WHERE GEOPOLITICS MEETS BUSINESS

June 13-14, 2016

Gateway House Compendium No. 1, June 2016

GATEWAY HOUSE
INDIAN COUNCIL ON GLOBAL RELATIONS
भारतीय वैश्विक संबंध परिषद्

The Gateway of India Dialogue
Where geopolitics meets business

सत्यमेव जयते
Ministry of External Affairs
Government of India

Where Geopolitics Meets Business

Gateway House Compendium No. 1, June 2016

The Gateway of India Dialogue

Where geopolitics meets business

GATEWAY HOUSE

INDIAN COUNCIL ON GLOBAL RELATIONS

Ministry of External Affairs

Government of India

सत्यमेव जयते

Published by Gateway House: Indian Council on Global Relations
3rd floor, Cecil Court, M.K.Bhushan Marg,
Next to Regal Cinema, Colaba, Mumbai 400 039
T: +91 22 22023371 E: info@gatewayhouse.in W: www.gatewayhouse.in

Gateway House: Indian Council on Global Relations is a foreign policy think tank in Mumbai, India, established to engage India's leading corporations and individuals in debate and scholarship on India's foreign policy and the nation's role in global affairs. Gateway House is independent, non-partisan and membership-based.

Cover design: Madhu Amodia
Editorial team: Aditya Phatak, Elvira Eilert Pignal, Sharmila Joshi
Layout: Alaric Moras
Printed by: Airolite Printers

Table of Contents

Foreword

The Gateway of India Dialogue, Mumbai, 13-14 June 2016, has gathered together the foremost minds in Indian and international policy, government, and business, to debate the issues of the day in foreign policy and geoeconomics. Organised and co-hosted by Gateway House: Indian Council on Global Relations and the Ministry of External Affairs, Government of India, this is a landmark event for India, and the first, we hope, in an annual series.

Hosting this dialogue in Mumbai enhances the city's position as India's commercial and financial capital, and acknowledges the contribution of corporate India to expanding the country's global engagement.

The establishment of the conference at this critical, complex moment in world affairs reflects India's readiness to participate, beyond just the level of the government, in the global dialogue. A confident nation that now feels simultaneously global, developing, and Asian, has valuable lessons and practical ideas to share for the future. This includes new thinking on the divergences and convergences of geoeconomics, climate change, energy, cyber-security, soft power, and also a fresh perspective on how the past links to the present.

The conference itself will provide a rich examination of these issues. But to offer additional analysis on the subjects covered at the meeting, Gateway House asked a range experts to bring their voices to the debate through the essays in this compendium. The contributors are established experts from key academic and corporate institutions, and also Gateway House's own scholars.

In this volume, they offer their perspectives on topics that preoccupy policymakers and which will be discussed at The Gateway of India Dialogue. These include the economic fragmentation effect of mega-trade deals, the international financial architecture's resistance to correcting its pro-rich countries bias despite the changing nature of global capital flows, India's need to derisk its import-heavy energy policy and dependence on supplies from a volatile West Asia, Mumbai's position as a regional financial centre, and the subterranean role of *hawala* in terrorism financing, and the challenges this poses for national security.

We hope that this compendium will enrich your attendance at the conference and stimulate further reflection and discussion at the event and beyond.

Aditya Phatak
Elvira Eilert Pignal
Sharmila Joshi

Editorial Team
Gateway House: Indian Council on Global Relations
Mumbai

The *Arthashastra* in Modi's India

In Modi's worldview, bolder than that of his predecessors, India has a bigger place than envisaged before. Consonant with this, the prime minister's foreign policy mirrors the Arthashastra's emphasis on pragmatic and intelligent use of power for the larger cause of the people. Has it been successful so far?

Rajiv Bhatia

Not only western scholars, but even Indian experts nurtured on modern education, may balk at using the *Arthashastra*, written 2,300 years ago, to evaluate Prime Minister Narendra Modi's foreign policy. They should, however, reconsider their perception.

Interest in studying Kautilya, author of the *Arthashsastra* and mentor of Emperor Chandragupta Maurya, and the appreciation of his contemporary relevance, pre-dates the Modi government. Serious studies have been carried out by the Institute of Defense Studies and Analyses (IDSA), a premier Indian think tank since 2012 with support from Shivshankar Menon, former national security adviser (NSA) and foreign secretary. [1] This special project has built on the many years of previous work by Indian and western scholars. More recently, Henry Kissinger's depiction of the *Arthashastra* as "a practical… guide to action" for rulers has underlined its seminal significance. [2]

The *Arthashastra* is a timeless and comprehensive treatise on all facets of statecraft: politics, law, economy, management of war and peace, intelligence, foreign policy, and diplomacy. It explains the fundamental purpose of a state, namely, to ensure welfare and protection of its people.

The complex security-development matrix is an integral feature of international politics at present. Both security (in a wider sense) and development are essential. They are inherently interlinked in the globalised society in which people live—under the shadows of nuclear arsenals and multiple traditional and non-traditional threats to security. Former NSA

Shivshankar Menon has observed that "…in many ways the world which we face today… is similar to the world that Kautilya operated in when he built the Mauryan Empire to greatness." [3]

Restricting this analysis strictly to the *Arthashastra*'s relevance to international relations, one may highlight that the treatise's quintessence is reflected in its three theories of *saptanga* (which views state power as seven limbs, including the treasury, the prime minister, and the army); *raja mandala* (circle of states, where one's own country is surrounded by friendly and unfriendly neighbours); and *shadgunya* (six ways in which a state can conduct foreign policy). [4]

What Kautilya wrote and practiced (as a scholar, mentor, and minister of the emperor) about a State's continuing interaction with different categories of neighbouring, intermediate, and distant states, remains highly relevant. His teachings are a part of India's intellectual DNA. Michael Liebig, a strategic affairs scholar who participated in the IDSA project, states that Kautilya is "a key factor influencing India's strategic culture." [5]

Kautilya and India's foreign policy

In this context, a critical look at Modi's foreign policy and its past legacy is noteworthy. Four of his predecessors provide useful comparisons. Of them, Jawaharlal Nehru studied the *Arthashastra* and wrote about it in his *Discovery of India*. His policy of non-alignment, *panchsheel*, and Afro-Asian unity was a calibrated and earnest endeavour to promote the interests of India and the Third World in a bipolar era. But, by mishandling the relationship with China, he showed an inadequate grasp of Kautilya's realpolitik.

In contrast, his daughter Indira Gandhi exhibited a deeper understanding of geopolitics through her Pakistan policy that resulted in the creation of Bangladesh, which was a strategic masterstroke. In that sense, she was the best exponent of Kautilya's art.

Atal Bihari Vajpayee, the first Bharatiya Janata Party prime minister, shared many policy traits with his Congress predecessors, but his crucial contribution was to make India nuclear. This earned India a special place in the world. A poet and a man of peace, he believed in the realpolitik of

preparing for war in order to avoid it.

His successor Manmohan Singh, moving realistically beyond non-alignment and towards pluri-alignments, strengthened relations with major powers, which provided strategic resilience to the conduct of external relations.

In the past two years, Narendra Modi has practiced a realist foreign policy, anchored in his deep conviction that the people's enlightened interest lies in working "for a bold India and a better world, a harmonious neighbourhood and a happier world, a strong Asia and a safer world." [6]

Modi's emergence has reflected India's greater self-confidence. "Its foreign policy dimension is to aspire to be a leading power, rather than just a balancing power", stressed Foreign Secretary S. Jaishankar. [7] This is close to being *vijigishu* (one who desires victory), as delineated in the *Arthashastra*. The ambition to become a major power reflects the impulse to be a *chakravartin* (the ideal, universal leader) of Kautilya's conception. [8]

Modi and his advisers seem to have absorbed the *Arthashastra*'s fundamental message: the ruler should use power knowledgeably because knowledge is more valuable than power and wealth.

Kissinger saw Kautilya as "a combination of Machiavelli and Clausewitz." [9] He noted that European thinkers treated the balance of power as the objective of foreign policy, whereas the *Arthashastra* stipulated that the purpose of strategy was to conquer other states and prevail over the existing equilibrium to gain victory. Modi's worldview apparently conforms to this—here, it means that he wants India to emerge as a principal leader in the comity of nations. His vision is broader and bolder than that of his predecessors; it is one in which India has a bigger place than envisaged before. Clearly, he believes in widening the circle of friendly nations and keeping them in a creative and dynamic balance in order to counter threats to national security and accelerate economic transformation.

Has it been successful so far? Has India moved closer to this goal? A simple response is not appropriate at this juncture, but a nuanced assessment offers itself. One, progress is visible in the deepening equations with major and important powers across the geopolitical spectrum; two, both successes and setbacks have been experienced in India's relations with its neighbours; and three, far-reaching policy measures have been initiated to bolster India's role in the extended neighbourhood, Indian Ocean and the Asia-Pacific region. "The upshot of all this is that India is not a reluctant engager anymore," [10] said Arvind Gupta, India's deputy national security adviser, at an Asian security conference last year.

Modi's foreign policy thus mirrors the *Arthashastra's* emphasis on a realistic, pragmatic, and intelligent use of power, informed by knowledge and the larger cause or *yogakshema* [11] of the people. While focusing on enhancing hard power as advised by Kautilya, Modi's India continues to believe in *vasudhaiva kutumbakam* [12] and the use of other forms of soft power. A judicious blend of hard and soft power has the potential to turn India into a smart power.

But, for preparing a provisional or final scorecard on Modi's foreign policy, it may be wise to wait for November 2016 or May 2019 when the present government's five-year tenure will reach its mid-point and its end, respectively.

Rajiv Bhatia *is Distinguished Fellow, Foreign Policy Studies, Gateway House. He is a regular commentator on international affairs, an author, and a former Indian ambassador.*

References

[1] Shivshankar Menon was the national security adviser from 2010 to 2014, and foreign secretary from 2006 to 2009.

[2] Kissinger, Henry, *World Order: Reflections on the Character of Nations and the Course of History* (New York, Penguin Press: 2014), p. 195: "Millennia before European thinkers translated their facts on the ground into a theory of balance of power, the Arthashastra set out an analogous, if more elaborate system, termed the 'circle of states'."

[3] 'Kautilya's Arthashastra', address at IDSA, 8 October 2013.

[4] For a full explanation, please see: Mishra, Malay, 'Kautilya's Arthashastra: Restoring its Rightful Place in the Field of International

Relations', *Journal of Defence Studies* (April –June 2016, Vol. 10, No.2), pp.77-109.

[5] As cited by Col (Retd.) P.K. Gautam in the report on event held at IDSA on 19 April 2012, <http://idsa.in/event/KautilyasArthashastraandIndiasStrategicCulture>

[6] Nani Palkhivala Memorial Lecture on 'India and the World', Chennai, 18 October 2013 (i.e., before the last general elections.)

[7] Twenty-first IISS Fullerton Lecture, Singapore, 20 July 2015.

