

The 40th Anniversary of Korea-India Amity: Evaluation and Prospects of the Trade Sector

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The year 2013 represents the 40th anniversary of the establishment of Korea-India diplomatic relations. This report is prepared to evaluate the achievements and the future challenges in Korea-India economic cooperation. The study analyzes trade relations using all available sources from the 1970s until today as the trade sector is the most influential among all sectors between Korea and India in terms of their bilateral economic cooperation.

Trend of Korea-India Trade Volume since the

Diplomatic Relations

At the time of the establishment of diplomatic relations in 1973, bilateral trade between Korea and India was inactive, with a total volume of approximately USD 14 million. However, trade volume has shown a gradual increase since the beginning of the 1991 economic reform including trade liberalization. Around the early 2000s, when India experienced vigorous economic growth, bilateral trade increased rapidly. Although trade declined by approximately 8% in 2012 following the recent recession in India, the upward trend in trade volume is expected to continue.

Table 1: Import, Export, and Trade Volume between Korea and India

(Unit: thousands in USD, %)

Year	Trade volume (sum of export & import)		Export		Import	
	Amount	Growth rate	Amount	Growth rate	Amount	Growth rate
1971	12,353	86.9	2,502	366.8	9,851	62.2
1980	226,588	33.2	172,951	99.0	53,637	-35.5
1990	717,996	-23.0	435,315	-35.5	282,681	9.8
1995	1,924,111	10.3	1,125,814	-2.9	798,297	36.6
2000	2,310,872	8.5	1,326,166	-2.7	984,706	28.2
2001	2,513,359	8.8	1,407,728	6.2	1,105,631	12.3
2002	2,633,044	4.8	1,384,137	-1.7	1,248,907	13.0
2003	4,085,697	55.2	2,852,952	106.1	1,232,745	-1.3
2004	5,481,960	34.2	3,631,978	27.3	1,849,982	50.1
2005	6,709,913	22.4	4,597,837	26.6	2,112,076	14.2
2006	9,173,586	36.7	5,532,797	20.3	3,640,789	72.4
2007	11,224,460	22.4	6,600,039	19.3	4,624,421	27.0
2008	15,558,304	38.6	8,977,063	36.0	6,581,241	42.3
2009	12,154,912	-21.9	8,013,290	-10.7	4,141,622	-37.1
2010	17,109,052	40.8	11,434,596	42.7	5,674,456	37.0
2011	20,547,651	20.1	12,654,078	10.7	7,893,573	39.1
2012	18,842,863	-8.3	11,922,037	-5.8	6,920,826	-12.3
2013	13,313,830	-6.9	8,620,911	-6.2	4,692,919	-8.1

Note: Values for 2013 are between January and September.

Source: Kita.com (accessed on October 16, 2013)

Forecasting of Korea-India Trade Volume in 2020

According to a prediction through time-series estimation (vector autoregressive and vector error correction models), trade volume will show a declining trend in 2013 but will increase in 2014, reaching about USD 27 billion in 2015 and then USD 56 billion in 2020. This estimate is lower than the past predictions of USD 34 billion by 2015 and USD 68 billion by 2020 because the reduced growth rate is taken into account following the economic

recession of both countries in 2011 and 2012.¹² Nevertheless, if both countries take actions to expedite tariff reduction by upgrading the Korea-India CEPA or by enacting additional reduction/removal of the countries'

¹ India's real growth rate was 8.6% in 2009 and 9.3% in 2010 but showed a decrease of 6.2% in 2011 and 5.0% in 2012. Korea's growth rate in 2012 was 2.0%, marking its lowest record since 2005 2009 (Source: CEIC Database).

² The prediction by Lee, Song, and Cho (2011, p. 15) stated an average growth of 14.5% between 1993 and 2010 without reflecting the two countries' recession between 2011 and 2012.

bound tariff rates, a greater degree of trade volume than what is predicted can certainly be achieved.

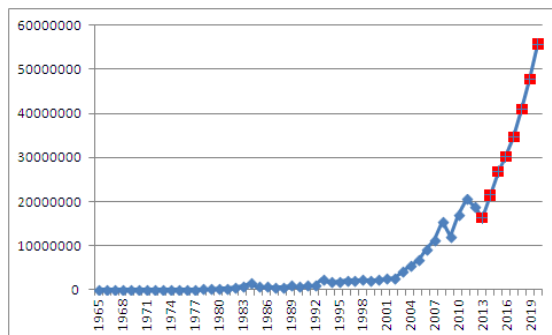
Table 2: Forecasted Trade Volume between Korea and India (2013–2020)

Year	Ln (Trade)	Trade (thousands in USD)
2013	16.6089	16,336,623.73
2014	16.8826	21,478,435.72
2015	17.1057	26,848,486.27
2016	17.2213	30,138,078.60
2017	17.3629	34,723,248.29
2018	17.5271	40,917,565.37
2019	17.6808	47,717,081.76
2020	17.8364	55,752,343.32

Note: Values in Ln (Trade) are in natural logarithm and the values are thousands in USD.

Source: The authors made the data with the data extracted from the CEIC database.

