

China-India Brief

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Guest Column

India's China Paradox: Decoupling by Deepening Dependence

By Keji Mao and Hu Keyi

India launched the Production-Linked Incentive (PLI) scheme in 2020, as the COVID-19 pandemic, the Galwan Valley clash, and intensifying US-China rivalry reshaped geopolitical environment. The purpose is to strengthen domestic manufacturing, boost exports, and reduce dependence on Chinese supply chains. Five years on, however, the PLI's results points to an unwelcome truth. The harder New Delhi has pushed to decouple from


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The *China-India Brief* is a monthly digest focusing on the relationship between Asia's two biggest powers. The Brief provides readers with a key summary of current news articles, reports, analyses, commentaries, and journal articles published in English on the China-India relationship. It features a Guest Column weighing in on key current issues in China-India relations.

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cont'd p2

China, the more clearly it has confirmed the opposite of what is intended: that China's role in India's industrialisation is not an external variable to be managed, but a structural condition to be accepted. Understanding the PLI scheme's mixed results, and India's evolving response to them, offers a window into the contradictions at the heart of China–India economic relations.

From Complementarity to Confrontation

The trajectory of China-India economic relations over the past decade largely explains how the PLI scheme was designed. Between 2014 and 2017, Modi's first **"Make in India"** phase was premised on substantial economic complementarity with China. During his May 2015 visit to Shanghai, Modi told Chinese executives that China was the "factory floor of the world" and India was its "back office." The two economies, he said, could complement each other **"in the present and future."** Since then, Chinese smartphone makers such as Xiaomi, Oppo, and Vivo moved rapidly into India. By early 2017, Chinese brands accounted for **over half** of Indian phone shipments. Since then, Chinese capital, components, and component ecosystems quietly made smartphone industry the poster child of India's manufacturing ambitions.

The 2017 Doklam standoff marked the turning point. Economic engagement was subsequently viewed through the national security lens in New Delhi. In April 2020, the Modi government issued **Press Note 3**, requiring government screening of

investments from countries sharing a land-border, which in practice meant China. After the 2020 Galwan clash, India **banned hundreds of Chinese apps**, restricted Chinese participation in government procurement, and subjected Chinese firms to a series of tax investigations.

Between 2020 and 2023, only about **a quarter of some 435 Chinese investment applications** were approved. The PLI scheme, launched in the same period as the border clash and the pandemic, was therefore conceived as a key building block for this decoupling. The logic was two fold. Restrictions would limit Chinese entry, while subsidies would build Indian capacity in precisely the sectors where dependence on China ran deepest: pharmaceutical ingredients, medical devices, electronics components and telecommunications.

The Dependency Paradox

Yet the PLI scheme has collided with a structural reality: China sits at critical nodes across all the supply chains PLI seeks to build. For instance, India's electronics exports reached \$38.5 billion in FY2025, yet component imports totalled \$36.8 billion in the first half of the year, with **40 percent sourced from China**. Similar dependence is evident in solar PV industry: China supplies around **95 percent** of India's imported cells. Switching to domestically produced cells nearly doubles the cost of a module. China also supplies **68 percent** of bulk drugs and intermediates on which India's pharmaceutical industry depends. Some Indian scholars have wryly observed that **"Make in India relies on Made in China."**

India's own tariff hikes on components and machinery, meant for force localisation, did the opposite: they raised input costs for assemblers. The India Cellular and Electronics Association estimates that tariffs alone leave assemblers **7 to 7.5 percent cost disadvantage** against Chinese and Vietnamese competitors, substantially eroding the value of PLI subsidies.

The results by early 2026 were sobering. Of the scheme's allocated 1.91 trillion rupees (approximately \$23 billion), barely **12.5 percent** had been disbursed. Even the flagship success, the **smartphone industry**, shows how partial the achievement is. India now manufactures 99 percent of the phones sold domestically and assembles a quarter of the world's iPhones, yet captures only the lowest-value assembly stage.

One study estimates that for a \$1,000 iPhone exported from India, local value added is just \$30. That is less than the subsidy rate itself, producing what former central banker Raghuram Rajan described as a **subsidised assembly trap**. Meanwhile, India's electronics trade deficit **widened** from \$58 billion in 2022 to \$60.5 billion in 2024. Exports grew, but imports of Chinese components grew faster still.

Structural Constraints and Policy Frictions

China-India economic friction is compounded by India's own policy contradictions. PLI's open-door design, which invited foreign firms to qualify for subsidies, was undercut by the security restrictions from the same government. Chinese component suppliers, equipment

installers and technicians, indispensable for scaling up capacity, were increasingly barred or delayed by visa controls and investment screening. Projects stalled not for lack of money, but for lack of the very Chinese inputs the **decoupling agenda sought to exclude**.

Beneath these frictions lie deeper constraints that no subsidy can offset. India's real consumer market, those who can actually afford mid-range goods, numbers **perhaps** 120 million people, not 1.4 billion, and roughly 90 percent of the workforce remains in informal employment. Structural problem compound the problem: land acquisition can take up to three years, power costs stay high due to distribution losses of about 20 percent; and much of India's transshipment containers still routes through foreign ports such as Colombo and Singapore. Crony ties between the state and conglomerates like Reliance and Adani risk turning industrial policy into "riskless capitalism" for incumbents rather than competition-driven upgrading. Under these conditions, PLI subsidies treat the symptoms of high costs rather than their causes. Investment has stagnated even as headline production figures rise

A Tactical Recalibration

By 2026, these structural limitations forced the Modi administration into a tactical pivot. It did not abandon its China-focused policy, but softening its edges. The Economic Survey 2023–24 conceded that **"the world cannot ignore China,"** recommending that hosting Chinese firms

to manufacture for Western export would serve India better than importing Chinese inputs for low-value processing.

Consequently, in March 2026, the Indian Cabinet revised Press Note 3, easing some FDI restrictions on Chinese investments, particularly for joint ventures in electronics component manufacturing where local expertise is absent. Yet the shift remains tactical, a targeted openness meant to draw in Chinese capital and know-how while containing strategic exposure. New Delhi also moved to streamline business visas for Chinese engineers, on the grounds that local factories could not install and operate advanced machinery without their technical support.

However, this policy shift will remain vulnerable to reversal, whether from external shocks or domestic politics. Nationalist sentiment, electoral incentives, and genuine security concerns continue to generate policy volatility. For Chinese firms the business environment remains extremely unpredictable; for Indian manufacturers, the absence of reliable, cost-competitive upstream supply from any source other than China remains a binding constraint.

Conclusions

PLI therefore illustrates a broader pattern in contemporary China-India economic interaction: India's will to reduce vulnerability sits alongside a structural

dependence that it cannot quickly unwind. The Modi government's fiscal incentives can alter location decisions at the margin, but they cannot deliver deeper reforms, on which competitiveness ultimately depends. Genuine upgrading would require not larger subsidies but systemic reform of land, labour, infrastructure, and state-business relations, alongside a more pragmatic, predictable approach to Chinese investment.

India's manufacturing ambitions are structurally entangled with Chinese supply chains. The attempt to build capacity while excluding the partner best positioned to supply that capacity has produced the scheme's defining paradox. Until India reconciles its security anxieties with its industrial needs, its flagship industrial policy will remain what the evidence suggests it already is: an expensive way to perform decoupling while deepening, in disguise, the dependence it seeks to escape.

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