[8] The ancient Sanskrit term that refers to an ideal, universal ruler.

[9] Kissinger, Henry, *World Order: Reflections on the Character of Nations and the Course of History* (New York, Penguin Press: 2014), p. 195: Machiavelli believed that public and private morality should be regarded as two different things, in order to rule wisely. Clausewitz, as experts point out, introduced systematic philosophy into western military thinking—both for the purposes of analysis and practical policy. Long before them, the Arthashastra presented these and other fundamental concepts of ethics, dharma (which is much wider in scope), warfare, and statecraft in a holistic and practical manner.

[10] Address by Arvind Gupta, deputy national security adviser, at the 17th Asian Security Conference at IDSA, 13 February 2015.

[11] *Yogakshema* means a blend of peace, security, and prosperity.

[12] The term means 'the world is one family'. At the JETRO Investment Seminar in Tokyo on 23 July 2012, Modi said that this dictum formed a part of our "genetic system." < https://www.youtube.com/watch?v=wMN759_7ZUI&feature=share&t=7m46s>

An India-ASEAN alliance for Asian integration?

At a time when New Delhi is beginning to not just 'Look East' but also 'Act East', and when parallel integrative processes are underway globally, including the ASEAN-led process, the incipient China-led process and the U.S.-led TTP, India and ASEAN could together produce a brilliant new era of Asian integration

Kanti Bajpai

One of the most successful experiments in Asian integration is ASEAN, the Association of Southeast Asian Nations. From fairly timid beginnings in 1967, it has risen to become the leading edge of the integrative process in the biggest and most dynamic continent on the planet.

Since 1990, it has also drawn India into Southeast and Northeast Asia, both economically and geopolitically. New Delhi now is beginning to not just 'Look East' but also 'Act East'. Its activism is largely welcome in the region. The two could innovate further to pull Asia and its partners together.

At the start, ASEAN was preoccupied with containing the spread of communism and ensuring that Southeast Asians built a system of peace within each member country as well as among the members. Economic development was a key ingredient: an economically dynamic ASEAN would reduce the lure of communism; and trade between the members would boost growth, interdependence, and solidarity. In essence, this was similar to the origins of European integration. Like Europe, ASEAN looked to a powerful protector, the U.S., to defend it against communism if the threat became too serious.

Since then, ASEAN has widened its integrative efforts. With the end of the Cold War, it has brought into its fold former regional adversaries, most importantly, Vietnam. It has also gradually enlarged its outreach to other great Asian powers—China, Japan, and most recently, India. It has done this by inviting these and other powers such as South Korea, Australia, and New Zealand into various regional institutions—the ASEAN Regional Forum, ASEAN Defence Ministers' Meeting, the East Asia Summit, and the Regional Comprehensive Economic Partnership (RCEP).

ASEAN has a series of "bilateral" summits with key powers—China, India, the European Union, and the U.S., among others. It also has free trade or comprehensive economic partnerships with China, India, Japan, South Korea, Australia, and New Zealand.

These arrangements together represent an enormous architecture that is pulling most of Asia into a web of integrative security, and diplomatic/political and economic linkages. ASEAN itself is drawing closer internally with the inauguration of the ASEAN Economic Community in 2015.

India's evolving outlook and role

In the 1940s and 1950s, India worked with Southeast Asian countries to further the cause of Asian regionalism. But the India-China war of 1962 and suspicion of Indian non-alignment distanced New Delhi from the affairs of Southeast and Northeast Asia. It was only with the end of the Cold War that India became more welcome in the region.

India's Look East policy was the vehicle of its return. It has gradually become an integral member of the now expanded ASEAN-led Asian community. India is an attractive partner for two broad reasons: the size and expansion of its market since 1990; and its geopolitical weight in a region that looks at the rise of China with awe and some trepidation. India looks at the region through rather similar lenses: the lure of dynamic economic markets; and comfort in numbers with respect to the Chinese giant. There are other common concerns that have cemented ties: fear of religious extremism, terrorism, piracy, drugs, human trafficking, disaster management, and epidemics, among others.

Since 1990, India has not only become a member of the alphabet soup of ASEAN-led institutions, it has also entered into a series of bilateral economic and security/defence arrangements with Southeast Asian countries. Its closest partners are Singapore, Vietnam, Indonesia, and Malaysia. A little farther afield is Australia, with which it now has a growing defence relationship. India has also made its views known on the South China Sea and has agreed to work with the U.S. to promote security in the Asia Pacific. More than ever, India is Acting East.

Parallel integrative processes?

The ASEAN-led integrative process in Asia is now faced with another similar process. This is led by China and encompasses a series of initiatives that have unfolded with great rapidity over the past 2-3 years. They include the BRICS New Development Bank, the Asian Infrastructure Investment Bank (AIIB), the SCO Development Bank, and the 'One Belt-One Road' project (funded by the Silk Route Infrastructure Fund).

Will this surpass the ASEAN-led structures, will it work in parallel, or will it gradually merge and link up with the ASEAN system? So far, it seems to be positioned in parallel. But the Chinese structures could merge and link up with the ASEAN system. India and ASEAN countries are members of the AIIB. China has approached India and others in the region to take part in One Belt-One Road.

A third integrative process could be described as being U.S.-led. This is the Trans-Pacific Partnership (TPP) arrangement that began with the efforts of smaller countries in Southeast Asia, including Singapore and Brunei. Four ASEAN states (Brunei, Malaysia, Singapore, and Vietnam) are now members of the TPP, which includes Australia, New Zealand, Japan, the U.S., and various other North and South American partners. The U.S. has older integrative links with the region, particularly its alliance and security relationships with Northeast and Southeast Asian countries. Washington's signing up to and promotion of the TPP is part of its pivot to Asia.

The great era of European integration seems to be faltering with the post-2008 economic crisis and the flow of refugees into the continent. Whether the Transatlantic Trade and Investment Partnership (TTIP) reinvigorates Europe and the North Atlantic remains to be seen.

In the meantime, Asia is poised to see integrative activity to an unprecedented degree. China, India, and Malay cultures fused in Southeast Asia to integrate the region and to connect it to the two giants of Asia. The ASEAN-led process, the incipient China-led process, and the U.S.-led TTP processes could be in conflict. Or they could produce a brilliant new era of Asian integration.

India and ASEAN can have a special role to play in reconciling, fusing, and amalgamating these different processes. They stand between China on one side and the U.S. on the other, geopolitically. They have deep economic and diplomatic links to both. They do not threaten each other: India is not regarded as a threat to Southeast Asian countries, and they are no threat to India. In this sense, they form what the political scientist Karl Deutsch referred to as a security community, a relationship in which there is no fear of war. This security community could be a force for greater Asian integration in the years and decades ahead.

Kanti Bajpai *is Professor and the Wilmar Chair in Asian Studies, Lee Kuan Yew School of Public Policy, National University of Singapore. His research and policy interests are Indian foreign policy and national security. He is currently completing a book on India-China relations.*

The politics of global capital flows

The global monetary and financial system is lopsided and designed to favour rich countries; an alternative economic and political doctrine, which takes into account the needs of emerging economies like India, must now be articulated to end this one-sided architecture

Rajrishi Singhal

At the spring meetings of the International Monetary Fund (IMF) and the World Bank in April 2016, Reserve Bank of India governor Raghuram Rajan was bitingly critical of how multilateral financial institutions were influenced by dominant western economic philosophy, but dismissed ideas from emerging economies as "crankiness". [1]

Earlier, in March, at a seminar jointly organised by the IMF and Indian government in New Delhi, Rajan had presented a vision [2] for creating a new global regulatory compact which will attempt, in this inter-connected world, to minimise the deleterious effects of a country's domestic monetary policy on other countries. He followed this up with a syndicated column advocating a new form of Bretton Woods agreement. [3]

Rajan has been deeply critical of western economic orthodoxy for a while. His campaign is part of a movement launched by emerging economies to re-align the prevailing ideological architecture and power structure in West-dominated multilateral institutions (IMF, World Bank) and private financial institutions (global pension funds, hedge funds, rating agencies), as well as in central banks and sovereign wealth funds. The need to construct an alternative architecture forms the ideological bedrock for regional groupings like BRICS as well.

Argentina's brush with vulture capital exemplifies the egregious domination of western precepts in the global financial system. Not only did U.S. courts exercised extra-territorial jurisdiction over another

country in this instance, but a handful of private U.S. financial institutions were also able to hold a sovereign and its citizens to ransom through the dominant Anglo-Saxon model of global capital markets. The enervating effect of unilateral economic sanctions imposed on Iran, or the sectarian manner in which ruling western economies have carved up leadership roles of multilateral institutions among themselves, are other examples.

It is now widely accepted that both the basic plumbing of the international monetary and financial system (IMFS) and the political philosophy behind the architecture, need radical reforms in favour of a system that is even-handed, not rooted to a dominant economic strategy that imposes a one-size-fits-all solution for all problems. This will not be easy, given the reluctance of the political class in rich countries to cede control over a system that's served them so well and for so long.

Problems related to the IMFS were discussed extensively in multilateral platforms like the G20 following the global financial crisis of 2008. In the immediate aftermath of the crisis, the G20 issued solemn homilies on coordinating monetary and financial policies. However, once the U.S. economy showed the first signs of green shoots, this promised coordination was quickly forgotten.

For example, the U.S. Federal Reserve Bank's loud thinking in May 2013 on rolling back its quantitative easing programme resulted in a taper tantrum, with sudden capital outflows causing intense volatility and economic instability in emerging economies. India, and most other emerging economies, experienced a sharp currency depreciation; this forced central banks to intervene in the currency markets, including by raising domestic interest rates to staunch the outflow. This constrained the economic impulse in the domestic economy.

According to the United Nations Conference on Trade and Development, the IMFS faces three fundamental challenges: [4] One, the earlier practice of countries accepting one or several currencies as store of value or means of payment, has been replaced by the dollar. This has attendant costs: large swings in the availability of international liquidity and exchange rates depending on the shift in currency-issuing country's central bank policies. Financial globalisation and the increasing role of private financial intermediaries in providing international liquidity are compounding the problem.

Two, while the IMF was created for providing access to short-term liquidity to overcome balance of payments shocks, the institution's handling of the Asian crisis has seriously dented its credibility. Countries have instead opted to accumulate forex reserves as a buffer against such crises. This has also contributed to global imbalances.

Finally, the contractionary bias of the IMFS forces current account deficit countries to curtail spending without symmetrical pressure on surplus countries to cut spending, leading to disequilibrium and low economic growth.

