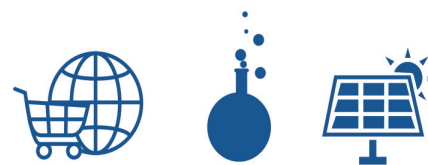


RESEARCH BRIEF No. 123

Building Value Chain: Opportunities for India and ASEAN



Introduction

The Southeast Asian region has emerged as one of the fastest growing regions in the world, on the back of its strong manufacturing sector. The existing ecosystem in the region supports sourcing, manufacturing, and shipping of finished goods from these markets. With its strategic location and abundant natural resources, the Association of Southeast Asian Nations (ASEAN) is one of the major regional blocs in the world. The economic and geopolitical importance of ASEAN countries is large and growing.

Economy, Trade and Investment in ASEAN

ASEAN as a regional grouping is a combination of ten heterogeneous economies, having a vast difference in geographical size, economic development, trade, and investment. The ASEAN economy has witnessed robust growth during the last five decades, reaching an estimated GDP of US\$ 3.2 trillion in 2019 - more than five times the level in 1999, when it first achieved the full membership of ASEAN-10. In 2019, the combined GDP of ASEAN, as a single economy, placed it as the 5th largest in the world and the 3rd largest in Asia.

International trade has gained increasing significance in the region with the establishment of the ASEAN Free Trade Area (AFTA), which has also resulted in higher growth in both the amount and volume of intra-regional trade flows. In 2019, ASEAN accounted for 7.4% of total global trade. Over the past decade, ASEAN's total trade witnessed an upward trend, increasing by 3.8% to US\$ 2.8 trillion in 2019 from US\$ 2.0 trillion in 2010, interspersed with a period of a relative slowdown in 2015 and 2019 in line with the moderating global trade.

ASEAN as a region majorly exported electrical machinery and equipment (26.6% of total exports of the region in 2019), machinery and mechanical appliances (10.6%), mineral fuels, oil and products of distillation (10.0%), pearls, precious or semi-precious stones and metals (3.4%), vehicles other than railway or tramway (3.3%), and plastics and articles (3.3%). The major imports from the ASEAN region in 2019 include electrical machinery and equipment (23.4% of total imports of the region), mineral fuels, mineral oils and products of distillation (14.7%), machinery and mechanical appliances (12.7%), plastics and articles (4.1%), transport vehicles (3.5%) and iron and steel (3.5%).

Presently, ASEAN's top trading partners include China, the US, Japan, and Germany. ASEAN's major export destinations in 2019 were China (14.2% of ASEAN's total exports), the US (13.0%), Japan (7.7%), Hong Kong (6.5%), and Malaysia (4.7%). On the other hand, ASEAN's major import sources

were China (21.4% of ASEAN's total imports), Japan (8.1%), the US (7.8%), South Korea (6.8%), and Taiwan (5.5%).

FDI inflows to the ASEAN region have witnessed an increasing trend during the last decade, albeit with some slowdown in between due to global economic conditions. However, from a broader perspective, it is evident that FDI flows have significantly evolved from US\$ 108.4 billion in 2010 to US\$ 158.9 billion in 2019, witnessing an almost 50.0% increase. Amongst the ASEAN economies, Singapore received the maximum FDI inflows in 2019, with a 58.0% share in ASEAN's total FDI inflows, followed by Indonesia and Vietnam. As regards sectors attracting investments in the region, the manufacturing sector has been the largest recipient of FDI in 2019, with a 35.4% share in total FDI inflows. Other major sectors to receive FDI in 2019 include financial and insurance activities (32.4% of total FDI), wholesale and retail trade, repair of motor vehicles and motorcycles (10.9%), and real estate activities (6.2%).

Major sources of FDI into ASEAN economies include the US (with a 15.2% share in total ASEAN investment inflows in 2019), Japan (13.0%), EU-28 (9.7%), and China (5.6%). The major sources of intra-ASEAN FDI in 2019 were Singapore, Thailand and Malaysia and major host countries were Indonesia, Thailand, Singapore, and Vietnam. As regards FDI outflows, total FDI outflows from ASEAN witnessed a moderation from US\$ 63.3 billion in 2010 to US\$ 56.0 billion in 2019. Singapore, Thailand, and Malaysia recorded the highest FDI outflows from the region, with 59.4%, 21.1% and 11.2% shares, respectively in total FDI outflows from ASEAN during 2019.

