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# India In The World

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What is India's place in the world today? The world's fastest growing major economy and fifth largest, soon to be its most populous nation; a nuclear power and increasingly a pivot point in Asian and global diplomacy, India is becoming a major force in its own right. Now it must also navigate a world ever more delineated by competition between the United States and China.

Most nations will gravitate primarily toward either a Chinese-centric or US + friends ecosystem of trade, production and investment: that is the new global context. For foreign investors, this China vs US+ pathway will determine what their inbound capital is helping to build, and, in extreme cases, where capital can flow to and from freely in the future and perhaps where it cannot. For the countries themselves, this decision is plainly even more important. It's a critical choice, and one that India has already decisively made.



IndiaCapital®

India Capital Management Ltd., 4th Floor, 19 Bank Street, Cybercity, Ebene 72201, Mauritius  
Tel: +230 404-8800 | Email: [info@indiacapital.com](mailto:info@indiacapital.com)

# First, A Look Back

It would be easy to suspect otherwise. Through most of the cold war, India was a leader of the so-called Non-Aligned Movement, an avowedly socialist country seeking a middle course between NATO allies and the Warsaw Pact. More recently, it has walked a careful line on the war in Ukraine, refusing to endorse or aid Russia's invasion, but continuing to buy its oil. While those purchases remain much lower than those of Europe, skeptics have cited India's energy appetite and history of procuring Russian armaments as reasons it might shift closer to Moscow.

Fortunately, the carbon intensity of the Indian economy has fallen dramatically, and renewables now represent more than half of new power generation capacity. A decade ago, Russian weapons accounted for 70% of Indian defense procurement; today, a majority is sourced elsewhere. It's no longer clear which country is more dependent on the other and Indian leaders have become comfortable charting their own course, vocally when moved to do so, to the apparent surprise of the Russian state (Figure 1).

Figure 1: Not Drifting In Russia's Direction



Source: CNN

# A 21<sup>st</sup> Century Question

Diplomacy on Ukraine carries an echo of 20th century Great Power conflict, with similar antagonists and alignments. How will India navigate this century's emerging geopolitical fault lines? Many developing countries have proven responsive to China's mix of investment, trade and forceful diplomacy. India, not so much.

Figure 2: Pakistan's Proximity To China; India Not So Much



Source: The Guardian

Unlike most of its South Asian neighbors, India has declined to participate in the Belt and Road Initiative, China's grand infrastructure/energy/defense project that has deployed more than \$1 Trillion across 146 countries. It has no Chinese ports, naval bases or mining projects, and consequently no sovereign borrowing from China whatsoever (Figures 2 and 3).

### Figure 3: Overview Of Chinese Investments In India And Its Neighbors

	Pakistan	Sri Lanka	India
<b>China - % of bilateral debt</b>	61%	52%	0%
<b>China - % of inbound FDI (last 5Y)</b>	32%	30%	0.4%
<b>Leading 5G Network Providers</b>	Huawei, ZTE	Huawei, ZTE, Ericsson	Ericsson, Nokia (No Chinese participation)
<b>Major Chinese-Funded Infra Projects</b>	<ul style="list-style-type: none"> <li>China-Pakistan Economic Corridor: \$65B in projects along 1,900 mile corridor</li> <li>Gwadar port - largest deep sea port in the region</li> <li>Road and rail lines linking Gwadar port to Xinjiang</li> <li>10GW of energy projects</li> </ul>	<ul style="list-style-type: none"> <li>Hambantota port - Sri Lanka's second largest port (now under Chinese control due to default)</li> <li>Mattala Rajapaksa international airport</li> <li>17-km elevated highway in Colombo</li> <li>Lotus tower</li> </ul>	None

Source: RBI, State Bank of Pakistan, Central Bank of Sri Lanka, News Articles

The two countries do trade, but the 2,100-mile border has only three navigable land crossings. The largest of these, at Nathu La, was open four days per week until COVID concerns led operations to be suspended entirely, and recorded Chinese exports of approximately \$426,000 per year, the trade in yak tails being among the most significant.

