
India-Russia Economic Ties Are Strengthening Rapidly—Especially in Terms of Crude Oil Trade

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Summary

1. As the international situation becomes more complex, India is strengthening its foreign policy stance of dealing with other countries impartially, with the aims of maintaining its autonomy/independence and maximizing benefits to itself. While India is deepening its ties with the G7 (major industrialized countries) with its policy toward China in mind, it is also rapidly increasing its imports of cheap Russian crude oil, going against the G7's economic sanctions against Russia. Background factors behind India's importing of Russian oil despite frowns from the G7 are that 1) India has various economic and social problems caused by its low income level, while its economic structure is vulnerable to the adverse effects of rising oil prices, and 2) it has become increasingly assertive as a major power due to its steadily growing presence in the world economy, and believes that its position and arguments will ultimately be accepted by the G7.
2. Russia's share of India's crude oil imports jumped from 2% in 2021 to over 20% in early fall 2022, making Russia India's largest supplier. Along with low prices, another reason for India's rapid increase in imports of Russian oil is its growing need to diversify sources of procurement. Because of the G7 economic sanctions against it, Russia is expected to face difficulties ahead in procuring goods such as automobiles, general machinery, and electronic equipment, and is switching its procurement sources from the G7 to China and India. The Indian government aims to translate this trend into the development of its own manufacturing industry and expansion of exports.
3. Looking ahead, the view should be that the development of India-Russia economic relations will see a series of bumps (i.e., regressions) centered on the oil trade. Given the relative cheapness of Russian crude and the stable supply of Middle Eastern crude, India is likely to adjust the proportion of oil it imports from Russia in a flexible manner. For commodities other than crude oil, the pace of bilateral trade expansion is expected to remain moderate, as the low export competitiveness of India's manufacturing sector and uncertainty surrounding Russia's politics and economy will constrain business expansion.
4. As the Indian and Russian economies move closer together, the effectiveness of G7 economic sanctions against Russia will be hampered, and this could prolong the global division over Ukraine. If India's growth rate can be boosted by the tailwind of production transfers to "neutral countries," while the economic growth rates of the two opposing camps decline, India's presence in the global economy should increase rapidly. However, if India is perceived by the international community to be partly responsible for the prolonged division of the world, it risks creating new fissures between India and other countries, which could actually reduce India's growth rate.

Introduction

As the international situation becomes more complex, India is pursuing a distinctive, balanced approach to diplomacy. With its policy toward China in mind, India is seeking to deepen its ties with developed countries through the Quadrilateral Security Dialogue (QUAD) and the Indo-Pacific Economic Framework (IPEF). On the other hand, India's stance on the Russia-Ukraine issue is in direct conflict with that of the G7⁽¹⁾ (the "Group of Seven" major industrialized countries). While the G7 has condemned Russia's military aggression and strengthened economic sanctions against Russia, India has maintained a position of "neutrality" and rapidly increased its oil imports from Russia, going against the G7's economic sanctions against Russia. In addition to this, India is also deepening its military ties with Russia. For example, in September 2022 it took part in the Russian-led "Vostok" joint military exercise in the Far East for the first time. India has taken a series of actions that could be interpreted as pro-Russian and have a lot in common with China's approach. These include abstaining from the UN draft resolution condemning Russia and expanding imports of oil from the country.

India's seemingly inexplicable diplomatic stance has raised various questions for many. Why is India moving closer Russia even to the detriment of its reputation among the G7, which from the standpoint of policy toward China and economics is the more important partner? Will the honeymoon relationship with Russia continue on the economic front, especially in terms of oil trade? Can India earn a "fisherman's profit" (i.e., profit while others fight) by trying to have it both ways in foreign policy toward Russia and the G7? Or is it running the risk of "chasing two hares and catching neither?"

How is India perceiving and attempting to respond to the changing international situation? As India's share of the global economy rises, it is becoming increasingly important to understand this issue. Therefore, to seek answers to the above questions, this paper will confirm India's basic foreign policy stance and examine the current

state and future of economic relations between India and Russia, which have rapidly been becoming closer recently. The paper will point out that while India and Russia have traditionally been friendly, India is not bound by its Russian ties and may review its economic relationship with Russia in response to changes in the future market environment.

1. The Russia-Ukraine issue and India

One reason for the long-standing friendship between India and Russia was that from independence until the 1980s, India promoted a planned economy⁽²⁾. With a background of opposition to exploitation and oppression by the British during the colonial period, many people, including the first prime minister, Jawaharlal Nehru, embraced socialism, which emphasizes the correction of inequality. However, the fundamental reason the friendship with Russia has endured is the international situation surrounding India. The undercurrent to India's relations with the outside world is its conflicts with Pakistan and China over the ownership of Kashmir. To understand India-Russia relations, an awareness of the post-World War II relations of both the U.S. and the Soviet Union with Pakistan and China is essential⁽³⁾. As Ito [2020] points out, India's foreign policy is based on three elements: 1) aspirations of becoming a great power orientation, 2) commitment to autonomy/independence, and 3) pragmatism. Examining India's behavior, which may appear incomprehensible, from such perspectives reveals that India's actions have been to some extent rational and consistent.

(1) History of India-Russia relations

Key events that provided the backdrop to India's closeness to the Soviet Union during the Cold War include 1) U.S. closeness to Pakistan in

the 1950s and 1970s, 2) the Sino-Soviet rift that surfaced from the late 1950s, and 3) closeness between the U.S. and China from the 1970s (Fig. 1).

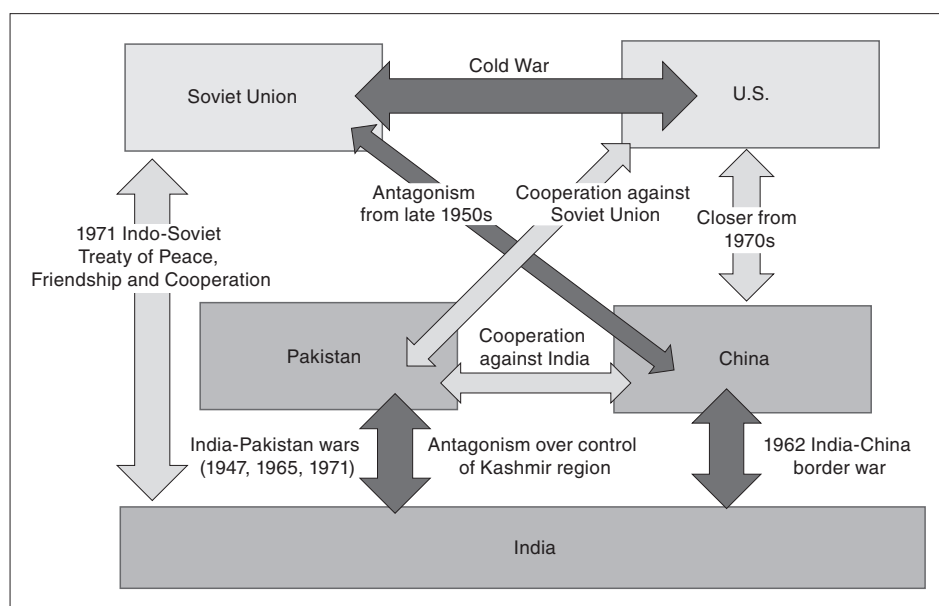
After World War II, the U.S. worked with other countries to establish an encircling net around the communist bloc in the Asia-Pacific region. Following the formation of SEATO (Southeast Asia Treaty Organization) in 1954, the U.S. began providing military assistance to Pakistan⁽⁴⁾. Furthermore, as the rift between the Soviet Union and China emerged, the U.S. also warmed to China with a view to strengthening its containment of the Soviet Union. Both China and the Soviet Union were socialist states, but from the late 1950s ideological disputes, including with respect to the pros and cons of shifting to a course of peaceful coexistence with the West, deepened political and military antagonism⁽⁵⁾. When a Sino-Soviet border dispute over the ownership of territories whose borders had not been demarcated erupted in 1969, the confrontation between the two nations became entrenched. Against this backdrop, U.S. President Richard Nixon visited China in 1972 to strengthen the encirclement of the Soviet Union and obtain

cooperation to end the Vietnam War, which had become a quagmire. During this visit, he met with CCP Chairman Mao Zedong and Premier Zhou Enlai, and in 1979, diplomatic relations between the two nations were established.