Another source of deep anxiety is the role of private financial flows, which rise and ebb in pro-cyclical response to their home country central bank's monetary and exchange rate policies. In fact, low interest rates in reserve currency issuing countries (such as the U.S. or Eurozone countries), which encourage rapid credit expansion in emerging economies, when combined with the IMF's past convertibility doctrine and the restrictive role of free trade agreements and bilateral investment treaties, leaves little room for recipient countries to implement remedial measures in crises. What's more worrying is the shortened time interval between such crises, leaving emerging economies with little time to recover or rebuild defences. [5]

There are many other broken parts of the system that directly affect the fortunes of emerging economies like India: vulnerability of international rating agencies to home country politics; the manipulative grip of systemically-important institutions over key commodity and financial indicators;, the rich countries' cliquish and vice-like control over multilateral financial institutions; beggar-thy-neighbour policies of western central banks; the undue influence acquired by a couple of currencies. All these flawed components add up to waves of pro-cyclical capital flows from developed to emerging economies, with long-term deleterious implications for recipient countries.

An alternative architecture, or a new global monetary order, is now indispensable to guard against the vagaries of global capital flows, which often leave behind serious economic damage in the wake of their exit. Many experts have suggested the creation of a common global currency, perhaps something like the special drawing rights, to delink the global economy from the overwhelming influence of the dollar or euro. However, this will require sweeping changes to not only the IMF's governance matrix and policy doctrines, but also need American politicians to agree to these changes. That currently seems unlikely.

One component of a possibly alternative architecture already exists, but needs further strengthening: currency swap arrangements between emerging economy central banks to address liquidity shortages. These should also be supplemented by regional monetary arrangements, like the Chiang Mai Initiative or the contingency reserve arrangement initiated by the New Development Bank.

This configuration also needs to be layered with local currency trade settlement between larger regional groupings, such as SAARC or ASEAN-plus-6. It will require rejuvenation of local currency settlement platforms, like the Asian Clearing Union, which went into a funk because of U.S.-imposed economic sanctions against Iran. [6] But it now stands a good chance of revival.

Rajrishi Singhal *is Senior Geoeconomics Fellow, Gateway House. He has been a senior business journalist and Executive Editor,* The Economic Times, *and was Head, Policy and Research, at a private sector bank. He is a member of the Core Advisory Committee of the National Insurance Academy, on the Advisory Board of India Knowledge@Wharton, and a regular op-ed contributor to various publications. He has a master's degree in Economics from Jadavpur University, Kolkata.*

References

[1] IMF Seminars Event, 'Fortifying the Global Safety Net', 2016 Spring Meetings, International Monetary Fund-World Bank Group, <http://www.imf.org/external/POS_Meetings/SeminarDetails.aspx?SeminarId=123>

[2] Rajan, Raghuram, 'Towards Rules of the Monetary Game', Speech at conference Advancing Asia: Investing for the Future; New Delhi, 12 March 2016, <https://rbi.org.in/scripts/BS_SpeechesView.aspx?Id=993>

[3] Rajan, Raghuram, *New Rules for the Monetary Game*, Project Syndicate, 9 May 2016, goo.gl/ZiX5c6 >

[4] UNCTAD, 'Systemic Challenges in the International Monetary System', Chapter 3, Trade and Development Report, 2015, <http://unctad.org/en/PublicationsLibrary/tdr2015_en.pdf>

[5] UNCTAD, 'The Recent Turmoil in Emerging Economies', Policy Brief No 29, March 2014, < http://goo.gl/dDVlLs>

[6] Singhal, Rajrishi, NDB: *A Pivot to Financial Alternatives,* Gateway House: Indian Council on Global Relations, 7 October 2015, <http://goo.gl/ixPRfx>

Bibliography

1. Bank for International Settlements, T*he International Monetary and Financial System*, Chapter 5, 85th Annual Report, June 2015, <http://www.bis.org/publ/arpdf/ar2015e.pdf>

2. UNCTAD, *Credit Rating Agencies: Junk Status?*, Policy Brief No. 39, November 2015, <http://unctad.org/en/PublicationsLibrary/presspb2015d13_en.pdf>

3. Bordo, Michael and Harold James, *Capital Flows and Domestic International Order: Trilemmas from Macroeconomics to Political Economy and International Relations,* WP 21017, NBER Working Paper Series, March 2015, < www.nber.org/papers/w21017>

Healthcare in Africa, built by India

New Delhi now has the capacity to move beyond the basics of economic diplomacy by using the strengths of India's private sector in healthcare. Africa would welcome such an initiative, which will improve the health and development capabilities of African countries. This will also serve India's geopolitical objectives and can precede a similar healthcare rollout to other regions

David Rasquinha

Economic diplomacy is the use of aid, trade, and investment policy tools to achieve a geopolitical objective. India's geoeconomic diplomacy has so far focussed mainly on the use of scholarships, grants, and concessional lines of credit. New Delhi now has the capacity to move beyond those basics by using the strengths of India's private sector in healthcare. Africa would welcome such an initiative, which will improve the health and thereby the development capabilities of African countries. This will also serve the geopolitical objectives of the Indian state.

A successful initiative in Africa can precede a similar healthcare rollout to other regions with homologation and scale.

Why Africa?

The African continent, with a population of 1.1 billion and projected to reach 2.7 billion by 2050, [1] lags behind most of the world in health indicators. Africans live 11.4 years less than the average world citizen, and 16.8 years less than the average European. [2]

The gap has widened since the 1980s, when HIV/AIDS impacted the region. Plagues, like those cause by the Ebola virus, have worsened the problem. The maternal and child mortality rates in Africa are more than double the world average. [3] Sadly, Sub-Saharan Africa accounts for 11% of the world's population, yet bears 24% of the global disease burden. [4] Thirty six of the 57 countries around the world, categorised as having critical shortages in healthcare services, are in Africa. [5]

According to the World Health Organisation, the African continent has about 930 registered hospitals (as of November 2015), compared with 650 registered hospitals in India alone. [6] A regular supply chain of affordable medicines and pharmaceuticals is also not in place because of limited indigenous production of drugs and scarce medical research facilities.

Aid currently provided by the World Bank and other institutions is often event-driven. For example, the ravages of Ebola were redressed by emergency aid directed at solving the basic disease. Even when multilateral funding is directed towards capacity-building and improvement of Africa's health sector, it is well below the massive needs of the continent.

What India can do

So what can Indian economic diplomacy do to alleviate this dire condition? Much, much more. And there is an existing, successful base to build on: India's Pan-African e-Network Project, set up by Telecommunications Consultants India Ltd. (TCIL), with financial support from the government of India. This project provides tele-medicine services by Indian medical specialists through on-line consultation to medical practitioners at the patients' locations in Africa. These are regularly conducted from super-specialty hospitals from India to various African countries based on need. In addition, regular 'Continuing Medical Education' sessions are conducted from 11 Indian super-specialty hospitals on this network. [7] These inputs have been very well-received by African countries.

In such a context, the private sector has a significant role to play. Large Indian hospital groups like Apollo and Fortis already have an on-ground tertiary hospital presence in countries like the Democratic Republic of Congo, Nigeria, and Tanzania. For example, Dr. Agarwal's Eye Hospitals are located across Madagascar, Mauritius, Mozambique, Nigeria, Rwanda, Seychelles, Uganda, and Zambia. However, these are isolated corporate initiatives and do not have a unifying strategy or

theme. This can, and should, change.

At the third India-Africa Forum Summit in New Delhi in October 2015, where 41 heads of state and government were present, as were officials from 54 African countries, Prime Minister Narendra Modi announced that in addition to the on-going credit programme, India will offer concessional credit of $10 billion over the next five years and increased grant assistance of $600 million. [8] This will include a $100 million India-Africa Development Fund and a $10 million India-Africa Health Fund. [9]

This new funding—the $10 million India-Africa Health Fund and the $10 billion concessional credit—can be best deployed in a continent-encompassing 'Madiba-Mahatma Initiative' to improve the health and capability of the African people. It is appropriate to name it after two of the greatest Africans and Indians of our Independence eras: Mahatma Gandhi and Nelson Mandela. This initiative was conceived by the Exim bank of India, after detailed consultations with Indian industry.

A new template for the health sector

The initiative can work in the following way:

1. The still-to-be utilised $10 million India-Africa Health Fund can be put to work to set up tertiary hospitals in six to eight African cities. To foster local ownership of the concept, New Delhi can consult the African Union to help identify the number and location of these hospitals. This will ensure a wide buy-in from the beneficiary countries and avoid any impression of a solution being thrust upon them. Indian consultancy firms can prepare the initial studies and the detailed project reports for the hospitals.

2. However, hospitals cannot function in a vacuum. While the primary and secondary health centres can be the responsibility of the host governments, the proposed hospitals will need to undertake seeding activity by way of nursing colleges and, in due course, by medical colleges. This will help reduce dependency and promote local employment and expertise.

3. Indian bilateral assistance is currently in the form of tied aid with a minimum Indian content by way of export of goods and services. It's important to keep in mind that India is a capital-scarce nation with significant poverty and development challenges of its own. For the immediate future therefore, the practical aspects of economics and politics indicate a continuation of the tied-aid approach. It requires Indian expertise and experience in the areas of hospital design, construction, operation, and maintenance to be of the highest order. Fortunately, this is not difficult to establish.

Indian firms like Larsen & Toubro, Shapoorji Pallonji, and others have a track record in the construction of hospitals (at the high end in the GCC countries, as well as more budget-oriented hospitals in India and other emerging economies). Hospital groups like Apollo, Fortis and others have developed the skills, expertise, processes and vision for JCI certification in India.

Twinning India's hospital construction expertise with its hospital administration expertise will be a focused, win-win approach for the Africa-India bilateral.

4. The success of the initiative will depend on an operation and maintenance (O&M) contract with the Indian private sector hospital group. Operating a tertiary hospital is a highly-skilled enterprise requiring professionalism, quality, and adherence to good practices. This cannot be learned overnight and must be evolved and internalised gradually.

O&M contracts to Indian hospital groups will keep the Indian private sector interested, and prevent the hospitals from becoming white elephants due to a lack of adequate local expertise in administration, equipment maintenance and upkeep, and operational systems management. The contracts must be limited to three to five years, so that local skills can develop and take over.

Just as the people of Bhutan remember that Indian soldiers built their roads, so also Africans who benefit from treatment at these hospitals will remember that India helped in this healthcare endeavour. The Indian private sector, which already has $35 billion invested [10] in Africa, in areas from consumer items to energy, will develop goodwill and brand recognition at no capital cost. At the same time, the Indian government will achieve its strategic goals while attracting the reputed Indian private sector into its economic diplomacy agenda.

This paper relies on Exim Bank research on the subject, due for publication soon.

