Delhi Policy Group

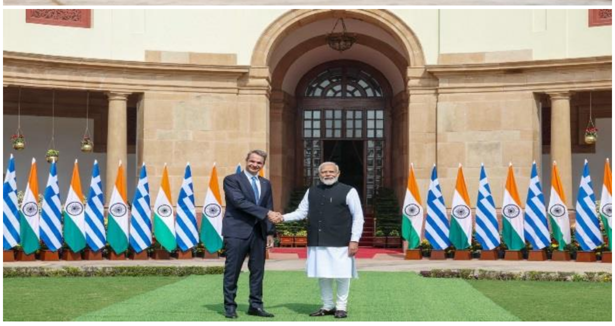
Advancing India's Rise as a Leading Power

ECONOMIC SECURITY AND RESILIENCE REVIEW

FEBRUARY 2024

Author

V.S. Seshadri



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ABOUT US

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Since 2016, in keeping with India's increasing global profile, DPG has expanded its focus areas to include India's regional and global role and its policies in the Indo-Pacific. In a realist environment, DPG remains mindful of the need to align India's ambitions with matching strategies and capabilities, from diplomatic initiatives to security policy and military modernisation.

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The views expressed in this publication are those of the author and should not be attributed to the Delhi Policy Group as an Institution.

Cover Image:

The Director-General, Ngozi Okonjo-Iweala, delivers an address at the 13th WTO Ministerial Conference in Abu Dhabi on February 29, 2024. (Source: WTO/Official X Account)
PM Narendra Modi along with the President of the United Arab Emirates, Sheikh Mohammed bin Zayed Al Nahyan during his visit to Abu Dhabi, in United Arab Emirates on February 13,2024. (Source: Prime Minister's Office/Official Website)
Prime Minister Narendra Modi and Prime Minister of Hellenic Republic (Greece), Mr. Kyriakos Mitsotakis arrive at Hyderabad House, in New Delhi on
February 21, 2024. (Source: Prime Minister's Office/Official Website)

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by

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Introduction

This month's ESRR draws attention to two recent reports of far reaching importance on trends in global trade and economic fragmentation, one by the McKinsey Global Institute and the other by the WTO. The former projects two possible scenarios by 2035, and the latter suggests a path of 'reglobalisation' that will better advance the world's interests. An assessment of the two reports is provided.

This issue goes on to examine the very limited progress made at the WTO ministerial meeting held in Abu Dhabi in late February. Decisions on several of the pending issues have been deferred for the future.

The India-Middle East-Europe Economic Corridor (IMEEC) initiative received prominence both during PM Modi's visit to the UAE, and during the India visit of Greek PM Kyriakos Mitsotakis. The UAE visit also witnessed the signing of a bilateral investment treaty and long term LNG supply agreements, signalling India's expanding economic ties with the Gulf nation.

The Union Cabinet in India accorded approval for the establishment of three more semiconductor manufacturing units in the country, in addition to the factory already under construction by Micron in Gujarat.

Among trade defense measures taken during the month, prominent were the probe ordered by President Biden into national security risks from import of internet connected vehicles from countries of concern, including China, and the anti-subsidy probe launched by the EU on the Chinese train maker CRRC in the context of a bid submitted by it for a Bulgarian public procurement contract for an electric train project.

For the first time, an Indian company, the Bengaluru based Si2 Microsystems, has been included in the latest package of economic sanctions announced by the EU aimed at Russia for restraining trade in certain electronic components.

Two recent reports reflect on global economic fragmentation trends

The World Trade Report 2023[1] on 'Reglobalisation for a secure, inclusive and sustainable future' published by the WTO recently, and the McKinsey Global Institute (MGI) report[2] entitled 'Geopolitics and Geometry of Trade' released in January 2024, both analyse in considerable detail the changing global trends in trade and investment in response to geopolitical and other crises that have impacted the world. Both reports point towards possible future fragmentation and diversification scenarios. The WTO report goes further to affirm that fragmentation is unlikely to increase security and urges instead a move towards a path of 'reglobalisation'. The key elements of the two reports, to the extent that they relate to economic security, are outlined below.