Foreign direct investment, the lever with which China has built influence in many countries, is also marginal. Indian FDI from China has fallen by more than four fifths since 2015 and now represents just 0.1% of inbound investment (Figure 5).

That's not the result of market forces alone. FDI from China requires government permission (investment from the US and most other countries

do not) and in recent times approval has only been granted for one application of every five. An increasing number of sectors have been deemed too sensitive for Chinese investment at all, a policy that has lately been expanded to banning TikTok and 200 other apps with ties to China.

Consider 5G infrastructure, perhaps the best publicized arena of bare-knuckled struggle between China and its competitors. The Chinese manufacturer Huawei recently announced that it has secured orders of more than \$40 Billion to build 5G networks in 59 countries, Germany and South Korea among them. That figure includes zero orders from Indian carriers, who have gone so far as to insist that deliveries from non-Chinese suppliers cannot be sourced from Chinese factories.

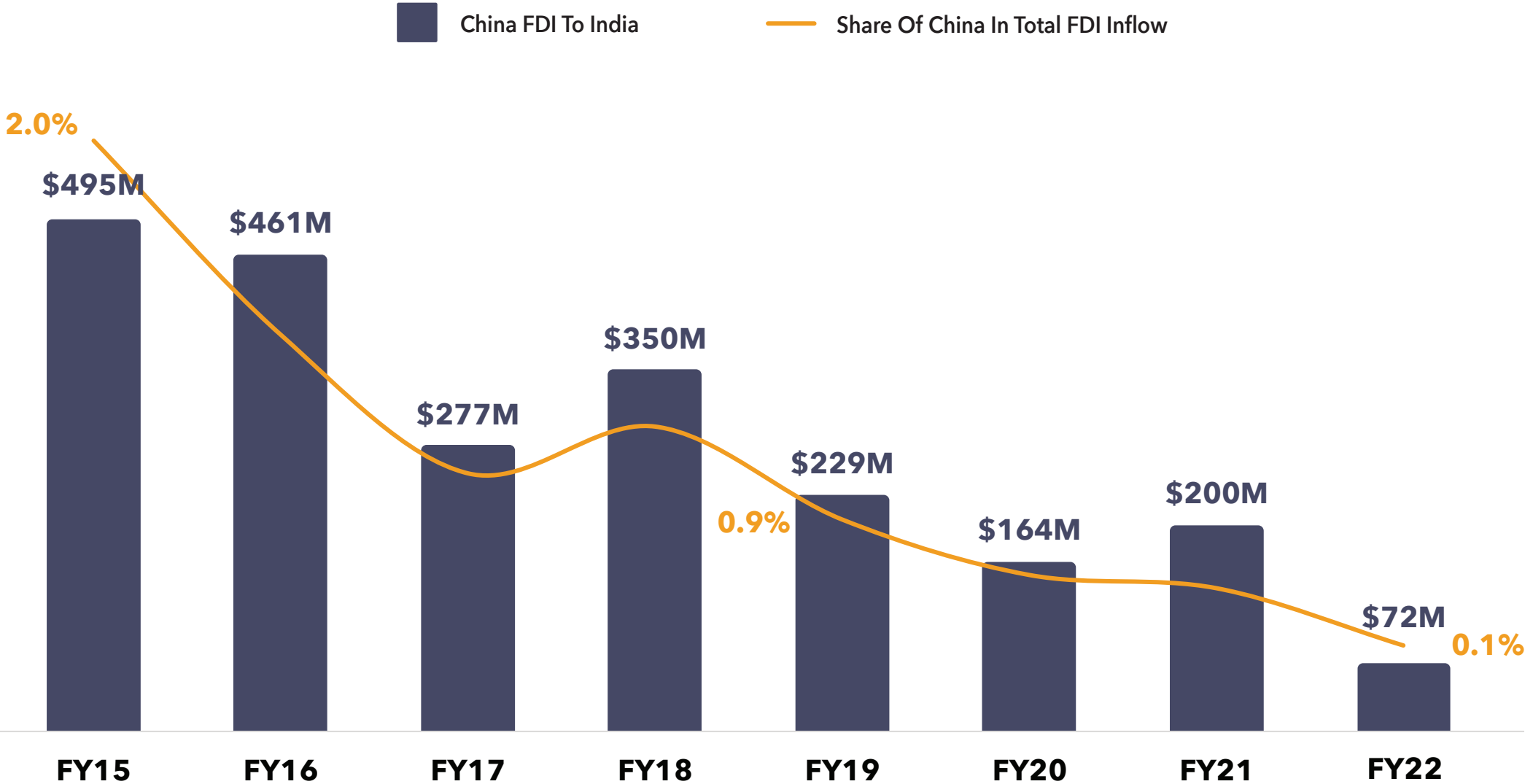
**Figure 4: The Nathu La Border Crossing; Traffic And Trade Remain A Bit Light**



