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India as a New Global Leader

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First published in 2005 by
The Foreign Policy Centre
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London
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UNITED KINGDOM

Email: info@fpc.org.uk

ISBN: 1 903558 52 2

Cover by R&D&Co, experts in branding and identity
www.r-d-co.com

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Acknowledgements

The Foreign Policy Centre would like to thank Phoebe Griffith and Martina Rydman for their commissioning work and Kalvin Bahia for editing the collection.

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About the Foreign Policy Centre

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- Partnerships with the private sector to deliver public goods
- Support for progressive policy through effective public diplomacy
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About the India and Globalisation Programme

This publication is the first in the Foreign Policy Centre's 'India and Globalisation' programme, launched on 3 February 2005 by P. Chidambaram, the Minster of Finance for the Indian government. The programme will be built around research, publications, forums and public discussions. It will aim to engage a broader group of actors with new thinking on the social and economic consequences of globalisation on India and the impact of India's growing influence on the future of globalisation. It will adopt a pan-European focus in exploring the way in which India fits into a changing world order and how the new 'rising powers', notably India and China, can be key actors in shaping it.

The programme will take Indian perspectives as its departure point, focusing on three principal areas:

- how India's government, interest groups and diverse communities see their values and how they project these values to the world;
- outside attempts to understand and engage with the paramount values of the Indian government, leading interest groups, diasporas, civil society and diverse communities; and
- the role of these diverse, often competing, Indian actors in globalisation and in shaping global trends.

The Foreign Policy Centre is working with a number of leading Indian think tanks and other partners in various fields, including: Indian investors in Europe; UK investors in India; prominent journalists, academics and opinion formers; Indian diaspora organisations in Europe, especially the UK; and NGOs, think tanks and research organisations.

Message from H.E. Kamalesh Sharma
High Commissioner for India to the United Kingdom

> *"I am convinced that the 21st Century will be an Indian Century. The world will once again look at us with regard and respect, not just for the economic progress we make but for the democratic values we cherish and uphold and the principles of pluralism and inclusiveness we have come to represent which is India's heritage."*[1]
>
> Dr. Manmohan Singh, January 7, 2005.

There can be no more appropriate caption to this publication of four quality reflections on the phenomenon of India rapidly modernising itself than the above citation made by Prime Minister Dr. Manmohan Singh earlier in the year. The quiet confidence, indeed certitude, informing the statement, expresses the mood of the nation and underscores the timeliness of the release of the publication and the launch of the India and Globalisation Programme of the Foreign Policy Centre through the Indian Finance Minister, Mr. P. Chidambaram. There is a great transformation underway in India which has taken the country's potential to a level not foreseen even a decade ago. It is clear at the onset of the new century that India will be a significant presence within it, be it as a vast inclusive and democratic society or as a burgeoning economy with particular aptitude in the knowledge-based economy and integral to the evolving global services supply chain. Indians are rediscovering self-belief and confidence in meeting the challenges posed by rapid national economic expansion as well as the competitive demands of a globalising world. The contribution India will make to global society in the decades to come is prefigured by the upsurge in the national mood which is marked by ambition, optimism and the spirit to accept the challenge of innovation and accomplishment. We are strengthening or developing capacities in diverse areas. In this

[1] Dr. Manmohan Singh, Prime Minister of India, addressing the Indian diaspora at the Pravasi Bharatiya Divas, Mumbai, January 7, 2005.

rediscovery of aptitude, one sees not only sound investments and policies of a large developing country, but the strength of ancient civilisational roots, revealing themselves in a modernising state only fifty years old. Hence, the belief of many that India will make its presence felt in this century.

However, a titanic struggle lies ahead for the country, vast sections of which are moving at different speeds. To cite only the most obvious challenges is the continuing one of still extensive though declining poverty, advancement in the basic social agenda of nutrition, health and literacy, job creation, position of women, lifting the agricultural potential, massive infrastructural upgradation, social equity and making advances in growth while preserving and strengthening social inclusiveness and participative politics. But nothing about India is small: neither the road ahead nor the path already covered.

The launch of the India and Globalisation Programme by the Foreign Policy Centre is therefore well timed. Observers are now alive to the emerging India story and would welcome an active internet site, both in terms of useful material posted on it as to browse or exchange opinions and perspectives.

The four quality contributions in the current publication are an excellent launching pad in both the substance they provide and the questions they raise. In 'India as a Bridging Power' Sunil Khilnani analyses what role India could play in the emerging uncertain global order. According to him, although the conventional indices of power may not be India's strength, it could still play a unique "bridging role" between the various competing forces, based on its accumulated strengths.

Parag Khanna delves into the subject of the role 'India's Diasporic Community' could play in enhancing regard and respect for their country of origin. Globalisation and technology have helped forge close links within the community and with India. Their role as potential "diplomatic force multipliers" is a new phenomenon, one that India watches with interest. It is pertinent that the Prime Minister made his statement at a conference to felicitate the Indian diaspora.

India recognises the value of the important human asset that the twenty million overseas Indians represent.

The potential of India's economic progress influencing its standing in the world rests on the pace of growth. Prasenjit K. Basu analyses the potential of India's economic progress in the coming decades. He is optimistic and has reasons to be so with faith firmly placed in the "stealth miracle", fuelled by achievements in education, demographic dividend, a sound financial system, growing services exports and a more sustainable, buoyant manufacturing sector. India has targeted a long term GDP growth rate of 8 percent and is confident that it has the will and the means to achieve this.

Energy security is a crucial issue for all countries today, even more so for India at its current stage of development. Lack of energy resources could jeopardise not only economic progress but also security and strategic interests. India is increasingly playing a more active role to secure its future needs. This has implications both for domestic and foreign policy. Professor Brahma Chellaney analyses the options available to India and the imperative need to hone its energy diplomacy, more so in the immediate neighbourhood, to make some of these options viable.

India's current economic dynamism has been acknowledged as one of the factors of global growth even as recession has affected large parts of the world. At the same time, India has embraced the logic of globalisation and accepted its challenges and opportunities with remarkable confidence. As one-sixth of humanity in India becomes more prosperous and integrated with the rest of the world, it will increasingly condition the global order in the 21st century.

The new programme of research, forums and public discussions on India and globalisation launched by the Foreign Policy Centre is well served by this exceptional inaugural publication. The programme will attract and engage a broad group of participants with fresh thinking on the role of India in the globalising world and its consequences. I am confident that the programme will serve as a useful and required forum for analysis, research and discussions on issues of interest, whether to diplomats, government organisations, journalists, academics, Indian diaspora, investors, NGOs and other research organisations or think tanks. It is sure to attract adherents and grow in scope.

26 January 2005

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India as a Bridging Power

By Sunil Khilnani

A recurring theme of Indian political and intellectual argument in the twentieth century was the desire to forge for India a place on the global stage. Intellectuals like Tagore, Gandhi and Nehru all consciously refused parochial perspectives: while acknowledging India's weakness when judged by the conventional indices of power, they nonetheless sought to address a global audience, and were determined that India acquire international autonomy and responsibilities. After independence in 1947, Nehru - through the pursuit of what he termed 'intelligent self-interest' - managed to transform this almost ludicrously optimistic ambition into a relatively effective policy of state: in the polarised and unpropitious circumstances of the Cold War, he established an international voice for his country, based not on 'hard' power but rather on a dextrous combination of moral legitimacy and realpolitik.

The Indian ambition of a global role has gained renewed force in recent years, driven by the deep internal changes which, more than forty years after Nehru, are remaking the country. India is experiencing a 'silent' social revolution: democratic politics and now economic growth are producing new elites, with new aspirations and energies, who seek a new status for India in the world. An inflationary rhetoric has recently crept into assessments of India's future prospects - by 2020, members of the former BJP-led government boasted, India would be a 'superpower'. Yet today, as in earlier decades, India's international aspirations exceed its actual capacities. In fact today, more than in earlier decades, India's options and room for manoeuvre are greatly constricted in what is, for the near future, a highly unsettled global order - dominated by one 'hyperpower'. Therefore, when thinking about India's future, a measure of sobriety is in order if India's leaders are to recognise and realise the more modest possibilities that do exist.

Historically, India has shown great resourcefulness in using its frugal reservoirs of 'hard' power to maximum advantage: and it will need through wit and intelligence to renew and enrich this capacity. The classical markers of military and economic power will not be available to India in sufficient quantities to enable it to make an impact on the international sphere. If India is to achieve an international role and influence, it will have to find ways of exploiting the international system as it exists. It will certainly need to maintain higher rates of economic growth and to base such growth on developing inter-dependencies with the advanced economies – a strategy which China has successfully pursued. It will also need to develop a national vision based on values and interests: one that can be realised through specific policies and institutions. Above all, it will need to marshal its limited resources to achieve ends that are clear, attainable and not self-frustrating.

India will have to pursue its international ambitions and interests in a world order that has become particularly fraught. State collapse and the rise of non-state actors have created international turbulence, which disturbs even the most militarily secure states. The existing order is being transformed from three further directions. First, the solidarities that have held the 'West' together over the past half-century are loosening. The end of the Cold War was supposed to mark the triumph of the West; in fact it has prompted, in David Calleo's phrase, 'a new age of geopolitical anxiety'. Europe, trying to compose a sense of itself in a new form, is also trying to figure out the terms of its relationship to its closest ally, the US - and this, for some time, will remain a nervous relationship. Second, the effects of the dissolution and failure of Arab nationalism, and its replacement by varieties of Islamic extremism, are being felt across Europe, the US, Asia and Africa. Third, and perhaps most significant of all in the longer term, is the rise of Asia: China in the vanguard, and India poised to find its place in this procession.

The result is a general uncertainty over the organising categories of the modern state system and over what the viable and durable currency of power will be. The rules of engagement governing the two primary institutions of the modern world - the state and the market - are in question as we see a clash, on the one hand, between judgements about the use of force and the norms that can govern this and, on the other, about the role of markets and scope of their regulation. Debates today include whether we are moving from an era of multilateral institutions to a classical balance of power system; whether multi-polarity has been replaced by uni-polarity; and whether globalisation is imposing uniformity upon states and homogeneity upon cultures. The new international settlement that will emerge out of these practical disputes remains unclear.

In these circumstances, every state with an international presence is warily engaged in a strategic competition with the others, each trying to edge forward. All are playing hedging strategies - even as they assert one thing, they are searching out possibilities in other directions. At this moment when international power is itself being redefined, it behoves India's elites to develop a more sophisticated understanding of such power - and an instinct for acquiring it.

Amidst this global churning, the one firm axiom for at least the next decade is that the US will remain the most decisive actor in the international field - whether it be in matters concerning the use of force, the regulation of global markets or the operation of international institutions. The US, and its own protected definitions of its interests in these areas, will count for more than other states.

The ultimate test of multi-polarity (if we are really referring to an effective system, rather than gesturing towards a desirable schema) is whether such a system can - collectively, or through any of its individual members - stop the actions of the most powerful when it comes to the use of force, the pursuit of economic interests or the operations of the international system. The evidence is clear that it has not been possible to stop the US if it decides to use force - and this fact is not likely to markedly change over the next decade. That is not to say that such superiority can make the US invincible or even invulnerable; or that it can claim legitimacy for its actions in these fields. Indeed, it is perfectly easy to show how the repeated use of force has depleted US legitimacy. One might say that as President Bush continues to 'spend political capital' (as he described his ambition for his second term), he will leave the US with a legitimacy deficit as large as its economic one.

Going further, one could also say that not merely has the US run down its soft power but even when it comes to the use of hard power, it faces limits – the ill-fated adventure in Iraq being a case in point. Yet one lesson of Iraq for the rest of the world is that the US can and will use force when it chooses to, regardless of what any other state or system of states may think - and that even when it gets it massively wrong, it can still absorb such mistakes without experiencing severe domestic disruption. It is hard to imagine any other power being able to survive such a major policy error without significant internal costs.

If internationally there is no state or group of states that can reliably restrict the scope of action of the US, within the US too, the internal system of political checks and balances has weakened. The second-term Bush presidency, with a popular mandate behind it, now has control over all the branches of the American state – executive, legislative, and judicial. One feature of this new administration is particularly relevant for the international system. In the first-term Bush administration, there was to some extent a division between what one might call universalists, those who held the view that the US should treat all other states in like manner, based on principles (for example, non-proliferation rules), and particularists – those who held that the US should operate a *quid pro* quo system, rewarding friends and punishing opponents, regardless of the principles at stake. That debate has now been won by the particularists. The second-term Bush administration will work with countries bi-laterally rather than through multi-lateral institutions and it will only accept those multi-lateral institutions in which it can preserve a decisive voice (for example East Asian security agreements).

The global predominance of the US is awkward news for India, given India's historical commitment to non-alignment and the idea of a multi-polar world. Yet India might also - indeed, will need to - discover some advantages to this arrangement. It has shown a desire to engage constructively with the US, and relations between the two democracies have vastly improved over the past five years. India will need to continue to craft its relationship with the US - and to try to build this on economic interdependencies. Apart from anything else, it is this relationship with the US that will be India's point of leverage in all its other relationships - whether it be Europe, China, or Russia, they will take India seriously to the extent that the US does.

India does possess room for manoeuvre within this context. It can, for instance, leverage for its own purposes the higher visibility it has gained in US eyes. The Bush administration is interested in India's strategic potential for US interests: as it stated in the 'National Security Strategy' (2002), 'today we start with a view of India as a growing world power with which we have common strategic interests'. This is perhaps the most explicit statement of an American perception of India as a global player. Although the US initially condemned India's decision to become a nuclear state in 1998, it has come to accept this in practice (if not yet *de jure*) and even to see certain advantages in a nuclear India. The fact is that the US has shifted the focus of its attention away from Europe and the Soviet Union to the volatile crescent that stretches from Palestine to Indonesia - and to the presence that looms over this geographical curve, China. From a US perspective, India, positioned at the heart of this crescent, offers a potential anchor against extremism, as well as a curb on China. In this respect, India's military power does take on significance. India's ability to develop an effective strategy of nuclear deterrence, its ability to practise, whenever necessary, 'coercive diplomacy', as it did in 2002, and above all its willingness and ability to export security - within its own region, but also beyond (for example, in the Indian Ocean sea lanes) - will win it greater international standing.

Even more importantly, in terms of giving India space for manoeuvre, will be how it manages its economic growth. A latecomer to the great Asian economic banquet, India now seems to have entered a phase of economic expansion. Over the past two decades, growth in annual national income has averaged almost 6 percent, and the 1990s saw the fastest decade of growth in India's recorded history. As recent experience has shown, the world economy can experience huge changes over 30 or 40 years: poor, late-developing countries have the potential to catch up rapidly.

The scale of India's economic under-performance is vast. But the long-term demographic balance is in India's favour and the country's large, youthful and poor labour pool is only beginning to be tapped by India's class of talented private entrepreneurs. Many indigenous start-ups are becoming global success stories and Indian business has done unexpectedly well in the more competitive atmosphere since the 1990s - largely the result of a more efficient use of resources, men and machines (the role of productivity in driving Indian growth over the past two decades is close to the highest ratios in the world). The main beneficiaries of this growth have been an emerging middle class. Its precise size is elusive, but according to a generous estimate, there are around 250 million Indians with an annual per capita income of $2000 or above (in a country where the average is around $500). Many of this class have links with the far-flung and successful Indian diaspora (in the US, Indians as a community are the highest earners, and in the UK they represent a success story, with high cultural visibility). The resources of this diaspora - financial, but even more importantly intellectual - are just beginning to seep back into the Indian economy. Yet it remains true that much of India's current growth has been in services and has produced relatively few jobs. To be 'Bangalored' - meaning to lose one's job - has entered the American lexicon, but in fact, and especially relative to China, India has so far only taken a tiny number of jobs from the US

If India is to maximise its international position, it should begin to operate with a more nuanced conception of power. If one limits the understanding of power merely to a narrow realist dimension, then it is hard to see how India can rival the prowess of the world's great states in the foreseeable future. It will remain in a middle group, well behind the first rank of present great powers, if one measures power purely in economic or military terms. However, 'world power' today is a complicated, continuous strategic project, not a once and for all acquisition. Some of its aspects are tangible enough; but others, no less important, emphatically are not.

Beyond GDP and growth rates, we need to look at a state's ability to access resources (through effective taxation) and its ability to use these efficiently, by for example, converting economic wealth into military power. But equating power simply with military power is equally misleading; one need only recall the studies which show that militarily stronger states emerge victorious less often than their weaker opponents. Resources and capabilities do not translate readily into positive outcomes: and the mere possession of economic and military force can be a recipe for catastrophe - think of the two World Wars and the fate of Japan and Germany.

In an interconnected world, the old billiard ball metaphor used to model power - where the bigger, faster-moving ball impels the smaller, static ones - no longer applies. The elements of power are now more diffusely spread, shared and even entangled. Its character changes constantly: some resources of power can be acquired cheaply and configured with novel effect - giving fresh opportunities to the less powerful. Thus, small, relatively powerless states (or non-state actors) can damage much more powerful states. Even the US finds itself in this paradoxical position: at once invincible, and yet vulnerable.

That vulnerability lies not only in the direction of terrorist attack. Unlike Britain at its imperial zenith, America needs permanently to import goods, services, capital and people to sustain its own momentum and fund its insatiable consumption. This makes it heavily dependent on the continuing faith and trust that the rest of the world places in the future of the American economy. It is worth stressing that such dependency is the fate of all powerful states with prosperous economies - it applies to China and will increasingly apply to India too, as its economy develops. No state today can be like a billiard ball, self-contained in its power. Modern power is transactional, based on interdependencies. Such interdependencies, while they may irritate classical notions of sovereignty, yield the prospect of new types of power.

India seeks a more decisive role in a world where marked asymmetries of power exist and where interests conflict. These asymmetries will exist and even sharpen in the twenty-first century, taking on new and complex forms. Take one example: in the twentieth century, poor states were usually weak and their demands could be brushed aside. But in the coming decades, certain states with very large poor populations will almost certainly become significant world powers. To differing degrees, both China and India, for instance, will be relatively rich states, but will preside over relatively poor populations - they will have high national wealth but low per capita income. The result will be internal tensions for each, in the face of their own people, and for the international order. It will produce struggles over the world economy and the environment, over control of high technology and of finance.

In the face of these persisting conflicts of interest, what common language of dialogue and persuasion can there be between the contending powers? This is a crucial question both for those who currently dominate the international order and for those who aspire to have an active role in it. They need to find a way of structuring conflicts of interests that does not break apart the international order. Breakdown can come from either end, from the powerless as much as the powerful. We have seen what an Osama or a Saddam can do.

