

APEC 2007: A Curtain Raiser **How Strong is India's Case for Membership?**

Mukul G. Asher* and Rahul Sen**

The September 2007 annual summit of APEC to be hosted by Australia will witness the ending of the decade long moratorium on membership. One of the major anomalies of the APEC is that while the three largest economies in the world in terms of PPP GDP are members (US, China and Japan), the fourth largest economy, India, which is in Asia, is not. India more than meets the criteria for membership set by the APEC ministerial meeting last year and presents strong case to be invited into the APEC forum.

***Professor, LKY School of Public Policy, National University of Singapore. Email: ** Fellow, Regional Economic Studies, Institute of Southeast Asian Studies (ISEAS), Singapore.**

The Asia-Pacific Economic Cooperation (APEC) is an important international forum for economic cooperation established in 1989 among 12 member countries comprising Australia, Brunei, Indonesia, Japan, Korea, Malaysia, Canada, Indonesia and New Zealand, Singapore, Thailand and the United States of America (USA). Subsequently, its membership was expanded over the next decade to include China, Hong Kong and Taiwan (1991), Mexico and Papua New Guinea (1993), Chile (1994), Peru, Russia and Vietnam (1998).

APEC's goal of being a leading forum for multilateral liberalization and deregulation in cross-border transactions relating to goods, services, investments, and manpower flows enunciated in the 1994 Bogor Declaration has been overtaken by several events. First, there has been a multiplicity of bilateral and sub-regional preferential trade and economic cooperation agreements, including those involving APEC members. As a consequence, multilateralism has taken a back seat.

APEC has played a useful role in trade facilitation, particularly in reducing transaction costs of conducting external economic relations among its members. The recommended measures, however, are non-binding, therefore reducing their effectiveness. Third, the establishment of the other forums such as the East Asian Summit (involving 10 countries comprising Association of Southeast Asian Nations ASEAN, and China, Korea, Japan, India, Australia and New Zealand) has diverted some of the energies formerly devoted to APEC.

While some analysts, such as Bergsten¹ have advocated for a free trade agreement among current APEC members to put pressure for faster progress in the Doha Round, this approach is widely regarded as a non-starter. The main role of APEC under the current and foreseeable circumstances is to be a forum for high quality discussions on economic policy issues, and to facilitate information dissemination and exchange. This is an important role as APEC brings together Asian, Australasian, Russian and such key Pacific powers as the US, in one forum. The so-called Track II deliberations involving APEC academics, businesses and policymakers have constituted an essential and useful element in developing Asia-Pacific regionalism.

The September 2007 annual summit of APEC to be hosted by Australia will witness the ending of the decade long moratorium on membership. The current APEC membership does not appear to reflect coherent criteria based either on geography or economic size and benefit. One of the major anomalies of the APEC is that while the three largest economies in the world in terms of PPP GDP are members (US, China and Japan), the fourth largest economy, India, which is in Asia, is not. It is significant that the Group of Eight (commonly known as G8) wealthy countries has decided to open talks with India and four other countries (Brazil, China, Mexico, and South Africa) to get them more formally involved in economic, energy, and social issues.

We argue that it is time to end the above anomaly, and invite India to be a member of APEC. The Ninth APEC Ministerial meeting had laid down certain guidelines for membership. This included geographical location in the Asia-Pacific region; broad based economic linkages with other APEC members in terms of size and share; significant integration with the world economy, and broad liberalization and deregulation policies designed to encourage external linkages.

India more than meets these criteria and therefore has a strong case to be invited into the APEC forum. There are mutual gains for India and for APEC from former's participation in this process. It is in the interest of the APEC and the wider world that India with more than a billion people and growing economic and technological capabilities, continues to remain a conservative status quo power.

Size and Prospects for India's Economy

India's trillion dollar economy is widely expected to continue to grow at about 12 per cent in nominal terms (implying annual GDP growth of around US\$ 120 billion, larger than the total GDP of several APEC economies) and between 7-8 per cent in real terms due to favourable demographics, high saving-investment ratios (they already are above 30 per cent of GDP), relatively efficient financial and capital markets, and a private corporate sector from which global companies are beginning to emerge. India's foreign exchange reserves exceed USD 200 billion; while its household's possess among the largest stock of gold in the world.

A recent report by McKinsey Global Institute (2007)² projects that India will become the world's fifth largest consumer market by 2025; and discretionary spending will account for 70 per cent of all spending. It is not just the rapid growth of the Indian economy and the consumer market, but its sheer size which makes it an attractive economic partner.