David Rasquinha *is Deputy Managing Director of the Export-Import Bank of India. The views expressed in this article are personal.*

References

[1] United Nations, Department of Economic and Social Affairs, Population Division, *World Population Prospects*: The 2015 Revision, custom data acquired via website < http://esa.un.org/unpd/wpp/DataQuery/>

[2] World Health Organisation, Global Health Observatory data, <http://www.who.int/gho/mortality_burden_disease/life_tables/situation_trends_text/en/>

[3 to 7] Export-Import Bank of India, *India-Africa Healthcare Cooperation, Working Paper No. 54*, May 2016 <http://www.eximbankindia.in/sites/default/files/Research%20Brief/wp54.pdf>

[8] Speech by Prime Minister Narendra Modi at the Inaugural Ceremony of the Third India-Africa Forum Summit, New Delhi, 29 October 2015 < http://www.mea.gov.in/Speeches-Statements.htm?dtl/25977/Speech_by_Prime_Minister_at_the_Inaugural_Ceremony_of_the_Third_IndiaAfrica_Forum_Summit_in_New_Delhi_October_29_2015#>

[9] Ibid

[10] Secretary (ER&DPA), speech delivered at Conference on *Africa: A land of Opportunities*, New Delhi, 4 December 2014,<http://indiainbusiness.nic.in/newdesign/index.php?param=newsdetail/10181/2>

India's geoeconomic dilemma in a realigning Asia

India may be less dependent on the Chinese market than some other countries in the region, but it too wants Chinese investment—and this ambivalence has been evident in India's varying approaches to the AIIB and OBOR. To balance this dilemma in an increasingly complex Asia, India must work with others, in particular with European countries

Hans Kundnani

China's geo-economic initiatives present India with a dilemma. While India wants Chinese investment, it is also aware that infrastructure initiatives such as One Belt, One Road (OBOR) have the potential to "redraw Asia's geopolitical map" as Brahma Chellaney has put it. [1] Although India has expressed skepticism about OBOR, it has—unlike Japan or the U.S.—become a founding member of the Asian Infrastructure Investment Bank (AIIB), which will finance OBOR projects. But in order to balance Chinese influence in the bank, India will need to work with others, in particular with European countries.

The strategic context in Asia now looks somewhat different from the one described by the American analysts Evan Feigenbaum and Robert Manning in an influential article [2] published in 2012. They argued that two Asias were emerging: an "economic Asia" centered on China and based on a win-win logic of cooperation and integration and a "security Asia" centered on the U.S., based on a zero-sum logic of competition and disintegration. They wrote that "economic Asia" could become "an engine of global growth", while "security Asia" could, in the worst-case scenario, lead to great power war.

In the four years since the article was written, however, the two Asias—which Feigenbaum and Manning argued were "increasingly irreconcilable"—seem almost to have merged. While military spending

continues to increase throughout Asia and some speculate about an arms race, economic tools are now also increasingly being used for strategic purposes. What looked like two Asias with quite different dynamics now looks more like one complex Asia in which economic as well as military power are being used within a competitive logic between states.

And connectivity, India's Foreign Secretary Subrahmanyam Jaishankar said in recognition of this new reality at the Raisina Dialogue in New Delhi in March, "has emerged as a theatre of present day geopolitics." [3]

There are precedents in history for this kind of strategic development of infrastructure. Perhaps the most compelling comparison is the Berlin-Baghdad railway, which too was seen as a new Silk Road. The plan, initiated by Kaiser Wilhelm II at the beginning of the 20th century, was to create a link between Berlin and Mesopotamia—then part of the Ottoman empire—and eventually the Persian Gulf. The railway would cut the time it took to transport raw materials for Germany's rapidly growing industry, and also displace British influence in West Asia.

The comparison fits into what Edward Luttwak—who first formulated the concept of "geo-economics"—has called the "inevitable analogy" [4] between Wilhelmine Germany and contemporary China. Just as Germany sought to compete with Britain, at the time the pre-eminent maritime power, China is now seeking to compete with the U.S.

China presents its geo-economic initiatives as a "win-win" or as public goods. It is tempting for countries in Asia that need infrastructure of the kind promised by OBOR, and the investment promised by the AIIB, to take Chinese rhetoric at face value. But they are well aware that China's initiatives also have the potential to change the balance of power in Asia by creating relationships of dependence. As Jaishankar put it, while India wants to develop connectivity through a process of consultation, "others"—by which he clearly meant China—"may see connectivity as an exercise in hard-wiring that influences choices."

In some respects, nearly all countries in the Asia-Pacific region face the same dilemma. With the exception of Pakistan and North Korea, they see the rise of China simultaneously as an opportunity in economic terms, and also as a threat in security terms. But China's geo-economic initiatives also have the potential to divide Asian countries among themselves. It is not just that some countries are closer to the U.S. than others, but also that, based largely on geography, they differ in how they view the two parts of OBOR. While some feel more threatened by the Silk Road Economic Belt, others feel more threatened by the Twenty-First Century Maritime Silk Road.

Both the "belt" and the "road" are a potential threat to India. It is particularly alarmed, of course, by the China-Pakistan Economic Corridor (CPEC), which seems to be intended to link the two parts of the project—and thus in effect to encircle India. As a result, some such as Chellaney even see OBOR as a reincarnation of China's "string of pearls" strategy. [5] Even more problematically from an Indian point of view, CPEC passes through Pakistan-occupied Kashmir. India may be less dependent on the Chinese market than some other countries in the region, but it too wants Chinese investment—in particular to develop its manufacturing sector.

India's ambivalence has so far been manifested in its slightly different approach to the AIIB on the one hand and OBOR on the other—even though the AIIB is meant to fund projects that are part of OBOR. India has been skeptical of OBOR, which it sees as a national rather than an international or regional initiative. But it nevertheless agreed to be a founding member of AIIB and is the second-largest shareholder, with 7.5% of the voting rights. Perhaps like EU member states that joined the bank, India's aim is to influence the AIIB from within. India successfully pushed for the AIIB's Articles of Agreement to include a requirement that the financing of projects in disputed territory can only proceed if the disputants provide their consent.

In order to continue to influence the AIIB and through it OBOR, though, India will need allies. Collectively, Europeans have around 20% of the voting rights. Since China has 26% percent of the voting rights, Europe and India could balance Chinese influence in the AIIB

were they to cooperate. But whether the EU and India will be able to do so depends on whether they can develop a shared agenda.

Europeans instinctively share India's preference for multilateral rather than unilateral approaches to connectivity. But even though the precedents for China's geo-economic initiatives lie in their own history, Europeans tend somewhat naively to take at face value Chinese rhetoric about their "win-win" nature. India still has a way to go to make Europeans see OBOR from an Indian perspective.

Hans Kundnani *is a Berlin-based Senior Transatlantic Fellow at the German Marshall Fund of the United States. He was previously the Research Director at the European Council on Foreign Relations, Berlin.*

References

[1] Chellaney, Brahma, 'A Silk Glove for China's Iron Fist', Project Syndicate, 4 March 2015, <https://www.project-syndicate.org/commentary/china-silk-road-dominance-by-brahma-chellaney-2015-03?barrier=true>

[2] Feigenbaum, Evan. A., and Robert A. Manning, 'A Tale of Two Asias', 31 October, 2015, <http://foreignpolicy.com/2012/10/31/a-tale-of-two-asias/>

[3] S. Jaishankar, Raisina Dialogue, speech delivered at Raisina Dialgoue, 2 March 2016 <http://mea.gov.in/Speeches Statements.htm?dtl/26433/Speech_by_Foreign_Secretary_at_Raisina_Dialogue_in_New_Delhi_March_2_2015>

[4] Luttwak, Edward. N, *The Rise of China vs The Logic of Strategy* (Belknap Press, Harvard University Press: Boston), 2012.

[5] Kazmin, Amy, 'India watches anxiously as Chinese influence grows', Financial Times, 9 May 2016, <http://www.ft.com/intl/cms/s/0/e9baebee-0bd8-11e6-9456-444ab5211a2f.html%23axzz48Y6T7pzn>

A world divided by trade deals?

Amid the debate of a US-centric TPP template or a China-led RCEP model, it is important to consider if such trade agreements are building blocks or stumbling blocks to global free trade. With the passage of the TPP still uncertain in the US Congress, and the RCEP unlikely to be acceptable to the US, the more likely global trade scenario will be fragmentation

Leon Berkelmans

What sort of endgame does President Obama see in the push he and others are making for mega-trade deals? Will the endgame be a world where global rules are streamlined under a U.S. model, along the lines of the Trans-Pacific Partnership (TPP)? Or will it be a fragmented scenario, where China and deals such as the Regional Comprehensive Economic Partnership (RCEP) write the rules for one part of the world, while the U.S. writes them for another? Clearly Obama would prefer a U.S.-centric trade model, but a fragmented one cannot be ruled out.

We may be able to seek answers in the academic literature. Important papers have been written, from a theoretic and an empirical perspective, on whether preferential arrangements eventually lead to global free trade. Unfortunately, the literature offers few definitive answers. Theoretically, Harvard professors Philippe Aghion, Pol Antràs, and Elhanan Helpman find that preferential agreements can either be building blocks or stumbling blocks toward global free trade, depending upon the model's features. [1]

Empirically, studies can be found that go either way. Limão finds that tariff reductions agreed to by the U.S. under multilateral negotiations are smaller if the good is imported under a preferential agreement; this is consistent with the stumbling block thesis. [2] On the other hand, Baldwin and Jaimovich find that preferential trade agreements are in some sense contagious—if a given pair of countries

signs an agreement, others are more likely to do so; this is consistent with a building block effect. [3]

Meanwhile, as the scope of the mega trade agreements expands, consolidating such deals has become more complicated. New "21st century agreements" often contain provisions on items such as competition law, anti-corruption, and environmental protections, which are in large part new. For example, a key feature of U.S.-driven agreements, whether they are bilateral or mega-regional, is strong intellectual property (IP) protections. This typically locks signatories into protections similar to U.S. law, which contains more robust provisions than WTO standards.

Little theoretical support is available for the inclusion of strict harmonised IP standards in trade agreements. This is because, unlike many goods and services, intellectual property is non-rivalrous. Gene Grossman of Princeton University and Edwin Lai of the Hong Kong University of Science and Technology have written about this in a paper titled 'International Protection of Intellectual Property'. [4] They studied the theoretical underpinnings of harmonising intellectual property and concluded: "…harmonisation of patent policies is neither necessary nor sufficient for global efficiency." They found that harmonisation shifts gains from the users of intellectual property to the producers.

Moreover, the stronger intellectual property protections that are included in trade agreements are unlikely to encourage innovation. There is a body of economic literature arguing that existing intellectual property protections inhibit innovation, [5,6] as efforts by companies are diverted toward protecting monopoly rights and away from research and creation. In a notable example from 1991, Bill Gates wrote "[i]f people had understood how patents would be granted when most of today's ideas were invented, and had taken out patents, the industry would be at a complete standstill today." [7]

Will the U.S. template, with its emphasis on IP, be acceptable to other countries? So far it hasn't seemed to hurt the U.S.—other countries have been willing to sign preferential agreements with America. But the really tough nuts like China and India are still left to crack.

