

US-India Trade: A Counter to Chinese Dominance in the South China Sea

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13. SUPPLEMENTARY NOTES A paper submitted to the faculty of the NWC in partial satisfaction of the requirements of the curriculum. The contents of this paper reflect my own personal views and are not necessarily endorsed by the NWC or the Department of the Navy.					
14. ABSTRACT To effectively counter China in the SCS, the US needs to establish a formal bilateral trade agreement with India. This formal trade agreement would counter Chinese regional dominance in the SCS through a weakened Chinese economy, an India with strengthened regional influence, and the creation of a global supply chain competitor to China. A formal trade agreement with India that encourages a shift of US imports from China to India will weaken China's economy, resulting in a weaker military and belligerence in the SCS. India is already an informal trade and security partner with the US, which has provided the conditions to enter the next step of developing a formal trade agreement that will elevate India to a stronger political and military position in the region. India has the demographic and industrial characteristics to serve as a global competitor against China while also having the nationalistic and political will and a formidable military to counter China in the SCS. This paper explores the competition mechanisms that the USINDOPACOM can utilize as part of an operational campaign to develop leverage sufficient enough to influence China's activity in the SCS through a formal trade agreement with India.					
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Introduction

The world largely views India as a poor, inefficient, middle-power country, but in fact, India has the most potential to challenge China's regional aggression, including in the South China Sea (SCS). China's illegitimate claims of sovereignty over internationally recognized waters, as determined by the Hague,¹ and their refusal to acknowledge the international court's ruling concerning freedom of navigation through the SCS not only threatens the economic interests of the United States but more importantly regional powers like India. Aside from an ill-advised military response, the US does not have sufficient soft-power leverage on its own to counter Chinese belligerence in the SCS. Therefore, establishing a formal bi-lateral trade agreement between the US and India would effectively counter Chinese regional dominance in the SCS by weakening China's economy, strengthening India's economy, and leveraging economic competition between India and China.

Background

The political leadership in China dreams of a Chinese century, nostalgic of a time when China dominated regional and global politics and trade. To get there, China has to upend the current global order by replacing the US as the largest global economy, complete hegemony in its region, and achieve military parity with the US. From an economic standpoint, China is nearly there. Since adopting a market economy in 1979, China has sustained the fastest economic growth in history for a developed economy, with an average GDP growth rate of 9.5% thru 2018.² Today, China makes up 16% of global GDP, which gives it the honor of second largest

¹ Permanent Court of Arbitration, "The South China Sea Arbitration: The Republic Of The Philippines V. The People's Republic of China," The Hague, Netherlands, 12 July 2016, accessed 10 September 2020, <https://docs.pca-cpa.org/2016/07/PH-CN-20160712-Press-Release-No-11-English.pdf>.

² Wayne M. Morrison, "China's Economic Rise: History, Trends, Challenges, And Implications for the United States," *Congressional Research Service*, 25 June 2019, accessed 11 September, 2020, <https://fas.org/sgp/crs/row/RL33534.pdf>.

global economy.³ This impressive rise in a mere 40 years and the wealth generated during that time is primarily attributed to China becoming the world's factory.

This wealth has provided China the economic means to pursue its drive to regional hegemony with policies such as the One Belt One Road initiative (OBOR) and militarization of artificial islands in the SCS. It has also funded its breakneck pace in modernizing its military to achieve parity with the US by 2049.⁴ In its region, China's trade dominance, backed by its military, has allowed it to pursue economic coercion over SCS disputes, such as cutting imports from the Philippines and preventing fisheries access to Japanese fishing boats.⁵ Most of China's neighbors are much smaller countries with proportionally smaller militaries, which are simply not capable of standing up to China. On the other hand, the US, along with Japan and Australia, have challenged China's belligerence and unlawful sovereignty claims through Freedom of Navigation operations.⁶ However, neither military operations nor the international legal ruling has persuaded China to change its pursuit of control over the SCS. The best option for countering China is through its achilles heel: its economy.

India possesses the greatest economic potential in the region to counter Chinese dominance. India is the world's second-largest country with an estimated population of 1.37 billion people⁷

³ Jonathan Woetzel, Jeongmin Seong, Nick Leung, Joe Ngai, James Manyika, Anu Madgavkar, Susan Lund, and Andrey Mironenko, *China and the world: Inside the dynamics of a changing relationship* (New York, NY: McKinsey and Company, 2019), <https://www.mckinsey.com/featured-insights/china/china-and-the-world-inside-the-dynamics-of-a-changing-relationship#>.

⁴ U.S. Department of Defense, *Annual Report: Military and Security Developments Involving the People's Republic of China 2020* (Washington, DC: Office of the Secretary of Defense, 2020), i-vi, <https://media.defense.gov/2020/Sep/01/2002488689/-1/-1/2020-DOD-CHINA-MILITARY-POWER-REPORT-FINAL.PDF>.