India's relatively less developed physical infrastructure presents attractive opportunities to domestic and foreign firms. It has been estimated that India currently accounts for about a fifth of all infrastructure projects in the pipeline in Asia-Pacific³. Most of these projects are led by the private sector firms.

While India's economic growth is driven more by domestic demand than is the case for many East Asian economies, its total trade in goods and services in 2006 was US \$ 437 billion, approaching 45 per cent of GDP. India's share in global trade is expected to increase from 1.5% in 2006 to 2.0 per cent before the end of this decade. By beginning of the next decade, India's total international trade is also expected to exceed US \$ 1 trillion.

India's favourable demographics and the nature of its pension reforms based on individual savings are likely to sustain high savings and investment rates. India's stock market capitalization has recently touched US \$ 1 trillion; and there is still ample scope for it to increase as more companies are listed and as divestment of state enterprises continues. India's national airline is to be listed by 2008, and its national insurance company is likely to follow.

India's capital markets are intermediating between savings and investments in a relatively efficient manner. India is paving the way for more sophisticated financial

instruments such as credit derivatives to reduce the level of overall risks in India's financial system. The private equity flows in India has also been sizeable, though strong entrepreneurial culture centering on family businesses has meant that the deals have been relative simple and of moderate size. This is a positive factor for financial stability and diffusion of enterprise culture. The commodity exchanges and the use of futures and options are also gradually becoming an integral part of India's financial and capital markets.

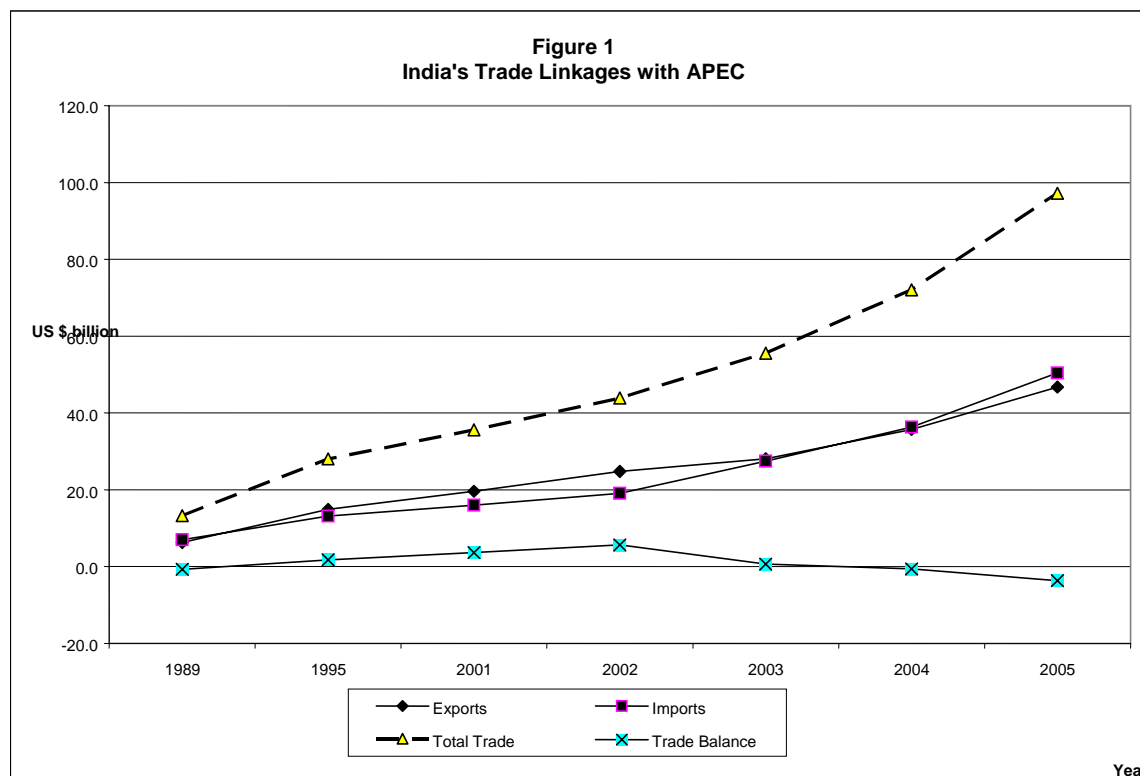
In spite of difficult international environment, India's macroeconomic management has kept inflation in product and asset markets in reasonable check, though there is no room for complacency. Among the key aspects of India's calibrated globalization have been unilateral liberalization and deregulation measures, particularly relating to the external sector. The average tariff rate in manufacturing sector in 2006 was about 10%, comparable to other APEC members. India's exchange rate policies are market-based; and it has substantially liberalized capital flows in both directions, including for resident Indians. As in other areas, it is pursuing gradual and prudent path towards full convertibility. The current uncertain international economic environment, given large macroeconomic imbalances in the world has made Indian policymakers more cautious.

