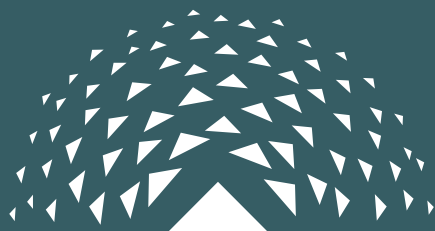


**Waiting for a Breakthrough:
the Economic Relations of India and the ASEAN Region**

Áttörésre várva:

India és az ASEAN régió gazdasági kapcsolatai

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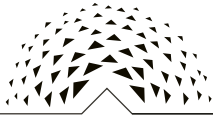
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Summary: India and Southeast Asia have been seeking more economic engagement in recent years. The ASEAN–India free trade agreement has resulted in a diversification of trade flows by partner country, but both regions have failed to increase their share substantially in each other’s overall trade volume. Service export may offer new opportunities, but India’s limited integration in regional production networks and the difference in the sectoral competitiveness of the two regions will make it difficult to elevate trade relations to a much higher level. India plays a minor FDI relationship with Southeast Asia that is limited to Singapore, and there are substantial barriers to diversification in that regard. India’s role in regional infrastructure development is minor compared to China or Japan. At the same time, the digital economy and the health industry may provide new opportunities for economic engagement between the two regions. Altogether, strategic cooperation is still to be translated into a breakthrough in the economic relations between India and the ASEAN region.

Keywords: India, ASEAN, Southeast Asia, economy

Összefoglalás: Az elmúlt években India és Délkelet-Ázsia igyekezett szorosabbra fűzni gazdasági kapcsolatait. Az ASEAN–India szabadkereskedelmi megállapodás óta India kereskedelme a térséggel partnerország szempontjából diverzifikáltabb lett, ugyanakkor egyik félnek sem sikerült jelentősen növelnie részesedését a másik teljes áruforgalmán belül. A szolgáltatás export új lehetőségeket hozhat, ám India korlátozott beágyazottsága a regionális termelési hálózatokban és a két régió különböző iparági versenyelőnye megnehezíti, hogy a kereskedelmi kapcsolatok sokkal magasabb szintre lépjenek. India FDI kapcsolata Délkelet-Ázsiával főként Szingapúrra korlátozódik, és a diverzifikációnak komoly akadályai vannak ezen a téren. India szerepe csekély Kínához és Japánhoz képest a régió infrastruktúra fejlesztésében. Ugyanakkor a digitális gazdaság és az egészségipar új lehetőségeket kínál a két régió közti gazdasági együttműködés bővítésére. Összességében várat magára, hogy India és az ASEAN országok a stratégiai szintű együttműködésre építve áttörést érjenek el a gazdasági kapcsolatok terén is.

Kulcsszavak: India, ASEAN, Délkelet-Ázsia, gazdaság

INTRODUCTION

2022 has been labelled the ASEAN-India Friendship Year, marking the 30th anniversary of their relations. Partnership with Southeast Asia has become more attractive for India since the end of the Cold War as the country started to build closer ties with the US and its allies in the region. At the same time, the country

moved towards a more open trade and investment regime in the early 1990s. Both trends were manifested in the Look East policy launched in 1992, which aimed to give impetus to India's engagement with Southeast Asia and offset the influence of China. As milestones of this orientation, India became a dialogue partner of ASEAN in 1996 and a summit-level partner in 2002. The relationship was upgraded to a strategic partnership in 2012.

While the Look East policy focused on the ASEAN region and mainly on the economic dimension of relations, its upgraded version, the Act East policy also focuses on East Asian nations, but it seeks deeper cooperation in security as well. The widening scope of the new strategy clearly reflects the challenge of the growing Chinese assertiveness in the entire Asia-Pacific region. Announced in 2014, the Act East policy targets connectivity, trade, culture, defence, people-to-people-contact, and the economic development of the north-eastern region of India, which is a natural gateway to Southeast Asia.

As for the ASEAN countries, the region has become a prominent stage of great power contest in recent years. As one of the fastest-growing regions of the global economy, Southeast Asia has been placed in the frontline of the rivalry between the US and China. As ASEAN countries struggle to avoid taking sides in the conflict, any opportunity for diversifying economic relations seems to be an attractive option for the region. Geographic proximity, its huge consumer market, and a fast-growing economy could make India an ideal alternative at first sight. This policy brief evaluates the recent dynamics of the economic relations between India and the ASEAN countries and explores whether this relationship can live up to the expectations.

