

# India-East Asia Integration: A Win-Win for Asia

*This paper argues that India's unilateral liberalisation policies since the early 1990s, and purposeful and strategic pursual of its Look East Policy have resulted in considerably greater integration with the rest of Asia than is commonly realised or acknowledged. Moreover, the enabling conditions for greater economic integration among major Asian economies have been laid. If Asia is to increase its economic and political weight in world affairs, India's involvement would have to be an integral part of the Asia-wide cooperation. It is in this context that closer cooperation among Japan, ASEAN, South Korea, India and China would provide considerable win-win opportunities and will have far-ranging implications for the world.*

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## I Introduction

As east Asian economies begin to emerge from the shadow of the 1997 crisis, there appears to be an increasing recognition that greater economic coordination and cooperation among the major Asian countries is essential to manage globalisation challenges, and to enhance Asia's role in world affairs. The devastation across many Asian countries caused by the tsunami on December 2004 in which more than 3,00,000 persons have reportedly perished, underlines the need for closer cooperation as natural disasters do not respect national borders.

India's unilateral liberalisation and deregulation, and a shift in its economic paradigm towards integration with the world economy in a market-consistent manner have contributed to creating a favourable environment for the emergence of New Asia which is not tied to the cold war thinking and institutions [Panagariya 2004]. India was severely impacted by the tsunami, but even then it has been among the core countries providing assistance to other affected countries under the UN leadership.

India has averaged a real annual growth rate of 6 per cent during the 1992-93 to 2003-04 period, and is expected to grow at a slightly higher rate over the next decade. In purchasing power parity (PPP) terms, India's 2002 gross national income (GNI) at US \$ 2.8 trillion makes it the fourth largest economy in the world. Even on the conservative estimates, at current exchange rates, India's GDP is set to exceed US \$ 1 trillion by the end of this decade [Sen et al 2004]. India has now achieved a high degree of consensus on the need to vigorously pursue economic reforms. This is indicated by the continuity in broad economic policies and strategies by the successive governments representing different political parties. The demands by the electorate for better economic governance have also been rising significantly. India has a vision to become a knowledge-based economy and achieve institutions and a mindset of a developed nation [Kalam and Pillai 2004; Mashelkar 2004]. This will be a major challenge for Indian polity and society, but India has the capacity to address it. This will, however, require substantial strengthening and broadening of political and social will to do so.

The flexibility shown by the EU in incorporating the east European countries and thereby expanding its membership to 25 countries, and adoption of the common currency euro provides a positive example of adjusting to the post-cold war globalised world. Similarly, the establishment of the North American Free Trade Agreement (NAFTA) in 1994 also reflects a similar adjustment. Preliminary discussions have taken place towards a free trade agreement involving nearly the entire American continent.

In Asia, there have been several efforts towards subregional, cross-regional, and bilateral regional trading arrangements (Table 1). While bilateral initiatives largely involve ASEAN economies, viz, Singapore and Thailand, some of the notable subregional economic cooperation efforts are the Bay of Bengal Initiative among Member States for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) comprising Bangladesh, India, Myanmar, Nepal, Bhutan, Sri Lanka and Thailand; the Mekong-Ganga Cooperation Group, involving India, Cambodia, Laos, Myanmar, Vietnam and Thailand. As maybe observed from Table 1, all the major Asian economies, and some of the sub-regional organisations such as Association of South-East Asian Nations (ASEAN) have been pursuing bilateral regional trading agreements.

India has persistently and purposefully pursued the Look East Policy initiated in 1991. It has operationalised bilateral trade agreements with Sri Lanka and Thailand, and has negotiated a comprehensive pact with Singapore and ASEAN<sup>1</sup> (Table 1). India has decided to upgrade all current FTAs to FTA plus, covering non-merchandise trade areas as well. This policy is to be followed in all current and future such negotiations. The bilateral agreements with China and Korea have been proposed and joint study groups have been established. An India-Japan study group to examine the feasibility for a similar agreement has also been established. It is hoped that this group will enable the two countries to evolve a strategic partnership.

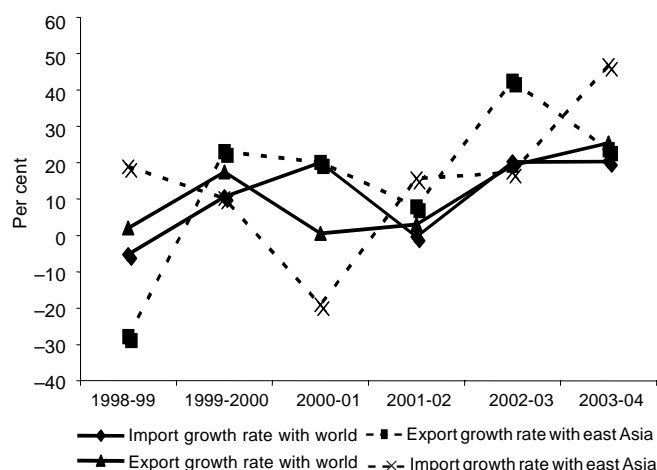
India is also deepening its linkages with the EU and the US as a part of its continuing efforts to seek constructive and mutually beneficial partnerships with key entities around the world. The bilateral trade between India and the EU was Euro 27.5 billion in 2003-04. The EU was the single-largest investor in India. At the fifth summit in Hague in November 2004, India and the EU