Figure 1: Trend of Trade Volume between Korea and India (actual and forecasted)



Note:

- 1) Trade volume = Export of Korea to India (FOB basis) + Import of Korea from India (CIF basis)
- 2) The values from 1965 to 2012 are actual (blue dots) and the values from 2013 to 2020 are forecasted (red squares).

Source: from 1965 to 2012 (CEIC Database); 2013 to 2020 (forecasted by the authors using VEC model).

Importance of the Indian Markets

This report emphasizes the importance of India because of the country's great potential. Between 2004 and 2006, when the Indian economy was at its peak, the share of consumer goods in Korea's export to India reached nearly 20% of the total export because of its brisk mobile phone exports. However, the share of consumer goods has rapidly dropped to below 5% between January and September in 2013. This is attributed to both the declining consumption in India caused by the recession and the lowered price competitiveness of Korean products.

Fortunately, the importance of the Indian consumption goods market is predicted to grow higher as the country's population is expected to exceed that of China with the blessing of demographic dividend, hitherto the world's most populous country sooner or later. It also contributes to the increased importance of the Indian market as Korean exports to China have been showing a downward trend since 2010 after experiencing more than a 20% annual growth on average in the past two decades. Therefore, Korean firms should maintain price competitiveness by differentiating their products to target the Indian market.

Necessity of Upgrading the Korea-India CEPA

Korea's imports from India have been affected by the implementation of the Korea-India CEPA. For instance, the tariff rate for naphtha, which accounts for more than half of the imports from India, had been 1% but was immediately removed after the Korea-India CEPA was implemented in 2010. Accordingly, Korea's import of naphtha from India increased to 34% and 51% in 2010 and 2011, respectively. This is one of the immediate benefits of India having signed an FTA with Korea,

which has a positive effect on both countries: production cost reduction in Korea and trade deficit mitigation in India. Thus, it is shown that both countries are mutual beneficiaries of the Korea-India CEPA.

The case of naphtha has well exemplified the relationship in terms of specialization of trade between Korea and India. Korea imports and refines raw materials like naphtha from India and exports petrochemical products. This could be considered a specialization based on the comparative advantage of each country. Discovering items in this type of relationship and eliminating related tariffs can lead to lowered costs for Korea and reduction of the trade deficit for India.

Moreover, as the revealed comparative advantage and market comparative advantage show, there are no overlapping items with high export competitiveness in each other's market and even in the global market. Therefore, firms and consumers of both countries should hereby benefit from mutual elimination of tariff and nontariff barriers.

Consequently, one of the most important issues in the economic cooperation between Korea and India is the resumption of the Korea-India CEPA upgrade negotiation. Korea will not be the only one to benefit from this but India will also obtain many benefits through the upgraded CEPA, which will broaden the range of tariff-free items and accelerate the reduction of existing bound tariff rates. As analyzed by Lee, Song, and Cho (p. 13),³ the wider the tariff reduction gap, the greater the decrease in India's trade deficit with Korea,

which means a potentially larger welfare effect for India. Because India is a beneficiary of the tariff elimination in the case of naphtha, India should be actively involved in the CEPA upgrade negotiation. If the tariff reduction/elimination through Korea-India CEPA upgrade is realized, the actual trade volume increase will be achieved, which could surpass USD 27 billion in 2015 as predicted by this study. In addition, it is very likely that the trade volume between Korea and India will jump above USD 60 billion, exceeding the predicted USD 56 billion in 2020.

However, the second Korea-India Joint Committee, which was scheduled in Seoul in 2012, has not yet convened and thus the negotiation to upgrade the Korea-India CEPA has been delayed. It is expected that when a new cabinet is formed after India's congress election in the first half of 2014, India will be able to engage with greater enthusiasm in negotiating Korea-India CEPA upgrade. Therefore, the Korean government needs to pay attention to the new administration of India after the election as well as to prepare adequate agendas and strategies for a successful negotiation on CEPA upgrade in the near future.

Appendix

In this report, the trade volume between Korea and India is forecasted using a Vector Error Correction (VEC) model. This study followed Keck, Raubold, and Trupia (2009) in forecasting with a little modification. Although they used the Vector Autoregressive (VAR) model, the VEC model was used instead because the variables adopted this study adopted turned out to be nonstationary but cointegrated.

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³ Woong Lee, Young Chul Song, and Choong Jae Cho (December 9, 2011), "Two Years On: Achievements and Challenges in Trade Sector of Korea-India CEPA, KIEP World Economic Update, Vol. 1, No. 3, Korea Institute for International Economic Policy.

Table 3: Johansen Cointegration Test

Number of Cointegrated Vectors	Trace Statistic	Critical Value (5%)
None*	39.8505	24.31
At most 1*	19.5237	12.53
At most 2	0.0035	3.84

Note:

- 1) Null hypothesis [H_0 : number of cointegrated vectors = n], alternative hypothesis [H_A : number of cointegrated vectors $\leq n + 1$]
- 2) "None" indicates the null hypothesis with no cointegrated vector and its alternative hypothesis of the number of cointegrated vector being less than or equal to 1.
- 3) In our case, the results reject the null hypothesis that the number of cointegrated vectors is at best 0 or 1 but they did not reject the null hypothesis that the number of cointegrated vectors is 2. Hence, the number of cointegrated vectors is 2.