The geopolitical fallout of the Israel-Hamas war

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One strategic shift and two tactical realignments. These were the driving forces of geopolitics in West Asia in recent years, until October 7. All were interrelated. The United States, the reigning superpower of the region since the end of the Second World War, had begun shifting its strategic focus to more conventional rivals such as Russia and China. But, to maintain its hold over and interests in the region, what the U.S. sought to do was to bring two of the pillars of its regional policy, Israel and the Gulf Arabs, closer. The Abraham Accords were a result of this policy, which was rolled out by the Donald Trump administration and embraced by the U.S. President, Joe Biden. A common Jewish-Arab front in a relatively peaceful West Asia would allow the U.S. to free up resources from the region which it could use elsewhere.

On the other side, the U.S.'s deprioritisation of West Asia led Gulf Arabs to make their own tactical changes in foreign policy for a more predictable and stable relationship in the region. This opened an opportunity for China, which has good ties with countries across the Gulf, to play the role of a peacemaker. The result was the Iran-Saudi reconciliation agreement. The U.S.'s response to the Saudi-Iran détente was to double down on the Abraham Accords. The Biden administration invested itself in talks between the Saudis and the Israelis. It was so confident about prospects of a deal that it unveiled the India-Middle East-Europe Economic Corridor (IMEC) proposal earlier this year, which hinged on Arab-Israel peace, and sold it as an alternative to China's outreach into the region. Then came the October 7 Hamas attack on Israel.

Re-regionalisation of Palestine

Hamas, which has been controlling Gaza since 2007, looked at these two realignments differently. For Hamas, a Sunni Islamist militant group, the coming together of Iran, a Shia theocratic republic which also has been its patron for years, and Saudi Arabia, a Sunni monarchy that has been wary of the Hamas brand of political Islam, is a welcome development. But it saw Saudi Arabia normalising ties with Israel, which has been occupying Palestinian territories at least since 1967, as a setback.

In 1978, when the Camp David Agreement was reached, Egypt got the Israelis to sign the Framework For Peace Agreement, which became the blueprint for the Oslo process in the 1990s. Jordan signed its peace treaty with Israel only after the first Oslo Accord was signed in 1993. But when the United Arab Emirates (UAE), Bahrain and Morocco signed the Abraham Accords in 2020, Israel did not make any concessions for the Palestinians. This was the clearest sign yet that Arabs, especially Gulf Arabs, were ready to delink the Palestine question from their engagement with Israel, which boosted Tel Aviv's efforts to localise the Palestine issue – to treat it as a mere security nuisance while continuing the occupation without consequences. When Saudi Arabia and Israel were in talks, nobody expected the Benjamin Netanyahu government, the most far-right government in Israel's history comprising settler extremists and ultra-Orthodox Zionists, to offer concessions to the Palestinians.

So, understandably, one of the goals of the October 7 Hamas attack was to break the walls of localisation, re-regionalise the Palestine issue, and thereby scuttle the Saudi-Israel peace bid. Israel's vengeful onslaught on the Gaza Strip, which followed the Hamas attack, killing at least 11,500 Palestinians, a vast majority of them women and children, made sure that Hamas met its goal, at least for now.

> With the Saudi-Israel peace plan derailed and Iran-Saudi engagement deepening, the United States is witnessing the limits of the Abraham Accords and the widening scope of the China-brokered regional détente

The way Arabs see it

Both the Arabs and Israel were ready to sidestep the Palestine question and chart a new course of partnership. But new regional realities emerged after October 7. The Palestine issue has now come back to the fore of the West Asian geopolitical cauldron.

Second, Israel's disproportionate and indiscriminate attack on Gaza has triggered massive protests across the Arab Street, mounting enormous pressure on monarchs and dictators. Arab countries, which witnessed violent destabilising street protests and civil strife just 10 years ago, cannot completely turn away from the growing pan-Arab sympathy with the Palestinians and the antipathy towards Israel.