As a matter of policy, India has long staked its international power heavily on multilateral institutions - variously, the Commonwealth, the Non-Aligned Movement, the UN and, in some respects, the WTO. It has often worked these effectively; but given the reality that in many matters of vital concern to India it will be US attitudes that determine the scope and efficacy of multilateral institutions, India will need to explore other avenues and methods to push its interests.

Historically, India has tended to position itself somewhere between the powerful and the powerless, the rich and the poor - and between contending ideological groups. Its primary mode of exercising autonomy in the international domain has been negative: refusing to participate in alignments, treaties and markets which it viewed as skewed in favour of the more powerful. This was perhaps an extension of the Gandhian strategy of boycotts and fasts; as Nehru put it in the mid-1950s: ‘Asian strength exists in the negative sense of resisting’.

Now, India faces choices as it seeks to devise a more positive conception, and exercise, of power. In the coming years India can choose to define itself as a ***middling*** power: it can follow the direction of a state like Israel. But if India wishes to have an impact on the international system, it will need to be able to reconfigure the attributes of hard and soft power into a new conception of power - for which we need a third term: call it intermediary, medium, or ***bridging*** power - a universal protocol that can bridge across the varieties of hard and soft power in today's world. There are no examples of such a role: but, by drawing on its experience, India could invent such a role for itself. After all, part of what it takes to be a great power is the capacity not just to conform to existing definitions but to re-define – as Gandhi did for another age - what power and greatness are.

As a bridging power, India can have a unique role: poised between the rich states and the poor, and between two countries currently sizing each other up: the most powerful state in the world, the US, and the most populous, China. There is considerable power to be gained from such a bridging role in the global order: it assures both independence and indispensability. All of the existing world powers have, to differing degrees, imperial pasts: among the contenders for world power, only India possesses a special insight into the complex nature of power that having been colonised gives. Encompassing elements of both hard and soft, India could become a power that provides the essential connective tissue, the connectivity, that a fragmenting world requires.

India will certainly need to build its economic wealth and military security. But if it seeks to be a bridging world power, its ability to identify the weak points in the global order, and in India's counterparts, will be crucial. The political skills that are required to build coalitions and persuade those with different or opposing interests - these intangible forms of power - will be a vital resource in the international order in coming decades. So too will the ability, wherever necessary, to work bi-laterally to further India's interests. In this respect, India will need to be prepared to enlarge its repertoire of techniques - its leadership will need to be able to judge, according to circumstances, when to use its economic resources, 'coercive diplomacy', moral legitimacy, or capacity for dialogue, to serve its interests.

Apart from the US, China will be the other major relationship which India will need to develop in the coming years. The relationship between these two Asian states will of course be overshadowed by the presence of that other great Asian power, the US. Although the US is currently exercised by the 'war on terrorism', the long term shift in its foreign policy is from a focus on Europe to one on Asia - which means that Asia can expect to be even more exposed to the vagaries of the US's judgements about its own interests in the region and globally.

Some analysts, particularly those in the US, speak of a triangular relationship emerging between the US, China and India; and some elements of the Bush administration - particularly those in the Pentagon - would like to see India becoming a buffer for the US against China. But the fact is that none of the three have sufficient interest or incentive to consolidate this triangle in one direction or another; each benefits by a certain distance and freedom of manoeuvre. This triangle is not best understood in terms of traditional power politics. In 1998, the US and China were united in chastising India for nuclear tests; currently, India and the US are together in worrying about China's role in nuclear proliferation to Pakistan and North Korea; and India and China are united together against the US on some WTO issues. This pattern, of coming together according to different and shifting interests and not to form stable and permanent alliances, is likely to persist. This suits India, since it is certainly not in its interest to be drafted into US contingency plans against China.

Hitherto, Asia has been quite sharply segmented into three sub-regions: East Asia, South East Asia, and South Asia, each based upon certain historical and cultural connections. But, with all Asian countries (with the exception of North Korea) now abandoning the autarkic route to development, inter-regional trade and investment flows are rising. East Asia and South East Asia are already major trading partners; South Asia lags behind, though India is actively pushing efforts to develop such links with the other regions of Asia. Regional institutions, such as the Asian Development Bank (India was founding member, China joined in 1986), APEC (India is not yet member) and ASEAN (India is a partner, though not yet member), are gaining new relevance and new ones will need to be invented.

China has been reluctant to recognise India as an 'Asian' country and has resisted Indian efforts to join such organisations. But China will need to re-think this position and become more open to India entering and playing a larger role in Asia. Identities such as 'Asia' or 'Europe' are not fixed or defined: their content is adjustable and expandable. Definitions of Europe have expanded and changed dramatically over the past 60 years as states have shed and donned the identity of being 'European'. The Asian states will also need to think imaginatively in order to develop mutually beneficial relations.

In some respects the Chinese look to India for lessons - for example, they admire how Indians have learned to operate multilateral institutions to India's benefit. But India has much to learn from China too, especially in crafting its relationship with the US. Even when faced by direct US aggression, the Chinese have managed to deflect this and pursue their own interests without alienating the US - in fact continuing to deepen economic interdependence with the US. India has now an opportunity to do something similar: to develop a relationship with the US that has a mutually beneficial economic foundation.

The US has itself offered bridgeheads in this direction and India must exploit and enlarge these. The Business Process Outsourcing (BPO) backlash seen in the 2004 US election campaign emphatically failed to gather steam and Bush II, backed by corporate interests, has cooled it further. Today, US corporations see themselves as free to go wherever they can to find the cheapest services at the quality levels they seek. While many countries are now vying to be the US's so called 'back office', India is, for the moment, one of the two or three great destinations. By seizing the political opportunity this presents to India and by taking the initiative to escalate economic interdependencies, India could devise a longer-term buffer against the more wayward aspects of US policy and administrations. Again, as the example of China bears out, engaging more deeply with the US does not mean falling to a supine stance. It means picking fights more selectively, husbanding resources and making pre-emptive economic moves.

However, India's place in the world will ultimately depend on something more than economic growth: its ability to nurture internal diversity and pluralism through the structures of liberal constitutional democracy. From the first, economics, stems power; from the second stems legitimacy. It is somewhat ironic that in India, the recent rise in economic and military strength has coincided with a decline in the one dimension where historically it enjoyed considerable strength: moral and political legitimacy. Such legitimacy is certainly a good in itself; but it also has instrumental value, and is part of the armoury needed to conduct realpolitik. Today we live in a world where what has been called the 'battle of ideas', as well as the clash of images, is a crucial terrain of action. In the middle decades of the twentieth century, India projected a clear image of what it stood for: while freely critical of the West, it firmly embraced shared enlightenment and modernist principles. In recent years, India has projected two quite opposing images - to put it in shorthand, 'Bangalore' and 'Gujarat': a choice between 'Brand Software' and 'Brand Saffron'; the promise of Bangalore and the threat of Gujarat. As India readies itself for a more active presence in the world, it will need to resolve such conflicts in the images it projects.

India cannot rely solely on economic growth and development to resolve political choices about its future. The country is only at the beginning of a decades-long process of economic development and the scale of the problems defies quick fixes. In the meantime, Indians will have to decide what they wish to stand for, and what they wish others to see them as standing for. The case of Gujarat makes it clear that economic growth is compatible with extremism - especially when such growth occurs within an already complex society possessing many potential lines of cleavage. Gujarat is one of India's most prosperous states, but also one crippled in its political imagination. Instead of becoming homogenised, as economic prosperity reaches more Indians and gives them greater autonomy over their lives, we will likely see more conflict: more and more experiments in living, some incompatible with one another.

Yet as these conflicts and experiments play out, India will, if it chooses, begin to tap one more vital and immediately available resource, which has imparted a distinct identity to it and which is a true global currency of political legitimacy: it is a form of political capital that has been amassed over the past five and half decades. The steady operation of constitutional democracy in a liberal and non-majoritarian form over this period has accumulated democratic capital that needs not only to be preserved, but also enhanced. India must find ways to make use of the 'democracy dividend', which it yields - it must be willing to play a role in the global 'battle of ideas'.

Internationally, US legitimacy is deeply in question, perhaps more than at any time since the Vietnam War. Europe increasingly appears as a conservative force: protectionist in relation to markets (and much else) and hoping merely to keep what it already has, it seems cornered by a triumphant US and an emerging Asia. China may have a dynamic economy but it remains a weakly legitimate actor in the global sphere. India, as the world's largest open society, is ideally poised to step into this opening, as it remains one of the great modernist political successes of the non-Western world and one of the very few that has amassed the political capital of a democratic state which has, to a large degree, respected internal diversity.

India's democratic order stands in a part of the world much buffeted by conflicts over the relationship between religious identity and the state: conflicts which carry dangerous international implications. India is the second largest Muslim country in the world - and it contains one of the largest bodies of Muslims living within a liberal democratic order. The subcontinent itself, encompassing Pakistan and Bangladesh, is home to the largest concentration of Muslims anywhere in world. At a time when the West is embarking on a nervous and intense relationship with Islam, and when Muslims feel increasingly alienated within the international order, the Indian model established in 1947 is a powerful example of how ancient religions can co-exist within a single political frame. If India can continue to deepen its capacity to integrate Muslims into the democratic system, it will earn, and deserve, an exemplary status. The recognition of conflict and the creation of a non-destructive context for it is part of the art of crafting a rich and sustainable democracy. Conflict can weaken but it can also give strength: it can be enhancing, by keeping diversity a live fact, rather than merely a decorative feature. This is contrary to the view that civilisations or nations based on a single principle are stronger and better adapted for survival. Diversity, the Indian model affirms, is a source of strength.

As the Indian Prime Minister, Manmohan Singh, argued in a recent speech in New Delhi (5 November 2004), India should draw upon its rich democratic experience to help strengthen democracy in the world. 'Just as many developed industrial economies assisted the so-called "Economies in transition" to make the transition from centrally planned economies to open market economies', he said, so 'the experience of a democracy like ours can be of some help in enabling "Societies in transition" to evolve into open, inclusive, plural, democratic societies'. This is an extremely important statement of how India can find a role for itself in the world order - aiding other societies to emerge as democracies without imposing it through military intervention. Given the botched efforts of the US to pursue such policies, India has an opportunity to offer an alternative method and model of building democratic states - coming forward to assist democracy wherever it is taking root: in Afghanistan, for instance, by offering to train and educate the political and administrative classes, and even in Iraq - by offering to train civilian bureaucrats and share knowledge of constitutional, judicial and electoral practices. And India needs to be less timid in standing up for democracy in its own immediate neighbourhood - in Pakistan, China, Burma, Nepal and the weakly democratic Bangladesh. Even while allowing realpolitik to shape its relations with these countries, it should also find ways to promote the principle and possibilities for democratic state-building in these locations. As Francis Fukuyama has recently concluded, 'the art of state-building will be a key component of national power, as important as the ability to deploy traditional military force in the maintenance of world order'. India, by exporting some of its accumulated expertise to places that need this, can make a significant contribution to an international system confronted with the problem of disordered states.

For centuries, Indian intellectuals struggled with the fact of India's relative weakness. It is this recognition of weakness, of India's proven conquerability, that has in varying ways shaped how Indians have conceived of power. Some Indian thinkers squared this by dividing spiritual from material power. While the West possessed the latter, India could claim the former. This often led to a rejectionist and relativist position: India did not need to engage with the world but could simply withdraw and revel in its profound spiritual superiority. But others read the implications differently. The very fact of unequal physical power meant that Indians had to find other ways to engage the stronger nations. They had to use not just their morals but their wits: to invent or discover a universalist language and to persuade. Nehru, in 1939, spoke of 'intelligent self-interest'. The times are vastly different now; the economic and democratic resources India possesses are far greater. Yet the tools India will rely on to become a bridging power in the new century - while perhaps more expansive in range - are essentially the ones it has possessed for centuries: wit, moral discipline, and faith in the power of example to persuade.

Bollystan: India's Diasporic Diplomacy

By Parag Khanna

Introduction

It is commonly accepted that there will be three great powers in the 21st century - the United States, the European Union and China - and a number of second-tier powers such as Brazil, India and Japan. Globalisation, however, complicates this picture by providing opportunities for smaller players to become leaders in areas of comparative advantage, projecting significant influence on global economic, political or cultural affairs. Countries that can leverage globalisation - rather than being circumvented by it - can rapidly advance their growth and status. Whereas Japan seems to have peaked too early to become Asia's dominant power, some say that India has arrived too late, overshadowed by the Chinese juggernaut. Yet India can still rise in the ranks of the globalisation game, skilfully using new diplomatic vehicles - particularly its diasporic agents - to attract positive attention, investment and clout. Indeed, India will only become a global player if its efforts are supported by the vast network of increasingly influential global Indians.

Bollystan

Salman Rushdie once argued that in the relationship between identity and space, a diaspora needs a geographic locus as a point of reference. This insight explains the difficulty faced by Indians in maintaining - and severing - ties to their Motherland during the waves of 19th and 20th century migration which brought them in significant numbers to East Africa, the Persian Gulf, Southeast Asia, Great Britain, and the United States. Departure was permanent, communication slow, and loyalty confused.

Globalisation has changed all of this. Instead of remaining geographically fragmented, the potent cocktail of technology and culture now enables Indians everywhere to exist in a real, imagined and shared space. This Indian cosmopolitanism is what I call 'Bollystan', a realm in which Indian roots are planted everywhere, but the flowering of the trees traces back only loosely to the original seed. Bollystan is emerging organically, a diasporic salad bowl of ethno-commerce and a new model of geographically transcendent sovereignty. In contrast to what Rushdie described as a one-way street of cultural transmission, Bollystan no longer implies a unidirectional cultural flow. After all, the saying goes that India does best what it regulates least: producing movies, microchips and Miss Universes - many of which are now emerging outside of India itself.

Indeed, with globalisation the second generation has become its own core: confident, creative and productive, a web of relationships charged with an inherent spirit. Literature of the diaspora tops best-seller lists, and fusion food is served at the top tables in London and New York. Bollystan's import-export marketplace of literary genius, spiritual essence, cinematographic border-crossing and, increasingly, political savvy, can do for India what nuclear weapons have not: make it a great power. But to achieve this, the Global India must begin to integrate on many levels.

Culture, not politics, lies at the heart of Bollystan, making India shine more than any BJP electoral campaign. A.R. Rahman's *Bombay Dreams* has made it big both on London's West End and New York's Broadway. The 2004 Edinburgh International Book Festival invited Indian authors as diverse as Anita Desai, Hari Kunzru and newcomer Siddharth Shangvi. The mere presence of Indian populations overseas boosts demand for and interest in Indian cultural exports and products. With a global viewing population of billions, it is no surprise that Amitabh Bacchan topped BBC's online poll to name an "actor of the millennium." Prashant Agarwal, in the New York Times argues, "The day will come when Bollywood stars are just as famous in the United States as they are in India."[1]

A decade ago, Joel Kotkin explained how cosmopolitan groups "do not surrender their sense of a peculiar ethnic identity at the altar of technology or science but utilise their historically conditioned values

[1] "Dream On", New York Times, 29 April, 2004.

and beliefs to cope successfully with change."[2] Like the Anglo-Saxons, Jews and Chinese, Indians are building a networked civilisation, an archipelago of nodes linked by mutual trust and a belief in knowledge and the virtues of technology. Today, the population of the Indian diaspora is over 20 million, with 10,000 or more overseas Indians in at least 48 countries. In a dozen countries there are more than half a million persons of Indian descent, representing a significant proportion of the population of those countries. Only China has a larger diaspora globally, but no large country has yet designed a workable, sustainable strategy towards its foreign nationals. Even in the US, which has only 6 million nationals overseas, neither party focuses on issues of importance to expatriates such as extension of Social Security benefits and easier transmission of citizenship to children born abroad. Absentee electoral balloting entails a cumbersome and inefficient process.

For India, the diaspora's potential as a diplomatic force multiplier is vast. Consider the many nodes already in place - settling, expanding and encroaching. Boasting several British Lords, senior justices across post-colonial Africa, the president of Guyana, a dozen Canadian MPs and increasingly high-level federal appointees in America, Indians are poised to capitalise on the double dip diversity of Western democracies. In London, colonialism is being reversed, with Jack Straw convening minorities to discuss the "domestic echoes of foreign policy." Western diplomacy will not work without plugging into Asians' knowledge and networks. Policies are shifting. As part of its 'India and Globalisation' project, the Foreign Policy Centre will undertake research on public diplomacy to assess how India's brands, icons and diaspora shape its global image and perceptions.

The rapidly growing prominence of Indian Americans demonstrates the sudden shift in the diaspora's balance of power from the UK to the US. Indian Americans (de-hyphenated to allow flexible identity) are the wealthiest per capita ethnic group in the United States today, with a median income of $60,093 (double the American average)

[2] Joel Kotkin, *Tribes* (Random House, 1994).

and boasting 200,000 millionaires.[3] Centered in the key technology and financial centres, they have sprouted dozens of professional and social organisations, from the American Association of Physicians of Indian Origin to the Indian National Overseas Congress. Consistent with other diaspora groups, accruing wealth is an essential first step to gaining access and influence in the democratic marketplace. A half-century after Dilip Singh Saund became the first Indian American to serve in Congress, Republican whiz kid Bobby Jindal won a seat in the House of Representatives from Louisiana in the recent US election. A clutch of groups such as the US-India Political Action Committee (USINPAC) are becoming Washington power brokers, using power lunches to recruit the likes of New York Senator Hillary Clinton for the Senate's growing "Friends of India" caucus. In 2002, USINPAC led the charge in rallying to defeat a five-term Congresswoman from Georgia, Cynthia McKinney, who for years had taken hard-line pro-Pakistan and Khalistan positions. (But the lobby dropped the ball last year: McKinney recently won a different seat from Georgia, and now joins Jindal back in the House).

Crossing party lines, dozens of Indians had formal roles in the 2004 Republican and Democratic national conventions, and have raised millions on both sides of the American political aisle. In pre-election interviews, both presidential candidates acknowledged and praised the "extraordinary contributions to all aspects of American society" made by Indian Americans, hinting at appointing an Indian American to a cabinet or sub-cabinet level position. It is now recognised that the Indo-US relationship is too important to receive attention only around election time, and that the president should visit India at his earliest convenience. Soon, such a visit could be as routine as going to European capitals.