**Table 1: Recently Established or Proposed FTAs in Asia, 1999-2004**

Country/ Grouping	Partners	Status of Agreement, 2004	Country/ Grouping	Partners	Status of Agreement, 2004
ASEAN	China	Framework agreement signed	Malaysia	China	Under negotiation
	India	Framework agreement signed		Japan	Under negotiation
	Japan	Framework agreement signed		USA	Proposed
	Korea	Under study			
	USA (TIFA)	Under negotiation			
	CER	Under study			
	ASEAN+3	Under study			
EU	Proposed				
China	ASEAN	Agreement signed	Philippines	China	Under negotiation
	Australia	Proposed		Japan	Under negotiation
	India	Under study		US	Proposed
	Japan	Proposed			
	Hong Kong	Agreement signed			
	Macau	Proposed			
	Malaysia	Under negotiation			
	New Zealand	Proposed			
	Philippines	Under negotiation			
Singapore	Proposed				
India	ASEAN	Framework agreement signed	Singapore	Australia	Agreement in force
	China	Proposed		Canada	Under negotiation
	Korea	Proposed		China	Proposed
	Japan	Proposed		Egypt	Proposed
	Singapore	Agreement in force		EFTA	Agreement in force
	Sri Lanka	Agreement in force		EU	Proposed (rejected by EU)
	Thailand	Agreement in force		India	Under negotiation
	BIMSTEC	Framework agreement signed		Japan	Agreement in force
	SACU	Proposed		Jordan	Agreement in force
	COMESA	Proposed		Korea	Negotiations completed
	MERCOSUR	Framework agreement signed		Mexico	Under negotiation
	Mauritius	Under negotiation		New Zealand	Agreement in force
	GCC	Proposed		Sri Lanka	Under negotiation
	Chile	Proposed		Pakistan	Proposed
SAARC/SAFTA	Agreement in force	US	Agreement in force		
		Panama	Proposed		
		Pacific	Under negotiation		
		Three(P-3) (New Zealand and Chile)			
Japan	ASEAN	Framework agreement signed	Thailand	Australia	Agreement signed
	Canada	Proposed		Bahrain	Agreement signed
	Chile	Under study		China	Agreement signed
	India	Proposed		India	Agreement in force
	Korea	Under study		Japan	Under negotiation
	Malaysia	Under negotiation		Korea	Under study
	Mexico	Under negotiation		New Zealand	Under study
	Philippines	Under negotiation		Peru	Agreement signed
	Singapore	Agreement in force		South Africa	Under Study
	Thailand	Under negotiation		USA	Under negotiation
	Australia	Proposed			
Korea	Australia	Under study			
	China	Under study			
	Chile	Agreement signed			
	India	Proposed			
	Japan	Under study			
	Mexico	Under negotiation			
	Peru	Proposed			
	New Zealand	Under study			
	Singapore	Under negotiation			
	Thailand	Under study			
USA	Under negotiation				

Source: Adapted and updated from Rajan and Sen (2004).

**Figure 1: Growth Rates of India's Merchandise in the Post-East Asian Crisis Period**



Source: Computed from CMIE (2004)

announced the launch of a strategic partnership covering both economic and security issues.

The bilateral trade between India and the US was US \$ 18 billion in 2003, and is growing rapidly. The two countries have been deepening their engagement and the prospects for robust bilateral economic dialogue are encouraging [Mansingh 2004]. As India's prime minister has stated in November 2004, India-US strategic partnership is "...an idea whose time has come". Indeed, there is a preliminary thinking about an FTA between the two countries [Bery 2004]. India, Brazil and South Africa have also established an informal, yet, substantive dialogue covering a wide range of economic and security issues.

This paper sets out a case for engaging India as an integral partner in constructing building blocks which would lead to the emergence of a new Asia. It is argued that in an era where each country (and its business organisations) needs to both compete and cooperate at the same time, it is imperative that all the major Asian economies begin a dialogue process so that the win-win opportunities can be explored and translated into concrete benefits for Asia as a whole. This will require a mindset change in certain circles in east Asia which continue to view India from a cold war perspective, and which are not conversant with rapid integration of India with the world economy.<sup>2</sup> The Indian policymakers and businesses have undergone a significant mindset change and are now determined to engage east Asia in the spirit of win-win cooperation and they recognise that there are many areas where east Asia's experience and expertise could be helpful in meeting India's developmental challenges. This is also reflected in significant lessons that draw from selected countries in east Asia in formulating and implementing India's economic policies in general and trade and investment policies in particular.<sup>3</sup> As a result, there is an increasing policy convergence between India and east Asia. This increases the complementarities for economic partnership.

The remainder of the paper is organised as follows. Section II analyses India's merchandise trade with east Asia, highlighting the rapid growth and diversification among trading partners. The bilateral merchandise trade between India and Japan, however, has exhibited a significantly adverse trend and the two trading partners need to urgently take concrete steps to reverse it. Section III

focuses on the significant potential for cooperation in trade in commercial services between India and east Asia, and on the fact that this has been largely ignored by popular indicators due to data limitations. This section also argues that economic integration cannot always be measured by gross flows, and that certain qualitative aspects (e.g., location of chip design work in the electronics sector) need to be taken into account. Section IV focuses on the potential of investment flows between India and east Asia; while Section V analyses the implications of demographic complementarities. The final section provides concluding observations on the strong case for India to be an integral part of a new Asia.

## II

### India's Merchandise Trade with East Asia

Tables 2 and 3 present the trends in merchandise trade between India and the east Asian economies. It is observed that with the exception of Japan, India's trade with other east Asian countries has increased rapidly since the crisis of 1997-98. Thus, barring few exceptions, the growth rate of India's exports to and imports from east Asian economies (viz., China, Japan, Korea and the ASEAN-6) was in general higher than that of India's exports and imports to the world (Figure 1).

India's overall merchandise trade with east Asia more than doubled from about US \$ 13 billion in 1997-98 to about US \$ 27 billion in 2003-04 registering a compound annual growth rate of 13 per cent (Tables 2 and 3). The bulk of this increase was contributed by the rapid increase in bilateral merchandise trade between India and China, which expanded more than fourfold from about US \$ 1.7 billion in 1997-98 (US \$ 0.7 billion in exports and US \$ 1 billion in imports) to about US \$ 7 billion in 2003-04 (US \$ 3.0 billion in exports and US \$ 4.0 billion in imports). In calendar year 2004, the bilateral merchandise trade between India and China is expected to exceed US \$ 10 billion.

