FORTY YEARS OF KOREA-INDIA DIPLOMATIC RELATIONS AND ECONOMIC COOPERATION[1]

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Abstract

2013 marks the 40th anniversary of diplomatic relations between the Republic of Korea (ROK) and India. This relationship, based primarily on economic cooperation, has slowed down since the 2000s in contrast to other East Asian countries and India. In particular, FDI from Korea to India has been losing its vigor, and now is the time to find a new breakthrough. This article covers the economic cooperation between Korea and India in the aspects of trade, FDI and FTA. Support policies for mergers and acquisitions (M&A), finance and infrastructure, in addition to Korea-India CEPA upgrade negations, are needed. Above all, Korea-India summits should be regularized.

Introduction

Since the eruption of the U.S. financial crisis in the second half of 2008, which led to the fiscal crisis of Europe, the global economic slowdown has continued. In 2012, India and Korea recorded their lowest growth rates for the past decade. It is in this environment that Korea and India are celebrating the 40th anniversary of the establishment of diplomatic ties in 2013.

In the meantime, Korea and India have raised their relationship to a strategic partnership and launched an FTA between them, the Korea-India Comprehensive Economic Partnership Agreement (CEPA). At the same time, trade and FDI between the two countries have also consistently increased, making Korea and India very important partners for economic cooperation. Despite many achievements, however, the two countries will face more challenges in the next 40 years.

Status of Economic Cooperation

Trade

Diplomatic relations between Korea and India were established in 1973, followed by a trade agreement in 1974, yet the trade volume between them was imperceptible. Throughout the 1980s, the annual trade amount did not reach beyond $900 million and the growth rate of trade between the two countries in the 1980s was only 11 percent, smaller than Korea's growth rate of total trade in the same period, 13 percent. The two countries' trade volume began exceeding $2 billion in 1993, the year in which Prime Minister Narasima Rao of India visited Korea and had a summit talk for the first time in 20 years. Even after this, trade between the two countries experienced a short slowdown, but for the 1990s in general, its growth rate marked 14 percent, which was higher than Korea's growth rate of total trade of 8 percent.

The dramatic surge of trade between the two countries started in the 2000s. Trade volume, which had been about $2.3 billion in 2000 increased to $11.2 billion in 2007 and set a record of $20.6 billion in 2011. During this time, the annual average of Korea-India trade growth rate was 24 percent, which was double the annual average growth rate of Korea's total trade of 12 percent. As a result Korea's trade position increased from 17th in 2000 to 13th in 2012 (Table 1).

The main factor leading to the rapid increase of trade with India since the 2000s is a significant rise in India's trade demand. Since 2005, the Indian economy enjoyed an unprecedented boom achieving over 9 percent growth rate for three years in a row. Accordingly, the trade volume of India grew very sharply from $100 billion in 2002 to surpassing $500 billion in 2010. This is much faster than the duration taken for Korea and China to surpass the trade volume of $100 and $500 billion, 17 and 13 years respectively.

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Since beginning trade relations with India, Korea has maintained a trade surplus. In 2012, despite the volume of trade decreasing by 8.3 percent to $18.8 billion because of the two countries' economies slowing, Korea's trade surplus continued to grow.

On the other hand, the competition for export share in the Indian import market has gradually intensified. In particular, there is a high potential that the competition between Japan and Korea will escalate. For the last decade through 2011, the Japanese share in the Indian import market experienced a gradual decrease from 3.7 to 2.4 percent. The export growth rate of Japan, however, has stayed higher than that of Korea since 2007. Korea's share in the Indian import market increased from 2.2 to 2.7 percent in the same time period, but with a 3.1 percent in 2009 as its peak, it continuously decreased and narrowed its gap with Japan. Meanwhile, China's share drastically increased from 4.6 to 12 percent in the same period.

The difference between China's share in the Indian import market, versus that of Korea's or Japan's, is too large to find the degree of direct competition as very intense. Nevertheless, the composition of the main items exported to India or the export similarity index indicates that the competitive relationship is intensifying. As for the top five items that each country exports to India, Korea's top four items (machinery, electrical equipments, steel and auto-components) coincide with Japan's top four items. Korea and China also have the same top three items (machinery, electrical equipments and plastics).