TRADE RELATIONS: HURDLES AND OPPORTUNITIES OF EXPANSION

Entering into force in 2010, the ASEAN–India Free Trade Agreement (FTA) established one of the largest free trade areas in the world, incorporating a market of almost 1.8 billion people. In the FTA the ASEAN and India pledged to gradually eliminate duties on 76.4 percent of goods and to liberalize tariffs on over 90 percent of goods. The parties also signed a separate agreement on services in 2014, and along with the ASEAN-India Investment Agreement, the three pacts together form the ASEAN-India Free Trade Area. However, based on the trade figures of [ASEANstats](#), the FTA fell short of elevating the trade relationship to a much higher level. As highlighted in Figure 1, bilateral trade has seen ups and downs following the signing of the FTA, and a slowdown can be recognised overall in the growth of bilateral trade volume compared to earlier periods of the relationship.

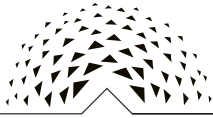
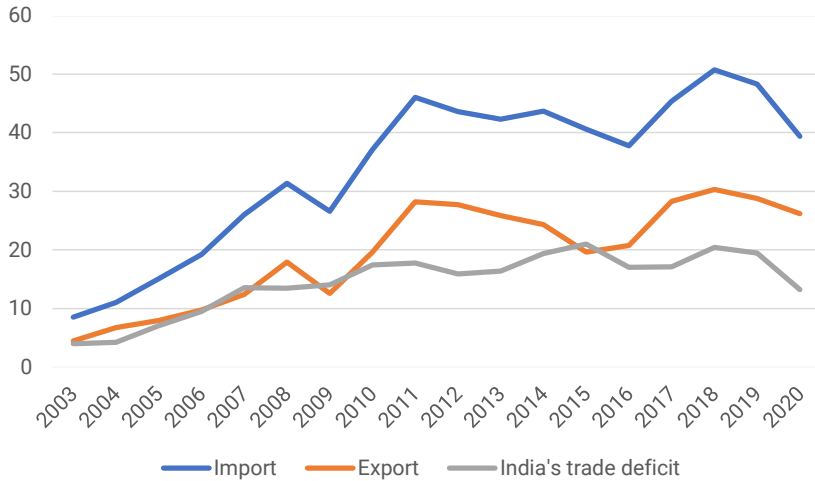


Figure 1

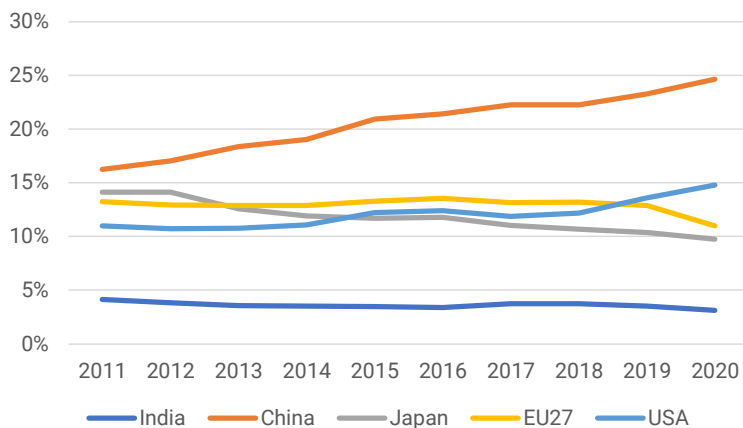
India's merchandise export to and import from the ASEAN countries (USD billion)



In 2020, the Indian government raised the issue of reviewing the FTA. [The National Institution for Transforming India reported](#) that the FTA had resulted in a growing trade deficit with ASEAN nations in most economic sectors. On the one hand, the utilisation rate of the trade pact by Indian exporters remained very low indeed, [between 5% and 25%](#) as of 2019, but on the other hand, the increase of India's trade deficit towards the ASEAN slowed down as the FTA entered into force. Overall, India has failed to increase its weight among the major trading partners of the ASEAN region since 2011, as highlighted in Figure 2.