India's bilateral trade with ASEAN-6 expanded from US \$ 5.8 billion in 1997-98 to US \$ 12.7 billion by 2003-04; while the corresponding increase with Korea was from about US \$ 1.5 billion to US \$ 3.2 billion (Tables 2 and 3). While data are not presented separately, there has been a considerable diversification of India's trade relations among the ASEAN members [Sarma and Mehta 2002; Sen et al 2004]. Among the ASEAN-6, Malaysia, Singapore, Thailand and Indonesia are all emerging as strong trading partners of India. This has significantly increased the prospects for achieving India-ASEAN bilateral trade goal of US \$ 30 billion by the end of the decade.

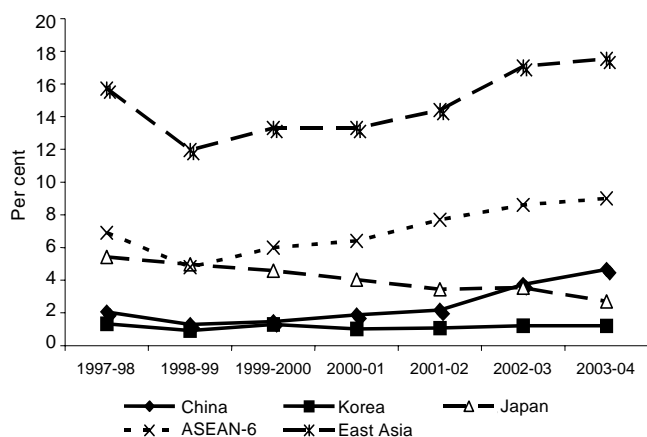
**Table 2: India's Exports to East Asia: 1997-98 to 2003-04**  
(US \$ million)

	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04
World	35048.7	33211	36760	44147	43976	52856	63622
China	719	427	539	830	955	1981	2967
	(2.1)	(1.3)	(1.5)	(1.9)	(2.2)	(3.7)	(4.7)
Korea	468	307	476.5	447	473	646	764
	(1.3)	(0.9)	(1.3)	(1.0)	(1.1)	1.2	(1.2)
Japan	1901	1651	1685	1782	1515.6	1869	1719
	(5.4)	(5.0)	(4.6)	(4.0)	(3.4)	(3.5)	(2.7)
ASEAN-6	2419.6	1589.2	2190.3	2813.7	3390.2	4528	5700
	(6.9)	(4.8)	(6.0)	(6.4)	(7.7)	(8.6)	(9.0)

Notes: Figures in parentheses indicate share in India's total world exports. ASEAN-6 includes Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam.

Source: CMIE (2004).

**Figure 2: Shares of East Asia in India's Exports: 1997-98 to 2003-04**



Source: Computed from CMIE (2004).

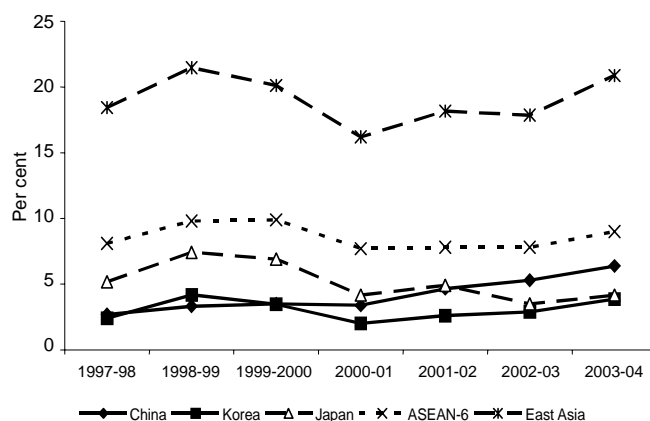
The bilateral trade between India and Japan has exhibited a sharp downward trend, particularly concerning India's exports to Japan. The two sides must urgently consider ways to deepen their bilateral merchandise trade relationship, particularly as there are wider areas where their interests converge. The Korean companies have been more proactive than their Japanese counterparts in trade generating as well as domestic demand-oriented investments in India, and have reaped considerable economic benefits.

Figures 2 and 3 provide the share of east Asia in India's exports and imports for the 1997-98 to 2003-04 period, respectively. It is observed that east Asia's share (except that of Japan) in India's exports has been increasing particularly since 2000-01, with that of India's imports also exhibiting similar trends. In particular, China's share in India's exports and imports expanded from 1.9 per cent and 3.4 per cent to 4.7 per cent and 6.4 per cent, respectively, while that of ASEAN-6 increased from 6.4 per cent and 7.7 per cent to 9 per cent, respectively for both flows.

However, the trade shares do not provide any indication as to the extent to which two countries prefer to trade amongst themselves, relative to their other trading partners in the rest of the world. For this reason, bilateral trade intensity indices are often considered as a more useful tool for analysing bilateral trade linkages. In the context of this paper, the indices are designed to capture the extent to which the home country (India) regards its trading partners (the east Asian economies) as being important in relation to the former's trade with the rest of the world (ROW), and vice versa. An index value above unity indicates a relative 'over-representation' of the trading partner in the home country's trade.<sup>4</sup> The indices are computed using the data from IMF's *Direction of Trade Statistics Yearbook*.

