

# Economics of Influence: China and India in South Asia

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India has enjoyed substantial regional influence across South Asia due to its size, comparative economic might, and historical and cultural relevance to the region. China's history of involvement in South Asia is limited in comparison, though its long-standing ties to Pakistan are a notable exception. But over the past decade, China has become a significant economic partner to countries throughout the region, forging particularly strong ties with smaller states through trade, diplomacy, aid, and investment.

China's increased involvement in South Asia poses a challenge to India as the regional economic and diplomatic heavyweight. Yet this is not a simple story of regional displacement. Despite recent headlines proclaiming [India's eclipse by China](#), several threads of economic interaction continue to link India with its neighbors quite deeply. China has not eclipsed India across South Asia, but it is catching up in its trade and investment, and in some cases, its economic diplomacy has been accompanied by expanded strategic cooperation with India's neighbors. As China steps up its engagement with the region and promotes Asian connectivity, largely through its [Silk Road "belt and road" vision](#), it can marshal extensive resources on initiatives such as the [Asian Infrastructure Investment Bank](#) that will likely outpace other financial sources. With an eye on India's own regional position, Prime Minister Narendra Modi has [doubled down](#) on his outreach across South Asia, stressing infrastructure development, people-to-people connectivity, and a "lift all boats" approach to help India's neighbors gain from its own rise.



Indian

Prime Minister Narendra Modi and Chinese President Xi Jinping shake hands before they hold a meeting in Xian, Shaanxi province, China, May 14, 2015. (Photo: Kim Kyung-Hoon/Reuters)

### Trade With South Asia

The South Asian region is one of the **least economically integrated regions** in the world. Intraregional trade remains well **below its potential** due to high transport costs, protectionist policies, and political tensions. The South Asian Association for Regional Cooperation (SAARC) agreements, the South Asian Preferential Trading Arrangement, and the South Asian Free Trade Arrangement, have failed to **break down trade barriers**. The deep-seated enmity between India and Pakistan, punctuated by four wars, has stood in the way of broader regional trade expansion, slowing the flow of goods to a mere trickle across the India-Pakistan border. Most SAARC countries rely heavily on developed nations as export destinations, and increasingly import from China.

Due to its size and location, India was a natural top trading partner for South Asian countries for decades. India and Nepal share an open border; India signed its first free trade agreement with Sri Lanka; India and Bhutan share “**mutually beneficial economic inter-linkages**”; and India has been a major economic partner to Bangladesh since its independence in 1971.

With the exception of China’s extensive economic relationship with Pakistan, China’s growing influence in South Asia is a relatively recent phenomenon. The China-Pakistan axis stands as a special and separate case, one that reflects a unique strategic logic unparalleled with other South Asia countries. China’s most recent economic commitment to Pakistan—a declared package of \$46 billion

in infrastructure development and assistance—thus represents an intensification of, but not a strategic change in, a longstanding relationship going back five decades. Their current two-way trade volume surpasses \$16 billion.

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In the past decade, China has emerged as a top exporter of goods to the region, including to India, breaking into South Asian markets with its export-led growth strategy. Bangladesh provides the starkest example of this trend. Around 2005, China **overtook** India as Bangladesh's top trading partner. China **displaced** many Indian goods in Bangladesh, offering cheaper Chinese products (especially **cotton and other fabrics** central to the garment industry) without the visa, transport, and customs challenges that had limited trade between India and Bangladesh. The 2015 **Land Boundary Agreement** between India and Bangladesh, however, positions both countries to address border issues affecting trade in the near future.

China's trade with Nepal and Sri Lanka still lags behind India's, but the gaps are narrowing. Sri Lanka is among India's top trading partners in South Asia, and India is Sri Lanka's [largest trade partner \(PDF\)](#). Since 2005, however, Chinese exports to Sri Lanka have quadrupled to close to \$4 billion, coming closer to Indian levels. China and Sri Lanka are also negotiating an FTA to further boost trade and provide better access for Sri Lankan goods in Chinese markets; the current trade balance overwhelmingly favors China.

Given Nepal's strategic location, it attracts [significant attention](#) from both of its neighbors. A 1996 trade agreement between India and Nepal increased bilateral trade volume, which now accounts for [more than half \(PDF\)](#) of Nepal's total trade. In 2005, at the peak of Nepal's Maoist insurgency, a low point in its relations with India, Sino-Nepali relations shifted both economically and politically. Chinese goods flooded Nepali markets as Nepal diversified its imports and lessened its dependence on India.

In Afghanistan, both China's and India's trade volumes with the landlocked country are under \$1 billion, but expected to grow. India's plans for [sea-land access](#) to Afghanistan via Iran's Chabahar port are expected to materialize in 2016, which will allow India to bypass Pakistan, dramatically cutting transportation costs that hamper India's trade with Afghanistan. However, increased Chinese involvement in Afghanistan and the completion of its [economic corridor connectivity plans through Pakistan](#) could also alter trade dynamics by opening up routes to Afghan markets through Pakistan.