Although the main focus of the U.S. at the time was the Soviet Union, India could not overlook the U.S.'s warming to Pakistan and China. India had been at war with Pakistan three times, in 1947, 1965, and 1971, and relations with China had cooled since a border clash in 1962. Therefore, India cozied up to the Soviet Union to deter the U.S. India began receiving weapons assistance from the Soviet Union in the 1950s, and economic ties deepened when the Soviet Union helped India build a steel mill, leading to the conclusion of the Indo-Soviet Treaty of Peace, Friendship and Cooperation in 1971, which could be considered a de facto military alliance.

In the 1990s, although there was no change in India's basic foreign policy of maintaining autonomy/independence to maximize its national interests, India's foreign policy changed drastically in response to the two developments described

Fig. 1 International Environment Surrounding India during the Cold War



Source: Prepared by JRI

below. As a result, the importance to India of the India-Russia relationship declined significantly.

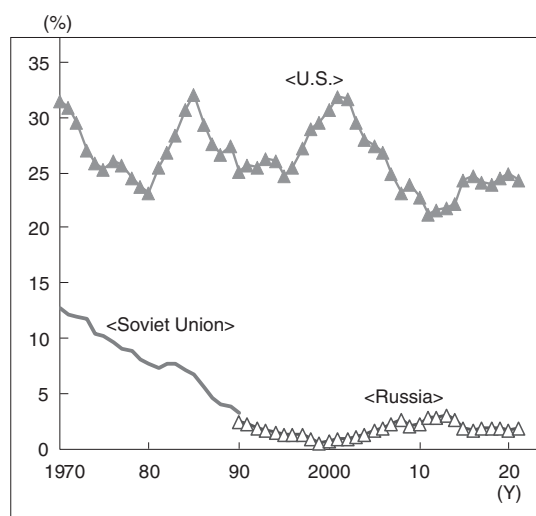
The first development was the end of the Cold War. The Soviet economy had been stagnant since the 1980s because of the limitations of its planned economy, and when the Cold War ended, the presence of the Soviet Union in the world economy declined significantly (Fig. 2). Furthermore, since the U.S. had halted military aid to Pakistan, the need for India to get closer to the Soviet Union for such purposes as deterring the U.S. had also decreased.

The second development was the opening up of India's economy. A balance of payments crisis in 1991⁽⁶⁾ prompted India to liberalize trade and investment. This move led to a deepening of economic ties with the West. Furthermore, in the 2000s, the need to build good relationships with a wide variety of countries/territories, including China and ASEAN members, increased against the backdrop of globalization and the rise of emerging economies. In response to these changes in its environment, since the 1990s India has been pursuing an "omnidirectional foreign policy" of actively seeking to build good relations with other countries⁽⁷⁾. This has seen it enter into "strategic partnerships," deals that are one step

below alliances, with numerous countries, and it has also joined various frameworks such as the Regional Comprehensive Economic Partnership (RCEP), the BRICS, the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC), and the Shanghai Cooperation Organization (SCO). In this way, it has strived to follow a foreign policy that is not overly skewed toward specific countries/territories. So in the 2000s, even though the U.S. moved economically closer to China, which was emerging as the "world's factory," and improved relations with Pakistan, which would play an important role in the war on terrorism, the Indian government did not use such developments as reasons to rethink its relationship with Russia⁽⁸⁾.

With the inauguration of the Putin administration in 2000, which aimed to rebuild a "strong Russia," India-Russia relations began to move closer again. The two countries entered into a strategic partnership with nuclear power and energy cooperation in mind and later upgraded it to a "special and privileged strategic partnership." However, the importance of Russia to India had actually declined against the backdrop of increasing globalization and changing international relationships. India's primary concerns were how to control its relations with China, with which it had a "hot economics, cold politics" relationship, and with the U.S., with which it has a "hot politics, cold economics" relationship⁽⁹⁾. Its relationship with Russia was not a central issue in its foreign policy⁽¹⁰⁾. India has expanded imports of weapons from Europe and the U.S., with which it has deepened ties as a reflection of its policy toward China, while Russia's share of weapons imports has dropped from around 70% in the 2000s to about 40% of late (Fig. 3). Regarding nuclear power, following the revision of the Nuclear Suppliers Group (NSG) Guidelines in 2008, which allowed countries to supply nuclear energy-related materials to India, the country concluded nuclear energy agreements with the U.S., France, the U.K., Canada, Japan, and other nations, so Russia's importance to India diminished.

Fig. 2 Soviet/Russian Share of World GDP



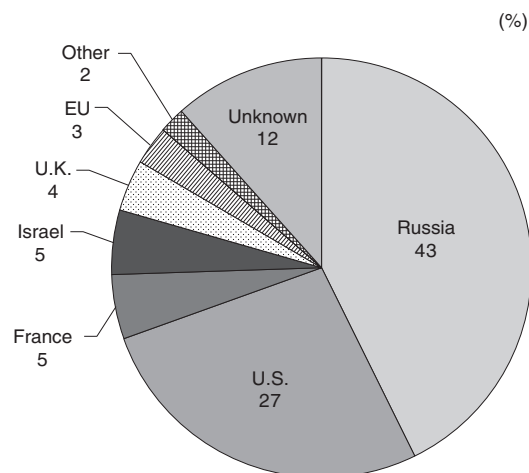
Source: Prepared by JRI based on data from the United Nations

Fig. 3 Percentage of India's arms Imports by Country



Source: Prepared by JRI based on data from SIPRI Arms Transfers Database, Stockholm International Peace Research Institute

Fig. 4 Questionnaire Survey of Indians: “Which country has been the most reliable partner since independence?”



Source: Prepared by JRI based on data from the ORF Foreign Policy Survey 2022, Observer Research Foundation

(2) India's response to the Russia-Ukraine issue

Looking at India's response since Russia launched its military invasion of Ukraine in February 2022, it can be noted that India has taken a “neutral” position on the political front while rapidly drawing closer to Russia on the economic front.

Regarding the former (“neutrality” on the political front), India calls on all parties to 1) comply with the UN Charter and international law, 2) respect sovereignty and territorial integrity, 3) immediately cease violence, and 4) resolve issues through dialogue. In September 2022, India's Prime Minister Modi attracted attention when, in a meeting with Russia's President Putin, he stated that “now is not the time for war,” and urged Russia to end the war, but he also called on Ukraine's President Zelensky to end the war in a telephone conversation in December of the same year, thus emphasizing his neutrality. India therefore abstained from a draft UN Security Council resolution condemning Russia that would name only Russia in its criticism⁽¹¹⁾. The three points below can be highlighted as background factors

to India's behavior, which from the standpoint of developed countries could be perceived as “pro-Russia” despite India's claims that its position is one of “neutrality.”

First, there is no advantage for India to explicitly support either of the belligerents. Supporting Russia would inevitably worsen relations with Western countries, which support Ukraine. On the other hand, supporting Ukraine would bring Russia and China closer together and increase India's security risks. Therefore, as in the past, India wishes to continue its omnidirectional foreign policy in the name of “neutrality,” and to deal with each country impartially.

Second, India has been on good terms with Russia until now. Although Russia's importance in Indian foreign policy has faded since the end of the Cold War, it still remains an important partner for India in areas critical for security such as nuclear power and weapons. In addition, India and Russia have a “reciprocal” relationship, as both sides abstained from voting on UN resolutions condemning the Soviet Union's 1979 invasion of Afghanistan and India's 1998 nuclear tests. Furthermore, given the highly positive attitudes toward Russia among Indians (Fig. 4), it is possible that they be-

lieve that the eastern expansion of NATO (North Atlantic Treaty Organization) is what pushed Russia to launch its armed invasion of Ukraine⁽¹²⁾.

Third, there is distrust of the U.S., which is providing unconditional support to Ukraine. The U.S. is an “extremely important partner” for India in the areas of economics and policy toward China, but is not seen as a “reliable partner.” While the U.S. strongly condemned Russia’s attempts to unilaterally change the status quo, it did not condemn China in 2019-2020 when it attempted to increase its effective control over territory in eastern India by constructing a village for thousands of people. The withdrawal of U.S. troops from Afghanistan in 2021 also increased the risk of Islamic militants from Afghanistan entering Kashmir and engaging in terrorism there.