In the Indian import market, the export similarity index between Korea and Japan and between Korea and China is gradually increasing. The export similarity index calculated by HS2 units between Korea and Japan stayed at only 69 in 2002, but it rose beyond 70 in 2011, while the export similarity index between Korea and China increased from 54 in 2002 to 59 in 2011. So the export similarity index is lower between Korea and China than between Korea and Japan, but recently there has been a rapid increase between Korea and China.

Table 1 India's Top 20 Trade Partners in 2012/2013* (US$ millions)

Rank	Country	Export	Import	Total Trade	Trade Balance
1	UAE	36,316.65	39,138.36	75,455.01	-2,821.72
2	China	13,534.88	52,248.33	65,783.21	-38,713.45
3	USA	36,155.22	25,204.73	61,359.95	10,950.49
4	Saudi Arabia	9,785.78	33,998.11	43,783.89	-24,212.33
5	Switzerland	1,117.28	32,166.54	33,283.82	-31,049.25
6	Germany	7,246.20	14,325.79	21,571.99	-7,079.58
7	Singapore	13,619.24	7,486.38	21,105.63	6,132.86
8	Iraq	1,278.13	19,247.31	20,525.44	-17,969.18
9	Indonesia	5,331.30	14,879.49	20,210.79	-9,548.19
10	Hong Kong	12,279.20	7,907.17	20,186.37	4,372.04
11	Japan	6,100.06	12,412.29	18,512.35	-6,312.24
12	Kuwait	1,061.08	16,588.13	17,649.21	-15,527.05
13	Korea	4,202.25	13,105.12	17,307.37	-8,902.87
14	Qatar	687.18	15,693.08	16,380.26	-15,005.89
15	Belgium	5,507.30	10,046.87	15,554.17	-4,539.57
16	Australia	2,348.65	13,085.70	15,434.34	-10,737.05
17	Iran	3,351.07	11,594.46	14,945.53	-8,243.39
18	UK	8,612.54	6,293.09	14,905.62	2,319.45
19	Nigeria	2,740.04	12,086.11	14,826.15	-9,346.07
20	Malaysia	4,444.07	9,951.06	14,395.13	-5,506.99
Total of Top 20 Countries		175,718.13	367,458.11	543,176.24	-191,739.98
India's Total		300,400.67	490,736.64	79,0987	-190,335.97

Note: *Indian fiscal year criteria (April 2012 to March 2013).
Source: Ministry of Commerce and Industry, India (http://commerce.nic.in/eidb/iecnttopnq.asp)

Foreign Direct Investment

Korea began investing in India after 1993, when Prime Minister Narashima Rao of India visited Korea, and after 1996, when President Kim Young-sam of Korea made a return visit to India and signed a Bilateral Investment Promotion/Protection Agreement (BIPA) between the two countries. Japan's investment in India began in the early 1980s, but with the exception of Japanese companies like Suzuki, most experienced a tough time in the mid-1990s. This led Korea to hit its stride in investment to India, led by Daewoo Motors, Daewoo Electronics, LG Electronics, Samsung Electronics and Hyundai Motors. In 1996, about 9 percent of direct investment to India was from Korea's large-sized companies. At the same time, the investment share of Japan and Singapore stayed at 4.1 percent and 0.9 percent respectively. In 1999, Korea's investment share approached 13 percent, with Korea ranking in the top fifth of investors, next to the U.S. and the UK. Currently, Korea's large-sized companies are capturing the first and second largest shares in Indian electronics and the automobiles market, which is a result of Korea's intensive investment in India at the end of 1990s.