Economic Linkages with APEC

India's economic and strategic linkages with many APEC members have deepened and broadened considerably since the adoption of its Look East Policy in 1991. For the period 1989-2005, India's total merchandise trade with APEC members (excluding Taiwan) recorded nearly an eight-fold increase, from US \$ 13.3 billion to 97.2 billion (Figure 1); while APEC's share in India's total merchandise trade increased from 34.2% in 1989 to 42.3 per cent in 2005. The APEC's share in India's merchandise exports is now about 50 per cent, while in imports, it is approaching 40 per cent (Figure 2). India's trade with China has shown extremely rapid growth, and some commodity diversification.

India's share in global service exports was 2.7 per cent in 2006, 10th largest in the world; while its share in imports was 2.7 per cent, 12th largest in the world. With respect to service exports, India's ranking is higher than all but three APEC economies (US,

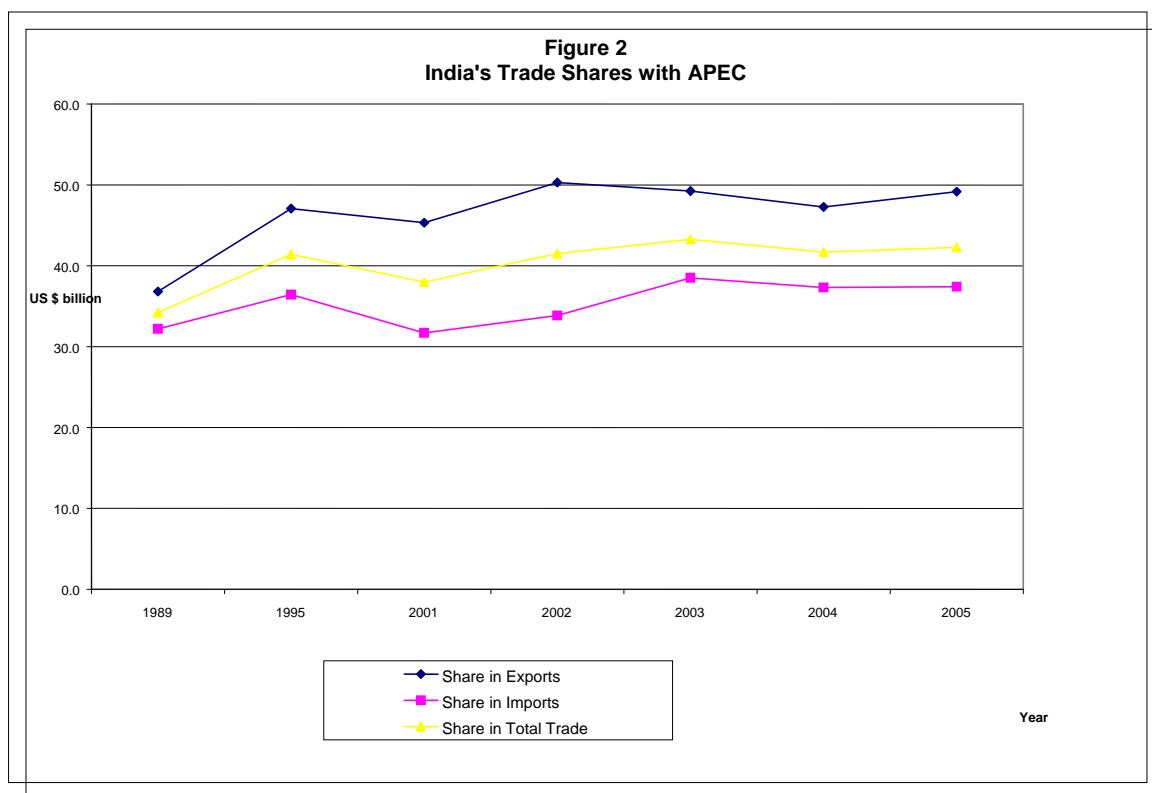
Japan, and China). With respect to service imports, Canada also ranks above India. India as an important supplier of off-shored ICT services is helping to contribute to greater international competitiveness of APEC economies.



