Since the late 1950s, relations between India and China have been fraught with tension and conflict. Yet the two countries have recently enjoyed a significant improvement in bilateral relations. In this article, we explore potential economic reasons for this rapprochement. We set out three possible mechanisms by which commercial interdependence could lead states toward peace, and then examine their operation in the India-China case. We conclude that the most likely explanation for the relational change is the concerted effort in both countries to be seen as responsible participants in the global economy. Thus, general economic prudence, rather than any specific bilateral factor, may be having a positive effect on the India-China relationship.

Key words: China-India relations, economic development in Asia, BRICs

Introduction

The BRICs countries (Brazil, Russia, India, and China) have shared a common experience of rapid and substantive economic change over the last decade. While economic growth has had varied consequences for India’s foreign policy, we focus on India-China relations, asking whether economic interdepen-
dence could lead to more wide-ranging political cooperation between the two largest BRICs. This dyadic interaction is of great geopolitical significance: The two countries are home to over a third of the world’s population, have nuclear arsenals, and have been involved in an actual shooting war with each other. Moreover, the India-China case study can help us understand how the rising economic power of the BRICs may affect global stability. In the last decade, India and China have enjoyed the best bilateral relations since the early 1950s. Could new economic ties be impelling this improvement in their relationship? In this article, we examine the impact of a number of economic factors on the strategic relationship between India and China.

In the article’s first section, we briefly summarize the troubled history of Sino-Indian relations. Following that, we provide a brief overview of the key changes in the Indian and Chinese economies in the last three decades, and concomitant changes in their political and diplomatic behavior. In the article’s third section, we lay out three potential mechanisms linking economic interdependence and strategic deescalation. The next section examines the operation of these mechanisms in the India-China case. We conclude with our predictions concerning the future conduct of Sino-Indian relations.

A Tense Half Century in Sino-Indian Relations

India became independent two years before the Chinese Communist Party (CCP) secured power in China in 1949. India’s first prime minister, Jawaharlal Nehru, initially conceived of a synergistic relationship between New Delhi and Beijing: Both countries had huge populations and immense developmental challenges, and were thus natural partners. China and India also shared a wariness of Western political meddling. India, in fact, was the first noncommunist state to formally recognize the People’s Republic of China (PRC). In 1954, talks in Beijing between Premier Zhou Enlai and an Indian government delegation resulted in the signing of the Panchsheel Agreement, which formally envisioned “peaceful coexistence” between China and India.1

1. B. M. Jain, “India-China Relations: Issues and Emerging Trends,” The
The India-China honeymoon of the 1950s began to show signs of strain by the latter half of the decade. In 1956, the CCP promulgated its first official map of China and the surrounding area, rejecting the McMahon line first demarcated by the British colonial authorities in 1914. The map showed large swathes of Indian territory within the borders of China. The Indian government reacted angrily, accusing the CCP of arbitrarily extending China’s borders. In 1958, to improve Chinese leverage in the altercation, the CCP ordered the covert construction of a network of roads. The Indian response—the construction of military posts along the McMahon line—proved unacceptable to the Chinese. In October 1962, the People’s Liberation Army (PLA) launched a preemptive assault, obliterating India’s weak and unorganized defenses. After a month of intense fighting, China declared a unilateral ceasefire. The PLA withdrew from some of the conquered areas, but retained over 38,000 square kilometers of disputed territory. Diplomatic and economic relations between Beijing and New Delhi collapsed after the 1962 war. In the three subsequent decades, bilateral trade figures dwindled to negligible amounts.

In 1971, India supported East Pakistan (later Bangladesh) in its war of secession from Pakistan. The role India played in the partition of Pakistan—a close ally of China—and its refusal to renounce its nuclear ambitions, put China on guard. In the summer of 1974, India detonated an underground atomic device, proving its nuclear-weapon capabilities. Although Prime Minister Indira Gandhi (1967-1977; 1980-1984) ordered the 1974 test, she also pursued the renewal of the Beijing-New Delhi diplomatic relationship. Ambassadorial-level relations were restored in 1976. Although diplomatic tension reemerged as a corollary of the 1979 Sino-Vietnamese war, this was merely a small bump in relations; in 1980, Indira Gandhi returned to power and met with the Chinese premier, reaffirming her desire to maintain friendly ties with Beijing. She also indicated that she shared the Chinese aspiration for greater economic cooperation. China and India granted one another Most Favored Nation (MFN) trading status in August 1984. Nonetheless, as late as 1990, bilateral trade amounted to a mere $190 million.2

