LADAKH STANDOFF

Tensions Escalate Along India-China Border

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Executive Summary

At least 20 Indian soldiers have been killed following clashes between India and China at the Line of Actual Control (LAC) on the night of June 15. In an official statement, Ministry of External Affairs (MEA), Government of India said that the violent face off happened between both the sides because of an attempt by the Chinese side to unilaterally change the status quo. The statement also mentioned that there were casualties on both sides, however, China is yet to officially declare the exact number of casualties. The statement further emphasised that casualties could have been avoided had the agreement been "scrupulously followed" by the Chinese side.

In May 2020, a deep territorial discord between India and China came to the fore with incursions by soldiers from China in the Indian territory of Ladakh. The de facto border between India and China in the Union Territory of Ladakh is the LAC following a bilateral agreement between both the countries in 1993. The two countries have since continued to claim different lines despite the bilateral agreement.

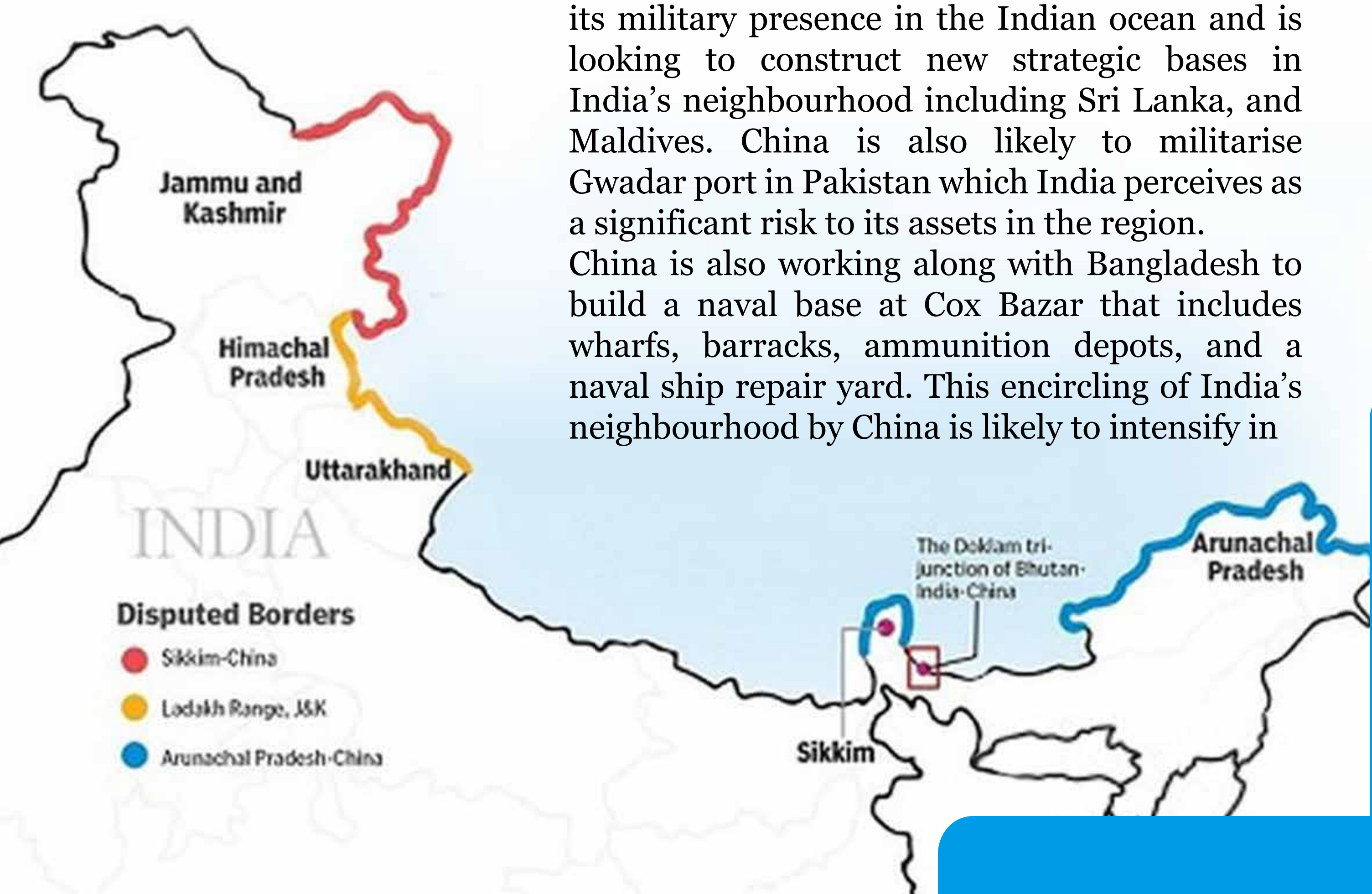
The Pangong Tso lake is a 135 KM long, narrow, deep, and landlocked lake which covers an area around 700 sq. km. The western portion of the lake, 45 km long is under Indian control. However, following the incursions by China, the People's Liberation Army (PLA) of China claimed the whole Galwan valley region that includes the Pangong Tso lake. While the Indian govt. has neither accepted nor denied any loss of territory, various media reports and strategic affairs analysts have emphasised that India has lost a part of the territory to China. The Defence Minister of India also claimed that China has entered deeper into the Indian territory than the previous incursions.