MGI report

The MGI report analyses the changing geometry of global trade across four parameters - trade intensity, geographic distance, geopolitical distance and import concentration - and points out that presently:

- nearly 20% of global trade in goods is between geopolitically distant economies;
- almost 40% of trade in globally concentrated products is between geopolitically distant economies (for example iron ore, soya beans, flat panel display manufacturing equipment, laptops, cell phones, computer monitors, critical minerals etc.,); and
- nearly 40% of all flows of globally concentrated products come out of China, typically in the form of manufactured products.

The MGI report also looks at recent investment trends that can be a precursor to future shifts in trade patterns. While announced greenfield investments into Greater China (-67%), mainland China (-70%) and Russia (-98%) have declined substantially from pre-pandemic averages, those into developing economies and advanced economies of Asia, Europe and North America have experienced marked increases. While developing economies have received investments from across the geopolitical spectrum, India has seen declining investments from China even as FDI announcements have surged from economies spanning Asia, the US and Europe. The report also recognises that India sits towards the global average across dimensions, reflecting its broad relationships

[1] https://www.wto.org/english/res_e/booksp_e/wtr23_e/wtr23_e.pdf
[2] https://www.mckinsey.com/mgi/our-research/geopolitics-and-the-geometry-of-global-trade

with Asia, Europe and the US which also support relatively diversified relationships. India's trade travels geopolitical distances that are similar to the global average.

Based on a detailed analysis, the MGI report projects broadly two global scenarios by the year 2035. One is a more fragmented and deglobalised world, driven principally by reducing the geopolitical distance, with significant friction between the Eastern (mainly China and Russia) and Western groups, but nearly friction free trade with other midaligned group countries, including India. Consequently there will be a significant drop in trade (-70%) between the Eastern and Western groups, but the value of trade within the Eastern group more than doubles and the value of trade within the Western group rises by 40%. Almost all of the trade lost with the Eastern group by the West is picked up by other Western group economies, while the Western group trade with midaligned groups will remain similar to today at 20%. For the Eastern group, for which almost 50% of the trade is presently with the West, this trade share will fall to 15%, with a notable shift in trade with midaligned countries who could also reorient their trade more with Eastern group countries. The economic impact on the midaligned group may not be much compared to the Eastern and Western groups, but import concentration could significantly rise, by around 13%, for midaligned countries.

The second is a diversification scenario driven more by an effort to reduce import concentration. In this case, the overall geometry of global trade may largely remain unchanged but substantial shifts would occur within and among sectors. Most material shifts in this scenario will occur vis-à-vis China. It will lose its share in trade partners' imports in sectors where it is currently concentrated, but will gain share with other partners and in other sectors. In general, concentrated sectors tend to shift to the next-best suppliers, with patterns differing by geography. Midaligned economies gain share where they have substantial existing relationships, offering an opportunity to scale in diversification. However, midaligned economies that have less established global supply relationships will not experience significant increases.

Overall, the report notes that increased trade participation and economic upsides are not guaranteed for midaligned developing economies in either a fragmented world or in the type of diversification considered in the report. Additional measures may be needed to achieve improved outcomes. Such measures could include sustained domestic and foreign investment into productive industries, supportive trade policies, infrastructure development, and upskilling of human capital and capabilities as well as institutional enablers.

The World Trade Report 2023

The data presented in this report broadly corresponds with the MGI report. As per the WTO analysis, 'bottleneck products' (products exported on average by only four economies or less) have increased from 14% of traded goods in the year 2000 to 20% in 2021, and at the same time the share of those products in total trade has doubled from 9% to 19%. China, by far, is the largest source of these products providing more than 36% in 2021 even as this constituted a decline from a peak of 40% in 2017. The second most dominant supplier accounts for barely 6% of potential bottleneck products.

Secondly, flowing from the activities of the WTO Committees, the report confirms the sharp increase in the number of trade concerns raised by members on grounds of standards, sanitary and phytosanitary measures, unilateral environment based measures, security grounds, or those allegedly used for political coercion. The quantitative restrictions notified by the WTO Members under Article XXI (Security) have risen from under 60 in the year 2012 to around 160 in 2018 and to over 180 in 2023. And the specific national security concerns raised in the WTO Committees which were only 2 in the year 2010, went up to 8 in 2017 and 11 in 2023. The share of trade affected by economic sanctions has also gone up to reach 12% of global trade in 2022, as against only 4% in 2016.