What deeper impact can the diaspora have on Indo-US relations? With almost 80,000 Indian students in the US, the most from any country, the next generation is poised to boost the technical and knowledge flow. The Bush administration is now busy exploring

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[3] Amit Gupta, "The Indian Diaspora's Political Efforts in the United States," ORF Occasional Paper, September 2004.

ways to broaden and deepen bilateral ties beyond the agreed “Next Steps for Strategic Partnership”. Focusing on scientific and military cooperation, the Partnership has, to date, been more talk than action. With the Indian American community consistently nipping at the government’s heels, the US will no longer take Indian goodwill for granted. State Department officials are already weary of persistent Indian American lobbying for a permanent Indian seat on the United Nations Security Council.

Of course, the growing reputation of the Indian diaspora has had more to do with Silicon Valley and Wall Street than Washington. Fifteen percent of technology start-up companies are owned by Indian Americans. Former Indian Finance and Foreign Minister, Yashwant Sinha, unleashed praise on his native sons and daughters, proudly referring to them as the “computer geeks” behind almost half the Bay Area’s biggest start-up firms. An increasing percentage of the key players in Dow Jones listed companies are also of Indian origin. The nexus of technology and finance is increasingly taking on a darker hue and the synergistic reaction promises accelerating gains for Indians in the US. What more appropriate civilisation to reinvent the “topology of political space,” in the words of James Bennett, than that of the Indus entrepreneurs who have shrunk the world byte by byte?

Global India Inc.

India’s government and citizens have been experimenting with various modalities to expand the Indian tent to leverage its gargantuan diaspora, but the task is not easy. Some of India’s recent policy innovations, such as an extended insurance scheme for Gulf-based workers, are strikingly progressive, particularly for a developing country. The 3.6 million Indians working in the Persian Gulf have the highest stakes and play the greatest role in India’s development, contributing over half the total Non Resident Indian (NRI) investments.

Within India itself, the possibility of having a foreign-born prime minister represents the triumph of openness and pluralism. In the US this remains a constitutional void. Only recently has Utah

Senator Orrin Hatch, supported by Austrian-born California governor Arnold Schwarzenegger, proposed an amendment to allow naturalised citizens of twenty years to run for President. India's present could actually be America's future. The issue of citizenship is crucial, for if the Government of India seriously aims to compel its diaspora to demonstrate greater loyalty, it must, to invert Nehru's advice to his daughter Indira, get sentimental - and certainly sensible - about their needs and expectations. At the 2004 Pravasi Bharatiya Divas conference in New Delhi, Sinha called upon NRIs - India's "informal ambassadors" and "expatriate-patriots" - to "redeem the pledge" in honour of Gandhi's famous return to India. But the PBD affair in fact revealed the philosophical, political and economic struggles of conceiving and building Bollystan as a networked, borderless global polity. Take the Overseas Citizenship Act, which could eventually make India the only nation besides the US to offer voting to its diaspora around the world (though India's is ten times larger). Is the Government of India just offering a glorified Person of Indian Origin (PIO) card with tax breaks for the new Rajput princes in Oceania, Scandinavia and the Americas - a limited, post-remittance economy of continued central management - or is it genuinely committed to a high-tech joint-venture in binding cultural loyalty across the oceans? India's government has given an inch but a chorus of NRIs wants the whole yard. For the people of South Asia, democracy - even the world's largest - it is not enough.

But India has enough voters already and, these days, voting is more a matter of the feet and the wallet. What is needed, then, is to amplify Bollystan's hard-wiring. There is little chance of India becoming a respected global player unless it develops itself. No great power in history has had half its population illiterate and living in poverty. India's economy is growing but the benefits are not being distributed evenly. Dot.com employees constitute a mere sliver of the Indian population: not even 2 percent of the Indian population is affected substantially by the IT boom, and their growing taste for Western products does little to aid struggling Indian manufacturers. The BPO economy can neither solve India's broader governance crisis nor fund the solutions. The sprouting of Silicon Valley style campuses will not solve the water shortage that forces poor people to pay up to 15 times more for bottled water than the potable drinking water to which they have no access. These are challenges that the outsourcing of jobs to India simply cannot solve.

A large economy is only great if equity is considered and the country is viewed as treating its citizens well. India has been energised and inspired by a widely cited Goldman Sachs report that it could be the largest economy aside from the US and China in 30 years,[4] but Prime Minister Manmohan Singh knows that his government cannot do it alone. During his recent visit to the United Nations, he urged Indian Americans in New York to "contribute more directly to the quality of teaching and research, of infrastructure and our services sector,"[5] with the aim of making Indian education, healthcare, financial services and tourism all world class. If, as Singh noted, Indian Americans "help to make America competitive, your (Indian Americans) minds are at the cutting edge of research, and your services in a wide variety of professions enhance the quality of life in this great country,"[6] then why can they not do more for India itself, which genuinely requires these innovative boosts? Though remittances are already five times greater than FDI in India (rising 30 percent from 2002 to 2003 to $18.2 billion), Harvard economist Devesh Kapur has argued, "More than financial remittances, if you think of long-term development, it's going to be social remittances, the flow of ideas, that's going to really matter."[7]

NRIs have gone from "not required Indians" or "not really Indian" to a driver of innovation within India. Philanthropic ventures abound and need to be scaled up by all means. Thousands of teachers, doctors, social workers and students of Indian origin have completed stints building schools, working in hospitals and advising NGOs all across the country, but there is as yet no Bollystan Peace Corps. The scale of India's challenges, however, demands just that. Worldwide, Indian-owned tourist agencies could promote "homecoming" packages. Consultants could offer pro-bono services and scientists,

[4] "Dreaming with BRICs: The Path to 2050," Goldman Sachs Global Economic Paper, October 2003.
[5] Speech to Indian-American Community in New York, 23 September, 2004.
[6] *Ibid*.
[7] "Remittances and the War on Global Poverty", Centre for Global Development, 12 October, 2004.

researchers and engineers could increase subcontracting of research to Indian institutions.

But overall the diaspora has, to date, kept too much money in the short-term markets, whereas it could help tremendously in providing the long-term infrastructure investment which has eluded India in the last decade. Currently, under 10 percent of India's total FDI comes from the diaspora. Tycoon Sam Pitroda, whose WorldTel pioneered the ubiquitous STD/ISP booths, is now laying fiber-optic cable in Tamil Nadu and Gujarat. Indus Entrepreneurs pioneer Kanwal Rekhi donated $2 million to IIT Bombay to start a School of Information Technology. But these are outstanding examples of leadership, not an established pattern. The Government of India, of course, could help to sweeten the deal, for example by expanding Resurgent India Bonds to mobilise billions more than at present and enlarging Special Economic Zones for PIO-driven investment projects. Surveys show that what members of the diaspora want - or rather demand - is access to top-tier professional networks, better Indian public relations overseas and more streamlined regulations for investment and partnerships.

So the Global India must be, at a minimum, a two-way street: exporting its principles and products and attracting its diaspora's experience. Not a brain drain, but a "brain bank" or "brain exchange." The dot.com and outsourcing explosions are slowly rebalancing the division of labour within Bollystan: India can keep exporting raw talent and labour with plenty left to spare, yet in the last three years, 25,000 technical professionals have returned to Bollystan's Motherland. It is not unforeseeable that India could create even more comparable career opportunities to lure its expatriates home from all stages of careers developed overseas. China has had great success in this regard, with many scientists returning immediately after completing graduate education at the American taxpayer's expense.

Something rotten in the state of Bollystan…?

Relating to India's vast diaspora will require much more than the single roving NRI ambassador appointed by the BJP. A new Ministry of Non-Resident Affairs, headed by Jagdish Tytler, is intended to build coherence, cohesion and efficiency. The India Brand Equity Foundation, created in 2003, has also been created to develop India's brand ambassadors. This combined effort could multiply Indian soft power in ways even the best diplomatic corps cannot match. This will not be easy, for while India's diaspora may be decisive in cultivating India's global role, the contest to steer India involves not only the forces of technocratic talent but also controlling emotions such as guilt, pride and greed. Many NRIs have grown accustomed to the efficiency, transparency and corporate governance standards of the West, and have been known to impatiently bang their fists at what they see as cultural laggardness. Some fear that Bollystan could thus become a political Pandora's Box: a fraternal civil war, defying the predictability of any Bollywood script yet potentially as gory as any Greek tragedy.

Ideally, a diaspora brings out the best of India, while working to correct the worst. Though the BJP did ample fundraising among supporters in the UK and US the diaspora is largely unable to justify either the caste system or other fundamentalisms overseas, and chooses mostly to direct its energy towards stonewalling perilous populism in favour of charity, social development, health and education. The next generation is getting increasingly involved in development work through organisations such as the America India Foundation (AIF) and IndiCorps. After India claimed to make the nuclear Buddha smile in 1998, even winners of New Delhi's *Bharat Samman* awards Shashi Tharoor and Megnand Desai were left with a bad taste in their mouths. The Nobel committee spoke up too, bestowing its Economics prize in 1998 to Amartya Sen, who shames India's militarism in the face of staggering poverty and illiteracy.

In a world where tribes can become violently tribal, Indians worldwide must work together to ensure that Bollystan becomes a role model rather than an anti-democratic remote controlled state. As Israeli leaders have learned, and India's are now discovering, a consequence of pan-territorial community is that diasporas often demand equal voice, sometimes at odds with "the nation." According to Rana Sarkar, a London-based strategy consultant,

> "Diasporas can be like dysfunctional families, ungovernable and fraught with false-familiarity and misunderstandings. But for a global Bollystan to resonate in the heart of global culture, it must wear its ethics on its sleeve. Uncomfortable truths must be confronted and not swept away in a desire to cleanse the message, to promote only good news. AIDS, poverty and peace must be public debates, not inside conversations. For the spirit of Bollystan to succeed, it cannot condone conformity, nor can it shy away from harsh realities."[8]

There is great potential here. With its splendidly rich Hindu-Muslim-Sikh-Buddhist-Christian-Jewish-Jain-Parsi history, India is the "clash of civilisations" that wasn't. Secularism, pluralism, tolerance, diversity - the increasingly confident Indian experiment can teach the dozens of ongoing blue-ribbon inter-faith dialogues run by Saudi princes and American think tanks a thing or two about so-called universal values. The common mission must be to work for India - all of it.

Conclusion

An India which understands its power as lying with the talents and resources of its global population will pursue a different course than an India which conceives of power in terms of territory and exclusion. Journalist Swapan Dasgupta has summed up this neo-Curzonian confidence: "If India is to resume the role it abandoned after 1947, it has to create its own ideal based on imperial partnership. It has to be willing to transcend the humdrum of domestic squabbling, look outwards and think big. It has to create a new Global Bollystan blessed with the spirit of adventure and enterprise."[9] Today, it is possible for India's claim to "great power" status to be based on the contributions its citizens make around the world to improving livelihoods and advancing knowledge. This, not any other form of power, is what defines greatness in an interdependent era. Thus it is the path of the super-ego which India

[8] "Branding Bollystan", *Another Generation*, Fall 2004.
[9] "Civis Brittanicus Sum: Writers of the new Raj," *Another Generation*, Fall 2004.

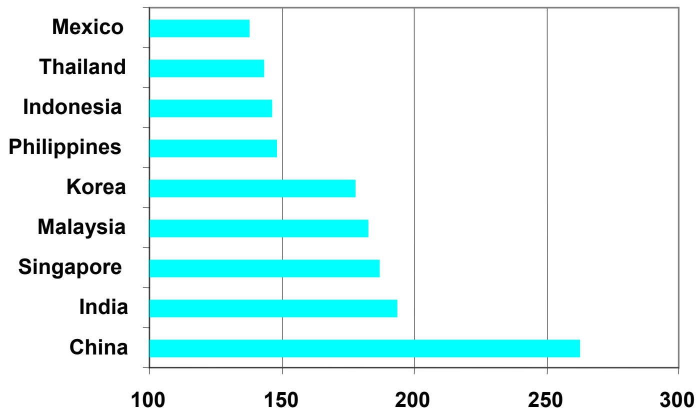
should choose; as Gandhi said, it is the truth that India can and should live.

India and the Knowledge Economy: The "Stealth Miracle" is Sustainable

By Prasenjit K. Basu

Over the past 24 years, India's real GDP has grown at an average pace of 5.9 percent a year. Never in human history has a democracy containing more than 150 million people achieved such growth rates over a two-decade period. India's economic achievement is unprecedented, and should therefore have qualified to be labelled an "economic miracle". Most commentators appear unaware that India has grown faster than all the Asian "miracle" economies (save China) since 1992. And even those dimly aware of India's strong growth in the past decade would be surprised by the assertion that India's growth rate has been above the average growth rates achieved by the eight Asian "miracle economies" since 1980. In fact, India's growth rate even in the 1980s was slightly above the average growth rates achieved by the Asian miracle economies during that decade.

Figure 1: 2003 Real GDP (1992=100)



Data source: CEIC database

As India's economic achievement over the past quarter century is unprecedented among large democracies, is outstanding even by comparison with the fastest-growing part of the world economy (Asia), and yet remains largely unheralded, I label India the "stealth miracle economy". India's economic achievements remain subject to endless unflattering comparisons with neighbouring China; there is little doubt that India suffers by comparison with China on most standard measures of economic achievement – including growth, per capita income level, consumption of key consumer and food items, social indicators such as life expectancy, literacy and infant mortality. But the persistent comparisons with China are inappropriate on several counts (apart from the obvious one that India is a democracy, with all the attendant strengths and weaknesses of democracies vis-à-vis dictatorships like China's):

(a) In 1984 (just as Deng Xiaoping announced the Open Door policy and established the SEZs, following the success of his 1978 agrarian reforms), China inherited Hong Kong, a world-class financial centre that the People's Republic had done nothing to create (apart from causing the mainland's capitalists to flee there in the wake of Mao's revolution). Although Hong Kong was formally handed over to China only on July 1, 1997, the 1984 Sino-British agreement obliged Hong Kong's businessmen to orient themselves toward China, which they vigorously did – as they moved their manufacturing rapidly to the Pearl River delta in anticipation of the political change that was inevitable in 1997. China's growth performance cannot properly be compared with any other economy's that has not similarly inherited a world-class financial centre.

(b) Today's dynamic, coastal parts of China's economy were all part of Japan's pre-1945 empire. It was not an accident that Manchuria (the region Japan ruled for longest – from 1931, with considerable economic influence since 1919) was the most advanced and industrialised part of China throughout the Maoist period (and despite the famine that followed the Great Leap Forward, the ravages of which were concentrated in Manchuria). The legacy of Japanese rule was superior physical infrastructure and the rudiments of an industrial revolution – evident in Korea and Taiwan (where the post-war institutions of economic stewardship closely resembled those of Japan) as well as in Manchuria and coastal China (Guangdong, Fujian, Beijing, Shanghai and Nanjing were all part of Japan's empire, and Hong Kong too fell to it soon after the war began).

(c) Taiwan (which Japan formally ruled from 1895 to 1945) was even more advanced and benefited after 1945 both from the flight of the mainland's economic elites and from inheriting the public enterprises and infrastructure that Japan was forced to peremptorily abandon after the Hiroshima/Nagasaki bombs forced an abrupt surrender in mid-August 1945. Today, Taiwan accounts for more than half of all foreign direct investment (FDI) into China, and runs a bilateral trade surplus of about US$55bn annually with mainland China. In effect, Taiwan (one of the world's main centres of high-technology industry) has made mainland China the primary focus of its investment spending – and the massive flows of capital (and the machinery and technology they embody) from Taiwan to China are the key driver of China's on-going industrial revolution.

(d) China also "inherited" several ports (and associated infrastructure) from the period of "unequal treaties" that the PRC uses so effectively as a nationalist tool to berate the west for past exploitation, and whip up nationalist fervour against historic humiliations. Since China was not colonised by a single power, but had only "leased" its ports to the different powers, each of them competed to build the best possible infrastructure in the port that they controlled – thereby giving China a considerably superior urban infrastructure in these ports than other developing countries (including India) inherited from their periods of colonialism. Most of China's social indicators were only marginally better

> than India's in the late-1940s[1], but its inheritance of physical infrastructure was considerably superior. Port Arthur (in today's Dalian) was controlled by Russia from 1898-1905, Japan from 1905-45 and partly by the Soviet Union from 1945-55, Qingdao by Germany (therefore justly famed for its Tsingtao beer and much industry besides), Hong Kong and Weihaiwei by Britain, Macao by Portugal, and Kwangchowwan by France.

These unique features of China's economic "inheritance" have placed it in an extraordinary position relative to other emerging economies – and it is therefore inappropriate to compare China's growth experience with other economies that do not have these unique advantages conferred by history and circumstances. In fact, although Maoism throttled China's economic potential and caused a massive flight of capital and human expertise, most of this human and material capital was effectively held "on deposit" in Hong Kong and Taiwan (as well as in overseas-Chinese communities of long standing in south-east Asia). Deng Xiaoping clearly deserves credit for his acuity in capitalising on the opportunity presented by the huge pool of capital and skilled-labour represented by the overseas Chinese communities – but at least some of these (those living in Hong Kong) were virtually compelled to turn their attentions to the PRC because of the change in political circumstances.

With the enormous advantage conferred by its inheritance of Hong Kong's entrepreneurs and financial acumen, and effective luring of Taiwan's human capital and technological expertise, China has had one of the most rapid and extraordinary industrial revolutions in all of human history – with only Japan's (and to some extent, Korea's and Taiwan's) being of similar depth and breadth. However, Japan's post-WWII industrial revolution was preceded by the build-up of its human capital over the period from 1868 to 1939 (becoming the first nation after the US to achieve universal literacy, and developing a broad and effective secondary, tertiary and vocational educational system). As Mancur Olson (among others) has pointed out, the

[1] Jean Dreze and Amartya Sen, *India: Economic Development and Social Opportunity*, OUP, Delhi, 1998. Pages 66-67.

strength of its human capital gave Japan (and Germany) a huge head-start in development relative to other developing economies that were seemingly as poor at the end of the 1940s[2]. Taiwan and Korea similarly built significantly on the legacy of human capital inherited from Japanese rule (much better than in former British colonies like India); by 1960, for instance, Korea had a literacy rate of over 65 percent - levels that India did not achieve until 2001. While Japan, Korea and Taiwan had painstakingly developed their "human capital", China was able to "import" largely whatever human capital it did not have - specifically entrepreneurs, engineers with *appropriate* industrial experience, accountants, lawyers, investment bankers, etc. - from Hong Kong, Taiwan and elsewhere.