Source: Computed from UN-Comtrade Database; data excludes Taiwan

India's share in global service exports was 2.7 per cent in 2006, 10th largest in the world; while its share in imports was 2.7 per cent, 12th largest in the world. With respect to service exports, India's ranking is higher than all but three APEC economies (US, Japan, and China). With respect to service imports, Canada also ranks above India. India as an important supplier of off-shored ICT services is helping to contribute to greater international competitiveness of APEC economies.

A recent study by Technology Forecasters, a California based consultancy, has projected that India's share in manufacturing outsourcing in the electronics sector will increase from 2 per cent (US \$ 5 billion) in 2005 to 10 per cent (US \$ 39 billion) in 2010 (*Financial Times*, May 23, 2007). India is gradually developing better balance between its manufacturing and services capabilities.



Source: Computed from UN-Comtrade Database; data excludes Taiwan

Several APEC members rank among the top 10 foreign equity investors in India. As flow as well as stock of inward FDI into India increases, (in 2006 FDI flow was US\$ 16 billion), the stake of many APEC economies in India will also become greater. Moreover, the market value of the portfolio investments into India, a substantial proportion of which is from the APEC economies, is around US\$ 120 billion. Financial institutions from many APEC economies, particularly those with excess savings such as Japan, Australia, Korea, Singapore, and Taiwan have set up presence in India's financial and capital markets. This trend is expected to continue.

The outward flow of capital from India has also been considerable in recent years. Indian companies have invested nearly half of their total outward FDI flows in variety of industrial and ICT related activities of APEC economies during 1996-2003, with U.S, Russian Federation, Hong Kong, Vietnam, Singapore and Australia being the prime destinations. According to advisory firm Grant Thornton, during the first four months of

2007, there were 72 foreign takeovers by Indian companies worth US \$ 24.4 billion. In the same period, there were 38 foreign purchases of Indian companies worth US \$ 17 billion.

India's outbound investment deals exceeded inbound ones for the first time in 2006. Many of the outbound deals have been with the APEC members. Examples of deals in 2007 include Tata Power's stake in two Indonesian coal groups for US \$ 1.1 billion; and ESSAR group's purchase of Canada's Algoma Steel for US \$ 1.6 billion and of Minnesota Steel of the USA for an undisclosed amount. Another example includes an agreement between Tata Steel and Vietnam's steel corporation for a US \$ 3.5 billion venture in Vietnam. Indeed, India's Tata Steel has steel manufacturing capacities spanning most of the Asia-Pacific. India's outward bound investment is relatively recent but it already has had significant impact in selected areas in APEC countries. If the presence of India's service companies in IT and healthcare is also included, then the evidence of India's impact and integration with the APEC economies becomes even stronger.

India's international competitiveness in generic and other drugs has the potential to substantially benefit APEC economies as evidenced by the experience of the Philippines and Thailand in obtaining lower-cost high quality generic drugs;⁴ and an agreement between an international foundation established by former US President Bill Clinton and Indian companies for providing cheaper HIV drugs. India is also developing as a hub for biotechnology research. The partnership between the Indian and multinational pharmaceutical firms, many of whom are from APEC countries, has the potential to substantially reduce the cost of bringing new drugs to the market. This will benefit consumers in APEC and other countries. The longer life expectancies have made managing the cost of drugs a particular challenge for the policymakers.

There are also strong demographic complementarities between India and many APEC members. Population in high-income affluent APEC member's viz. Japan, USA, South Korea, Taiwan, Australia and others is expected to decline in absolute terms by the end of this decade and median age of its population will continue to increase due to individual ageing. India in contrast is entering a demographic gift phase resulting in rising proportion of population in the working age group. It is expected to have nearly 50

million internationally competitive persons that could potentially assist APEC members experiencing rapid individual and population ageing. Skilled labour from India has been helping to offset the shortages in the US and other countries with mature demographics. The contribution of India and the Indians in sustaining Singapore's international competitiveness and in assisting it to manage rapid ageing has been considerable though not well acknowledged.