The WTO report, therefore, admits that recent headlines suggesting a trading system in crisis is to some extent supported by data, as indeed are trends towards 'friendshoring'. But the report argues that deglobalisation will leave the world economy poorer, less efficient, less innovative and more resource constrained, and reduce the ability to advance environmental, social and security interests. Certain types of fragmentation, like 'friendshoring', may not provide the degree of security expected by their proponents, since geopolitical alignments of governments are at times volatile. The WTO report instead suggests 'reglobalisation' through a three way approach:

1. Diversifying trade to new actors and new areas through the multilateral trade system - through WTO reform, introduction of plurilateral initiatives on investment facilitation, e-commerce, regulation of services, and addressing non-tariff measures through tools like the Trade Facilitation Agreement of the WTO;

2. Limiting trade restrictions during crisis: introduction of new commitments not to impose any restrictions or duties in a number goods deemed essential; and

3. Improvement in the functioning of the WTO's deliberative process on security related measures, enhancing transparency, and reaching agreement on an interpretation of the use of security exceptions.

Analysis of MGI and WTO Reports

1. Both reports have brought out the changing realities on trade and investment patterns and the underlying factors that are driving the fragmentation trends. Both of them, however, assess the geopolitical positioning of countries based on UN voting trends that are somewhat skewed, compared to the ground geopolitical realities. Examples exist of countries that vote significantly differently at the UN but are close partners on the economic or even defense fronts. Similarly, several countries also treat China and Russia rather differently, even as a broad brush categorisation puts both these countries as part of the Eastern group or block. India itself is an example on both these counts.

2. The MGI report projects two possible scenarios, one of fragmentation and the other of diversification. More likely, perhaps, the outcome could be a mix of both scenarios. There could be greater fragmentation particularly in critical sectors, where strategic competition and retaining the technology edge form a priority, and where even the so-called China plus one approaches may attract closer scrutiny. If so,' a country like India may be a preferred option for 'friendshoring' in such areas. Other areas could see greater diversification. Here, inputs from China or China controlled entities, and use of China plus one options, may find greater acceptance. ASEAN countries could figure more prominently in such a scenario.

3. The reglobalisation imperative projected in the WTO report falls more in the realm of wishful thinking by the WTO Secretariat than what appears feasible or seems likely in the prevailing geopolitical context. To suggest that further trade and investment liberalisation, even with some reforms, is the need of the hour overlooks emerging concerns about the hollowing effects on manufacturing that some economies had to experience, or the trade concentration and dependency scenarios it has brought about. The WTO report also underplays yet another aspect: how trade concentration and dependence have come to be used as coercive instruments for political objectives. The report makes no mention, for example, of how China took trade actions in recent years against Australia, or against Lithuania. That said, the suggestion in the report for greater clarity on the use of the security exception in the WTO rulebook merits consideration.

4. There can be little doubt that the recent Ukraine crisis and other developments like COVID-19 have helped in diminishing global trust that had earlier driven globalisation trends, and have now raised doubts about interdependence as a factor for peace and global growth that had formed a foundational argument for the establishment of the Bretton Woods institutions or the GATT (and then the WTO) in the post-World War II era. The risks associated with manufacturing concentration, trade dependencies and lack of logistic or shipping options suddenly loom large, notwithstanding the benefits of efficiency or cost that the earlier globalisation model carried. Narratives are also increasingly emerging[3] of how China systematically used/abused government investment, regulatory management, product registration, investment approval and product safety - virtually every tool in the trade toolbox - to advantage its domestic manufacturers. Another strategy used was to create overcapacity in a range of areas - metals, solar panels, and now electric vehicles or batteries - that can then flood global markets and ruin the prospects for its competitors. Global businesses are, therefore, reconfiguring their activities taking cues from their governments, several of which are introducing industrial policies and adopting newer regulations aimed at reducing strategic dependence.