It is hard to see China signing onto these U.S.-influenced IP protections anytime soon. India was opposed to the stronger intellectual property protections that formed a part of the founding of the World Trade Organisation—its concerns included the restrictions IP would impose on medicines. However, at the time of singing in 1994, India acceded under the threat of being left out. [8] India has since shown it will hold up WTO negotiations if it is unhappy with the outcomes, as it did in 2008 during the "breakdown ministerial," [9] and would conceivably hold up efforts to multilateralise further expansions in IP protections.

So it is unlikely that large emerging countries will embrace the U.S. template.

Perhaps, instead of the TPP, the RCEP, a proposed free trade area including both India and China, will form the basis of a multilateral deal. It will presumably reflect a trade agenda in line with the needs and vision of emerging economies.

However, I suspect the prospects of globalising this sort of deal are also poor. If efforts were made to expand the deal, it is difficult to see the U.S. signing on to something that lacks bite in the 21st century areas, like IP, it holds dear.

Perhaps fragmentation is the most likely outcome. But an even more consequential possibility is lurking in the current configuration of deal-making.

As of writing, passage of the TPP through the U.S. Congress is uncertain. In a sign that is not promising for its prospects, no major presidential candidate has endorsed the deal. If the Congress does not ratify the TPP, then what does the world look like?

It will still look fragmented, but perhaps not neatly carved up between a U.S. sphere and a non-U.S. sphere. And this brings up more questions. For example, if the TPP stalls, could this make it more difficult to finalise the Translatlantic Trade and Investment Partnership (TTIP) between the European Union and the U.S.?

If the U.S., which has championed the TPP, cannot ratify the

agreement, it will also signal a clear failure of America's global leadership. It will be another example of the country's leadership credentials being spoiled in the Indo-Pacific—other examples include its long-delayed ratification of International Monetary Fund reform, and its mishandling of the Asia Infrastructure Investment Bank, when the U.S. unsuccessfully attempted to prevent allies from joining.

A common thread in all these instances is the U.S. Congress. It held up the IMF reform, and any proposal for AIIB membership would face enormous difficulties in getting the required votes (although the farce of attempting to prevent allies signing on had nothing to do with the Hill).

Similarly, the U.S. Congress could stop the TPP cold in its tracks. Connelly has argued that Congressional gridlock has hindered U.S. policy toward the Pacific because it had few champions in either house in recent years. [10] He suggests that new leaders need to be cultivated. The U.S. would do well to take note.

***Leon Berkelmans** is the Director of the International Economy Program and the G20 Studies Centre at the Lowy Institute. Prior to this, he was a Senior Manager at the Reserve Bank of Australia, where he worked on the Chinese and Indian economies, investment, trade, and financial markets. Leon has also worked at the Federal Reserve Board of Governors in Washington D.C. He has a PhD in economics from Harvard University.*

References

[1] Aghion, P., Antràs, P. and Helpman E., 'Negotiating free trade', *Journal of International Economics*, vol 73, no 1, 1–30, 2007.

[2] Limão, N., 'Preferential Trade Agreements as Stumbling Blocks for Multilateral Trade Liberalization: Evidence for the United States,' *American Economic Review*, vol. 96 no. 3, 896-914, 2006.

[3] Baldwin, R. and Jaimovich, D., 'Are Free Trade Agreements contagious?', *Journal of International Economics,* vol 88, no 1, 1-16, 2012.

[4] Grossman, G., and Lai, E., 'International Protection of Intellectual Property', *American Economic Review,* vol. 94 no. 5, 1635-1653, 2004.

[5] Boldrin, M. and Levine, D., *Against Intellectual Monopoly*, (Cambridge,Cambridge University Press, 2008).

[6] Tabarrok, A., *Launching the Innovation Renaissance: A New Path to Bring Smart Ideas to Market Fast*(TED Books, Kindle Edition, 2011).

[7] The New York Times, *A Patent Lie,* Lee, T, 9 June 2007, <http://www.nytimes.com/2007/06/09/opinion/09lee.html?_r=0>.

[8] Panagariya, A., *India, the Emerging Giant*, (New York, Oxford University Press, 2008)

[9] Brookings Institution, *The Nine-Day Misadventure of the Most Favored Nations: How the WTO's Doha Round Negotiations Went Awry in July 2008, Blustein, P., 5 December 2008*, <http://www.brookings.edu/research/articles/2008/12/05-trade-blustein>

[10] Lowy Institute for International Policy, *Congress and Asia-Pacific policy: Dysfunction and neglect*, Connoelly, A., 2015, <http://www.lowyinstitute.org/publications/congress-and-asia-pacific-policy-dysfunction-neglect>

Bombay's past and future as an IFC

The historic role of Bombay (as it was then called) as a hub for banking, commerce, trade, and shipping, and its financial clout a 100 years ago, are little known today. With the city scheduled to soon open an international financial services centre, it is worthwhile to recall and integrate this legacy with Mumbai's present strengths in order to attract global capital to its IFSC

Sifra Lentin

India's second international financial services centre (IFSC) is scheduled to open soon in Mumbai's Bandra-Kurla commercial complex. The IFSC will have an edge over neighbouring Gujarat's GIFT (Gujarat International Financial Tec-City), which opened in April last year, for two main reasons: it is located in India's financial capital, and it can draw on Mumbai's legacy as an international financial centre from the late 19th to the mid-20th century.

The push for Mumbai as the ideal location for an IFSC began with the 2007 'Report of the High Powered Expert Committee on Making Mumbai an International Financial Centre' (popularly known as the 'Percy Mistry report'). [1] This report's recommendations largely drew on the fact that Mumbai already had a pool of professionals, institutions, banks, corporate headquarters, and markets.

To this mix can be added Mumbai's long history as an IFSC a century ago, when the city managed the monetary policies of geographical regions such as the Trucial Coast (the United Arab Emirates), Bahrain, Qatar, Oman, and the Protectorate of East Africa (Tanzania, Kenya, and Uganda), under the British Raj. These are the same regions which Mumbai's IFSC can now serve, especially because of the high-value transactions and remittances between India and the Gulf.

Many Indian multinational companies currently have investments in the Gulf, including a major project by L&T, the Rs. 2,085 crores Al

Batinah expressway in Oman. [2] Moreover, remittances from Indians working in the Gulf countries form an important component of India's foreign exchange earnings; inward remittances were worth $48 billion in the current fiscal year, as of March 2016. [3]

However, Mumbai's historic role as a nodal hub for banking services, commerce, trade, and shipping, and its enormous financial and political clout in the past, are little known today because the city was unable to build on this legacy after India's Independence in 1947. A combination of factors contributed: restrictive foreign exchange and trade policies, energy dependency, and a polarised world economy.

The potential to reactivate Bombay's past links multiplies the city's chances of developing better, broader, and deeper markets for the circulation of foreign capital, currency, and credit through its IFSC.

The subcontinent's first financial centre

Long before Dubai and Singapore became major financial centres, from the mid-19th to the mid-20th centuries, the city of Mumbai was a global trade and finance hub. This was a time when New York, London, Hong Kong, and Shanghai were also hubs—a role they are still engaged in 100 years later.

Mumbai's role, like that of these historic centres, became more central when a global economy coalesced due to European imperialism between 1870-1914. This was aided by better transportation (an expansion in railways, steamers, and the opening of the Suez and Panama canals) and communications (the telegraph and the beginnings of the telephone). [4]

One of the strongest factors that made the city a financial hub was the wide acceptance of the Indian rupee as a currency of circulation. During the 1890s, the fiscal and monetary policies of the Trucial Coast (UAE), Bahrain, and Qatar, were determined by the Presidency of Bombay.

This role devolved on the city with the signing of the Exclusive Agreement (from 6-13 March 1892) between each Trucial sheikhdom and Britain. Under the fiduciary clauses of this treaty, the British

Indian government looked after the fiscal and monetary policies of these sheikhdoms. Subsequently, the Indian rupee became the official currency. Other regions soon followed, including Oman and Kuwait, and for a brief period, the British Protectorate of East Africa.

Though the Indian rupee became the official currency of circulation in these British-dominated regions, the old multi-currency regime of the Indian Ocean trading world continued alongside.

But even before it became an official currency the rupee was already in circulation in these Arabian Sea littoral regions. It circulated first as the Mughal rupee, which was the precursor of the rupee of Bombaim (first struck at the Bombay mint in 1677). This Bombay silver rupee and its denominations remained in circulation till 1835, when the three separate currency circles of the presidencies of Bombay, Bengal, and Madras were abolished. They were replaced first by the East India Company rupee (till 1858) and then various issues of what is commonly referred to as the British Indian rupee (1858-1947).

Three factors promoted the popularity of the rupee in the 19th century: one, the sheer volume of the dhow merchandise trade between the subcontinent and this region; two, the large Indian diaspora (notably in Muscat and Oman) who preferred using the rupee; and three, the silver rupee's credibility which derived from its standardisation and metallic value (weighing 180 grains or 11.66 grams, with a silver content of 165 grains (11/12 fineness) after uniform coinage was introduced in 1835. [5]

With the formation of the Reserve Bank of India (RBI) on 1 April 1935, the monetary and fiscal policies of these regions came under the purview of the RBI (headquartered in Bombay). In fact, these countries maintained a sterling balance with the RBI, against which Indian rupees were issued to them. This continued even after Indian Independence and until 1959, when the RBI issued a special currency for this region, the Gulf rupee, to distinguish it from the Indian rupee. The Gulf rupee remained in circulation till 1970, when Oman, among the last of the fiduciary sheikhdoms, shifted to its own currency, the Omani rial. [6]

International banking in Bombay

As the financial capital of British India, Mumbai was also closely linked to the City of London, the world's banking and money market capital since the 19th century.

In the early-to-mid-19th century, the East India Company largely controlled the foreign exchange business emanating from Bombay. This option was not open to the quasi-government Bank of Bombay—the city's first modern bank as well as its first Anglo-Saxon bank, set up in 1840 as a chartered presidency bank on the initiative of a mix of expatriate and Indian merchants. [7]

The Company appropriated this privilege even after its India Charter lapsed in 1813. This monopoly increased the cost of foreign trade credit for Indian and British merchants, and kept the cost of remittances high, as the exchange rate offered by the Company on the British pound and Indian rupee was always to the disadvantage of its clients.

The Bank of Western India was an attempt by its promoters (among them well-known merchants Jagannath Shankarshet and Dadabhoy Rustomjee) to break into the lucrative foreign exchange business. But it was only in 1851 that this bank, founded in 1842 (and renamed in 1849 as the Oriental Banking Corporation, OBC), succeeded in its fight for a charter that endorsed its foreign exchange business and gave it the protection of limited liability. The litigation was necessitated as banks then were partnership firms with unlimited liability. The protection of limited liability could only be acquired through a charter from the Company or the British Parliament.

The fall-out of the Bank of Western India's nine-year-long litigation was that as the OBC it became headquartered in London, came under the control of a European board of directors, and became the first British overseas bank with a charter to operate in India.