⁵ Dan Blumenthal, "Testimony," *On The China Challenge, Part I: Economic Coercion as Statecraft: Subcommittee on East Asia, the Pacific, and International Cybersecurity Policy to the Senate Foreign Relations Committee*, 115th Cong., 2nd sess., 2018, https://www.foreign.senate.gov/imo/media/doc/072418_Blumenthal_Testimony.pdf.

⁶ Sam LaGrone, "USS Bunker Hill Conducts 2nd South China Sea Freedom of Navigation Operation This Week," *US Naval Institute*, 29 April 2020, accessed 13 September 2020, <https://news.usni.org/2020/04/29/uss-bunker-hill-conducts-2nd-south-china-sea-freedom-of-navigation-operation-this-week>.

⁷ The World Bank, *Population Total – India*, (Washington, D.C.: The World Bank, 2020), <https://data.worldbank.org/indicator/SP.POP.TOTL?locations=IN>.

and the 5th largest global economy with a 2019 GDP of \$2.875B.⁸ India is the world's largest democracy with a tremendous amount of regional influence. It also has the second-largest military in the world, with over 1.3 million active-duty personnel.⁹ Economically, since Prime Minister Modi was elected, India has pursued economic reforms that have made foreign investment more attractive. These reforms have led to the US overtaking China as India's largest trade partner.¹⁰ While India and US relations have grown closer, both economically and militarily, they have yet to formalize a trade agreement despite China's increasing encirclement of and soured relations with India. Chinese aggression toward India, most recently in the contested Kashmir Region, turned deadly.¹¹ The current political, diplomatic, and economic situation in the region and improved relations with the US has made India an attractive trade alternative to China that could ultimately leverage Chinese influence in the SCS.

A Weaker China

Shifting more US trade sourcing from China to India will weaken China's economy and limit its aggressive actions in the SCS. China's national source of power-or center of gravity-is its economy. Weakening China's economy will influence their military actions in the SCS. The trade war with the US has weakened China's economy, with tariffs impacting exports. GDP growth in 2019 dropped to its lowest level in 30 years at 6.11%.¹² The US market remains the

⁸ The World Bank, *Gross Domestic Product: 2019*, (Washington, D.C.: The World Bank, 2020), <https://databank.worldbank.org/data/download/GDP.pdf>.

⁹ Martin Armstrong, "The Largest Militaries in the World," *Statista.com*, 6 January 2020, accessed 15 September 2020, <https://www.statista.com/chart/20403/largest-militaries-in-the-world-active-manpower/>.

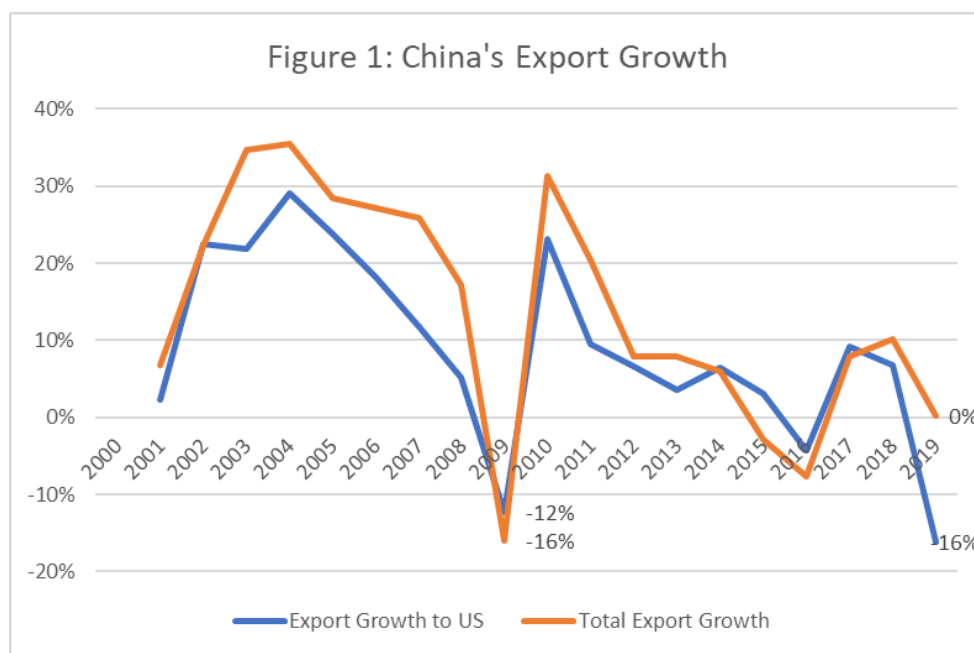
¹⁰ David Fickling, "The Most Troubling China-India Conflict Is Economic," *Bloomberg*, 19 June 2020, accessed 15 September 2020, <https://www.bloombergquint.com/opinion/india-and-china-need-to-rebuild-economic-ties-to-stave-off-war>.

¹¹ Manu Pabu, "Indian Army concludes inquiry into Galwan valley clash," *The Economic Times*, 11 August 2020, accessed 16 September, 2020, <https://economictimes.indiatimes.com/news/defence/indian-army-concludes-inquiry-into-galwan-valley-clash/articleshow/77475329.cms>.