Source: Hindustan Times



# Figure 5: Indian FDI From China



Note: H1 FY22 numbers annualized to estimate FY22 FDI from China

Source: Business Standard, RBI

# Hindi Chini Bhai Bhai

Government and corporate decisions in part reflect sentiment already widespread among the Indian public. Morning Consult, an international polling firm, recently found that Indians had a net 39% unfavorable view of China (Figure 6), correlating with about 70% of respondents holding negative views, assuming everyone had an opinion on the subject.

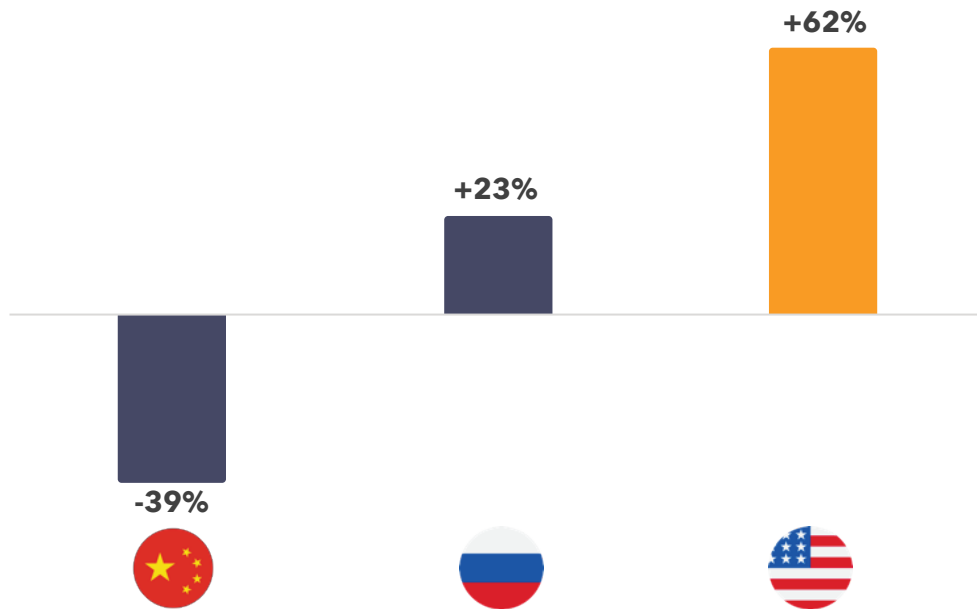
That sentiment reflects more than just national chauvinism –Indians have solidly positive views of their neighbor Bhutan, for instance– and owes something to history as well. Jawaharlal Nehru, India’s first Prime Minister, believed China was a natural ally, a hopeful philosophy he distilled to the

slogan “Hindi Chini bhai bhai” (‘Indians and Chinese are brothers’), and one that guided his expectations right until China invaded India in 1962. The resulting war was short and painful; the peace that followed, humiliating, if not especially costly in territory or treasure. China established the principle that it would dispute India’s frontiers based on a vague historical record and the precedent that it could do so through force of arms. While neither country has evinced much interest in further conflict, border tensions have flared with some frequency, events which have attracted little attention in the West but are widely followed in India. Little wonder that the public, political class, defense establishment and business leadership have no appetite for embedding themselves in Chinese supply chains or geopolitical strategy.