India's trade (exports plus imports) intensity indices with China, Japan, Korea and ASEAN-6 over the period 1993-2003 are highlighted in the Figures 4a and 4b. It is evident from the Figures 4a and 4b that before the 1997 crisis in east Asia, ASEAN-6 economies were the only ones to have a value of trade intensity greater than or equal to unity. However, since 2000, India's export as well as import intensity with Korea and China have also been increasing, although the latter's values are yet to be greater than unity. The trends, therefore represent an 'over-representation' of ASEAN-6 as a trading partner for India vis-à-vis ROW, and an 'over-representation' of Korea as an import source for India's imports compared to ROW. The trends in export index values

**Figure 3: Shares of East Asia in India's Imports: 1997-98 to 2003-04**



Source: Computed from CMIE (2004).

for India's trade with China, Japan and Korea, suggest an 'under-representation' of these countries compared to India's exports to ROW. This indicates that although bilateral trade shares may have expanded, potential for expansion of India's trade linkages with these countries vis-a-vis India's other trading partners are potentially significant.

Considerable acceleration in the merchandise trade linkages not withstanding, rapid growth and substantially enhanced capacities strongly suggest that there is substantive scope for the expansion of trading relations between India and east Asia. India's 2004-09 National Trade Policy envisages its merchandise exports and imports to rise to US \$ 195 billion and US \$ 210 billion, respectively by 2009. If trade in service transactions is added, India's total international trade is set to exceed US \$ 500 billion by the end of the decade.

India's vigorous unilateral liberalisation (its tariff levels are approaching those in ASEAN), and its pursuit of bilateral trade pacts, could facilitate this expansion. India and Sri Lanka after highly satisfactory experience with limited FTA are negotiating a Comprehensive Economic Partnership (CEP) agreement which will also include investments and services. Further, the India-ASEAN FTA is also likely to be operational by next year with an 'Early Harvest' scheme involving 105 products. This is likely to be expanded to include other areas in due course. Concomitantly, the Comprehensive Economic Cooperation Agreement (CECA) pact between India and Singapore is reportedly progressing towards the concluding stage.

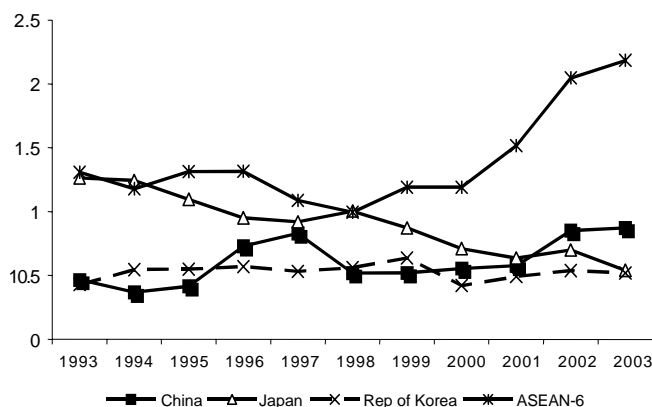
**Table 3: India's Imports from East Asia: 1997-98 to 2003-04 (US \$ million)**

	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04
World	41534.6	42379.2	49798.6	50056.3	51588.4	61571.6	77237
China	1120.7 (2.7)	1096.5 (3.3)	1288.3 (2.6)	1494.9 (3.4)	2043.3 (4.6)	2799.3 (5.3)	4059.1 (6.4)
Korea	1002.9 (2.4)	1394.1 (4.2)	1274.9 (3.5)	891 (2.0)	1145.3 (2.6)	1525.9 (2.9)	2460.1 (3.9)
Japan	2147.5 (5.2)	2465.2 (7.4)	2538.9 (6.9)	1835.5 (4.2)	2153.7 (4.9)	1841.1 (3.5)	2649.3 (4.2)
ASEAN-6	3382.3 (8.1)	4142.6 (9.8)	4918.9 (9.9)	3881.2 (7.7)	4025 (7.8)	4825 (7.8)	6959 (9.0)

Notes: Figures in parentheses indicate share in India's total world imports. ASEAN-6 includes Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam.

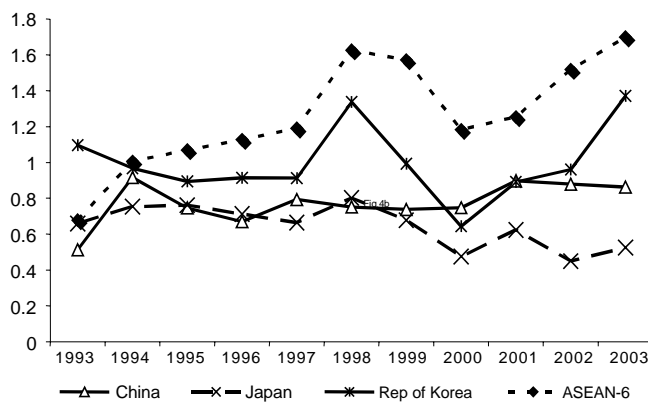
Source: CMIE (2004).

**Figure 4a: Trends in Bilateral Export Intensity between India and East Asia**



Source: Computed from CMIE (2004).

**Figure 4b: Trends in Bilateral Import Intensity between India and East Asia**



Source: Computed from CMIE (2004).

India, in cooperation with Brazil and China, played a key role in developing a consensus at the WTO's General Council meeting in Geneva in July 2004. India's integration with east Asia could thus prove to be a further catalyst in making WTO, a preferred institution for multilateral liberalisation, more effective and responsive. There is, indeed, emerging a consensus among the economists and trade policy specialists that bilateral and sub-regional FTAs which have been in fashion recently are at best of symbolic value, though they may occasionally provide political cover for liberalisation. If pursued too vigorously, such FTAs could end up increasing the transaction costs, and reducing the allocative efficiency due to net trade diversion. Therefore, multilateral liberalisation through WTO remains the first best option, particularly for Asia.

