



Illustration by BINAY SINHA

Tasks for an emerging superpower

Rapid economic growth and increasing military strength are essential to meeting geo-political challenges, says DEEPAK LAL

With its decisive victory, the new Manmohan Singh government should at last be able to implement the required second generation reforms. Their lineaments are well known and with the removal of the Left's veto, many of those stalled in the legislature as well as those which were forestalled can now be implemented. These should be able to put India back on a 9-10 per cent per annum growth path. There are, however, many new policies that the new government will have to develop, if India's potential emergence as an Asian superpower competing with China is to be achieved. One of these is economic, the others concern foreign policy. These are the subjects I address.

As noted in my February column the current financial crisis marks the end of undisputed US financial hegemony. China now seeks to make the yuan an international reserve currency. It wants to make Hong Kong-Shanghai an international financial centre challenging New York and London. These ambitions are unlikely to be fulfilled unless China lets the yuan float, and opens its capital account. Its recent bilateral trade-cum-currency deals with various developing countries are akin

to the bilateral trading system created by the Soviets under Comecon. But, China is still reluctant to open the capital account and make the yuan fully convertible. For financial repression remains a major tool for the CCP to maintain its political control. It is unlikely to allow the freedom which free capital movements provides ordinary citizens to protect themselves against the predations of the State. China's recent pronouncements on international financial arrangements are more a realisation of its foolish accumulation of \$2 trillion of foreign exchange reserves which could be decimated by the US through the well worn inflationary means of 'euthanising the rentier'.

It is in this context that a high priority for India is to do what China will be unable to do: make its currency a viable international reserve currency and turn Mumbai into a major financial centre. With enough reserves to smooth the domestic effects of any perceived 'stops' in capital inflows or speculative outflows, India can fully open up its capital account and allow the rupee to float. With reduced financial repression, a wealth of financial expertise, and an acceleration of infrastructure investment, Mumbai could become an interna-

tional financial centre on the lines set out in the Percy Mistry report.

But with the necessary privatisation of the banking system, the development of universal banks should be resisted. For, it was the licence given to the US universal banks, by the abolition of the Glass-Steagall Act, to gamble with their deposit base which was in part responsible for the ongoing financial crisis. With implicit or explicit deposit insurance unavoidable today, the 'utility' deposit taking banks must be kept separate from the 'gambling' investment banks, and should be tightly regulated. The pure investment banks can then be lightly regulated (as is the stock exchange) to prevent fraud but allowing financial innovations. But, to prevent moral hazard, no public bail outs of the new investment banks should be permitted, if necessary through an Act of Parliament.

These measures for India's rise as an economic superpower need to be accompanied by various means to improve its geo-strategic position. Apart from the threats from the Western front including from jihadist terrorists discussed in my last column, India also faces encirclement by China. As part of its military buildup, China is emerging

as a major naval power in the Indian Ocean. Its construction of ports in Kyauk Phyu in Burma, Hambantota in Sri Lanka and Gwadar in Pakistan could be converted into Chinese naval bases. Though this naval expansion can be seen, as the Chinese profess, to be a means to guarantee the safety of the Indian Ocean supply routes for the natural resources it imports from the Middle East and Africa, it could—if China decides to become an expansionist power in the future—pose a grave threat to India. Similarly, the recent takeover of Nepal by Maoists and the string of Naxalite rebellions through eastern India provide troubled waters with enough co-ideologists for the Chinese to fish if they seek to create an internal dagger into the heart of India. To counter these possible future threats, India needs urgently to expand its Navy and scotch the internal Naxalite rebellion.

With the diminution of US economic hegemony and Obama's projected switch of military expenditures towards fighting counter insurgencies rather than conventional wars, India can no longer depend on the US to provide a unilateral naval shield. It is in its interest to see that China remains a peaceful and not a threatening expansionist power in the emerging new geo-strategic order. As natural resource importers, China and India share an interest with the US and Japan to keep vital shipping lanes safe and open. With Australia's growing resource exports to China and its projected naval expansion, a five-power formal naval agreement to police the Asian seas maybe feasible. A multilateral naval policing plan which includes China may also soothe any fears of encirclement arising from the inevitable Indian, Japanese and Australian naval expansions, which a future revanchist Chinese government could use as a reason to follow an expansionist policy like the Japanese did before their entry into the Second World War.

But, for India to meet all these geo-political challenges, rapid economic growth and increasing military strength remain essential. A recent Intelligence2 debate in London on the motion "The future belongs to India, not China" (with Mark Tully, Gurcharan Das and myself in favour) was decisively defeated, because of the opposition's emphasis on China's current economic and geo-political strength, and the seeming emergence of a G2. If Manmohan Singh can now complete the economic reforms and the geo-political initiatives he began, a similar motion debated in the future would hopefully be resoundingly affirmed.