Third, there is always the Iran factor. Ever since the Palestine issue got re-regionalised, Iran has stepped up its pro-Palestine rhetoric and called for collective action against Israel, while its proxies, the Houthis in Yemen and Hezbollah in Lebanon, have launched limited attacks on Israel. Iran is trying to claim the leadership of the Islamic world, bridging the Shia-Sunni divide. This has left Saudi Arabia and other Arab countries with difficult choices. They can either ignore the anger in the Arab Street, letting Iran take up the cause and go ahead with the planned peace agreement with Israel or halt the talks and return to the original King Abdullah Initiative, which called for the formation of an independent Palestine state based on the 1967 border in return for Arab recognition of Israel. The Saudis convened an Islamic summit on Gaza, which saw the landmark visit by Iranian President Ebrahim Raisi to the Kingdom, and reiterated its call for the creation of a Palestine state based on the 1967 borders for peace and security in the region. In effect, Mohammed bin Salman, the Saudi Crown Prince, has relinked the Palestine issue with peace talks with Israel. This is a setback for both America and Israel.

The U.S. might still hope that the situation would be conducive to reboot the Abraham Accords once the dust settles. This is entirely possible. But a key challenge is that it is still not clear what Mr. Netanyahu's endgame is in Gaza. He has already signalled that Israeli troops would continue to play an overall security role in the enclave – which means, Israel would reoccupy the territory from where it withdrew in 2005. The U.S. had proposed that post the war, the Palestinian Authority, which runs parts of the West Bank with limited powers, should take over Gaza as well. But Mr. Netanyahu has shot down that proposal. So, if Israel reoccupies the territory, home to 2.2 million people living in distress and misery, the current wave of violence would only be the beginning of a long spell.

Regional dynamics

The Iran-Saudi reconciliation, under Chinese mediation, itself was a setback for the U.S. In recent years, Arab countries have also shown an increasing hunger for autonomy. The UAE and Saudi Arabia refused to join American sanctions against Russia after the Ukraine war. Saudi Arabia continued its Organization of the Petroleum Exporting Countries (OPEC) Plus cooperation with Moscow, defying Washington's requests and diktats. China is playing an increasingly greater role in the Gulf, which includes secret plans to build a military facility in the UAE. The current crisis is expediting these changes in the regional dynamics. With the Saudi-Israel peace plan derailed and the Iranian President having visited the Kingdom to discuss Israel's war on Gaza, what Washington is witnessing is the limits of the U.S.-brokered Abraham Accords and the widening scope of the China-brokered Iran-Saudi détente.

The situation in Gaza is effectively back to the pre-2005 days, but the geopolitical reality is entirely different from the early 2000s when the U.S. was the sole superpower in the region. Russia and China may not replace America in West Asia in the near future given the U.S.'s huge military presence, but the growing footprint of other great powers is offering space for better manoeuvrability for regional players. By tying itself deeply with Mr. Netanyahu's brutal, endless war on Gaza, the Biden administration has put the U.S. in a difficult position in a region that is already in a flux.

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State of the economy — temper the euphoria

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In its semi-annual report, World Economic Outlook, 'Navigating Global Divergences' October 2023, the International Monetary Fund (IMF) has revised its projected GDP growth rate for India for 2023-24 to 6.3%, up from the earlier 6.1%. For India's policymakers, it is a vindication of their short-term economic management. The success is sweeter as the IMF revised downwards world GDP growth projection, including China's by 0.3 percentage points, to 4.2%. Official spokespersons have sought the IMF's endorsement to silence its critics.

That the economies that were worst affected during the COVID-19 pandemic were also the ones to record a steep recovery is widely acknowledged. India, which was one of the worst affected, has followed the pattern. During the second quarter of 2020, India's GDP contracted by 25.6%, quarter on quarter, the worst among the world's major economies as reported by the then IMF Chief Economist, in a tweet on September 2, 2020. The output contraction in 2020-21, at 8.5% over the previous year, was one of the worst among the world's large economies.

Taking a slightly longer view, India's real (inflation adjusted) annual GDP growth rate slowed down from 6.8% in 2016-17 to 2.8% in 2019-20, immediately prior to the pandemic. Real per capita income level in 2021-22, at ₹1.09 lakh, was higher than that in 2019-20 by about ₹600. In the following year, 2022-23, recovery gained momentum as domestic supplies were restored and global supply chains were straightened out.

