

PERSPECTIVE

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ASEAN-India Economic Relations: Low Base, Large Potential

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EXECUTIVE SUMMARY

- The ASEAN-India partnership has grown over the last 25 years, but critics have observed that India's economic relations with ASEAN is weak in comparison with other regional powers.
- India's tough negotiation stance in trade with ASEAN is often criticised and is cited as a factor limiting its ability to develop close economic ties with ASEAN.
- In fact, it is due to India's late entry into globalisation and the mismatch of economic priorities between ASEAN and India.
- However, there are bright spots in ASEAN-India's economic relations:
 - ASEAN features prominently in India's outward investments in oil and gas, pharmaceuticals, information technology, telecoms and financial services.
 - Services trade has the potential to grow from improved connectivity and people-to-people ties.
 - The Indian diaspora in ASEAN countries plays an important role in bilateral trade, investment, and tourism development.

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INTRODUCTION

India's long association with ASEAN started in 1992 with it being a sectoral dialogue partner¹ to the organisation. Subsequently, the partnership advanced to include 30 dialogue mechanisms, covering a summit and seven ministerial-level meetings for a range of sectors. Since the commencement of the ASEAN Community in 2015, there have been regular and frequent bilateral visits. Top-level leaders of India have visited all of the 10 ASEAN countries in the last four years.²

Last year, ASEAN and India celebrated their 25 years of Dialogue Relations. To mark the occasion, besides holding a commemorative summit in New Delhi, the 10 ASEAN leaders attended India's Republic Day Parade on 26 January 2018.³ It was the first time that India had invited a regional grouping as Chief Guest⁴ for its most prestigious national event that showcases its varied culture and military capability. All these reflect India's interest in the ASEAN region.

Despite such broad-ranging interest, however, India is repeatedly criticised for its tough stance with regard to trade agreements with ASEAN. It took seven long years for the ASEAN-India FTA (AIFTA) to conclude negotiations on trade in goods. More recently, there is noise that India has been dragging its feet on the Regional Comprehensive Economic Partnership (RCEP) negotiations. Although the agenda of RCEP was finalised in 2013 followed by agreements on the modalities, the issue of market access continues to be deliberated even after 23 rounds of negotiations. India has regularly cited its large trade deficit with China as a reason for taking a conservative approach to trade liberalization.

Moreover, India is often compared with ASEAN's East Asian Dialogue Partners to highlight its limited economic engagement with ASEAN. For example, at the end of 2015, while ASEAN's total merchandise trade with India was US\$58.5 billion, the same with China, Japan and South Korea stood at a staggering US\$345 billion, US\$238 billion and US\$122 billion respectively.

Why do ASEAN and India have such a muted economic relationship? This Perspective looks into the matter and discusses the political-economy challenges that is restraining the relationship to advance further. It concludes that although the absolute levels of trade and investment are low due to India's approach to trade policy and to the mismatch in sectoral interest in trade negotiations, there are economic upsides, given the Indian diaspora in ASEAN countries, improved air connectivity, services trade complementarities and India's quest with domestic reform.

ASEAN-INDIA ECONOMIC RELATIONS

The section takes a multi-dimensional approach to gauge the current state of economic relations between ASEAN and India.

