



10th India-Korea Dialogue
**India-Korea CEPA:
Prospects and Challenges**

*A Summary Based on
Conference Deliberations*

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Organized by

Indian Council for Research on
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The 10th India-Korea Dialogue was organized by the Indian Council for Research on International Economic Relations (ICRIER) on 8-9th November 2011 at Chennai. The track-two India-Korea Dialogue was initiated in 1996 and the Korean dialogue partner is the Seoul Forum of International Affairs (SFIA).

The objective of the India-Korea Dialogue is to improve mutual understanding through dialogue among scholars, industry representatives, and policy-practitioners on contemporary issues relating to Indo-Korean relations. The focus of the discussions is on relevant political, economic and strategic issues that India and the Republic of Korea face as members of the dynamic Asian economy and the prospects for greater bilateral cooperation. The attempt of both ICRIER and SFIA has consistently been to invite high-level participation from both sides.

The discussion theme for the 10th India-Korea Dialogue at Chennai was “*India-Korea CEPA: Challenges and Prospects*”. The chosen venue was Chennai in the light of its increasing importance as a destination for Korean investments in India.

At the 10th India-Korea Dialogue at Chennai the delegation from the Republic of Korea was led by Dr. Sung-Joo Han, Former Minister of Foreign Affairs. The Indian delegation was led by Dr. Parthasarathi Shome, Director and CE, ICRIER. The notable participants included H.E. Kim Joong Keun, Ambassador of Republic of Korea to India and H.E. Skand Ranjan Tayal, Ambassador of India to Republic of Korea.

The papers and proceedings of the 9th India-Korea Dialogue have been published as a book which was formally released at Chennai. The editors of the book are Dr. Choong Yong Ahn, Distinguished Professor, Graduate School of International Studies and Foreign Investment Ombudsman, Korea Trade-Investment Promotion Agency and Dr. Pravakar Sahoo, Associate Professor, Institute of Economic Growth, New Delhi.

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The deliberations at the dialogue were divided into the following sessions:

1. Recent Economic Trends in India and Korea
2. Indo-Korea Trade Prospects and Non Tariff Measures
3. Indo-Korea Foreign Direct Investment
4. Indo-Korea Trade in Services and Green Energy Development
5. Global Security Issues: Prospects and Challenges for India and Korea

We report below some of the key issues discussed at the 10th India-Korea Dialogue at Chennai

Recent Economic Trends

The world economy is headed for another crises, though of a different nature, after a partial recovery from the 2008 debt crises. The crises was caused by a “balance of imbalances”. The US economy and Europe ran large current account deficits reflecting low domestic savings. These deficits were matched by surpluses emanating mainly from three sources- the emerging economies particularly China, oil exporting countries and to a lesser extent the metal exporting countries. As these surpluses could not be absorbed domestically, it flowed to developed economies like the U.S. These surpluses were used to invest in innovative financial instruments which finally led to the crisis. The re-emergence of the crises in the US is linked to the large bail out and stimulus packages which has led to shift from private liability to Government liability. This in turn has resulted in the government incurring huge debt and downgrading of credit ratings. Coupled with this, the country’s low fiscal capacity has resulted in low growth prospects for the economy. Similarly in Europe weaker countries are under major debt where there have been huge bail outs. These developments are likely to result in weak growth prospects for the region.

This crisis is now likely to affect economies like India in terms of worsening global prices of food and crude oil both of which have a considerable bearing on the Indian economy. Crude oil and food prices reflect the vulnerability of the Indian economy on the inflation front. India has remained focussed on monetary policies to control inflation as fiscal policies have failed to achieve this objective. Lower growth rates have been witnessed due to high inflation, high revenue deficit and a growing current account deficit. The management of inflation in India will depend largely on how the fiscal deficit and the revenue deficit is managed.

The demographic dividend for India could be an important growth driver. The demographic dividend can provide labour, capital and opportunity for absorption of technology. However, the industry and service sectors will be able to absorb the working population only if the skill levels are adequate. Fiscal capacity would be required for training and skill upgradation so that the demographic dividend is realized.

Since the Asian financial crisis, Korea has restructured many of its sectors including the banking, corporate, and its public enterprises. It is now an upper middle income country and hence faces many of the problems faced by such economies. The two main problems facing the country are that of polarization of income and the rising age of its population. Inequality has been on the rise since the Asian financial crisis mainly because of two reasons. First, the manufacturing sector is not creating enough jobs. Second, Korean companies have been hiring non-regular workers. Korea is also faced by an aging population and it also has the lowest birth rate in the OECD countries. These could lead to a decline in potential growth rates which is the main challenge that Korea faces in the coming years.

Trade Prospects and Non-tariff Measures

India and Korea entered into a Comprehensive Economic Partnership Agreement (CEPA) in 2009. Preferential tariffs is a key feature of the agreement. These preferential tariff rates were accorded on 2006 base line tariffs. In the last five years, India has reduced its MFN tariffs considerably. As a result, in 2010-11, India's MFN tariffs were lower than those committed to Korea under the bilateral free trade agreement. This has raised concerns about the utilization of preferential tariffs under CEPA. Such an anomaly needs to be rectified. However, the CEPA does not have any clause that would permit a review of the tariff liberalization program. The two countries should revise the agreement to include the relevant clause that will allow countries to review their tariff commitments. Another step that India can take to avoid a similar situation from occurring in other FTAs to have a co-ordinated approach between the Ministry of Commerce responsible for negotiating FTAs and the Ministry of Finance which is responsible for setting the MFN tariffs.

