

# TESTIMONY

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## China's Economic and Political Impact on South Asia

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China's Economic and Political Impact on South Asia\*  
Before the Commission on U.S.-China Economic and Security Review  
China's Growth as a Regional Economic Power: Impacts and Implications  
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Thank you Madame Chairman and Commissioners for the opportunity to speak before the commission today. After decades of tensions, India and China are moving closer in a shift that is affecting the strategic realities of Asia. A recent visit to Beijing by Indian Prime Minister Vajpayee has produced a promising set of agreements to help settle the long-standing border dispute, increase trade, and decrease mutual distrust. A critical factor in drawing the two countries together has been their growing economies. However, while the probability of military conflict is increasingly low, bilateral economic competition could be the source of possible friction in the relationship.

*Implications of China's Economic Power*

China's economic growth and liberalization has affected India in significant ways. China set a positive example for India in the 1980s by liberalizing its economic system and transforming China into an economic success story. However, the lessons of China's modernizations were implemented by its neighbor a decade later, after an economic crisis forced India to reform its bureaucratic economic system. China's economic growth and wealth has also decreased the incentives for it to engage in conflict with its neighbors, increasing its initiatives to make peace with India. Similarly, India's liberalization and growth has led its leaders to accept the same conclusion.

China and India are currently addressing their challenges with very similar programs that are meant to propel their economies and strengthen their militaries. Both countries face the threat of growing income disparity, ethnic unrest, and separatism and both China and India are focused on modernizing and developing their economies to integrate more closely with the rest of the world. Minor

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disputes over territory do not further this agenda well. For China, high tensions with Taiwan provide a good reason to resolve old quarrels with India. In addition, China has concerns with internal security. Separatist movements in Xinjiang and Tibet continue to absorb much of its attention, and reflect problems that China is facing regarding its ethnic composition. Rising unrest from unemployment and gaping inequalities in income distribution between regions are exacerbating these ethnic divides. Securing its external borders and relations with neighboring countries allows China to focus on these growing internal problems.

Indian policy makers are more confident than their Chinese counterparts regarding their ability to deal effectively with domestic ethnic and economic forces. In fact, they overwhelmingly state in interviews that the unity of the Indian state does not hinge upon keeping Kashmir, whereas in the view of most Chinese policy makers, a separation from Taiwan could mean the end of China as we know it.

Rather than worrying about the country disintegrating, India is trying to refocus its national efforts on economic growth in order to match China's success. Indian growth rates have averaged 6% in the past decade, but growth needs to be even faster to eradicate poverty and raise living standards. Conflict and tensions with neighboring China and Pakistan have posed a large economic hurdle for India in the past, impeding foreign investment and absorbing critical budgetary resources. Moves by Vajpayee's government to foster ties with Pakistan complement the recent initiatives in China, and could eventually lead to a significant demilitarization of India's northern borders.

A breakthrough in relations with China is also likely to mean a tremendous growth in trade between the two countries in coming years. Whereas a decade ago, trade volume was a paltry \$300 million per year, it has now increased to \$5 billion, and growing. Trade estimates for 2004-2005 are closer to \$7 billion, and trade is expected to reach \$10 billion by 2005-2006. These changes mean a boost to the Indian economy, and greater interdependence between the two economies.

Of course, the field for competition has also shifted to economic interests. India eyes with envy China's rapid growth rates and competitiveness in the consumer goods sector. For years, Indians were worried that cheap Chinese goods were flooding the Indian market and threatening domestic manufacturing. In the past few years, however, businesses are looking to China more as a model for attracting foreign investment. The difference in FDI to the two countries is stark, China drew an estimated \$52.7 billion in FDI in 2002, whereas India attracted only \$5.5 billion. Indian businesses realize that much effort is needed to match

China's performance in this arena, including added attention to education, infrastructure, and less bureaucratic entry and exit procedures for businesses.

China, for its part, is hoping to emulate India's success in the information technology arena. In China, recent media reports indicate that concerns are rising regarding India's increasing competitiveness in microchip manufacturing. Chinese analysts argue that because India's salaries are lower, costs are cheaper, thereby making Indian products more competitive. Language is also a factor in China's concerns. Businesses in China fear that U.S. businesses will prefer Indian products because of the Indian facility with English relative to their Chinese counterparts. In a strange turn of events, the Chinese population is now asking whether their market is likely to be flooded with cheap Indian goods. With common strengths and export markets, trade competition is inevitable. But competition on economic terms is beneficial for both countries.