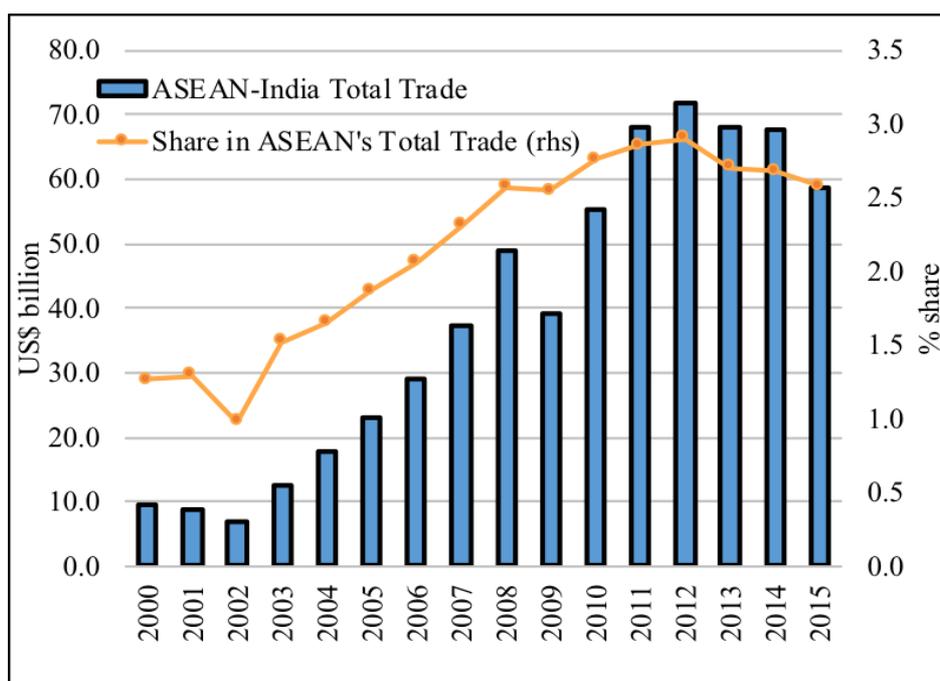
a) Merchandise Trade

ASEAN’s total merchandise trade with India increased from US\$10 billion in 2000 to US\$58.5 billion in 2015, growing at a rate of 13% per annum, much higher than ASEAN’s total trade growth of 8%. However, most of the growth was observed from 2002 to 2008, after which it moderated or declined. An almost similar trend was observed for India’s share in ASEAN’s total trade which peaked at 2.9% in 2012 (Figure 1). The patterns partially reflect the global trade environment in the post-2008 Global Economic Crisis era. It also reflects trade diversion as other ASEAN trade agreements became operational⁵ and as the prevalence of protectionist sentiments on both sides increased.⁶

After AIFTA came into practice in 2010, ASEAN’s trade with India grew by 1.1 times, same as ASEAN’s total trade. There are clear differences in performance between individual ASEAN countries and India. The Philippines, Malaysia, Cambodia and Laos have shown a positive growth trend, while the same has slowed down for Singapore and Thailand (Table 1). With AIFTA in operation, Singapore’s role in the entrepot trade between ASEAN and India has decreased.

Unlike China or South Korea whose shares in ASEAN’s total trade went up at a steady pace,⁷ India’s merchandise trade with the region is yet to experience a stable relationship. Nonetheless, it should be noted that ASEAN features among India’s top five trading partners, following closely behind the US, China and the EU. This reflects India’s economic interest in ASEAN, which will remain pertinent going forward.

Figure 1: ASEAN-India Bilateral Merchandise Trade



Source: The ASEAN Secretariat Statistical Publication (various years), author’s calculation

Table 1: ASEAN Countries' Merchandise Trade with India

(US\$ billion)	2010	2015	% Rate of Growth (2010-2015)	Ratio 2015/2010
Total ASEAN	55.44	58.50	1.4	1.06
Brunei	0.51	0.62	5.0	1.22
Cambodia	0.06	0.12	18.9	2.00
Indonesia	13.02	14.36	2.5	1.10
Laos	0.01	0.05	49.5	5.00
Malaysia	9.00	12.02	7.5	1.34
Myanmar	1.13	1.43	6.1	1.27
Philippines	0.98	1.66	14.1	1.69
Singapore	22.60	16.43	-7.7	0.73
Thailand	8.15	6.70	-4.8	0.82
Vietnam	0.00	5.11	n.a	n.a.