The WTO Ministerial concludes with very modest outcomes

The thirteenth WTO Ministerial meeting was held in Abu Dhabi from February 26-29, 2024 at a time of rising unilateral trade actions and uncertainties. Even after the meeting was extended by a day, intended to help forge convergence and agreement among the members, there was no major outcome. The Ministers could only agree to renew their commitment to have a fully and well functioning dispute settlement system by 2024, and to hold further discussions towards reaching agreement. Similarly, a final deal could not be arrived at on the remaining part of fisheries negotiations (subsidies that result in overcapacity and overfishing), or on the discussions on a draft text for launching negotiations on agriculture. India's demand for a permanent solution on public stockholding of foodgrains for providing livelihood security too saw no resolution as the divergent views could not be bridged.

What was agreed upon was on maintaining the current practice of not imposing customs duties on electronic transmissions until the 14th ministerial or March 31, 2026, whichever was earlier. What is noteworthy was a clear

[3] See for example the write-up on 'The China dilemma' by Geoff Colvin and Ram Charan in the February/March 2024 issue of Fortune magazine

statement that the moratorium will end on that date. The Ministerial also saw the entry into force of new disciplines on services and domestic regulations intended to streamline and simplify regulatory procedures. Another move made by 123 WTO Members was the adoption of a declaration marking the finalisation of the investment facilitation for development agreement. However, despite these members' request, this plurilateral deal could not be integrated into the WTO agreements. India is not a member of both these plurilateral initiatives on services regulation and investment facilitation.

IMEEC figures prominently at India-UAE and India-Greece summits

The India-Middle East-Europe Economic Corridor (IMEEC) initiative saw some concrete progress during the visit of PM Modi to the UAE from February 13-14, 2024, when an MOU for the creation of an inter-governmental framework between India and the UAE on IMEEC was signed, marking the first such agreement among the participating governments. The main elements of the framework[4] included the development and management of a logistical platform, including a digital ecosystem, and provision of supply chain services to handle all types of cargo, bulk, containers and liquid bulk in order to enable IMEEC.

Ahead of the visit, the Indian engineering consultancy company, RITES Ltd., and the Gujarat Maritime Board also signed agreements with the Abu Dhabi Ports Group[5]. The MOU signed between RITES and the Abu Dhabi Ports Group in particular aims to bring about mutual engagement with the objective of exploring potential opportunities of joint cooperation ~~for working together~~ in the upcoming IMEEC, and in the areas of infrastructure development such as the multi-modal logistics parks, free trade zones, rail connectivity projects and logistics infrastructure services, as per the joint statement by the two companies.

Prime Minister Modi and Greek Prime Minister Kyriakos Mitsotakis also held discussions on IMEEC when the latter visited New Delhi from February 21-22, 2024. The joint statement at the conclusion of their talks[6] noted that they exchanged their perspectives regarding cooperation between the countries of

[4] https://www.mea.gov.in/bilateral-documents.htm?dtl/37629/Joint_Statement_Visit_of_Prime_Minister_to_the_United_Arab_Emirates__February_1314_2024

[5] https://infra.economictimes.indiatimes.com/news/ports-shipping/rites-ad-ports-group-sign-pact-for-infrastructure-development/107690009

[6] https://www.mea.gov.in/bilateral-documents.htm?dtl/37656/IndiaGreece_Joint_Statement

the region, including in the fields of trade, commerce, investment, technology, energy, logistics, ports and infrastructure.

What was also interesting was the pitch made by PM Mitsotakis at the inaugural session[7] of the Raisina Dialogue on February 21, wherein he said that the emergence of groundbreaking projects like IMEEC held great promise to supercharge connectivity between India, the growth economies of the Middle East and Europe. Marketing for Greek ports and shipping capacities in this context, he said Piraeus was one of the busiest European ports and Greek shipowners controlled the largest merchant fleet in the world. Referring to the war in Gaza and the turmoil in the Middle East, he said that while these trends were no doubt destabilising, they did not undermine the profound powerful logic behind the IMEEC.

