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Guest Column

The "New Normal" of Sino-Indian Economic Relations after Galwan

By Daniel Balazs and Xue Gong

The China-India economic relationship has witnessed considerable changes over the past four years. In early 2020, New Delhi initiated policies restricting Chinese business activities in India, a measure that intensified following the deadly military confrontation in the Galwan Valley in June of that year. India's crackdown on Chinese companies continued until 2024, when several officials from the Indian government began advocating for the easing of restrictions against Chinese investments.

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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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By August 2024, reports emerged claiming that India had approved multiple Chinese investment proposals, followed by further media claims that India was planning to officially ease these restrictions. As the "epic bust-up between China and India" appears to be toning down, the two giants have to come to terms with the new normal in their bilateral economic relationship: reduced Chinese economic activity in India, influenced by targeted restrictions on Chinese businesses and a more guarded stance from Beijing.

Although the Sino-Indian border patrol agreement reached on October 21, 2024, is a positive turn, it is very likely that the strategic mistrust will continue to constrain the economic engagements between the two countries.

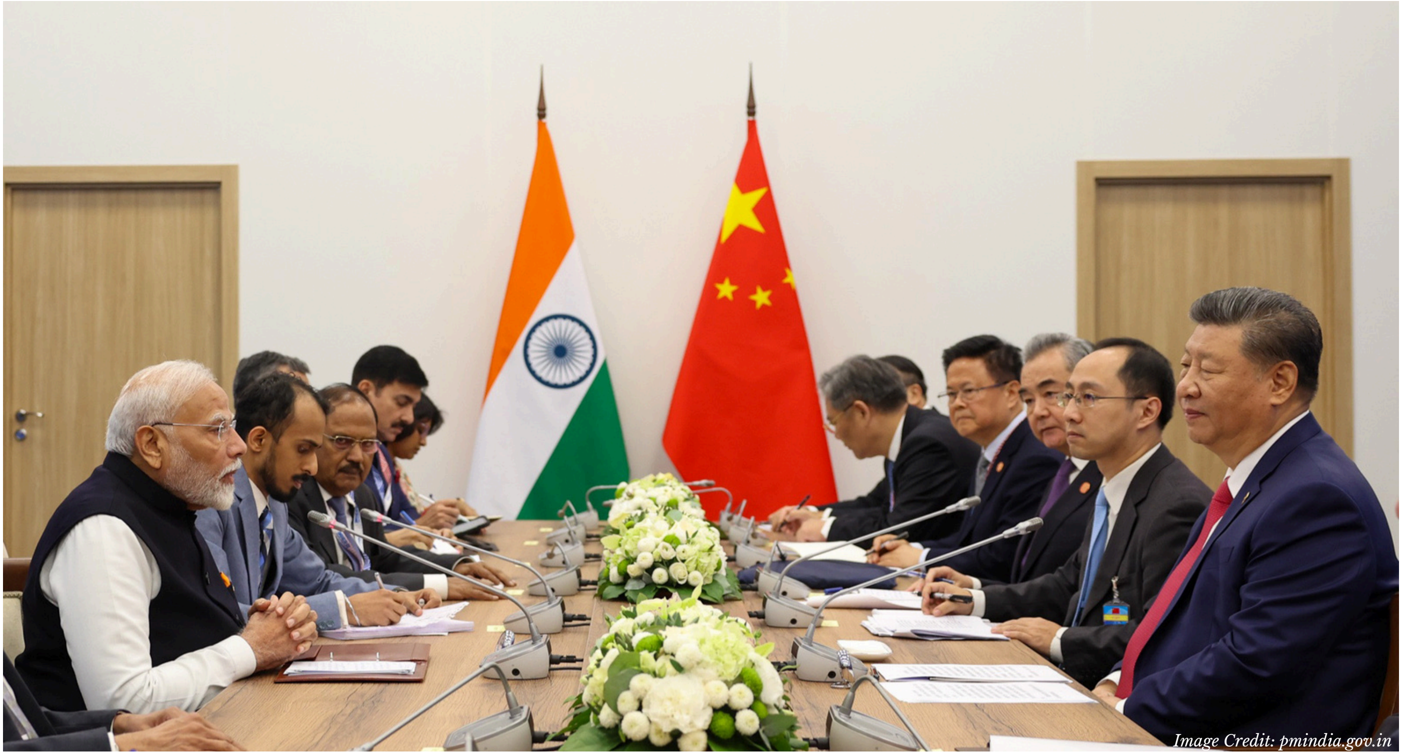
The Border Dispute and the Post-Galwan Ripple Effect

The China-India relationship holds tremendous economic potential, given that these two Asian giants are home to the world's largest populations. However, there have been numerous challenges in realising this potential. In the past, protectionist policies from both sides had resulted in discriminative measures against each other. Moreover, recurring border clashes and growing mistrust have driven the securitisation of investments, particularly from India, based on national security and strategic concerns.

The mutual distrust between China and India stems from their longstanding border dispute, which reached a peak in the 1960s and led to a deadly border war in 1962 with a decisive Chinese victory. For decades, stability was maintained through confidence-building measures despite occasional low-intensity confrontations. However, this stability was disrupted in 2020 when China deployed 5,000 soldiers to disputed areas along the border, leading to a bloody clash in the Galwan Valley on June 15, 2020.

India responded to the clash with a multi-faceted approach that included a revised security posture that entailed greater engagement with the US and its allies, as well as new economic policies designed to curb China's clout in the country.