Soon after, a multitude of exchange or British overseas banks set up branches in the city. The most well-known was the Chartered Bank of India, Australia & China (today's Standard Chartered Bank), which opened its Bombay branch in 1858. Various other foreign banks started

operations in Bombay, with the mandate of facilitating trade between their region or country and the subcontinent. Among these were France's Comptoir National D' Escompte in 1861, the Hong Kong & Shanghai Banking Corporation (HSBC) in 1869, and the Yokohama Specie Bank in 1894. By 1908, four British overseas banks and three foreign banks were operating in the city. [8]

In turn, banks founded by Mumbai's local merchant community, like the Indian Specie Bank (1906) and the Tata Industrial Bank (1917), opened branch offices in London in the early 20th century. This further strengthened the connection between the city and the London inter-bank money market and foreign currency market.

In the final count, Bombay's centrality as a finance and trade hub would not have been possible—even with its captive financial hinterland and overseas connections—without the dynamism of its indigenous merchant and banking community. If it wasn't for the feisty fight put up by the Bank of Western India, the London-headquartered British overseas banks would not have had a presence in India, and branches of Indian banks (like the Indian Specie Bank) would not have been opened abroad.. This was just one important component among others that made Bombay an IFC from the late 19th to mid-20th century.

A century later, will Mumbai live up to this legacy through its new IFSC? It certainly can. Mumbai has all the financial micro-structures and fluencies that only a city with a deep history of such networks can possess. Besides, India already has world-class capital market structures (like Mumbai's stock exchange) and regulations, and these could act as a platform to integrate the money, bonds, foreign exchange, and commodities markets. This, in turn, can attract global capital that can be processed through the city's IFSC.

Sifra Lentin *is the Mumbai History Fellow at Gateway House. She has been published in MARG's* Indian Jewish Heritage: Ritual, Life-Cycle & Art *(2002); she has also written a book for the Indian Navy's Western Fleet, titled* A Salute To The Sword Arm: A Photo Essay On The Western Fleet *(2007).*

References

[1] Ministry of Finance, Government of India, *Report of the High Powered Committee on Making Mumbai an International Finance Centre (2007)*, <http://finmin.nic.in/mifc/mifcreport.pdf(2007)>

[2] Kumaraswamy, P.R., ed., *Persian Gulf 2014: India's Relations with the Region* (New Delhi, Sage India, 2013), p 153. See also: <http://timesofindia.indiatimes.com/business/india-business/LT-wins-Rs-2085-crore-contract-for-building-expressway-in-Oman/articleshow/21119113.cms>

[3] Reuters, *After benefits of cheap oil, India counts cost of reduced Gulf remittances*, Economic Times, 25 May 2016, <http://economictimes.indiatimes.com/nri/forex-and-remittance/after-benefits-of-cheap-oil-india-counts-cost-of-reduced-gulf-remittances/articleshow/52428340.cms>

[4] Overy, Richard, ed., *The Times Complete History of The World* (London, HarperCollins, 2010), pp 276-77.

[5] From the author's interview in 2013 with Bazil Shaikh, former RBI principal chief general manager and secretary.

[6] Ranjan, Ravi, and Anand Prakash, *Internationalisation of Currency: The case of the Indian Rupee and the Chinese Renmimbi* (Mumbai, RBI, 18 May 2010), < http://www.w-t-w.org/en/wp-content/uploads/2013/10/Internationalization-of-Currency.pdf >

[7] Bagchi, Amiya Kumar, The *Evolution of the State Bank of India: The Roots 1806-1876* (New Delhi, Penguin India, 2007), p 473.

[8] Edwardes, S.M, *The Gazetteer of Bombay City And Island: Volume 1, 1909*,(Bombay, Gazetteer Department Government of Maharashtra, Reprint 1978), pp 292-93.

Three tiers of energy security for India

India imports 80% of its oil and 80% of the imports are from vulnerable regions. This high-cost, high-risk approach is not sustainable, and the current low price of oil offers India an opportunity to secure its long-term energy needs by taking three concurrent steps: diversifying supply sources, investing in oil fields, and using financial instruments

Amit Bhandari and Kunal Kulkarni

India has a large and growing oil requirement, over 80% of which is currently met through imports. Although prices have fallen over the last few years—during 2015-16, the country imported 1.25 billion barrels of oil at an average price of $46.2 per barrel, [1] as compared to an average of $105 per barrel in 2013-14—the cost of imports is not a sustainable long-term approach for India.

But the country's need for oil will only keep growing, and India must adopt a three-tier strategy to secure its long-term oil availability at a reasonable price: diversify supply sources, acquire oil fields, and use financial hedges. It is important that these measures work together; none of them in isolation can entirely protect India from price fluctuations and supply hiccups.

The current scenario of low oil prices, low prices of energy assets, and new oil supplies coming into the world market offers India a rare opportunity to put this strategy into practice, and reduce the country's vulnerability to price spikes and supply disruptions.

Diversifying supply sources is one part of this strategy. Apart from the fluctuating or high price of imports, India faces another risk—80% of its oil comes from countries facing severe problems or located in unstable regions. West Asia accounts for 58% of India's oil imports. [2] This region is vulnerable to terrorism, internal political upheavals, and a possible confrontation between Saudi Arabia and Iran. Libya and Syria, also in the same region, are collapsed strife-torn states.

India's biggest non-West Asia sources of oil are also vulnerable. Venezuela and Nigeria, together provide 22% [3] of India's oil imports—but Venezuela is dealing with economic collapse, while Nigeria is facing persistent terrorism.

Taking note of these uncertainties, India must look to other sources: it currently imports less than 1% of its total oil from Russia and Canada, [4] both of which are major oil producers with big reserves. The U.S. too is going to become an exporter, with its growing production of shale oil. [5] These are politically stable countries and India can channel more of its imports from them.

However, such a shift will only account for a fraction of India's oil needs. And it will still leave India vulnerable to a spike in global oil prices, which can go up irrespective of where India is buying oil from.

This is where the second tier of the strategy can come in: India must become more proactive in acquiring oil fields in other countries. The ownership of oil fields will allow India to accrue some of the value of rising oil prices; it will also offer a measure of protection against rising oil prices.

The public sector Oil and Natural Gas Corporation has been acquiring small stakes in oil fields in several countries for over a decade. In recent years, other government firms such as Indian Oil, Oil India, and Bharat Petroleum have done the same. However, the total oil production from these assets is less than 5% of India's oil imports. [6] The low price of oil offers these companies a chance to buy more oil fields cheaply—the share prices of many listed oil companies have fallen by 70-80% in the past two years.

ONGC and the other three Indian companies have, since September 2015, signed agreements with Rosneft of Russia to acquire stakes in large oil fields. [7, 8] India needs to identify other hydrocarbon rich countries where it can invest safely. Venezuela, Ecuador, Bolivia, and Argentina are all rich in hydrocarbons, but not necessarily good destinations for India's investment diversification. All four countries

have a poor track record of respecting the property rights of foreign firms. All have, in the past decade, in a move driven by high oil prices, nationalised oil fields owned by foreign firms. [9] ONGC also has oil fields in South Sudan, which have been shut down due to the deteriorating security situation.

Any investment has to consider the political stability of the host country. Here again, the U.S. and Canada offer an opportunity—there are hundreds of listed companies in both countries that can be acquired. Both however place some restrictions on the acquisition of hydrocarbon assets by state-owned firms, which India will have to follow. [10]

Since only a few states rich in oil are safe for foreign capital investment, this option too will cover only a fraction of India's oil needs.

India must therefore also put in motion the third tier of its energy security strategy: turn to the financial markets to protect itself against price spikes.

The Indian government bears a direct risk from rising oil prices. In the past, it has had to share the burden of high petroleum prices by reducing the taxes on petroleum products and by giving direct subsidies to vulnerable consumers—of as much as $15 billion during 2013-14. [11]

Hedging is therefore strategically necessary. There is a precedent for governments hedging their energy risks: Mexico, which relies heavily on oil revenues, spent $1.09 billion to hedge its oil sales for 2016, in order to ensure that it gets a floor price for its oil. [12] As oil revenues are important for the Mexican government, the expenditure is deemed worthwhile.

But India sits on the other side of the oil trade, and must act accordingly to protect itself. The best way to do this is to use call options, which give the holder the right, but not the obligation, to buy an asset at a predetermined price. Crude oil is one of the most highly traded commodities globally, and such options can be purchased years in advance for large quantities.

For instance, the call option to buy oil at $70 per barrel in December 2017 can be currently purchased for $2.12 per barrel. [13] This contract allows but doesn't compel India to get oil at $70 per barrel, irrespective of the market price. This is similar to buying insurance—pay a small premium upfront to protect against a potential disaster.

It is these three steps together—diversification of supply sources, acquiring oil fields, and financial hedging—that can help cap India's oil import bill. This cost has been a major worry for planners, and the low energy prices since early 2015 have resulted in an annual saving of $75 billion. The time is clearly right for India to reduce its long-term vulnerability to the cost of imported oil and close one critical source of financial uncertainty.

Amit Bhandari *is Fellow, Energy and Environment Studies, Gateway House. He has worked in the business media and financial markets for over a decade, and was responsible for setting up India Reality Research within CLSA India, a stock broking firm. He has a Master's degree in Business Administration from IIM- Ahmedabad and a bachelor's degree in Technology from the Benares Hindu University.*

Kunal Kulkarni *is a Senior Researcher at Gateway House. He has a Master of Laws degree from the University of London, and a Bachelor of Legal Science/ Bachelor of Law from the Government Law College, Mumbai.*

References

[1] Petroleum Planning & Analysis Cell, Ministry of Petroleum & Natural Gas, Government of India, *Ready Reckoner*, March 2016, <http://ppac.org.in/WriteReadData/Reports/201604191010304216675SnapshotofIndia'sOil&Gasdata-March2016.pdf>

[2] Lok Sabha, Government of India, *Starred Question Import of crude oil, Annexure I*, 7 December, 2015, < http://164.100.47.192/Loksabha/Questions/QResult15.aspx?qref=25281&lsno=16>

[3] Ibid

[4] Ibid

[5] Egan, Matt, 'After 40-year ban, U.S. starts exporting crude oil', *CNN Money*, 29 January 2016, <http://money.cnn.com/2016/01/29/investing/us-oil-exports-begin/>

[6] ONGC Videsh, '*O+OEG Production*', <http://www.ongcvidesh.com/performance/production/>

[7] Oil and Natural Gas Corporation Limited, *Press Release pursuant to Regulation 30 of the Listing Regulations,* 17 March 2016, <http://corporates.bseindia.com/xml-data/corpfiling/AttachHis/469EF225_B82C_497C_AB10_0C0EB1E0F628_103944.pdf>

[8] Bharat Petroleum Corporation Ltd., Press Releases, *Corporate Announcement,* 16 March 2016, <http://corporates.bseindia.com/xml-data/corpfiling/AttachHis/9E2371DC_9C0D_4374_A3F5_D966C7D8CD54_152008.pdf>