Source: ASEAN Community in Figures, The ASEAN Secretariat (various issues); author's calculation

b) Services Trade

While bilateral services trade data are not available for ASEAN countries and India, one can make some inferences using global services trade data and anecdotal evidence. In 2015, ASEAN and India together constituted 10% of total global commercial services trade, of which Singapore had the highest share of 3.2%, followed by India at 3% and Thailand 1.1%.⁸ Sector-wise, for the ASEAN countries other than the Philippines and Singapore, travel and transport services trade are crucial. For India, the other commercial services⁹ are prominent (Table 2). In general, services trade between the two sides can be observed in ICT and related professional business services, financial services, logistics, education, healthcare services, travel and tourism.

Table 2: Trade in Commercial Services, 2015

	Commercial Services, US\$ billion	% Share in Total Trade in Commercial Services			
		Goods-related Services	Transport	Travel	Other Commercial Services
Brunei	1.9	0.0	37.1	31.8	31.0
Cambodia	5.6	0.0	25.6	63.7	10.7
Indonesia	52.3	2.4	24.9	34.5	38.2
Laos	1.4	0.0	6.2	87.3	6.5
Malaysia	74.3	3.9	19.5	37.9	38.6
Myanmar	6.2	7.6	29.4	34.1	28.9
Philippines	52.4	0.3	11.0	31.7	56.9
Singapore	302.6	2.5	31.8	12.8	53.0
Thailand	103.6	0.0	20.7	50.8	28.5
Vietnam	27.4	0.0	40.2	39.6	20.2
Total ASEAN	627.9	1.9	26.5	27.5	44.1
India	278.4	0.2	23.9	12.9	63.0

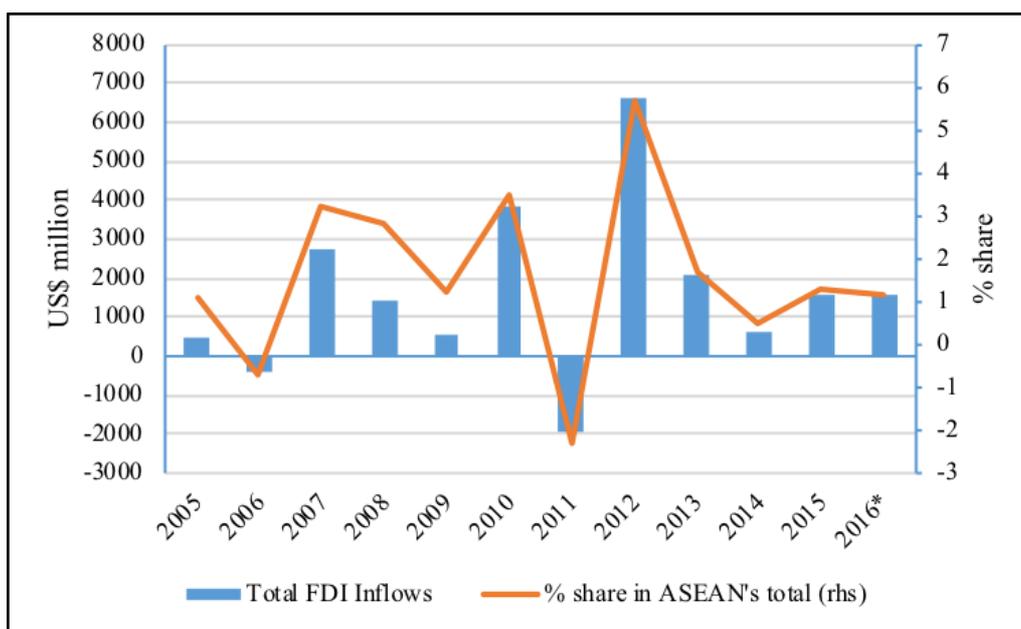
Source: WTO Trade Database; author's calculation

c) Investment Linkage

ASEAN’s FDI inflows from India had fluctuated widely in the range of US\$ -1.9 to US\$6.6 billion. The inflows declined from US\$2.1 billion in 2013 to around US\$1.6 billion in 2016. The latest figure is 1 per cent of total ASEAN’s FDI inflows (Figure 3). The fluctuation in FDI inflows resulted in India’s outward FDI (OFDI) stock in ASEAN going down from US\$20.8 billion in 2010 to US\$18.4 billion in 2015.