¹² The World Bank, *GDP Growth (%) - China*, (Washington, D.C.: The World Bank, 2020), accessed 14 September 2020, <https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=CN>.

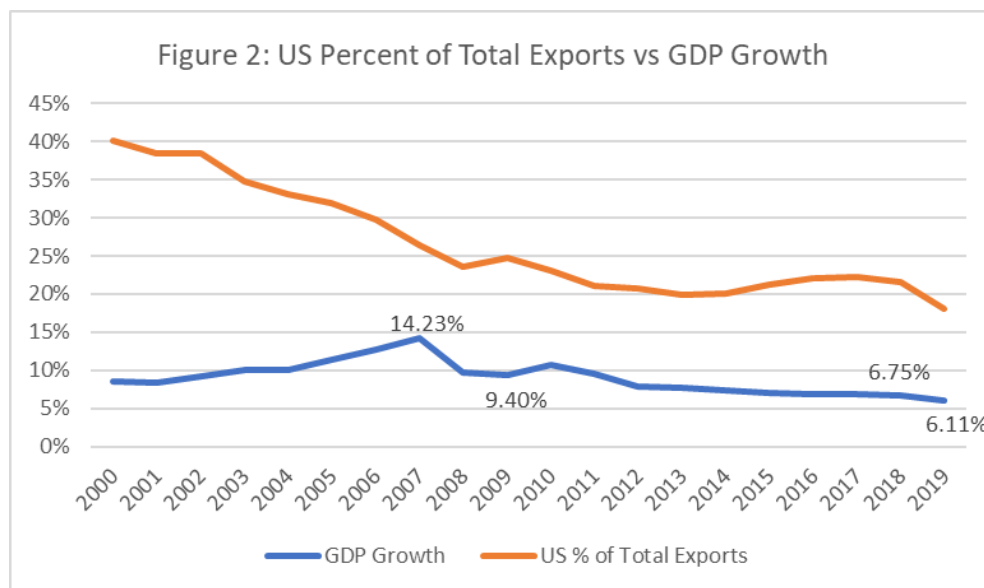
largest export market for China, making up 16% of China's overall export income, but it has been decreasing since 2018. A weakened economy directly affects China's economic performance and, therefore, military spending.

Reducing US trade with China by shifting to alternative markets such as India will significantly decrease China's exports and the overall economy. Researchers found a direct correlation between China's economy and its exports.¹³ The number of China's exports to the US has corresponded, for the most part, to their total exports and, therefore, directly impacts China's economy. Several instances have demonstrated how closely tied the US is to China's overall exports. In the economic crisis of 2008-09, China's exports to the US dropped 12%, which translated to a drop of 16% in total exports (See Figure 1), corresponding to a 34% drop in China's GDP growth from 14.6% to 9.4% (See Figure 2).¹⁴



¹³ Kishor K Guru-Gharana, Deergha R. Adhikari, "Econometric Investigation of Relationships Among Export, FDI and Growth In China: An Application of Toda-Yamamoto-Dolado-Lutkepohl Granger Causality Test," *Journal of International Business Research* 10, no 2, (2011), 31-43, accessed 28 September 2020, ProQuest.

¹⁴ Figure 1, created by the author, U.S. Census Bureau, *Trade in Goods with China*, (Washington, DC: U.S. Department of Commerce, 2020), accessed 28 September 2020, <https://www.census.gov/foreign-trade/balance/c5700.html>, and The World Bank, *Country Export Data*, (Washington, D.C.: The World Bank, 2020), accessed 28 September 2020, <https://wits.worldbank.org/CountryProfile/en/CHN>; Figure 2, created by the author,



