INDIA'S ECONOMIC DEVELOPMENT AND THE AUSTRALIA-INDIA RELATIONSHIP

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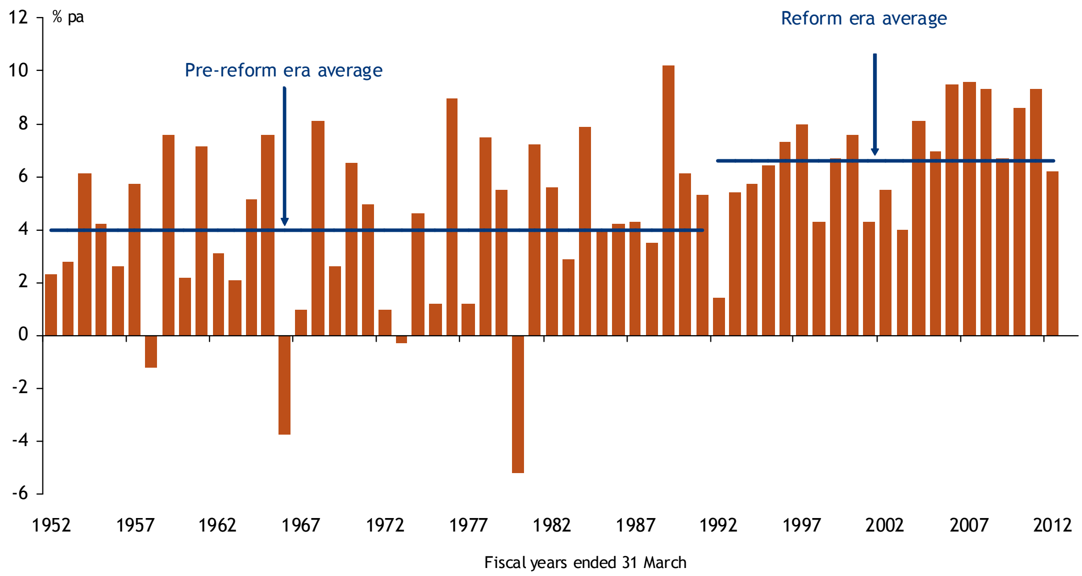
* The opinions expressed in this Oration are entirely those of the author, and do not necessarily represent those of his employer or any of its other associated entities

Since it began opening up to the rest of the world in 1991, India's economy has grown at an average annual rate of 6¾% – 2¾ pc points per annum faster than during the first four decades of India's independence – propelling it from the 9th largest to 3rd largest in the world (using the same measuring stick that now ranks China's economy as the world's 2nd largest).

Chart 1: Growth rate of India's real GDP



Note: Real GDP is at factor cost, in accordance with conventional Indian practice. *Source:* India Central Statistical Office.

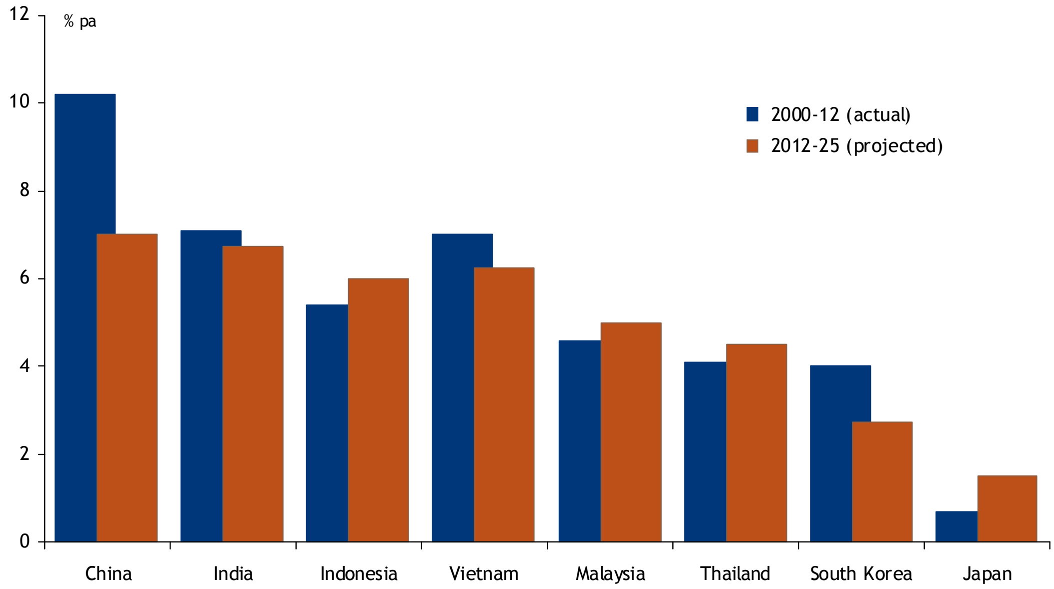
The Australian Government's *Asian Century White Paper* published in October last year projects that India's economy will continue to grow at this 6¾% annual rate at least through 2025 (Australian Government, 2012: 53), whereas China's growth rate is forecast to slow to 7% per annum over this period, from an average of 10.1% per annum over the past two decades (see Chart 2 on page 2).

Longer term, the OECD (2012: 22) projects that India's economy will grow at an average annual rate of 4.9% through to 2060, a percentage point faster than China (see Chart 3 on page 2). If that turns out to be correct, then some time between 2045 and 2060, India's economy will move past that of the United States, to be the world's second largest after China's, which is set to overtake America's by 2017 (according to the IMF's most recent set of forecasts) (see Chart 4 on page 3).

Importantly, however, India's longer-term growth prospects owe more to demography than those of most other countries. According to the OECD projections from which I've just quoted, population growth will contribute 1.1 percentage points per annum to India's economic growth rate over the next five decades (Chart 5 on page 3). That's a higher figure than for any of the other 41 (developed and emerging) countries for which the OECD makes projections than (ironically in view of their other differences) Israel and Saudi Arabia.