Figure 2

The share of major partners in the total trade volume of the ASEAN bloc

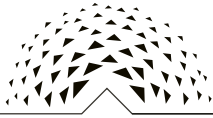


However, the same applies to the ASEAN region's weight in India's trade relations as well. According to ASEANstats, the share of Southeast Asian countries in the total trade volume of India amounted to 9.7% in 2011, which ratio increased by only 0.5% till 2020. At the same time, the weight of China and the US in India's total merchandise trade climbed by 4.5% and 2.6% respectively in the same period.

There are a couple of reasons for India not being able to gain more advantages from the FTA. The country has not been successful so far in getting integrated in regional production networks. India adopted a relatively open trade policy only in the 1990s, while Japan already had an open economic model decades earlier, and China had been introducing economic reforms since the late 1970s. Even most Southeast Asian countries have been pursuing an outward-looking trade and investment regime since the 1980s. As a consequence, India has been lagging behind these countries in getting integrated into regional manufacturing networks, and it has been struggling with creating a business-friendly and harmonised internal investment environment in the country and raising the overall productivity of its manufacturing sector. Besides, India's home market is huge enough to generate income for domestic manufacturing companies, thereby demotivating them from developing business abroad.

Another reason for the low effectiveness of the ASEAN–India FTA is the difference in the sectoral competitiveness of the two economies. While Southeast Asia has its comparative advantage mostly in the manufacturing industries, the service sector has been the real growth engine of the Indian economy. In 2019, it recorded a services trade surplus of USD 85 billion with the rest of the world based on [UN Comtrade data](#). However, the cross-border trade of services is especially hampered by regulatory hurdles, and the sector is particularly exposed to external competition, which together make the liberalisation of services trade more challenging, and this applies to the ASEAN–India relationship as well. Despite all these headwinds, India's services trade with ASEAN economies was expected [to increase to around USD 100 billion by 2025](#). Between 2011 and 2020 the total service import of the ASEAN nations increased by 22.2%, while merchandise import grew by around 10% in the same period, which is indeed a good reason for optimism for Indian service exporters.

While India has not been able to improve its trade balance in absolute terms with the ASEAN since the FTA entered into force, the country has still managed to diversify its merchandise trade relations within the bloc. Based on [ASEANstats](#) data, in 2011 Singapore and Indonesia together accounted for more than 62% of ASEAN-India trade flows in goods, while in 2020 the two countries added up to only 43% of the total trade volume. The share of Vietnam increased the most, from 5.3% in 2011 to 14.8% in 2020, although the other CLMV countries, together with the Philippines, have failed to become more



important trade partners for India in the region, with the share of Singapore dropping by 16.4% to 22%. However, the city-state is still the largest trading partner of India within the ASEAN bloc with this ratio.

FDI AND OTHER FIELDS OF ECONOMIC ENGAGEMENT

Singapore's dominance is much more overwhelming in the foreign direct investment (FDI) relations of India and the ASEAN region. Since 2000, [21.5% of total Indian outward FDI has targeted the ASEAN countries](#), and Singapore accounted for 92.1% of all FDI flows from India to Southeast Asia in that period. Major recipient industries of FDI from India included financial and insurance activities, real estate, wholesale and retail trade. Singapore's outstanding attractiveness for Indian FDI is supported by several factors, including the Singapore-India Double Taxation Avoidance Treaty, good air connectivity, the existence of a solid Indian diaspora, the developed financial market, and the world-class business environment of the city-state. The India-Singapore Comprehensive Economic Cooperation Agreement could also boost the growing partnership between the two countries. All these factors motivate Indian companies to consider Singapore as a gateway for their expansion to the rest of Southeast Asia.

The enormous and expanding consumer market of the ASEAN and its rapidly developing manufacturing sector offer new growth opportunities for Indian companies. Based on a PwC report and survey, 90% of Indian businesses are attracted by the size of the ASEAN market, while 51% is driven by the extensive talent pool of the region. 61% of Indian companies considered Indonesia to be the top ASEAN market for expansion, followed by Vietnam (49%), Malaysia, and Singapore (46% each). Despite all these pull factors, India has failed so far to become one of the most important investors in the region, as the country [was not included in the top 10 FDI sources for the ASEAN bloc](#) between 2014 and 2021.