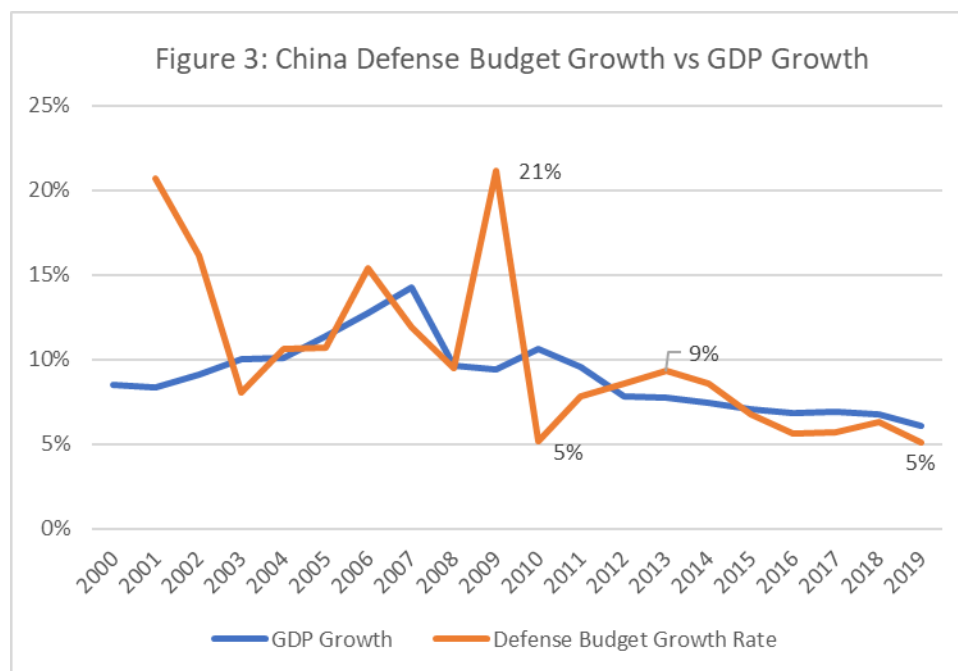
More recently, the US-Sino trade war has again demonstrated the reliance that China’s economy has on exports to the US, that a US-India trade agreement could disrupt. In 2019, exports to the US decreased by 16%, total exports were unchanged (See Figure 1), resulting in a 9% decline in GDP growth from 6.75% to 6.11% (See Figure 2). This demonstrates that the ongoing trade war is an excellent example of the impact that US consumption of Chinese goods and services has on their economy. Some experts have estimated that US tariffs’ impact on Chinese goods decreased China’s GDP by 1% in 2019.¹⁵ Additional weak spots in the Chinese economy that would accelerate the economic decline caused by a significant reduction in exports are massive national debt and increased reliance on domestic spending; both require constant economic growth.¹⁶

The World Bank, *China GDP Growth %*, (Washington, D.C.: The World Bank, 2020), accessed 28 September 2020, <https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=CN>, and a combination of Figure 1 data.

¹⁵ James T. Areddy and Chao Deng, “China’s Slowing Growth Underlines Stress Facing Its Economy in 2020,” *Wall Street Journal*, 17 January 2020, accessed 29 September 2020, <https://www.wsj.com/articles/chinas-economic-growth-slows-to-6-1-as-trade-and-business-confidence-suffer-11579236022>

¹⁶ Riley Walters, “Understanding China’s Economic Weaknesses Key to US Policy Development,” *The Heritage Foundation*, 16 December 2019, accessed 29 September 2020, <https://www.heritage.org/asia/report/understanding-chinas-economic-weaknesses-key-us-policy-development>.

An economically weaker China will slow its military modernization program and reduce its belligerent activities in the SCS. Except for 2009, China's military budget has mostly trended with its GDP; as its GDP growth has slowed, so has its military spending growth rate (See Figure 3).¹⁷ China's official military budget for 2020, while still expanding, is at its lowest



growth rate in decades. In fact, some experts estimate when considering inflation, the 2020 budget has actually shrunk from the previous year.¹⁸ This consistently slowing growth in military spending is directly tied to a drop in US-bound exports.

With a significant decrease in US exports, China's leadership would have to determine the military priorities: modernization or continued development and protection of an expansive chain of military outposts throughout the SCS that are increasingly costly to maintain. There are

¹⁷ Figure 3, created by the author, Stockholm International Peace Research Institute, *SIPRI Military Expenditure Database 1949-2019*, (Solna, Sweden: SIPRI, 2020), accessed 27 September 2020, <https://www.sipri.org/databases/milex>, and The World Bank, *China GDP Growth %*, (Washington, D.C.: The World Bank, 2020), accessed 28 September 2020, <https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=CN>.

¹⁸ Bonnie Glassor, Matthew Funaiolo, and Brian Hart, "Breaking Down China's 2020 Defense Budget," *Center for Strategic and International Studies*, 22 May 2020, accessed 15 September 2020, <https://www.csis.org/analysis/breaking-down-chinas-2020-defense-budget>.

significant cost challenges in maintaining a physical presence in the SCS. One expert noted that China had experienced crumbling structures, equipment failures, and weapon system issues related to the environment; this has led to a reduced footprint of systems occupying the chain.¹⁹ There are additional signs of how the economic slowdown places pressure on China's signature strategic projects and military modernization initiatives. Two examples, China has stopped funding of major OBOR projects in Pakistan and Myanmar and indefinitely suspended the development of nuclear-powered aircraft carriers.²⁰

China's reliance on exports to the US, and additional domestic economic weaknesses could be leveraged to influence its military spending and actions in the SCS. The mounting cost of its OBOR program and maintaining a physical presence throughout the SCS are issues tied to China's economic health. A USINDOPACOM campaign focused on overcoming maritime challenges in the SCS should exploit the "weaken"²¹ competition mechanism through the economic lever of national power. Establishing a formal trade agreement with India would shift sourcing of a significant amount of US imports from China to India, weakening the Chinese economy, which would reduce its ability to finance its strategic and political objectives in the SCS. A weaker Chinese economy correlates to a weaker military through reduced budgets, limiting its pursuit of both military modernization and illegal aggression in the SCS.

