalization**

One of the economies that are well positioned to benefit from these trends is India. Of course, in the autumn of 2020 one has to look beyond the current malaise of the Indian economy. The world’s toughest lockdown was not only ineffective in reducing the spreading of the virus, but it led to a dramatic reduction of economic activity as well as severe problems in the financial sector.[8] Currently, many banks are suffering from non-performing loans due to the economic effects of the lockdown (Economist Intelligence Unit 2020, p. 5). However, after this shock the Indian economy will probably enjoy a rapid recovery and will become a major beneficiary of the Cold War.

The first reason for this optimistic assessment is political. After years of hesitation, the Indian government has started to commit itself firmly in the Alliance of democratic countries in the Pacific. India’s support for the Quadrilateral Security Dialogue (Quad)

[7] Ibid.
[8] Laura Höfliner, Sunaina Kumar, Zerstörte Träume, Der Spiegel, 26 September, pp. 70-73.

between the United States, Japan, India and Australia is rising considerably.[9] India's increasing focus on China, rather than on neighboring Pakistan, has resulted in some US observers believing that New Delhi's anger about the assertiveness of China's foreign policy may eventually result in the ability to form an alliance with India against China.[10]

The second reason for optimism is that India is the only major developing economy that offers both attractive conditions for manufacturing and has sufficient idle capacity, in particular a large enough labor force. Vietnam, for example, is already stretched to the limit and cannot provide the resources that would be needed to host a large number of transnational corporations beyond those that already produce there.

Needless to say that success of the endeavor is not guaranteed. Neither the government's initiative the produce in India for Indian consumers (Self-reliant India or Atmanirbhar Bharat) nor the related goal to produce in India for others markets are without risks. But against the background sketched out above, the chances for a boom in Indian manufacturing are relatively high. Pharmaceuticals and electronic components may continue to thrive. The investment of large foreign manufacturers like Foxconn, Samsung and Pegatron illustrate this point very clearly.[11]

The main risks are a lack of capital for investment and a repetition of the ill-fated industrial policies prior to 1991. But capital continues to be cheap and available, at least in many financial markets. The question is how to tap the markets and how to create additional incentives for more foreign manufacturers beyond pharmaceuticals and electronic components. The second risk appears to be rather remote. The current Indian government appears well aware of the fact that de-coupling from the global economy is not an attractive option. Whilst it will be politically beneficial to reduce economic ties with China, India will most probably integrate itself more deeply into the global economy.

[9] Motoko Rich, One Long Fist Bump Underscores Pacific Alliance to Counter China, The New York Times, 7 October 2020, p. 14.
[10] Pranshu Verma, As India and China Feud, U.S. Sees an Opportunity to Build an Alliance, The New York Times, 4 October 2020, p. 14.
[11] Economist Intelligence Unit, Self-reliant India: closing the door to China, 22 September 2020.

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