### III India's Trade in Commercial Services with East Asia

The emphasis on merchandise trade alone ignores the increasingly critical role of international trade in the commercial service transactions. The services sector has been rapidly expanding in India as well as in many east Asian economies, and has come to occupy prominence in their production and employment structures. Technological changes and globalisation have led to significantly enhanced scope for trade in commercial services, both domestically and internationally. Indeed, it is the services such as retail trade, and logistics sector, which have witnessed among the most rapid increases in productivity and efficiency. It appears that the value added by services in manufacturing has also increased rapidly. In 2003, the total merchandise trade was US \$ 15.3 trillion, while the trade in commercial services was US \$ 3.6 trillion, about a quarter of the value of merchandise trade. It should be stressed that the critical importance of the service transactions is not always measured by the dollar values alone. As an example, the chip is an indispensable component in the electronic manufacturing sector. However, the dollar values associated with chip design are low, even though chip represents the 'brain' of the electronic product. India is contributing modestly to the chip design as one of the key chip design centres for Intel is being located in India. It should also be noted that India is gradually developing capacities in some areas of electronics hardware, and will be a modest player in this area,<sup>5</sup> complementing

its competitive advantage in software. Therefore, it should also be considered as part of the electronics sector in Asia.

The analysis of service transactions for Asian economies is seriously hampered by data limitations. This is because unlike the OECD countries, the Asian countries do not publish the relevant data which are comprehensive, detailed, timely and internationally comparable.

One of the difficulties is due to the distinct nature of services which are non-storable, unlike goods.<sup>6</sup> With trade liberalisation in services gaining greater focus at the regional and bilateral levels (apart from the multilateral level under the GATS), recent RTAs and bilateral FTAs (involving India and various east Asian economies) have focused on this as a key negotiation area along with merchandise trade. In this context, good quality and accessible data on trade in commercial services trade at a detailed sectoral level becomes absolutely essential for Asian countries, including India.

According to the WTO rankings of commercial services trade in 2003, India ranked 21st in global exports and imports of commercial services accounting for 1.4 per cent of global service exports and 1.2 per cent of global services imports, respectively.<sup>7</sup> Among Asian economies, India ranked the 6th and 7th largest global exporter and importer of commercial services respectively, with Japan, China, Korea and Singapore ranked higher than India (Table 4). The composition of India's services trade indicates

**Table 4: Leading Exporters and Importers in World Trade in Commercial Services, 2003**  
(Billion dollars and percentage)

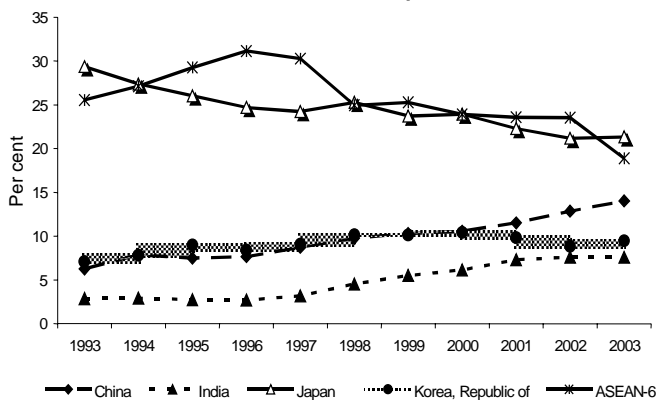
Rank	Exporters	Value	Share	Rank	Importers	Value	Share
1	United States	287.7	16.0	1	United States	228.5	12.8
2	United Kingdom	143.4	8.0	2	Germany	170.8	9.6
7	Japan <sup>a</sup>	70.6	3.9	3	United Kingdom	118.3	6.6
8	Netherlands	63.0	3.5	4	Japan	110.3	6.2
9	China	46.4	2.6	8	China	54.9	3.1
10	Hong Kong, China	44.6	2.5	14	Korea, Republic of	39.0	2.2
17	Korea, Republic of	31.3	1.7	17	Singapore	27.2	1.5
18	Singapore	30.4	1.7	19	Hong Kong, China	25.2	1.4
21	India	25.0	1.4	20	Taipei, China	24.8	1.4
28	Thailand	15.7	0.9	21	India	21.6	1.2
29	Malaysia	13.5	0.7	25	Thailand	18.3	1.0
40	Indonesia <sup>b</sup>	6.4	0.4	26	Indonesia <sup>b</sup>	18.0	1.0
				28	Malaysia	17.3	1.0

Note: a WTO secretariat estimate for exports in 2003 based on the methodology applied by the Bank of Japan up to 2002.

b WTO Secretariat estimate.

Source: WTO (2004).

**Figure 5a: Share of East Asian Economies in Asia's Service Exports**



Source: Computed from CMIE (2004).

that other services (that includes communication and computer-related services and business and professional services) constitutes the bulk of the share in both exports and imports of commercial services, followed by travel and transport services. The latter has been a laggard, but is expected to grow at a higher rate than the recent past.

India's 2004-09 Foreign Trade Policy envisages service exports to grow to US \$ 150 billion by 2009, of which software will account for US \$ 65 billion. To the extent these targets are realised, India's global ranking in services trade may improve further.

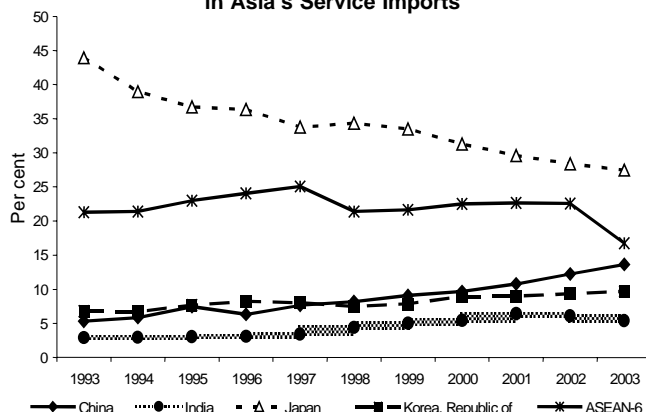
Figures 5a and 5b indicate the trends in share of these economies in Asia's commercial services trade over 1993-2003. It is observed that India, China and, to a lesser extent Korea have been increasing their share in Asia's total services exports and imports, while that of Japan in particular, has been on a decline. The share of India in Asia's services exports more than doubled from 2.9 per cent to 7.6 per cent over a decade, while that in services imports increased to 5.4 per cent. The above trends indicate that India is increasingly becoming an important player in global commercial services trade, both globally as well as in Asia. As bilateral services trade data are not available, it is impossible to undertake a more rigorous analysis of India's services trade with individual Asian countries.