In addition, the India-U.S. relationship is also being affected by economic conflict. Since the mid-2010s, the U.S. has become increasingly frustrated by India’s slow pace in opening up its markets and inaction to prevent infringement of intellectual property rights, and has adopted a more protectionist stance toward the country. For example, it has raised tariffs on Indian imports, excluded India from the Generalized System of Preferences (GSP), and restricted the issuance of H1-B specialty-occupation visas, most of the recipients of which have been Indians. Furthermore, the introduction of secondary sanctions (economic sanctions against individuals and companies that deal directly or indirectly with U.S. sanctions targets) to enhance the effectiveness of economic sanctions against Iran forced India to stop importing oil from Iran, which had supplied about 10% of its imports, and to instead import more expensive crude from other countries. Underlying the distrust toward the U.S. is this series of U.S. actions that have adversely affected India’s security and economy.

Next, regarding the latter (increasing economic closeness with Russia), while the G7 has reduced its crude oil and natural gas imports from Russia to make its economic sanctions against Russia more effective, India has rapidly increased its oil imports from Russia. This policy of not giving in to economic sanctions against Russia ostensibly

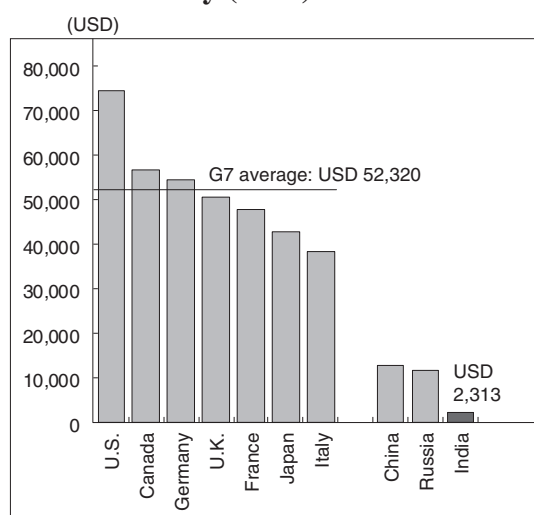
reflects India’s political neutrality. However, the rapid expansion of crude oil trade between India and Russia seems to be more rooted in pragmatism: Russia wants to secure an alternative oil export destination to the developed countries, and India wants to procure cheap crude to curb inflation.

But even so, questions remain about India’s actions. The G7 has expressed displeasure with India’s moves, as they have reduced the effectiveness of the G7 economic sanctions against Russia⁽¹³⁾, and deteriorating relations with the G7 could have a negative impact on the Indian economy in various ways in the future. India wants to be re-designated as beneficiary of the U.S. GSP and to conclude an FTA with the EU, but if negotiations toward these goals stall, the development of manufacturing industry in India, which is essential to create jobs and reduce the country’s trade deficit, will inevitably be delayed. The two points below can be highlighted as reasons that India has dared to expand its crude imports from Russia despite such risks.

First, India is saddled with numerous economic and social problems stemming from its low income level, as well as an economic structure that is vulnerable to the adverse effects of rising oil prices. India’s per capita GDP is in the USD 2,000 range, one-twenty-sixth of the G7 average and one-sixth of China’s (Fig. 5), and it still faces a variety of economic problems, including poverty, hunger, and unemployment. Rising oil prices destabilize India’s economy and society by causing economic deterioration through such channels as lower household purchasing power due to accelerating inflation and a weaker rupee due to a widening of the trade deficit⁽¹⁴⁾. In foreign policy, therefore, India needs to give greater consideration to the near-term impact on its own economy than to Ukraine or the G7.

Second, India has growing confidence in itself as a major power. In 2022, India’s GDP surpassed that of its old colonial master, the U.K., making India the world’s fifth largest economy after the U.S., China, Japan, and Germany. And in the same year, India overtook Japan in automobile sales to rank third in the world behind the U.S.

Fig. 5 Per-capita Nominal GDP by Country (2022)



Source: IMF "World Economic Outlook 2022 October"

and China. India's population is expected to surpass China's to become the world's largest by the end of 2023. Given its potential to catch up with developed countries and its future demographics, there is no doubt that solid growth will continue over the medium to long term. With growth remaining resilient compared to other countries on the back of the normalization of economic and social activities since the COVID pandemic, the Indian government is increasingly of the view that India's "golden age⁽¹⁵⁾" will continue for the next quarter century until the centennial of its independence. Therefore, it is pursuing its own, Indian-style "neutral foreign policy" in the expectation that it will not be possible for the world to ignore the status and assertions of India as it gradually usurps China as the leader⁽¹⁶⁾ among emerging countries⁽¹⁷⁾.

2. The Indian and Russian economies are rapidly coming closer together

After the end of the Cold War, India-Russia economic relations were tepid for a long time,

but bilateral ties have rapidly grown closer over the past year, mainly due to the oil trade. In November 2022, as the G7 was discussing how to set a ceiling price for Russian oil as a means of strengthening economic sanctions against Russia, Indian Foreign Minister Jaishankar met with Russian Foreign Minister Lavrov, and the pair announced plans to develop India-Russia economic relations in the future, including in areas other than oil.

In light of the following, it seems that India is more focused on the economic benefits that trade with Russia could bring to the Indian economy than on the indirect impact of such trade on the situation in Ukraine.

(1) Russia has emerged as India's largest supplier of crude oil

To begin with, let us look at the trend with trade in crude oil, the biggest item in India-Russia trade. Traditionally, India has got its oil from geographically closer Middle Eastern countries such as Iraq and Saudi Arabia, from which transportation costs are lower, and in 2021 Russia accounted for only 2% of its crude imports. However, India has rapidly increased its imports of Russian oil on the back of the following two factors, with Russia becoming its largest supplier, accounting for 25% of its crude imports, in September 2022 (Fig. 6).

The first is a significant discount in the price of Russian crude oil. Russia, which lost its crude oil supplier status in conjunction with the G7 economic sanctions against it, began exporting crude at prices well below those charged by other oil-producing countries. The price difference per barrel between Urals from Russia and Brent crude oil from the U.K. North Sea has widened sharply to around USD 35 per barrel since early spring 2022 (Fig. 7). As a result, India's import costs from Russia, including transportation and insurance costs, are now lower than those for other import suppliers⁽¹⁸⁾ (Fig. 8). From the early fall of 2022, the sense that Russian crude was underpriced receded as prices of oil from various places declined

Fig. 6 Origin of India's Crude Oil Imports (Volume)

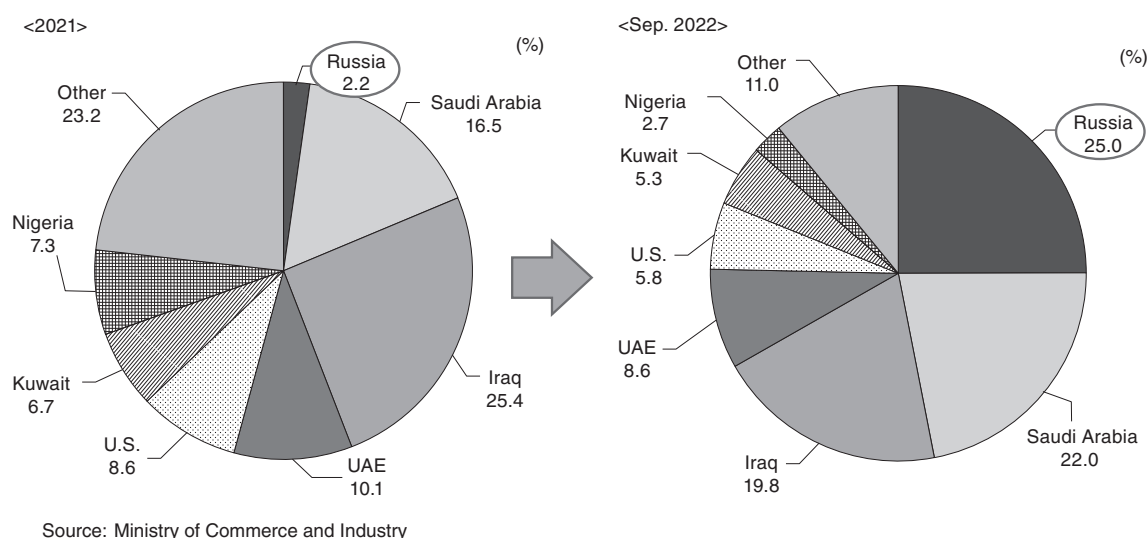


Fig. 7 Oil Price Spreads (Urals - Brent crude oil)