Nonetheless, like all Communist economies, China also did very well in achieving basic levels of literacy, health, nutrition, life-expectancy – and most other social indicators – and considerably exceeded India's achievements in these areas. The gap in social indicators between China and India had opened up by the 1960s and 1970s – a period during which, data now shows, their economic performances did not diverge at all. China's considerably better social achievements cannot persuasively explain its better economic performance since 1978. And, despite China's much stronger economic performance since 1978, levels of urbanisation in China are not markedly different from those in India: about 60 percent of China's population remains rural, only slightly less than India's 66 percent rural population. The rate of urbanisation also does not differ much, despite China's higher literacy and more labour-intensive approach to manufacturing, both of which should have boosted the pace of urbanisation there relative to that in India.

The initial period of faster economic growth in China (1978-84) was largely a result of agrarian reforms that allowed peasants and farm

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[2] Mancur Olson, *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities*, Yale University Press, New Haven, 1982. Although Olson primarily argued that the destruction of distributional coalitions (pursuing sectional interests) during the war helped Japan (and Germany) adopt the latest technologies and sustain growth for longer before redistributive coalitions could coalesce, he also acknowledged the importance of human capital – especially in comparison with other poor countries.

households to keep larger proportions of their output - and this extra incentive set off a towering productivity revolution in Chinese agriculture, in turn helping to finance the township and village enterprises (TVEs) that formed one of the backbones of the subsequent economic boom. However, that productivity boom has long since waned (and China's grain output, for instance, has stagnated for the past eight years). The primary source of the post-1984 boom in China was foreign direct investment (FDI) - the bulk (over two-thirds) of it from Taiwan and Hong Kong, with some of the rest coming from other Overseas Chinese.

India's own Green Revolution (1966-79) actually occurred earlier than China's, and was a result of India abandoning its previous strategy of modest land reform, and instead allowing its most productive farm areas to apply high-yielding varieties (HYV) of seed, irrigation, fertilisers and credit – without the previous excessive focus on nation-wide equality, which had constrained the growth of the more productive (and historically better-irrigated) areas. But the impact of India's Green Revolution on the overall economy was less pervasive than in China – partly because it occurred during a period in which rising oil prices weakened India's overall economic performance, especially that of the manufacturing sector, but also because it benefited only a specific geographic area (primarily Punjab, Haryana and western Uttar Pradesh) where the agrarian structures were conducive to a productivity revolution (some other areas, particularly West Bengal after its tenurial reforms of the 1980s under the Left Front, also saw a considerable rise in agricultural productivity in later years).

India vs. China: India scores on tertiary education and financial stability

Just as China's achievements in basic literacy and primary education considerably exceed what India has achieved in these areas, so India's own achievements in secondary and tertiary education dwarf China's attainments – and so help to explain India's huge advantage in internationally-traded services and knowledge-based industry. In 1995, *the proportion of the population going to* *universities in India was almost six times the comparable proportion in China* [3]. Anecdotal evidence suggests that China has somewhat closed this gap in recent years, but any breakneck pace of increase in university enrolment is likely to have occurred at the expense of quality.

India had an illiteracy rate of more than 86 percent at independence. The contrast with Korea is particularly stark: in 1946, only 39.6 percent of Korea's work-force had had no schooling – and by 1963 this proportion was already down to just 5.5 percent[4]. Japan itself attained universal literacy several decades before Britain did, so it is probably not a coincidence that a former Japanese colony had considerably stronger educational attainments than the former jewel in Britain's imperial crown. Inspired by Germany and Japan, independent India's first Prime Minister, Jawaharlal Nehru, sought to create a strong secondary and tertiary education system that would equip India with the wherewithal for modern economic growth. Perforce (and especially in contrast to other developing countries in east Asia), this meant a relative neglect of elementary education, although India achieved progressive improvements in the literacy rate, raising it by about 10 percentage points each decade – to 65.6 percent at the time of the last census in 2001. (India's neighbours, Pakistan and Bangladesh – who had the same institutional legacy – performed much worse on all literacy indicators). But *by 1965* (a year after Nehru's death following 18 years as prime minister[5]), *the proportion of secondary students as a percent of secondary-age population in India was no different than in Korea (29 percent) and much higher than in wealthier developing economies like Turkey and Mexico*[6].

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[3] Dreze and Sen. This is mentioned on page 181, although the authors choose to look at India's high share of university students as a perversion rather than an achievement.

[4] Alice Amsden, *Asia's Next Giant: South Korea and Late industrialization*, Oxford, New York, 1989. Page 222, table 9.3.

[5] Nehru was Prime Minister of independent India for slightly less than 17 years (from August 15, 1947 to his death on May 27th, 1964). But he was also Prime Minister of the Interim Cabinet formed in September 1946 to rule all of British India (including present-day Pakistan and Bangladesh) in the run-up to independence.

[6] Amsden, page 218, table 9.2.

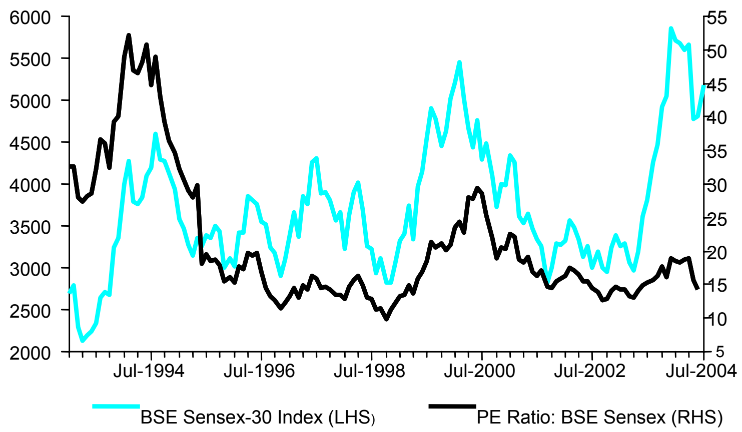
Nehru's vision in establishing the Indian Institutes of Technology (IITs) and the Indian Institutes of Management (IIMs) created high-quality tertiary institutions that are almost unique in the developing world (with only Korea having any institutions of comparable quality). Coupled with the use of English as the language of instruction, the IITs and IIMs have produced more top-notch academicians in these fields - and senior personnel in corporate board-rooms and R&D departments - than any other comparable developing-country institutions. And they have, in turn, spawned a massive number of imitators that today produce more management and technological graduates in India than any other nation on earth. The Indian private sector was slow to benefit fully from this enormous pool of skilled personnel - as large proportions chose to pursue far more lucrative opportunities overseas, thereby ensuring that India's subsidies for tertiary education funded the supply of cheap researchers, managers and scientists in the US and elsewhere. But the liberalisation of the economy since 1991 has begun gradually to reverse this "brain drain" (or, as Rajiv Gandhi more appropriately labelled it, "the brain deposit overseas"), helping to enhance the supply of highly-skilled managers, scientists and technological personnel available to India's own corporate sector, thereby enabling it to rapidly gain global competitiveness.

Apart from the relative advantage conferred by its much stronger attainments in secondary and tertiary education, India's other strength relative to China is the financial system. India has a better-regulated and more well-functioning capital market – partly aided by the fact that India opened its domestic capital markets (especially the equity market, but eventually the bond market too) to foreign investment almost at the outset of its liberalisation drive. While there were limits (in terms of the percentage of foreign ownership allowed for each stock), these were progressively liberalised, and foreign participation and ownership has been a notable feature of India's capital markets – contributing to their efficiency. China, by contrast, has given foreigners very limited access to its own equity and bond markets – but opened a window for foreign portfolio investment by allowing a limited number of domestic companies to list on foreign bourses (primarily Hong Kong, but eventually also New York, London, etc.) and in the "B" shares on the Shanghai and Shenzhen exchanges. By thus limiting the supply of stocks available to foreigners (thereby creating an artificial scarcity), China has inadvertently contributed to their over-valuation – much as Japanese, Taiwanese and Korean stocks were over-valued before the full opening of their markets (in fact, China is now seeking to emulate Taiwan's experience – or folly – by gradually introducing the system of qualified foreign institutional investors to continue controlling access to its equity markets).

Foreign ownership of (and relatively unfettered foreign access to) domestic financial instruments also usually ensures that they are subject to an extra dose of discipline and transparency – although, ultimately, effective regulation and systemic sturdiness also play key roles in the efficiency of capital-market pricing. In India's case, the early bursting of the huge bubble that was inflated within the first three years of the opening of the market contributed to a healthy scepticism about equity market investing among local investors. By all accounts, India's stock-markets have been well-functioning ever since, regulated ably by SEBI and with equity prices properly reflecting the earnings growth of companies and their future prospects. In India, companies that fail to live up to earnings expectations are brutally punished by the stock-market – and this has happened to more than half the stocks that were listed among India's top-10 largest companies by market capitalisation in 1991. Although there was a massive run-up in stock prices in 2003, and a renewed surge in 2004 the market's overall price-earnings ratio remained at reasonable levels (having risen toward 50 in 1994, the trailing P/E ratio remained below 20 through 2003 and 2004) reflecting the strong profit performance of listed Indian companies.

In China, on the other hand, the sheltered "A" shares of Chinese companies remain massively over-valued – even using the poorly audited accounts reported by most of the companies listed on these bourses. Several thousand new listings of "A" shares have occurred over the past half-decade, all largely at the lofty and unrealistic valuations that are typical for "A" shares in China. While there was a modest sell-off in "A" and "B" shares through 2004, the truly major correction of "A" shares (that will drive their P/E ratios from their current 60 to a more realistic 15-20) is still to come. When it does come, and when other promoters of local companies inevitably produce results that are much weaker than promised in their IPO prospectuses, Chinese domestic investors will be scarred for years (as their Indian counterparts were for almost a decade after the crash of 1994). India, by opening its capital market early, has suffered the consequence of a bubble early and learnt a salutary lesson - one that China will have to painfully learn in the future, only with even more severe pain because its stock-market will by then be much larger relative to the overall economy than India's was in 1994.

Figure 2: The 2003-04 stock price surge reflected a broad earnings rebound...unlike in 1994



Data source: CEIC database

Not only are India's capital markets much more sound than those in China, India's banking system is also in substantially better shape. S&P currently estimates that non-performing loans (NPLs) in China's banks amount to 45 percent of all loans (in August 2003, S&P estimated the NPL ratio to be 50 percent, but continued strong loan growth - and possibly some "ever-greening" - has helped to reduce the ratio slightly). This level of NPLs is much worse than even in Japan or Thailand at the worst point in their late-1990s recessions.

That China has such a high ratio of NPLs at a time when its economy is still growing at a spectacular 9 percent rate suggests that things could get substantially worse in a genuine economic slowdown. In effect, China's banks face a basic problem of "adverse selection": the best potential borrowers (the export-oriented firms operating in coastal China) are predominantly foreign-owned or foreign–invested, and so have scant need for bank credit. Instead, banks' primary customers are state-owned enterprises (SOEs) and property companies/developers. Given the ample supply of bank deposits (in a country with a high household savings rate of 35 to 40 percent that is similar to the East Asian average), banks have huge supplies of loanable funds – and so the freedom to continue misallocating these funds, much as their East Asian counterparts did prior to 1997.

In effect, China's banks are helping to keep SOEs afloat by continuing to lend to them regardless of their ability to service debt: that China's banks grew their loans by 26 percent in 2002 and a further 21.4 percent in 2003, despite the fact that half of their existing loans were non-performing, is suggestive of irresponsibility on a grand scale. And this irresponsibility goes largely unpunished: banks have simply been permitted to shift some of their NPLs from their own books to that of asset management companies (AMCs), without having to take a "hair-cut". The AMCs have, in turn, been able to sell these NPLs on the secondary market for less than 10 cents on the dollar – implying that banks should have taken a loss of over 90 percent of the face value of these loans when transferring them to AMCs. The fact that banks did not bear these losses of course means that moral hazard has been hugely increased in China's banks: managements that made poor lending decisions in the past can persist with their impunity in the future too. Had AMCs in Malaysia or Korea adopted such liberal approaches to the treatment of NPLs, they would have been excoriated by analysts, but China has got away quite lightly.

If China's banks persist with these lending practices, of course, the government (i.e., tax-payers) will end up bearing an even larger burden in the future. At 173 percent of GDP, China's domestic credit/GDP ratio is already exceedingly high for a developing economy - and if NPLs are 45 percent of total credit, they amount to 77 percent of annual GDP. Even fixing the current size of the hole in Chinese banks' balance sheets will conservatively raise China's public debt to about 90 percent of GDP from the current 45 percent - and the huge additional issuance of government debt will likely raise the whole structure of interest rates in China, slowing economic growth in the medium-term as bank rehabilitation takes precedence over the "growth-at-any-cost" doctrine during Zhu Rongji's stewardship of the Chinese economy.

At the beginning of the 1990s, India's banks also had many of the problems China's banks face today. They were in fact obliged to lend to public enterprises, the agriculture sector and exporters (at a time when the overvalued exchange rate made exports pretty unprofitable), and their gross NPLs were estimated to be close to 30 percent in the early-1990s once loss-recognition norms were tightened, BIS capital-adequacy ratios stringently applied and prudential norms made more consistent with international practices. But India's state-owned banks have gradually reformed over the past decade, restraining their lending growth as they sought to repair their balance sheets. The Securitization Act (passed by parliament in November 2002) further strengthened banks' ability to cease the assets of delinquent borrowers. Consequently, by the end of March 2004, even India's nationalised banks had gross non-performing assets of a modest 7.8 percent of total loans (net NPLs of 2.9 percent); and, given that India's banks still hold about 37 percent of their assets in government securities, the NPLs are even lower as a percent of total assets: gross NPLs as a percent of nationalised banks' total assets had declined from 5.3 percent in March 2001 to 3.5 percent in March 2004, while net NPLs declined from 2.7 percent in March 2001 to 1.3 percent in March 2004.[7] Private sector banks' net NPL to total assets ratio declined from 2.3 percent to 1.3 percent during the same period.

To end this section comparing India and China, the following summary conclusions can be drawn: (a) it is unlikely that India (or,

[7] Reserve Bank of India, *Report on the Trends and Progress of Banking in India: 2003/04*, Mumbai, November 2004.

for that matter, any other emerging economy) can emulate China's growth path of the past two decades because China's circumstances and historic "inheritance" was unique – in that Hong Kong and Taiwan "preserved" and helped nurture the capital and expertise that China effectively expelled in the aftermath of the 1949 revolution, and a large part of China's success has come from luring back these "overseas deposits" of capital/expertise from these laboratories of capitalism that were politically outside China's control but retained old links to it; nonetheless, India has (apart from the longer-term strengths of democracy) two significant sources of strength that will lend its economy greater stability and robustness in the medium term: (b) India's financial system (both its capital markets and its banks) are significantly more sound than those of China, and the latter is likely to feel the brunt of both the bursting of its domestic asset bubble and either a meltdown or a massive bailout of its banking system which will rein-in growth over the following five to ten years; (c) while India has fallen behind in elementary education, India's attainments in secondary and tertiary education dwarf China's - and should ensure that India comfortably sustains its lead over China in internationalised services and knowledge-based industry.

India's Growth Experience: 1950-90

The stylised facts about India's economic performance over the past half-century have been best summarised by Bradford de Long and Gurcharan Das[8]: between 1900 and 1950 (under the British Raj), India's real GDP grew 0.7 percent a year (implying a decline in per capita income); between 1950 and 1980, real GDP grew at an average pace of 3.7 percent per year (and per capita income just 1.5 percent), marginally above the global average for that period; but then real GDP accelerated to 5.9 percent growth (and per capita income to 3.8 percent) in the 1980-90 period, and to 6.2 percent (with per capita income growing 4.4 percent) annually in the 1990-

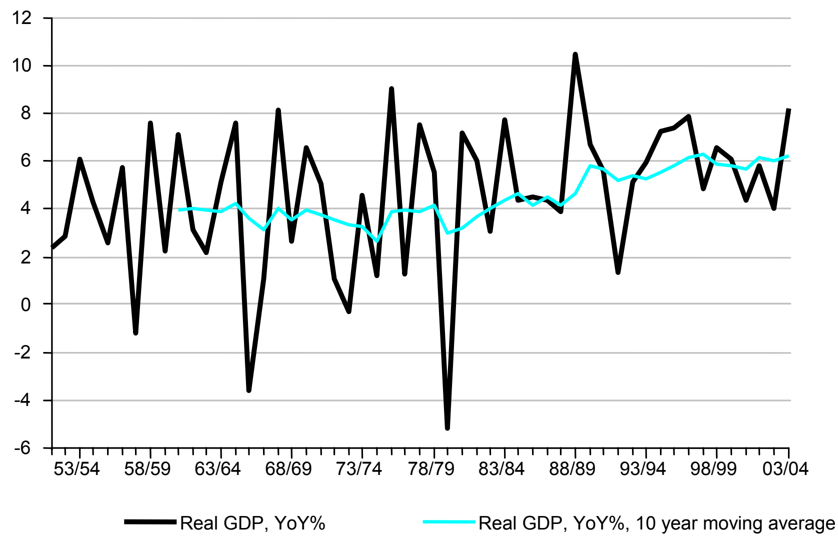
[8] Bradford de Long, *India since Independence: An Analytic Growth Narrative* (April 2001 draft at http://www.j-bradford-delong.net/Econ_Articles/India/India_Rodrik_draft1.html) and Gurcharan Das, *India Unbound,* Penguin, New Delhi, 2000.

2000 period. Professor de Long points out that, at the average pace of 1980-2000, India will achieve the per capita income levels of the present-day United States by 2061.

The noteworthy feature of India's growth experience (summarised in Figure 3 below) is that there were greater fluctuations before 1980 than after that year - and periods of faster growth (averaging over 5 percent annually for about 5 years) in the 1950-80 period were followed by a year of severe recession. These recessions were caused either by a foreign-exchange crisis (FY1957/58), a food crisis in the aftermath of war (FY1965/66), the first oil crisis (FY1973/74) or drought coupled with an oil-related inflationary surge (FY1979/80), when the Iran-related oil-price surge was exacerbated by food inflation induced by the attempt of Charan Singh - finance minister and later Prime Minister that year - to raise the relative prices of agricultural products, resulting in the worst drought since the mid-1960s. Since 1980, India has had no genuine recession (i.e., in no year since 1980 has real GDP declined). China too has had no year of decline in real GDP over that period (if the data are to be believed), but all other Asian economies have had at least one recession – and most have had two (around 1984-86 and 1997-98). The FY1990/91 oil crisis (resulting both in huge oil-related inflation, but also a collapse in overseas worker remittances from Kuwait and Iraq) led to yet another balance of payments crisis in India, but this time a full-blown recession was avoided – despite severe import compression – as major structural reforms rebuilt confidence in the currency and induced significant new foreign-capital inflows for the first time. But before delving into the details of that transformative story, it would be helpful to take a slightly detailed detour into India's economic history since independence.