**Figure 6: Indian Public Opinion**

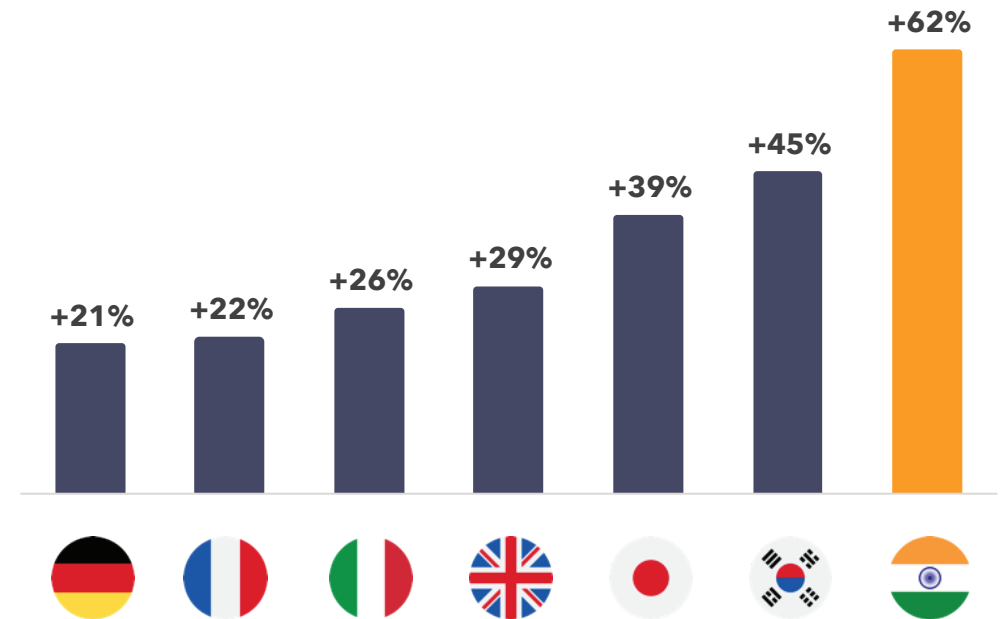
## Indians’ Perception Of Selected Countries

(Net Favorability Score, April '22)



## How The US Is Perceived By Various Countries

(Net Favorability Score, April '22)



Note: Net favorability rate refers to the share of adults that have favorable view towards a country minus the share with unfavorable view

Source: Morning Consult



# Permanent Interests

The same public opinion survey that showed widespread skepticism of China suggested that some 80% of Indians have a favorable view of the US. That is the most positive view of the United States of any country surveyed and similarly the US is the foreign country about which Indians have the most positive opinion. That resonates with the longstanding experience of those of us who have lived in India as foreigners, where views were overwhelmingly warm toward even those American leaders who the rest of the world found an acquired taste: Presidents Clinton, Bush, Obama and Trump all drew rapturous welcomes on their visits and there's no reason to expect President Biden will fare any differently.

Recent decades have drawn the world's oldest representative democracy and its largest ever closer. But is mutual affection enough? Lord Palmerston famously opined that Britain, and presumably all countries, had "no eternal allies", only "perpetual interests. . . and those interests it is our duty to follow". Such a world view does little to produce warm feelings in prospective allies, but in any case India and the United States share critical interests as well as common democratic values.

Reviewing the measures of economic interdependence against which we earlier assessed China, the United States is India's largest trading partner and a leading source of foreign direct investment, which last year alone was more than 5x that of aggregate flows from China since 2015, a ratio that is likely to grow even more skewed as American companies build supply chains independent of China. India has relatively little sovereign external debt, but the majority of it is US dollar denominated.

From an Indian standpoint, services exports to the United States, IT foremost among them, finance its continued appetite for energy to fuel growth, while inbound investment fuels the development and job creation to which its leaders and people aspire. The constituency for India in the US includes companies with increasing ties to Indian suppliers and partners,

a thriving Indian American community and of course investors seeking to connect surplus savings to India's surplus growth, opportunity and productive uses for capital.