India-ASEAN Trade: Current Trends

ASEAN is a strategic pathway for India to expand its economic interests and strategic outreach to the Asia-Pacific region. ASEAN and India together represent a combined population of 2.02 billion which is over a quarter of the global population and a GDP of over US\$ 6.1 trillion, creating one of the largest economic spaces in the world. The combined GDP of ASEAN and India is expected to touch US\$ 8.4 trillion by 2025. There exist a lot of complementarities between India and ASEAN countries. The ASEAN region has a shared border with India at the North East Region (NER), as Myanmar shares a land boundary of around 1,643 km with four Indian states including Manipur, Mizoram, Nagaland and Arunachal Pradesh.

In recent years, ASEAN has become one of the largest trading partners for India. India-ASEAN trade has significantly increased from US\$ 7.7 billion in 2001 to US\$ 52.6 billion

in 2010, and further to US\$ 91.3 billion in 2019. In the post-FTA period, however, India's merchandise exports have not witnessed a significant rise compared to ASEAN's exports to India, which is indicated by the rising trade deficit witnessed by India with ASEAN, which has widened from US\$ 6.7 billion in 2010 US\$ 22.8 billion in 2019.

While India's exports to ASEAN have grown at a compound annual growth rate (CAGR) of 4.5% between 2010 and 2019, India's imports from the region have grown by a CAGR of 7.5% during the same period. The majority of India's exports to ASEAN have been directed towards Singapore, which accounted for 31.4% of India's total exports to the region, followed by Malaysia, Vietnam, Indonesia and Thailand. Indonesia accounted for the majority of India's imports from ASEAN during 2019, with a share of 27.3%, followed by Singapore, Malaysia, and Vietnam.

Mineral fuel, with a 19.0% share was the major exported commodity from India to ASEAN during 2019, followed by ships and floating structures, machinery, and meat and edible meat offal. Mineral fuels also remained the major imported commodity by India from ASEAN during 2019, followed by electrical machinery and equipment, machinery, and animal or vegetable fats and oils.

According to the Export Potential Map of ITC Geneva, India currently has an untapped export potential of US\$ 30.3 billion with ASEAN, with the greatest export potential in diamonds; followed by aluminium, not alloyed and unwrought; jewellery of precious metal; medicaments consisting of mixed or unmixed products for retail sale; and frozen boneless bovine cuts.

Though it is noteworthy that ASEAN-India Trade in Goods Agreement (AITIGA) has resulted in a sharp increase in total trade between India and ASEAN, imports have risen at a much higher pace than exports in the case of India. The widening trade deficit is a matter of concern for long-term sustainability of bilateral trade relations. India is also facing significant non-tariff barriers (NTBs) in ASEAN countries, limiting its exports to the region. India and ASEAN, therefore, need to work together towards a mutually beneficial and more balanced trade.

ASEAN-India Investment Scenario

Bilateral Investment relations between ASEAN and India is yet to be fully explored. Although Singapore and, to some extent, Malaysia have significant investments in India, the investment relations with other ASEAN countries remain rather untapped. In the ASEAN region, CLMV countries are receiving strong investment interest from India in recent years mainly due to their high growth markets, low wage labour and natural resource reserves.

However, considering ASEAN's closer proximity to India and the complementarities of the two economies, two-way investments are noticeably limited. Among ASEAN countries, Singapore has been the major investor in India, with a share of 94.0% of India's total FDI inflows from ASEAN, followed by Malaysia and Indonesia. Singapore is also the major destination of India's FDI outflows to ASEAN, accounting for 97.6% of India's total outflows to ASEAN, followed by Malaysia and Indonesia.

According to the fDi Markets database, ASEAN's FDI flows to India have primarily been in the real estate sector, which has a share of 38.0% in India's total FDI inflows from ASEAN during 2011-2020, followed by coal, oil and natural gas sector, with a share of 16.0%. Other major sectors which attracted FDI from ASEAN to India include renewable energy, chemicals, transportation, and financial services. During the period 2011 to 2020, a major portion of India's outward FDI to ASEAN is directed towards the coal, oil and natural gas sector, followed by software and IT services, metals sector, and business services.