Effects are cause for concern

Surely, output recovery is welcome, yet its effects on employment, its quality and persistence of inflation of essential food items affecting the poor the most remain causes of concern – as many critics have highlighted. However, even focusing on output recovery, a sectoral view with trade dimension, would perhaps expose chinks on the armour, as detailed below. Policymakers need to temper their optimism by taking a slightly longer view with a wider angle – appreciating the fast-changing geopolitical underpinnings of economic policy making. It perhaps bears repetition that 2022-23 heralded the end of globalisation as we knew it (since the Berlin Wall's collapse in 1989) with tectonic shifts in the world geopolitical order, revealing India's persistent vulnerabilities of oil and food shocks. In fact the Finance Ministry's Monthly Economic Review (September edition) alludes to these weaknesses.

Official commentators should engage with critics in appreciating the gravity of economic setbacks rather than quibble over the IMF's short-term growth projections

Growing deficit with China

However, the immediate concern is India's susceptibility to its soaring deficit with China. India's economic frailty has increased even as the net exports (exports minus imports) to GDP ratio has declined sharply. India's dependence on Chinese imports of manufactures seems structural, and not easily corrected by changes in relative prices.

It needs recollection that in May 2020, the government initiated the Atmanirbhar Bharat Abhiyan, amidst the Galwan crisis to curb Chinese imports of critical industrial products. China accounts for: 15%-16% of India's imports and a third of India's trade deficit. The trade deficit continues to rise, however ("India's Trade dilemma with China", Pal and Ray, *businessline*, June 20, 2023). Willy nilly, India undid many import restrictions, as domestic production was getting throttled for lack of critical Chinese inputs. The mirror image of rising Chinese imports is a steady decline in industrial growth rate, from 13.1% per year in 2015-16 to negative 3.5% per year in 2019-20 (before COVID-19). Industrial growth rates as per the Index of Industrial Production (IIP), despite its limitations, shows an alarming regression over a longer period. During the boom period (2004-05 to 2013-14), manufacturing grew at an annual average rate of 5.7%; the rate declined to 3.1% during 2014-15 and 2022-23 – the fall is acute in capital goods, plummeting from 9.7% to 1%.

From 2011-12 to 2021-22, gross fixed capital formation to GDP ratio at current prices, declined steadily from 34.3% to 28.9% – an unprecedented fall in post-independent India. And its public sector share has remained constant at 8% (National Accounts). Net foreign direct investment (excluding disinvestment and outward foreign direct investment), to current GDP ratio fell from 3.6% in 2008 to 2.4% in 2022 (World Development Indicators).

The official optimistic picture of public investment growth since FY22, based on budgetary statistics, seems suspect. Public investment has three parts: the central government, the States and central public sector undertakings (PSUs). Public investment by State governments, based on the Centre's loans and advances to States, is conditional upon policy reforms. The widely reported rise in the Centre's investment is apparently due to the merging of extra-budgetary borrowing by central PSUs with the Centre's own Budget. Hence. the projected boost in public investment seems illusory. Combining the three items, public investment seems around 6% of GDP – perhaps similar to its pre-COVID-19 levels ("Is public Sector Capex really rising?", Nikhil Gupta, *businessline*, January 2, 2023).

Credibility of the HDI

On social development, official spokespersons and critics have battled over the veracity of (questionable) multidimensional poverty measure, and the unrepresentativeness of the Global Hunger Index. Instead, the UN Development Programme's Human Development Index may be more credible and an acceptable measure. The value of India's HDI index moderated from 0.645 in 2018 to 0.633 in 2021; and, its global rank went down by one rank during 2015-21 – meaning that other countries have performed better than India.

To sum up, if official spokespersons enlarged the frame of economic assessment slightly, a few stark facts come into focus. These are: the strategic threat posed by an unrelenting rise in trade deficit with China, despite government's best efforts; its mirror image is a decline in industrial output growth rates, especially capital goods' decimation; and a decade long, unprecedented, decline in the economy's fixed investment rate; with an unchanging public sector's share in it, at least up to 2021-22; India's HDI ranking slipped by one. Official commentators would perhaps do well to engage with its critics in appreciating the gravity of economic setbacks in recent years than scoring brownie points over the IMF's short-term growth projections.