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Rajiv Gandhi (1984-1988), more than any other Indian prime minister, focused his diplomatic efforts on reconciliation with China. In 1988, he made an historic visit to Beijing, the first prime ministerial visit in thirty-four years. These overtures led to the creation of a Joint Working Group (JWG) to address the border issue. Rajiv Gandhi and the CCP leadership also signed several scientific and cultural exchange agreements during this meeting. Prime Minister Narasimha Rao (1991-1996) continued Rajiv Gandhi’s diplomatic efforts. In 1993, Rao and Jiang Zemin signed an agreement for “the maintenance of peace and tranquility along the Line of Actual Control (LAC).” They also set up the India-China Expert Group of Diplomatic and Military Officers, tasked with advising the JWG. These diplomatic steps led both the CCP and the Indian parliament to ratify mutual troop reductions along the LAC in 1997.

Starting in the mid-1990s, China also began to adopt more even-handed rhetoric in discussing Indo-Pakistani relations, and the issue of Kashmir in particular.

The incremental advances made in Sino-Indian diplomacy were dramatically set back after India conducted tests of its nuclear weapons in 1998. A letter, sent by Prime Minister Vajpayee (1996; 1998-2004) to U.S. President Bill Clinton, was leaked to the New York Times. In the missive, Vajpayee defended the nuclear tests by pointing to China as a potential threat to Indian security. The Chinese government repudiated Vajpayee’s reasoning, calling his justification “utterly groundless.” China then declared Pakistan’s nuclear tests a necessary “reaction” to India’s “hegemonic designs.” Beijing also expressed discontent by canceling the annual JWG meeting. However, shortly afterwards, India commenced a conscious process of reestablishing relations with China. There were several high-level meetings between the leaders of both countries, and the nuclear issue was put firmly on the back burner. When India and Pakistan were embroiled in a short, sharp war in the summer of 1999, China refrained from overt support for the
latter.

In 2006, a Memorandum of Understanding on Defence Cooperation was signed during the Indian defense minister’s visit to China. The agreement increased the number of military exchanges between the armed forces of the two countries. The move was hailed in India and abroad as facilitating a joint concentration on economic growth. The Chinese defense and foreign ministers made specific reference on the occasion to the goal of promoting prosperity in the region.

In sum, numerous diplomatic efforts have been made to expand Sino-Indian rapprochement over the last three decades. However, there remain points of genuine contention, with the demarcation of the border being the most salient. Although the JWG has met thirteen times, it has failed to bring about any formal alteration to the border.

India and China: Autarky to Cautious Globalization

India’s Growth

India, on gaining independence, chose a path of import substitution (“self-sufficiency”), moderately-centralized state direction (“planning”), and a mix of private and public enterprise, with the latter having a monopoly over “the commanding heights of the economy.” An inward-looking economic orientation allowed Indian policy makers to shape external economic links in ways complementary to India’s perceived international political interests. At independence, India’s trade links had been concentrated in the British Commonwealth. Subsequently, during the cold war, particularly under the premiership of Indira Gandhi, India enjoyed a special economic relationship with the USSR, and selectively cultivated trade with the nonaligned

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countries. These factors—combined with galloping population growth, the constraints of an active democracy, and an undeveloped post-colonial infrastructure—produced a low annual gross domestic product (GDP) growth rate hovering around 3 percent.

Domestic economic deregulation began in the mid-1980s under Rajiv Gandhi. In the early 1990s, the collapse of socialist economies worldwide coupled with a foreign exchange crisis at home allowed the Indian government to push through pioneering reforms. There were five major components to the reforms: export promotion, domestic deregulation (including ending state monopolies in several sectors), privatization of loss-making state enterprises, permission for foreign capital to enter the economy, and reduction of tariff and non-tariff barriers on imports. Incremental but significant globalization—integration with the international economy—has gone hand in hand with domestic economic liberalization. Indian policy makers also reoriented foreign economic policy along more commercial lines. Officials from the ministry of commerce, as well as representatives of industry groups, think tanks and foundations, and even private business interests, gradually began to play a larger role in foreign economic policy.

