

# Research Global

## Why India is a key swing state in the new cold war era

- As the debate of a new world order gains speed, we think India will be the country to watch. Dating back to the cold war, India has a long history of successfully implementing its nonalignment strategy, and this strategy is as alive as ever.
- India's rapid economic growth and its geographical location make it a crucial swing state for both 'blocs'. Same time, the country is setting an example for other EM countries on how to navigate the new world order, and even benefit from it.
- India's heightened role brings opportunities, but the economy has a lot of catching up to do. Playing both sides could also fail, highlighting the fact that as much as everyone needs India, the still-poor country needs its external partners even more.

As geopolitical tensions continue to brew and as rising populations of the Global South increasingly want their voices heard, the debate of an alternate world order is gaining speed. With most Western economies facing constraints from aging populations and weak productivity growth, and the Chinese economy struggling with both cyclical and structural challenges, there is room for a new economic and political powerhouse. We think this is the role that the new expanded BRICS+ is seeking, albeit without success in near term (see *Research Global – BRICS+ is not a love marriage*, 25 August). But even if we are sceptical that the BRICS+ could become a credible challenger for the West anytime soon, some countries will grow to have more sway in superpower politics, India being one of them.

**In superpower politics, historically, India has always favoured neutrality, and they strongly advocate for their right to work with everyone.** The country's first Prime Minister Jawaharlal Nehru's famous quote rings as timely as ever: "We are not pro-Russian, nor for that matter are we pro-American. We are pro-Indian." India's history of being colonised still plays a role in defining its attitude towards the West. Echoing comments from China, India's foreign minister has used the expression of '*centuries of humiliation*' when commenting on the economic exploitation during the British colonial rule. Such remarks tend to resonate in the Global South where many countries share similar experiences. For many countries in the west, their colonial past remains a baggage as they seek to deepen and expand relations in the Global South.

**India's influence in global arenas has grown and will grow even more, underscored by its bright economic prospects.** India's population has already surpassed China, and over the past years, India has grown faster than other major economies, ascending to the fifth largest economy in the world by GDP. The IMF foresees the annual GDP growth rate of India to top 6% throughout projection horizon, while China's economic growth is set to slow down markedly (see also *Research China – Downside risks return*, 6 September).

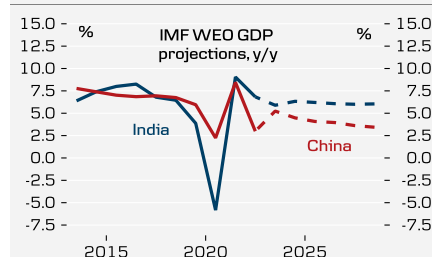
**In terms of trade, India needs other superpowers, and the world needs India.** The country is the world's third largest maker of drugs, and it accounts for 60% of global vaccine production. India's pharma exports are *set to grow nearly twice as fast this year* compared to previous year, driven particularly by US buying. Overall, with a share of 18%, the US is India's main export market while China comes third after the UAE. However, China is by far India's most important trade partner for imports.

### Further reading

- *Research China – Downside risks return*, 6 September
- *Research Global – The new BRICS+ is not a love marriage*, 25 August

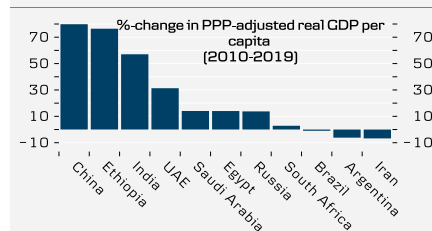
[Link](#) to our Geopolitical updates.

### India's economy is expected to outperform China in the coming years



Source: World Bank, Macrobond Financial, Danske Bank

### Living standards in India have not risen as rapidly as in China



Source: World Bank, Macrobond Financial, Danske Bank

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Considering India's huge population and booming economy, it is no wonder the country has been suggested as one of the winners if and when supply chains are being reshuffled from China. However, FDI statistics do not support the case yet. Net FDI in India is positive, unlike in China at the moment, but the trend in inflows is not encouraging. One reason could be that, historically, India has been quite closed for foreign investments. Up until the 1990s, foreign trade policy focused on import substitution clearly reflecting the country's independence from British colonial rule. For instance, Indian firms were forced to restrict their foreign shareholdings to only 40%. After the liberalisation in 1991, the FDI landscape has gradually improved, supported by various government reforms. Yet, the level remains modest. Additionally, looking at total investments to GDP, with a ratio of 31%, India considerably lags behind China's 44%, albeit this gap is expected to narrow in the coming years.

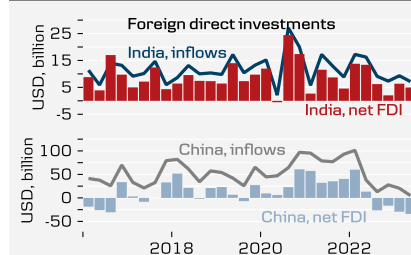
Another reason for weak FDI is India's challenging business environment<sup>1</sup>. Corruption still plagues India, and on the Transparency International Corruption Index, India ranks behind China and Vietnam, the latter having initiated an extensive anti-corruption campaign to enhance its appeal as a new global production hub. Moreover, despite various reforms being made, India's *bureaucratic and fragmented government* continues to reduce its attractiveness compared to other nations in the region. Multinational corporations such as *Apple* have complained about logistics, tariffs and infrastructure. Overcoming these challenges will be decisive for India when it aims to benefit from supply chain reshuffling. But even if India is not yet living up to its potential in that regard and FDI growth is slow, growth in total investments is set to gradually drive a deeper integration of Indian businesses into global value chains. *JP Morgan's recent decision to include India in its emerging market index* is one encouraging signal.

