

India - ASEAN Economic Engagement and its Impact on Indian Economy

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In the aftermath of the economic crisis of 1991, the need for urgent economic reforms became imperative, to restore confidence in India and rebuild the economy. This was met by extensive reform measures, initiated by the then Prime Minister P.V. Narasimha Rao and the then Finance Minister Manmohan Singh. While the economy started to reshape itself, further steps were taken, one of which came to be known as the “Look East Policy” or LEP. With this policy, India set on path towards greater economic interaction with Eastern and Southeast Asian countries.

The relationship between the East and the Indian subcontinent is deep rooted and it can be traced back to many centuries. However, there is no doubt that these relationships have gained immense importance in the age of globalisation wherein countries and regions are not only intertwined and interdependent but also interconnected to such a large extent that they influence every aspect of the nation.

A major event, which gave a thrust to greater regionalism in Asia, was the Asian Financial Crisis of 1997. As the East Asian region reconstructed its economy after the crisis, it recognised the need for greater economic integration and cooperation to face the challenges posed by globalisation and to boost its economy.¹ It was argued that in an era where each country 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”.² From there began the India-ASEAN³ relationship, which has been evolving since.

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History and Evolution of the India-ASEAN Relations

After its Independence in 1947, India followed a policy of Non-Aligned Movement (NAM) and became a champion of decolonisation, including in Southeast Asia. However, during the 1970s, India's perceived tilt towards the Soviet Union led Southeast Asia to drift away from India as both followed different economic and political ideologies.⁴ However, circumstances changed by early 1990s and bilateral cooperation began with the ASEAN in the economic sphere. India was accorded full ASEAN Dialogue Partner Status in 1995, followed by its membership in the ASEAN Regional Forum. The India-ASEAN Relations soon broadened its cooperation into political as well as security arenas. India also joined the East Asian Summit (EAS) in 2005.

One of the major consequences of India's engagement with ASEAN has been the ASEAN-India Free Trade Agreement (AIFTA), which was seen as an essential step towards deeper economic integration. Its initial framework was signed on 8 October 2003 in Bali, Indonesia and the final agreement was signed on 13 August 2009, coming into effect from 1 January 2010.

The AIFTA classifies the tariff lines into the following four broad heads (as in 2009):

1. Normal Track - Wherein applied MFN rates would be reduced and subsequently eliminated, which is further subdivided into two tracks with different implementation periods, i.e. NT-1 till 2018 and NT-2 till 2021. Meat, edible fruits and nuts, cinnamon, wheat bran, spices, electrical equipment, etc. are a few examples of products included in this list.
2. Sensitive Track - For the first stage implementation, applied MFN rates above 5 per cent would be reduced to 5 per cent as per country specific reduction schedules. Products like organic chemicals, plastic products, rubber products, machinery and electrical machineries, textiles and footwear, etc. are included in this list.⁵
3. Special Products – These are products on which India decided to reduce tariff rates at a more gradual pace than the normal or sensitive track. These include India's crude and refined palm oil, coffee, black tea and pepper.
4. Exclusion List - No reduction commitments have been made. However, the list would be subjected to an annual tariff review in order to improve market access. The products excluded by India are mainly agricultural products, textiles, iron and steel, automotive, and ceramic tiles. This involves 1,298 tariff lines.⁶

The AIFTA

Ever since the discussion on signing the AIFTA agreement began, scholars, economists and strategists have been debating whether an ASEAN-India FTA is equally economically beneficial for India as it is for the ASEAN; or would one side benefit more at the cost of the other. The AIFTA has been considered a “major foray by India into a formidable regional trade block”.⁷

It was believed by some scholars in 2005 that if FTAs were pursued too vigorously it could end up increasing the transaction costs and reducing the allocation efficiency due to net trade diversion. Therefore, it was stated that multilateral liberalisation through WTO was the best option, particularly for Asia.⁸ It was also felt that an FTA would make issues such as employment and livelihood in India even more challenging with more competition in the domestic market.