[9] Ellsworth, Brian, 'Venezuela seizes operations from oil majors', Reuters, 1 May 2007, <http://www.reuters.com/article/us-venezuela-nationalization-idUSN0149302220070501>;

Valencia, Alexandra, and Alexandra Ulmer, 'Ecuador to pay $980 million to Occidental for asset seizure', Reuters, 13 January 2016, <http://in.reuters.com/article/ecuador-occidental-idINL2N14X0U420160113>;

'Bolivia sends military to oil fields in Chaco', Reuters, 16 April 2007, <http://uk.reuters.com/article/bolivia-naturalgas-idUKB28786320070416>;

Bronstein, Hugh, 'Argentina nationalizes oil company YPF', Reuters, 4 May 2012, <http://www.reuters.com/article/us-argentina-ypf-idUSBRE8421GV20120504>

[10] Bhandari, Amit, and Kunal Kulkarni, 'North America: petro state', Gateway House: Indian Council on Global Relations, 13 April 2016, <http://www.gatewayhouse.in/petro-state/>

[11] Ministry of Finance, Government of India, *Reduction in Subsidy,* 11 July 2014, <http://pib.nic.in/newsite/PrintRelease.aspx?relid=106437>

[12] 'Mexico wraps $1.1 billion oil options hedge to lock in $49 floor', Reuters, 20 August 2015, <http://www.reuters.com/article/us-mexico-oil-idUSKCN0QP0X020150820>

[13] Crude Oil Options Quotes, CME Group, '*American Options,* Dec 2017, All', <http://www.cmegroup.com/trading/energy/crude-oil/light-sweet-crude_quotes_globex_options.html?optionExpiration=Z7#strikeRange=ALL> Accessed 3 May 2016

LNG strategies for the EU and India

India's gas consumption is lower than the EU's, but it too, like the EU, relies heavily on imports. With LNG likely to remain a key part of India's gas supplies in the future, and given recent changes in the global market, what is the future potential of LNG imports for the EU and India? What are the best energy policies for the two regions?

Arno Behrens

India and the European Union (EU) share a common fate in terms of fossil fuels: both are poor in proved indigenous reserves and need substantial amounts of imports to fill the gap between domestic production and consumption.

This is also true for natural gas. Given recent changes in the global market for liquefied natural gas (LNG)—including flexibility of trade and falling prices—what is the potential of LNG imports in the future for the EU and India? What are the LNG strategies that the two regions can consider?

In the EU, the gap between domestic production in 2014 was around 255 billion cubic meters (bcm). [1] It is mainly covered by imports of piped gas, roughly two-thirds of which come from Russia and Norway. In recent years, LNG accounted for 10% of total gas imports, [2] far below the EU's 2015 total regasification capacity of 195 billion cubic meters per year (bcma). [3]. Although the EU's demand for gas peaked in 2010 and has decreased since, the need for additional imports is likely to rise in the future due to more rapidly decreasing domestic production.

LNG could play an important role, not only in filling the supply gap, but also in reducing the dependence on imports from Russia.

India's gas consumption, at 50.6 bcm, is much lower than the EU's, but with production only at 31.7 bcm, [4] it too relies to a large extent on imports. For natural gas, the supply gap in 2014 amounted to around 19 bcm. [5] In the absence of import pipelines, India exclusively relied on LNG imports to its four existing terminals with a total capacity of around 35 bcma. [6]

Although India's gas demand peaked in 2011, it is still projected to more than double until 2030 due to population and economic growth, and poverty reduction. [7] Without the development of substantial domestic gas fields, this means that the supply gap will increase in the future, raising the question where the gas for India will come from. Given the political difficulties associated with building import pipelines in the region to access Caspian or Iranian gas (through Afghanistan or Pakistan), LNG is likely to remain a key pillar of India's gas supplies in the future.

The EU's new LNG strategy

The EU's energy policy is based on three pillars: security, competitiveness, and sustainability. Against this background, the European Commission proposed a strategy for LNG and gas storage in February 2016. [8] In terms of security, the strategy aims to diversify import sources and routes, with a particular focus on Eastern Europe. Given that some 95% of existing EU LNG import capacity is in Western Europe, the EU needs to explicitly aim at improving access to LNG particularly in Eastern European countries currently dependent on only one import source.

In terms of competitiveness, the strategy proposes a three-pronged approach. First, it focuses on infrastructure, which is not only needed to complete the EU's internal gas market but also to improve access to international LNG markets either directly or through other member states. Within this context, the Commission also highlights the role of gas storage in optimising gas infrastructure use and in balancing the system. Second, it urges the completion of the internal gas market in order to send the right price signals for both LNG imports and for required infrastructure investments. And third, the strategy calls for closer cooperation with international partners, both suppliers and major consumers of LNG (including India), in order to remove

obstacles in the trading of LNG and to advance towards free, liquid, and transparent global LNG markets.

Regarding sustainability, the EU LNG strategy highlights the potential of LNG in transport, in particular as a means to decarbonise shipping and heavy duty vehicles (such as trucks). It also points to the possibility of using small-scale LNG to replace more polluting fossil fuels in the heat and power sectors, for example in remote or off-grid locations.

Elements of a successful LNG strategy [9]

Current global market dynamics could support further diversification towards LNG. Increasing the flexibility of LNG trade, decreasing LNG prices and LNG charter rates, and a reduction in Asia-Pacific import prices could all reinforce the economic viability of a LNG strategy. This is true for the EU as well as for India, and these trends are expected to continue as more LNG enters the market, mainly from new suppliers such as Australia and the U.S.

However, in order to be effective and to avoid mismatches between investments and market reality, a LNG strategy should be part of a broader natural gas and energy strategy. This latter strategy should not only consider issues related the security of gas supplies, but also take into account potential future developments of gas demand—also within the context of Paris Agreement on climate change. A LNG strategy should thus seek to define a space for LNG in the overall demand equation, taking into account the whole energy system and interactions between different energy sectors (for example, between gas and power markets, and gas and the transport sector). This will help avoid inefficient investments, as was the case in Europe in the recent past driving down utilisation rates of EU LNG terminals to 19% in 2015. [10]

As important, the key to a successful LNG strategy is to develop sufficient infrastructure. Low utilisation rates of EU LNG terminals can be explained by decreasing gas demand, but partly also by the fact that there are not enough interconnections between EU countries (for example, between Spain and France). In order to fully exploit the benefits of LNG, a system of interconnectivity requires three essentials: (i) additional infrastructure, either in the form of interconnectors or additional LNG terminals; (ii) a clear regulatory framework avoiding contractual congestion at the interconnection points; and (iii) properly functioning gas hubs to facilitate trade.

In addition, any type of infrastructure to be built should be based on a cost-benefit analysis, taking into account possible lower cost alternatives. For example, LNG Floating Storage and Regasification Units (FSRU) may turn out to be more cost-effective than large LNG terminals or new pipelines. They can add flexibility to the system and can be used for trading if utilisation rates are too low.

Finally, the element of international cooperation between the EU and India should be strengthened with the aim to promote transparent and liquid LNG markets around the world. The European Commission [11] particularly highlights the need to ensure that market participants are not prevented from establishing commercial relationships (for example, by territorial restrictions) and that there are no limitations to the free trade of LNG—both under normal market conditions and in the event of an external shock.

Arno Behrens *is Head of Energy and Research Fellow, Centre for European Policy Studies (CEPS), Brussels.*

References

[1] BP, *BP Statistical Review of World Energy*, June 2015.

[2] European Commission, *Liquefied Natural Gas and gas storage will boost EU's energy security,* European Commission – Fact Sheet, 16 February 2016.

[3] European Commission, *Commission Staff Working Document accompanying the Communication on an EU strategy for liquefied natural gas and gas storage*, SWD(2016) 23 final, 16 February 2016.

[4] BP, *BP Statistical Review of World Energy*, June 2015.

[5] Ibid.

[6] EY, *Gas market in India* – Overview and future outlook, 2016.

[7] IEA, *World Energy Outlook 2015*, OECD/IEA, 2015.

[8] European Commission, *Communication on an EU strategy for liquefied natural gas and gas storage,* COM(2016) 49 final, 16 February 2016.

[9] Molnar, G., Behrens, A., Egenhofer, C., Genoese, F., Europe's LNG Strategy in the Wider EU Gas Market, CEPS Policy Brief No. 33, October 2015.

[10] European Commission, *Commission Staff Working Document accompanying the Communication on an EU strategy for liquefied natural gas and gas storage*, SWD(2016) 23 final, 16 February 2016.

[11] European Commission (2016c), *Communication on an EU strategy for liquefied natural gas and gas storage*, COM(2016) 49 final, 16 February 2016.

How *hawala* impacts national security

The hawala system to move funds globally for terrorist financing is huge, secretive, and layered—and a challenge for national security agencies. Although India has taken regulatory and institutional steps to counter this form of financing, it must also create a community intelligence network and ensure financial inclusion to weaken the system

Sameer Patil

Across the world today, even as terrorist groups search for new technologies, new methodologies of operation, and newer source of funding, their reliance on one traditional system remains unchanged—they still use *hawala* to move and distribute funds to their cadres and sympathisers across the globe.

For instance, in the July 2006 Mumbai train bombings carried out by the Indian Mujahideen (IM), the Pakistan-based handlers of the group used the *hawala* route to transfer money to IM cadres to execute the attack. [1] Similarly, in the 2010 Times Square car bombing attempt in New York, the perpetrator, Faisal Shahzad, had received money through *hawala* to plot the attack. [2]

Inevitably therefore, the efforts by India, the U.S., and European countries to seal the sources of terrorism financing include containing the *hawala* or *hundi* system. [3] But this remains a tough task, because the very nature of *hawala* ensures that of all terrorism-related domains, it is the most difficult to gather precise information about.

It is not as if the entire *hawala* system is undesirable, or only used for illegal purposes. The system originated in the 11th century in West Asia and the Indian subcontinent. [4] It was used to move funds for long-distance trade, at a time when modern banking facilities had not yet developed. The ease of transferring funds and the anonymity of

the transactions carried out by the service providers—known in the Indian subcontinent as *hawaldars*—eventually took *hawala* beyond trade and made it the preferred system for criminals looking to move funds across countries without alerting the authorities.

This is why, despite the emergence of a formal system of banks and remittance services, *hawala* continues to thrive. Terrorist groups and organised crime syndicates have used it to launder the money from the sale of narcotics and other criminal activities, across jurisdictions. Al-Qaeda and drug traffickers, for example, regularly use the *hawala* network in Pakistan and Afghanistan. [5]

But the dynamics of *hawala* changed after the 11 September 2001 attacks in the U.S. American security agencies suspected that one of the attackers may have received money through *hawala*. [6] Although the National Commission on Terrorist Attacks Upon the United States (also known as the 9/11 Commission), found no definitive evidence, it concluded that Al-Qaeda had been using *hawala* to finance its activities. [7] That inference was enough for many countries in Europe and Asia to attempt regulating *hawaldars*—through measures that included asking them to register their business and introducing *hawala*-specific laws.