The barren mountains jut forward into the lake at eight different points. These points are officially referred to as “fingers”. India claims that its territory goes until the easternmost finger, that is Finger 8. The Chinese have made incursions till Finger 4 according to various news reports and strategic experts.

The Foreign Ministers of India and China are likely to meet on June 22 to ease the tensions. While China claims an agreement has been reached with India, the Indian side sought restoration of the status quo ante before the first detection of Chinese troops at Galwan. There have been reports of release of 10 Indian soldiers late on Thursday, 18 Jun 2020, however Indian government has made no comment on the issue so far. Army however released a statement saying: “It is clarified that there are no Indian troops missing in action” after the fighting in the Galwan Valley area of Ladakh. Talks among the militaries of both countries are expected to continue taking place in the near term at the border.

Geopolitical Risks

While both countries claim to work towards de-escalating tensions at the LAC, the strategic implications for both go beyond just the LAC. China is growing its military presence in the Indian ocean and is looking to construct new strategic bases in India’s neighbourhood including Sri Lanka, and Maldives. China is also likely to militarise Gwadar port in Pakistan which India perceives as a significant risk to its assets in the region.
China is also working along with Bangladesh to build a naval base at Cox Bazar that includes wharfs, barracks, ammunition depots, and a naval ship repair yard. This encircling of India’s neighbourhood by China is likely to intensify in



the near to medium term.
India has also had a recent border dispute with another neighbouring country, Nepal. The Nepal parliament passed a resolution recently showing Indian territory as a part of Nepal. Recently few Indians citizens were shot by the Nepal border police at the International border in Sitamarahi in Bihar resulting in death of one labourer. Both the countries are claiming the disputed Kalapani territory. Nepal has protested India's construction of the road connecting to the border with China, at the Lipulekh pass. While it is not certain whether China has played a role in Nepal's protest against India following the tensions with China, Nepal has been diversifying its strategic alliances including strengthening of relations with China in recent times.
The recent conflicts between India and China are likely to continue intensifying in the near term with China building massive infrastructure along the LAC, and China's strategic manoeuvring in South Asia and the Indian Ocean Region is only likely to lead to potential escalations between the two countries.

Domestic Impact

The escalations between the two countries are likely to impact businesses in India in the near to medium term. The Indian government has revised the Foreign Direct Investment (FDI) rule aiming to curb "opportunistic takeovers or acquisitions of Indian companies due to the COVID-19 pandemic". The ongoing escalation between the two countries is likely to further aggravate businesses in India as Chinese companies will find it harder to invest in India with new guidelines. China has objected to India's new revised FDI norms stated that it violates the World Trade Organisation (WTO) guidelines.