¹⁹ Steven Stashwick, "China's South China Sea Militarization Has Peaked," *Foreign Policy*, 19 August 2019, accessed 30 September 2020, <https://foreignpolicy.com/2019/08/19/chinas-south-china-sea-militarization-has-peaked/>.

²⁰ Salvatore Babones, "China's Superpower Dreams Are Running Out of Money," *Foreign Policy*, 6 July 2020, accessed 14 September 2020, <https://foreignpolicy.com/2020/07/06/china-superpower-defense-technology-spending/>.

²¹ Note: Weaken, Strengthen, and Create are Competition Mechanisms defined in the Joint Concept for Integrated Campaigning; Chairman, US Joint Chiefs of Staff, *Joint Concept for Integrated Campaigning*, (Washington, DC: CJCS, 16 March 2018), 15.

A Stronger India

A US-India bilateral trade agreement would also provide an economically stronger India that could counter China's influence in the SCS. A bilateral trade agreement versus a multilateral agreement, like the Trans-Pacific Partnership, would provide more simplicity and the flexibility for the US to negotiate a trade agreement that would be mutually beneficial. Transitioning even half of US 2019 imports from China, valued at \$225B, to India, would significantly increase India's exports to the US (\$57B) by 387%²² and overall GDP by 8%.²³ This dramatic increase would allow India to have more economic influence throughout the region. India, with a more robust trade position facilitated by the US, would allow it to increase Association of South East Asian Nations (ASEAN) trade and investment while giving it the means to accelerate its military modernization initiatives. An increase in trade, especially with the US, would further incentivize India's desire to influence the SCS in order to protect its trade routes and uphold the legal right of freedom of navigation through the SCS.

A US trade agreement with India would also increase its ability to compete militarily in the SCS. Through a modernization program, India has become the second-largest weapons importer accounting for 10% of global arms imports in 2019.²⁴ This modernization program has improved trade relations with the US in recent years through purchases from Boeing, Lockheed Martin, and other large US defense contractors. India's defense budget has averaged 2.5% of total GDP.²⁵ Using the previous scenario and the 2020 defense budget of \$67B, if trade with the US

²² U.S. Census Bureau, *Trade in Goods with India*, (Washington, DC: U.S. Department of Commerce, 2020), accessed 11 October 2020, <https://www.census.gov/foreign-trade/balance/c5330.html>.

²³ The World Bank, *GDP - India*, (Washington, D.C.: The World Bank, 2020), accessed 25 September 2020, <https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?locations=IN>.

²⁴ Stockholm International Peace Research Institute, *SIPRI Arms Transfers Database*, (Solna, Sweden: SIPRI, 2020), 26 September 2020, <https://armstrade.sipri.org/armstrade/page/values.php>.

²⁵ Stockholm International Peace Research Institute, *SIPRI Military Expenditure Database 1949-2019*, (Solna, Sweden: SIPRI, 2020), accessed 26 September 2020, <https://www.sipri.org/databases/milex>.

increased GDP by 8% to \$3.1T, the military budget would likely increase by 15% to \$77B. This increase in only one year would, for example, cover the purchase of over half of the 114 fighter aircraft sought in their largest contract.²⁶ A significant increase in India's military budget through a formal trade agreement with the US would strengthen India's military, combined with US Naval power, would provide a direct deterrent to China in the SCS.

Heightened tension underscores the need for India to accelerate its military modernization plans and raises the importance of a closer security relationship with the US that a formal trade agreement could advance. India has felt encircled by China with OBOR partnerships in Pakistan, Bangladesh, Myanmar, and Sri Lanka.²⁷ China has been challenging India's sovereignty more aggressively in the Kashmir region with a recent deadly clash in the Galwan valley that resulted in a deployment of the Indian navy to the SCS.²⁸ China's increasingly provocative and aggressive acts toward India has motivated India to establish a stronger presence in the SCS.

A formal trade agreement with the US would further strengthen India's will to be more assertive in the SCS. A significant increase in trade with the US would further incentivize India's need to maintain open shipping routes through the SCS. Despite not having a territorial dispute in the SCS, India already has geopolitical and trade interests there. Roughly 55% of India's current trade transits the Strait of Malacca to and from ASEAN and other Pacific markets.²⁹

²⁶ Irfan Mahar, "Indian Increasing Defense Budget and Military Modernization: Security threats for Pakistan," *Modern Diplomacy*, 25 April 2020, accessed 28 September 2020, <https://moderndiplomacy.eu/2020/04/25/indian-increasing-defense-budget-and-military-modernization-security-threats-for-pakistan/>.

²⁷ David Flicking, "The Most Troubling China-India Conflict Is Economic," *Bloomberg*, 19 June 2020, accessed 28 September 2020, <https://www.bloombergquint.com/opinion/india-and-china-need-to-rebuild-economic-ties-to-stave-off-war>.