Anecdotal evidence, however, suggests that India is increasingly becoming integrated with east Asia in the area of services trade as well. Thus, just as the slogan "made in India for the world" captures India's aspirations in the manufacturing sector, the slogan "served in India for the world" captures India's aspirations in the services area well. It is widely acknowledged that in many services, not just the ICT services, Indian businesses are globally competitive, and that they have made important contributions to enhancing competitiveness of firms around the world [The Economist, 2004].

More than 100 of the Fortune 500 companies have set up R&D or design centres in India. Some of the activities are dedicated to bringing about future high technology products. The east Asian firms have been relatively less proactive in setting up such centres in India. There are, indeed, untapped opportunities for firms from Japan, Korea, Singapore, Malaysia as well as China to partner India in setting up such centres for mutual benefits.

East Asia is particularly strong in the logistics sector. This is an area of comparative weakness for India. This could provide

**Figure 5b: Share of East Asian Economies in Asia's Service Imports**



Source: Computed from CMIE (2004).

considerable commercial opportunities for the east Asian businesses. India needs to develop an integrated strategy towards developing logistics and IT infrastructure and also enhancing its industry base, and partnering with east Asia could reap rich dividends, as the latter has already developed a significant expertise in this area [Viswanadham et al 2004].

India is a significant contributor to visitor flows in ASEAN. According to the ASEAN secretariat data, India ranked among the 10th largest visitor-generating market for ASEAN (excluding intra-ASEAN visitors). As air connectivity between India and east Asia improves further and as India follows ASEAN and China in emphasising the role of tourism sector in its own economic growth and employment generation strategies, the volume of service transactions relating to tourism trade are also expected to rise rapidly. India has already an open sky policy for all airlines as far as cargo is concerned; and is committed to facilitating substantially greater air connectivity for its own airlines and for those from ASEAN.

## IV

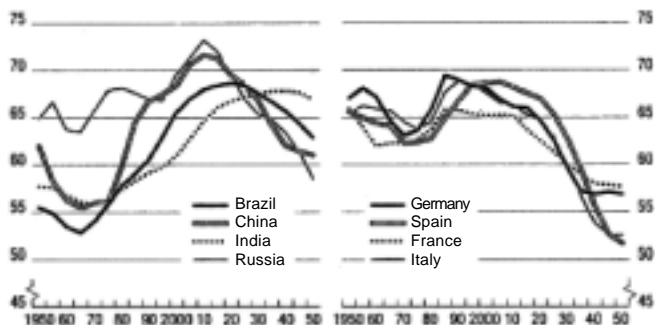
### Investment Flows between India and East Asia

It is now well accepted that Foreign Direct Investment (FDI) has a crucial role to play in today's global economy. In particular, FDI has the potential to facilitate technological diffusion and promote greater trade and integration of developing economies with the global market. It can potentially thus play a catalytic role in economic development, provided the recipient country has the requisite institutions and governance structures. It is thus not surprising to note that FDI has increasingly become the largest single component of private capital flows to developing countries, and all countries need to adjust to this fact.

Since the initiation of economic reforms in India, foreign investment flows (both in terms of FDI and portfolio investments) have gained an increasingly greater acceptance in a wide range of manufacturing, services and infrastructure sectors. Both the flows and the stocks of FDI and portfolio investments have grown; and the prospects for continued growth are quite encouraging.

In 2003-04, India actually received US \$ 4.7 billion in FDI (equivalent to 0.6 per cent of GDP), and US \$ 11.4 billion in portfolio investment [Reserve Bank of India 2004]. As maybe expected, portfolio investment flows have exhibited much greater volatility than the FDI. India is increasingly aligning its FDI

**Figure 6: Working Age Population Share in Selected Developing Countries**  
(Percentage of total population)



Source: IMF, UN.

reporting with the international practice which includes reinvestments, external commercial borrowings and loans to affiliates [Srivastava 2003]. As the stock of FDI continues to grow, the reinvestment and other components will become increasingly important in providing a steady base of FDI inflows.

It is worth noting that since a significant proportion of FDI has been in the R&D and service sector facilities, which do not require large investments, the linkages and employment multiplier impact of such FDI is also higher per each million dollar of FDI as compared to the situation where most of the FDI is in capital-intensive manufacturing and other activities. India, however, is beginning to be a destination for outsourcing of manufactured products for many multinational companies. The Confederation of Indian Industry [CII 2004] estimates that the manufactured product outsourcing mainly in auto components, consumer electronics, pharmaceuticals and others could touch US \$ 10 billion by 2007 and US \$ 50 billion by 2015.

Although detailed data on actual country-wise FDI inflows to India from east Asia remains unavailable, the figures on FDI approvals from Korea, China, Japan and Singapore suggest that these Asian economies have made significant direct and/or portfolio investments in India.<sup>8</sup> India has received portfolio investment from foreign institutional investors (FIIs) of around US \$ 60 billion by end November 2004; while India's market capitalisation was US \$ 350 billion [Gupta 2004]. The density of transactions on the Indian stock exchanges is the third largest in the world; while transaction costs for FIIs on India's stock exchanges are the second lowest in the world after New York. India's financial and capital markets are contributing to more efficient market-based allocation of the nation's savings. The prospects for their continuing growth and sophistication are promising.