## **Migration and Remittances**

Labor migration reflects economic and cultural linkages among South Asian countries. Here, India is linked much more deeply than China across South Asia. The remittances resulting from such migration represent substantial economic ties. Around five million South Asian migrant workers in India sent more than \$7.5 billion in remittances back to their home countries in 2014, while just twenty thousand workers in China sent \$107 million (including to India), [according to the World Bank](#). In the case of Bangladesh, remittances from India inject the Bangladeshi economy with more than \$4 billion, nearly eight times the value of the \$557 million in Bangladeshi goods imported by India in

2014—making remittances a [vital economic component](#) of the relationship.

WORLD BANK BILATERAL REMITTANCE ESTIMATES FROM INDIA AND CHINA TO SOUTH ASIA, 2014 (\$US MILLIONS)

REMITTANCE-RECEIVING COUNTRY	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka	Total
FROM INDIA	1	4,163	1	-	0	832	2,061	488	7,546
FROM CHINA	0	10	0	57	-	4	16	20	107

Source: World Bank Bilateral Remittances Matrix 2014

Credit: Ashlyn Anderson, Julia Ro

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Looking in the other direction, hundreds of thousands of Chinese workers and millions of Indian workers in South Asia also send significant remittances home. India received almost \$9 billion from migrant workers in the region, while China received more than \$1 billion in 2014. Notably, \$958 million of China’s remittances from South Asia came from Bangladesh which, as noted above, has cultivated extensive trade ties with China.

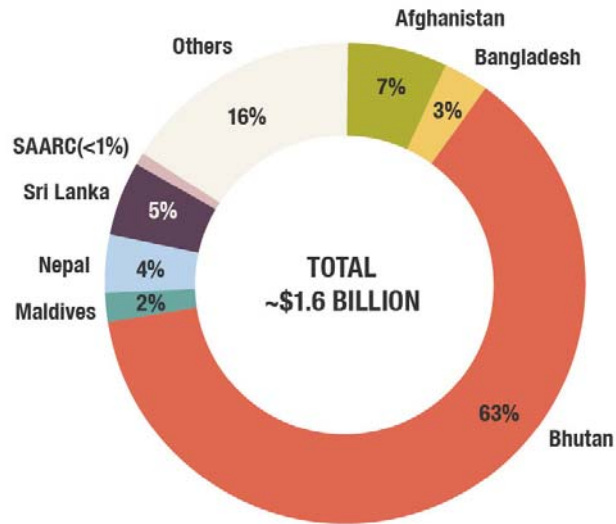
## Aid and Investment

Much of the recent attention to China’s growing footprint in South Asia focuses on its development assistance and government investment programs, particularly for large infrastructure projects. This component of economic interaction is also the one for which apples-to-apples data is hardest to find. Overseas development assistance, as defined by the OECD, requires a “[grant element of at least 25 per cent](#),” meanwhile, the debt-servicing conditions on Chinese loans often fall outside of OECD standards. According to Beijing’s [2014 foreign aid white paper](#), concessional loans represent more than half of China’s aid. Projects funded by Chinese concessional loans must also be awarded to Chinese companies and source Chinese goods, linking Chinese aid to its government investment activities. Lack of transparency also hinders comparison: while India releases its figures publicly, China provides only outlines.

The allocation of India’s foreign aid in the most recent budget covering 2015–2016 prioritizes Bhutan, demonstrating the special economic relationship that India and Bhutan share. It is likely also designed to ensure that Bhutan continues to opt out of [diplomatic ties with China](#), and continues to look to New Delhi as the regional power. Though not reflected in the budget figures, India’s recent announcement of an additional [\\$1 billion to Nepal](#) for post-earthquake reconstruction shows that New Delhi can move quickly and at scale when needed. The pledge matches India’s budget allocation

to Bhutan. Afghanistan is also a significant recipient of Indian aid (the second-largest beneficiary in the most recent budget), and to date, New Delhi's [pledged assistance to Afghanistan](#) nears \$2 billion.

**INDIA'S 2015-16 FOREIGN AID BUDGET**



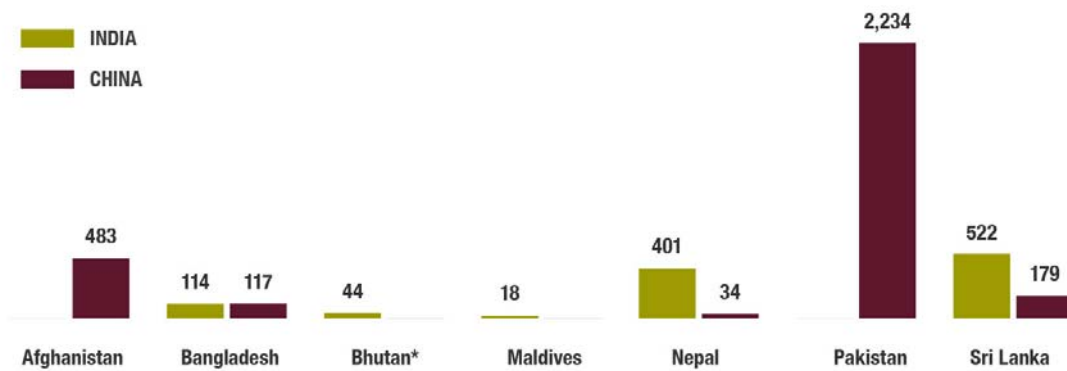
Source: India's Expenditure Budget 2015-2016

