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An Analysis on India's Foreign Economic Relations and Its Implications for Korea-India Cooperation

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I. Introduction

Economic exchanges between Korea and India have been expanding since the signing of the Korea-India CEPA, which took effect in 2010, and the promotion of the New Southern Policy (NSP) by Korea, but the level of exchange still remains insufficient considering the potential of the two countries.

India has achieved great results in lowering tariff rates and easing investment barriers by promoting full-fledged liberalization policies since 1991. In particular, investment barriers have been significantly lowered and automatic approval is now being implemented in most areas, reflecting the remarkable improvements made in the investment environment since the inauguration of the Modi government. But at the same time, India has continued to actively utilize non-tariff barriers such as anti-dumping measures, and has been showing a trend of raising tariff barriers since 2018 with the aim of establishing its economic self-reliance. In short, India has placed its focus on developing its own production base by attracting foreign investments. And in spite of steady liberalization, India's trade policy continues to lean towards the protection of domestic industries.

Against this background, we aim to contribute to deepening Korea-India trade cooperation by analyzing India's foreign trade investment relations. Part II and III examine India's recent trade and investment structure with major countries including Korea, and Part IV analyzes India's status on the global production networks. In conclusion, Part V presents various implications for Korea-India trade cooperation.

II. Goods Trade Structure of India

India has the highest share of intermediate goods in both exports and imports, with exports moving from developed countries to developing countries and imports from North America and Europe to Asia. It is noteworthy that the share of intermediate goods in imports is higher than that of raw materials, despite India's large imports of crude oil and mineral. Before the 2000s, India's exports were mainly labor-intensive industries such as precious metal and textile products manufacturing, but since then, it has been mostly made up of capital-intensive industries such as chemical product and petroleum refining manufacturing.

Considering the recent increase in the share of capital goods in trade, India is evaluated to be solidifying its position as a global production base through active trade of intermediate goods and capital goods.

However, the two pillars of India's trade have not changed much: crude oil is imported to export refined petroleum products, and diamonds and gold are imported to export precious metals. While India continues to pursue liberalization, it has tended to take a protectionist stance on imports, but at the same time has a chronic trade deficit with China, Korea, and Japan as well as the world. India's export partners are limited to the geographically adjacent Southwest Asia region. In other words, India's protectionist policy seems to be a factor limiting the advancement of India's trade structure and expansion of trade rather than reducing the trade deficit.

Table 1. India's Trade Intensity Index (TII)

Trading partners	2016	2017	2018	2019
Bhutan	40.99	35.99	34.75	39.23
Nepal	34.11	31.26	28.49	31.30
UAE	6.57	5.99	5.70	7.00
USA	0.93	0.90	0.91	1.03
China	1.04	0.97	0.96	0.92
Japan	0.56	0.52	0.56	0.57
Korea	**0.88**	**0.92**	**0.89**	**0.91**

Source: Author's calculations using the data from the UN COMTRADE.

Trade in goods between Korea and India expanded significantly in the 2000s, but has been growing at a rather slow pace since the Korea-India CEPA came into effect. India's largest export item to Korea was naphtha, regardless of whether or not the CEPA was in effect. Moreover, many of India's exports to Korea are easily affected by fluctuations in oil prices and raw material prices. On the other hand, India's imports from Korea are concentrated in the chemical, steel, machinery, and electronics industries, which is attributable not only to the impact of the CEPA but also to the increase in India's domestic demand due to the growth of the Indian economy.

Comparing the trade volume between Korea and India and the imports share by liberalization level before and after the agreement entered into force, the Korea-India CEPA seems to have had a greater impact on India's import market opening than Korea. However, this CEPA also had a positive effect on India in that it increased the diversity of imported items. Excluding crude oil and gold, major items recently imported from Korea to India account for a high proportion of India's imports from the world. Therefore, as the Korea-India CEPA remains in effect, it is highly likely that India's imports from Korea will expand. However, so far, Korea's exports to India have not increased significantly, as factors such as the expansion of China's exports to India, the enforcement of the Japan-India CEPA, and the Modi government's policy to pursue economic self-reliance have had an impact as well.

Table 2. Korea's Export Similarity Index (ESI) by Industry in the Indian Market (2019)

Industry	CHN	DEU	JPN	USA
Chemical	0.198	0.247	**0.346**	0.305
Basic metal	0.229	0.191	**0.323**	0.057
Machinery	0.445	0.470	**0.522**	0.422
Video/audio/communication equipment	0.355	0.343	0.335	**0.404**
Automobile	0.515	0.499	0.583	**0.615**

Source: Author's calculations using the data from the UN COMTRADE.