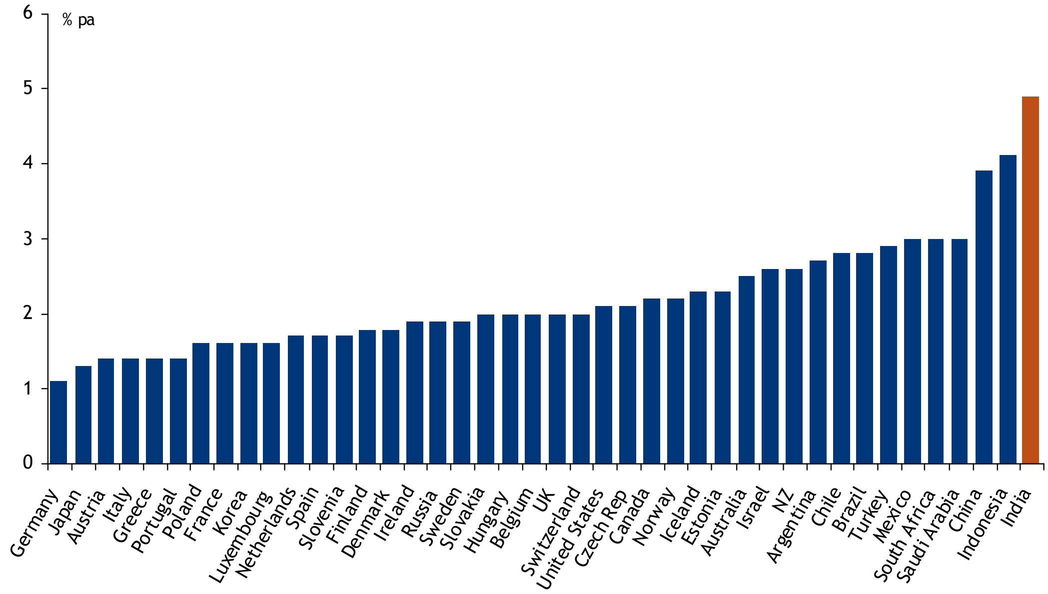
This is in marked contrast to China, where demography will detract from growth by a greater margin than for any other country except Russia.

Chart 2: Selected Asian Economies – actual and projected real GDP growth to 2025



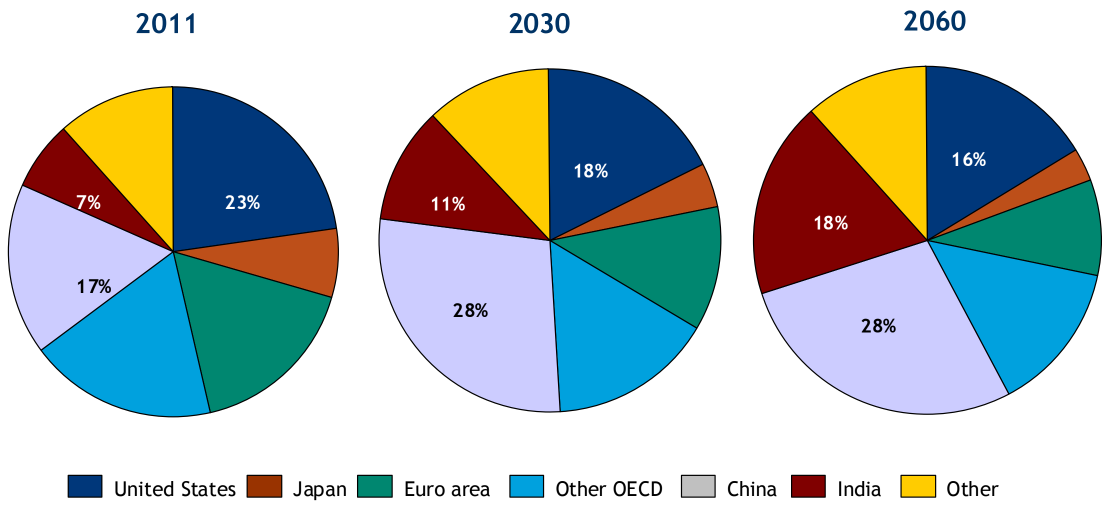
Sources: International Monetary Fund (2012); Australian Government (2012), Table 2.1 p. 51.

Chart 3: Projected annual average trend real GDP growth rates 2011-2060



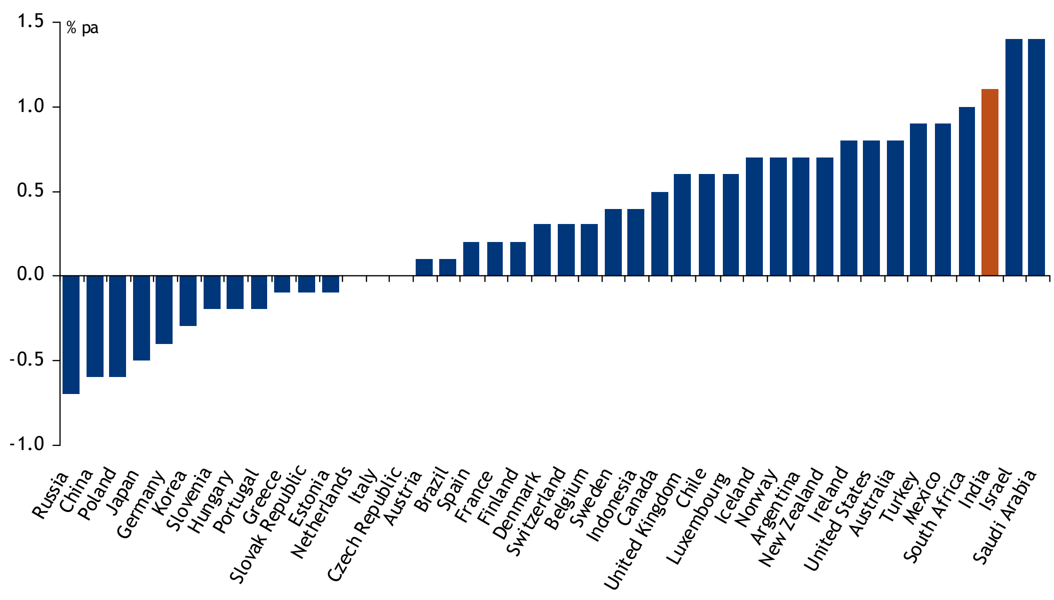
Source: OECD (2012), p. 22

Chart 4: Projected shares of world GDP – 2011, 2030 and 2060



Source: OECD (2012), p. 23.