By December 2020, the ASEAN region [accounted for 22.2% of FDI stock in India](#). Taking a look at the annual FDI inflows from the ASEAN countries, a clear upward trend can be identified, with an investment volume of USD 4.3 billion in 2011 and USD 18.9 billion in 2020. The industries that attracted the most investments from Southeast Asia included the service sector, computer software and hardware, and trading. Singapore's dominance is also remarkable in the investment flows targeting India, as the city-state accounted for 97.7% of all FDI from the ASEAN region between 2000 and 2020. Nevertheless, it is more than probable that local subsidiaries of multinational companies are behind most of the Singapore FDI projects that were implemented in India.

However, there are substantial barriers for India to diversify its FDI relations in the region. Its late and slow integration in regional production networks has already been mentioned, while non-tariff barriers, poor physical connectivity,

and the lack of supply chain infrastructure all hinder a boom in FDI flows with the rest of Southeast Asia. Moreover, in several respects India can be seen as a competitor for Vietnam, which is also an emerging manufacturing powerhouse in the region. Key elements of the value proposition of both countries towards foreign investors include fast economic growth and a young and abundant labour force. India has the advantage of a larger internal market, while Vietnam is closer to the economic gravity centre of the east coast of China. Electronics is the sector where their competition for FDI projects could be the most intense. Both countries are integrated in the midstream part of the global and regional electronics value chains and are struggling to capture more added value through future FDI projects. Nevertheless, there is a potential for expanding economic interactions between the two countries. As mentioned earlier, Vietnam's share has increased the most since 2011 in the India–ASEAN trade relations. In addition, the increasing geopolitical tensions in the South China Sea and the imperative of cutting economic overdependence on China motivate Vietnam to diversify its economic relations, and India could be an obvious candidate for that process. If India intends to offset the growing influence of China in mainland Southeast Asia, then it has to strengthen its economic presence in the CLMV countries, and Vietnam could serve as a bridge in that process. However, bilateral trade and investment relations have so far failed to exploit this potential, as [stated by the Vietnamese deputy minister of planning and investment](#).

Another factor that could boost trade and investment flows between India and the ASEAN is the improvement of connectivity. India has introduced ambitious plans to upgrade its seaports for enhanced trade with Southeast Asia, and it has started joint projects with [Indonesia](#) and [Thailand](#) on the cooperation and development of ports. The India–Myanmar–Thailand Trilateral Highway and the Kaladan Multimodal Transit Transport projects both aim to boost connectivity and economic interactions among the participating countries. The highway could open a gate for India into mainland Southeast Asia, while the Kaladan project could plug the landlocked north-eastern territory of India into the circulation of the Southeast Asian economy. However, [there is much uncertainty regarding the implementation](#) of the projects, which has been very slow so far. India is also engaged in so-called Quick Impact Projects in Cambodia, Laos, Myanmar, and Vietnam. The small-scale, short gestation projects mostly provide development assistance to local communities in the fields of education, water resources, health, and hygiene.

Looking beyond conventional trade and FDI flows, there are some segments of economic relations that promise more engagement between India and the ASEAN nations in the future. Southeast Asia is one of the fastest-growing digital economies worldwide, and the COVID pandemic has only accelerated the adoption of digital technologies, both in business and in everyday life. India is a frontrunner in providing IT solutions and services globally, so its companies are



well-positioned to tap into this booming market. Technology-based segments like e-commerce, telecommunication, or ride hailing are equally expanding in India and the ASEAN countries, which provide opportunities for more cooperation between emerging start-ups in the region. The [India-Singapore Entrepreneurship Bridge](#) is a good example for this, as the digital platform aims to inspire the entrepreneurs of both countries to connect with each other.

Healthcare is increasingly in the focus of ASEAN governmental policies, and the COVID pandemic has further amplified this trend. As a global leader in the production of vaccines and generic drugs, India seems to be a natural partner for Southeast Asia in this field. [India has already offered cooperation](#) in the manufacturing of generic drugs, medical technology, and vaccines. [As declared by the Indonesian President](#), joint actions may include diversifying the manufacturing locations of medical products, increasing drug and vaccine production, cooperating in research and development, building industry clusters, and improving the regional logistics in the pharma industry.