Nevertheless, Korea's investment in India faced a rapid slowdown at the turn of 2000s. Until 2011, Korea's share in total direct investment to India was below 1 percent, except when it reached beyond 1.5 percent in 2005. On the contrary, Singapore and Japan, both of whose investment to India had faltered in 1990s, are now experiencing a rapid increase of investment to India after the 2000s. Japan implemented large-scale investments in the early 2000s, causing the market share to rise dramatically to 11 percent in 2002. After that, Japan's investment in India faced a slowdown for a short moment but soon made a sharp rebound in 2008, and in 2011, its share increased to 11.3 percent. Since Japan signed the Comprehensive Economic Partnership (CEP) with India in 2006, Japan's investment in India has definitely increased. In Singapore, after the Singapore-India CECA and the improvement of a double tax avoidance agreement came into effect in 2005, investments in India have also rapidly increased. Singapore's share of investment in India was only 1.7 percent in 2004, but increased to 7.3 percent in 2005 and showed a drastic increase to 15.4 percent again in 2011.

The difference is more visible with the examination of investment volume. In 2011, Japan and Singapore each made a new investment of $3.1 billion and $4.2 billion, while Korea made a new investment of only $130 million. Accordingly, from April 2000 to March 2013, Singapore's accumulated investment volume was $19.46 billion and Japan's was $14.55 billion, but Korea's was only $1.23 billion. Therefore, for the share of accumulated investment in the same period, Singapore captured more than 10 percent and ranked 2nd. Japan captured more than 7 percent and ranked 4th, but Korea was able to hold only 0.6 percent and ranked 13th (Table 2). On the other hand, Korea has received more than $568 million from India through the first half of 2013.

Table 2 Cumulative Country-wise FDI Inflows from April 2000 to March 2013

Rank	Country	FDI Inflows (Rs. Crore*)	FDI Inflows (US$ million)	Share in Total FDI Inflows
1	Mauritius**	341,124	73,666	38.1
2	Singapore	90,182	19,460	10.1
3	UK	80,458	17,548	9.1
4	Japan	70,094	14,550	7.5
5	USA	50,922	11,121	5.8
6	Netherlands	42,378	8,965	4.6
7	Cyprus**	32,328	6,889	3.6
8	Germany	25,512	5,480	2.8
9	France	16,864	3,572	1.9
10	UAE	11,307	2,422	1.3
13	Korea	5,821	1,231	0.6
15	Hong Kong	4,769	1,028	0.5
19	Indonesia	2,825	610	0.3
21	Malaysia	2,730	549	0.3
30	China	1,428	278	0.1
Subtotal		778,742	167,369	86.6
Grand Total		896,912	193,403	100.0

Notes: *10 million Rupees
**Tax-haven country
Source: Ministry of Commerce and Industry, India

Free Trade Agreement

The Korea-India CEPA began with official negotiations with President Abdul Kalam's visit to Korea in 2006 and entered into force four years later in January 2010. The Japan-India CEPA, of which negotiations had started a year later than the Korea-India CEPA, came into effect in August 2011, a year and a half behind the Korea-India CEPA. In contrast, negotiations on the Singapore-India CECA began in 2003 and came into effect in August 2005.

Comparing the level of concessions the three countries receive from India, first in the commodity sector, Singapore is ranked the highest. Singapore, in terms of its export amount, obtained 93 percent concessions until 2015. On the other hand, Korea and Japan obtained 86 and 90 percent from India, respectively. With the two countries' level of concession being lower than Singapore's, the allowed period of tariff reduction and elimination enactment appears to be much longer, each lasting until 2019 and 2021 respectively.

On the other hand, it is difficult to determine whether Korea's level of concession from India in the commodity sector is higher than Japan's or vice versa. The reason is that Japan has a slight advantage in terms of the range of tariff reduction/elimination, but in terms of the speed of tariff reduction, Korea gets ahead of Japan. Also the same rules of origin apply to Korea-India CEPA and Japan-India CEPA. In contrast, Singapore-India CECA's rules of origin are definitely stricter than Korea-India and Japan-India's CEPA.

In the service sector, Singapore and Japan obtained a larger amount of concessions than Korea. Korea obtained 11 fields and 81 sections of the service sector, in addition to the condition of favorable consideration about establishing up to ten Korean bank branches in India, within four years since Korea-India CEPA took force. Singapore did not gain concessions like Korea and Japan, but it was granted a variety of benefits in the area of business service, construction engineering, finance, communication, transport and others. For example, in the finance industry, three Singaporean banks were given merchant bank status within India, and were privileged to receive a favorable consideration about establishing up to 15 branches within four years since the Singapore-India CECA came into force. In fact, these privileges enabled Singapore's DBS and other banks to establish 15 branches by 2009.