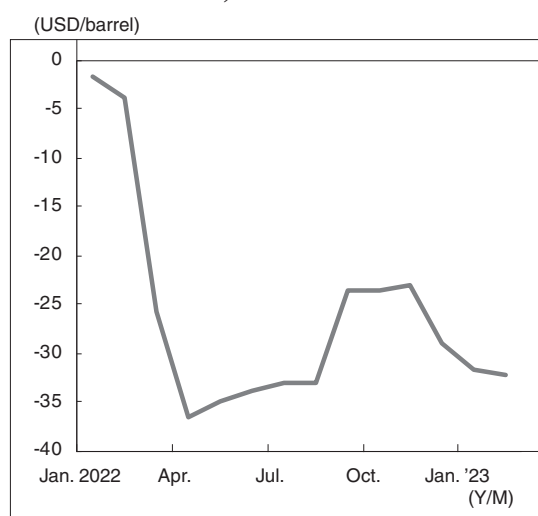
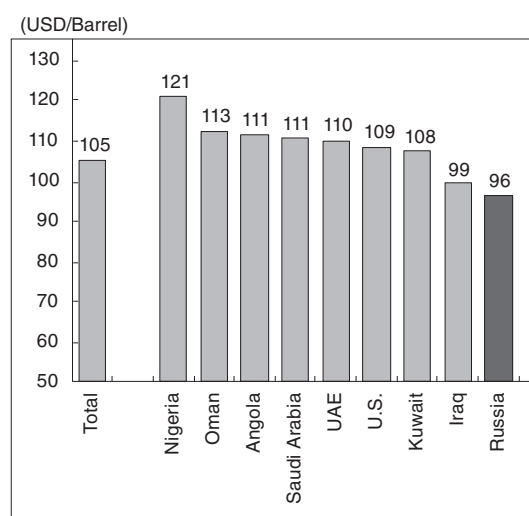


Fig. 8 Cost to India of Importing Crude Oil from Various Countries (April-September 2022)



against the backdrop of concerns over a global economic slowdown, but the feeling that Russian oil is cheap has strengthened again, mainly because the G7 introduced regulations in December 2022 to cap the import price of Russian crude oil at USD 60 per barrel.

The second is the growing risk of political and social instability in the Middle East. Looking at

Iraq, traditionally India's largest import supplier, the end of the U.S. combat mission in Iraq triggered a serious confrontation between pro-Iranian factions and anti-U.S. and anti-Iranian factions, leading to a year-long political vacuum following the October 2021 general election. Although a new government finally took office in October 2022, it has indicated its intention to hold another

general election within a year, and there remains a risk that intensifying political conflict could stall oil field development and destabilize exports⁽¹⁹⁾. Meanwhile, in Saudi Arabia and the UAE, oil production facilities and pumping equipment have frequently been destroyed in terrorist attacks by Yemeni militants. Although the Yemeni civil war was halted following a time-limited UN-brokered ceasefire agreement in April 2022, the agreement expired in October of the same year, so clashes could flare up again. The risk of prolonged political and social turmoil in the region has increased, in part because the U.S. is scaling back its involvement in the Middle East.

In addition to this, there is a risk that relations between the Hindu supremacist Indian People's Party / Modi government and Muslim countries will deteriorate. Tensions between India and Middle Eastern countries increased in June 2022, when a campaign to boycott Indian products was launched throughout the Middle East after remarks made by spokespersons for the Indian People's Party about the Islamic prophet Muhammad were perceived as insulting. In the event of future repression of Muslims in India, the possibility that Middle Eastern countries riled by such moves could restrict crude supplies to India cannot be ruled out.

As a result of the rapid expansion of their trade in crude oil, both Russia's share of India's total imports and India's share of Russia's total exports have risen to about 10% (Fig. 9). If this expansion continues at the current pace, the make-up of the two countries' trading partners will change dramatically over the next few years. China, which like India has been maintaining a pro-Russian stance, has also expanded its crude oil imports from Russia, though Russia's share of China's total crude imports has not changed significantly from the previous year (Fig. 10). There are a number of reasons for this, such as 1) the fact that in China inflationary pressures remained weak in 2022 due to the economic slowdown resulting from the zero-COVID policy, which meant that China had no need to rapidly increase its imports of Russian crude oil to curb inflation, as India did, and 2) concerns that the expansion of crude imports from Russia would further aggravate the U.S.-China conflict. Given the rising share of its oil imports from Malaysia, a known transit point for Iranian and Venezuelan crude oil, China may be increasing the import of oil from jurisdictions under U.S. economic sanctions⁽²⁰⁾.

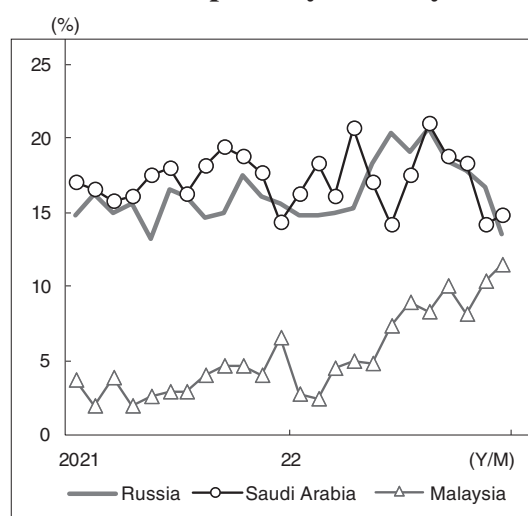
India is also rapidly increasing imports of fertilizers from Russia to control inflation and diversify its sources of procurement. Unlike crude

Fig. 9 India-Russia Trade Dependence



Source: Prepared by JRI based on Direction of Trade Statistics, IMF and data from the Ministry of Commerce and Industry

Fig. 10 Percentage of China's Crude Oil Imports by Country



Source: General Administration of Customs

oil, the G7 has not introduced an explicit import ban on Russian fertilizer. However, trade between countries and Russia has been declining due to Russia's exclusion from the SWIFT international payment system, and Russia is giving discounts of 10-25% on exports to India to ensure it has a market for its products⁽²¹⁾. As a result, fertilizer imports from Russia have increased nearly six-fold over the past year, with Russia's share of fertilizer imports to India rising from 3% in 2021 to 14% (Fig. 11). On the other hand, the share of fertilizer imports from China, with which conflict in the area of security is deepening security, has halved.

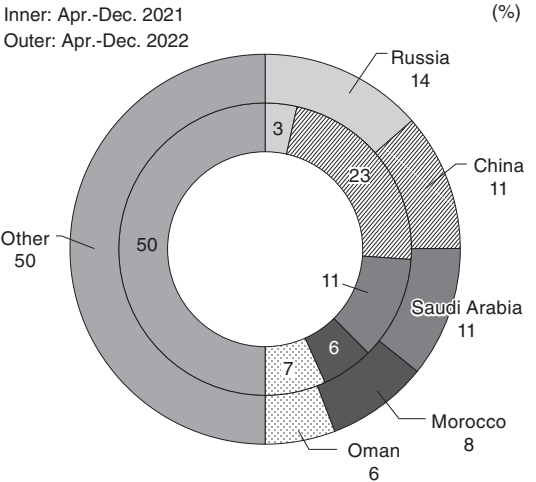
(2) Governments of India and Russia expect non-oil economic relations to deepen

While India's imports from Russia, mainly crude oil and fertilizers, have risen sharply, exports from India to Russia have declined by about 10%, with the bulk of this drop being seen in vehicles, electronics, and steel (Fig. 12). This can be attributed to the deterioration of the Russian economy in the face of the G7's economic sanc-

tions and voluntary curtailment of business with Russia by Indian firms keen to avoid hurting their business with the West⁽²²⁾. Another factor may be that Indian companies are increasingly turning to domestic sales rather than exporting their goods, reflecting robust domestic demand resulting from the release of pent-up demand (carry-over demand) as economic and social activities have normalized since the COVID pandemic.