People-to-people connections could play a major role in fulfilling the potential in the above-mentioned economic segments. Singapore, Malaysia, and Indonesia are home to a large Indian diaspora that could be a platform for stronger ties, [as the external affairs minister of India has pointed out](#). In addition, the number of Indian tourists visiting the ASEAN [countries almost doubled between 2011 and 2019](#), which trend was only interrupted by the COVID lockdown in 2020.

CONCLUSIONS

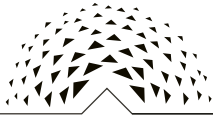
Regarding their economies, India and the ASEAN region have a lot in common. They share similarities in the level of economic development, they are home to fast-growing markets, and tackling the infrastructure deficit is high on the agenda in both regions. In terms of nominal GDP, India is already the sixth largest economy in the world, and it has every chance to make the top three by the mid-2030s. As for Southeast Asia, it is a core interest of the region to cut off economic overdependence on China and avoid taking sides in its rivalry with the US at the same time. Based on that, one would expect that building economic relations with India is considered to be an escape route in capitals throughout Southeast Asia. However, reality is quite different. [The latest annual survey of the Singapore-based ISEAS-Yusof Ishak Institute](#) reflects a lukewarm attitude of policymakers and thought-leaders in the ASEAN region regarding relations with India. Only 0.1% of respondents marked India as a country that is the most influential economic power in Southeast Asia. It is even more meaningful that this ratio has not changed since 2019. Furthermore, only 5.1% of respondents would select India as a strategic partner to hedge against the uncertainties of the US-China rivalry. And finally, 47.8% of the respondents had a high level of distrust towards India.

All these perceptions point out that India's significance as an economic partner for the ASEAN region is very far from reflecting the sheer size of its economy. The main arguments of this policy brief have shed some light on the reasons behind this. First, in terms of trade, the FTA has resulted in a diversification of the India–ASEAN trade flows by country, but both regions have failed to increase their share substantially in the other's overall trade volume. The missed opportunity is even more pronounced when compared with the growing weight of China in both India's and the ASEAN's trade flows. Considering the fact that India has opted out of joining RCEP, and it is not part of CPTPP either, it is highly unlikely that the country could substantially improve its weight among the major trade partners of the ASEAN nations in Asia. Services may promise the enhancement of trade relations, particularly on the Indian export side, although this is a bumpy road considering the regulatory environment and the international competition.

Second, investment relations show a pattern that is even more difficult to be modified substantially. Based on the statistics cited above, currently the India–ASEAN FDI relationship is mostly limited to investment flows between India, Singapore, and global companies located in the city-state. This one-sided pattern is unlikely to change dramatically in the middle run due to some crucial pull-back factors, despite the Indian government's campaign to encourage domestic manufacturing activity. The reason behind this is that India and most ASEAN countries have similarities in their value propositions as FDI locations, which means that the opportunities for creating India-Southeast Asia value chains are quite limited. Nevertheless, lead firms and emerging unicorn start-ups in both regions may pave the road for their domestic counterparts to locate more investments at the other.

Third, India's significance as an economic partner still cannot be compared to that of China or Japan in Southeast Asia due to its limited role in developing physical connectivity in the region. The handful of projects with India's participation that have already been launched are progressing very slowly. Considering the overwhelming demand for infrastructure development in Southeast Asia, the actor that can address this need could enhance its influence in the region substantially. China's Belt and Road Initiative (BRI) is good proof for this, while it is also quite meaningful that the US and its allies make every effort to launch their own regional initiatives in this regard. India itself is in desperate need for infrastructure development and related financing, therefore the country is mostly on the recipient side of official development aids (ODA), together with most ASEAN nations. On the contrary, China, Japan, and even South Korea are major providers of ODA for the region, which usually paves the way for their companies to develop business in the recipient countries.

Fourth, Southeast Asia is increasingly becoming a scene of the US-China rivalry, and their Big Tech is well positioned to cover most of the rapidly growing digital market of the region. This may limit the business opportunities of large



Indian tech companies, while on the other hand Indian IT can be a solution for Southeast Asian actors who want to avoid being drawn into the technology orbit of either the US or China.

In terms of strategic cooperation, India and the ASEAN region are close partners, but this partnership could not be translated into a real breakthrough in economic relations so far, and the obstacles to future success seem to be substantial. It remains to be seen whether the ASEAN-India Friendship Year in 2022 will bring new efforts to tackle them.