Added to that increasingly dense web of connections is a shared wariness of China. More than just common values then, India and the United States are linked by public sentiment, economic interests and a shared adversary.

## Two Countries, Two Systems

In reality, we believe Indian leaders regard China less as an adversary than a competitor, and most of all as a different flavor of national project entirely. There is little antipathy, but neither is there much scope for partnership between two countries on fundamentally different paths, traveling in wholly different directions.

A lot of ink has been spilled on where each nation is headed, but as it happens the leaders of both laid out their visions recently in public forums. President Xi's speech at the 20th Chinese Communist Party Congress emphasized the need to "build a high-level socialist market economic system. . . consolidate and develop the public ownership system" (Figure 7). Prime Minister Modi, speaking at India's 75th Independence Day, also had his country's needs in mind: to "turn India into a developed country in next 25 years. . . I call upon the private sector to come forward."

Both leaders' addresses are consistent with facts on the ground. China's increasing state intervention in the economy has been well documented. Less well covered has been the Indian government's easing control and ownership of the corporate sector. Government shareholding of leading companies is now less than a quarter of that in China (Figure 8).



## Figure 7: Different Agendas



***"We must build a high-level socialist market economic system...consolidate and develop the public ownership system."***

-Xi Jinping, 20th Party Congress, October 16th, 2022



***"We must turn India into a developed country in next 25 years... I call upon the private sector to come forward...we have to take our products to the world."***

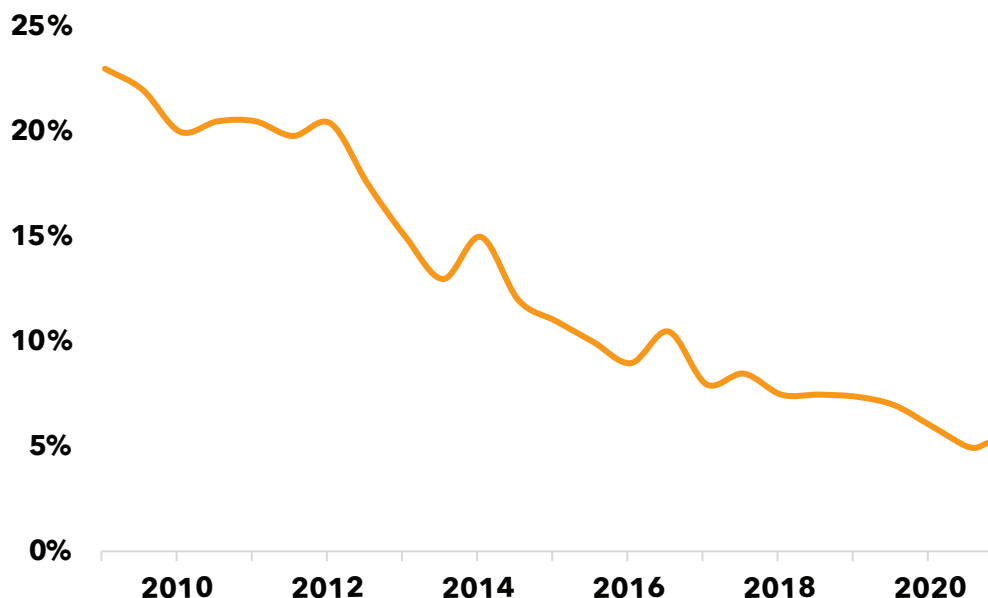
-Narendra Modi, 75th Indian Independence Day, August 15th, 2022