Despite such lacklustre performance, ASEAN remains India’s leading overseas investment destination. India’s 2015 OFDI to ASEAN constitutes 22% of its total OFDI stock, which is larger than ASEAN’s share in Japan’s OFDI stock at 13%, the US’s 5%, China’s 6% and the EU’s 2%.¹⁰ Moreover, during the decade ending with 2015, India’s investment to ASEAN rose at an average annual rate of 67%, much higher than India’s global investments growth rate of 40%.

Figure 2: ASEAN’s FDI Inflows from India



Note: *2016 is an estimated figure

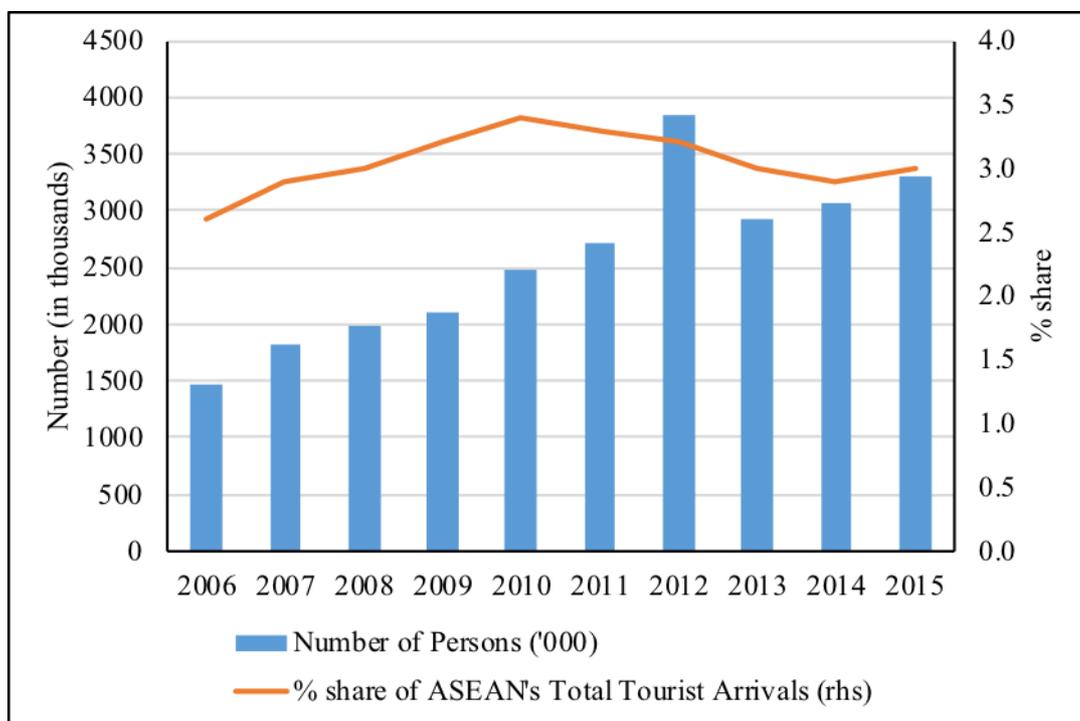
Source: The ASEAN Secretariat Statistical Publications (various issues), author’s calculation