Korean traders face several market access barriers. In particular, antidumping measures imposed by India have been a key concern. The CEPA should include a provision that would allow a consultative mechanism between the two countries before filing a petition. Other barriers that Korean businesses face are related to cumbersome procedures, and complex tax structures. There are severe infrastructure constraints particularly those related to roads and ports. Inadequate power is another problem that is being faced by foreign investors in India.

Rules of origin requirements are also increasingly being used as Non-tariff Barriers (NTBs) and sometimes the domestic industry comes up with rules which are very onerous. Paperwork required establishing these rules are enormous. Due to these problems, the utilization of preferences is limited. It is a challenge to simplify the rules of origin. Increased automation can be used effectively to reduce the burden to meet the requirements of establishing rules of origin.

Foreign Direct Investment

Comprehensive Economic Partnership agreements are increasingly being used by countries to reduce barriers in cross border investment flows. The investment related provisions under India Korea CEPA on coverage, non-discrimination, standard of treatment, investor protection, movement of personnel and dispute settlement suggest that deep integration is possible through this agreement. Even though Korean investment in India has been quite significant since the early 1990s, FDI inflows from Korea have not increased much since the signing of the agreement. On the other hand since the signing of the India Singapore CECA, there has been a significant increase in FDI from Singapore to India. Investment from Singapore has been mainly in the services sector.

India's FDI policy has been one of gradual opening up. Much of the increase in FDI inflows is in the services sector. However, FDI inflows from South Korea have been mostly in the manufacturing industries.

The India-Korea CEPA is the first agreement for India with a negative list for investment. Korean investors are allowed to enter overall manufacturing but not the primary sector including agriculture, fishery and the mining industries. Similarly, Indian firms are allowed to invest in all sectors except rice and barley cropping in the agricultural sector.

Recently Indian firms, particularly automobile firms have started entering the Korean market through mergers and acquisitions with Korean firms. The two prominent ventures are the Tata-Daewoo and Mahindra- Ssangyong. A key feature of the Tata-Daewoo venture is that it has successfully involved local managers in the decision making process.

The Government has taken several initiatives to attract FDI in India. The development of the Delhi Mumbai Industrial Corridor (DMIC) is one such initiative. This project is aimed at the development of futuristic industrial cities in India which can compete with the best manufacturing and investment destinations in the world and is expected to attract huge FDI inflows. Such opportunities for Korean investors will also help them to diversify investments into other areas. However, no special incentives are being offered to foreign investors under the DMIC initiative. This is unlike the incentives offered earlier to investors in the Special Economic Zones.

Recognizing that there are huge transaction costs incurred due to the time taken in getting clearances and the complex procedural requirements, the government of India is in the process of developing an e-Biz program which will enable investors to obtain clearances from of a single point. This will transform the business environment in the country by providing efficient, and transparent electronic services to investors.

Services and Green Energy

The services sector is important for both economies. There are trade complementarities between the two countries in several service sectors. While India has a comparative advantage in software and information services, Korea has an advantage in transportation services. Unavailability of bilateral trade data makes it difficult to analyse bilateral flows. Trade associations in the two countries can play an important role in making available to governments such country-wise trade data on different service sectors.

India and Korea have undertaken commitments to liberalize their services sector both under the GATS framework and under CEPA. India has made more liberal commitments in cross border trade and is more restrictive in permitting commercial presence under CEPA compared to what it has offered under GATS. On the other hand Korea has more liberal commitments in commercial presence than under cross border trade. An important feature of the CEPA is that the two countries have exchanged a large list of professionals who would be permitted to work in each other's markets.

India and South Korea are already making rapid progress in combining their complementary services in the information technology (IT) sector. Korea is a major manufacturer of

electronic hardware while India has a comparative advantage in software. South Korea is expanding investments in the IT sector in order to facilitate the domestic IT services growth. India can play a major role in achieving this. Opportunities for potential collaboration between the two countries exist in areas such as green IT and sustainable energy, digitising of reading material, cloud computing and mobility, security and unified communication.

Co-operation between the two countries can also be envisaged in the green energy sector. While Korea has a comparative advantage in photovoltaic sectors, the trade between the two countries is low. India can gain considerably by collaborating with Korea in this sector. On the other hand India is competitive in towers for the wind power sector and the two countries can cooperate to promote domestic offshore wind power projects and expand into the overseas market in future. In the case of smart grids, while Korea has comparative advantage in terms of hardware, it can strengthen its software capability by taking advantage of India's strength in this sector.

Global Security Issues

Along with the rise of China the growing relations between India and the United States underline the strategic complexity in Asia today. In the case of China uncertainty prevails with regard to its long-term intentions wherein 'hedging' is the response of the other countries in the region. On the one hand there is increasing economic interaction with China but at the same time the region is wary of China's military modernization and tendency to escalate tensions flexing its new military prowess.

In this context there is growing regional attention towards India. India's impressive economic growth and the deepening relations between India and the United States have led to India moving to the category of "likeminded partners" for countries like South Korea. The areas of strategic partnership between South Korea and India as likeminded countries in the global order, as middle powers in the hierarchy of nations and as collaborators in the geography of peace are – global security, regional security, Korean peninsula security and non-traditional human security.

The two countries share the goal of preserving and developing a liberal and International Order. The bilateral CEPA is in this sense more than just a free trade agreement. It is the manifestation of a common strategic vision between the two countries.

A Track II trilateral dialogue between India, Republic of Korea and Japan would strengthen the bilateral initiatives already underway between among these 'likeminded' countries.