India's attempts to counter *hawala*

However, India had been grappling with the use of *hawala* for terrorist financing well before September 2001. The 1993 Mumbai serial blasts, carried out by the Dawood Ibrahim crime syndicate, were financed through *hawala*. [8] Since then, the *hawala* angle has cropped up in multiple investigations related to terrorist financing, including in the 2006 Mumbai train blasts. [9]

At present, the National Investigation Agency (NIA) is investigating 11 cases of *hawala*-routed terrorism funding in India. [10] The most prominent among these is related to the Jammu & Kashmir Affectees Relief Trust (JKART), a front organisation set up in Rawalpindi, Pakistan, by the anti-India terrorist group, Hizbul Mujahideen (HM). The NIA believes that the HM, under cover of the JKART, transferred Rs. 80 crores through *hawala* over a span of many years to fund terrorist activities in Jammu and Kashmir.[11]

Cases such as these are just the tip of the iceberg within Kashmir Valley—security agencies allege that Kashmiri separatists receive regular *hawala* payments from Pakistan for anti-India activities. In one prominent case, the police twice arrested Ghulam Mohammad Bhat, an aide of Syed Ali Shah Geelani (who heads the hardliner faction of the Hurriyat Conference) in 2008 and 2011, for allegedly receiving money from Pakistan via *hawala* for separatist activities. [12]

Recent media reports indicate a surge in *hawala* funding from charity organisations in the Persian Gulf to the seminaries in the Kashmir Valley; these funds are used to indoctrinate the local youth. [13]

But looking for *hawala* transactions in terrorist financing remains a search for a needle in a haystack. *Hawala* transactions are highly anonymous—*hawaldars*, for business reasons, are reluctant to ask questions about the source of the money and the purpose of a transfer. The lack of a proper paper trail is further complicated by the usually small amounts—less than Rs. 1 lakh—of individual *hawala* transactions. The deep links between *hawala* and 'black money'— many politicians and businessmen allegedly use *hawala* to launder money and evade tax—add another layer of complexity to the investigations.

There is another aspect of *hawala* which is not related to terrorist financing: Iran, which was locked out of the international financial system under western and international sanctions until recently, has used *hawala*—locally known as *havaleh*—for decades. A bulk of these transactions were routed through Dubai, a known *hawala* hub. [14] Some financial exchanges between Iran and Pakistan were reportedly routed through *hawala* instead of the Asian Clearing Union. [15]

Hawala is also used by a growing number of the Indian diaspora in West Asia, Europe, and North America to send money home. This is because it is cheaper than the formal remittance services, and many migrants (some of them illegal) do not have access to banks. These remittances bring much-needed liquidity to the system by providing the *hawaldars* with readily available cash, which they then use for their other transactions.

It is difficult to quantify the number, but there are estimates: a 2009

study by the U.S. State Department noted that funds transferred through *hawala* were equal to 30-40% of the formal remittances market in India. [16] Recent World Bank data notes that during 2006-2015, the Indian diaspora formally remitted approximately $558 billion to India. [17]

Considering the adverse security implications of *hawala*, India has taken a number of steps to combat the system:

• The Foreign Exchange Management Act (1999) treats *hawala* transactions as illegal. [18]

• Under the Prevention of Money Laundering Act (2002), *hawala* is illegal if the proceeds from such transactions are used for money laundering. [19]

• As a member of the Financial Action Task Force (a 37-member inter-governmental body that combats money laundering), India set up the Financial Intelligence Unit (FIU) in November 2004, and became a part of the Egmont Group (an informal network of national FIUs). [20]

• India is also part of other international initiatives like the Eurasian Group on Combating Money Laundering, and the Asia/Pacific Group on Money Laundering.[21]

But beyond these necessary regulatory and institutional steps, India lacks a robust community intelligence network among the *hawaldars*, which can report on suspicious transactions involving proceeds from narcotics smuggling, money laundering, and terrorist financing. In the past, a high-handed approach towards *hawaldars*—security agencies would close their operations and seize their assets—has been counter-productive and has only forced them to go further underground.

Another important initiative in containing *hawala* is financial inclusion. To address the reasons why the diaspora uses *hawala*, the formal financial system—banks and remittance services—will have to improve their services by reducing the commission charges for remittances and offering better services. This will bring more people into the formal banking sector.

The United Nations Sustainable Development Goals, adopted in

September 2015, have, for the first time, put this issue on its agenda by agreeing to reduce to less than 3% the transaction costs of migrant remittances, and to eliminate remittance corridors with costs higher than 5%. [22]

But reducing or eliminating *hawala* remains a difficult endeavour, one which requires greater political will in India. A system which has proved to be resilient for centuries will not disappear easily and immediately, and especially not when it is also allegedly used by some politicians. But steps can be taken to weaken it.

Sameer Patil *is Fellow, National Security, Ethnic Conflict and Terrorism Studies, Gateway House. Prior to this, he was Assistant Director at the National Security Council Secretariat in the Prime Minister's Office, New Delhi. Sameer has written extensively on national security, including cyber security, fake currency, terrorism, India-Pakistan relations, India-China relations, the Kashmir issue, and nuclear proliferation. He has an MA and MPhil in International Relations from Jawaharlal Nehru University, New Delhi.*

References

[1] Press Trust of India, '2006 Mumbai Train Blasts: Police Chargesheet Details Role of Accused', NDTV, 14 September 2015, <http://www.ndtv.com/india-news/2006-mumbai-train-blasts-police-chargesheet-details-role-of-accused-1216756>

[2] Federal Bureau of Investigation, Department of Justice, United States Government, *Manhattan U.S. Attorney Charges Long Island Man with Engaging in Hawala Activity That Funded Attempted Times Square Bombing*, 15 September 2010, <https://www.fbi.gov/newyork/press-releases/2010/nyfo091510a.htm>

[3] Hawala is an Arabic-origin word and refers to a bill of exchange or promissory note. In Hindi or Urdu, it additionally means 'trust' or 'reference', signifying the operating principle of this system. Hundi, a Sanskrit word, also means a bill of exchange or promissory note.

See: Jost, Patrick M. and Harjit Singh Sandhu, *The Hawala Alternative Remittance System and its Role in Money Laundering*, Financial Crimes Enforcement Network and INTERPOL/FOPAC, <https://www.treasury.gov/resource-center/terrorist-illicit-finance/Documents/FinCEN-Hawala-rpt.pdf>

[4] Mabrey, Daniel, 'Demystifying Hawala: Understanding Terrorist Financial Networks', *Crime and Justice International*, Volume 19, No. 69, January 2003, <http://www.cjimagazine.com/archives/cji3773.html?id=27>

[5] Peters, Gretchen, *Seeds of Terror: The Taliban, the ISI and the New Opium Wars* (Gurgaon: Hachette India, 2009), p. 111 and 164.

[6] South Asia Terrorism Portal, 'Asif Reza Commando Force', <http://www.satp.org/satporgtp/countries/india/terroristoutfits/ARCF.htm>

[7] National Commission on Terrorist Attacks upon the United States, United States Government, *The 9/11 Commission Report*, 22 July 2004, <http://govinfo.library.unt.edu/911/report/911Report.pdf>, p. 171

[8] Press Trust of India, '1993 blasts were planned in April but Tiger advanced them', *The Economic Times*, 21 March 2013, <http://articles.economictimes.indiatimes.com/2013-03-21/news/37903453_1_tiger-memon-bomb-blasts-serial-blasts>

[9] Press Trust of India, '2006 Mumbai Train Blasts: Police Chargesheet Details Role of Accused', NDTV, 14 September 2015, <http://www.ndtv.com/india-news/2006-mumbai-train-blasts-police-chargesheet-details-role-of-accused-1216756>

[10] Lok Sabha, Government of India, 'Funding through Hawala', Unstarred Question no. 3288, 12 December 2014, <http://164.100.47.192/Loksabha/Questions/QResult15.aspx?qref=10904&lsno=16>

[11] National Investigation Agency, Ministry of Home Affairs, Government of India, 'Final Report (U/S 173 Cr PC), State (NIA)

V/s Syed Salahuddin and Others', 30 November 2013, <http://www.nia.gov.in/writereaddata/Portal/CasesPdfDoc/RC-11-2011-DLI-CS-3.pdf>

[12] ITGD Bureau, 'Geelani aide arrested in Hawala case, Rs 21 lakh seized', *India Today,* 23 January 2011, <http://indiatoday.intoday.in/story/geelani-aide-arrested-in-hawala-case-rs-21-lakh-seized/1/127499.html>

[13] Press Trust of India, 'Gulf funds being used to radicalise Kashmir youth', *Daily Excelsior*, 24 April 2016, <http://www.dailyexcelsior.com/gulf-funds-used-radicalise-kashmir-youth/>

[14] Fifield, Anna, 'How Iranians are avoiding sanctions', *Financial Times*, 14 April 2008, <http://www.ft.com/intl/cms/s/0/6ca69788-0a48-11dd-b5b1-0000779fd2ac.html>

[15] Reschikov, Oleg, 'Iran: Opposition to Western Sanctions in the Banking Sector', *New Eastern Outlook*, 30 January 2015, <http://journal-neo.org/2015/01/30/rus-iran-protivodejstvie-zapadny-m-sanktsiyam-v-bankovskoj-sfere/>

[16] Bureau of International Narcotics and Law Enforcement Affairs, U.S. Department of State, *2010 INCSR: Countries/Jurisdictions of Primary Concern: Guatemala through Mexico,* 1 March 2010, <http://www.state.gov/j/inl/rls/nrcrpt/2010/vol2/137212.htm>

[17] World Bank, 'Migration and Remittances Factbook 2016- Country Tables', December 2015, <http://siteresources.worldbank.org/INTPROSPECTS/Resources/334934-1199807908806/4549025-1450455807487/Factbook2016_Countries_A-L.pdf>, p. 88

[18] Ministry of Finance, Government of India, 'The Foreign Exchange Management Act, 1999', 29 December 1999, <http://finmin.nic.in/the_ministry/dept_eco_affairs/capital_market_div/FEMA_act_1999.pdf>

[19] Ministry of Finance, Government of India, 'Prevention of Money Laundering Act, 2002', <http://finmin.nic.in/law/moneylaunderingact.pdf>

[20] The Egmont Group of Financial Intelligence Units, 'About', <http://www.egmontgroup.org/about>

[21] Patil, Sameer, *Combating terror financing through SAARC*, 25 November 2014, Gateway House: Indian Council on Global Relations, <http://www.gatewayhouse.in/combating-terror-financing-through-saarc/>

[22] United Nations, 'Sustainable Development Goals-Goal 10: Reduce inequality within and among countries', <http://www.un.org/sustainabledevelopment/inequality/>