In the 1950s, India under Nehru focused on import-substituting industrialisation (ISI) - then the orthodox approach to economic development recommended by the World Bank and most of the leading economists of the time. The ISI strategy was also founded on the belief (among developed economies) that the developing countries would primarily substitute imports of consumer goods with domestic production but would still need to import capital goods (and probably most intermediates) from the developed world. It was argued that the successful growth of the developing countries would boost their demand for capital goods – so the ISI strategy was seen as a win-win situation for both sides.

Figure 3: India's Real GDP growth and 10 year moving averages



Data source: CEIC database, Economic Survey: MoF, GoI (various issues)

Two factors intervened to alter the outcomes that most planners/economists had expected from ISI: (a) many developing countries (including India) sought to substitute imports with domestic production not only of consumer goods but also of capital goods (with only limited success, especially as parts and intermediate-goods proved intractably import-dependent); and (b) Japan began to demonstrate an alternative, export-led path to industrialisation that some of its East Asian neighbours began to emulate (starting with its erstwhile colonies – Taiwan and Korea – and its wartime occupied territories of Singapore and Hong Kong, all of which adopted the export-oriented strategy in the 1960s, while the other formerly occupied territories of Malaysia, Thailand, Indonesia and China did so in the 1980s).

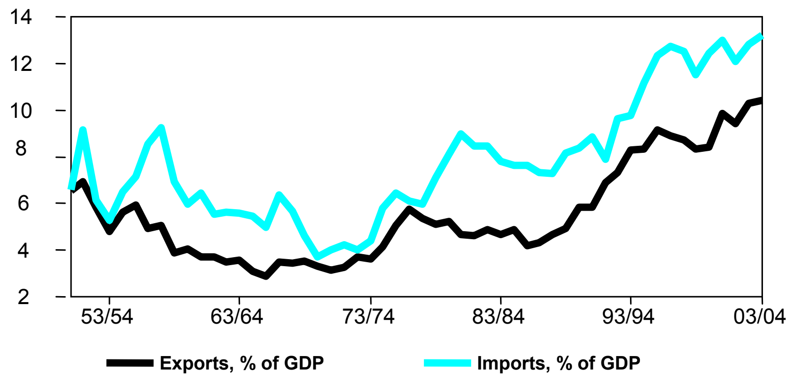
At a more fundamental level, the overarching problem with ISI was that – by protecting domestic industry with high tariff and non-tariff barriers (in India's case, a blanket ban on imports of virtually all consumer goods) – the exchange-rate was effectively over-valued, and severely biased against exports. The existing export products (agricultural commodities, minerals and textiles) suffered from this anti-export bias. In India's case, this meant that the mini-industrial boom of the 1940s and early-1950s (from the demand surge on account of the Second World War and the Korean War, especially for textiles) petered out by the mid-1950s as Nehru proclaimed public enterprises to be the "temples of modern India" that would capture the "commanding heights of the economy". Despite the anti-export bias (which also throttled the potential of the agriculture sector) and the resulting balance of payments crisis in 1957-58, Nehru's India comfortably achieved real GDP growth of about 4 percent annually, slightly better than the global average during that period. However, the brief wars with China (in October 1962, in which India's army was humiliated) and Pakistan (in September-December 1965, which was an "honourable draw" with India slightly in the ascendant) substantially weakened the economy.

Under India's second Prime Minister, Lal Bahadur Shastri, the first steps toward the Green Revolution were adopted and power was concentrated more closely in the Prime Minister's Office (PMO), where Shastri's advisor, L.K. Jha, began to adopt more market-oriented and less statist policies. Indira Gandhi, Nehru's daughter, became India's third Prime Minister in January 1966, and continued her predecessor's modest moves toward market-based policies in her early years (until 1969), beginning with a 57 percent devaluation of the rupee and the adoption of a slew of export incentives. With the aid of her agriculture minister, C. Subramaniam, the policy changes that were to usher in the Green Revolution were fully adopted in these early years. But, facing a potential revolt from the old guard of the Congress party (who, Indira credibly believed, were plotting with right-wing parties to replace her as Prime Minister with the Deputy Prime Minister and finance minister, Morarji Desai, who had successfully led India's response to the 1957 balance of payments crisis and was well-regarded for his administrative acumen), Mrs. Gandhi engineered a split in the Congress party in 1969 – and adopted a strongly leftist policy stance, including nationalising most of the country's larger banks and abolishing the "privy purses" (that had been awarded to the erstwhile princes of British India as an elaborate pension-in-perpetuity to compensate them for the loss of their dominions).

Indira Gandhi's leftist stance was initially a pragmatic response to the loss of her parliamentary majority upon the split in the Congress party – which required her to seek the support of left-wing parties (the two Socialist parties, the Communist parties and some of their smaller allies) in order to retain her hold on power. She then called a parliamentary election in 1971 (a year earlier than required), and won a sweeping two-thirds parliamentary majority with her slogan of "Garibi Hatao" (Eliminate Poverty). The Supreme Court (which had narrowly struck down the nationalisation of banks and abolition of privy purses on the grounds that they violated the Right to Property) was gradually transformed with the appointment of justices more "committed" to leftist policies. And Indira Gandhi adopted the Monopolies and Restrictive Trade Practices (MRTP) and Foreign Exchange Regulation Acts (FERA), which further consolidated the socialist orientation of policy; FERA effectively obliged most of the older foreign companies to sell their holdings at throwaway prices.

Nehru had established public enterprises, and created a labyrinthine web of regulations that restricted private companies' ability to expand capacity, change product mix, etc. This had the ultimate effect of ossifying the existing industrial structure, by providing an elaborate system of protection both from external competition (through import bans on consumer goods and high tariffs on intermediate and capital goods) and internal competition (through the licensing system, which also of course limited the growth of the more dynamic companies). But the overall orientation under Nehru was capitalist, albeit perhaps state-led capitalism. Indira Gandhi's nationalisation of banks and introduction of MRTP and FERA completed the panoply of a socialist economy. The 10-year moving average of real GDP growth hit its nadir in FY1974/75, and Indira was obliged to introduce an Emergency to retain power as extra-parliamentary agitation and protest (especially against inflation) reached a crescendo in mid-1975 under the leadership of Jayaprakash Narayan in Bihar and Morarji Desai in Gujarat.

Figure 4: Trade/GDP ratio resumes rising in the 1990s...having edged lower until the mid-1970s



Data source: CEIC database

After Mrs. Gandhi declared the Emergency, India had its first experience with East Asian-style authoritarianism. Although the electorate firmly repudiated the experiment when given an opportunity (in March 1977), there can be no gainsaying the fact that the Emergency not only caused trains and planes to run on time, the cities to be cleaner than they ever were previously or since, and civic services to be delivered with efficiency – but the economy also had its best performance since independence, real GDP growing 9 percent in FY1975/76 and the current account swinging to a comfortable surplus. The "controlled experiment" with autocracy showed that India could indeed generate substantially stronger growth under authoritarianism (even with the "socialist" perversions introduced in the 1969-75 heyday of policy excess under Indira Gandhi), but the electorate decisively voted in favour of freedom over bread in 1977.

The Desai-led Janata government formed in 1977 was an ideological mish-mash of some of the Socialist parties that had supported Indira Gandhi in 1969-71 (including some who had formed a ginger group within Congress at the time, called the Young Turks), Desai's "Organisation" (or Rightist) wing of the old Congress that remained after the 1969 split, the right-wing Hindu nationalist Jana Sangh, a farmer's party led by Charan Singh, and a recent breakaway faction of the Congress led by Jagjivan Ram (a prominent minister in Indira's cabinet and leader of the former "untouchables"). A rightist ally of Desai's, HM Patel, was finance minister, and adopted orthodox policies that began the process of rolling back some of the socialist excesses of the Indira years. But the Socialist George Fernandes was minister for Industry – and he engineered the early departures of Coca-Cola and IBM from India. Perversely, the latter probably played an important part in the genesis of the software revolution in India, as several companies emerged over the next few years to fill the hardware and software vacuum left by IBM's departure – and three of them (Tata Consultancy Services or TCS, Wipro and Hindustan Computers Ltd or HCL) were to be at the vanguard of the 1990s IT revolution in India.

When Indira Gandhi returned to power in January 1980, she had shed her ideological rigidity of the 1970s, having promised to provide "competence" and stability, and end the "chaos" of the Janata years. She took a massive US$5 billion loan from the IMF (then the largest loan ever given by the IMF), with a promise to begin Structural Adjustment and maintain a growth rate of 5 percent annually in order to reduce poverty. Although, only about US$3.9 billion of the loan was drawn down, a modest liberalisation of the economy began. In particular, there was a modest liberalisation of the industrial licensing regime – allowing firms to diversify into inter-related areas and expand capacity without seeking a fresh licence[9]. Having presided over the period of India's slowest growth in her first decade

[9] T.N. Srinivasan and Suresh Tendulkar, *Reintegrating India with the World Economy*, Institute for International Economics, Washington DC, March 2003. Pages 22-23.

as prime minister, Indira Gandhi also began (in a modest way) the reforms that set growth onto a permanently higher trajectory in 1984.

The structural reforms continued under Rajiv Gandhi (who was Prime Minister from November 1984 to November 1989), albeit at a modest pace: industrial de-licensing made a little more progress, and piecemeal liberalisation of imports continued (although this often tended to make capital goods imports cheaper while actually increasing effective protection for final products). This piecemeal liberalisation was accompanied by fiscal reform – including a substantial reduction in prohibitively high rates of direct taxes, and the introduction of a modified value-added tax to ease collection of indirect taxes. Most important from a longer-term perspective, Rajiv encouraged the adoption of computers in key government departments and public-sector companies – often in the teeth of obstreperous opposition – and began reforming the telecommunications system.

Although real GDP growth did accelerate to 5.8 percent in the 1980s (above the average achieved by the eight East Asian miracle economies), India's external debt was growing by about US$8 billion annually by the end of the decade - having already risen from US$20.6 billion in 1980 to nearly US$70.2 billion in 1990. In FY1990, commercial loans accounted for 26.3 percent of the external debt; loans from international institutions, especially the World Bank, made up 45.2 percent; borrowing from foreign governments (especially Japan, Germany, and the United States) accounted for 28.5 percent. Aided by a 26 percent depreciation of the rupee in REER terms between 1984 and 1990, however, India's exports doubled from US$8.9 billion in FY1985-86 to US$18.1billion in FY1990-91.

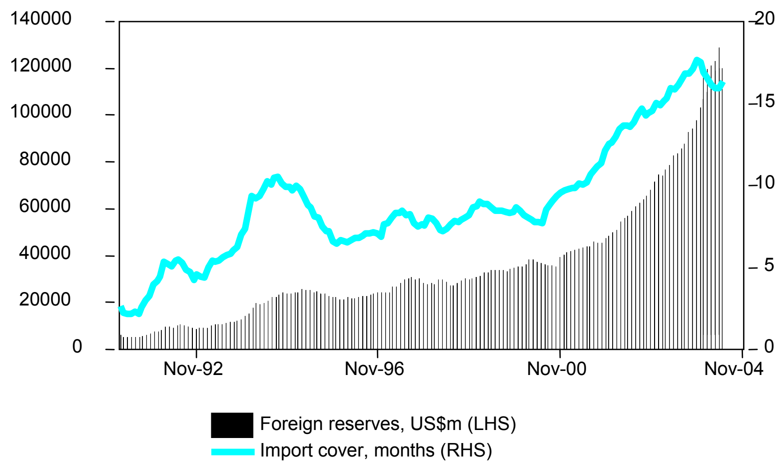
The 1990s and Beyond: India capitalises on Globalisation

Confronted with a severe balance of payments crisis in 1991, Prime Minister P.V. Narasimha Rao appointed Dr. Manmohan Singh as finance minister with a mandate to undertake sweeping structural economic reforms. Two weak coalition governments headed by VP Singh (November 1989-November 1990) and Chandrasekhar (December 1989-May 1991) had seen India's foreign exchange reserves deplete in the run-up to and aftermath of the first Iraq War. In FY1990/91, India's current account deficit widened to 3.2 percent of GDP – and external debt-service payments rose to 35 percent of current receipts. Political instability exacerbated capital flight (especially by non-resident Indians), and foreign reserves declined to just two months' import cover by the time elections were held in May 1991 - during which the Congress leader, Rajiv Gandhi, was assassinated. The assassination resulted in a modest "sympathy wave" in favour of Congress (which performed much better in states that went to the polls after the assassination than in those where the election had been completed before Rajiv's death). Although Congress was marginally short of an absolute majority, Rao was able to form a stable government that lasted its full term with only a few political hiccups, and was able to make far more progress on liberalising the economy than most observers dared imagine before 1991.

Rao and Manmohan Singh's reforms encompassed: (a) stabilisation measures to compress imports and reduce the current account deficit, including a two-step devaluation of the rupee, and fiscal and monetary contraction; and more importantly (b) a slew of micro-economic reforms aimed at wholesale structural adjustment, including a sweeping de-licensing of virtually all of industry, a substantial phased reduction in import tariffs, and the removal of almost all non-tariff barriers to imports of capital and intermediate goods. Additionally, the capital market was liberalised, by abolishing the government bureau that controlled capital-issues by companies – and the banking sector benefited from a gradual de-regulation of interest rates. By the mid-1990s, the rupee was fully convertible on current account, and virtually all lending and deposit rates were de-regulated (although some administered-interest-rate schemes existed outside the banks, particularly the Small Savings schemes, and the various Provident Fund schemes).

The external sector responded powerfully to these reforms, voting strongly in their favour with a large voluntary inflow of foreign capital (mainly portfolio investment and substantial inflows from NRIs, but also the first significant inflows of FDI). By 1993, the annual increases in external debt was just US$1 billion (down from US$8 billion annually in the last couple of years before the crisis), as a rebound in the current account balance and strong capital inflows allowed foreign reserves to rise to US$21.6 billion by July 1994, three years after the introduction of Manmohan Singh's reforms. Foreign reserves have in fact continued to grow at a spectacular pace throughout the period since - and, at US$127 billion at the end of November 2004, now provide over 17 months' import cover.

Figure 5: Foreign reserves have soared spectacularly



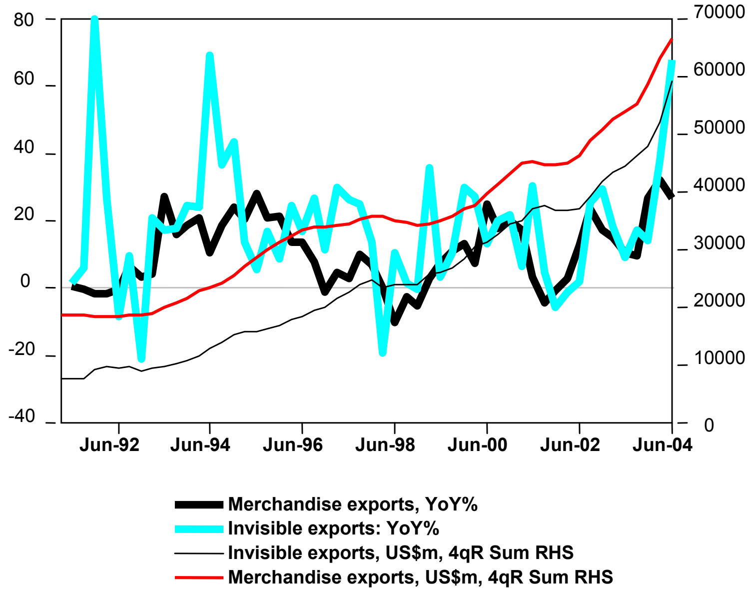
Data source: CEIC database

Initially, capital inflows were the primary manifestation of the improvement in external confidence in India once the broad structural reforms had been introduced. But exports also responded spectacularly to the elimination of the bias toward domestic-orientated production – aided, of course, by the big one-off depreciation of the real effective exchange rate (REER) in the 1991-94 period. There was a moderation in export growth in the late-

1990s in response to the sharp real appreciation of the rupee during this period (as East Asian currencies collapsed while the rupee held broadly stable against the major currencies). Over the past five years, the Reserve Bank of India (RBI) has kept the rupee's REER broadly stable – which has meant a nominal effective depreciation, despite the rupee's strength against the US dollar over the past two years – but merchandise exports have continued to grow rapidly.

Services exports have done even better, growing even when the rupee was appreciating against the dollar – and despite the fact that nearly two-thirds of all software exports go to the US market. Software exports decelerated slightly in the aftermath of the bursting of the 1999-2000 bubble in the IT-"dot-com" sector, but have re-accelerated in the past year and appear set for a renewed burst of growth as India's software companies gain from the surge in business process outsourcing (BPO) and as they begin competing for the lucrative consulting business at the high-end of the software market. Measured most broadly, exports of "invisibles" (services, transfers and investment income) have risen nearly seven-fold, from US$7.49 billion in the twelve months to June 1991 to US$59.1 billion in the 12 months to June 2004. Merchandise exports have not been laggards either – rising by about 260 percent over the 13-year period, from US$18.48 billion at the starting point to US$66.48 billion in the latest period. Taken together, India's exports of goods and services have nearly quintupled over the past 13 years to US$125.6 billion. In the second quarter of 2004, "invisible" exports of US$17.7 billion exceeded merchandise exports (US$16.8 billion) for the first time ever – although this will not be repeated (except in the April-June quarter which is a seasonally-weak one for merchandise exports) for another couple of years. Perhaps most importantly from a comparative perspective, *India's exports are predominantly generated by India's own companies* (as is true in Japan, Korea and Taiwan) *rather than by foreign companies (who generate the vast* *majority of the exports of the ASEAN economies and China)*.