According to the analysis of export competitiveness, the level of competition between Korea and Japan is high in the chemical, basic metals, and machinery industries. And the most competitive sector between Korea and India's major trading partners was automobile manufacturing. In the case of video/audio/communication equipment manufacturing, as export items are simplified mainly for digital electronic integrated circuits (HS 854221), export competitiveness is decreasing.

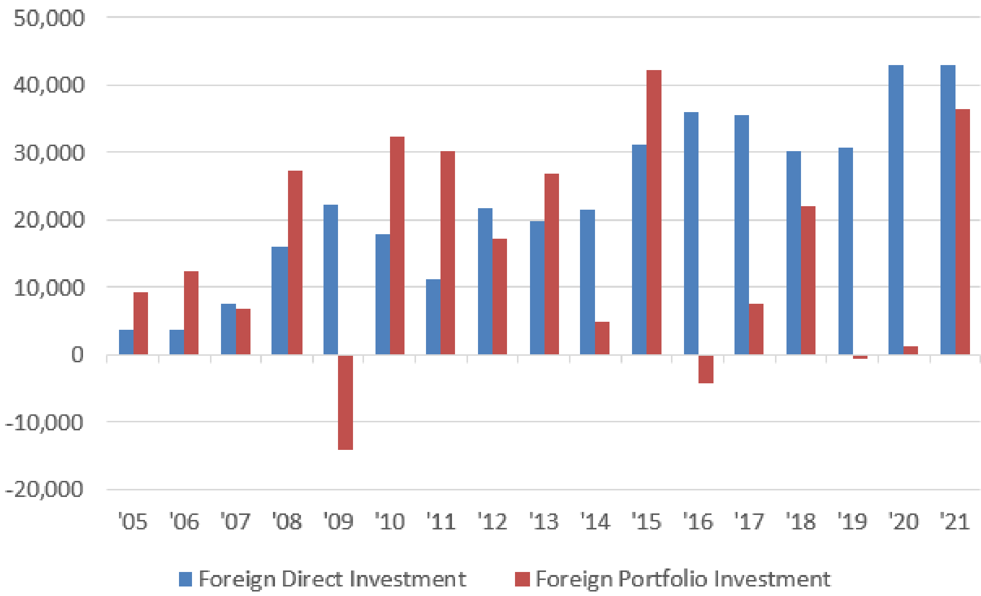
III. FDI and Service Trade of India

In recent years, India has grown rapidly as a major investment destination in the global market. In particular, even in 2020, when the global economy contracted significantly due to the spread of COVID-19, the global market paid attention to India's growth as it recorded a significant increase in FDI inflows along with China. Major countries investing in India are Mauritius, Singapore, the United States, and Netherlands. Also, in recent years, FDI investment in India showed a notable increase in brownfield investment over greenfield.

The US is actively investing in India with a focus on IT and digital services, whereas ASEAN, the largest foreign direct investment entity of India, has increased its investment in India in recent years, focusing on services, trade, and computer software and hardware. Since around 2018, EU has been investing in India with a focus on services, chemicals, and automobiles, while China has been aggressively investing in future industries such as Indian startups since around 2015.

Figure 1. India's FDI & FPI Inflows

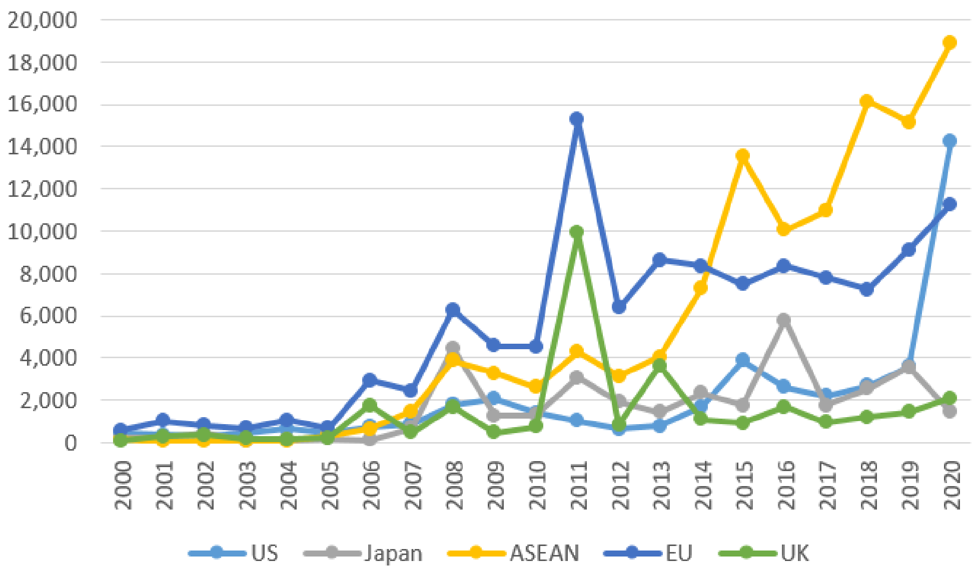
(Unit: million USD)



Source: Author's calculation using RBI and CEIC database.