Large infrastructure investments in roads, airports and sea ports are being made in India. Countries such as Malaysia have won substantial projects in roads in an open competitive bidding. India is also increasingly playing a role in two way flow in education services. Many Indian students study in the rest of Asia, while Indian schools (two are already operating in Singapore, and they have plans to set up operations in Malaysia) and universities are venturing into south-east Asia. India is also expanding collaboration with Malaysia beyond just medical education. India's world-class technical and management institutions are being recognised in the rest of Asia as well. Its media and entertainment industry is influencing audiences in Asia as well as the rest of

the world, and Bollywood is now a global brand. India is increasingly cooperating in satellite and space technology and related services with Asian countries such as Malaysia and Indonesia.

In recent years, as India's foreign exchange reserves position has become comfortable (as at the end of December 2004, India's foreign exchange reserves were US \$ 131 billion), and as the Indian companies begin to regionalise and globalise, the outward flow of FDI from India has also been increasing [Awasthi and Ganguly 2003; Kumar 2004; Merchant 2004]. India's total FDI stock abroad is estimated to be around US \$ 6 billion and rising rapidly. As an example, Tata Steel's recent acquisition of National Steel based in Singapore will impact several south-east Asian economies where National Steel has manufacturing facilities. Similarly, Tata Motors' acquisition of Daewoo's truck plant in South Korea will enhance its presence in east Asia.

It should be noted that this figure does not include investments made by the nearly 25 million strong Indian diaspora. With some notable exceptions, such as Malaysia and Singapore, the socio-economic position of the persons of Indian origin who are the citizens of their respective countries, is above that of the average for the whole population. There is anecdotal evidence that some sections of the Indian diaspora are shifting from being professionals to being entrepreneurs, particularly in the ICT sector. This can only strengthen the trade and investment relationships of the respective countries with India.

Encouraging the formation of the Indian diaspora and leveraging on their strengths could be an element of the strategy of some of the east Asian countries in deepening the linkages with India. The citizens of Indian origin in Asian countries, including in Malaysia and Singapore need to recognise that if India is perceived to be successfully addressing its challenges, it would provide them with an additional leverage to preserve their existing gains and to expand on them. Thus, their own enlightened self-interest requires them to play a constructive role in facilitating India's deeper engagement with the rest of Asia. As this is also in the interest of the countries of their citizenship, there are no dilemmas involved.

It is also worth noting that in almost every Asian country, the Indian diaspora is making important economic contributions as managers, technicians, professionals and semi-skilled workers. These do not get captured in the usual statistics, but nevertheless are an important indicator of India's integration with east Asia. The diaspora has also been instrumental in expanding India's civilisational influence in Asia and rest of the world.

## V

### Demographic Complementarities between India and East Asia

India is entering the phase of demographic gift when the share of working age population will be increasing for the next three to four decades (Figure 6). As the figure shows, this share in China will begin to decline around 2015, only a decade from now. The proportion of elderly in Japan will increase rapidly from 18.5 per cent in 2002 to 25.3 per cent by 2014. The life expectancy in Japan is also among the highest in the world [Takayama 2003]. Similarly, Korea and Singapore are also experiencing rapid individual and population ageing. There are thus complementarities between India on the one hand and Japan (as well as Singapore, Korea and China on the other) in demographic patterns.

These complementarities provide a strong reason for Japan, Korea and Singapore to utilise India's knowledge-based human resources without having to consider long-term immigration, and thereby extend their economic space by partnering India. It is noteworthy that the businesses from OECD countries, which experienced rapid ageing earlier (Figure 6), have been substantially enhancing their competitiveness by partnering India in variety of knowledge-intensive service activities [Farrell 2004].

## VI Concluding Remarks

The analysis in the paper strongly suggests that India's participation in existing and prospective formal organisations and institutions will significantly enhance Asia's capacity to address the continent's challenges; and enhance its leverage and influence in world affairs. It is in this context that focusing integration efforts on east Asia alone is arguably not an optimal strategy for Asia as a continent. While India will need to be more proficient at strategic economic diplomacy, and at soft power skills, east Asia will need to shed its cold war mindset and its insularity to grasp win-win opportunities.

The analysis shows that India is forging partnerships with the key entities around the world such as the EU and the US. It is keen to play a constructive and cooperative role in building a post-cold war new Asia. India's growth strategy based on the strong and increasingly globally competitive and networked domestic companies could provide a balance for highly trade and FDI-dependent east Asian economies.

The analysis also suggests that there is a strong case for initiating a strategic partnership between India and Japan.<sup>9</sup> First, the two countries have teamed up with Germany and Brazil to coordinate their efforts in becoming permanent members of the UN Security Council. A strategic partnership would give greater depth and breadth to this cooperation. Second, Japan's energy security and trade flows are heavily dependent on secure routes through the Indian Ocean. India is in a position to cooperate and constructively contribute towards this objective. Third, as indicated in Section V, the demographic complementarities between the two provides considerable opportunities for mutual gain from deepening economic linkages. Fourth, there are significant possibilities for cooperation between the two in certain high technology sectors, viz. space technology and biotechnology. A strategic partnership will provide greater confidence to both sides for cooperation in these areas. Fifth, a strategic partnership with India would widen Japan's opportunity set in meeting its regional security and other challenges.

Finally, Japan envisages its future sustainability of economic growth in developing and commercialising high-technology innovations in the core areas. By partnering with India, Japan will have an additional avenue for expanding its reach and leverage in the core technologies. One of its Asian rivals, Korea is already leveraging on India's strengths in this area; and so are many Fortune 500 companies.<sup>10</sup> Japanese companies have similar opportunities, but need to change their mindset further to benefit from them. There are only 265 Japanese firms in India, with total investment of US \$ 2 billion. This is minuscule as compared to Japanese investments of US \$ 50 billion in south-east Asia, and US \$ 40 billion in China. Therefore, higher levels of investments in India at the margin would enable Japanese companies to diversify their global risk as well.