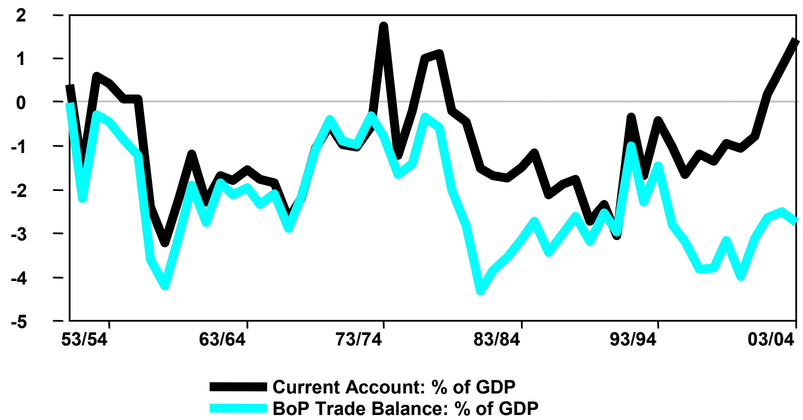
Figure 6: All exports have surged, but especially services



Data Source: RBI Balance of Payments statistics; data points shown are quarterly; transformations by the author

India's revealed comparative advantage in services has also contributed to a structural improvement in the current account balance, which has moved to a surplus in the past three fiscal years primarily because of the large net surplus in services trade. India has traditionally under-exploited its potential as a tourism destination but this is beginning to change too: foreign tourist arrivals rose 26 percent in 2003 and are estimated to have grown 35 percent in 2004 (based on data through the first 11 months) – and this too will contribute to the improvement in the services balance, although tempered slightly by the concomitant rise in Indians venturing overseas themselves.

Figure 7: Current account swings to surplus, led by services

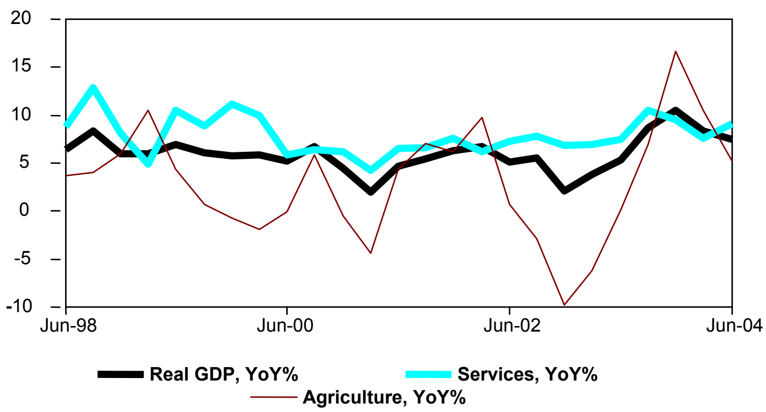


Data sources: CEIC database, RBI Balance of Payments statistics

Services were traditionally considered to be “nontradable” across borders, thereby limiting developing countries’ ability to take advantage of their much lower costs for producing services. However, more and more services have become internationally tradable as the cost of communication (in particular) has fallen with the telecommunications and information-technology revolution. While exports of software services account for about 2.5 percent of GDP – and all “invisible” exports are about 13 percent of India’s GDP – the broader, domestically-oriented services sector (telecommunications and transport, banking/finance, etc.) has also been growing strongly. Over the past eight years, the real growth of the services sector has usually exceeded 8 percent annually. And since services are almost half of GDP, the strong growth of the services sector has also underpinned the overall growth of the economy (see Figure 8 below). Although agriculture remains volatile, the services sector’s steady growth has ensured that – even in a bad year (such as FY2002/03), the floor for real GDP growth is now set at 4 percent, and average real GDP growth is in excess of 6 percent.

Manufacturing has been the relative laggard – with real value-added in the sector growing at a modest average pace of 7 percent per year through the decade between FY1993/94 and FY2003/04. This period marked a slump in Asia in 1997-99, during which there was an average real effective depreciation of over 20 percent in Asian currencies. The Indian rupee consequently appreciated in real terms during the period – thereby both weakening the export performance, and hurting import-competing industries that faced deflationary pressures from the declining price of imports from the east. After growing at an average pace of 11 percent in real terms in the four years from FY93/94 to FY96/97 (both years inclusive), real manufacturing growth slumped to just 2.8 percent in the subsequent three years as industrial investment declined during the period while industrial companies restructured in the face of the heightened international competition.

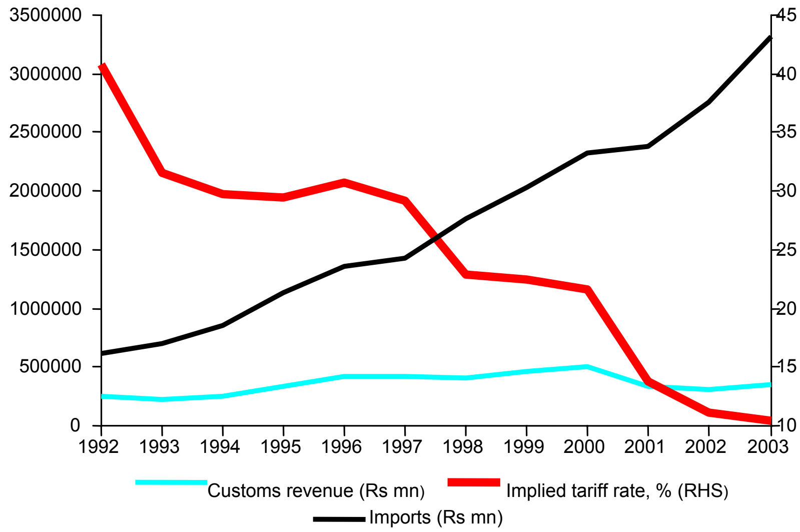
Figure 8: Services growth is steady; agriculture volatile



Data source: CEIC database

While the deflationary burden in the aftermath of the 1997-98 Asian crisis exacerbated competitive pressures from imports, Indian industry has in fact been subject to the vicissitudes of a steady decline in average protection throughout the past 13 years. The average weighted tariff rate (as measured by customs duty revenues as a percentage of total imports) has declined steadily over the period (see Figure 9 below); the only year in which this measure of the average import tariff did not fall was 1996 (a year of political instability resulting from the inconclusive general election in April-May 1996 at the end of the Rao government's term). And not only have tariff rates fallen, non-tariff barriers (including the outright ban on imports of some 7000 consumer goods) were gradually dismantled over the 10-year period ending March 2003.

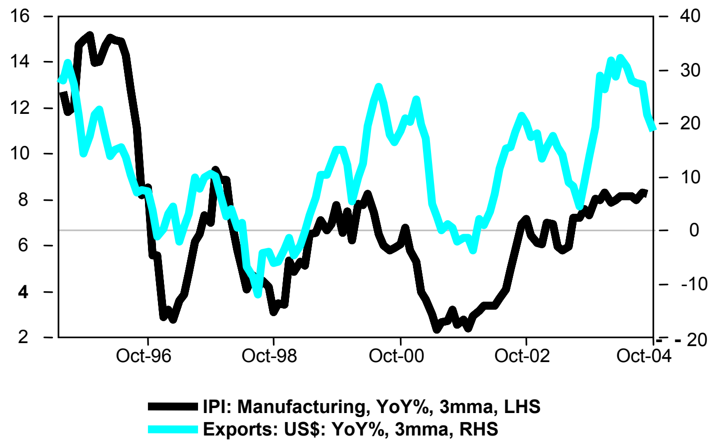
Figure 9: India's Import-tariff rates have declined steadily



Data source: CEIC database; calculations by the author

Notably, while imports have grown more than five-fold over the period, customs duty revenues have barely increased (see Figure 9). In January 2004, then Finance Minister Jaswant Singh announced a further large reduction in import tariffs – cutting them, on average, by over 6 percent, and lowering the top rate of customs duty on industrial imports to just 20 percent (in line with ASEAN economies other than Singapore). This was remarkable from at least two perspectives: (a) Jaswant cut import duties despite the fact that a general election was just months away, but he was criticised for giving “sops to consumers” (rather than for “reducing protection for domestic industry”, as would have been the litany a decade earlier) reflecting the mindset change in India; and (b) tariffs were being cut even in the face of rising oil prices, which were expected to sharply increase India’s import bill. In fact, of course, lower tariffs (on petroleum products too) helped mitigate some of the impact of the higher international prices of oil. More importantly, the comfortably large current account surplus (still expected to be 2 percent of GDP this year) provided ample leeway to the Hindu-nationalist finance minister to cut customs duties.

Figure 10: Dichotomy between exports and overall manufacturing



Data source: CEIC database; transformations by the author

The reforms and structural transformation of the economy have meant that the hitherto-protected segments of the economy have been forcibly opened to both domestic and foreign competition (because of de-licensing and the removal of import protection respectively). Companies in these formerly-protected sectors were able to ossify their quasi-monopolistic and oligopolistic positions in the market, especially during the Indira Gandhi years - in which there was little scope for additional entry into industry, and ossification even extended to the secondary-school enrolment ratio (which barely edged up to 30 percent in 1978 from 29 percent in 1965, while Korea's ratio doubled during the same period[10]). *But in the 1990s, companies either had to invest in upgrading their machinery/technology, restructure or watch their market share melt away*.

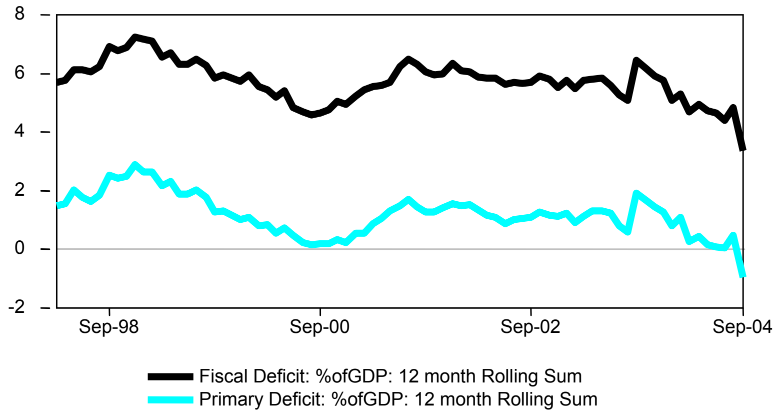
While some companies were not able to cope – and did see their market share erode drastically – most of corporate India has responded to the challenge well. Initially, there was an investment boom (1992-95) during which companies eagerly sought to invest in new capacities and enhanced technology. This partly came to grief, as the Asian and global downturn (particularly in sectors like steel and petrochemicals) hurt precisely those companies that had led the investment boom – setting off a period of painful restructuring (1997-2001). However, by 2003, a new investment-led recovery was clearly visible – led by knowledge-based manufacturing sectors (automobiles, auto-components, electronics and pharmaceuticals), but also extending to commodity-manufactures like aluminium and steel (in both of which India is the lowest-cost manufacturer in the world), cement and petrochemicals. Capital goods output has been growing in strong double-digits for two years now (and grew 16 percent year-on-year in the third quarter of 2004). Consumer goods have also grown strongly, but the data suggests (as shown in Figure 10 above) that overall manufacturing growth has lagged the strength of exports (85 percent of which comprise manufactured products). Actual manufacturing growth is probably much stronger than what has been officially reported in the past four to five years, primarily because the industrial production index is unable to account for rapid changes in technology (such as the shift from black and white TVs to colour, or scooters to motor-cycles; the index over-weights the older-technology product, and so under-estimates growth – particularly of fast-growing consumer goods segments).

[10] Amsden, table 9.3.

Additionally, in recent years, the textile and garment industry has begun to gear up to take advantage of the dismantling of the Multi-Fiber Arrangement (MFA) at the beginning of 2005. The growth of India's textile industry has been severely constrained in recent years by MFA quotas, especially in the US where India's quota of just over 2 percent is puny when compared with the 20 percent effective quota that China enjoys (12 percent for the PRC and 8 percent for Hong Kong). Several major private players in India's garment/textile sector have quickly geared up to take advantage of the opportunities presented by the withdrawal of MFA quotas – including Reliance (which bought the German specialised-textile manufacturer, Trevira, in August 2004 to help exploit the European market), Arvind (the world's largest denim manufacturer), Raymond's and Grasim (which have both restructured to gain market share at the high end of the domestic market and export). Studies by the World Bank and WTO suggest that India's share of the global market for textiles and garments should rise to about 15 percent (from the current 2.5 percent) as a result of the dismantling of MFAs; while this is seemingly dwarfed by the expected rise in China's global market-share (from 20 percent to 50 percent), the six-fold increase in market share expected for India would of course provide ample scope for strong growth over several years.

The Achilles Heel of the Indian economy has been the fiscal balance – and the related perception that infrastructure presents insurmountable bottlenecks to growth. After some improvement in the first three years under Finance Minister Manmohan Singh, the central government's fiscal balance has been stubbornly high – at 5.5 percent to 6.5 percent of GDP – for most of the past decade. However, the NDA (National Democratic Alliance) government took several important steps to widen the tax base – by obliging more of the population to file tax returns (based on known ownership of specific high-value consumer goods) and introducing a tax on services for the first time – and also both to raise revenues and reduce the long-term call on the exchequer by starting an ambitious privatisation programme. Consequently, there was a decisive decline in the fiscal deficit – to 4.7 percent of GDP in FY2003/04, the first time in over a decade that the deficit was lower than the originally-budgeted figure (and by a very comfortable 0.9 percent of GDP in this instance).

Figure 11: Fiscal and primary deficit shrink to 6-year lows



Data source: Controller-General of Accounts, GOI; CSO for GDP; transformations by the author

The fiscal improvements have continued into the current fiscal year, aided by the continued strengthening of the industrial sector (which remains the main contributor to government revenues; agricultural income is untaxed, and services sector incomes have just started being taxed in recent years, and are still small by comparison). In the first half of FY2004/05, the fiscal deficit was just 3.7 percent of GDP – as net revenues from personal income taxes rose a robust 73 percent year-on-year, enabling income tax revenues to exceed customs revenue for the first time. Already, net corporate tax revenues (which rose 37 percent in FY2003/04) are greater than customs revenue – thereby completing the transition of the Indian fiscal system from its unhealthy dependence on customs duties to a more sustainable reliance on direct taxes on personal and corporate income.

Figure 11 (above) uses a 12-month rolling sum of the fiscal and primary deficit to smooth seasonal fluctuations – and to provide a monthly update of the fiscal position relative to history and budgeted targets. The 12-month rolling sum of the fiscal deficit fell to 3.4 percent of GDP in September 2004 – well below the target of 4.4 percent for the year – and the primary fiscal balance swung to a surplus of 1 percent of GDP. With the stock market transactions tax being introduced in October (replacing the capital gains tax that was abolished in July; the transactions tax is expected to deliver about 10 times the annual revenue from the capital gains tax), the fiscal improvement should be sustained through the rest of this fiscal year and (if a nationwide VAT is introduced this April) into the future.

The new United Progressive Alliance (UPA) government has effectively shelved the NDA government's privatisation programme – although the NDA had also shifted to the more politically-palatable route of partial disinvestments in the last year of its term in office. In 2001-03, the NDA was able to complete several major privatisations – including of Maruti Udyog Ltd. (MUL), the largest car manufacturer, VSNL (the former international long-distance monopolist), BALCO (the second largest public sector aluminium maker), Hindustan Zinc (the largest zinc producer), CMC (the legatee of IBM in India), Modern Foods (a baker) and numerous smaller companies. In all these cases, the new private shareholders gained management control as well as ownership. In FY2003/04, however, the NDA mainly sold off minority stakes – albeit in large government companies such as the oil exploration and production behemoth ONGC. The UPA has signalled that it is willing to continue with the latter, and has already "disinvested" 10 percent of the government's shares in one major public-sector enterprise (that of National Thermal Power Corporation). Privatisation led to a marked improvement in the financial performance of most of the privatised companies. The slowdown in privatisation is a modest setback, although not one that will slow overall economic growth.

Conclusions: India is likely to grow faster in the future

India's physical infrastructure remains noticeably worse than virtually anywhere in East Asia (even Ho Chi Minh City's airport is distinctly better than most of India's airports). But this has not stopped India from growing real GDP at an average pace of 6.2 percent a year over the past ten years (faster than all the East Asian economies save China and Vietnam). The reason is primarily that, while the absolute level of physical infrastructure remains poor, it is steadily improving at the margins. Tele-density, for instance, has improved from seven phones per 1000 people in 1994 to 86 per 1000 in November 2004; port handling times have more than halved (although they are still very slow by Singapore standards); and the national highways have improved dramatically (especially with the completion of most of the Golden Quadrilateral highway-building and extension programme). Airports and power remain the two areas where progress is relatively slow, although several domestic airports have improved markedly.

With the expected privatisation of the two largest international airports – and a new privately-built airport likely in Bangalore – there should be further improvements. And the Electricity Act, 2002, provides the road-map for reform of the power sector but progress on implementing it has been fitful – especially with several state governments making electoral promises in 2004 that directly challenged the provisions of the Act. Once in power, however, most Indian ministers prove much more pragmatic in policy implementation than their rhetoric on the hustings would suggest, and electricity reform is likely to make progress (albeit fitful) in the years ahead.

Given the steady improvements in other areas of infrastructure, an unexpected decline in the fiscal deficit (which means less need for India's interest rates to rise), and the large demographic dividend set to unfold over the next 15 years, India's real GDP is set to accelerate in the period ahead. India produces about 3.1 million college graduates each year[11], 50 percent more than the 2 million churned out by the next biggest producer of graduates (the US). Of these, about 260,000 consist of engineering and science graduates – again a considerable lead over the US and everybody else. Tertiary enrolment – especially in engineering, technical and management schools – is rising rapidly, and is expected to rise 50 percent from the levels of last year by 2008[12]. Increasingly, new urban centres (such as Calcutta and its suburbs, and the Delhi suburbs of NOIDA and Gurgaon) are taking up where Bangalore and Hyderabad (the original software and IT-services boom towns) have left off. As the latter move into the higher-end services, newer cities and towns are taking over the medium- and low-end of the services export business – and there is a vast pool of smaller cities and towns (Chennai, Pune, Kanpur, Lucknow, Guwahati, Bhubaneswar, Ahmedabad, Jalandhar, etc.) that will take up the baton in future. This iterative process should continue to ensure that India retains its lead in software exports, BPO and other internationalised services over the next 10-15 years.