India has steadily expanded its institutional linkages with Asia-Pacific economies. Initiated by its Look East policy in 1991, India has significantly deepened the density of economic relations with the members of ASEAN, many of whom are APEC members, from a dialogue partner to an Annual Summit level partner over the past decade. India's relations with the US have undergone a qualitative and a quantitative shift in recent years. India is also developing a close economic partnership with Japan and Korea.

The greater integration of India with the rest of Asia is also indicated by its participation in the East Asian Summit (EAS) in 2005 and 2006. In addition to India, the participants included China, Japan, Korea, Australia and New Zealand and also 10 Southeast Asian countries comprising ASEAN. There is a substantial overlap in the membership of the EAS and APEC, thus implicitly recognizing India's integration with these economies.

India can play a constructive and significant role in maritime security involving the Indian ocean which is an important channel through which international trade vital to APEC economies takes place.

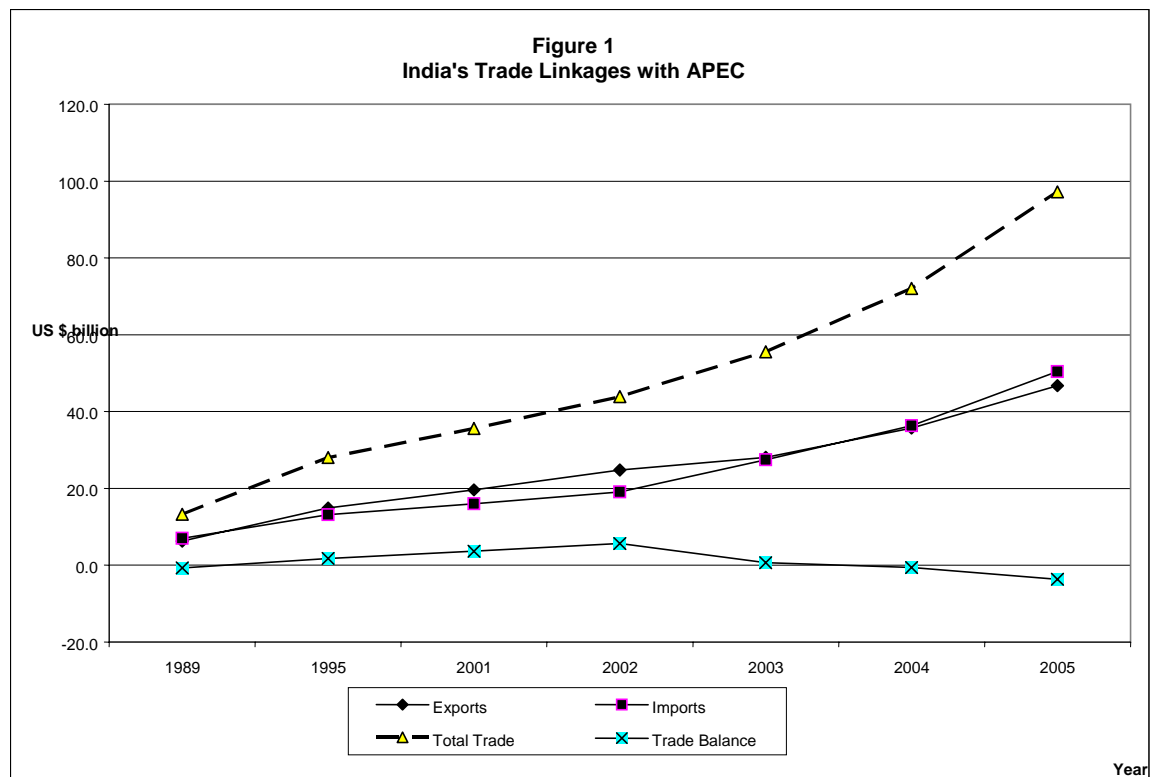
India's energy needs and its potential for generating environmental impact, both positive and negative, are considerable. It is desirable that these be addressed in an atmosphere of cooperation. APEC membership could be a positive signal in this direction.