These reforms facilitated a period of high growth, which shows no signs of slackening. From 2000 to 2006, India’s mean growth was nearly 7 percent, and in April 2007, the International Monetary Fund (IMF) predicted that GDP growth for the next two years would be around 8 percent. The agricultural sector’s share of the trillion-dollar economy (in purchasing power parity terms) has fallen from 38 percent in 1980 to only 22 percent in 2006. The highest growth rates in recent years have been in services, such as software, accountancy, financial and legal ser-

vices, health, tourism, and air transport, which contributed 54 percent of the GDP in 2003. International economic links also have multiplied. For example, from 1990 to 2005, India’s merchandise trade to GDP ratio more than doubled, rising from 13 to 29 percent, while annual net foreign direct investment (FDI) inflows exploded from $0.2 to $6.6 billion. Portfolio inflows in the form of foreign institutional investment (FII) have recently averaged $1.5 billion annually.

China’s Reforms

Meanwhile, China was engaged in a similar, though even more far-reaching, transformation of its domestic economic regulatory framework. Most analysts point to the Third Plenum of the CCP (December 1978) as the harbinger of China’s economic transformation. Deng Xiaoping’s speech at this plenary went much further toward establishing a new economic model for China than any other previous reform. Deng pursued a policy of economic modernization, decentralization, and privatization. Although he maintained a rhetorical focus on the “socialist” benefits of economic change, Deng parted with Mao’s trenchant anti-private sector and anti-market exhortations. He also rejected Mao’s hostile attitude toward the West and the international system in general. The bellicosity of Mao’s “war and revolution” slogan was replaced with a declaration of “peace and development.” Deng stated that a world war was unlikely in the next decade, and argued that China’s constant state of war readiness was financially taxing, unnecessary, and counterproductive to

the national interest.18

Rather than rejecting economic engagement outright, as Mao had done, Deng tied Chinese nationalism to the pursuit of wealth and commercial achievement. Upon taking over the leadership of the CCP in the early 1990s, Jiang Zemin continued Deng’s broad reforms. Jiang’s rhetoric and policies were even more explicitly global than Deng’s; China, he argued, could use its growing economic power to secure its rightful place at the table of the great powers. Jiang connected Chinese national identity to shrewd fiscal and commercial policy, innovative business practices, and robust market competitiveness.19

Decentralization was crucial to China’s economic overhaul. Even before Deng’s landmark 1978 speech, the control of a number of state-owned industrial enterprises was transferred from the central government to local governments. By 1985, the central government controlled only 20 percent of the output from state-owned enterprises, whereas provincial, city, and county governments controlled 54 percent. The decentralization of state enterprises attracted more foreign capital; foreign investment increased from $4.5 billion in 1985 to $19.2 billion in 1992.20 In 1979, China created four special economic zones: Shenzhen, Zhuhai, Shantou (across from Hong Kong), and Xiamen (adjacent to the Taiwan Strait).21

After the fall of communism in Europe, some within the CCP reflexively sought to protect the party through re-centralization. However, the winning factions within the leadership resisted this temptation, understanding that an end to economic growth would actually challenge the legitimacy of the CCP more than anything else. Moreover, the semi-privatized economy was now far too massive and dynamic for the CCP to rein in.22 Meanwhile, a bureaucratic transformation also helped usher in economic reform. Mandatory retirement age forced revolution-

22. Ibid., p. 70.
ary veterans to step down, allowing less ideologically rigid civil servants to move into the public service. Bureaucrats were also allowed to move away from public service to join the business community. This educated group of ex-bureaucrats—comfortable with and well versed in the Byzantine nature of the Chinese business climate—formed a new entrepreneurial, commercially-oriented class.23

From 1979 to 2003, China’s economy grew at an annual rate of 8 to 9 percent. China’s foreign trade volume increased twenty-four times in the same period, reaching $1 trillion in 2004.24 Between 1987 and 2000, China’s exports grew from $39.44 billion to $249.2 billion.25 China’s rapprochement with the United States—which began after President Richard Nixon’s visit to China in 1972, and gained additional impetus after Deng’s policy shift—facilitated a massive increase in the China-U.S. trading relationship. Between 1987 and 2000, Chinese exports to the United States, as a percentage of total U.S. imports, rose from 7.7 percent to 20.9 percent.26

From Economic Interdependence to Peace?