India knows its weaknesses, and Prime Minister Narendra Modi's government has conducted some important structural reforms that aim to improve the environment for businesses and investors. Modi's achievements are related to improving the tax administration and promoting digitalisation. Indeed, the number of internet users has grown significantly in the last few years, and digital payments are booming. In 2022, *BCG estimated* that digital payments would constitute nearly 65% of all payments by 2026, and the *RBI is planning* to introduce its own digital currency. Digitalisation has the potential to become a significant boost to productivity where India still lags behind China, but more focus is needed on inclusion. Since 2018, no progress has been made in penetration of mobile subscriptions. Also, on the Global Innovation index that tracks e.g. investments into research and education, India remains behind China and the gap has even grown in the last 10 years.

Meanwhile, India's democratic backsliding is becoming a growing concern for some. According to *V-Dem Project*, India's democracy has broken down and the country is now best defined as an electoral autocracy. The country is currently in the middle of a diplomatic spat with Canada as the local authorities are investigating allegations of a potential link between Indian government and the killing of a Sikh Canadian citizen. Despite the severity of the claims, the US, wary not to alienate India, has picked their words carefully. This is good news for Modi, who has assaulted *democracy and free speech many times*. A prime example is the *expulsion and prisoning of Rahul Gandhi*, India's top opposition leader, after Gandhi criticised Modi (a decision that the Supreme Court suspended, though).

<sup>1</sup> The World Bank's Ease of Doing Business (EDB) Index was discontinued in 2020, and the new *B-READY* report is not out yet. In the 2020 EDB report, India ranked 63<sup>rd</sup> out of 190 countries and was one of the biggest climbers, but it did fall short of the government's official target of making it into the Top50. And for comparison, Taiwan ranked 15<sup>th</sup>, Thailand 21<sup>st</sup> and China 31<sup>st</sup>.

#### FDI inflows to India are on a declining trend



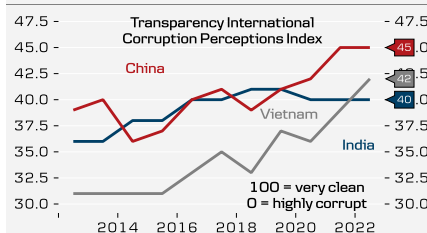
Source: Macrobond Financial

#### Narrowing gap in total investments to GDP between China and India



Source: IMF WEO, Macrobond Financial

#### Corruption could limit India's bright prospect



Source: Transparency International, Macrobond Financial

Modi's reign has also been marked by rising Hindu nationalism, with Modi orchestrating a *systematic crackdown against the country's Muslim minority*. In a new cold war era, authoritarian leaders of the emerging world can easily tighten their grip and commit human rights offenses home and abroad without negative consequences from their key western partners, as long as they don't align with China.

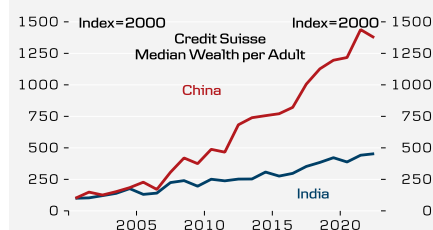
**With regards to their long-standing non-alignment strategy, it is clear that thus far India's political juggling has been successful.** The country's leadership has stopped short of condemning Russia's invasion and has continued to engage in oil and arms trade with Russia. Doing so did not prevent *Modi from receiving VIP treatment* during his visit to the US in June. In fact, the country is deepening collaboration with the US in high tech and *semiconductor space*, as well as in defence industry. India's security partnership with the US takes place through the Washington-led Quad, but same time, India is also part of the Beijing-led Shanghai Cooperation Organisation (SCO) where it even holds the rotating presidency in 2023. Other members of the organisation include Russia, Iran and Pakistan.

**Despite their collaboration in BRICS+ and in SCO, India's relations with China remain sour.** The *source of tensions* is the disputed 3,440km borderline in Himalayas. Three years ago, 20 Indian soldiers were killed in what was the first deadly clash in the area in at least 45 years, and another face-off in 2021 left troops on both sides injured. Of course, India's fighting with China is exactly the factor that makes it interesting for the west; India's intelligence regarding China's activities in the neighbourhood is valuable for the US. On the other hand, if China wants to put more pressure on India, it could easily do that by increasing its military presence in the sensitive border region.

**India's military collaboration with both west and the east and their continued engagement in trade with Russia just illustrates how India is sticking to their own interests – an approach they should not be shamed for.** The US also has a history of *supporting authoritarian regimes*, and even starting wars, if and when it suits their interests. India definitely seeks to leverage its new role for its own good, but to what extent it succeeds is a difficult call. For now, we think their nonalignment strategy is definitely the winning one. The US, China and Russia all want to sustain a good working relationship with India to secure their own interests, ignoring higher values when necessary.

**While playing both sides benefits India for now, the role of a double agent is always a precarious one.** The economy has a lot of catching up to do. China's real GDP per capita is more than twice that of India's, and based on a median wealth measure, the gap is even larger. It has an even longer way to go to be able to deliver living standards comparable to those top Asian economies. Also, China's share of the world GDP (PPP-adjusted) was 18.5% in 2022, while India's was mere 7%. In nominal terms, Chinese economy is adding 1.15 trillion per year vs. India's 180 billion. For companies scouting for alternative markets for China, purchasing power and volumes are what counts, and there, India's lure does not match China's. This only underlines the fact that as much as everyone needs India for now, on the long journey of economic development, India needs its external partners even more.

#### Living standards strongly improving, yet far from China



Source: Credit Suisse, Macrobond Financial,  
Danske Bank

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