Credit: Ashlyn Anderson, Julia Ro

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Turning to investment data, a comparison of the bilateral foreign direct investment figures from the UN Conference on Trade and Development (UNCTAD) and the International Monetary Fund (IMF) reveals data gaps and discrepancies between reporting countries. The data suggests some general trends, but problems in the classification of Chinese development assistance for well-known infrastructure projects in South Asia further complicate the picture.

**CHINA'S AND INDIA'S FDI STOCK IN SOUTH ASIAN COUNTRIES, 2012 (\$US MILLIONS)**



\*India did not report its FDI stock in Bhutan so figures provided are reported by Bhutan

Source: UNCTAD Bilateral FDI Statistics, as reported by China and India

Credit: Ashlyn Anderson, Julia Ro

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Sri Lanka has been the paradigmatic case for the sudden rise of Chinese influence in South Asia. The uptick in Chinese development assistance to Sri Lanka—mostly in the form of concessional loans—began in 2009 after the Sri Lankan civil war and then spiked dramatically in 2011. Chinese support for a port, airport, and cricket stadium in Hambantota, the hometown of the former Sri Lankan president, revealed an increasingly close relationship between the two countries.

The upgrade of the China–Sri Lanka relationship to a “[strategic cooperative partnership](#)” in 2013 demonstrated the geopolitical influence of China’s generous support to Sri Lanka. Detailed loan disbursements available from the Sri Lankan government show a dramatic gap between Indian and Chinese contributions. Between 2012 and 2015, China disbursed almost \$2.5 billion, of which more than 75 percent came from the Export-Import Bank of China. During the same period, India extended \$660 million in lines of credit.

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Sri Lanka also features prominently in China’s Maritime Silk Road project. Beijing’s focus on deep seaport development played on New Delhi’s fears of a Chinese “[string of pearls](#)” encircling India. The Colombo port of call of two Chinese submarines in late 2014 and reports that Sri Lanka granted Chinese state-owned enterprises operating rights at the Hambantota port exacerbated Indian concerns. But upon taking office, Sri Lanka’s new president, Maithripala Siresena, [suspended](#) several Chinese projects, including the \$1.4 billion Colombo port city due to the opacity of financing terms. As Sameer Lalwani noted in *Foreign Affairs*, the Chinese-funded projects are [flashy but of](#) lesser impact compared to Indian investments in projects like housing and railways that have benefitted the local population over the past decade.

Both India and China share a common interest in a stable Afghanistan and have been stepping up their engagement. Investment has been a new, and substantial, component. Indian companies won a \$10 billion tender in 2012 to the [Hajigak iron ore deposit](#), and China invested in the [Aynak copper mine](#) in 2007. However, India’s and China’s mining projects face security threats from the Taliban that could jeopardize or delay operation.

### **A Future of Cooperation and Competition**

With an unresolved border and a contentious history, India often views China’s activities in the South Asia neighborhood warily. Yet China’s and India’s efforts in South Asia can overlap, such as in the development of the [Bangladesh-China-India-Myanmar economic corridor](#), opening up new opportunities for constructive cooperation. India’s “[Act East](#)” policy aims to facilitate commerce,

culture, and connectivity throughout Southeast Asia, an area that also captures China's focus. The two countries' efforts will likely be complementary since the region's infrastructure needs are so pressing and **require trillions of dollars** in capital. Greater connectivity will enable both China and India to tap further into Asian markets through trade and investment, although India will be hard-pressed to provide products as inexpensive and plentiful as China can in the near term.

In the region's west the competitive edge will more likely go to China. With the international troop drawdown in Afghanistan, South Asia faces security challenges that require coordination between India, China, and other regional countries. China's connectivity plans have the potential to help stabilize and strengthen not only Afghanistan but also all of Asia by opening up trade routes and creating new economic opportunities and linkages. Should the China-Pakistan Economic Corridor, a vision to link western China by road and rail down to the Gwadar deep water port, come to fruition in the near term, India may find itself on the outside of a new transformational supply chain in the middle of the region. In addition, Beijing's infusion of resources to create its Silk Road Economic Belt will position China as a benefactor without parallel. It is the major donor to the AIIB (capital pool of \$100 billion), and to the reserve fund of the New Development Bank (the "BRICS bank"), and on top of those multinational institutions, has created its own Silk Road Fund of \$40 billion in capital. India can gain from greater connectivity and the redevelopment of trade ties across Asia, but New Delhi will also need to step up its economic diplomacy if it plans to keep pace.

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