Nonetheless, the Trade in Goods (TIG) agreement was signed in 2009 and its main target was trade liberalisation, and elimination and reduction of tariffs on various tariff lines. However, the agreement gave the provision to India and the ASEAN to exclude some of the products from the tariff concessions or eliminations. India’s access to the ASEAN market was seen optimistically as it was believed that this market would prove beneficial to Indian business and industry. However, from the very beginning there was scepticism regarding the FTA’s effect on certain industries such as the plantation sector, the marine products industry and the light manufacturing industries.⁹

The initial apprehensions of India were that as the ASEAN countries were more competitive in sectors like agriculture, textiles, auto and auto components, and electronics, India might face negative consequences in these sectors and the AIFTA agreement would favour the ASEAN countries more.¹⁰ Sikdar and Nag (2011) predicted that India would experience a 1.07 per cent fall in GDP and a 58.6 per cent fall in employment.¹¹ According to scholars like Parthapratim Pal and Mitali Dasgupta, India was likely to gain and not lose because of cheaper availability of intermediate goods from the ASEAN.¹² However, such trends have not occurred yet. Food and agriculture related products as well as intermediate and light industry goods were seen likely to suffer in future because of this agreement. Some of the reasons, which led to reservations regarding the FTA, were:

- India already had a trade deficit with the ASEAN. In 2007–08, India had a trade deficit of more than \$6 billion with the ASEAN.¹³

- The ASEAN countries were more dependent on trade than India. No major immediate market access benefits were seen to be forthcoming for Indian producers.
- India already had trade agreements with major markets of the ASEAN like Singapore and Thailand

However, with the efforts of the government and the reassurance given to the public on the protection of domestic industries, the FTA was carried forward. Soon scholars and analysts began focusing on how to make AIFTA more beneficial for the Indian economy, rather than criticising the step. Ambassador Rajiv Sikri and Prashanth Parameswaran stated that India needed to be more open about FTAs as it provided an “opportunity to reform agricultural and plantations sectors”¹⁴ and a protectionist policy by India would only impede deeper economic integration.¹⁵ Similarly, writing in 2010, Ranajoy Bhattacharyya and Avijit Mandal stated that the negative effects on goods would be outweighed by the positive effects emanating from other fronts like trade in services and FDI to and from these countries.¹⁶ Sikdar and Nag (2011) also noted that India’s trade gains would be the highest under full liberalisation.

It was believed that the success of the FTA would critically depend on the existence of good institutions and an efficient regulatory environment, which would enable the benefits of such an agreement to spread throughout the country.¹⁷ The competitiveness that the FTA would usher in would be an instrument to improve and enhance domestic industries. Such views have led to a transformation in the way the AIFTA is looked at, along with its impact on India.

There onwards the doors to discussions on further integration opened, which finally concluded in the services agreement that was signed on 9 September 2014 between India and the ASEAN. Additional 24 categories of services would be open this year to advance ASEAN investment under the ASEAN Framework Agreement on Services (AFAS), which aims to reduce investment barriers in the service sector.

Contemporary Discourse on the ASEAN-India Free Trade in Goods and Services

Despite the apprehensions and reservations, India did continue with its AIFTA agreement and moreover, has extended and elaborated the range of bilateral FTAs with the ASEAN members. As enough time has not yet elapsed since its

implementation, conclusive analysis of its current impact on India has not been done. Nonetheless, scholars and economists continue to weigh and debate the pros and cons of FTA for India. In 2012, the ASEAN's exports were valued at \$43.84 billion and imports from India amounted to \$27.72 billion. The target has been set at \$100 billion by 2015 for the India-ASEAN trade.¹⁸ This imbalance in trade is a cause of worry to Indian planners.

Nevertheless, among ASEAN+FTAs, the AIFTA is still regarded as the FTA's lowest level liberalisation.¹⁹ The India-ASEAN FTA, at present, primarily focuses on merchandise items. Nilanjan Banik (2014) believes that India has huge potential to participate in the "ASEAN production network system".²⁰ He singles out areas such as energy where India needs assistance from Myanmar; whereas Indonesia offers an investment opportunity for oil and natural gas exploration. However, in order for India to optimally utilise the FTA, it needs to bring about systematic changes in making the country investment and business friendly, create a predictable and supportive policy environment, have infrastructural development, bring about labour market reforms, etc. It can be said that with PM Narendra Modi, steps towards such reforms have been initiated, and hence, whether this positively affects the AIFTA or not can be seen in the near future.

A report by the Standard Chartered Bank states that India appears to have a clear comparative advantage in exports of products like chemicals and pharmaceuticals, gems and jewellery, and iron and steel. On the other hand, the ASEAN appears to have an advantage in natural resources (edible oil, rubber, wood) and electrical machinery.²¹

Areas of competition as far as India is concerned, as per the report, include petroleum products, apparel, vehicles, and mechanical items. In apparel, India's main competitor within the ASEAN is Vietnam while in autos it is Thailand.²² Across these items, India's relative cost-competitiveness is likely to be a structural advantage versus the ASEAN economies and this is substantiated by the fact that India's working-age population is likely to peak later than that in the ASEAN countries, indicating that wage costs are likely to remain lower for a longer period.