Three Mechanisms of Strategic Deescalation

A rich literature connects economic interdependence to a reduction in international tensions. Different theories, variously known as the “Manchester Doctrine,” the “Liberal Peace,” and “Interdependence Theory,” postulate that as economic ties grow among states, the incidence of violent conflict will be reduced. In thinking about our case, we conceived of three logical paths through which closer economic ties could lead to more peaceful relations.27

23. David D. Li, “Changing Incentives of the Chinese Bureaucracy,” Ameri-
26. Ibid.
27. Another mechanism in the literature expects peace to result from the growth of cultural understanding and tolerance between the trading countries. Interaction between India and China is gradually increas-
ing—until 2002 there were no direct flights between India and China,
Hypothesis One: As economic interdependence increases, the opportunity costs of conflict rise and the benefits of conquest are reduced.

When economic interaction with external actors becomes sufficiently important that any limitation or obstruction would fundamentally damage the economic health of the country, the government will be averse to exacerbating conflicts. States are dissuaded from initiating conflict with trade partners because of the resultant decrease in the economic gains derived from that relationship.\(^{28}\) This mechanism, relying on cost-benefit logic, focuses on the material incentives for conflict and economic exchange.\(^ {29}\) We hypothesize that the state, acting as a unitary actor, will reevaluate the benefits of conflict once its calculus has been changed by bilateral commerce.

Hypothesis Two: Private economic actors exert pressure on state authorities to avert aggression.

Our second hypothesis opens up the “black box” of the state. Some contemporary Liberal theorists suggest business interests are more “pacific” than other elements, and will mobilize against the risk of war. This is particularly true in democratic societies.\(^ {30}\) The presence of domestic political institutions that magnify the influence of such groups will intensify the effects of external economic linkages. Assuming that politically influential domestic groups develop stakes in the economic relationship,
we hypothesize that they will use their influence to restrain aggressive elements in their own governments.

_Hypothesis Three: A state will refrain from aggressive behavior in order to maintain its reputation as a responsible participant in the global economic system._

In our final hypothesis, a desire to preserve its reputation as a secure destination for investment and a reliable trading partner in the global market will oblige a country to eschew costly aggression, even when dyadic economic ties are not yet significant enough to influence security policy. Aggressive behavior by a state on security issues would signal to its economic partner(s), as well as to the rest of the world, that it is ready to risk the benefits of economic interdependence. A country that unilaterally snubs the “international code of good behavior” risks incurring adverse reactions.31 Thus, we hypothesize that state officials with a long-term perspective will assume that third parties, particularly potential foreign investors and perhaps also their governments, will be favorably impressed by both trade and peace with neighboring states. Consequently, these policy makers will abjure opportunities to score immediate strategic points in favor of seeking continued gains from participation in the global economy.

These hypotheses represent three different potential pathways connecting greater economic intercourse and a reduction in tensions in the security arena. In the next section, we return to the India-China case to assess the operation of these mechanisms. We look for evidence for each mechanism from publicly available sources, including economic databases. While we attempt a thorough analysis of both states, our sources—particularly with regard to the activities of private economic actors and governmental policy makers—are weaker for China, due to the opacity of its political system.32 In these cases, we have presented data exclusively from Indian sources.

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32. But see the paper by Wei Liang in this special issue for insight into Chinese commercial and strategic goals.
Assessing the Mechanisms in the India-China Case

Many analysts argue that the India-China relationship is dominated on both sides by “Realist” considerations: a prioritization of security imperatives over the “low politics” of economic interest, wariness toward erstwhile enemies, and a preoccupation with territorial sovereignty. Both countries are rising powers, and they have a history of conflict, most prominently over the unresolved border. China’s military and nuclear support of Pakistan and India’s backing of separatist elements within China’s restive Tibetan population are additional indications of the persistent dominance of security considerations in the dyad. The current improvement in Sino-Indian relations potentially challenges this interpretation. Could it be that economic interdependence is mitigating security apprehensions? Here, we examine our three mechanisms in the contemporary Indo-Chinese context.

Hypothesis One: Economic Interdependence and the Costs of Conflict

A number of questions are implied in the assessment of economic interdependence. Has economic interaction increased to the point that it has become costly for governments to disrupt it? Is the bilateral economic relationship equally vital to both economies, or do we find asymmetric gains? How is this relationship valued in comparison to other economic imperatives? Finally, does increased economic activity impinge on sensitive security-related concerns?