India's inclusion in the APEC club will help diversify global economic risks for its members, while further integrating India into the Asia-Pacific cooperation framework. As in other countries, managing globalization in a constructive way is a challenge for India as well. APEC membership will help solidify India's economic reforms and calibrated globalization process. This is consistent with APEC's own goals and with enhancing stability and prosperity in Asia-Pacific. More than a billion people outside the

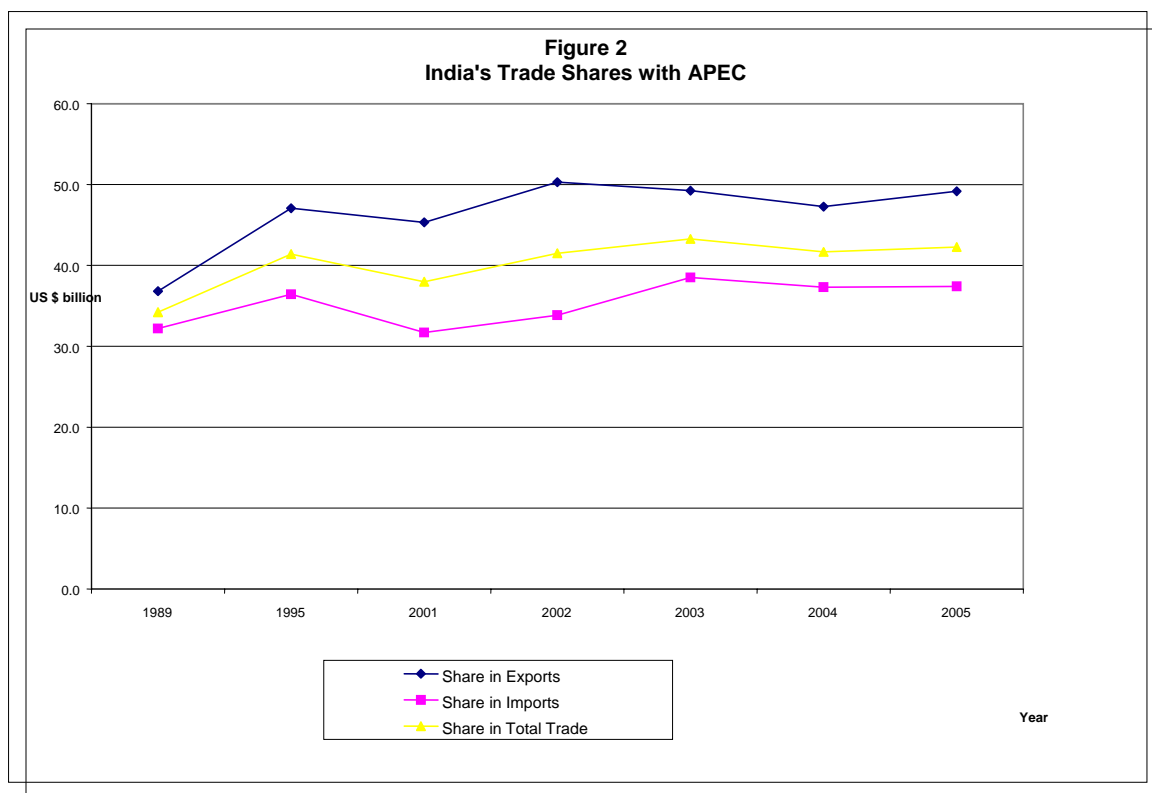
regular process of consultation and meetings on the future of Asia-Pacific is not in the interests of the APEC. In conclusion, the following observation made by Woo⁵ more than two years ago is even more valid today. He observed

...as the second membership moratorium draws to a close, APEC members will have to again take up the issue of whether to expand the organization and, especially if it can afford to not have India in the fold. This issue is of at least as much importance to APEC's continued relevance as a trans-Pacific institution as it is to India.

[The views expressed are personal]



Source: Computed from UN-Comtrade Database; data excludes Taiwan



Source: Computed from UN-Comtrade Database; data excludes Taiwan

¹ C. Fred Bergsten, "Plan B for World Trade: Go Regional" *Financial Times*, August 16, 2006

² McKinsey Global Institute (2007), "The 'Bird of Gold': The Rise of India's Consumer Market", May.

³ Dorrain, J. (2007), "Taking the Direct or Indirect Investment Route with infrastructure: Which works best?" presented at a conference on Investing in Infrastructure Assets, 4-7 June 2007, Singapore.

⁴ The first batch of HIV AIDS medicines from India to Thailand has resulted in a price reduction of more than half, and allowed an additional 20,000 AIDS patients to get the medicines (*Financial Times*, May 11, 2007).

⁵ See Woo, Y.P (2005), "A review of the APEC membership debate and prospects for India's Admission after 2007", URL : http://www.asiapacificresearch.ca/caprn/cisp_project/2005/papers/woo_back.pdf