Asher and Sen (2005) had indicated that India would need to be more proficient at "strategic economic diplomacy" and at "soft power skills"; whereas East Asia will need to shed its "cold war mindset" and its insularity in order for both to take advantage of the win-win opportunities.²³ Furthermore, India's growth strategy based on the strong and increasingly globally competitive and networked domestic companies could provide a balance for both, high

trade, and FDI-dependent East Asian economies. Hidayat (2013) indicates the importance of addressing the issue of capacity building for Small Medium Enterprises (SMEs), which would prove to be fundamental for inclusive growth; this has been noted as an issue of concern for many especially with regard to India.²⁴

As exports to the ASEAN are believed to be growing fast as indicated by the Standard Chartered Report, the importance of the region for India would only increase in the near future. It can be said that as far as India is concerned there is still a lot of scope of improvement within India for it to be able to take complete advantage and reap the benefits of such agreements. Strengthening India's own economic institutions and creating a new environment of "Make in India" would play a vital role for Indian economy, domestically as well as internationally.

In the case of services, Banik sees a comparative advantage for India in contrast to the disadvantages India is likely to have through free trade agreement in the manufacturing and agriculture sector. He believes that service liberalisation should be encouraged, as welfare gains such as employment and higher growth are likely to be more than trade liberalisation. However, for the services sectors, India needs stable regulatory bodies, which would assure quality and smooth flow of services.

India has been taking steps for improved integration with the ASEAN. At a policy level, India is drafting a five-year plan of action starting 2016 to take the trajectories of common interests with the ASEAN to a new level, particularly emphasising improvement of connectivity in the region to further boost trade and people-to-people contact.²⁵ Expectations from the ASEAN Free Agreement on Services are high and it is hoped that it would boost the benefits from the present ASEAN-India FTA.

The World Trade Report 2013 estimates that the share of services trade will rise substantially by 2035. Thus, the ongoing discussions regarding the AIFTA are likely to boost the trade, particularly in the field of IT services. India would immensely benefit from services agreement as it is seen to have a surplus in service trade. Therefore, Philippines initially showed concerns about its own service industry, as it believed that opening up the service sector would have adverse effects on Philippines given India's strength in the same.

However, evidence from other countries regarding the benefits to India from the services agreement is not very encouraging. As India already has similar agreements with Japan and Korea under the Comprehensive Economic

Partnership Agreement (CEPA), no significant results have been evident in transfer of human resources or services from India to these countries. However, it is too soon to assess the impact of the services agreement with the ASEAN.

Conclusion

The AIFTA and the Agreement on services have been undergoing a strict scrutiny since their inception. By 2050, Asia is expected to account for more than half of trade, investment and world GDP, as per the Asian Development Bank estimation. Therefore, this region is of immense importance for India's foreign trade.

Whereas views on the AIFTA's impact on the Indian economy vary, it is difficult to pass a judgment yet, as enough time to clearly see the impact backed by statistical data has not yet lapsed. As the ASEAN and India move at a fast pace towards further integration, it might be wise for India to adopt a gradualist approach in order to be able to better understand the repercussions. In the case of the services agreement, the opinion of the experts seems largely to be in favour. It is believed that the young Indian population would be an asset propelling deeper and better integration with the South East Asian region as India holds the regional competitive advantage in services. Nevertheless, how the agreement is implemented and what the ground reality turns out to be cannot be assessed until the agreement is operationalised and trends are visible to support the prediction. Examples of countries like Japan and South Korea have been cited to prove that the services agreement does not automatically result in easy access to countries for Indian professionals and service providers.

As far as the AIFTA is concerned, even though it was initially criticised by many scholars there is also a group of economists that feels that the AIFTA could compel the Indian economy to perform better under pressure. Prime Minister Narendra Modi recently highlighted the need to review the existing FTA with the ASEAN in order to make it more balanced and beneficial for all, while simultaneously urging for the FTA on services and investment to be implemented at the earliest.²⁶ Narendra Modi's "Act East" policy is believed to further enhance cooperation and engagement with the ASEAN.