Source: Reuters, Times Of India

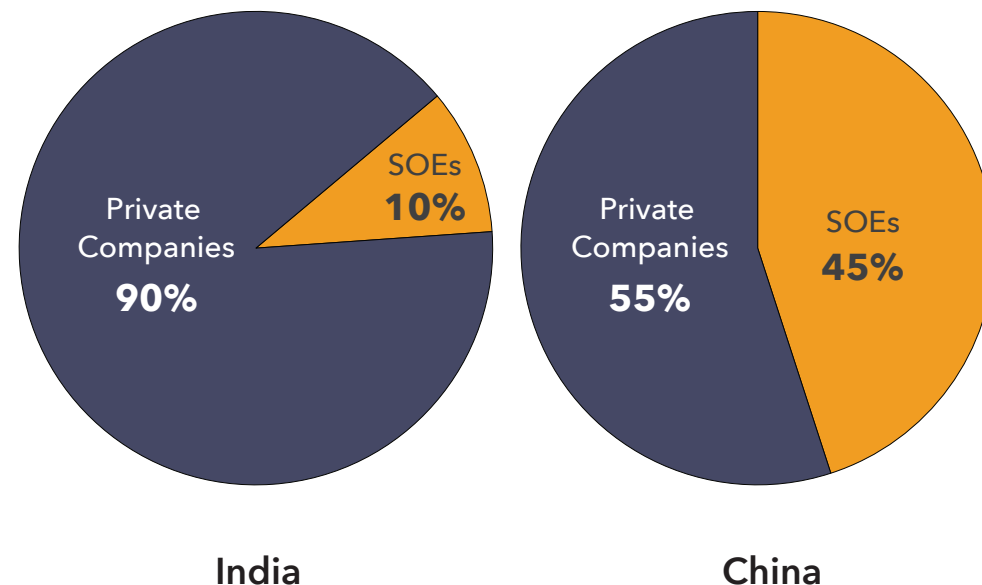


## Figure 8: Different Outcomes

**India - Share Of Government Ownership**  
(Total Listed Universe)



**Market Cap Split - SOE Vs. Private**  
(Top 50 Companies)



Source: Business Standard, HDFC Securities, CLSA

The trend of diminishing state ownership is not new, but it has accelerated under the current administration, which has shed stakes in the national airline and the country's largest insurance company, among others, and privatized more state-owned assets in value terms than all previous governments combined.

That's of a piece with policy that has become more predictable and rule based. Labor law has been simplified, the bankruptcy code brought more in line with global norms and corporate income tax rates cut. Arguably of greater importance, legislation was enacted to simplify the capital gains tax obligation of foreign companies buying and selling Indian assets. That

brought to an end the historical practice of pursuing tax claims on long-since-closed transactions, which foreign companies had considered one of the biggest headaches of operating in India. Upon passage, the government refunded \$1 Billion to Britain's Cairn Energy for a tax payment which it determined was no longer due per the terms of the new code.

For investors, a key test of policy stability is the free flow of capital, and on that we have direct experience. Operating in India for more than 28 years, including some volatile ones, we have never faced a legal hitch exiting an investment or repatriating the proceeds.