²⁸ News 18 India, "Amid Tensions with Beijing Post Galwan Clashes, Indian Navy Warships Set Sail for South China Sea," 31 August 2020, accessed 28 September 2020, <https://www.news18.com/news/india/indian-navy-warships-set-sail-to-join-us-destroyers-in-south-china-sea-amid-tensions-post-galwan-clashes-2833615.html>.

²⁹ Amrita Jash, "India and the South China Sea," *Indian Council on Global Relations*, 11 June 2015, accessed 30 September 2020, <https://www.gatewayhouse.in/india-china-and-the-south-china-sea/>.

India's total trade with ASEAN nations in 2019 was over \$86B³⁰ compared with exports alone to the US of over \$57B. Additionally, India imports over 84%³¹ of its energy requirements with sources in the SCS becoming increasingly more important. Because of increasing regional tension, India has demonstrated a willingness to challenge China in the SCS, recently partnering with Russia to establish a sea route that traverses the region.³² A substantial increase in trade with the US would increase India's economic need for uninhibited sea traffic through the SCS while leveraging India's existing influence and agreements in the region.

Elevating trade and, subsequently, India's economy is key to strengthening their influence in the SCS. A USINDOPACOM campaign focused on influencing the SCS should encapsulate efforts using the "strengthen" competition mechanism by facilitating, through a formal trade agreement, a more powerful Indian military, and a strengthened resolve in the SCS. A formal trade relationship with India would provide a partner in the region with the military strength to challenge China and the political influence of SCS nations. A substantial increase in US trade would provide the means to substantially increase India's strength through the acceleration of its military modernization efforts while also solidifying India's will to maintain freedom of navigation through the SCS. A stronger Indian military and their motivation to sustain open trade routes to the US would provide a regional counterbalance to China that would be more receptive to SCS nations than the US.

³⁰ Ministry of Commerce and Industry, *Foreign Trade (ASEAN)*, (New Dehli, 2020), <https://commerce.gov.in/InnerContent.aspx?Id=74>, (India).

³¹ The Economic Times, "India's oil import dependence jumps to 84 per cent," 5 May 2019, accessed 11 October 2020, <https://economictimes.indiatimes.com/industry/energy/oil-gas/indias-oil-import-dependence-jumps-to-84-pc/articleshow/69183923.cms?from=mdr>.

³² Laura Zhao, "India challenging China's influence in the South China Sea with outreach to Russia and other regional powers, analysts say," *South China Morning Post*, 8 September 2019, accessed 11 October 2020, <https://www.scmp.com/news/china/diplomacy/article/3026120/india-challenging-chinas-influence-south-china-sea-outreach>.

Create Global Economic Competition

A US-India trade agreement would also elevate India to a global trade and investment competitor with China, providing the US with sufficient economic leverage to counter China in the SCS. China dominates global manufacturing, making up 28% of global output, 11% higher than the US, the second-largest global manufacturer.³³ This dominant position with both tier 1 and 2 suppliers in nearly every sector gives China a significant amount of control over global pricing and supply that is almost impossible to get around. Risks of an overreliance on China has been highlighted by the COVID-19 pandemic, where 57% of global companies were experiencing supply problems because of their reliance on China.³⁴ India is a prime alternate supplier, with a comparably abundant, skilled but cheaper workforce, similar geographic location, and a proven democracy not bent on global hegemony. Not only would shifting large amounts of manufacturing and investment from China to India afford alternate supply chain sources that could overcome pandemics and increase market pricing competitions, but the move would also provide geopolitical leverage in the SCS.

India's combination of a large, educated population and lower income per capita makes it an attractive trade competitor to China. From a labor cost standpoint, India has become much more attractive than China. China's cost advantages have historically been attributed to cheap labor sourced from its rural communities, but since 2010 there has been a labor shortage which has increased wages.³⁵ India, on the other hand, still has a large and cheap labor pool. In 2019,

³³ Felix Richter, "China Is the World's Manufacturing Superpower," *Statista.com*, 18 February 2020, accessed 12 October 2020, <https://www.statista.com/chart/20858/top-10-countries-by-share-of-global-manufacturing-output/>.

³⁴ Manisha Mirchandani, "Reducing Global Supply Chain Reliance on China Won't Be Easy," *Brinknews.com*, 22 April 2020, accessed 12 October 2020, <https://www.brinknews.com/coronavirus-global-supply-chain-reliance-china-manufacturers-economic-recession-risk/>.

³⁵ Douglas Bulloch, "China is Running Out of Cheap Rural Labor and It's Because of Failed Reforms," *Forbes*, 3 March 2017, accessed October 12, 2020, <https://www.forbes.com/sites/douglasbulloch/2017/03/03/china-is-running-out-of-cheap-rural-labor-and-its-because-of-failed-reforms/#6c3ef20a25c6>.

income per capita for China was \$10,261 as compared to India at \$2,104.³⁶ This cost advantage makes India a highly attractive alternative to China.