In conclusion, the time has come for Asia to put behind the cold war mindset and its institutions. It is essential that all the major Asian economies are represented in the post-cold war new Asia. As observed by India's prime minister Manmohan Singh, bringing together all major Asian countries in Asian Economic Community would constitute an "Arc of advantage, across which there would be a large-scale movement of goods, services, people, capital, ideas and creativity".

## Annexure: Trade Intensity Indices

### (a) Total Trade Intensity

The bilateral trade intensity index for total trade is as follows:

$$T_{ij} = [(X_{ij} + M_{ij}) / (X_i + M_i)] / \{ [X_{wj} + M_{wj}] - (X_{ij} + M_{ij}) / [(X_w + M_w) - (X_i + M_i)] \}$$

where:  $T_{ij}$  = Total trade intensity index of country i with country j;  $X_{ij}$  = Exports of country i to j;  $M_{ij}$  = Imports of country i from j;  $X_i$  = Total exports of country i;  $M_i$  = Total imports of country i;  $X_{wj}$  = Total world exports to country j;  $M_{wj}$  = Total world imports from country j; and  $X_w$  = Total world exports;  $M_w$  = Total world imports.

This index is interpreted as a relative measure of two ratios. The numerator represents the share of bilateral trade between country i and j as a percentage of total trade of country i. This forms the numerator of the total trade intensity index. The second ratio in the denominator represents the total trade of country j with the world excluding country i as a share of total world trade excluding country i. This forms the denominator of the total trade intensity index.

If the numerator exceeds the denominator, i.e., if the value of  $T_{ij} > 1$ , it implies that the bilateral trade intensity for country i with country j is greater than in comparison to country i's trade with the rest of the world (ROW). For instance, if India is regarded as country i and country j is represented by its trading partners, viz. China, then a value of  $T_{ij} > 1$  implies that India prefers to trade more intensely with China than trading with the rest of the world.

### (b) Export Intensity Index

The bilateral export intensity index among country i and country j may be stated as follows:

$$X_{ij}^a = [X_{ij} / X_i] / [(M_j - M_{ji}) / (M_w - M_i)]$$

where: in addition to the notations in the bilateral trade intensity index,  $M_j$  = Total imports of country j and  $M_{ji}$  = Imports of country j from country i. A value of this index above unity implies that country i's relative share of exports to country j exceeds country j's share of imports from the ROW. This implies an over-representation of country j in country i's export market. From country i's point of view, the value of greater than one indicates that country i has relatively more intense preference for exporting to country j as compared to country j's imports from the ROW.

### (c) Import Intensity Index

The import intensity index may be stated as follows:

$$M_{ij}^a = [M_{ij} / M_i] / [(X_j - X_{ji}) / (X_w - X_i)]$$

where: in addition to the notations in the bilateral trade intensity index,  $X_j$  = Total exports of country j; and  $X_{ji}$  = Exports of country



$j$  to country  $i$ . A value of this index above unity implies that country  $i$ 's relative share of imports to country  $j$  exceeds country  $j$ 's share of exports to the ROW. This implies an over-representation of country  $j$  in country  $i$ 's import market. From country  $i$ 's point of view, the value of greater than one indicates that country  $i$  has relatively more intense preference for importing from country  $j$  as compared to country  $j$ 's exports to the ROW. **[27]**

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## Notes

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- 1 Indian policy-makers have recognised that a prior condition for FTAs is suitable adjustments in tax and duty structures to ensure a level playing field for local manufacturers. The 2005-06 budget has further addressed this aspect as some anomalies still exist.
- 2 The Malaysian prime minister indicated during his December 2004 visit to India that his country is now ready for a substantial widening and deepening of bilateral relations with India. This is a hopeful sign as this represents a mindset change on the part of Malaysia. His visit has led to a reasonable expectation among Indian policy-makers and research circles that an invitation would be extended to India when Malaysia hosts the ASEAN Plus Three (China, Japan and South Korea) meeting in 2005.
- 3 As an example, this is reflected in India's announcement of the first-ever National Foreign Trade Policy 2004-09, which integrates foreign trade with broader economic growth and employment generation strategies just as the east Asian countries have done so successfully for several decades. India aims to double its share of global merchandise trade from 0.8 per cent to between 1.5 per cent-2 per cent by 2009. India also aims to substantially increase its current 1.4 per cent share in global trade in commercial services, particularly in the information and communication technology (ICT)-related services.
- 4 See Annexure, which is based on Rajan (1996a), See Sen (2002), for details on the formulation of these indices.
- 5 Examples include a South Korean firm building a global scale semiconductor plant in the country, while Ericsson is manufacturing radio transmitters and receivers for cellphones in India. Elcotech, a contract manufacturer to Nokia, is set to begin manufacturing handsets in India by early 2005. Another South Korean firm LG is setting up a cellular phone factory in India and plans to make India its second largest overseas production base. The Indian company Moser Baer is also expanding its hardware production capacities. India is obliged under the WTO agreement to phase out duties on 217 IT and Telecom products by 2005. The manufactures are moving into India's Special Economic Zones (SEZs) and Electronic Hardware Technology Parks (EHTP) to maintain their competitiveness.
- 6 Stibora and De Vaal (1995) note that since services trade cannot be modelled in a perfectly competitive market, a model of vertical product differentiation suits better for this purpose. Further, due to the simultaneous interaction of producer and consumers, asymmetric information among producers and consumers lead to the problems of adverse selection and moral hazard.
- 7 If intra-EU trade is excluded, India is ranked the 10th largest global exporter and 11th largest global importer of commercial services [WTO 2004].
- 8 In particular, these countries contributed to about 15 per cent of India's total approved FDI in 2003 [Asher and Srivastava 2003].
- 9 Japan's preference for WTO plus agreements involving services, investments and manpower flows, is consistent with India's perceptions of partnership with Japan.

10 As an example, Samsung has set up one of its core research centres in India. Samsung India has developed a mobile phone which can work anywhere in the world regardless of technology.

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