With regard to individual ASEAN countries, most of India’s investments are concentrated in Singapore, followed by those in Malaysia, Indonesia, Thailand and Vietnam. India also pays special focus to less-developed ASEAN members. In particular with Vietnam, India has industrial cooperation in large projects in oil exploration, power generation and chemical manufacturing. There were around 85 India-funded projects in Vietnam as of early 2015. In India’s 2015-2016 annual budgetary allocation, the commerce ministry requested for US\$16.1 million as Project Development Fund to establish manufacturing hubs in less-developed ASEAN members.¹¹

d) People-to-People Ties

Tourism is a simple indicator for people-to-people linkage between ASEAN and India. Tourist arrivals from India to ASEAN increased from 1.5 million in 2006 to 3.3 million in 2015, reflecting a growth rate of 10.7% per annum. In 2015, India had a share of 3% in ASEAN’s total tourist arrivals (Figure 3), which though much smaller than China’s 17%, is relatively less skewed vis-à-vis South Korea’s 5.4% and Japan’s 4.3%. For Indian travelers, Singapore, Thailand, Malaysia and Indonesia are prominent destinations in ASEAN. They contribute significantly to the travel industry sectors of these countries.¹²

Figure 3: Indian Tourist Arrivals in ASEAN



Source: The ASEAN Secretariat Statistical Publications (various issues)

A key factor that has contributed to this positive development is improved air connectivity between ASEAN and India.¹³ Singapore is connected to multiple Indian destinations through 480 weekly flights. Similarly, Malaysia and Thailand are connected to India by around 114 and 150 flights respectively. National air carriers from both sides are flying to each other’s destinations,¹⁴ pushing down airfares between India and ASEAN countries. Better air connectivity is further supported by visa-on-arrival/e-visa facilities for Indian tourists in several ASEAN countries, such as Thailand, Indonesia, Cambodia, Malaysia, Vietnam and Singapore.¹⁵

One can conclude that ASEAN-India relations need to be studied from multiple facets beyond merchandise trade. To be sure, in absolute terms, ASEAN’s trade and investment levels with India are low and unsteady, especially when compared to those for ASEAN’s other East Asian partners. But there are positive signs. Besides ASEAN being India’s

prominent partner for OFDI, the services trade has room to grow. People-to-people ties remain highly significant.

POLITICAL-ECONOMY CHALLENGES

This section outlines three underlying challenges in ASEAN-India trade negotiations.

The first relates to India's approach to trade policy. For two decades since the 1970s, India followed an Import Substitution Industrialisation (ISI) policy¹⁶ that regulated imports, promoted large state sectors and provided limited incentives for private sector players. The resulting lack of competition strengthened ties between business and labour, who asked for a protected market. It was only in the early 1990s that India decided on its liberalisation policy and adopted the Look East Policy (LEP), leveraging upon historical and cultural ties.¹⁷ It subsequently signed several FTAs and transformed its LEP to Act East Policy.

However, the path to liberalisation was not easy for India. On the one hand, India undertook reforms such as the abolition of industrial licensing, tariff reduction and capital account convertibility. On the other hand, many domestic reforms in line with outward-looking policies remained problematic, mainly due to India's multi-party politics. The anti-liberalisation lobby stayed prevalent, and as a result, despite being a member of GATT WTO, India remained relatively protected. No doubt, it partook in several trade deals but these were often limited in scope and their implementation stayed patchy.

The second factor derives from India's missed opportunity to be part of the regional production network. While India adopted a relatively open trade policy in the 1990s, the countries in East Asia undertook domestic reforms to liberalise their economies far ahead of that. China had been pursuing economic reform since the late 1970s, with trade and investment as core components of its development strategy. Japan had an open-economic model since the end of World War I, and practiced economic diplomacy with the wider Asian region through trade, technical assistance and foreign aid. Even the ASEAN countries had been following an outward-oriented trade and investment policy since the 1980s by liberalising investment flows in manufacturing sectors and in the parts and components industries and investing in infrastructure to improve the business climate. As a result, these East Asian countries have been successful in integrating themselves into regional production networks – the core of international trade – since the late-1980s. By the time India decided to jump on the bandwagon, it needed to grapple with its domestic economy concurrently to raise overall productivity, undertake reforms in state and private sectors and build infrastructure. It also needed to prepare its manufacturing sector for integration into production networks by providing incentives to raise its competitiveness. Domestic concerns therefore tended to take priority.