While software export revenues are just 2.5 percent of GDP now, they should rise to 6 to 7 percent of GDP by 2008 – and total "invisible" exports should rise from the current 13 percent to nearer 25 percent of GDP by 2010. As that happens, the multiplier effects on the economy (generated by the domestic spending of the dollars and Euros earned through services exports) will be progressively larger than they are now. Additionally, knowledge-based manufacturing should also gather momentum – as consumer-electronics join the already-buoyant pharmaceutical, automobile, auto-component and fine-chemical export sectors. And the abolition of MFA quotas should also generate a multi-year boom in textile and garment manufacturing and exports, helping to boost industrial employment in the medium-term.

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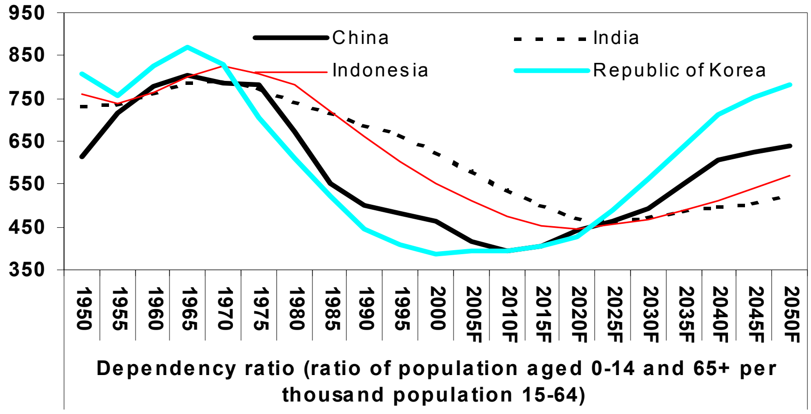
[11] Manjeet Kripalani and Pete Engardio, *The Rise of India*, Business Week, 3 December 2003.
[12] Ibid.

Figure 12: Dependency Ratios



Datasource: UN, with transformations by REAL-Economics

India's demographic dividend is unfolding a bit more slowly (and later) than in all of East Asia. While most East Asian countries saw their dependency ratios begin declining around 1970, India (and Indonesia) only began to see the dependency ratio decline decisively after 1980. As dependency ratios decline, national saving rates typically rise – and a higher savings rate boosts the investment-GDP ratio, enabling labour productivity to rise faster; in the long term, of course, productivity is the main determinant of prosperity – and most of East Asia has seen this virtuous demographic and economic circle unfold since 1970. India began to benefit from this process in 1980 (so it perhaps should not have been too surprising that India's growth acceleration also began that year).

With everything else remaining broadly unchanged, India should grow at about 7 percent a year over the next 10 years, benefiting from the demographic dividend, the growing share of services exports in the economy, and a more sustainably buoyant manufacturing sector (led by knowledge-based industry and textiles). The impact of biotechnology on the agriculture sector could also deliver gains. But if the already-enacted power sector reforms are truly implemented, and infrastructure bottlenecks are more rapidly eliminated as the fiscal situation improves, real GDP growth could accelerate to 8 to 8.5 percent annual growth over the decade. Finally, if labour-sector reforms also occur (currently quite unlikely in the next five years) growth over the next decade could actually accelerate to China-like figures of over 9 percent a year. But that would be asking for too much: in the likeliest scenario, India will grow at a little over 7 percent a year – the fastest pace of growth ever witnessed in a large democracy – over a decade.

India's Future Security Challenge: Energy Security

By Brahma Chellaney

In a world characterised by both rapid change and uncertainty, India has to make the best use of available resources and opportunities to promote the well-being of its people. India's interests demand a stable, quiet environment in which it can concentrate on economic and social modernisation and technological development. A country's desire for peace and rapid development, however, cannot by itself be a guarantee of its security and prosperity.

India is pursuing a pioneering model of modernisation via democracy - a model that holds important lessons for both India and other developing countries. It is a model that provides for grassroots participation in governance and development and whose openness, transparency and free avenues for expression are in accord with India's historical character as a benign, assimilative civilisation. India's political system complements its traditions of tolerance and compassion, and its partiality towards cooperation and conciliation.

Democracy may have become a political norm in Europe but that can hardly be said about Asia. Political asymmetries are striking in Asia, a continent whose significance in international relations in the coming years will begin to rival that of Europe in the 18^{th} and 19^{th} centuries. The centre of gravity in world affairs is slowly but noticeably moving towards Asia, which has the fastest-growing economies, the fastest-rising military expenditures and the areas with the most serious potential for crisis. This continent, also at the centre of the global war on terror, will determine the new world order.

At a time when international terrorism has intensified debate on the potential role of democracy to moderate extremist trends, India serves as a reminder that democracy and freedom are not luxuries but central to the building of stable, pluralistic and prospering states.

In a world in which rapid economic growth has usually been set in motion through political autocracy, India presents itself as a commendable democratic model of modernisation. Even as Indian voters have regularly thrown out politicians who became too big for their boots, India has quietly moved from being an emblem of poverty to being a knowledge-driven nation threatening to steal high-tech jobs from the West.

India demonstrates that democratic politics and market economics can blend nicely for developing nations and that they need not follow the model set by South Korea, Taiwan, Thailand and other states which first achieved impressive economic growth under authoritarian rule before moving to democracy under pressure from their burgeoning middle classes. Autocratic rule is addictive and, as exemplified by Singapore, a transferral to a fully-fledged democracy can at times be difficult to achieve. Another lesson is that democracy takes roots through self-choice, not through imposition from outside.

Democracy is also a great moderating influence. At a time when extremism and terrorism are getting unfortunately linked with Islam, the world's second largest Muslim population in India stands out as a welcome exception. The avenues for free expression and debate, and participation in the democratic processes, have helped foster a moderate Indian Muslim community that has provided no known recruits to Al Qaeda or other such terrorist organisations.

Terrorism not only threatens the free, secular world but also springs from the rejection of democracy and secularism. The terrorism-breeding swamps can never be fully drained as long as the societies that rear or tolerate them are not de-radicalised and democratised. Without an accompanying effort to inculcate a secular and democratic ethos in societies steeped in religious and political bigotry, the global war on terror can hardly score any enduring success.

Democracy also makes India's political future less uncertain in comparison to states that practice autocratic politics. For example, the question many ask is whether China will continue to grow economically and militarily in a linear fashion. That question arises from a basic contradiction in the two paths China is committed to pursuing: political autocracy and market capitalism. If China manages to resolve that contradiction, it could emerge as a peer competitor to the United States. The other possibility is that the paths of political autocracy and market capitalism are not reconcilable and that at some point they will collide, as they did in Indonesia, with negative consequences. If they do collide, the next question is whether China will be able to handle and manage the adverse fallout in a way that preserves its unity and rising strength. No one, however, is raising such questions about India.

Whether India will assume a global role commensurate with its size depends on a host of factors, including its leadership quality, strategic vision, continued pursuit of growth-boosting policies, control of corruption, spread of education, political stability and internal cohesion. A key determinant of India's future will be its ability to meet its spiralling energy needs. Despite that challenge, India appears set on a rising economic path.

Although democracy remains India's biggest asset, populist electoral considerations have prompted federal and state governments to ignore hard choices and seek soft options. An example is the way the unchecked influx of millions of illegal immigrants from Bangladesh has been allowed to strain the already-fragile ethnic balance in several parts of India's diverse North-East and exacerbate the internal security challenges there.

More broadly, to help sustain its pride as the world's largest democracy, India has to demonstrate that fair elections bring not just new governments but also good, clean, national interest-focused governance. Having disproved that its inherited social values are a barrier to rapid economic growth, India can now show that those values do not promote a lack of accountability, or a tolerance of political corruption, or even an aversion to hard decisions. It is against this background that India's energy-security challenges need to be seen.

Energy and Security

Inter-state conflict in the coming years will be driven not by ideology but by competition over scarce resources. The likelihood of resource wars has to be seen in the context of the growing inter-state competition in the world. The more the world has changed, the more it has remained the same in some critical aspects. The Information Revolution and globalisation have not changed the nature of international relations or the makeup of the international system, even as they have triggered fundamental changes in polity, economy and security. The rapid pace of technological change is itself a consequence of nations competing fiercely and seeking relative advantage in an international system based not on collective security but on national security.

What have altered are the forms and dimensions of conflict,[1] as the rise of both intra-state strife and unconventional aggression in the form of terrorism attest. Inter-state war, however, is unlikely to disappear as a feature of international relations. In fact, "the only thing more common than predictions about the end of war has been war itself".[2]

Nothing better illustrates the dangers of resource wars than the emerging situation in Asia, where high economic growth rates have fuelled concern and competition over raw materials and energy resources. Energy has become critical to continued economic expansion in Asia and the spectre of inadequate energy supply has intensified geopolitical rivalry among outside powers in oil-rich Central Asia, the Caspian Sea basin and West Asia. The two largest countries, India and China, which make up more than a third of the global population, are already competing to source energy supplies from overseas. For the United States, the global war on terror has allowed Washington to set up new military bases in the Caspian Sea basin and Central Asia, even as it attempts to subdue a spreading

[1] Lawrence Freedman, "The Changing Forms of Military Conflict," *Survival*, Vol. 40, No. 4 (Winter 1998-99), pp. 39-56.
[2] Donald Kagan, *On the Origins of War* (New Haven, Connecticut: Yale University Press, 1998).

insurgency in Iraq, a state with large oil reserves. As India seeks to build a strategic partnership with the United States, it finds US forces now stationed in five neighbouring nations - Tajikistan, Kyrgyzstan, Uzbekistan, Afghanistan and Pakistan.

A striking feature of Asia is how energy demands are influencing strategic thinking and military planning there. With China seeking greater influence from the Pacific to the Himalayas and the Persian Gulf, its rising dependence on oil imports has served to rationalise its desire to carve out a greater strategic space for itself. For example, China's 1992 "Law on the Territorial Waters and Their Contiguous Areas" claimed four-fifths of the South China Sea, underscoring its creeping jurisdiction claims. Through an inclusive, horseshoe-shaped baseline in its maps, Beijing has signalled its intent to assert its control over the South China Sea as its "historic waters" in case oil and gas are found there. Freedom of navigation and overflight principles do not apply in historic waters. Having already declared the Paracel Islands to be part of its historic waters, China now wields the threat of doing the same to the Spratlys to the south.

India's energy vulnerability is greater than that of China's, which has in recent years become an oil importer. India's increasing concern over energy security arises from its fast-rising dependence on oil and petroleum products imported by sea from the Gulf region. That concern has underscored the importance of protecting sea-lines vital to India's economic and strategic interests. The Indian Navy, whose modernisation had been neglected for almost 15 years, is now receiving special attention from policy-makers in New Delhi.

A rapidly modernising India will inescapably face growing challenges on the energy-security front. Although it is already the world's sixth largest energy consumer, India is witnessing its energy consumption rise at one of the fastest rates in the world, owing to its accelerated economic modernisation and continued population growth. A linear analysis of India's demand-and-supply situation over the next two decades shows a ballooning energy deficit.

The oil situation is particularly alarming. In the face of limited new discoveries of hydrocarbon resources in the country, the relationship between demand and domestically produced supply has become increasingly adverse over the decades. Domestic oil production met nearly half of the national demand in the 1980s. But over the past two decades, domestic production increased only marginally, because the government failed to provide exploration and production incentives to the private sector.[3] Today domestic production can meet less than 30 percent of the demand - a figure likely to plummet to a single digit in a decade, at the current GDP growth rate of 6 to 6.5 percent annually. In fact, the government has told the national Parliament that the country’s current oil reserves are likely to last only until 2016 if no new major oil discovery is made in the meantime.[4]

Oil, however, accounts for barely one-third of India's total energy consumption.[5] To meet its rapidly rising energy needs, India is making major investments in energy infrastructure, particularly to try to fill the shortfall in supply of electric power. It is adding 100,000 megawatts (MW) over the next decade to the existing 120,000 MW electricity-generating capacity. This has been made necessary by the fact that the single biggest constraint to rapid economic development is the deficit in electricity supply, with power outages endemic across India. It is largely domestic capital that is currently financing new power-generating projects because foreign direct investment has mostly been scared away by the continuing problems with India’s state electricity boards (SEBs) that control the power distribution infrastructure. The much-heralded Electricity Act of 2003 was designed to help overcome the problems plaguing the

[3] K.K. Birla, “Oil Our Machinery”, *The Hindustan Times*, December 11, 2004.
[4] Statement in Parliament by Petroleum Minister Mani Shankar Aiyar, December 2, 2004. Mr. Aiyar said: "As per the Ninth Five-Year Plan document, presuming no further discoveries are made, the hydrocarbon reserves of the country are unlikely to last beyond 2016 at the production levels of 2001-02".
[5] Figures on energy production and consumption in India have been drawn from public information provided by the following: India's Ministry of Power, India's Ministry of Petroleum and Natural Gas, Oil & Natural Gas Corporation Limited, The Energy and Resources Institute, Tata Energy and Resources Institute -- North America and EIA - Country Information on India.

power sector. But the change of government in New Delhi in May 2004 has considerably slowed power-sector reforms.

As the third largest producer of coal in the world, India relies on coal for at least 50 percent of its total energy needs. About 70 percent of the coal is used for power generation. However, given the high ash content and low calorific value of Indian coal, India has to import most of the coking coal it needs. Although India's coal consumption is growing by 10 percent every five years, low productivity and high cost of coal production have made imported coal cheaper and more attractive. Moreover, trade unions have stymied coal-sector liberalisation, with the state-run Coal India Limited (CIL) controlling most of the country's 390 mines.

India's oil imports are expected to rise sharply as its oil consumption jumps 25 percent in the next six years to an estimated 3 million barrels per day (bpd). The offshore Mumbai High remains India's largest oil-producing field, yielding nearly a third of all oil domestically produced. The other oil fields are spread across India, including in Upper Assam, Cambay and the Krishna-Godavari and Cauvery basins. To help reduce its import dependence, the Indian government unveiled in 1997 the New Exploration Licensing Policy (NELP), which opened oil exploration to foreign firms. Of the 90 exploration blocks awarded so far under the NELP programme, 19 have been found to contain oil and gas.[6] Foreign investment in the oil sector is also being encouraged to help bring in technology to improve India's low drilling recovery rates.

More than oil, however, it is natural gas whose consumption is growing the fastest in India. The demand for natural gas, according to the government, is expected to increase to 400 million standard cubic metres (MSCM) per day in 20 years, when India's production presently is barely 100 MSCM per day.[7] Despite recent discoveries of significant quantities of natural gas at the Krishna-Godavari basin in Andhra Pradesh and in the states of Orissa and Gujarat, India will have to continue to import increasing amounts of natural gas - either

[6] Statements by Petroleum Minister Mani Shankar Aiyar at news conferences on November 15, 2004, and January 7, 2005.
[7] Ibid.

in liquefied form or through prospective pipelines - to meet its domestic demand.

As India steps up electric power capacity, its imports of natural gas would likewise rise, because the power sector remains the single biggest consumer of gas. To cope with the spiralling domestic demand, India is building an ambitious natural gas infrastructure, including a pipeline connecting Calcutta and Chennai and the doubling of the throughput capacity on the main Hazira-Bijaipur-Jagdishpur pipeline.

New Liquefied Natural Gas (LNG) import terminals on India's western coast, stretching from Gujarat to Kerala, symbolise the LNG-supply relationships India has entered into with Iran and Oman. In addition, India is seeking to import natural gas via pipelines, with one project already underway following a natural gas find in Burma not far from the Indian border. Indian state-owned companies own 30 percent equity in the newly found Burmese reserves. In order to begin laying the pipeline, Burmese military forces, in a major operation in November 2004, cleared the remote region of Karen insurgents and rebels from India's North-East who had taken refuge there. According to Indian media reports, the Burmese forces lost 20 men in the clearing operation.

The gas pipeline from Burma could help invigorate economic development in India's restive North-East, which is connected to the rest of the country through an exceptionally narrow corridor crammed between Bhutan and Bangladesh. A key challenge for India is to help the North-East break out of the vicious cycle in which it finds itself: inadequate infrastructure and development breed popular disaffection that meddling external forces exploit to set off disruption and violence, which in turn scare away private investors. The manner in which the North-East has lagged behind is apparent from its economy growing by barely a third of the national average in the past decade. Given the uneasy ethnic mix in the North-East, made tenser by the rise of sub-ethnic identities, this region offers a fertile ground for external troublemakers. It should not be forgotten that insurrectionary seeds were sown in India's North-East first by a foreign power - China. In fact, Pakistan only took a leaf out of the Chinese book by initiating a proxy war to bleed India in Kashmir in the same manner that Mao Zedong intended by arming India's Naga and Mizo guerrillas. With India now signing a free-trade agreement with Thailand and preparing to conclude a similar accord with Singapore, an economically vibrant North-East could serve as its gateway to closer cooperation with ASEAN states.

Overall, India's energy future looks dependent on high-volume imports. As of April 1, 2004, the balance recoverable oil plus oil equivalent of gas (O+OEG) in India was quantified at 1.66 billion metric tons, according to government estimates It may, however, be possible for India to stem its ballooning energy deficit through a strategy that combines four essential elements.

The first pillar of this strategy would be to encourage a more aggressive search for oil and gas finds in India by providing major incentives for exploration to Western and Indian companies. Increasing overall recovery rates from drilling, so far averaging only about 30 percent, has to be part of this effort. Oil and gas exploration in India has followed a conservative path in the past, because such exploration was led by public-sector firms. With the entry of Western companies, this picture is changing. In fact, the federal government is now offering attractive terms for exploration. The major oil find in Rajasthan state in January 2004 - the largest discovery in any country in the past year - underscores the promise of additional major discoveries. India is geographically diverse and thus a fertile environment for oil and gas exploration - from the desert of Rajasthan, to offshore basins, and to island chains.

The western part of Rajasthan adjacent to Pakistan looks very promising after Britain's Cairn Energy reported several oil discoveries in 2004 in that region. The biggest find, the one in January 2004, was at Mangala, estimated to contain at least 500 million barrels of recoverable reserves. Commercial production at this field is slated to begin by 2007, with an expected volume of more than 100,000 barrels per day (bpd).

A second pillar of the energy-security strategy has to be a greater emphasis on generating commercial nuclear power. India needs not only more electricity but also less pollution. India's heavy dependence on coal for generating electricity has contributed to high levels of carbon emissions. In fact, India has the dubious distinction of having one of Asia's highest levels of carbon intensity, defined in terms of carbon emissions per dollar of GDP. However, as a non-Annex I country under the United Nations Framework Convention on Climate Change, India is not obligated to reduce its emissions of carbon and greenhouse gases (GHG). Yet, if India is to meet its energy-security needs in a more environmentally friendly way, it will increasingly have to turn to the GHG-free commercial nuclear power. The challenge for India is to make nuclear power commercially more competitive.