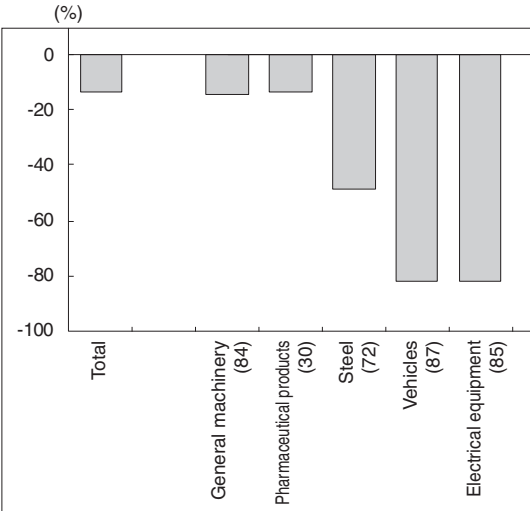
Although trade between India and Russia remains weak, with the exception of certain commodities such as crude oil and fertilizers, the two countries are aiming to expand their trade and investment relationship in areas where their interests coincide in the future. Russia is looking to India to supply products that have become difficult to procure from developed countries due to economic sanctions against Russia. The G7 nations, including Japan, are restricting exports of products that would strengthen Russia's military capabilities and industrial base, such as machine tools, high-performance semiconductors, telecommunications equipment, and trucks (Table 1), and it is highly probable that Russia will face difficulties in procuring the parts necessary for the maintenance

Fig. 11 India's Fertilizer Imports by Country



Source: Prepared by JRI based on data from the Ministry of Commerce and Industry

Fig. 12 Indian Exports to Russia(April-December 2022, USD, YoY)



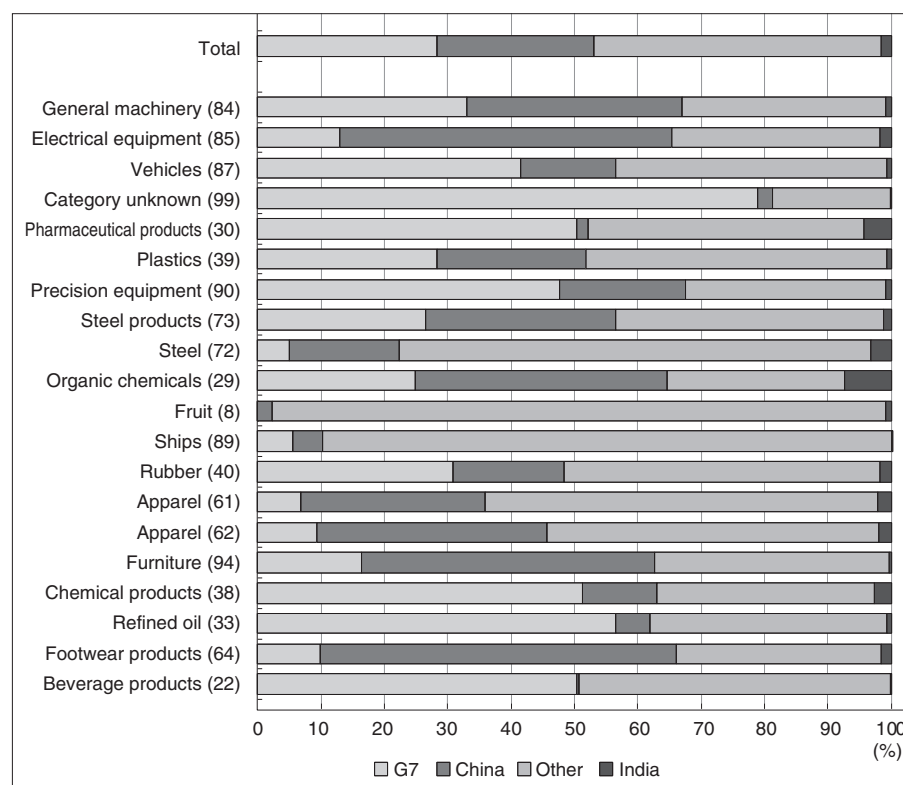
Notes: Numbers in parentheses on the horizontal axis are the HS two-digit codes.
Source: Prepared by JRI based on data from the Ministry of Commerce and Industry

Table 1 Japan's Export and Import Restrictions on Russia

	Field	Example items
Export restrictions	Items that can be repurposed for military use	Machine tools, carbon fiber, high-performance semiconductors, communications devices, chemical substances, equipment for manufacture of chemical/biological weapons
	Items that would strengthen Russia's industrial base	Quantum computers, 3D printers, trucks, bulldozers, oil-refining equipment
	Luxury items	High-end automobiles, jewelry
Import restrictions	Resource-related	Import of crude oil above ceiling price (and services related to maritime transportation)
	Other	Alcohol, timber, machinery, electrical equipment

Source: Prepared by JRI based on "Revision of Export Trade Control Order based on Foreign Exchange and Foreign Trade Act Etc. (Prohibition of Export to Russia of General Items Related to Strengthening of Military Capabilities)," Ministry of Economy, Trade and Industry, January 27, 2023

Fig. 13 Percentage of Russia's Major Imported Goods by Country/Territory (2021)



Notes: Numbers in parentheses on the item axis are the HS two-digit codes.

Source: Prepared by JRI based on data from the United Nations

of these products in the near future. In response to this situation, Russia is switching its procurement sources from the G7 to China and India. Therefore, in November 2022, Russia reportedly sent India a list of more than 500 products it needs to sustain key industries and asked for confirmation that they would be available to Russia⁽²³⁾.

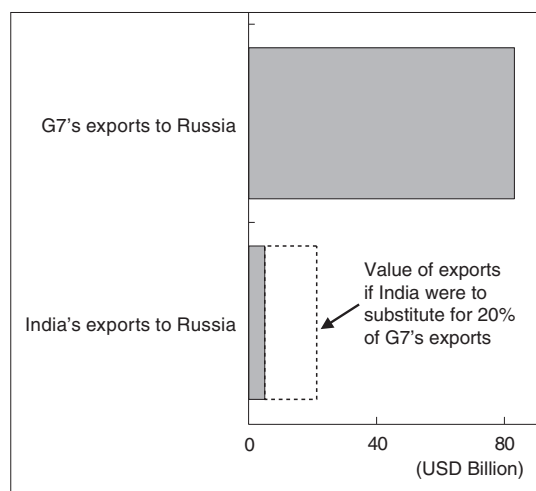
Unsurprisingly, the Indian government sees such overtures as an opportunity to develop its

manufacturing industry and expand exports. Indeed, Foreign Minister Jaishankar has expressed a positive attitude toward expanding trade, revealing, "We have given Russians a set of products which we believe we are very competitive in and which we feel should be getting access to the Russian market⁽²⁴⁾." So far, India has been supplying only 2% of Russia's total imports (Fig. 13), but even if India were to replace 10-20% of imports

from the G7, which had supplied about 30% of Russia's imports, India's exports to Russia would increase three to five times (Fig. 14).

Exporting to Russia items designated under the G7 economic sanctions against Russia is viewed by the G7 as anti-G7 and pro-Russian conduct. Therefore, if exports from India to Russia expand, India will likely face criticism from the G7. In response, India will demand that the G7 accept India's version of "neutrality," arguing that its exports to Russia are rooted in purely economic objectives, such as developing its own manufacturing industry, rather than the political objective of supporting Russia in its conflict with Ukraine and the G7⁽²⁵⁾. Since the definition and interpretation of "neutrality" differs from country to country, and because it is difficult to quantitatively determine the extent to which political considerations lie behind economic transactions, the perception gap between the G7 and India over neutrality will not be easily bridged, and may become a source of antagonism in the future.

Fig. 14 G7 and Indian Exports to Russia (2021)



Source: Prepared by JRI based on data from the United Nations

3. What is the outlook for India-Russia economic relations?

India's attitude of putting its own economic interests first and dealing with other countries impartially is expected to remain unchanged in the future. Therefore, understanding how the environment surrounding the Indian economy will change is the starting point for looking at the prospects for India-Russia economic relations. Given the magnitude of global economic and political uncertainty and the fact that crude oil is the most important item traded by India and Russia, it is necessary to assume that the India-Russia economic relationship will not see a smooth expansion going forward, but rather will be marked by numerous bumps along the way. Although it is difficult to foresee the exact timing of these bumps, a proper understanding of what could be the main causes of such bumps is key to assessing the outlook for India-Russia economic relations.