Chart 5: Contribution of labour supply to projected growth in real GDP 2011-2060

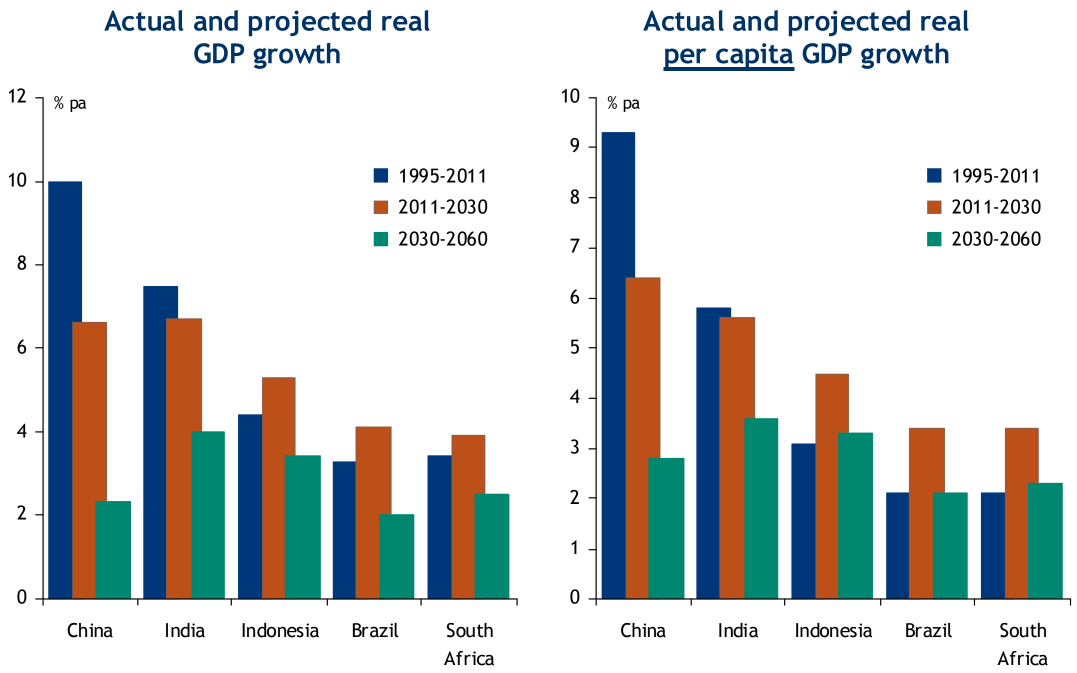


Source: OECD (2012), p. 22

There are a number of well-known downsides to a declining and rapidly ageing population, particularly for a country that has yet to build up adequate means of providing for retirement incomes and for health and aged care needs.

However, the larger-than-average contribution which population growth will be making to India's economic growth also means that economic growth won't translate into improvements in average living standards as rapidly as they will in other countries. Hence, for example, although India's real GDP will grow by 1.1 pc pt per annum faster than China's between 2011 and 2060, according the OECD's projections, India's *per capita* GDP growth rate will be only 0.2 pc pts higher than China's over this period (Chart 6).

Chart 6: Actual and projected real and real per capita GDP growth



Source: OECD (2012), p. 31.

That is, even when India becomes the second largest economy in the world, India's people will still be among the poorest in the world, on average.

If the OECD's forecasts turn out to be precisely correct, then India's economy – which last year was 35% of America's and 38% of China's – will by 2060 be 38% larger than America's and two-thirds the size of China's. But India's per capita GDP – which is a widely accepted, if incomplete and imperfect, measure of average economic well-being – will still be 52% lower than China's, which is not much improvement over last year, when India's per capita GDP was 57% below China's.

And while material living standards are by no means the be-all and end-all of well-being - a point that has been elegantly stated by the Nobel Prize-Winning Indian economist Armatya Sen (1999), and by Stiglitz, Sen and Fitoussi (2009) - there aren't too many examples of countries with relatively low per capita GDPs who do well on other measures of well-being.

As Andrew Leigh, who was a Professor of Economics at ANU before entering Parliament in 2010 and has just been appointed Parliamentary Secretary to the Prime Minister, has put it,

> "In countries with higher levels of GDP per capita, people are more likely to say that they experienced enjoyment, and more likely to say that they were pleased at having accomplished something. People in affluent nations are less likely to have experienced physical pain, loneliness depression and boredom".

So before I talk about Australia's economic relations with India, I want to make a few observations about India's economic performance and prospects. And it is hard not to do that without making some comparisons with China – which of course Indians routinely do themselves.

In 1950, India's per capita GDP was 78% higher than China's. Both countries entered the post-War era bearing heavy scars. China had experienced centuries of decay under the Qing (who were foreigners to most Chinese in the same sense that the Mughals were to most Indians), followed by a half century of (at various times) political instability, civil war and (for 12 years) being an active theatre of the Second World War, during which 15-20 million people are thought to have died (of whom 'only' about 2.2 million were military casualties).

India's experience of World War II was less traumatic than China's. Apart from the Andaman and Nicobar Islands, and (briefly) part of Nagaland in 1944, India wasn't occupied or invaded; and Indian cities weren't bombed. However some 2½ million Indians served with Allied military forces, of whom 35,000 died; and it's thought that between 1½ and 4 million Indian civilians died in Bengal in 1943, in part as a result of British policies intended to deny Japanese forces access to food supplies in the event that they did invade.

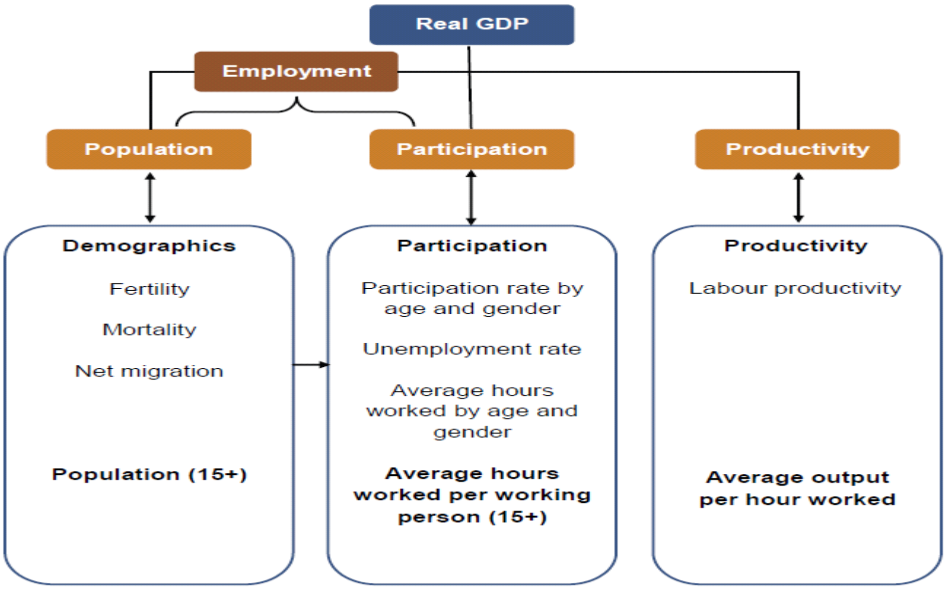
Immediately after World War II, India was of course also emerging from nearly three-and-a-half centuries of British rule, and from the trauma of partition.

Nonetheless, according to the best available estimates (Maddison 2010), China's per capita real GDP was 18% lower in 1950 than it had been in 1900, while India's was 3% higher. So China arguably had more 'catching up' to do. Still, it wasn't until 1984 that China's per capita GDP exceeded India's (for the first time since 1850). By 2001, China's per capita GDP was 50% higher than India's; by 2007, it was double India's; and last year, China's per capita GDP was 130% higher than India's (Conference Board 2013).