### *Security Relations*

Both countries fought a border war in 1962, leaving a sense of suspicion and tension between the two countries in the following years. Diplomatic relations were reinstated in 1976, but both sides have retained thousands of troops along their disputed borders for years. Complicating matters further, India's 1998 nuclear tests were initially interpreted as a hostile maneuver aimed at China. The situation was exacerbated by the Indian Defense Minister's statement claiming that China was India's main threat. Since then, both countries have slowly come to the understanding that their national interests can be compatible. When asked, leading officials and scholars in both countries state that remaining disputes on borders are not worth a war. As the populations of these two countries comprise a total of a third of the world, this is no small achievement. Furthermore, India's decision to formally accept Tibet as a part of China, and China's decision to show flexibility on the issue of Sikkim in recent discussions has helped to ameliorate relations.

The U.S. role in Asia is undoubtedly a significant factor in China's strategic calculus with regard to India. Calls within the U.S. to work with India to contain China have provided Chinese strategists with a reason to warm relations with India. A closer relationship with India is beneficial to China in that it precludes the U.S. from being able to co-opt India into a containment strategy, whereas the existence of tensions between China and India would provide an ideal opportunity for both the U.S. and India to work together in containment.

China and India's growing economies and trade ties have also had considerable influence on improving their security relationship. Both countries have come to the understanding that economic cooperation is the key to the future, and closer diplomatic and security relations must follow.

The shift in relations has been manifested most recently in the first bilateral military exercises between China and India that took place in November 2003. Both countries engaged in a joint naval search and rescue exercise off the coast of Shanghai, a significant move in their relationship, though limited in its military significance. Working together in the military arena will undoubtedly decrease the possibility of miscommunication and misunderstanding, making conflict less and less probable. The joint exercises also serve as confidence building measures between the two countries militaries. However, the exercises do not mark the beginning of a security alliance by any means. China and India will take time in deepening their security ties. Trust will need to be built through expanding economic interdependence, political agreements, and further military cooperation to create a mature and stable relationship.

### *China and Pakistan*

China's relationship with Pakistan has also been shifting in recent years. During the Cold War and the 1990s, China maintained a close relationship with Pakistan, to India's disadvantage. China's military assistance, including the possible transfer of nuclear and missile technology, to Pakistan has been a persistent irritant in Sino-Indian relations. However, China has in recent years emphasized its intent to pursue a balanced foreign policy towards India and Pakistan, a change from the past policy that was markedly in Pakistan's favor. This shift is likely a result of India's growing significance as an economic and military power in Asia. However, other issues are increasingly affecting China's relations with Pakistan. Revelations of Pakistan's transfer of nuclear technology to North Korea have placed China in a difficult position vis-a-vis the international community and North Korea. China finds that it must now scramble to defuse the situation in Northeast Asia created by North Korea's nuclearization. In addition, whereas Pakistan's support for fundamentalist groups was previously not a priority to China, reports now indicate that the numbers of Uighur separatists trained by Pakistan has created problems for China in Xinjiang. As a result, the issue has become a liability for Pakistan in the bilateral relationship. Nonetheless, the strong historical relationship between the two countries is unlikely to disappear. Military cooperation continues, and China may want to maintain close ties with Pakistan as a hedge against being surrounded by a hostile U.S., Japan, and India

in an unknown future. However, cooperation with Pakistan will increasingly be tempered by the current trend of warming ties with India.

*Implications for U.S. Interests in South Asia*

The implications of closer Sino-Indian relations for U.S. foreign policy are far reaching. Although India's close relations with the U.S. will remain a priority, maintaining positive ties with its large neighbor will probably be increasingly important to ensure future security. A warming of ties between these two countries also means that the U.S. needs to understand that China, India, and Japan could work cooperatively in the future, and attempts to play off India against China may be unlikely to bear fruit. At the same time, a more secure India will mean a more stable partner for the U.S. in South Asia, a less dangerous Asian dynamic, and a more attractive destination for U.S. investment in the future.