Trends in Global Value Chains in ASEAN and India

ASEAN as a grouping has made remarkable progress towards economic integration not only within the grouping but also in the greater Asian region. An analysis of international trade in ASEAN countries, India, and China in terms of technology-based exports revealed that while 57.5% of Chinese exports and 51.3% of ASEAN exports belong to mid- and high-tech items; only 32.9% of Indian exports have been concentrated in the mid- and high-tech items. Increased integration into Global Value Chains (GVCs) make it easier for India and some of the ASEAN countries to move away from export reliance on resources and low technology products and to become major exporters of mid- to high-tech manufactured goods and services.

A comparative analysis in terms of value-added exports shows a higher contribution of foreign value added (FVA) embodied in gross exports in the case of ASEAN compared to that of India and China, while India and China have higher contents of domestic value added (DVA) in their value-added exports compared to that of ASEAN. In 2018, 35.7% of the total value-added exports of ASEAN contain imported inputs, and the rest 64.3% of value-added was created domestically. In the case of China, 12.9% of its value-added exports contain imported inputs, and the rest 87.1% of value was created domestically. Similarly for India, 14.1% of value-added exports were produced using imported inputs, and the balance 85.9% of value-added exports were created domestically.

GVC participation in ASEAN, while witnessing an increase compared to 1990 levels, remained lower than rates in 2000 and 2010. While all the ASEAN countries witnessed a fall in GVC participation rate in 2018 as compared to that of 2010, only four countries viz. Brunei, Indonesia, Malaysia, and Vietnam, witnessed higher GVC participation rate in 2018 compared to the rates achieved in 2000. India's GVC participation rate has also declined from 45.0% in 2010 to 41.4% in 2018. Using foreign value-added content of gross exports as a parameter to measure the extent of participation in GVCs through backward linkages, it is observed that India's integration in GVC is low.

ASEAN has witnessed high backward linkages, with FVA components accounted for as much as 35.7% of gross exports in 2018. The share of FVA in exports or backward participation is high for economies like Singapore or Vietnam as they are heavily reliant on foreign inputs for their exports. Currently, Brunei, Indonesia and Myanmar have high levels of forward linkages among the ASEAN countries, as a high portion of domestic value-added of these countries are being used in other countries' exports. For India, while the backward participation in 2018 was 14.1%, the forward participation was 27.3%. India has emerged as an assembly hub for foreign-owned companies from the US, Japan, China, and Republic of Korea, which have invested in the country to gain market access. China's forward participation or domestic value-added share in exports has increased sharply in the last three decades.

Moreover, China with its large and diverse manufacturing base, and extensive presence in assembling and processing high-tech products, procure intermediates on large scale from ASEAN countries. China is the largest source of imported inputs for gross value-added exports for ASEAN, with its share increasing from 2.7% in 1990 to 15.6% in 2018. India was the 12th largest source of imported inputs for ASEAN exports, with its share increasing from 0.7% in 1990 to 2.3% in 2018. China contributed 15.7% of imported inputs/intermediaries used in ASEAN's primary sector exports, 15.1% in the secondary sector and 11.9% of foreign value-added in the tertiary sector exports in 2015. The highest sub-sector using Chinese inputs was motor vehicles and other transport equipment, with a 30.6% share in its foreign value-added. India's share ranged from 1.0% to 3.8% in various sub-sectors during the same year.

Development of Value Chain between India and ASEAN

The development of value chains offers a great opportunity to scale up India's engagement with ASEAN countries. Creating a Regional Value Chain (RVC) at different stages

of industrial manufacturing between India and ASEAN countries would facilitate the relocation of production bases at various stages across India and ASEAN seamlessly. Some of the strategic sectors for the development of an RVC between India and ASEAN countries would include, amongst others, electronics sector, automobiles and auto-component sector, healthcare and agro-processing sectors.

Electronics Sector

Indian electronics industry manufactures a wide range of goods across the entire spectrum of electronics and ICT, from entry level to state-of-the-art electronic products. India's biggest challenge in the electronics industry arises from the fact that it is hugely dependent on China for imports. Several ASEAN countries have strong manufacturing base in the electronics sector. Moreover, electronic companies in ASEAN are well-diversified producing electronic parts and components to producing mid-tech to high-tech products and are involved in both capital and labor intensive stages of electronics manufacturing, with all aspects of production being operated simultaneously. The advantage of ASEAN electronics component companies is their absorptive capacities to imbibe the best technology and process, leading to increased productivity. India is increasingly trying to diversify into the manufacturing of electronic products and electrical parts. Indian companies could try to establish manufacturing assembly units in ASEAN countries, including Vietnam. Increased investments from ASEAN, through long-term partnerships in the electronics sectors and setting up manufacturing in India, would support in building local capabilities in India, to source strategic electronic goods domestically. Other areas for collaboration between India and ASEAN economies are the medical electronics devices segment, R&D and skill development in electronics, semiconductors, and materials, as well as in areas such as 5G, automated manufacturing robotics, etc.