The Australian Treasury has constructed a framework for analyzing long-term economic growth rates which it has used in the three *Intergenerational Reports* published since 2001 and which has come to be known as the 'Three Ps' framework because it posits that real GDP growth ultimately comes from three sources – population, participation (in the labour force) and productivity (Swan (2010): 3) (see Chart 7 on page 6). The same framework can be used to show the contributions of labour force participation and productivity growth to the long-term growth rate of *per capita* real GDP. Applied to a comparison of India's per capita real GDP growth with China's, what this shows is that:

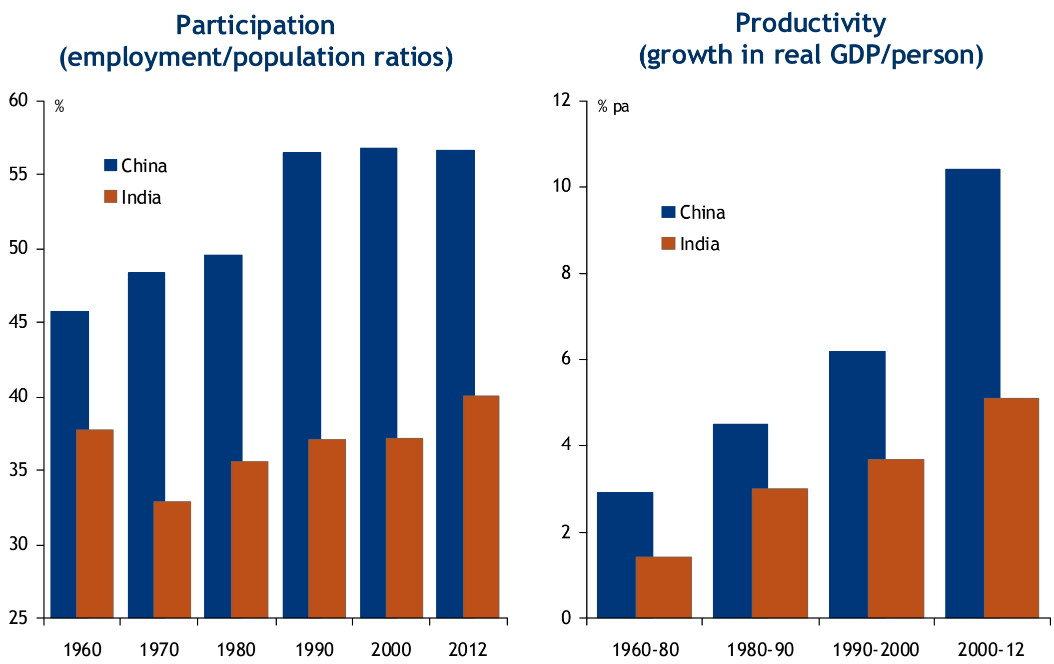
- India has been much less successful at lifting labour force participation than China: since 1960, employment as a percentage of the total population has risen from 37.7% to 40.1% (an increase of just 2.4 percentage points), whereas in China over the same period, employment as a percentage of the population has risen from 45.8% (ie, it was higher 50 years ago in China than it is today in India) to 56.6%, an increase of 9.8 percentage points (see Chart 8);

Chart 7: the "3 Ps" framework for dissecting economic growth



Source: Swan (2010), p.4.

Chart 8: Sources of growth in real per capita GDP in China and India, 1960-2012



Source: The Conference Board (2013).

- India has also been much less successful at improving labour productivity growth: average annual growth in output per person employed in India has increased from 1.4% during the 1960s and 1970s to 5.1% per annum so far in the 21st century; whereas in China it has risen from 2.0% to 10.4% per annum over the same period[1].

Why has India performed so poorly on both of these critical drivers of long-term economic growth relative to its principal comparator?

A growing number of people – especially, I suspect, business people – would answer this question by pointing to politics: and, specifically, that India has since 1947 had a democratic political system in which governments have had to submit themselves to the judgment of the people at regular intervals, whereas China has since 1949 been a one-party state in which political leaders don't have to worry about the possibility of losing office if their policies are temporarily unpopular.

Although I readily acknowledge that a number of countries, principally in East Asia, have made enormous economic advances under political systems that are often referred to as 'benign dictatorships', there are at least as many examples (including some in East Asia) where dictatorship has been neither 'benign' nor (especially in Africa and the Middle East) particularly conducive towards sustaining strong economic growth over long periods of time. And in fact formal statistical investigations have consistently refuted the suggestion that democracy is bad for economic growth (see for example Przeworski et al (2000), Knutsen (2010) and Easterly (2011)).

As a more practical matter, I would observe that the East Asian countries which appear to have sustained rapid rates of economic growth over long periods under what could arguably be termed 'benign dictatorships' have generally had high degrees of racial or ethnic homogeneity, very little religious diversity, and a very strong national identity[2]. By contrast, India is an incredibly diverse country – ethnically, religiously, culturally, linguistically and in other ways – and I suspect that as such, the forms of 'benign dictatorship' which may have 'worked' in other less diverse countries would probably not have been sustainable in India.

So I hope we can put that proposition to one side.

I think that India's under-performance relative to China (and other emerging economies) can be traced to a variety of other causes.

First, India has not done as well as others (not just China) have done in getting 'the basics' of economic development right - in particular, basic education and health care. As Amartya Sen put it more than a decade ago,

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[1] The labour productivity measure used here is real GDP per person employed, rather than the more conventional per hour worked, owing to the absence of comparable data on hours worked for India and China.

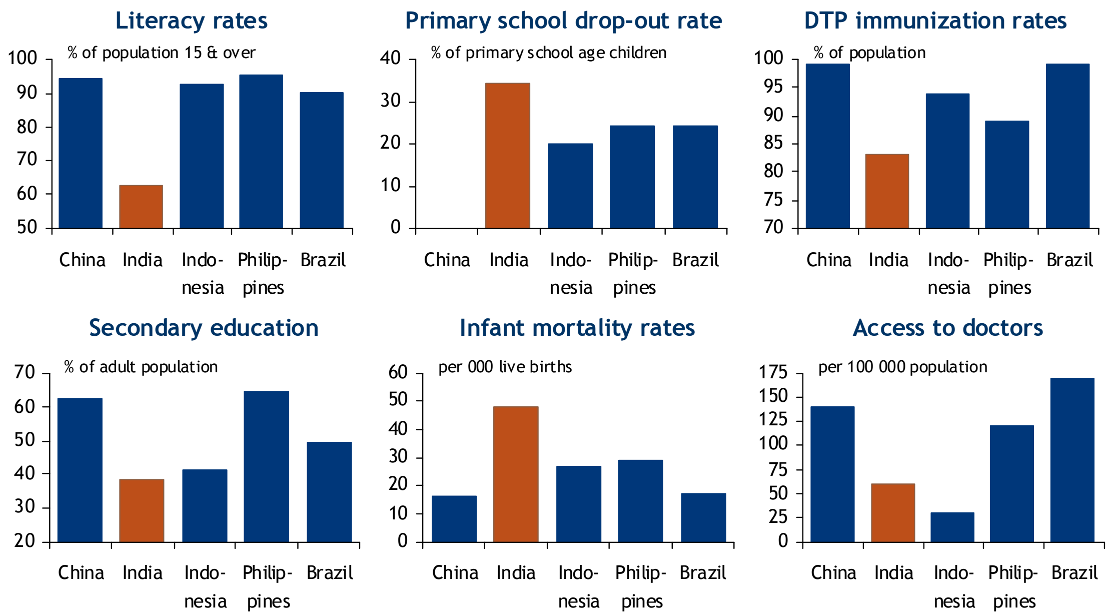
[2] Some may regard Singapore and Malaysia as exceptions to this generalization. However I would note that Singapore's population is 74.2% ethnic Chinese; and while Malaysia is much more ethnically diverse (ethnic Malays making up about 50% of the population, Chinese 25%, Indians 7% and other 'bumiputras' 11%), it has arguably been both more 'democratic' than other East Asian countries (albeit that there have been no changes of government since 1957) and less economically successful than (say) Singapore, Korea or Taiwan.