Figure 2. India's FDI Inflows from Major Countries

(Unit: million USD)



Source: Author's calculation using DPIP and CEIC database.

Korea's FDI to India started in earnest with the entry of Korean manufacturing companies into India in the 1990s, and increased further with the commencement of the Korea-India CEPA in 2010. Compared to the US, UK, and Japan, Korea's FDI to India is highly concentrated in the manufacturing sector and in greenfield investment, that is to say, its investment fields are standardized and limited.

India, which recorded $270 billion in total service trade in 2019, has continued to record a service surplus over the past decade. India's major service export sectors are information and communications, transportation, and tourism, while imports include tourism, transportation.

Service trade between Korea and India totaled $6.22 billion in 2019, and India's exports and imports of services to Korea increased by 26% and 29%, respectively, from 2015 to 2019. As for India's service imports from Korea, transport and transportation accounted for 34.6% of the total, while tourism and communication and information sectors had a relatively low share.

IV. Global Value Chain Structure of India

The analysis of the previous section shows that India's FDI inflows and trade have expanded significantly in recent years. This trend implies that India's production chain has become more complex towards many countries, especially in manufacturing sectors. Recognizing this state of affairs, we analyze the structure of the global value chain of India based on World Input Output Tables. When looking at the trend of production contribution between India and other countries, the United States, China, Germany, Japan, Indonesia, Vietnam, and Korea show high connection. Accordingly, our analysis is focused on these seven countries.

Table 3. India's Contribution to Foreign Production, by Country (2009-2019)

(Unit: Million USD, %)

2009				2019			
Rank	Country	Contribution	Share	Rank	Country	Contribution	Share
1	China	88,544.7	16.8	1	United States	103,056.2	11.6
2	United States	39,450.8	7.5	2	China	92,072.2	10.4
3	Singapore	22,667.9	4.3	3	Germany	30,069.2	3.4
4	Japan	14,308.8	2.7	4	Singapore	27,089.6	3.1
5	Germany	13,401.3	2.5	5	Korea	23,913.5	2.7
6	Korea	13,011.7	2.5	6	Japan	21,033.9	2.4
7	U.K	11,522.4	2.2	7	Turkey	20,298.1	2.3
8	France	9,603.7	1.8	8	France	19,505.0	2.2
9	Italy	8,278.0	1.6	9	U.K	18,633.1	2.1
10	Brazil	7,264.7	1.4	10	Italy	17,827.5	2.0
	Other	298,828.3	56.7		Other	511,796.6	57.8
	Total	526,882.3	100.0		Total	885,295.1	100.0

Source: Author's calculations using the data from ADB-MRIO.

When we look at the intermediate goods trade, India shows an increase in exports of manufacturing intermediate goods to the United States, Germany, and Indonesia, while its exports of agricultural and mining intermediate goods to the United States and Germany increased as well. Specifically, India's exports of coke oil refining to the United States and exports of automobile transportation manufacturing to Germany and Indonesia increased.

When it comes to India's exports towards China, Japan, Vietnam, and Korea, India showed an increase in final goods exports to China, Japan, Vietnam, and Korea, especially in the agriculture/mining and manufacturing sectors. Specifically, India's oil refining exports increased to all four countries, and textile and clothing manufacturing final goods exports toward China, groceries, beverages, tobacco manufacturing final goods export towards Japan, primary metal manufacturing, chemical manufacturing export towards Vietnam, and transportation and chemical manufacturing export towards Korea has increased.

Meanwhile, all seven countries show an increase in intermediate goods exports to India. China's intermediate goods exports towards India increased mainly in the manufacturing industry, while the intermediate exports of the United States, Germany, Japan, Indonesia, Vietnam, and Korea have increased in agricultural/mining and business/personal services sectors in addition to manufacturing. Most of these countries have increased their supplies of intermediate goods in automobile transportation and primary metal manufacturing towards India, while Korea has increased intermediate goods exports in the chemical manufacturing industry.

Looking at the trends in exports and production contributions by India and major countries, India's contribution to production and exports to the manufacturing industries of Germany and the United States is increasing. In particular, India's chemical manufacturing industry has increased its contribution to exports of chemical manufacturing in the United States and Germany. In terms of production, India's rental and business support services have improved support for the production of rental and business support services in the United States and Germany.