Not only does India have lower labor costs, but it also offers other competitive advantages. India has a large, skilled, and semi-skilled workforce that can compete with China in labor-intensive bulk manufacturing, assembly, and processing operations. India also values the law and meets legal obligations that offer customers dependability without government manipulation risks. Geographically, India is well-positioned to provide comparable transportation costs.³⁷ Some large companies are already realizing these advantages, including Samsung and Apple, who have recently shifted their manufacturing to India.³⁸

A formal trade agreement with India would create trade and investment competition with China that the US could leverage to influence the SCS. India is already working with Japan and Australia to develop an alternative supply chain to China called the Supply Chain Resilience Initiative (SCRI).³⁹ In addition to the SCRI, a formal US trade deal that would encourage US companies to source products from India would also encourage much of the world to transition their supply chains away from China to India. India currently accounts for only 2% of global exports⁴⁰, but some experts believe that because of its competitive advantages, India is poised to overtake China as the next factory to the world.⁴¹ This competitive environment will force China

³⁶ The World Bank, *GDP per capita (current US\$) – India, China*, (Washington, D.C.: The World Bank, 2020), accessed 10 October 2020, <https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=IN-CN>.

³⁷ Giridharadas, Akshobh; Desai, Vaman, “After COVID-19: Manufacturing India’s New Economic Potential,” *The Diplomat*, April 29, 2020, accessed 12 October 2020, ProQuest.

³⁸ Taha Ahmed, “Asia plots assault on China’s supply chain dominance,” *FDI Intelligence*, 8 July 2020, accessed 7 October 2020, <https://www.fdiintelligence.com/article/77872>.

³⁹ Pranab Dhal Samanta, “India-Japan-Australia supply chain in the works to counter China,” *The Economic Times*, 20 August 2020, accessed 13 October 2020, ProQuest.

⁴⁰ The World Bank, *Exports of goods and services (current US\$) – India*, (Washington, D.C.: The World Bank, 2020), accessed 25 September 2020, <https://data.worldbank.org/indicator/NE.EXP.GNFS.CD?locations=IN>.

⁴¹ Sintia Radu, “Countries Seen to Have the Lowest Manufacturing Costs,” *US News and World Report*, 14 February 2019, accessed 11 October 2020, <https://www.usnews.com/news/best-countries/slideshows/countries-seen-to-have-the-lowest-manufacturing-costs>.

to either compete by lowering cost while negatively impacting its economy through reduced export revenue or allow much of their manufacturing to leave the country. Neither option would economically support China's political objectives in the SCS. In either scenario, US trade policy would provide political leverage with China.

Global investment in India is another opportunity for increased competition that could serve as leverage over China. A large driver of China's success in becoming the factory to the world has been through Foreign Direct Investment (FDI). In 2019 China was the second-largest recipient of global FDI, receiving \$140B, while India received \$45B.⁴² Building India into a competitive counter to China in terms of trade, must be done through substantial FDI. India recognizes the need for investment to compete; the SCRI's primary objective is to attract significant FDI to build a supply chain that can compete with China.⁴³ With a large US investment shift to India and a proportional reduction in China, some experts believe that China will become less competitive globally, weakening its economy.⁴⁴ Elevating India, as an alternative competitor with China for FDI gives the US additional leverage in the SCS.

Through a formal trade agreement, India would become a global trade competitor with China. By elevating India to a competitor status, other nations would transition trade and investment from China to India. A USINDOPACOM campaign should utilize the "create" competition mechanism to develop economic policies that encourage trade and economic investment into India. China does not have a formidable trade competitor in their region. Through a whole of government approach, this campaign could create economic competition

⁴² UN Conference on Trade and Development, *Global FDI Flows Flat In 2019, Moderate Increase Expected In 2020*, Investment Trends Monitor, no. 33, (New York: UN, 2020), accessed 13 October 2020, https://unctad.org/system/files/official-document/diaeiainf2020d1_en.pdf.

⁴³ Pranab Dhal Samanta, "India-Japan-Australia supply chain in the works to counter China," *The Economic Times*, 20 August 2020, accessed 13 October 2020, ProQuest.

⁴⁴ Andrew Bloomenthal, "6 Factors Driving Investment in China," *Investopedia.com*, 30 April 2020, accessed 12 October 2020, <https://www.investopedia.com/articles/economics/09/factors-drive-investment-in-china.asp>.

between India and China that would allow US trade and investment policy toward China to be used as leverage to influence their actions in the SCS.

Counter Argument

Some experts would argue that China has shifted to a consumer-driven economy less reliant on US trade; thus, a formal US-India trade agreement would not provide enough leverage to influence the SCS. An Economist with ANZ bank told CNBC that “China’s growth is domestically driven.”⁴⁵ This statement is supported by the fact that China’s exports as a percent of GDP are at its lowest point in 14 years. The consulting firm McKinsey found that “in 11 of the 16 quarters since 2015, domestic consumption contributed more than 60% of total GDP growth.”⁴⁶ These two facts would seem to indicate that China’s economy is much less vulnerable to a reduction in exports. Additionally, China has been intentionally shifting to a domestic consumer-driven economy to be less reliant on exports.