Each FTA's level of concession in the investment sector was similar, except for in the human resource movement, in which India has a high interest, the level of concession differs slightly by each FTA. Korea and Singapore opened their doors to India for about 163 and 129 professions, respectively, and also to the existing Contractual Service Suppliers (CSS) and Independent Professionals (IP). Korea and India designated 85 of 163 professions to be in IT, so that they could further promote the exchange of IT human resources between the two countries. Japan and India divided all sectors into CSS and IP, and opened doors in the fields required by each country. Japan opened up 14 fields to India, including travel, accounting, market research, business consulting, advertisement and exhibition in the sector of CSS, and ten fields, including computer, architecture, natural science research, engineering and city development in the IP sector.

In addition, each FTA included various cooperation sectors reflecting special features between the contracting parties and pending issues at the time of contract. Japan and India included the pharmaceutical sector and metallurgical technology sector (rare-earth resource development). Singapore and India included infrastructure development and vocational training. Korea and India included joint development of audiovisual contents as a particular interest.

Meanwhile the Singapore-India CECA is the most exemplary case of upgrading the agreement through its joint committee. By improving the agreement in 2007, two years after it entered into force, the two sides made a considerable increase in their rate of concession in the commodity sector, from 75 percent to 93 percent. Since 2010, the two countries have been conducting negotiations on the second additional improvement on the agreement. In contrast, Korea and India decided to process the agreement improvement at their first joint committee in 2011, but their second joint committee was not realized until 2013.

Tasks to Deepen Bilateral Economic Cooperation

Establishment of an Enhanced Cooperation System

The cooperation system established so far between Korea and India is relatively more vulnerable than its counterpart between Japan, China and Singapore. Currently, the highest-level talks between the two countries are with the ministers of finance, commerce, foreign affairs, etc. Yet even these meetings are not held on a regular basis. Accordingly, the private dimension of this cooperation system is also weaker than with the three other East Asian countries.

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Upgrading the Korea-India cooperation system to the level of regular summit talks is the most urgent and important challenge. Through summit talks both countries have to intensify and improve the bilateral strategic partnership established from 2010. China and Japan have held summits with India annually since 2005. Until now, the process of developing bilateral economic cooperation from the top-down rather than bottom-up was more efficient.

At the same time, both minister-level and private discussions by each cooperation sector need to be established and maintained on a regular basis. In doing so, the two countries will keep the subjects of cooperation active and improve the synergy of cooperating departments.

In addition, cooperation with India's state governments as well as the central government should be enhanced, as is the case with Japan and Singapore. Because of India's decentralized governing system, enhanced cooperation at the state level is indispensable. Japan's JETRO and Singapore's state-owned real estate development business, Ascendas, signed MOUs with Rajasthan, Tamil Nadu and Gujarat.

Improvement of CEPA and Maximization of its Use

The most comprehensive and institutionally well-established system so far, in the aspect of Korea-India economic cooperation, is the 2010 Korea-India CEPA. Trade items that satisfy the rules of origin already enjoy preferential tax rates, but there are a lot more areas for improvement.

The two countries must resume their joint committee as soon as possible to improve their relatively low concession rate compared to the other FTAs. This will preserve their chance to grow each market, which was obtained by establishing the FTA earlier than other competing countries. Additionally, India should note that as the tariff reduction rate accelerates, India's exports increase, and therefore, the effect of decreasing India's trade deficit with Korea becomes larger.

In the commodity sector, use of the Korea-India CEPA must also be enhanced, along with the promotion of outstanding Indian IT professionals. With the popularization of smart phones, tablets, and other mobile devices, software competition, rather than hardware, has recently become more significant. Since 2010, a movement of Independent Professionals and Contractual Service Suppliers in 163 professions has occurred between the two countries. Of these professions, 85 are IT related. In particular, the Korean government should reinforce its institutional support for Korea's small and medium-sized IT enterprises to use Indian IT professionals more efficiently.