PM Modi's visit to the UAE also witnessed other important outcomes

PM Modi's visit to the UAE from February 13-14, 2024 also resulted in two other significant outcomes that have a bearing on economic security. These included the signing of a bilateral investment treaty which was referred to in the joint statement by the two leaders as being a key enabler for further promoting investments in both countries across sectors. The text of the treaty has, however, not been made public yet.

Another significant outcome was the signing of new long term LNG supply agreements between ADNOC Gas and Indian Oil Corporation for 1.2 MMTPA and between ADNOC Gas and GAIL for 0.5 MMTPA. The joint statement noted that these agreements marked the beginning of a new era in energy partnership between the two countries.

Union Cabinet approves three more semiconductor plants

On February 29, 2024, India's Union Cabinet approved[8] the establishment of three more semiconductor units under 'Development of Semiconductors and Display Manufacturing Ecosystems in India'. All three units are to start construction within the next 100 days. These will be in addition to the Micron semiconductor unit in Sanand, Gujarat which is already under construction. The three newly approved semiconductor units are:

1. Semiconductor Fab in Dholera, Gujarat:

[7] https://www.primeminister.gr/en/2024/02/21/33705
[8] https://pib.gov.in/PressReleaseIframePage.aspx?PRID=2010132

Tata Electronics Private Limited (TEPL) is to set up this semiconductor fab in partnership with Powerchip Semiconductor Manufacturing Corp (PSMC), Taiwan in Dholera, Gujarat with an investment of Rs.91,000 crore. It will manufacture high performance computer chips with 28 nm technology for electric vehicles (EV), telecom, defence, automotive, consumer electronics, display, power electronics, etc.

2. Semiconductor ATMP unit in Assam:

Tata Semiconductor Assembly and Test Pvt Ltd (TSAT) will set up a semiconductor unit in Morigaon, Assam with an investment of Rs.27,000 crore. This unit will develop indigenous advanced semiconductor packaging technologies, including flip chip and ISIP (integrated system in package) technologies, for use in the automotive, electric vehicles, consumer electronics, telecom, and mobile phones sectors.

3. Semiconductor ATMP unit for specialized chips:

CG Power, in partnership with Renesas Electronics Corporation, Japan and Stars Microelectronics, Thailand will set up a semiconductor unit in Sanand, Gujarat, with an investment of Rs.7,600 crore. This unit will manufacture chips for consumer, industrial, automotive and power applications.

US House passes a Quad bill

The US House of Representatives passed a Quad bill on February 16, 2024, aiming to enhance collaboration among the US, Australia, India and Japan and seeking to promote stability, security and prosperity in the Indo-Pacific region. The bill directs the Biden Administration to establish a Quad Inter-Parliamentary Working Group to facilitate closer cooperation among the four nations and serve as a platform for strategic discussions and cooperation on various regional and global issues. The bill also establishes a US group, comprising a maximum of 24 members of the US Congress, to represent the US in the Quad Inter-Parliamentary Working Group. The bill has now been passed on to the US Senate, which has referred it[9] to its Committee on Foreign Relations.

[9] https://www.congress.gov/bill/118th-congress/house-bill/5375/all-info?s=1&r=28

President Biden orders probe into national security risks from import of connected vehicles

President Biden on February 29 directed[10] the US Department of Commerce to investigate the national security risks posed by internet connected vehicles that incorporate technology from countries of concern, including China, and consider regulations to address those risks. In a statement accompanying the announcement, President Biden said[11] that "China is determined to dominate the future of the auto market including by using unfair practices. China's policies could flood our market with vehicles, posing risks to our national security. I am not going to let that happen on my watch". The White House readout explained that autos increasingly leveraged advanced technologies to enable navigational tools, provide driver assist features, and reduce operating costs and carbon emissions through fast and efficient charging. These autos were constantly connecting with personal devices, other cars, U.S. infrastructure, and their original manufacturer. New vulnerabilities and threats could arise with such connected autos if a foreign government gained access to these vehicles' systems or data. Connected vehicles collect large amounts of sensitive data on their drivers and passengers; regularly use their cameras and sensors to record detailed information on U.S. infrastructure; interact directly with critical infrastructure; and can be piloted or disabled remotely. Connected autos that rely on technology and data systems from countries of concern, including the People's Republic of China, could be exploited in ways that threatened national security.