Bilateral trade has increased, but is asymmetric: India depends more on China than vice versa. In 2005, India-China trade increased by 37 percent over the previous year, touching the $18-billion mark, although as recently as 2002 it had amounted to a paltry $5 billion. Recently China replaced Japan as India’s top trading partner in Asia. In 2005, the United States and China were India’s top export destinations, receiving 18 and 9 percent of Indian exports, respectively. Moreover, China and the United States are roughly tied as the major sources of India’s

imports, with China providing 7 and the United States 6 percent. China depends much less on trade with India. Out of a total trade volume of $1.4 trillion in 2005, Chinese trade with the United States amounted to $204.7 billion, and Sino-Japanese trade amounted to $189.4 billion, while trade with India was a mere $18 billion, approximately 1 percent of China’s total trade. India was the sixteenth-largest exporting nation to China in 2005 and the thirteenth-biggest importer of Chinese products.

Moreover, the composition of India-China trade arguably is not conducive to value-addition and rapid growth in India. Indian exports are predominantly made up of base metals and low-value commodities, especially iron ore. In 2005 ores, slag, and ash comprised 56 percent of India’s exports to China. With primary products exports, many of the benefits of value addition—such as increased employment, higher profitability, and technological upgrading—are lost. These exports are driven by the Chinese construction boom and the inability of its domestic iron and steel industry to meet demand, and are thus vulnerable to changes in these conditions. It would also be comparatively easy for China to replace India as a supplier since there are many sources for these commodities. Chinese exports to India are slightly higher on the value chain, comprising goods such as electrical machinery and equipment, mechanical appliances, organic chemicals, and iron and steel.

How do the benefits from the bilateral relationship stack up against other economic imperatives, such as competition in third countries for markets, investment, and access to natural resources? India-China competition over markets is a mixed picture. Econometric studies show that while India has Revealed Comparative Advantage (RCA) in metals, China’s RCA lies in the manufacturing of instruments, arms, and toys. India, but not China, enjoys RCA in agricultural products. Overall, they compete in only 25

34. Ibid.
35. India’s main trading strategy today is to emphasize the export of services, principally to English-speaking countries. Interview with a former official at the Indian Embassy in Beijing, July 2007.
36. Ibid.
percent of their products exported to world markets. Only in textiles and clothing do both have RCA, but even here India has higher RCA in basic materials while China has RCA in produced articles of clothing. It appears that India and China are not direct competitors in most goods. Nonetheless, in rapid-growth environments, the future composition of the economy cannot be easily determined, so we cannot rule out competition in the future.

India attracts less foreign direct investment (FDI) than China. In 2006 China’s total FDI inflows were worth $72 billion, about double those of India’s. However, recent work by Greg Xiao estimates that Chinese FDI figures are exaggerated by 26 to 54 percent on account of “round-tripping” (Chinese citizens investing in China, using other jurisdictions to obtain better terms). We also find that the same sources are not investing in India and in China. From 1991 to 2004, according to Indian government figures, Mauritius was the main source of inward FDI into India, with 34 percent of the total, though both Mauritius and Hong Kong serve as fiscal conduits for third-country foreign investors, making it hard to discern the regional origin of investment into India. In contrast, as much as two-thirds of China’s FDI derives from the Chinese diaspora, though in 2000 Hong Kong was listed as the source of 38 percent of Chinese FDI. A reasonable estimate is that overseas Chinese provide at least 50 percent of inward Chinese FDI, while Indians abroad contribute less than 10 percent of India’s inward FDI. These figures suggest that the

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43. Tarun Khanna and Yasheng Huang, “Can India Overtake China?” Foreign Policy, No. 137 (July-August, 2003), p. 80.
two countries do not directly compete over FDI at present.