The period of concession for Korean banks to establish ten branches in India over a four-year period, established when the Korea-India CEPA took effect in 2010, should be extended. Only one has opened in 2012, with two others pending approval. It seems impossible to establish seven additional branches by the 2013 deadline. Therefore, the period of favorable consideration for Korean bank branch establishment should be extended from the current four years to a more practical length of time through resuming talks with through the Korea-India CEPA joint committee.

Joint production of audiovisuals and other subordinate agreements are also in need of prompt conclusion. The Korea-India CEPA specifies that the audiovisual contents produced jointly by the two countries can not only be recognized as mutually domestic products, but also be supported with various benefits such as subsidies, according to the joint production agreement, which will be signed afterward. To jointly pioneer the global market of cultural contents, as well as the vast Korean or Indian domestic cultural content markets, requires immediate signing of the subordinate agreements. The two countries have a particular interest in entering overseas markets: when the two countries jointly produce, the synergy will increase, and stimulate wider dissemination of the Korean wave and Indian wave.

Intensification of Supporting Entries

In comparison with other major Asian countries' economic cooperation with India, FDI remains the weakest section between Korea and India. Establishing a policy to support Korean business development through M&A, as well as in green field investment, is essential. As India rapidly grew at the turn of 2000s, obtaining land areas with adequate infrastructure became more difficult and conflicts with the people residing in the areas occur more often. The environment for green field investment, obtaining land in India and establishing plants, is getting difficult. Consequently, there is a great demand for entering the market through M&A type investment, as recently demonstrated with companies from Japan, Singapore, Europe and the United States. Only a few Indian companies, such as Tata and Mahindra, are entering Korea through M&As.

Support for entries into India's infrastructure sector should be enhanced. Under the 12th five-year development plan, which began in 2012, the Indian government is planning on a $1 trillion investment to expand the infrastructure sector. One trillion amounts to approximately 53 percent of India's 2011 GDP. The plan is for the government to provide half of the trillion dollars, with the other half coming from private investments, including foreign investments. For this reason, the Indian government prioritizes cooperation for infrastructure development over all types of economic cooperation. During a summit talk with Korea, India's former president Patil, as well as Prime Minister Manmohan Singh, also requested the expansion of investment in India's infrastructure development. India also puts great emphasis on the participation of Japan, Singapore and China in the Indian infrastructure sector, as reflected in economic cooperation efforts.

Since India is geographically large and has different business environments by state, there must be a system established where Korean companies can access information about business opportunities by priority and state. Considering the current trend toward development-type businesses rather than simple subcontract types, consortiums among Korean and Indian enterprises should be built to distribute risks and maximize synergy in the infrastructure sector. Moreover, there should also be more enhanced financial support by the two countries. In this aspect, the five-year period—a billion-dollar joint financing project by the two countries' export-import banks promised at the third Korea-India Finance Minister meeting in 2012—was a very appropriate action. Future support would allow the expansion of financing.

Conclusion

The relationship between Korea and India will continue to develop into a center of economic cooperation. The Korea-India relationship is relatively weak in the aspects of diplomacy and security, as economic cooperation remains the focus. Looking at Korea's relationship with China and China's relationship with India in particular, Korea-India relations are inevitably limited.

This implies both opportunity and risk at the same time. Being able to focus merely on economic cooperation is the opportunity, and the risk comes if economic accomplishments are insignificant because cooperation in political, diplomatic and security areas are rather limited. In other words, if economic cooperation is also weak, then the impetus and the need of Korea-India cooperation could be undermined. In this point of view, Korean enterprises' entry into India in the early 1990s, and Korea-India CEPA coming into force earlier than Japan, is significant.

The problem is that Korea's performance in economic cooperation with India is relatively lower than that of other

East Asian countries such as Japan, Singapore and China in the late 2000s. In particular, the relatively small number of FDI entries between each other is a very alarming phenomenon that needs immediate improvement. The two governments must develop policies for M&A, finance and infrastructural sector, etc., to accelerate this entry. Upgrade of the Korea-India CEPA must proceed quickly. Through these measures, the private sectors of both countries, which are the final beneficiary and the substantial subject of the economic cooperation, ought to be vitalized. The best chance to achieve this vision is to establish regular summit talks between the two countries as soon as possible.

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