The costs of building a plant to produce electricity from nuclear energy are higher in any country, as compared to coal and natural gas stations. That is a key reason why India, despite having one of the world's oldest commercial nuclear power programmes, remains more attracted to coal and natural gas for electricity generation. If one factors in the costs involved in energy firms controlling the discharge of pollutants from coal and natural gas combustion through anti-pollution technology or the incalculable costs of environmental degradation from the uncontrolled or unmanageable release of greenhouse gases, commercial nuclear power makes economic sense. Nuclear power, of course, poses a spent-fuel problem. Spent fuel can safely be disposed of through technological innovations, either by burying it several kilometres deep in a borehole or placing it in mined repositories.

India, however, intends to recycle spent fuel as new fuel for its next generation of commercial nuclear plants, known as fast-breeder reactors. India currently operates 12 Pressurised Heavy Water Reactors (PHWRs) that employ natural uranium as fuel and generate only a small fraction of the total electricity produced in the country. India's plans to move to fast-breeder reactors flow from two factors: its limited natural-uranium reserves that can support only 10,000-megawatt generating capacity; and its present place outside the international non-proliferation regime.

A major handicap for India is that, unlike China, it cannot invite foreign corporations to set up commercial nuclear power plants because of the continuing restrictions New Delhi faces from the Nuclear Suppliers' Group (NSG). Founded in 1974 in response to India's first nuclear test, the NSG is a US-led syndicate that seeks to penalise those countries that have remained outside the Nuclear Non-Proliferation Treaty (NPT), like India, or have signed the NPT but are still viewed as states of proliferation concern. India, a vocal critic of the NPT for dividing the world between nuclear haves and have-nots, gate crashed the nuclear club in 1998 by carrying out a series of nuclear tests and simultaneously declaring itself a nuclear state.

Paradoxically, the very subject that bedevilled relations between the United States and India in the past and continues to be the main obstacle to high-technology commerce between the two - the nuclear issue - acted as a catalyst for the positive transformation of the relationship between the world's most powerful and most populous democracies. India's 1998 tests marked the defining event in elevating US-Indian ties and promoting closer engagement. A nuclear India received greater attention and respect in the world, including from Washington, opening the path to the first US presidential tour of India in more than two decades and to strategic cooperation. An ongoing US-Indian initiative, called the "Next Steps in Strategic Partnership" (NSSP), turns the NSG's founding principle on its head by promising India greater access, not greater restriction, to high technology. The NSSP, in the years to come, could ease some of the NSG's core restrictions against India and permit at least a case-by-case approval of turnkey commercial nuclear power projects in India under the safeguards of the International Atomic Energy Agency (IAEA). American, French and Russian nuclear firms are keen to enter India's commercial nuclear power sector.

However, until that happens, India will have to expand its nuclear energy generating capacity with its own capital and technology. This entails greater investment of public funds in the nuclear energy sector. The state-run Indian nuclear power industry has found it difficult to raise capital from the commercial market. The government needs to encourage private Indian firms to play a bigger role in commercial nuclear power. Several major private firms are already manufacturing systems and components for nuclear power plants.

India plans to build by 2020 four fast-breeder reactors of 500-megawatt capacity each, with the first one already under construction. India has little choice but to go in for breeder reactors because it cannot even buy natural uranium from the international market. By contrast, most other states involved in commercial nuclear power can buy natural uranium at falling international prices because new uranium discoveries have led to a supply glut. According to the head of India's nuclear programme, "In this situation of plenty of uranium availability, there is no urgency for these countries to move on to fast-breeder reactor technology. This, however, is not the case with us".[8] Through the fast-breeder reactor route, India can recycle the spent fuel from its natural uranium-fuelled plants to potentially support an electricity-generating capacity as large as 500,000 megawatts. Commercial nuclear power can make an important contribution to meeting India's growing electricity needs while helping to reduce carbon emissions.

Yet another pillar of India's search for energy security has to be the building of bilateral energy cooperation with neighbouring nations to facilitate plans for regional natural gas and oil pipelines, including from Burma, Bangladesh, Iran and Turkmenistan. The lowering of India-Pakistan tensions due to the start of a dialogue process has raised expectations that New Delhi would yield to the Pakistani and Iranian desire for a $3 billion India-Iran gas pipeline via Pakistan. Such an overland pipeline, which is also being promoted by Australia's Broken Hill Proprietary (BHP) company, would be a major foreign exchange earner for Pakistan. Islamabad could earn up to $735 million a year in transit fees and other charges. This, however, is not the only option for India to import natural gas by pipeline from Iran's huge South Pars field. Two offshore routes bypassing Pakistan have also been technically analyzed by international firms at the behest of the Indian and Iranian governments.

[8] Interview with Dr. Anil Kakodkar, Chairman, Atomic Energy Commission, published in *The Hindu,* November 24, 2004.

The overland pipeline route from Iran would already have become a political reality had Pakistan established normal trading ties with India. Such ties could significantly aid Pakistan's own economy and help attract foreign direct investment to that country. The military regime in Islamabad, however, still refuses to reciprocate India's action years ago in granting the most-favoured-nation (MFN) status to Pakistan. Yet, in the hope of earning hundreds of millions of dollars in annual fees, it wants India to accept the overland Iranian gas pipeline project proposal. And it is willing to offer pipeline-related 'international guarantees', notwithstanding its record of covert actions in breach of international law, including the export of terrorism to India.

While the debate over the overland pipeline proposal has raged inconclusively, India in the meantime has entered into major LNG-import arrangements I with Iran. In the latest and biggest deal, India signed a 25-year contract in January 2005 to annually import 7.5 million metric tons of LNG from Iran starting from 2009. In fact, various studies have shown that the landed cost of Iranian liquefied gas already being shipped to India under existing contracts is no higher than the projected price of natural gas by pipeline via Pakistan if transit fees are and infrastructure costs taken into account.

The Burmese military junta's decision to start building a pipeline to India's North-East underscores the potential of bilateral energy cooperation in southern Asia. Once Burma's international isolation eases and Western petroleum firms explore oil and gas there, it is conceivable that Rangoon could become an important source of energy supply at least to India's eastern states. So also can Bangladesh. Bangladesh can not only earn substantial foreign exchange by selling natural gas to India, it also can earn large transit fees from a pipeline running across its territory from Burma to India's West Bengal state, of which Calcutta is the capital. In a softening of its stance, Bangladesh has now agreed in principle to permit the construction of a pipeline from Burma through its territory, but the actual construction is still not near.

Bangladesh, by the most conservative estimates, has proven national-gas reserves of at least 14 trillion cubic feet (Tcf), with Western firms like Shell and Unocal placing those reserves as high as 38 Tcf. However, Bangladesh's surprising refusal to sell gas to India - ostensibly until it has reliably assessed its reserves and dealt with questions of domestic supply - has already led Unocal to put its Bangladesh operations on hold.

Politics, not economics, has guided Bangladesh's short-sighted approach against exporting gas to India. In fact, the politics has become only more intense in the face of mounting Indian complaints about the unchecked influx of Bangladeshis and the use of Bangladeshi territory by those engaged in subversion in India, including Pakistani intelligence and insurgent groups from India's North-East. While Dhaka insists it is not providing sanctuary to groups that are hostile to India, the incontrovertible influx of impoverished Bangladeshis into India has already made native populations into minorities in Lower Assam and Tripura. For India, the ethnic expansion of Bangladesh beyond its political borders not only sets up enduring trans-border links but it also makes New Delhi's already complex task of border management more onerous. In the long run, it threatens to make India's hold over the North-East more taxing and tenuous.

Economically, Bangladesh cannot indefinitely persist with its reluctance to commercially tap its gas reserves because of the mounting costs of such a defiant stance. It is losing hundreds of millions of dollars every year by refusing to sell gas to the only customer it presently has - India. Rather than undermine its financial and larger interests, Bangladesh has the choice to chart a better future for its large, growing population and stem the flow of Bangladeshis seeking employment opportunities in India. The worst choice for Bangladesh is to continue to export surplus labour to India while not taking steps to generate employment at home by exporting gas to India and employing the revenues from such sales for economic development. With India signing a free-trade agreement with Thailand after such accords with Sri Lanka and Nepal, Bangladesh cannot keep itself isolated from the regional-cooperation trends.

A fourth pillar of India's energy security strategy would be for its large petroleum companies - five of which figure on the *Fortune* 500 list - to acquire ownership rights over oil reserves in other parts of the world. China has been aggressively pursuing this path, entering into major deals in Central Asia and Africa. India's state-owned firms like the Oil and Natural Gas Corporation (ONGC) and Gas Authority India Limited (GAIL) have now started buying equity in oil and gas reserves in other parts of the world. Examples of that are the ONGC's investments in Iran's Yadavaran and Jufeyr oil fields.

Building a sensible strategy for energy security demands a comprehensive, integrated approach encompassing military, diplomatic, economic and political levers. A pragmatic foreign policy that seeks to engage other states while determinedly pursuing national interests is a necessary component of any energy security plan. India also has to build the required defence capabilities to guard against potential oil-supply disruption and other unforeseen energy-related problems.

Future Outlook

India has been a beacon of democracy and stability in a vast region stretching from West Asia to Burma where both remain the exception. India's success in information technology, pharmaceuticals and auto parts, signals its rising economic power. The thriving service sector now accounts for half of India's GDP. Demographics are likely to accelerate the economic change, with nearly half of the Indian population now 25 or under. Just as China has become the global factory for cheap consumer goods, India, with its massive pool of scientific manpower, could emerge as the global laboratory for technological research. Meeting India's growing need for energy, however, will be a major challenge if it is to become, as envisaged by Goldman Sachs, the world's third-largest economy by the middle of the century, after China and the United States.

India has to deal with three key interrelated challenges: stemming its growing energy deficit; containing active and emergent security threats; and limiting greenhouse gas emissions adequately while satisfying its energy needs for social and economic modernisation. Energy and security are closely linked. The 1991 Gulf War was fought partly over the issue of protecting global oil supply and safeguarding the economic well-being of the United States and its allies.[9]. More recently, Iraq, with its strategically vantage location and bountiful oil reserves, became a target for US occupation as part of a neoconservative agenda in Washington to reorder the Middle East. With resource wars likely to be a pattern in the future, no important state can ignore its defence requirements.

India's security challenges are daunting because it is wedged in an arc of autocratic states, including failing or problem states. In fact, the region to the west of India is the global epicentre of Islamic radicalism and terrorism. India, with a large Muslim population of 150 million that could surpass 300 million in a generation, has a major stake in the stability of the region stretching from Pakistan to Iraq. If this region sinks further in fundamentalism, extremism and terrorism, India's security could be undermined. Spreading Islamic radicalism now threatens the social fabric of even Bangladesh.

Added to the terrorism challenge in the region is the nuclear-proliferation problem involving covert transfers across national frontiers. China has had a long-standing relationship with Pakistan in weapons of mass destruction and missiles. As a consequence, "India is contained geopolitically by Chinese-Pakistani cooperation".[10] In what is the worst proliferation scandal in world history, it became known in early 2004 that Pakistani scientists had sold nuclear-weapons secrets to three other renegade states - Iran, Libya and North Korea. It is unlikely that such transfers would have been possible without the support of the Pakistani military.

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[9] As far back as 1980, the US President had declared that, "An attempt by an outside force to gain control of the Persian Gulf region will be regarded as an assault on the vital interests of the United States of America, and such an assault will be repelled by any means necessary, including military force". Jimmy Carter, *State of the Union Address 1980*, www.jimmycarterlibrary.org/documents/speeches/

[10] Zbigniew Brzezinski, "A Geostrategy for Eurasia," *Foreign Affairs*, Vol. 76, No. 5 (September/October 1997), p. 58.

The possibility of terrorists getting hold of nuclear, biological or chemical weapons used to be the stuff of Hollywood movies. But in the weeks following the September 11 terrorist strikes, that threat was brought home starkly to US President George W. Bush. According to Bob Woodward, Bush was led to believe by US intelligence reports that Al Qaeda intended to carry out a crude nuclear attack on the US capital in October-November 2001 with radioactive material procured from Pakistan. "We began to get serious indications that nuclear plans, material and know-how were being moved out of Pakistan," Bush is quoted in the book as saying.[11] It is the failing nature of the Pakistani state, and the old ties between its military and Islamists, that arouse fears of terrorists there getting hold of a crude nuclear device. According to one Pakistan-born analyst, "Pakistan is on the way to becoming the world's first failed nuclear state",[12] while an American writer has described Pakistan as a "Colombia with nukes and Islamic fundamentalism".[13] During the Senate hearings to confirm her as Secretary of State, Condoleezza Rice stated that the United States was "prepared to try to deal with" the threat of Pakistani nuclear weapons falling into terrorist or *jihadist* hands.

In addition to countering land-based threats, India has to support maritime security in the Indian Ocean region. India is a peninsular country with a long coastline and vast exclusive economic zone (EEZ). The movement by sea of 95 percent of its external trade and 84 percent of its oil makes India's maritime interests particularly susceptible. While military threats from across land borders can be anticipated, threats from the seas are less predictable because of the flexibility, mobility and stealth of naval forces. Threats from the sea can materialise in days or even hours, but building a strong navy is a task of many decades. It is central to India's energy-security interests that its navy play a greater role in the Indian Ocean region, which is critical for oil and trade for much of the world. In the years to come, the

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[11] Bob Woodward, *Bush At War* (New York: Simon and Schuster, 2002).
[12] Mansoor Ijaz, "Stop Pakistan's Fall into Nuclear-Armed Failure," *International Herald Tribune*, May 4, 2000, p. 8.
[13] Sebastian Mallaby, "Pakistan's Palaver Turns Democracy on Its Head," *International Herald Tribune*, April 28, 2000, p. 6.

concentration of remaining oil reserves in the Persian Gulf area would make the Indian Ocean region even more important.

In recognition of that need, India has been consciously seeking to play an expanded naval role of late. This is best illustrated by its US-encouraged naval escort of commercial ships passing through the Strait of Malacca. Due to such patrolling, Indian naval presence gained rapid acceptance and legitimacy in South-East Asia. What would normally have taken years was achieved speedily owing to India's joining of hands with the United States to advance common anti-terror objectives. When the Indian Ocean region was struck by a tsunami disaster of epic proportions after the 2004 Christmas Day, the first outside force to come to the aid of Sri Lanka, the Maldives and Indonesia's Aceh province was the Indian Navy, despite thousands of fatalities and widespread destruction in India itself.

India, however, can expect to face competition from China in the Indian Ocean region. China appears to be positioning itself along the vital sea-lanes from the Persian Gulf to the South China Sea. It has helped Iran upgrade its Bandar-e-Abbas port. It is building a deep-water naval base and port for Pakistan at Gwadar. It has begun military cooperation with Bangladesh and it has strategically penetrated Burma, positioning itself in the Coco Islands, at Hainggyi port and elsewhere along the Burmese coastline. In addition, there is the problem of creeping Chinese jurisdiction over the South China Sea. It would seem that China wants to control vital sea-lanes between the Indian and Pacific Oceans.

China's growing focus on the seas has to be seen in the context of its rising oil imports. Although a new importer of oil, it is already importing 80 million metric tons per year - more than one-third of Japan's. By 2015, it could be importing as much oil as Japan. The growing oil-import needs act as justification for China's assertive maritime role. Already, the rising oil imports by China and India have sharpened competition over energy resources and pushed up international oil and gas prices. In the years ahead, it is very likely that Chinese submarines would be in the Indian Ocean. The issue, in fact, is not 'if' but 'when'. Beijing clearly perceives the sea as a sphere of opportunity for extending its strategic, political and trade influence. China's new strategic focus on the seas, in return, is influencing India's long-term security planning.

As the inter-state competition over energy resources becomes sharper and as energy needs begin to dictate military planning, the central challenge for India is to both meet its rising energy requirements for modernisation, and to build power and influence so that it can be a major player on the chessboard of international politics. One critical political factor in energy security is foreign policy. A foreign policy that is dynamic, goal-oriented and focused on the timely exploitation of opportunities can go a long way to enhance India's international profile and aid its energy-security strategy. For the first time, India has begun to integrate its energy policy with foreign policy by consciously promoting oil diplomacy geared towards seizing energy-related opportunities overseas.

In the years to come, it may be possible to embark on a regional energy lattice of gas and oil pipelines flowing from Bangladesh, Burma, Turkmenistan and Iran to meet the large demands of India. But for the foreseeable future, the bilateral route would remain the best option for India to source energy supplies from across its frontiers. The idea of a regional energy grid would become more practicable once Iran and Burma are reintegrated into the international mainstream, Afghanistan becomes free of regional warlords, and Pakistan becomes more co-operative.

India would be better placed to handle the geopolitics of energy resources if it closely integrated its economic and political policies to create synergy and countervailing leverage. The unbalanced geographical distribution of fossil fuels has helped spur oil-related geopolitics. This imbalance is evident from the location of four-fifths of the world's oil resources in politically troubled areas at a time when international competition for oil and other natural resources is sharpening.[14] These troubled areas, from the Gulf to Central Asia, are part of what India regards as its extended neighbourhood. The new 'Great Game' for power and influence in this region is

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[14] Michael T. Klare, "The New Geography of Conflict", *Foreign Affairs,* Vol. 80, No. 3 (May/June 2001), pp. 49-61.

underscored by the link between energy, nationalist and sectarian strife, and weapons of mass destruction.

Given the global trend towards greater deregulation and privatisation in the energy sector, India would also do well to adapt its energy security strategy to the emerging market conditions in which governmental intervention is not easy. At the same time, India needs a more coherent policy to promote domestic energy use in a more efficient, environmentally sustainable fashion. The new governmental push to turn to renewable energy is a necessary first step in that direction. Organised protests over the displacement of local people by large hydroelectric projects, however, have acted as a damper to the promotion of hydroelectricity. Commercial nuclear power remains an appealing but more costly energy option for India. As an energy-poor nation that wishes to harness the atom for electricity generation, India is set to develop a self-sustaining plutonium economy for its planned breeder reactors. Nuclear power, however, is likely to account for a small share in the mix of energy resources that India wants to use in the future.

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