LOWY INSTITUTE
FOR INTERNATIONAL POLICY

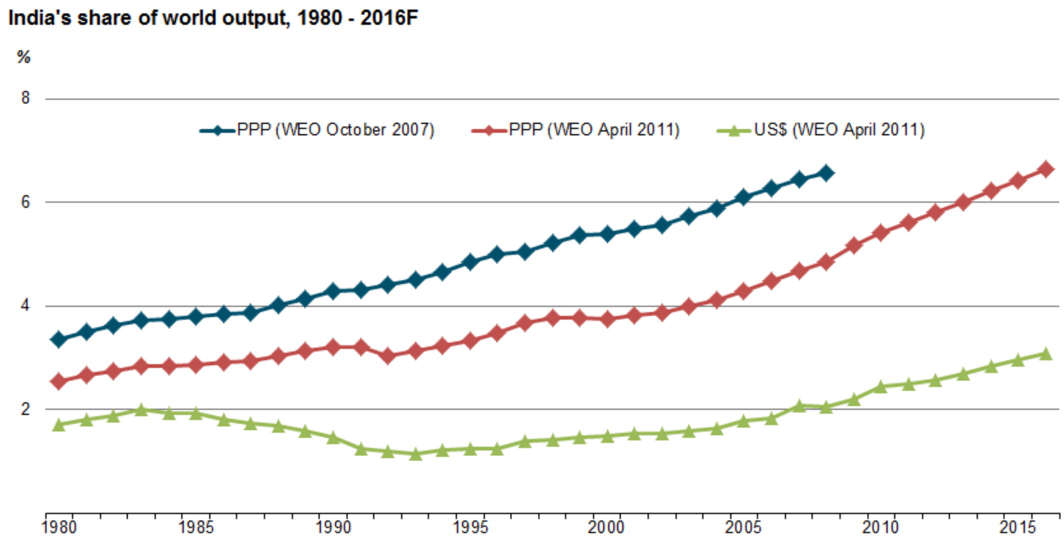
*International Economy Comments*

IEC #22, 19 SEPTEMBER 2011

## Integrating with India

*When we published* India: the next economic giant, *we predicted that India would become an increasingly important economic partner for Australia. So far, our forecast is mostly on track.*

Back in 2004, we argued that India was emerging as a major economic power and as a consequence Australia-India economic ties were set to grow in importance over the next few years.[1] So far, our optimism about India's economic trajectory has proved well-founded. In the years between 2004 and 2010, India has achieved an average annual GDP growth rate comfortably in excess of eight per cent, and done so in a period spanning a global financial crisis. This strong performance has delivered a steady increase in India's relative economic weight as measured by its share of world output:[2]




Source: IMF World Economic Outlook databases, October 2007 and April 2011

India's share of world GDP measured on a Purchasing Power Parity (PPP) basis has risen from a bit less than four per cent in 2002 to about 5.4 per cent by 2010. Using US$ exchange rates, the equivalent rise is from 1.5 per cent to 2.4 per cent.

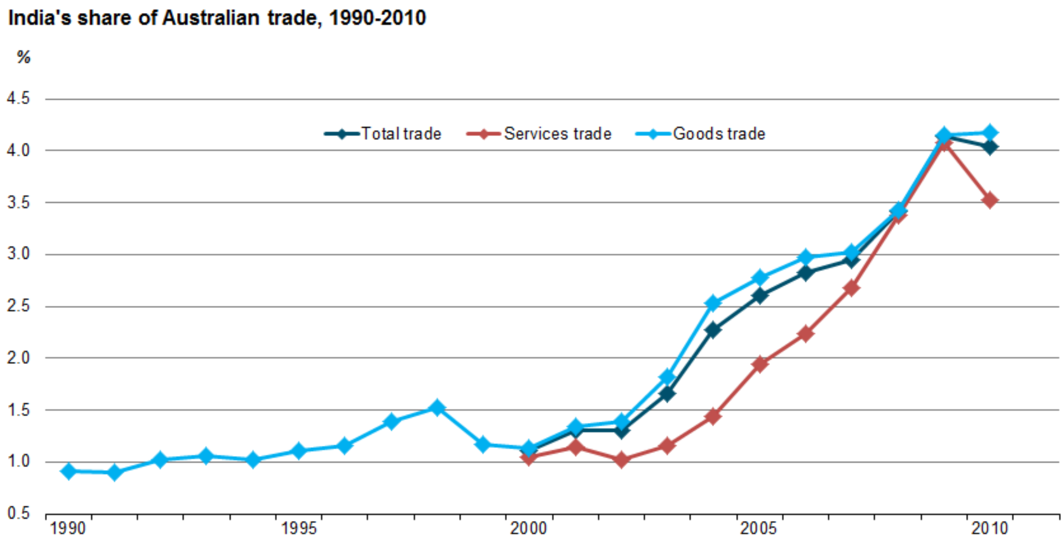
Over the same period, India has also been successful in growing its share of world trade. According to the WTO, as of 2002 India's share of world merchandise trade was still below the level it had reached in the 1950s and 1960s: just 0.8 per cent of world merchandise exports and 0.9 per cent of imports, making the country the world's 30th largest exporter and 24th largest importer. In the same year, India was the 19th largest exporter and importer of commercial services, with a share of 1.5 per cent of world commercial services exports. By 2010, India had increased its share of world merchandise exports to 1.4 per cent, making it the world's 20th largest goods exporter, and its share of world imports to 2.1 per cent, making it the 13th largest importer. More strikingly, India was the world's tenth largest exporter of commercial services in 2010, with a share equal to three per cent of the world total, and the seventh largest importer with a 3.3 per cent share.