All in all, the analysis reveals that India's global production network is linked to various countries and differs by country and industry. The characteristics of the overall change in the global value chain between India and major countries are summarized as follows. First of all, India's recent global value chain shows increasing connection with ASEAN countries such as Vietnam and Indonesia. India has increased imports of intermediate goods from both India and Vietnam. This increase in the connection between India and ASEAN in the global value chain is based on the New East Policy, which is India's regional policy towards Asian countries. In addition, an increasing share of India's imports from major countries consists of intermediate goods. This can be attributed to India's policy on domestic production and tariffs, which aims to increase domestic production.

V. Implications for Korea-India Cooperation

Korea and India are excellent cooperative partners, especially in the manufacturing sector, meeting each other's needs. Korea has the ability to invest in key manufacturing industries that India seeks to foster, such as electrical/electronics and automobiles. Meanwhile, India continues to conduct active trade in intermediate goods while exhibiting a strong will to foster its manufacturing sector. Moreover, India needs a partner that can alleviate its excessive economic dependence on China, all of which is likely to expand Korea's opportunities.

In the process of bolstering its production network with India, Korea should keep in mind its connection with Southeast Asia. From a strategic point of view, Korea needs to minimize the risks associated with US-China conflict by streamlining investment deployment, making it is necessary to expand the existing Korea-ASEAN production network to India. As found in this study, India has recently been trying to reinforce production connections with Southeast Asia. This could offer opportunities for Korea to establish a three-nation production network by expanding production and exports of final goods in India using Vietnamese intermediate goods. Developing these links in the mid to long term can further boost Korean companies' trade and investment in the New Southern Region, which could also lead to expansion of India's participation in the global production network.

Considering this potential, Korea and India should break away from the trade imbalance issue and take the view of expanding and strengthening the bilateral economic cooperation relationship. According to the findings of this study, the Korea-India CEPA is not a direct cause of the trade imbalance between the two countries, but could instead be a result of failure to fully reflect the characteristics and potential of the bilateral trade structure. Given this fact, the two countries should shift to a forward-looking perspective to further expand liberalization through further negotiations to improve the CEPA.

Meanwhile, Korea should actively consider diversifying its investment in India in addition to manufacturing. This study shows that Korea's investment in India is biased toward manufacturing compared to major countries, and competition with Germany, Japan, and China is likely to intensify. It is worth noting that investment in India from major countries has been increasing recently, mainly in services, computer software/hardware, renewable energy, communication, and infrastructure. And in terms of investment methods, it is recommended to actively consider brownfield investment. According to this study, while Korea's investment in India has been concentrated in greenfield investment, most of the major countries have a very high proportion of brownfield investment. These investment fields are where India's demand is increasing, and companies in major countries are enjoying a rapid first-mover effect through brownfield investment.

Korea is currently in dialogue with India's trade authorities, focusing on improvements of the Korea-India CEPA and India's trade relief measures with Korea, but these efforts seem insufficient to broaden its understanding of the potential for cooperation. Therefore, the country should establish regular trade policy dialogue channels with India to broadly understand each other's core policies, raise immediate issues, and continuously discover possibilities for cooperation. In addition, the Korea-India CEPA must be upgraded into a comprehensive platform for economic cooperation by including areas such as infrastructure, energy, and digital industries, which India is currently focusing its efforts on.

As well as the intergovernmental trade policy dialogue channel, a joint initiative should be pursued between Korea and India as a trade and investment support channel in which various economic actors, including Korean and Indian companies, governments and institutions, can participate. The Korea-India joint initiative would serve as a comprehensive platform for bilateral cooperation, which can be used as a window to specifically identify the immediate needs of the two countries, match companies, and directly communicate difficulties in business activities with the Indian government. It is also necessary to create a Korea-India cooperation fund in connection with this joint initiative. This should be utilized to further encourage projects and research across almost all fields related to bilateral cooperation. More specifically, this fund can support business matching projects between companies in both countries, and could help companies related to the CEPA and support joint research to revitalize trade investment.

When cooperating with India, it is critical for Korea to prioritize investment that meets India's needs. This is because India prefers partners that solve its needs through investment rather than unilateral expansion of exports. In other words, it would be feasible for the Korean government to preemptively present the investment projects that India needs in terms of economic policy and receive support from the Indian government. One such example is the India-Japan Investment and Trade Promotion and Asia-Pacific Economic Integration Action Plan agreed upon by Japan and India in 2015. At the time, Japan suggested expanding investment in India and inviting Japanese companies into the market, focusing on major projects, based on which India provided Japanese companies with trade investment benefits. In order to proceed with such large-scale projects, not only corporate investment but also government support in the form of ODA, etc., must play an important role. KIEP