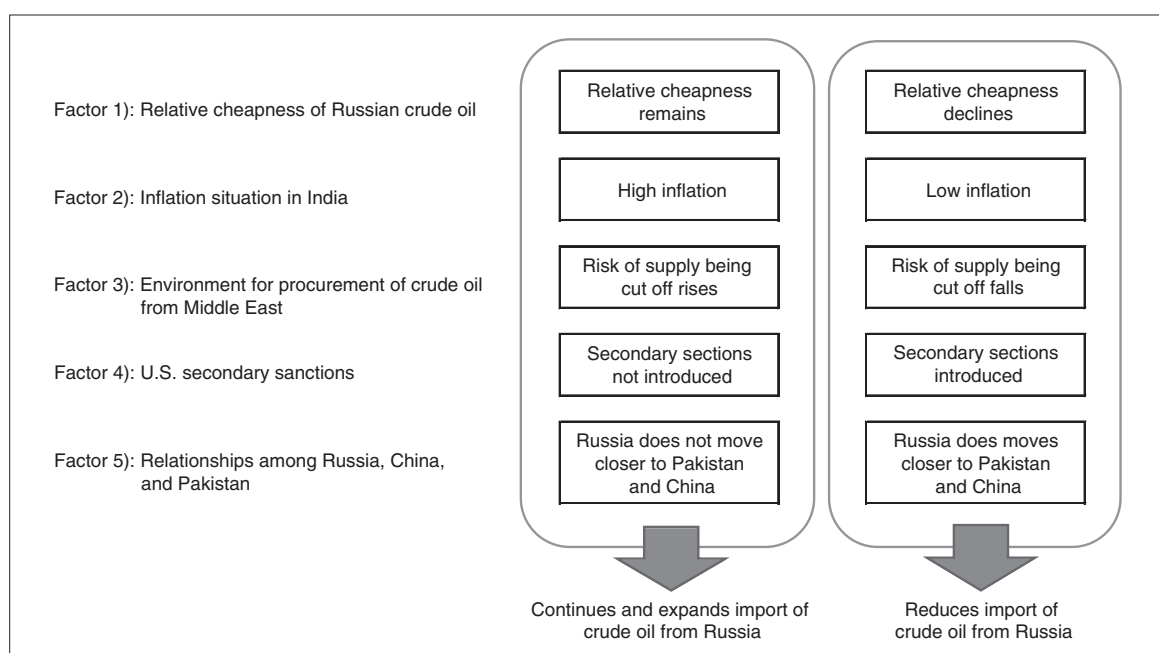
(1) Factors that will affect future India-Russia economic relations

Crude oil trade between India and Russia is expected to depend on the five factors described below⁽²⁶⁾ (Fig. 15).

The first is the low price of Russian crude oil. Taking into account the cost of transportation from Russia to India, Russian oil needs to be at least USD 25 per barrel cheaper than oil from other regions to be attractive to India⁽²⁷⁾. While global crude prices are soaring, India will consider further increasing the proportion of oil it imports from Russia if the price of Russian crude remains below USD 60 per barrel due to the G7 economic sanctions or if Russian crude becomes even less dear.

On the other hand, the relative inexpensiveness of Russian crude oil will naturally decline if global oil prices fall sharply. The cost of producing Russian crude oil is estimated to be USD 30-40 per barrel, so if the price of oil exported from

Fig. 15 Factors Influencing India-Russia Crude Oil Trade



Source: Prepared by JRI

other oil-producing countries drops to USD 50-60 per barrel, Russia may demand that India reduce its discount, which could trigger a reduction in India's crude oil trade with Russia.

The second is India's inflation trend. In a phase of high inflation, it is vital for India to import undervalued Russian crude oil. On the other hand, in a situation of relatively stable inflation, India can be expected to also emphasize factors other than prices when selecting its crude oil procurement sources. Given that 1) prices of mineral fuels will continue to swing up and down against a backdrop of global economic and political uncertainty⁽²⁸⁾, and that 2) prices of food, which accounts for about 40% of consumption, are easily affected by weather factors, the inflation rate in India is expected to rise and fall repeatedly, and the importance of Russian crude oil will change accordingly.

The third is political trends in the Middle East. As previously mentioned, one factor behind India's expansion of imports from Russia has been concern about the possible destabilization of crude oil procurement from the Middle East. This in turn suggests that if the political situation in

the Middle East stabilizes, there is a possibility of a renewed reliance on the Middle East, which is geographically closer and offers lower transportation costs. Of particular importance are developments surrounding Iran, which once accounted for about 10% of India's crude oil imports. If negotiations between the U.S. and Iran progress and oil exports resume, India will resume oil procurement from Iran. In addition, if success in negotiations to end the civil war in Yemen reduces the risk of terrorism in countries such as Saudi Arabia and the UAE and makes the supply of Middle Eastern crude oil more secure, India would consider reducing the share of Russian oil and increasing the share of Middle Eastern oil in its imports. Russia also faces the risk of its oil-related facilities and transportation infrastructure being destroyed in attacks by Ukraine⁽²⁹⁾, as well as various business challenges, including opaque law enforcement and corruption (Table 2). Therefore, even if no major changes in the political situation in the Middle East occur, India is still expected to be cautious about the degree to which it will expand the share of its oil imports coming from Russia from the current level⁽³⁰⁾.

Table 2 Factors Influencing India-Russia Crude Oil Trade

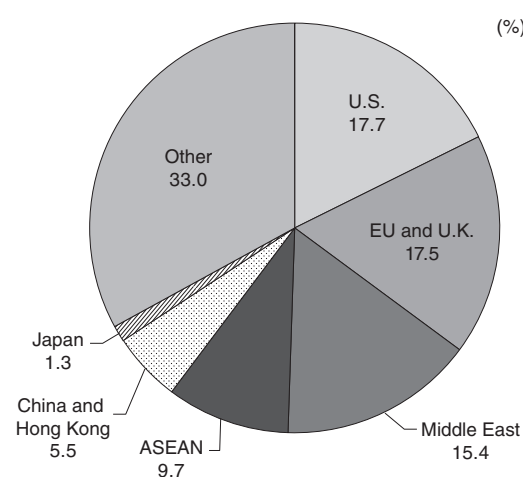
	Simple average of 1) - 6)						
	1) Voice and Accountability	2) Political Stability and Absence of Violence/ Terrorism	3) Government Effectiveness	4) Regulatory Quality	5) Rule of Law	6) Control of Corruption	
U.S. (5.8%)	72.9	46.2	87.0	87.5	88.5	82.7	77.5
UAE (8.6%)	16.4	66.0	88.0	82.7	79.3	83.2	69.3
Kuwait (5.3%)	30.0	54.7	45.7	62.5	63.5	53.8	51.7
Saudi Arabia (22.0%)	5.3	22.6	58.7	61.5	60.1	63.0	45.2
Russia (25.0%)	19.8	20.8	54.8	36.1	22.6	19.2	28.9
Nigeria (2.7%)	32.4	4.7	13.0	13.9	21.2	13.5	16.4
Iraq (19.8%)	20.8	1.4	9.6	8.7	3.8	9.1	8.9

Notes: Figures in parentheses next to the country names are the shares of India's imports of crude oil.

Source: Prepared by JRI based on World Bank, "The Worldwide Governance Indicators, 2021 Update"

The fourth is developments with U.S. secondary sanctions. The U.S. is India's largest export destination (Fig. 16) and also an important partner in terms of investment and aid. Therefore, if secondary sanctions are introduced, India may reconsider its oil trade with Russia. There is a precedent here in that India suspended its import of Iranian crude oil, which accounted for around 10% of its crude imports in 2019, after the U.S. slapped a ban on the import of oil from Iran. In February 2023, on the first anniversary of the start of Russia's invasion of Ukraine, the G7 demanded that third countries stop providing material support to Russia, with a view to forestalling the provision of weapons to Russia, warning them that they would "face severe costs" if they did not cease their assistance. There has been no mention yet of the specifics of these "severe costs," but it is possible that the G7, not just the U.S., will consider introducing secondary sanctions in a concerted fashion.

The fifth is the political relationships among Russia, China, and Pakistan. India basically pursues a pragmatic approach to diplomacy, but in situations where the risk of its territory and sovereignty being threatened have heightened, it sometimes tries to deter or exclude the other country even at the expense of its own economy. In fact, China could play an important role in India's economic development, particularly in the areas of electric vehicles (EVs), renewable energy, and next-generation telecommunications, but since the border clash in 2020 raised alarm about China, the Indian government has been tightening regula-

Fig. 16 Indian Exports by Country (2022)

Source: Ministry of Commerce and Industry

tions to exclude Chinese companies.

Unlike China, Russia is a friend to India and there are no border issues between India and Russia, but since the 2010s, Russia has been moving closer to China and Pakistan in an effort to diversify its partnerships⁽³¹⁾, and India is becoming increasingly wary. If China, Russia, and Pakistan increase trade in arms with each other in the future and security risks related to Kashmir increase, India may seek to review its trade with Russia for political reasons, even if Russian oil is cheap, in order to restrain Russia.