A final crucial locus of economic competition may be over the essential resource of energy, where we observe both conflict and cooperation. Currently, China has an advantage in the contest for energy. Chinese companies have been willing to pay high prices for third-country energy assets, often besting Indian competitors for the same resources, as in a recent contest over a stake in Angola’s state petroleum company. In another instance, the China National Petroleum Company (CNPC) beat out India’s Oil and Natural Gas Corporation (ONGC) to buy PetroKazakhstan and Nations Energy. China’s energy supply network is also much broader than India’s, with assets in Latin America, Africa, Central Asia, and Canada. More recently, policy makers in both India and China have gradually come to recognize the mutual disadvantages of competition over scarce natural resources. Thus, in August 2005 and January 2006, officials from both countries held talks to fashion bilateral cooperation in the energy sector. As a result, ONGC and CNPC successfully made joint bids for shares in the Great Nile Oil Project in Sudan, the Al Furat oil field in Syria, and most recently for the assets of Omimex of Colombia.

We note further that actions taken to ensure access to energy also may have security implications for both countries, potentially raising tensions. For example, the Chinese Navy will likely seek to increase its presence in the Persian Gulf, the Straits of Hormuz, and the Indian Ocean, alarming military officials and policy makers in New Delhi. A growing number of Indian naval vessels in the Burma Sea, the Straits of Malacca, and off the coast of Vietnam would have a similarly startling effect on Beijing.

Finally, the two governments are also wary of the effect of economic activity on sensitive sectors such as telecommunications and transportation. The Sino-Indian border was for many years “sterilized” for reasons of defense, and natural routes of

45. Malik, “China’s Strategy of Containing India.”
47. Ibid.
48. Malik, “China’s Strategy of Containing India.”
commerce and social interaction among the peoples of the region were disrupted. On the one hand, as tensions have deescalated, governments have recognized the gains to be had from allowing cross-border activity, the Nathu La pass being a prime example. This traditional trade route between India and China, located in the Indian state of Sikkim, was closed to trade after the 1962 war, but was formally opened in 2003, leading some analysts to predict that trade through this route could eventually amount to millions of dollars.49 The historic Silk Route between India and China will also be opened shortly to link Sikkim and Tibet.50 Another plan proposes to establish a “growth quadrangle” including Southwest China, Northeastern India, Northern Myanmar, and Bangladesh.51

On the other hand, bureaucratic actors still raise security-oriented objections, restricting flows of labor and capital. For example, India’s Foreign Exchange Management Act requires the central bank to approve all proposals for establishing an Indian office from a firm based in Bangladesh, China, Iran, Pakistan, or Sri Lanka.52 Recently, Chinese firms Hutchison Port Holdings and China Harbor Engineering Corporation were denied permission to expand port operations in India, while in the telecom sector Huawei and ZTE Corp were similarly stymied.53

In sum, although the level of trade between India and China is on the rise, it is less vital to the Chinese economy than to the Indian economy. Looking to the future, we identify certain areas where the two countries will be competing in the world market. Finally, we note that Indian decision makers are uncomfortable with the loosening of borders and regulations when it comes to Chinese firms. Therefore, the first hypothesis, which relies on a

simple cost-benefit calculus, seems too fragile and fraught with caveats to serve as a structural conduit for enduring Sino-Indian rapprochement.

**Hypothesis Two: Domestic Actor Interests and State Policy**

Our second hypothesis assumes that private economic interests will develop a stake in external commercial relations and lobby their governments for their continuation. Certainly, private economic actors on both sides of the border are increasingly developing stakes in the bilateral relationship. For example, the Indian conglomerate Tata is constructing a port in the northeastern Indian state of Orissa, adjoining its $3-billion steel plant, specifically in order to improve delivery times for its exports to China and elsewhere in the region. The chairman of another large Indian corporation, Reliance Industries, recently pressed the government to accelerate visa and immigration clearance for nearly 2,000 Chinese technical executives hired for a gas pipeline project. Growing economic engagement with China was also one of the factors behind the Indian government’s decision to construct seven strategic roads in Arunachal Pradesh in areas bordering China, reversing a policy of using inhospitable terrain to deter Chinese invasion.