The economic response had several components, including investment screening measures, product bans, and tax investigations. India tightened existing restrictions imposed on Chinese capital flows into the country, building on a regulation introduced in April 2020, after China's central bank increased its stake to over 1 percent in HDFC, India's biggest private bank. The acquisition was seen in India as a predatory purchase that took advantage of the bank's low valuation amid the pandemic, and could pave the way for future "opportunistic takeovers" of Indian companies by China. To prevent this, the Indian government mandated that all inbound investments from India's land-based neighbours required government approval.



Such government approvals became increasingly rare in the wake of the Galwan clash. The Indian government rejected ten Chinese FDI applications in the 2021 financial year, thirty-three in 2022, and fifteen in 2023, while fourteen FDI proposals were put on hold. Major Chinese firms were hit hard by the new measure. Great Wall Motors, a major Chinese car manufacturer, abandoned its plan of investing USD 1 billion in India after waiting almost a year for a government approval that never came. Similarly, the Indian government blocked BYD's plan to establish a USD 1 billion factory in partnership with Hyderabad-based Megha Engineering and Infrastructure Ltd.

Investment restrictions were merely the tip of the iceberg. Between 2020 and 2023, India banned at least 250 Chinese mobile apps, including social networking, messaging, video, and gaming apps like WeChat, PUBG, and TikTok, citing national security concerns and impacting major tech firms such as Tencent and Baidu. Some estimates and put this figure even higher. Investigations were also launched against Chinese telecommunications companies like ZTE, Huawei, OPPO, Vivo and Xiaomi over allegations of tax evasion and money laundering. Finally, Chinese firms were excluded from India's 5G trials and government tenders, including highway projects.

China Plays the Long Game

Various analyses have highlighted Beijing's use of economic coercion when territorial disputes with other countries arise. However, China's reaction to the Galwan clash and India's subsequent economic retaliation, has been uncharacteristically restrained. While China's Foreign Ministry blamed India for the violence, the clash was scarcely covered in state media, and Beijing only confirmed the death of four Chinese soldiers eight months after the confrontation occurred.

Economically, China refrained from any overt retaliation against India and chose to respond in words instead. Beijing argued that the border dispute should be treated separately from the broader bilateral relationship, and it called India's mobile app bans and the FDI restrictions as discriminatory trade measures. Chinese state media also chimed in, criticising New Delhi's post-Galwan economic policies for transforming India into a "graveyard for foreign companies" characterised "by opaque market regulations and capricious law enforcement targeting foreign, especially Chinese, businesses."

China's restrained response is unsurprising for two reasons. First, the Sino-Indian economic relationship gives China a significant advantage, as it has remained one of India's largest trading partners with a substantial trade surplus and often alternates with the US for the top spot. In the 2024 fiscal year, despite India's stringent post-Galwan measures, Chinese exports to India exceeded USD 100 billion, once again making China India's top trading partner. This recurring trade dominance gave China the confidence to wait out the situation until India adopted a more flexible economic stance.

Second, China aims to deter Indian adventurism on the border without pushing New Delhi closer to Washington. Even in critical areas like pharmaceuticals, where India heavily relies on Chinese Active Pharmaceutical Ingredients (API), China has not imposed restrictions.

This reflects Beijing's broader strategy of refraining from leveraging its economic influence against India in order to avoid further escalation.

India's Policy Adjustments

China's no-retaliation policy appears to be paying off. In 2024, India showed signs that it was willing to relax its aggressive economic measures. At the Davos World Economic Forum in January 2024, Rajesh Kumar Singh, Secretary at the Department for Promotion of Industry and Internal Trade, suggested that the Indian government might ease restrictions on Chinese investments if the border remained peaceful. In July 2024, India's Chief Economic Adviser V. Anantha Nageswaran argued that New Delhi needed more Chinese investments to strengthen its global trade position. In August 2024, media reports emerged claiming that India had approved Chinese investment proposals from electronics players Luxshare and Huaqin Technology.

India's policy shift is driven by at least three key factors. First, stability along the disputed border has improved significantly since the start of 2024, which is demonstrated by the recent Sino-Indian agreement reached on October 21 this year that allows the two sides to continue patrolling the border as they did before May 2020. Second, reports suggest that New Delhi has been facing significant pressure from its own domestic automotive and electronics industry to ease restrictions on Chinese investments.

Finally, the Indian government has established a framework that allows it to selectively target Chinese companies and limit their involvement in joint ventures.

While the situation appears to be shifting in China's favour, scepticism remains. Chinese state media reports following the approved investments highlighted that Chinese companies would likely remain reluctant to do business in India due to the discriminatory and unpredictable business environment. Indeed, this scepticism seems warranted as measures such as the possible "CCTV crackdown"—the Indian government's effort to acquire surveillance cameras from only "trusted locations," thereby limiting acquisition of such equipment from Chinese suppliers—and potential company deregistrations by India's Ministry of Corporate Affairs, could significantly impact Chinese businesses operating in India. Nevertheless, India's current approach seems to be more targeted and selective than during the 2020-2023 period.

The Dawn of a New Era?

The Galwan clash marked a turning point in Sino-Indian relations, significantly impacting their economic ties. In the wake of their bloodiest confrontation in decades, India implemented sweeping measures to curtail Chinese economic activity and influence in the country. Meanwhile, Beijing opted for "strategic patience" to avoid further escalating tensions, a step that seems to be paying off as India gradually renews its economic outreach to China. Nonetheless, the two countries are unlikely to see a quick return to their pre-2020 economic relationship, despite a recent breakthrough made on the border issue. The new normal of Sino-Indian economic ties is likely to feature continued, targeted countermeasures from India and a more cautious economic engagement from China.

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