Each of the factors influencing the future of crude oil trade between India and Russia is subject to great uncertainty. Therefore, it is difficult to

predict when a “bump” will occur, but given that 1) the volume of oil trade between India and Russia accounts for 1-2% of global consumption⁽³²⁾, and that 2) even if the U.S. introduces or lifts secondary sanctions, a certain grace period would be likely established to avoid adverse impacts on India and oil-producing countries, the impact on the crude oil market and oil-producing countries of a change in India’s crude procurement from Russia as a share of its crude imports is viewed as being limited⁽³³⁾.

For non-oil commodities, it is unlikely that the trading relationship will expand at the pace expected by the two governments, given the following factors:

First, India’s exports are less competitive than those of economic rival countries that have not imposed economic sanctions on Russia, such as China. In automobiles, the Indian market is dominated by small cars, and there are few production lines for medium- and large-sized cars, which are popular in Russia. As for electronic equipment, India relies on imports of high-value-added raw materials from other countries, and against the backdrop of delayed trade liberalization and an underdeveloped logistics infrastructure, industrial clusters have not yet formed. It can therefore hardly be described as competitive. In addition, there is a risk that the G7 will tighten restrictions on exports of intermediate goods and production equipment to India as a means of curbing Indian exports to Russia. Furthermore, the high level of uncertainty surrounding Russia’s politics and economy and the negative impact on business with developed countries of enthusiastically conducting business in Russia are limiting the expansion of India-Russia business⁽³⁴⁾.

(2) How will India’s closeness to Russia change its position in the world economy?

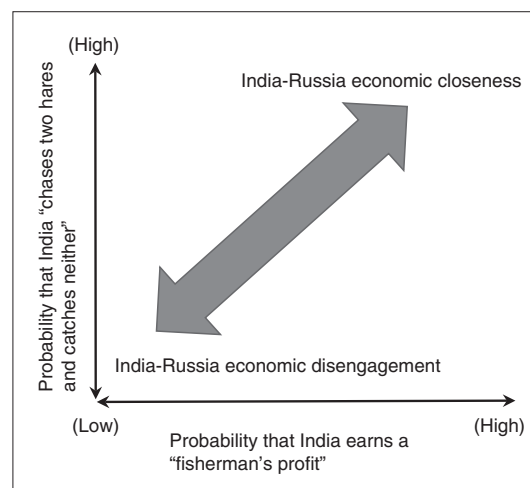
Finally, let us consider how fluctuating closeness and disengagement in India-Russia economic relations will change India’s position in the world

economy. To sum up in advance, the increasing closeness of the India-Russia economic relationship should be viewed as having two aspects: the chance for India to earn a “fisherman’s profit and rapidly increase its presence in the world economy, and the risk of a division between India and other countries by “chasing two hares and catching neither” (Fig. 17).

To summarize the process by which India could earn a “fisherman’s profit,” the expansion of India-Russia trade, especially oil trade, could reduce the effectiveness of the G7’s economic sanctions against Russia and increase the likelihood that Russia will delay any commencement of peace negotiations with Ukraine. In response, the G7 would further strengthen its economic sanctions against Russia, and if Russia takes retaliatory measures, global fragmentation will become more serious and prolonged⁽³⁵⁾. In addition, a further escalation of the tense situation in Ukraine could make the U.S. more anxious about the situation with Taiwan and stoke the confrontation between the U.S. and China.

Declining trade and investment between the nations opposed to one another, particularly between the U.S. and China and the G7 and Russia, will

Fig. 17 India-Russia Economic Closeness and Disengagement: Illustration of Impacts on Indian Economy



Source: Prepared by JRI

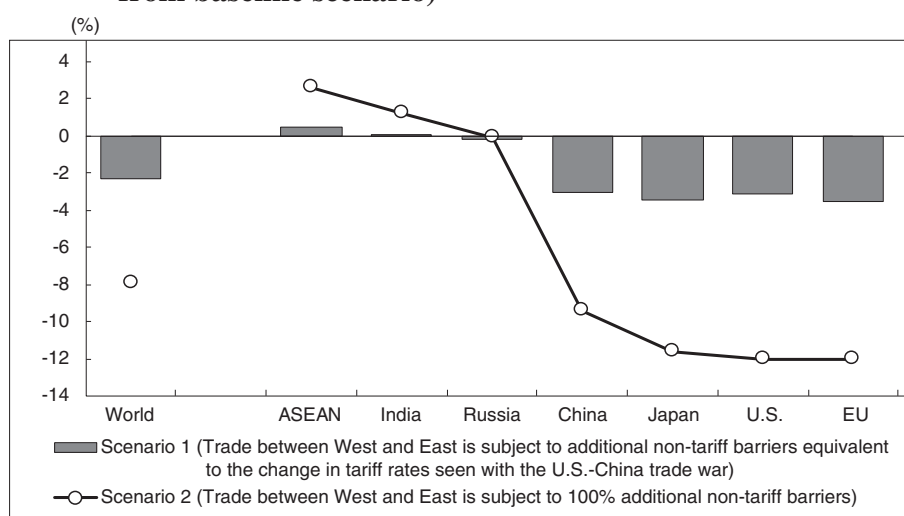
reduce growth rates for both sides, while India's relative presence will increase if it is added to the list of relocation destinations as it pushes for the transfer of production to "neutral countries." Analysis by the Institute of Developing Economies⁽³⁶⁾ (Satoshi Kumagai et al. [2023]) indicates that if, after 2025, tariff rates imposed on trade between opposing camps are raised to levels equivalent to those seen with the U.S.-China trade war, the GDP of the U.S., Japan, the EU, China, and other countries would be about 3% lower than the baseline scenario, but that the impact on India and the ASEAN zone would be negligible (Fig. 18). In the event of even more severe measures than seen with the U.S.-China trade war, the negative impact on the global economy would be even greater, while for India and the ASEAN countries, the effect would be offset by the relocation of production⁽³⁷⁾.

However, the analysis is based on the assumption that India is treated as a "neutral" country" and that trade between the camps and "neutral" countries will continue as usual. If more members of the international community come to regard In-

dia's continued trade with Russia as partly responsible for the making global division more serious and protracted, India will no longer be viewed as a "neutral" country. If the G7 works together to impose secondary sanctions against India, and India responds with countermeasures, new divisions could arise. A World Trade Organization (WTO) analysis (WTO [2022])⁽³⁸⁾ based on the assumption of a fissure forming between India and the West, estimates that the negative impact for India would be greater than that for China, the U.S., the EU, and others (Fig. 19). The risk of an economic downturn resulting from India's getting dragged into the global divide will hinder the relocation of production from China to India, and "Make in India" will be more difficult to achieve.

India is currently confronted with great opportunities and risks. However, given that 1) it will be difficult for India to maintain its position as a "neutral country" as it continues to do business with Russia while the Ukraine issue drags on, and that 2) reform in highly controversial areas such as land and labor will not be easy, and the slow development of an environment conducive to busi-

Fig. 18 Impact of Global Fragmentation on GDP 1)(deviation from baseline scenario)

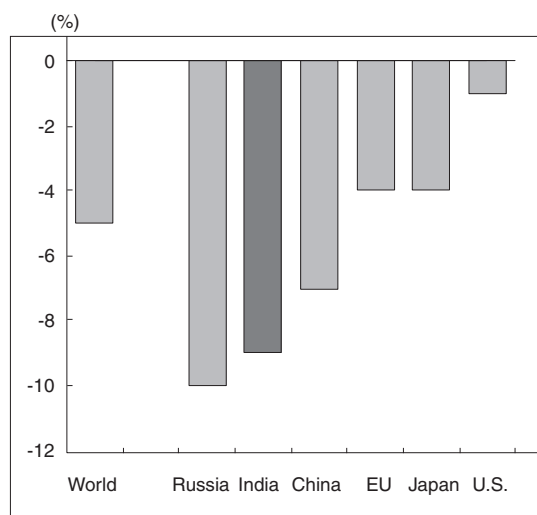


Notes: West: U.S., U.K., EU (incl. U.K.), Canada, Japan, South Korea, Taiwan, Australia.

East: China, Russia, Belarus, Cuba, Venezuela, Nicaragua, Iran, Iraq, Yemen, Lebanon, Myanmar, Libya, Sudan, Democratic Republic of Congo, Zimbabwe, Somalia.

Source: Prepared by JRI based on Table 1. Economic Impacts of Scenario 1 (2030, compared with the baseline scenario) and Table 2. Economic Impacts of Scenario 2 (2030, compared with the baseline scenario) in Kumagai et al. [2023], "Calculating the Impact of Global Decoupling on the Global Economy – Research Using IDE-GSM."