"When China turned to marketization in 1979, it already had a highly literate people, especially the young, with good schooling facilities across the bulk of the country … In contrast, India had a half-illiterate adult population when it turned to marketization in 1991, and the situation is not much improved today … the health conditions in China were also much better than in India because of the social commitment of the pre-reform regime to health care as well as education … The social backwardness of India, with its elitist concentration on higher education and massive negligence of school education, and its substantial neglect of basic health care, left that country poorly prepared for widely shared economic expansion" (1999: 42).

And although India has been making progress in these areas over the past decade, it remains a long way behind. According to the United Nations' most recent *Human Development Report*:

- Only 62.8% of India's population aged 15 and over are literate – compared with 94.3% of China's (and, for that matter, 92.6% of Indonesia's, 95.4% of the Philippines', and 90.3% of Brazil's);
- Only 38.7% of India's adult population has a secondary education or higher – compared with 62.7% of China's (and 41.4% of Indonesia's, 64.8% of the Philippines', and 49.5% of Brazil's);
- 34.2% of Indian primary school age children fail to complete primary school, compared with none of China's (and 20.0% of Indonesia's, 24.2% of the Philippines', and 24.3% of Brazil's);
- India's infant mortality rate of 48 per 1000 live births is far higher than China's (16), Indonesia's (27), the Philippines (29) or Brazil's (17);

Chart 9: Human Development indicators – India and other selected 'emerging' economies



Source: United Nations Development Program (2013) pp. 166-173.

- India's immunization rates for diphtheria, tetanus and pertussis (DTP) and malaria are, at 83% and 74% respectively, still far lower than China's (99% for both), Indonesia (94% and 89%), the Philippines (89% and 88%) and Brazil's (99% for both).

- India has just 60 doctors per 100,000 people, compared with 140 in China, 120 in the Philippines and 170 in Brazil – although at least on this score India is better off than Indonesia, which has only 30 doctors per 100,000 people (United Nations 2013: 166-173).

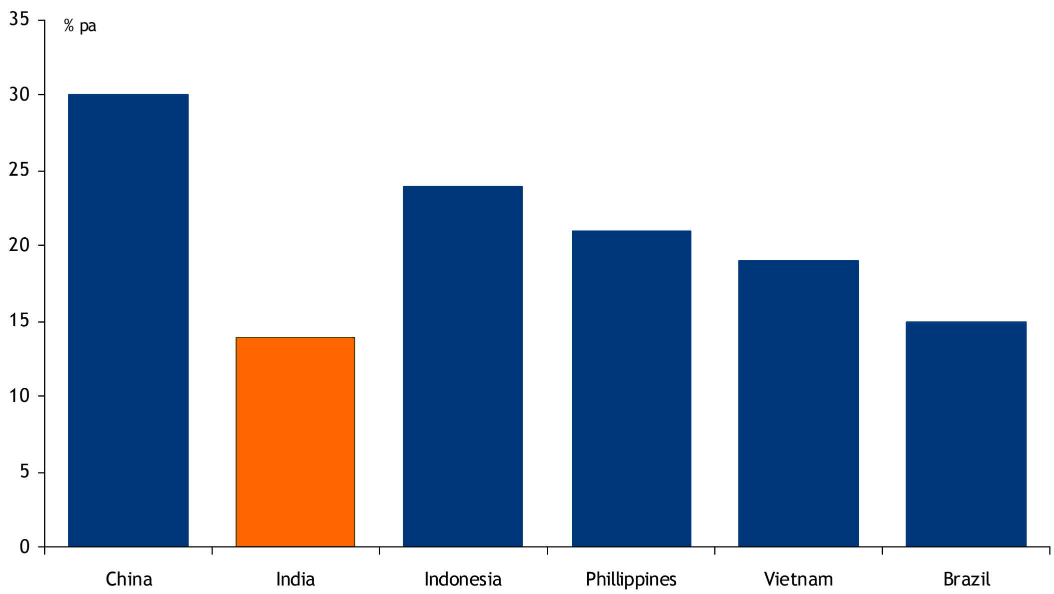
Second, India's economic development has been retarded by its distrust of large businesses – unless they are owned by the State (and that qualification is something to which I will return).

This hostility towards 'bigness' stems in no small part from Mahatma Gandhi , who emphasized among other things economic self-sufficiency at the village level through small-scale 'cottage industries'. With all the respect that is due to Gandhi for his other achievements, he was in my view no better informed on economics than Mao Zedong was – and I would note in that context that Jawaharlal Nehru took a rather different view of this issue than Gandhi's (Bhatt 1982: 85).

The antipathy towards large-scale enterprises has prevented India from reaping the productivity gains that usually come with scale – especially in manufacturing – and in turn helps explain one of the more unusual features of India's economic development compared with that of other 'emerging and developing' economies, namely, the relatively small role played by manufacturing (see Chart 10 below).

The experience of most other 'emerging' economies – and, for that matter, most of what are today classified as 'advanced' economies when they were themselves 'emerging' – is that it is largely through the movement of labour and capital from subsistence agriculture into manufacturing that a country achieves the productivity gains which allow a sufficient proportion of people to lift their income to a level above which people then start to spend a growing proportion of their incomes on services, subsequently allowing an increasing proportion of the country's workforce to be employed in services.

Chart 10: Manufacturing as a share of GDP, 2010



Source: The World Bank databank,

However, as an insightful paper from the OECD observes,

> "India's development path appears to be somewhat unusual as the production shift from agriculture into manufacturing has proceeded more slowly than in most other countries at a similar stage of development while that to services has proceeded more rapidly …. In comparison with other large economies, its manufacturing share is only a little over half that of China, Indonesia, Malaysia, Thailand as well as Korea" (Dougherty et al 2008: 5).

While some parts of India's services sector have done very well, as I have already noted that hasn't been sufficient to narrow the gap in terms of per capita GDP between China and India. Moreover, as the OECD paper goes on to note,

> "India's revealed comparative advantage is, in fact, in many of the same labour and resource-intensive manufacturing sectors as China's … it would seem unnecessary and suboptimal for India to pursue such a unique path of development given its potential strengths and comparative advantages" (Dougherty et al 2008: 10).