The third underlying actor are the different sectoral priorities of ASEAN and India. While the comparative advantage for a large proportion of ASEAN countries lies in manufacturing activities, India's strength is in services. For India, trade in goods is limited since its

manufacturing and agriculture sectors are less competitive and the domestic market is large enough to generate income. Most regularly, it was felt that liberalising merchandise trade would result in larger jumps in imports versus exports, leading to a larger trade deficit, at least in the short-run.¹⁸ Alternatively, India has comparative advantage in information technology, telecom services, financial and tourism services. In 2015, it ran a services trade surplus of US\$33 billion with the rest of the world, compared to the US\$2.2 billion surplus in the same sector managed by ASEAN countries.

This mismatch in priorities leads to difficulties in trade deals between ASEAN and India. It took seven long years to negotiate the ASEAN-India Trade in Goods Agreement and services and investment negotiations were concluded even much later. For RCEP negotiation, India is heard to be demanding larger services liberalisation in return for granting greater goods market access to others. This is highly unpopular as the demand for services trade liberalisation simultaneously requires investment liberalisation and, often, movement of professionals. While investment liberalisation is relatively easy for a sector like tourism, it gets complicated for sectors in public services such as education, health-care and transport which are subject to distinct domestic regulations. Social and economic considerations, such as the government's priority to support local SMEs, can stymie investment liberalisation decisions in the services sector. Cross-border movement of skilled labour remains restrictive due to its political sensitivity. Till now, most of ASEAN's trade agreements have focused on goods and paid limited attention to services. Trade in services, in particular, is vulnerable to international competition and involves many regulatory barriers.

THE FUTURE: UPSIDE POTENTIAL AWAITS

Going forward, the economic relation between ASEAN and India has significant upside potential. The two sides together cover a market of 2 billion people and boasts a GDP of US\$5 trillion. Both have young populations to match labour market needs and growing middle classes to support consumption. In addition, ASEAN and India are estimated to grow in 2018-2020 at an average rate of 5.7% and 7.7% respectively, compared to 6.3% for China and 2.0% for the US.¹⁹

In terms of economic relations, ASEAN is the fourth largest merchandise trading partner for India²⁰ and features prominently as India's key overseas investment destination. There are approximately 2,000 Indian firms²¹ operating in multiple ASEAN countries, including Singapore, Malaysia, Indonesia, Thailand and Vietnam (Table 3). Many factors have contributed to these investment decisions, including the Singapore-India Double Taxation Avoidance Treaty,²² the Singapore-India and Malaysia-India bilateral trade agreements,²³ strong air connectivity, the presence of an Indian diaspora, and the region's business-enabling environment. Singapore particularly acts as a gateway for Indian investment to the rest of the region.

There is good potential for further growth, especially in light of the current US-China trade friction. ASEAN economies and India offer each other an alternative destination to trade and

investment. Moreover, in case of a long-drawn trade war between the US and China, trade and investment rules in AIFTA can facilitate reconfiguration and relocation of production lines from being China-centric and move them to ASEAN. As such, the ASEAN members are in an advantageous position as the ASEAN Economic Community offers a robust and efficient regulatory environment around trade, while AIFTA links it to a big economy in the region.