Fig. 19 Impact of Global Fragmentation on GDP 2) (deviation from baseline scenario)



Source: Prepared by JRI based on WTO [2022], "Long-run real GDP effects of decoupling scenario in the global economy"

true that the climate change issue cannot be addressed without India's cooperation. And it is also true that the G7 will continue to be India's most important partner in terms of policy toward to China and economics. Therefore, the G7 and India need to deepen mutual understanding to bring them a little closer together, instead of constantly confronting each other with the same old arguments, as they have done until now.

In 2023, Japan and India hold the presidencies of the G7 and G20, respectively, and at the Japan-India Summit Meeting that took place in March, the two countries' leaders discussed various issues facing the international community and reaffirmed their joint commitment to the success of both the G7 and G20 summits. The hope is that Japan will use such opportunities to bridge the perception gap between the G7 and India and contribute to the stability of the international community.

ness compared to that in the ASEAN zone will continue to be a disincentive to the relocation of production to India.

Conclusion

Given India's basic diplomatic stance as seen in its response to the situation in Ukraine, it is expected that India will stick to its own independent line on global issues such as energy and food security so as to maximize economic benefits for itself, and will actively pursue a foreign policy designed to gain it acceptance in the international community. India's hosting of a meeting among developing countries in January 2023 titled "Voices of the Global South Summit" can be viewed as an action in line with this approach. Compared to those of China, economic relations between India and other emerging countries are still shallow, but India is also open to deepening its economic ties with Africa and other emerging countries in order to secure natural resources and expand its exports, and India's real influence in emerging countries is expected to grow in the future.

While India's actions remain puzzling and unacceptable to the G7 in many respects, it is also

End Notes

1. Canada, Germany, Italy, Japan, France, the United Kingdom, and the United States.
2. India's first prime minister, Jawaharlal Nehru, stated at an Indian National Congress convention in 1929 that Indian society should follow a socialist path.
3. Yoshida [2004] argues that Indo-Soviet/Indo-Russian relations are a dependent variable of Indo-US relations. Meanwhile, Ito [2020] contends that India has based its relations with other countries on these principles: "there are no true friends," "the enemy of my enemy is my friend," and "the friend of my enemy is my enemy."
4. SEATO was dissolved in 1977, but when the Soviet Union invaded Afghanistan in 1979, the U.S. expanded economic and military aid to Afghanistan's neighbor, Pakistan, to counter the Soviet Union.
5. After the death of Joseph Stalin, the supreme leader of the Soviet Union, so-called "Stalin-bashing" began to occur, exposing problems with his political style, and ideological debates concerning the nature of socialism and relationships with the U.S. arose from around this time.
6. A sharp decline in foreign exchange reserves, driven by soaring oil prices triggered by the Gulf War and a drop in remittances from abroad following the return of migrant workers from the Middle East led to the devaluation of the exchange rate and the liberalization of the economy.
7. See Sunil, Rajiv, Pratap et.al [2012] and S. Jaishankar [2020] for background information on India's foreign policy shift.
8. The reasons India did not oppose the U.S. approach to China and Pakistan include 1) the fact that in the midst of globalization, maintaining good relations with the U.S. and China was in India's national interest, and 2) a reduction in the risk of terrorism in the Middle East would also be important for the stability of India's energy supply.
9. See Kumagai [2020] for a discussion of India's relations with the U.S. and China in the 2010s.
10. The central issue for Russian diplomacy was also how to confront the West, whose relations had deteriorated in the wake of the Crimean crisis in 2014.

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11. In addition, India's refusal to give permission for a Japanese Self-Defense Forces aircraft to land in India to pick up humanitarian supplies on its way to Ukraine raised eyebrows in Japan.
 12. See John J. Mearsheimer [2019] for a discussion of U.S. responsibility for the Russia-Ukraine problem, and Horimoto [2022] for a discussion of the degree of positive attitudes and trust toward the U.S. and Russia among Indians.
 13. In an online meeting in April 2022, President Biden rebuked Prime Minister Modi, telling him that Importing more oil from Russia was not in India's interest (April 12, 2022, *Nikkei Asia*, "Biden to Modi: Importing more Russian oil not in India's interest").
 14. See Kumagai [2022] for a discussion of the impact of oil price fluctuations on the Indian economy. If India limits the adverse effects of inflation by increasing fiscal spending and cutting taxes, its budget deficit will widen, destabilizing economic growth over the medium to long term.
 15. In recent years, the Indian government has used the Indian astrological term "Amrit Kaal," meaning a peak period, in various documents (e.g., Ministry of Finance [2023]). This lends added weight to the assertion that the Indian government is becoming more confident about the future of India's economy.
 16. Although China has closer ties with other emerging economies than India does in terms of trade, investment, and aid, and has established political trust with African countries, China is no longer the voice of the emerging economies as it nears entry into the club of high-income countries with a per capita GDP exceeding USD 12,000.
 17. India seeks neutrality in doing business with countries based on economic rationale without applying economic sanctions against any of them, and may believe that importing crude oil from Russia is not consistent with "neutrality."
 18. The aim is to bring non-G7 countries into compliance by prohibiting the provision of insurance coverage for the transportation of oil at prices that exceed the ceiling.
 19. See Ashihara [2021] for a discussion of Iraq's oil industry development.

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20. Reuters, December 21, 2022, "Russia overtakes Saudi Arabia as China's top crude supplier in November"
 21. The New Indian Express, August 8, 2022, "Discounts drive up India's fertilizer imports from Russia in current fiscal"
 22. There have been widespread moves among Indian companies to voluntarily scale back their Russian business. These include the suspension of business with Russia by steel giant Tata Steel and the closure of the Russian office of IT giant Infosys.
 23. Reuters, November 29, 2022, "Exclusive: India asked by sanctions-hit Russia for parts for key sectors"
 24. Reuters, December 6, 2022, "India shared a list of products with Moscow for access to Russian market - minister"
 25. Even before Russia's invasion of Ukraine, India and Russia had indicated their intent to expand their trade and investment relationship, so India is expected to make the case that its current moves are in line with its traditional policy.
 26. In addition, the extent of the transformation of India's energy structure to decarbonization will also affect the trend with India's crude imports from Russia, though the impact of this will be felt across all oil-producing countries.
 27. This figure is based on the fact that the cost to India of importing oil from Russia was about USD 10 per barrel lower than the average for all oil-producing countries during a phase when Urals crude was selling for USD 35 less per barrel than Brent crude.
 28. Since mid-2022, resource prices have continued to decline against the backdrop of an economic slowdown stemming from monetary tightening worldwide. However, a sharp economic recovery resulting from the lifting of China's zero-COVID policy could lead to another upturn in the future.
 29. In December 2022, a drone (unmanned aerial vehicle) attack by Ukraine caused a fire at a Russian oil storage facility (*Nihon Keizai Shimbun*, December 7, 2022, "Ukraine strikes Russia in another drone attack and oil tank catches fire").
 30. In addition, India is expected to avoid excessive dependence on imports from certain countries so that it can maintain price bargaining power.

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31. See Kurita [2018] for a discussion of Russia-Pakistan relations.
32. This figure is based on the fact that 1) India's crude oil consumption accounts for 5% of the world's total, and that 2) India currently depends on crude imports from Russia for about one-quarter of its total imports.
33. Some oil-producing countries such as Iraq and Kuwait, for which a large share of their crude oil goes to India, and for which these exports are high relative to their nominal GDP, will be exposed to the risk of economic instability associated with changes to the composition of India's crude procurement, but they will seek to limit the risk of economic deterioration resulting from a sharp decline in oil exports by diversifying their export destinations and expanding term transactions.
34. Even at the time of the Crimea crisis in 2014, there was no significant change in India-Russia economic relations, although there were hopes in both countries that India-Russia business would be boosted by the G7 economic sanctions against Russia.
35. In addition, a further escalation of the tense situation in Ukraine could make the U.S. more anxious about the situation with Taiwan and stoke the confrontation between the U.S. and China.
36. This analysis is based on the IDE-GSM (Institute of Developing Economies - Geographical Simulation Model, a CGE (computable general equilibrium model) that was developed to quantitatively analyze the impact of changes in economic policy.
37. The limited negative impact on Russia is due to China's substitution of trade between Russia and the West.
38. The analysis is based on Carlos Góes and Eddy Bekkers [2022], who used a foreign policy similarity index to determine which camp different countries fall into and analyze the repercussions of that.

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