They then point out that

> "[P]erhaps the most dominant characteristic of India's manufacturing sector is the extraordinary small scale of establishments relative to any OECD country or other emerging countries when measured in terms of employment and output. About 87% of manufacturing employment is in micro-enterprises of less than 10 employees, a smallness of scale that is unmatched, with the closes comparator being Korea, where less than half of employment is in micro-enterprises (Dougherty et al 2008: 11).

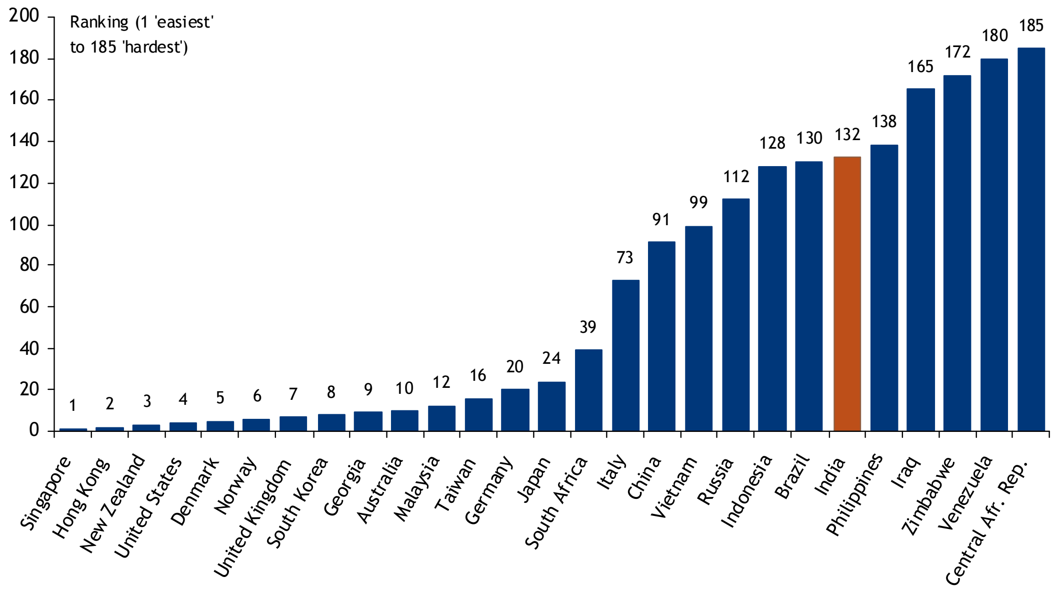
This partly reflects the lingering effects of regulations that were dismantled in the 1990s (such as a licensing system that stipulated that only one major company was allowed to operate in many industries, or which reserved others to 'Small Scale Industries') but whose legacy lives on. However, it also reflects the effects of other on-going regulation.

India ranks 132nd on the World Bank's assessment of 185 countries for 'ease of doing business' in them (World Bank 2013: 11) - below China (ranked 91st), Indonesia (128th), and Brazil (130th), though above the Philippines (138th) and, if it's of any comfort, countries such as Syria, Iran, Venezuela, both Congos, and the Central African Republic (see Chart 11 on page 11).

India ranks particularly poorly on the number of procedures, time and cost involved in starting a business (173rd out of 185 countries), the number or procedures, time and cost required to start a construction project (182nd), the compliance burden associated with paying taxes (152nd) and the number of procedures, cost and time involved in enforcing contracts (184th). India's 'least worst' ranking -23rd – is for obtaining credit.

In most developing countries, the movement of labour from low-productivity occupations (such as subsistence agriculture) into higher-productivity activities (whether in manufacturing or services) is a substantial source of overall productivity growth and thus of sustainable increases in national income.

Chart 11: 'Ease of doing business' rankings, June 2012



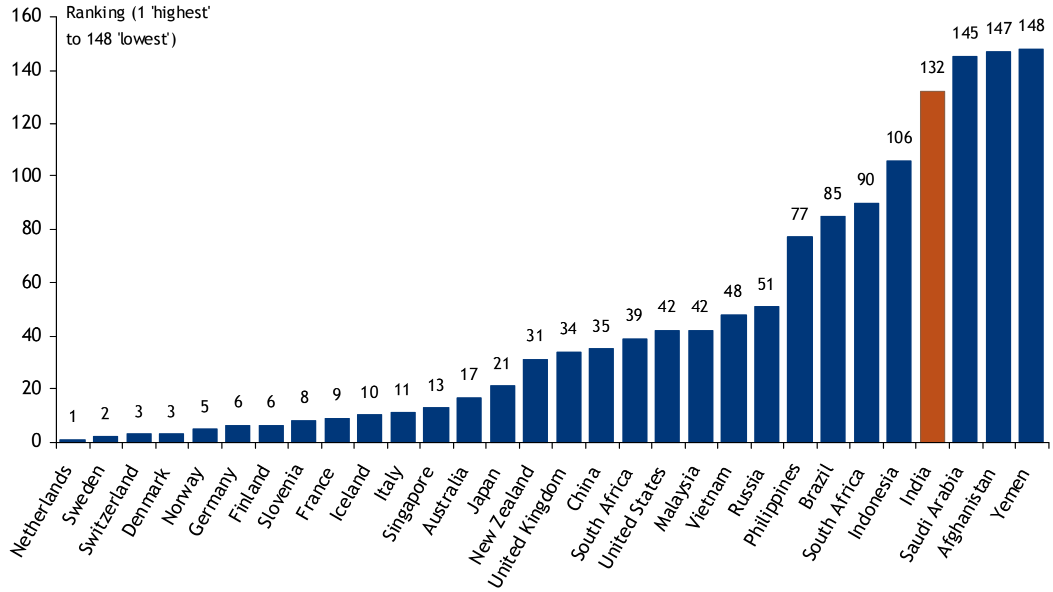
Sources: The World Bank (2013)

In India, however, as the OECD paper from which I have already quoted a number of times points out, "labour is highly immobile across states in India as a whole" with "almost half of the migrants across states [being] women moving for marriage while less than 10% move to find new employment" (Dougherty et al 2008: 15). And while it might be objected that India's plethora of languages and dialects makes internal migration much more difficult than in, say, China, another study finds that over the tend years to 2005 "there was twice as much migration within Europe as within India" (Topolova 2004).

Third, although India is refreshingly free of discrimination on the basis of religion, it nonetheless wastes an enormous amount of its human capital through discrimination on the basis of gender and caste, and – out of a well-meaning intention to offset some of the consequences of the latter type of discrimination, through 'reverse discrimination' in public sector employment. According to the UNDP *Human Development Report* from which I previously sourced comparative statistics on education and health,

- India ranks 132nd on an index of gender inequality, well behind China (35th), the Philippines (77th), Brazil (85th) and Indonesia (106th) – see Chart 12. For a country in which women have from time to time (including at present) played a reasonably prominent role, it must surely be disappointing to be keeping company with such paragons of women's rights as Iran (107th), Sudan (129th), the Congo (132nd), and Saudi Arabia (145th);
- India scores particularly poorly when it comes to women's education: according to the 2011 Census, only 65.5% of Indian females are literate, compared with 82% of males, a difference of 16.5 percentage points: in China, the corresponding figures for females and males are 95.7% and 87.6%, a difference of 8.1 percentage points;

Chart 12: Gender inequality rankings, selected countries



Note: The Gender Inequality Index is a composite measure reflecting inequality in achievements between women and men in reproductive health, 'empowerment' (as proxied by seats in the national Parliament) and the labour market
Source: United Nations Development Program (2013) p. 159.