At the same time, other private actors in India stand to lose from closer Sino-Indian trade ties, so the net effect of interest group lobbying is difficult to predict. For example, the deregulation of the early 1990s allowed a large influx of cheap Chinese goods into the Indian market, prompting manufacturers to put pressure on the commerce ministry to investigate “dumping” by Chinese firms. In 2001, ninety-three cases were filed against Chinese companies. The latest available figures show eighty-eight

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55. Srivastava, “Delhi Divided over Chinese Threat.”
cases pending in Indian agencies against China. Among all of India’s trading partners, China was the foremost target of antidumping investigations. China proposed a free-trade area (FTA) to India in 2004. But since India’s tariffs currently are much higher than China’s, an FTA, by bringing down tariff barriers, would increase Chinese exports to India (and Chinese profits), as well as reducing the Indian government’s revenues from duties on Chinese products. There would be a net gain for Indian consumers, who could buy lower-priced imports, and India might benefit if the FTA were to open up the Chinese service sector, where India might have a comparative advantage. Even so, much of Indian industry has opposed the FTA proposal, pointing out that Chinese firms benefit from government subsidies and that China does not deserve “market economy” status (only sixty-six countries accord China this status). The prestigious Times of India editorialized:

An FTA with India would help China consolidate its position as the factory of the world, particularly in textiles and steel, where its output and exports are at least 10 times India’s. That would scuttle an ongoing impetus in India in these two sectors, given China’s ability to produce 30 percent cheaper, with the help of non-transparent subsidies.

Thus we see conflicts within the Indian business community over the inherent desirability of enhanced trade with China.

These are not the only barriers to our second mechanism,

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which posits that domestic private actors pressure the government to preserve the bilateral commercial relationship. Within India, policy makers charged with the protection of national security generally are able to overrule both businesspeople and economic ministers. While the ministries of finance and commerce would like restrictions on Chinese companies to be lifted, the ministry of home affairs and the national security advisor support the retention of restrictions. One “insider” argues that, currently, the latter are still able to assert ascendancy by citing the existential threat potentially posed by China.

In sum, although bilateral economic interaction has given rise to certain groups in India that have an interest in a stable commercial relationship with China, these groups do not hold a dominant position that would allow them to exert overwhelming pressure on the Indian government, especially while other business groups and national security elites view China as a significant threat. We suspect that, within China’s still authoritarian political system, lobbying by business interests that stand to gain from continued close commercial ties with India will not receive high priority in policy-making circles. We think it unlikely that pressures from domestic business in favor of closer bilateral ties has been a major factor precipitating the current improvements in Sino-Indian relations.

**Hypothesis Three: India and China as Responsible Global Market Actors**

The mechanism underlying our third hypothesis enlarges our focus from the dyadic relationship to the roles of India and China in the global market. Could the imperatives attached to their actual and desired global economic roles induce New Delhi and Beijing to avoid conflicts that otherwise might occur? Decision makers in both countries, although presiding over very different political systems, have recognized that their legitimacy and stability must rest on the continued provision and wider distribution of economic benefits to their populations. India has focused on eco-

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62. Srivastava, “Delhi Divided over ‘Chinese Threat.’”
63. Interview with an official in the ministry of external affairs, New Delhi, August 7, 2007.
onomic growth as a means of achieving great-power status, as well as ensuring the unity and integrity of the state. In China, the CCP views continued economic improvement as crucial to remaining in power. Moreover, it also sees progress in commercial competitiveness and economic size as the most promising route to an overall increase in geopolitical prominence for the country. Although both India and China have large domestic markets, in order to sustain their present remarkable growth rates, they depend on outward-oriented economic strategies that focus on exports, as well as inputs of foreign investment and technology. Since they are in competition with other exporters and destinations for investment, India and China realize that they must reassure potential economic partners that security challenges will not disrupt the business environment.

Given that these economic strategic choices have already been made, the natural corollary is that India and China must create and consolidate reputations as safe and profitable players in the global market. A disruption of the currently propitious economic trajectory would be anathema to both Beijing and New Delhi. Consequently, they are likely to avoid high-risk military or foreign policy maneuvers because of the potential repercussions from global economic forces, which could punish them by diverting investment or commercial contracts. This general prudence has a major stabilizing effect on the bilateral relationship. Although their dyadic economic ties are not substantial enough to significantly alter their relationship, India and China will be reluctant to increase tensions with one another for fear of the consequences on their broader economic well-being.