Table 3: List of Selected Indian Companies Operating in ASEAN Countries

Mining Industry	Manufacturing Sector	Services Sector
Oil India, Bharat Petroleum, Indian Oil Corporation	Automotive – TATA Motors, TVS, Mahindra and Mahindra, Bajaj Auto Pharma and chemicals– SUN Pharmaceutical, Dr. Reddy’s Laboratories, Godrej Industries, UPL Ajanta Pharma, Torrent, CIPLA Industrial activities – Ultratech Cement, Lupin, Asian Paints, TATA Steel, Exide, Hindalco, Aditeya Birla Group	IT – Tata Consulting, Infosys, Wipro, HCL Technologies Telecom - Bharti Airtel, Tata Communications, Reliance Communications, Infotel Telecom, Spice Digital, Reliance Jio Financial Services – HDFC, State Bank of India, IOB, Kotak Mahindra Bank, Axis Bank, ICICI, Exim Bank, UCO Bank Construction – Lanco Infratech, Punj Lloyd, GMR Infrastructure, Madhucon. Real Estate - DLF

Source: ASEAN Secretariat (2017)²⁴

In addition, existing quantum and complementary relations point towards greater services trade between ASEAN and India in the future. The ASEAN countries aim to strengthen their participation in the regional production network, and this is where India’s computer and information services’ firms can help to link the fragmented production structure. In addition, both sides have the potential to benefit from each other’s emerging sectors and policy discussions over digital economy, e-commerce and smart cities.

People-to-people ties can be strengthened with the help of the Indian diaspora in ASEAN countries. In Singapore, Malaysia, Thailand, Myanmar and the Philippines, ethnic Indians constitute a notable percentage of the total population. This group of people are active in traditional economic activities, such as trading and textile industry. In addition, in recent years, Indian professionals are found actively involved in sectors such as medicines, banking, consulting, accounting, engineering and information technology.

There are also a number of Indian students located in ASEAN countries. For example, around 10,000 Indian students are in the Philippines pursuing medical and management degrees. Another 2,000 students are studying in Malaysia. The Government of India has also been offering a number of scholarships to ASEAN nationals for higher education and training. For

example, around 1,000 Lao and 1,400 Cambodian nationals are trained under Indian Technical and Economic Cooperation.²⁵

Connectivity is also a policy priority between ASEAN and India to strengthen their future relations. India has promised a US\$1 billion line of credit to ASEAN countries to promote physical and digital connectivity. A Project Development Fund has been announced to develop manufacturing hubs in less-developed ASEAN countries. India is implementing, albeit at a slow pace, the India–Myanmar–Thailand Trilateral Highway and the Kaladan Multimodal Transit Transport Project in ASEAN. Issues of extending the Trilateral Highway to Cambodia and Laos and Motor Vehicle Agreement across the Trilateral Highway are under discussion. India and ASEAN are also trying to work out a Maritime Transport Agreement and a Regional Air Services Arrangement.

The future potential in ASEAN-India economic relations can also be deduced from India's willingness to undertake domestic reform and to better engage at regional and global platforms. Of late, India has introduced several policy measures – Make in India, Skill India, Smart Cities, Digital India – in its home economy. In particular, the Make in India initiative is trying to revitalise the manufacturing sector. The idea is to improve competitiveness and bring back manufacturing investments that had fled to other Asian destinations. This is not only expected to create jobs in the domestic market but is also likely to help India specialise in one particular activity of manufacturing value-chain, thereby integrating better with other countries in the region. The latter was acknowledged during the ASEAN-India Summit in 2015.²⁶

Efforts to improve ease of doing business in India is gaining a lot of policy traction. As part of the Make in India initiative, fast registration of businesses, cutting bureaucratic red tape and simplifying regulations are important parameters that India is working on to attract foreign investors. Recently, India implemented a major tax policy, namely the Goods and Services Tax, to unify the country for better business climate. It is also implementing several infrastructure projects for seamless movement of goods, services and people. Indeed, the World Bank has recognised the country as one of the top 10 improvers in undertaking domestic reforms out of 190 countries. It ranked India at the 100th spot for 2018 compared to 130th in 2017.²⁷

That said, ASEAN-India's economic relations have significant room to grow in light of the global trade turmoil, services sector potential and people-to-people contacts. The domestic reforms undertaken by India in recent years reflect the country's wish to build a modern and competitive economy that has the capacity to integrate better with regional and global economies going forward.