Third meeting of the China-US Economic Working Group meeting held

The third meeting of the China-US Economic Working Group was held in Beijing on February 5, 2024. The US delegation was led by Under Secretary for the Treasury, Jay Shambaugh. The US officials also called on Chinese Vice Premier He Lifeng, who reportedly told the delegation[12] that the two sides should implement the important consensus reached by the two heads of state at their San Francisco meeting and called for China and the US to deepen exchanges and cooperate through the China-US Economic Working Group to stabilise and develop bilateral economic ties.

[10] https://www.whitehouse.gov/briefing-room/statements-releases/2024/02/29/fact-sheet-biden-harris-administration-takes-action-to-address-risks-of-autos-from-china-and-other-countries-of-concern/
[11] https://www.nytimes.com/2024/02/29/us/politics/biden-chinese-electric-vehicles.html
[12] https://english.www.gov.cn/news/202402/07/content_WS65c2b643c6d0868f4e8e3d81.html

News reports also conveyed that a key concern voiced by the US to the Chinese side at this meeting related to Chinese overcapacities in several areas, particularly in the clean energy sector such as electric vehicles, solar panels and lithium-ion batteries. Shambaugh, in an interview to the Financial Times, reportedly said that the US and allies will take action if China tries to ease its industrial over-capacity problem by dumping goods on international markets[13]. He was also quoted as having said " We are worried that Chinese industrial support policies and macro policies that are more focussed on supply rather than thinking about where the demand will come from are both careening towards a situation where overcapacity in China is going to wind up hitting world markets".

EU's new package of sanctions on Russia includes an Indian company

The EU agreed on a new package[14] (the 13th such package) of sanctions against Russia that for the first time also targets an Indian company. The package covers 17 Russian companies involved in the development, production and supply of electronic components, particularly used in connection with drone production. Targeted also are four companies registered in China, and one each registered in Kazakhstan, India, Serbia, Sri Lanka, Thailand and Turkiye, for trading in electronic components or other equipment that enable and support Russia's efforts. The package expands the list of advanced technology items that may contribute to Russia's military and technological enhancement, or to the development of its defence and security sector. It adds components used for the development and production of drones, such as electric transformers, static converters and inductors found inter alia in drones, as well as aluminium capacitors, which have military applications, such as in missiles and drones and in communication systems for aircrafts and vessels.

The Indian company, as per one news report[15], has been identified as the Bengaluru based Si2 Microsystems, which is involved in semiconductor research. The same company had been added to the US's restricted 'Entities List' in November 2023 for allegedly supplying US origin integrated circuits to the Russian military, despite these transfers being banned after the commencement of the Ukraine conflict.

[13] https://www.ft.com/content/96dc71be-b795-47dc-a1cc-cccc7aa6a481
[14] https://neighbourhood-enlargement.ec.europa.eu/news/eu-adopts-13th-package-sanctions-against-russia-after-two-years-its-war-aggression-against-ukraine-2024-02-23_en
[15] https://www.thehindu.com/news/national/government-examining-indian-tech-company-in-eu-us-sanctions-list/article67889474.ece

Anti-subsidy probe launched by the EU against Chinese trainmaker

The European Union has launched a probe[16] into unfair state subsidisation in respect of Chinese trainmaker CRRC's unit Qingdao Sifang Locomotive, over its bid for a Euro 610 m Bulgarian public procurement contract to provide electric trains, along with maintenance and staff training. This is apparently the first case under new rules that came into effect last year designed to prevent foreign subsidies distorting the EU's single market. The Chinese bid, it has been reported, was 46.7% below the cost estimated by the Bulgarian Railways and 47.5% below the price offered by the nearest competitor. The contract covered maintenance over a 15-year period, apart from staff training. The EU internal market commissioner Thiery Breton said that "Ensuring that our EU single market is not distorted by foreign subsidies to the detriment of competitive firms that play fair is vital for our competitiveness and economic security".

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[16] https://www.ft.com/content/6dbc828f-03bc-4418-bbd0-4ff194d3f830

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