Automobiles and Auto-components Sector

The ASEAN automotive sector over the years has emerged as the major production hub and dominant market for both original equipment manufacturers (OEMs) and auto-components suppliers due to a rapidly growing consumer market, integrated supply chains and comparatively lower labor costs. Most of the global auto firms have their presence in the ASEAN region, following a regional production networks strategy. However, auto-components are still imported in large scales into these producing countries, offering opportunities for suppliers from India. The growing automobile industry in ASEAN countries offers vast opportunities for investments for Indian manufacturers and distributors of automobile components.

Several ASEAN countries are also major natural rubber producers and exporters, with several opportunities for tyre manufactures.

ASEAN economies would be able to take advantage of India's relative competitiveness in design and engineering, and manufacturing skills. India has a very large market in both four-wheeler and two-wheeler passenger vehicle segments. However, there is considerable dependence on imports of certain auto-components majorly from China, which could be locally produced or diverted to ASEAN economies through integration in RVC. Collaboration with ASEAN component makers and designers through JVs and technical alliances could support India to bring advanced technologies in a shorter time, while over the long run, it could support India's plan to develop technology locally through increased in-house R&D, and hence support in developing local supply chains. India and ASEAN countries could look into increased cooperation in the production of electric vehicles, as well as setting up factories for nickel production.

Healthcare

India and ASEAN countries face several common health challenges including a growing geriatric population and an increasing prevalence of non-communicable, chronic and lifestyle diseases, resulting in growing healthcare expenditures. Increased cooperation among India and ASEAN countries through capacity development and joint research activity in healthcare has acquired renewed importance, especially in the current COVID-19 scenario. Moreover, the local production of pharmaceuticals and medical equipment in several ASEAN countries are unable to meet their domestic demand. While India is the leading producer of generic medicines in the world, ASEAN companies heavily rely on both China and India for meeting their API requirements. Accordingly, there exist increased investment and collaborative opportunities between ASEAN and India to produce API ingredients within the region through partnerships with multinational life science companies. India with its strong healthcare sector, skilled health professionals and affordable and quality medicines could play a major role in ASEAN's healthcare and pharmaceutical sector.

India could support ASEAN to enhance local production to meet the growing demand for medical products at cheaper costs, as well in building their capacity to produce essential medical products, including vaccines, antibiotics, medical equipment or personal protective equipment,

while India could learn from the successful universal health coverage scheme in ASEAN countries such as Thailand, as well as collaborate with ASEAN companies in providing e-consultation and telemedicine services.

Agribusiness and Food Processing

India and ASEAN are predominantly agriculture-based economies, with the sector having a large contribution to the region's GDP. ASEAN countries have been successful in building export industries around their natural resources, especially agricultural products. Despite these developments, ASEAN has a very limited arable land area, in addition to other challenges such as limited availability of bio inputs for organic production, inconsistent supply, and high production cost. Realizing its limitations, ASEAN economies are aiming for the sustainable development of the agricultural sector through sustainable organic value chains. Indian companies can collaborate with the private sector in several ASEAN countries and provide their expertise in terms of technological know-how as well as marketing services. By mapping each other's complementarities in the agricultural and food products, India and ASEAN countries can strengthen their comparative advantages and increase their supply of agricultural products. Innovative solutions are needed to ensure an efficient agri-supply chain mechanism in India and ASEAN countries, requiring joint cooperation and collaboration across all segments of the agri-food supply chain. Processing of non-food agricultural products (tobacco, rubber, wood etc) is another area with a huge scope of cooperation between India and ASEAN countries.

The contents of the publication are based on information available with India Exim Bank. Due care has been taken to ensure that the information provided in the publication is correct. However, India Exim Bank accepts no responsibility for the authenticity, accuracy or completeness of such information.

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