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- ¹ Sectoral partner on trade, investment, tourism and science and technology
- ² Top Indian Leaders include Prime Minister, President or Vice President.
- ³ <http://www.straitstimes.com/asia/south-asia/modi-invites-asean-leaders-to-attend-indias-republic-day-parade>
- ⁴ Earlier, it was attended by Abu Dhabi's Crown Prince Mohammed bin Zayed Al Nahyan, former French and the US Presidents Francois Hollande and Barack Obama respectively and Japanese Prime Minister Shinzo Abe.
- ⁵ ASEAN-India FTA became effective in 2010, when ASEAN-China and ASEAN-Australia-New Zealand FTA also came into practice.
- ⁶ This followed the global trend. In addition, there was rising fear that with ASEAN-China and ASEAN-India FTA together, cheap Chinese goods can flood Indian market.
- ⁷ During 2004-2015, China's share in ASEAN's total trade went up from 8.3 to 16.0. The same for South Korea was 3.8 to 5.3. Since 2012, China's share went up from 12.9 to 16 and South Korea's remained steady around 5.3.
- ⁸ As against this, China's share is 7%, Japan's 3.6% and South Korea's 2.2% (source: WTO Trade Database and author's calculation)
- ⁹ This includes construction, insurance services, financial services, and telecommunication and computer services
- ¹⁰ ASEAN Investment Report 2017, FDI and Economic Zones in ASEAN, The ASEAN Secretariat and UNCTAD, 2017
- ¹¹ Less developed ASEAN members are Cambodia, Laos, Myanmar and Vietnam
- ¹² <http://www.visitsingapore.com/content/dam/MICE/Global/bulletin-board/travel-rave-reports/Navigating-the-next-wave-of-Asias-Tourism.pdf>; <https://www.wttc.org/-/media/files/reports/economic-impact-research/regions-2017/southeastasia2017.pdf>
- ¹³ In 2003, India offered unilateral liberalization of air travel for ASEAN carriers. Since then, several bilateral air services agreements were signed between India and ASEAN countries.
- ¹⁴ For ASEAN, most prominent ones are Malaysia, Thailand and Singapore
- ¹⁵ Authors discussion with ASEAN-India stakeholders
- ¹⁶ The policy, in general, supports replacement of foreign imports with domestic production.
- ¹⁷ India's Shifting Trade Policy: South Asia and Beyond, Vinod K. Aggarwal and Rahul Mukherjee (https://basc.berkeley.edu/pdf/articles/Aggarwal_Mukherji_ANIA_Ch9.pdf)
- ¹⁸ In case of ASEAN-India, in the post FTA era of 2010, India's trade deficit with ASEAN went up from US\$7.6 billion in 2009/10 to US\$14.8 billion in 2015/16. ASEAN's share in India's total trade deficit has gone up from 7 to 12% during this time.
- ¹⁹ IMF World Economic Outlook, October 2017 Database
- ²⁰ <http://www.todayonline.com/singapore/greater-engagement-needed-boost-india-asean-ties-dpm-teo>
- ²¹ ASEAN Investment Report (2017), ASEAN Secretariat
- ²² The Double Taxation Avoidance Treaty between Singapore and India prevents double taxation of income earned in one jurisdiction by a resident of the other jurisdiction. In 2016, Singapore and India have reached agreement to phase out the capital gains tax exemption gradually
- ²³ India has signed CECA with Singapore in 2005 and with Malaysia in 2011.
- ²⁴ ASEAN Investment Report 2017, FDI and Economic Zones in ASEAN, The ASEAN Secretariat and UNCTAD, 2017
- ²⁵ Author's discussion with policymakers in the region.
- ²⁶ <http://asean.org/storage/2012/05/Overview-ASEAN-India-as-of-July-2017-r2-cl.pdf>
- ²⁷ <http://www.doingbusiness.org/reports/global-reports/doing-business-2018>

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