Preliminary evidence attests to the readiness of both governments to make concessions on the strategic front for the sake of their broader economic goals. India’s government has shown itself to be mindful of its reputation, reaching out to China when relations have become too rocky for comfort. As mentioned above, India’s reference to the Chinese threat to justify its nuclear tests led to tension in Sino-Indian relations, yet soon afterwards, India realized the importance of repairing relations with China. In the first half of 1999, India’s president and its foreign minister each paid noteworthy visits to Beijing. The JWG on the border began to meet again in 2000. In 2003, Prime Minister Vajpayee himself visited Beijing, announcing several historic decisions on
the border issue, including the first formal Indian recognition of Tibet as an “autonomous region” that is an “integral part” of China. The two sides also signed nine accords, including those on simplifying visa procedures, enhancing cooperation on renewable energy, and increasing contacts in the field of law and justice.\textsuperscript{64} Since bilateral economic ties were insignificant in 1998 when the current political warming began, they probably were not driving it. Conciliation was more likely a result of India’s desire to reassure the world—and especially its economic partners—that it was not a trigger-happy, aggressive power.

Similarly, the aforementioned Nathu La pass in the Himalayas symbolizes the evident priority given by the Chinese government to economic considerations. The acquiescence of Beijing to cross-border trade through Nathu La has been interpreted within India as an informal recognition of Indian territorial claims in the region. Even hawkish analysts on the Indian side, such as Mohan Malik and Brahma Chellaney, have described the opening of the Nathu La pass as driven by Chinese commercial aspirations: accessing the South Asian market, and providing economic opportunities to citizens in its volatile and currently underdeveloped western region.\textsuperscript{65} Thus, what they have termed a victory for the Chinese is in fact evidence of a Chinese foreign policy that is more economically focused, and consequently less provocative.

Of course, and as in our first hypothesis, future competition over markets, investment, and energy resources could challenge the operation of this third mechanism through which trade supposedly inspires peace. If economic competition becomes acute, India and China may risk their reputations in the global economic system to safeguard economic interests they deem more important. Nevertheless, the concern about reputation goes farthest in explaining the positive tenor of current Sino-Indian relations.


Conclusion

When speculating about the “long” long term, it is easy to slip into the discourse of realpolitik. Since countries’ intentions cannot be directly discerned, it seems prudent to assume that greater capabilities derived from economic growth will be turned toward aggressive ends. A recent RAND Corporation report, for instance, warns that after 2015 China could use the power acquired through its focus on the economy to fuel its realpolitik or revisionist strategies.66 Stephen P. Cohen, speculating on the effects of Sino-Indian economic integration, states: “As long as their relationship remains trade, economic ties, cultural . . . that is fine, but as soon as you get some confrontation, on the border, Chinese goods flooding into India, or an incident at sea, or in Tibet or Nepal, then things quickly become much more nationalistic and complicated.”67 Whether such a change will occur depends on the geopolitical conditions at the time, and also on whether the process of economic development has changed the internal balance of power within China. Similarly, one cannot definitively rule out a scenario where a materially robust India becomes expansionist and aggressive, although it seems improbable.

In spite of these long-term realist concerns, we believe the rapprochement in Sino-Indian relations is likely to continue. In this article, we have examined the likely economic factors undergirding this improvement in bilateral relations. Our analysis has shown that the first two economic mechanisms are too weak, under current conditions, to have brought about the current significant rapprochement. We place most credence in our third hypothesis, which rests on the general economic and reputational benefit of maintaining cordial bilateral economic and diplomatic relations. We have shown that leaders in India and China are, on the whole, making sage decisions to avoid conflict for the purpose of consolidating their national positions. The concentration on general economic development and global eco-

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conomic integration by both countries is having a mostly positive effect on their bilateral relationship. Given each country’s contemporary role in the global economy, we see a mixture of likely conflict and cooperation between the two countries.

Currently, there are low levels of competition over markets and inward FDI, relatively higher levels of competition over energy resources, and potential for great competition in all three dimensions in the future. At the same time, both India and China are making moves to reach out to one another and to put thorny strategic issues aside, in the absence of compelling interests originating in bilateral economic relations. These foreign policy choices are probably motivated by the need on both sides to concentrate on economic growth and consolidation of national power over the next decade or so.

We conclude that, in the likely event that leaders in both Beijing and New Delhi continue to focus on economic advancement as a primary goal, stability and peace in the Sino-Indian relationship will tend to be maintained. In other words, it is not so much the quantity and quality of economic intercourse between Beijing and New Delhi that will mitigate their mutual security vulnerabilities, but rather conscious policy choices in each country to avoid military entanglements during this period of domestic economic consolidation.

**Principal References**