# The Rise of Friendshoring

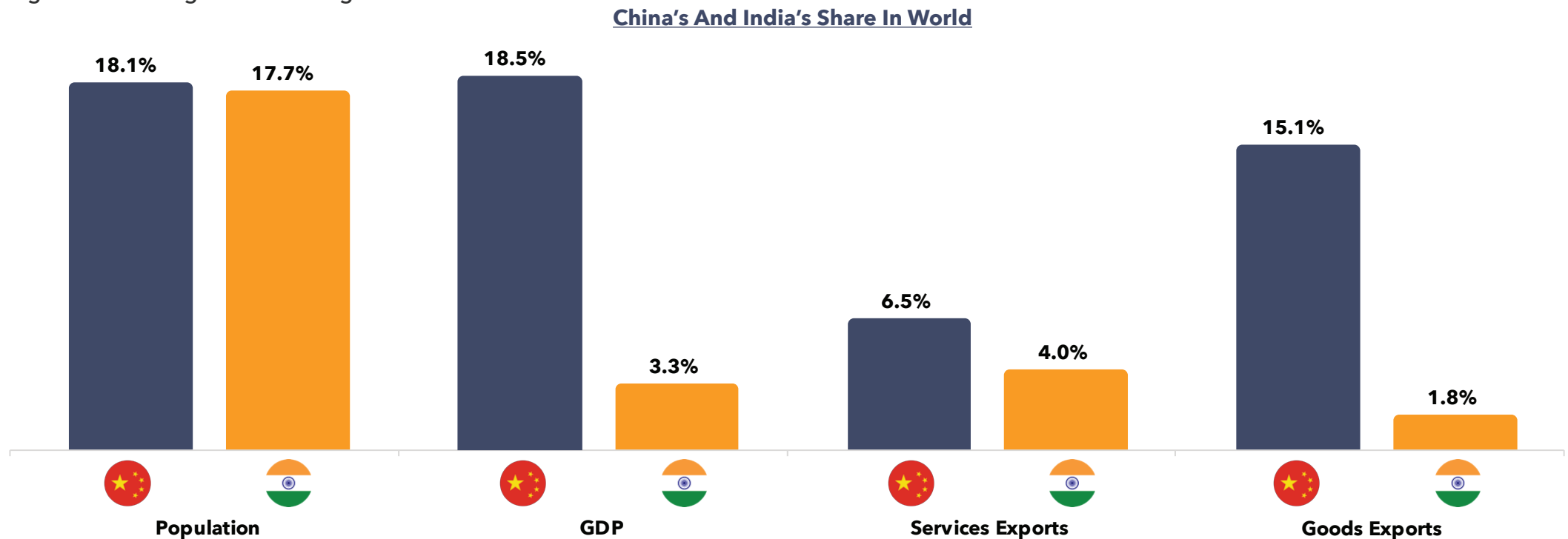
When US Treasury Secretary Janet Yellen visited Delhi last month, she took every opportunity to talk up “friendshoring”, the relocation of supply chains to geographies with lower risk of disruption from political or security disputes. While the phrase was coined only recently, India has some experience in the area, with Western IT and pharmaceutical companies overwhelmingly choosing to situate key functions there based on respect for their intellectual property and effective legal recourse if it ever were to be misappropriated.

In other areas, India has historically punched below its weight (Figure 9). China’s dominance in the manufacture of most products was self-reinforcing and left India with a modest share of global goods exports.

That has begun to change as global companies reconsider their sourcing and production decisions. In 2014, 92% of cell phones sold in India were imported and domestic production was limited to two factories. Today, there are 200 facilities producing phones in India and 97% of supply is produced domestically, including top of the line Samsung and Apple handsets.

Taiwan’s Foxconn, which set up Indian assembly for Apple, was no doubt attracted by India’s vast workforce and relatively low labor costs (Figure 10), but it must have also valued the ability to invest and grow in a country with which Taiwan will not conceivably end up at war.








Figure 9: Punching Below Its Weight



Source: Business Standard, Hindustan Times

For Indian manufacturers, the share of global electronics production has increased from 1.3% to 3.5%, a large jump from a low base that leaves a lot of room to grow further over time. For Indian workers, the benefits have come sooner. Foxconn and its joint venture partner are believed to pay line employees about 50% more than prevailing manufacturing wages. That's still a fraction of costs in China but stands to exert an upward pull on incomes for an increasingly broad swath of the Indian labor force, and with it on the country's GDP per capita.

**Figure 10: Just One Part Of The Story**

Countries	Working Age Population	Manufacturing Wage (\$/Hour)
 China	1,011M	\$7.1
 Malaysia	23M	\$4.7
 Thailand	49M	\$2.6
 Vietnam	67M	\$1.6
 Philippines	72M	\$1.5
 Indonesia	188M	\$1.0
 <b>India</b>	<b>940M</b>	<b>\$0.8</b>

Source: Morgan Stanley

Among our investments, banks in which we're invested have helped finance many of India's new manufacturing and logistics facilities. A leading producer of headlights and pneumatic cables in our portfolio has more than doubled its share of the export market. And a leading auto manufacturer grew exports by 148% last year, shipping vehicles to more than 100 countries.

Deciding to chart a course independent of its largest neighbor has certain costs for India. Its tech sector has in recent years mostly had to do without the largesse of investments from Alibaba, Tencent and others. Thousands of its soldiers must rotate through remote Himalayan outposts to continuously substantiate the fact that they are on Indian territory. But the decision has been made, deliberately, decisively and at this point unalterably. And as India integrates more closely with America and its friends with respect to trade, investment and supply chains, that has implications and even benefits, most of all for its people, and for its companies and investors, too.