The growing protests by many social and political groups to boycott Chinese products, goods and services is likely to have an adverse impact on businesses in India. If the situation with China continues to escalate in the near to medium term, India may witness protests from various political and trade union groups. Groups like the Swadeshi Jagran Manch are likely to stir protests across India to demand boycott of Chinese products. The anti-China sentiment among certain sections in India is also likely to make it difficult for Indian businesses to engage with their Chinese counterparts if the situation escalates between both the countries. The calls by various protest groups to boycott Chinese mobile apps could impact Chinese technology companies who view India as a crucial market for their business expansion plans.

The bilateral trade between India and China is likely to be adversely affected in the near term. India's imports from China usually comprise of capital goods like power plants, telecom equipment, metro rail coaches, iron and steel products; finished products like fertilisers, refrigerators, washing machines and air conditioners; intermediate products or components for a number of industries like electronics and mobile phones, autos, pharmaceuticals, chemicals and plastics, engineering goods etc. According to some recent reports India plans to impose higher trade barriers and raise import duties on around 300 products from China and elsewhere, as part of an effort to protect domestic businesses.

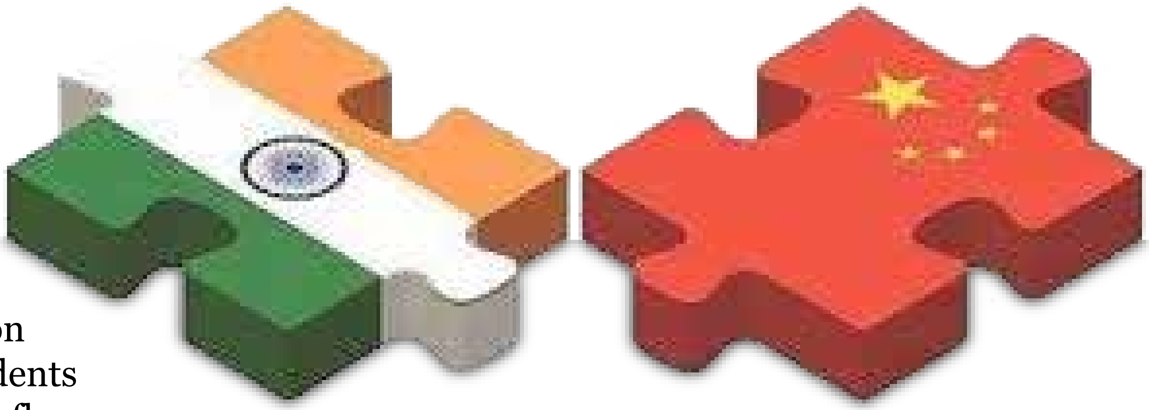
Most of India's exports to China comprise raw materials or primary products like iron ore, agricultural products. Only a small portion of it is manufactured or value-added products. China has investments worth around USD 8 billion in the digital space that includes many start-ups. If the situation at the LAC continues to intensify, many of the Indian businesses dependent on Chinese investors may be adversely affected in the near term.

If India decides to slowdown imports from China due to pressure from anti-China protest groups, it is likely to have an adverse impact on its own competitiveness, growth, and its exports as well. With the Indian economy already under recessionary pressures, adopting any protectionist policies may have a major adverse impact on Indian businesses. The solar sector is likely to be adversely impacted in India if the relations between the two countries continue to worsen as most key items are imported from China. The pharmaceutical sector will also be affected as India is heavily dependent on China for API (Active Pharmaceutical Ingredient) in this sector.

In the unlikely case of increased hostilities between the two countries, even the Most favoured Nation (MFN) treatment under WTO can be suspended thereby impacting trade between the two countries.

Conclusion

The current standoff between the two militaries is going to put tremendous pressure on both governments, especially India. The nationalistic passion which such incidents generate are likely to influence the response from Indian side in the short term. Given the current standoff it will be near impossible to look at a lasting solution at this point and both sides are likely to be engaged in managing the conflict and ensuring it does not escalate. Endeavour of both sides will be to look at returning to status quo as soon as feasible without compromising on their core positions.



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