Regional connectivity will also play a major role in the process of integration and two crucial projects underway are the India-Myanmar-Thailand Trilateral Highway (IMTTH) and the Mekong-India Economic Corridor (MIEC). It has been estimated that the cumulative impact of these on the GDP would be over

5 per cent for Cambodia, Myanmar, Thailand and Vietnam and over 2.5 per cent for India, between 2010 and 2030.²⁷

Thus, whether India can have an overall comparative advantage in trade in the region as a whole is questionable. However, what could be focused upon are the benefits, which India could gain from the regional integration as the ASEAN and India become significant players in shaping the regional trading architecture. How these agreements have an impact on the Indian economy in the near future would largely be dependent on India itself and its preparations to be able to optimally make use of the opportunities presented to it. India probably needs to be more cautious before deciding to further liberalise the current AIFTA, i.e. including more products in the Normal Track list, which seems to be the eventual aim. Domestic implications of such measures need to be taken into account rather than merely following the decided time frames on liberalisation of various products. Meanwhile India must put in efforts to strengthen domestic industries as well as economic institutions so they are better equipped to meet the future challenges of liberalisation; this should also be a simultaneous process. It may be said that such an approach fits in very well with the “Make in India” campaign of the present government. Such steps could help India realise the full potential of its economic agreements with the ASEAN.

Notes

¹ Mukul G. Asher and Rahul Sen, “India-East Asia Integration: A Win-Win for Asia”, *Economic and Political Weekly*, Vol. 40, No. 36, (Sep 3–9, 2005), p. 3932.

² Ibid. p. 3934.

³ Association of Southeast Asian Nations.

⁴ Prashanth Parameswara, “Strengthening ASEAN- India Relations in the 21st Century”, in The Project 2049 Institute, (May 27, 2010), p.1, see <http://project2049.net/documents/strengthening_asean_india_relations_21st_century_parameswaran.pdf>.

⁵ Smitha Francis, “The ASEAN-India Free Trade Agreement: A Sectoral Impact Analysis of Increased Trade Integration in Goods”, *Economic and Political Weekly*, Vol. 26, No. 2, January 8–14, 2011, p. 10.

⁶ Questions on AIFTA, MITI, Malaysia website, see <http://www.miti.gov.my/cms/content.jsp?id=com.tms.cms.article.Article_7894e31b-c0a8156f-44f544f5-c48814e4>.

⁷ Parthapratim Pal and Mitali Dasgupta, “The ASEAN-India Free Trade Agreement: An Assessment”, *Economic and Political Weekly*, Vol. 44, No. 38, (Sep 19–25, 2009), p. 11.

⁸ Asher and Sen, p. 3936.

- ⁹ Pal and Dasgupta. p. 11.
- ¹⁰ Ibid. p.13.
- ¹¹ Chandrima Sikdar and Biswajit Nag, “Impact of India-ASEAN Free Trade Agreement: A Cross Country Analysis Using Applied General Equilibrium Modeling”, Asia Pacific Research and Network on Trade, Working Paper Series, No. 107, November 2011, p. 15.
- ¹² Ibid. p. 14
- ¹³ Pal and Dasgupta. p. 13.
- ¹⁴ “India’s Look East Policy: A Critical Assessment, Interview with Ambassador Rajiv Sikri” in *IPCS Special Report* , p. 8.
- ¹⁵ Parameswaran, p. 5.
- ¹⁶ Ranajoy Bhattacharyya and Avijit Mandal, “Estimating the Impact of the Indo-ASEAN Free Trade Agreement on India’s Balance of Trade”, *Journal of Global Analysis* , Vol. 1, Issue 1, (January 11, 2010), p. 14.
- ¹⁷ “India ASEAN Free Trade Agreement, Implications for India’s Economy”, A Deloitte-FICCI White Paper, March 2011.
- ¹⁸ Nilanjan Banik, “India-ASEAN Free Trade Agreement: The Untapped Potential”, MPRA Paper No. 57954, posted August 18, 2014.
- ¹⁹ Agus Syarip Hidayat, “ASEAN-India FTA and Design of Future Regional Trading Architecture”, Dynamics of ASEAN-India Strategic Partnership.
- ²⁰ Banik, p. 5.
- ²¹ Radhika Kak, “India – Unleashing the ASEAN Opportunity”, Standard Chartered Global Research, August 21, 2014, p. 2.
- ²² Kak. p. 2.
- ²³ Asher and Sen, p. 3939.
- ²⁴ Hidayat, p. 34.
- ²⁵ Banik, p. 14.
- ²⁶ Remarks by PM Modi at the 12th ASEAN Summit, Nay Pyi Taw, Myanmar on 12 November 2014.
- ²⁷ Kak, p.13.