Similarly, India's importance in global financial flows has also increased, albeit from a low base. For example, in 2003, India only received some US$4.3 billion in foreign direct investment (FDI) inflows, and was the source of just US$0.9 billion of FDI outflows. By 2008, the value of FDI inflows to India had surged to US$42.5 billion while outflows had jumped to US$19.4 billion. Tougher global economic conditions have since seen both numbers fall back, but even last year FDI inflows stood at US$24.6 billion and outflows at US$14.6 billion.

As anticipated in 2004, the growth in India's global economic footprint has been reflected in the bilateral trading relationship. In 2003, total two-way merchandise trade between the two countries was worth A$4.3 billion (1.4 per cent of total Australian trade), and India was Australia's 15th largest trading partner and its ninth largest export market. India was also Australia's third largest export market for coking coal and its fifth largest wool export market. By 2010, the value of two-way merchandise trade had risen more than fourfold, to stand at A$18.4 billion, or a bit more than four per cent of Australia's total merchandise trade. India is now Australia's fifth largest trading partner.

The big driver of bilateral integration has been Australian merchandise exports, which in 2010 were worth A$16.4 billion and accounted for more than seven per cent of total goods exports. Last year, India was Australia's fourth most important export market, ahead of the United States. Key exports were coal (A$6.8 billion), gold (A$5.3 billion) and copper ores and concentrates (A$1.4 billion): India was Australia's largest export market for gold (it has been since 2004), accounting for about 37 per cent of total gold exports; our largest export market for copper ores and concentrates (27 per cent of total exports) and our second largest market for coal (16 per cent of total exports) and wool.

Merchandise imports from India have also increased, although the absolute numbers are less impressive here. By 2010, Australia was importing goods from India worth a bit less than A$2 billion in value, or not quite one per cent of total goods imports, leaving India just outside Australia's top twenty sources of imports.




Source: ABS and author's calculations

Services trade has also expanded. In 2003, services trade between the two economies was worth just A$0.7 billion, or about one per cent of total services trade. By 2010, India had become Australia's seventh largest services trading partner, accounting for about 3.5 per cent of total services trade, and our fifth largest export market for services, taking six per cent of services exports. Australian imports of services from India were smaller, accounting for a bit over one per cent of overall Australian services imports.

Australian exports of services to India were worth A$3.2 billion in value last year, with education related travel (A$2.7 billion) the dominant factor and a supporting role for tourism. Indian student enrolments in Australian tertiary education had already nearly tripled over the six years to 2003, rising to more than 14,000, to make India the ninth largest source of overseas students in Australia. By 2009, student enrolments from India had reached a peak of 120,913, or some 19 per cent of the total, and second only to China. As of last year, Indian students still comprised the second largest group of overseas students, although numbers had dropped dramatically, falling by about 17 per cent from the previous year to stand at 100,310, or about 16 per cent of the total. The fall was due to a range of factors including tougher visa requirements and a stronger dollar, but in particular the fallout from a disturbing series of attacks on Indian students. Meanwhile, Indian tourist arrivals in 2010 were 138,700, up from less than 10,000 in 1992 and from about 45,000 in 2002.

Finally, while the bilateral trade relationship has grown significantly, investment ties between the two economies remain more muted. Back in 2003, the stock of Indian investment in Australia was a very modest A$128 million, while total Australian investment in India was only a little higher, at A$873 million. In the intervening years there has been some deepening of the investment relationship, but it has not been dramatic. So, for example, although the stock of Australian investment into India had risen to A$4.8 billion by December 2010, that still represents less than one per cent of the overall stock of Australian outward investment.

Unfortunately, the ABS does not publish any data on the stock of Indian investment into Australia after 2006 (when it stood at just A$609 million). Still, a look at the annual reports from the Foreign Investment Review Board (FIRB) meshes with anecdotal evidence that Indian investment in Australia has increased. India did not appear in the FIRB's list of approvals by country of investor in either 2001-02 or 2002-03, only making an appearance in 2007-08, when India was ranked in 20th place, with some A$793 million of approvals, or less than half a per cent of total approvals that year. In 2008-09 India had moved up to ninth place in the FIRB's rankings by country, with A$4.2 billion of approvals, or some 2.5 per cent of the total. According to the latest (2009-10) report, India was ranked 13th in the FIRB's list of investment approvals by county of investor, with A$1.6 billion of approvals, or a bit over one per cent of the total. The overwhelming majority of these (more than 92 per cent) were in the resources sector.

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[1] Mark Thirlwell, *India: the next economic giant*. Lowy Institute Paper 01. Sydney, Lowy Institute for International Policy, 2004. Most of the data cited in that paper were for 2002 or 2003.

[2] In 2008, the International Price Comparison (IPC) program published new estimates of PPP exchange rates, leading to major revisions in the estimated size of developing countries' GDP. The effect can be seen by comparing India's share of world output as reported in the October 2007 World Economic Outlook (WEO), the last report to use the old IPC data, and those reported in the April 2011 WEO which reflect the new numbers (see chart). This means that the numbers on India's share of world output at PPP rates as reported in our 2004 report are not compatible with current estimates.