

China's growing reach in South Asia

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China's economic reach in the South Asian region has grown considerably since the late 1990s, while that of India has lagged behind. In 2012, India's trade with its South Asian neighbours — those in the South Asian Association for Regional Cooperation (SAARC) — [amounted to US\\$17 billion](#) ^[1], compared to China's trade with the same countries which amounted to US\$25 billion. China is currently the largest trading partner of India, Pakistan and Bangladesh, and the second largest trading partner of Sri Lanka and Nepal.



This trading pattern has arisen despite India's free trade agreements (FTAs) with Sri Lanka, Nepal and Bhutan, and its participation in the South Asian Free Trade Area (a free trade agreement with seven other South Asian countries). China only has one FTA with a South Asian country, that being Pakistan. Since 2001, it has had a preferential regional trade arrangement with India, Sri Lanka and Bangladesh under the Asia-Pacific Trade Agreement (APTA) for some goods. But India also has preferential market access to Sri Lanka and Bangladesh under APTA, which in any case remains a weak trade agreement.

Clearly, China's trading power indicates that it has more trading complementarities with the South Asian region than India. Chinese trade and investment links have led to growing Chinese financial flows in the form of loans and aid to the region since the mid-2000s. Most of these loans are associated with large infrastructure projects such as ports, highways, bridges and power plants. China has overtaken traditional donors to South Asian countries such as Pakistan, Sri Lanka and Bangladesh; since 2009, [China has become Sri Lanka's largest donor](#) ^[2]. China's [financial assistance to Pakistan](#) ^[3] is also substantial and includes military training. It

has also surpassed India as a major financier of projects in most small South Asian countries.

For now, China's foreign direct investment (FDI) in the South Asian region has not kept pace with growing trade — [it still lags behind Indian investment for most of India's neighbours](#) ^[4]. However, during the last three years, Chinese investment has grown rapidly in some South Asian countries such as Pakistan, Sri Lanka and Bangladesh. And, if FDI from Hong Kong is included, China's total FDI in the region comes close to that of India.

Also, China's increasing focus on the domestic economy may create some pressure on the yuan to appreciate. This would trigger an outflow of Chinese investment, as was the case with Japan after the appreciation of the yen in the 1980s. In that instance, ASEAN countries were the main beneficiaries of Japanese outflows. Thus, given China's strong trading and investment foothold, and the relatively low labour costs compared to East Asia, the SAARC region is in a position to attract more Chinese FDI in the coming years. Chinese FDI may well overtake that of India.

[China's growing presence](#) ^[5] in the region has raised some concerns in India, where the SAARC region is considered to be part of India's geopolitical backyard. [India can do very little](#) ^[6] to prevent the growing economic influence of China in the region, as South Asian countries require China's financial assistance and benefit from deepening trading and investment links. According to Professor S.D. Muni, [India's policy toward](#) ^[7] China revolves around the 4 'C's, containment, conflict, competition and cooperation. Various groups in India support different 'C's: the Indian business community supports competition, while part of the military supports containment, the bureaucracy calls for cooperation, and so on. Thus, the Indian's overall policy stance toward China is confused and diluted by the interests of various lobbies. Whether this will change under the [new Modi government](#) ^[8] is yet to be seen.

In the event of a dispute between China and India, the smaller South Asian countries — which have been growing under the shadow of India for centuries — could experience adverse spillover effects. China's recent disputes with Japan and Vietnam over the Senkaku/Diaoyu islands and oil drilling in the South China Sea, respectively should put them on guard. For these states, managing economic ties with China will be a challenging exercise in the near future.

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[1] amounted to US\$17 billion:

<http://businesstoday.intoday.in/story/india-losing-ground-as-trading-partner-south-asian-countries/1/201078.html>

[2] China has become Sri Lanka's largest donor:

http://www.ips.lk/staff/ed/publications_ed/international/china_srilanka_economic/china_sl_economics.pdf

[3] financial assistance to Pakistan: http://en.wikipedia.org/wiki/China_per_centE2per_cent80per_cent93Pakistan_relations

[4] it still lags behind Indian investment for most of India's neighbours: <http://www.lafollette.wisc.edu/publications/workshops/2013/China.pdf>

[5] China's growing presence:

<http://www.eastasiaforum.org/2014/06/12/wildcards-may-trump-india-china-relations/>

[6] India can do very little:

<http://www.eastasiaforum.org/2014/05/14/delhis-dance-with-the-great-powers/>

[7] India's policy toward: <http://www.routledge.com/books/details/9780415501910/>

[8] new Modi government:

<http://www.eastasiaforum.org/2014/05/31/can-modi-make-indias-dreams-reality/>