- Only 26.6% of Indian women aged 25 and older have completed at least a secondary education, compared with 50.4% of Indian men (and 54.8% of Chinese women, 65.9% of Filipina women, 36.2% of Indonesian women and 50.5% of Brazilian women) aged 25 and over.

This is a terrible waste of human potential. So is the continued existence of discrimination on the basis of caste, despite such discrimination having been officially prohibited by India's post-independence Constitutions[3].

Fourth, India's economic development has been hampered by its suspicious attitudes towards globalization and engagement with the global economy. While these are to some extent understandable in view of India's experience of Western imperialism and colonial rule, they have nonetheless been maintained at considerable cost to India's economic performance and the well-being of its people.

As one of India's greatest economists, Jagdish Bhagwati (2011), has argued,

> "Contrary to what skeptics often assert, the case for free trade is robust. It extends not just to overall prosperity, but also to distributional outcomes, which makes the free-trade argument morally compelling as well".

Amartya Sen – who is by no means an uncritical observer of the way the global economy works -– has also written:

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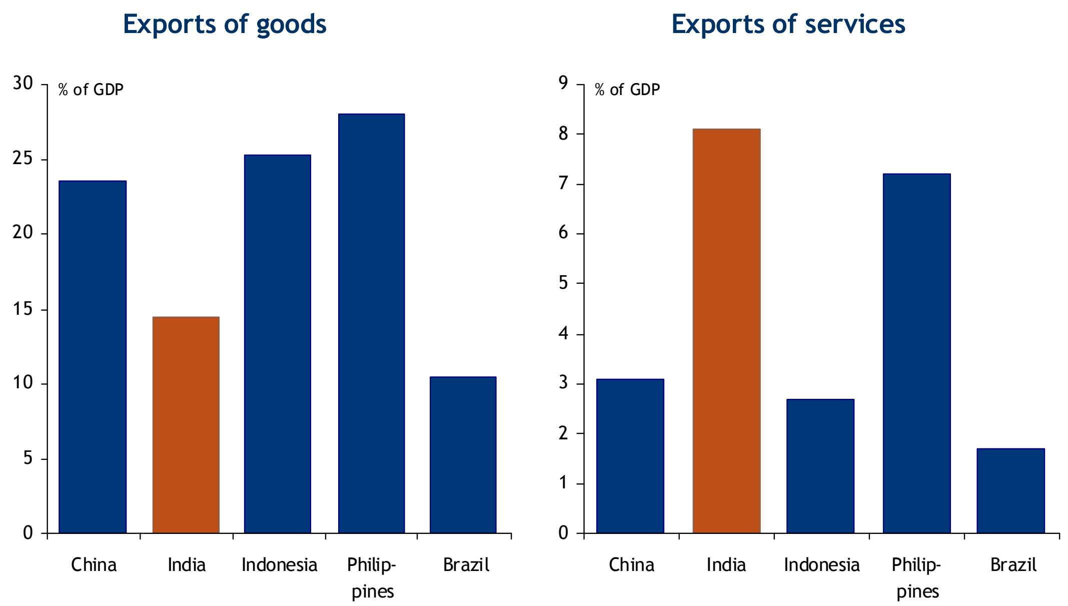
[3] See, for example, Siddique (2008), for a recent analysis of caste-based discrimination in hiring and wage-setting in private sector white collar occupations in India; or Sen (1999: 113).

> "To see globalization as merely Western imperialism of ideas and beliefs … would be a serious and costly error, in the same way that European resistance to Eastern influence would have been at the beginning of the last millennium …. We cannot reverse the economic predicament of the poor across the world by withholding from them the great advantages of contemporary technology, the well-established efficiency of international trade and exchange, and the social as well as economic merits of living in an open society' (Sen 2002).

Yet India remains a much smaller participant in the global economy than it should be. Despite having, as I noted at the beginning, the world's third largest economy, India is only the 19th largest merchandise exporter and the 12th largest importer. Even in the area of commercial services, which is one of India's strengths, it only ranks 8th in the world (between Spain and the Netherlands) (WTO 2012, Tables 1.7 and 1.9). Exports of goods and services account for only 22.6% of India's GDP, compared with 32.0% of China's, 27.6% of Indonesia's and 35.2% of the Philippines' (I am intentionally not comparing India with smaller East Asian economies like Korea or Taiwan) (Chart 13).

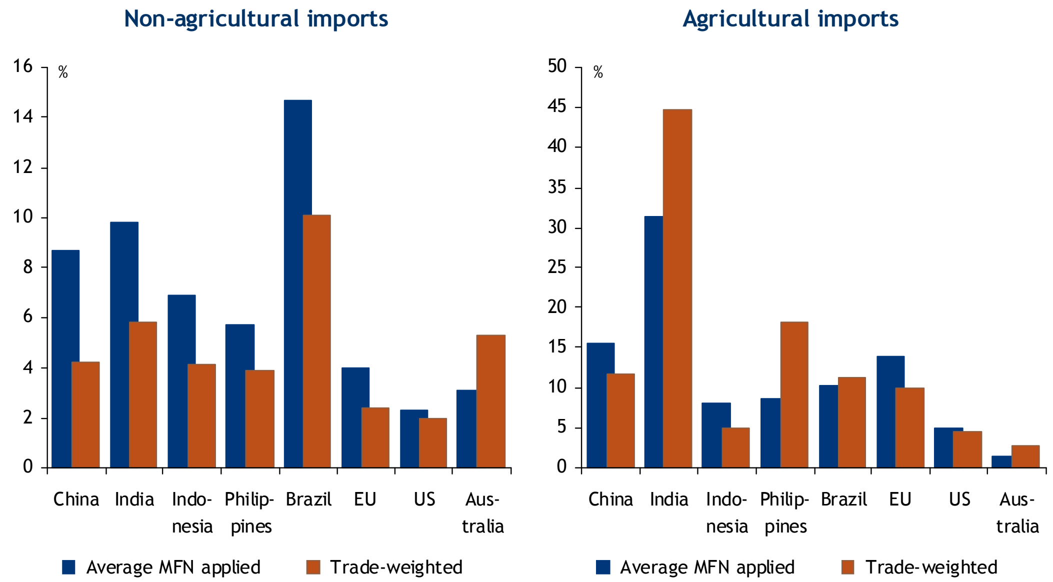
Chart 13: Exports as a share of GDP, 2012



Sources: UNDP (*2012*; IMF(2012).