This is one prevailing hypothesis; however, the facts do not support this theory. The COVID-19 pandemic has shown that China is still very much reliant on exports to maintain its economy, with a projected 2020 GDP growth of 1.2%,⁴⁷ its lowest in 30 years, along with a drop in US-bound exports by 13%⁴⁸ seems to indicate that domestic consumption is not propping up the economy as previously believed. Household consumption growth rate has been trending down

⁴⁵ Weizhen Tan, “China will likely wait out the trade war as it bets on its own economy,” *CNBC.com*, 29 August 2019, accessed 11 October 2020, <https://www.cnbc.com/2019/08/30/chinas-consumption-more-crucial-to-its-economy-than-trade-exports.html>.

⁴⁶ Jonathan Woetzel, Jeongmin Seong, Nick Leung, Joe Ngai, James Manyika, Anu Madgavkar, Susan Lund, and Andrey Mironenko, *China and the world: Inside the dynamics of a changing relationship* (New York, NY: Mckinsey and Company, 2019), <https://www.mckinsey.com/featured-insights/china/china-and-the-world-inside-the-dynamics-of-a-changing-relationship#>.

⁴⁷ International Monetary Fund, “World Economic Outlook Update,” June 2020, accessed 11 October 2020, <https://www.imf.org/en/Publications/WEO/Issues/2020/06/24/WEOUpdateJune2020>.

⁴⁸ U.S. Census Bureau, *Trade in Goods with China*, (Washington, DC: U.S. Department of Commerce, 2020), accessed 11 October 2020, <https://www.census.gov/foreign-trade/balance/c5700.html>.

since 2015.⁴⁹ China's most recent national holiday in October that is characterized by high consumer spending, had a flat consumption rate over 2019 despite the pandemic restrictions having been lifted in April and mandated factory reopenings.⁵⁰ China's internal economy is not self-sufficient and needs exports to support it.

Additionally, a drop in Chinese manufacturing as a result of sourcing from India would impact more than just the manufacturing sector. One researcher found that for every ten direct manufacturing jobs added to the economy, 3.4 non-manufacturing jobs were created.⁵¹ In 2019 China employed over 213 million in manufacturing,⁵² this would mean that at least an additional 73 million jobs are supported by the manufacturing sector, equating to nearly 34% of the workforce tied to manufacturing. One Chinese economist estimated in April that the major drop in exports and domestic consumption during the COVID-19 pandemic resulted in an unemployment rate of over 20%.⁵³ Combined, the economic downturn and the reliance of employment on manufacturing, along with the significant increase in unemployment paired with a five-year decline in domestic consumption, demonstrates that China is still very much tied to manufacturing.

⁴⁹ The World Bank Data, *Final consumption expenditure (annual % growth) – China*, (Washington, D.C.: The World Bank, 2020), accessed 11 October 2020,

<https://data.worldbank.org/indicator/NE.CON.TOTL.KD.ZG?end=2019&locations=CN&start=1996&view=chart>
⁵⁰ Frank Chen, "Golden Week deflates China's consumption boom hype," *Asia Times*, 7 October 2020, accessed 11 October 2020, <https://asiatimes.com/2020/10/golden-week-data-deflates-chinas-consumption-boom-claim/>.

⁵¹ Ting Wang, Areendam Chanda, "Manufacturing growth and local employment multipliers in China," *Journal of Comparative Economics* 46, no. 2 (June 2018), 516, accessed 9 October 2020, ScienceDirect.

⁵² C. Textor, "Distribution of the workforce across economic sectors in China from 2009 to 2019," *Statista.com*, 29 July 2020, accessed 9 October 2020, <https://www.statista.com/statistics/270327/distribution-of-the-workforce-across-economic-sectors-in-china/>.

⁵³ Marc Julienne, "Economy and Diplomacy: China's Two Challenges in the Post-COVID-19 World," *French Institute of International Relations*, May 19, 2020, accessed 9 October 2020, https://www.ifri.org/sites/default/files/atoms/files/julienne_china_post-covid_world_2020.pdf.

Conclusion

To effectively counter China in the SCS, the US needs to establish a formal bilateral trade agreement with India. This formal trade agreement would counter Chinese regional dominance in the SCS through a weakened Chinese economy, an India with strengthened regional influence, and the creation of a global supply chain competitor to China. China's economy is still reliant on exports, with the US market directly correlated to its GDP. A formal trade agreement with India that encourages a shift of US imports from China to India will weaken China's economy, resulting in a weaker military and belligerence in the SCS. India is already an informal trade and security partner with the US, which has provided the conditions to enter the next step of developing a formal trade agreement that will elevate India to a stronger political and military position in the region. With increased trade, India will increase its industrialization that will provide for global competition with China. India has the demographic and industrial characteristics to serve as a global competitor against China while also having the nationalistic and political will and a formidable military to counter China in the SCS. Using the weaken, strengthen, and create competition mechanisms, USINDOPACOM can utilize the Economic lever of national power as part of an operational campaign to develop leverage sufficient enough to influence China's activity in the SCS through a formal trade agreement with India.

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