Although they have come down a long way since 1991, the tariffs which India imposes on imports are still considerably higher than those imposed by other comparable countries (see Chart 14). India's average 'most favoured nation' import tariff is 12.6%, compared with 9.6% for China, 7.0% for Indonesia and 6.1% for the Philippines (although it is lower than Brazil's 13.7% - not that Brazil represents any kind of 'aspirational' benchmark for a trading nation). India's average tariff on agricultural imports is a staggering 31.4% - and this simple average of applied tariffs becomes one of 44.7% in trade-weighted terms – compared with 15.6% for China, 8.1% for Indonesia, 8.7% for the Philippines and 10.3% for Brazil.

Chart 14: Average tariff rates – selected countries, 2010



Source: World Trade Organization online database.

It's worth remembering here that – contrary to the way in which 'protection' is commonly depicted by those clamouring for it, and those (in government) giving it – tariffs aren't something you make foreigners pay in order to get their goods into your country, they are something you make your own consumers pay in order to keep foreign goods out of your country. India's high tariffs on imports of agricultural commodities are a particularly onerous burden on India's poorest citizens. More broadly, high tariffs on imports have retarded the growth of Indian exports, and helped to slow the process of moving labour and capital into higher-productivity uses.

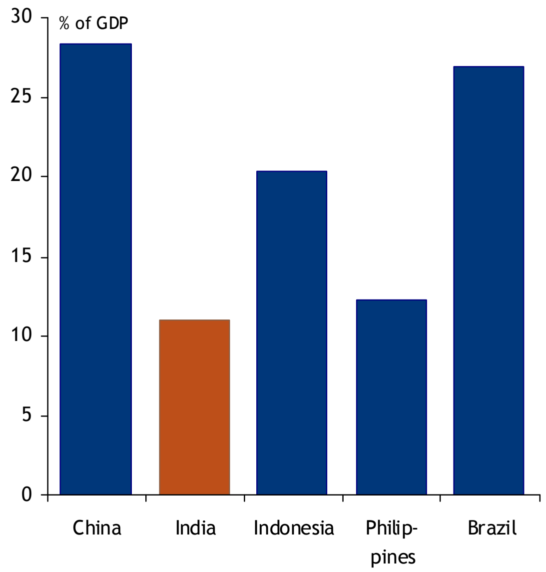
This ambivalence towards engagement with the global economy extends to India's attitudes towards foreign investment. India's stock of inward foreign direct investment as at the end of 2011 was equivalent to 11.0% of GDP, compared with China's 28.3%, Indonesia's 20.4%, the Philippines' 12.3%, and Brazil's 26.9% (UNCTAD 2012: 173-176) (see Chart 14).

This isn't because of any want of investment opportunities in India: it is, rather, because, as the OECD noted in its most recent survey of the Indian economy, "barriers to foreign direct investment in some large service sectors, notably retail, remain high" (OECD 2011: 4). It is encouraging that foreign direct investment inflows into India have picked up over the past five years (and actually exceeded inflows into China as a proportion of GDP in three of the past five years). However, foreign investors still aren't permitted to invest in Indian government bonds.

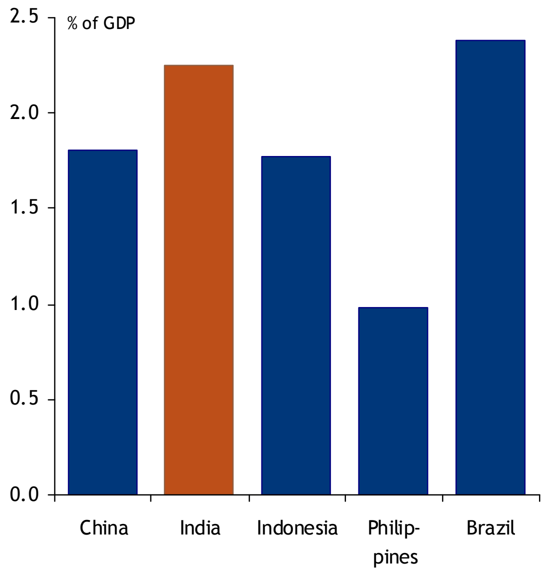
Finally, India's public sector doesn't contribute to achieving economic and social goals as effectively as it could. India has quite a large public sector by 'emerging' economy (and particularly by Asian) standards: according to the IMF's most recent *World Economic Outlook* database, 'general government' spending accounted for 28.0% of India's GDP last year – compared with 24.5% of China's, 19.8% of Indonesia's, and 19.2% of the Philippines' (although less than Brazil's 37.3%) (See Chart 15).

Chart 14: Stock and flow of inward foreign direct investment

Stock of inward foreign direct investment as at end-2011



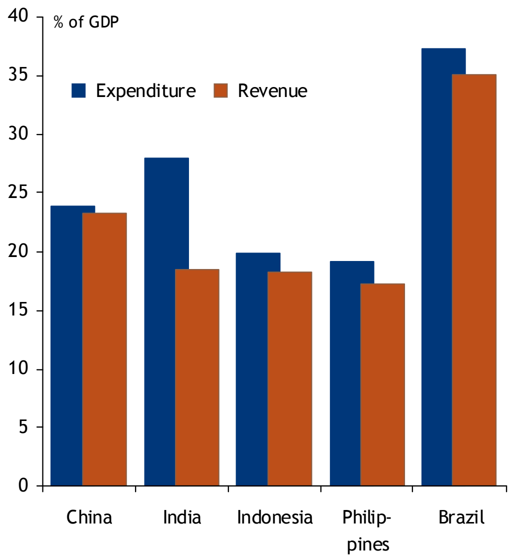
Flow of inward foreign direct investment 2007-2011



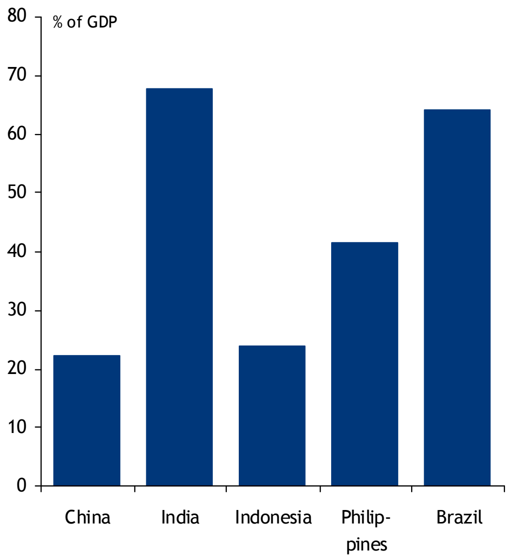
Sources: UNCTAD (2012) IMF (2012).

Chart 15: 'General government' spending, revenue and gross debt

'General government' spending and revenue as a pc of GDP, 2012



'General government' gross debt as a pc of GDP, 2012

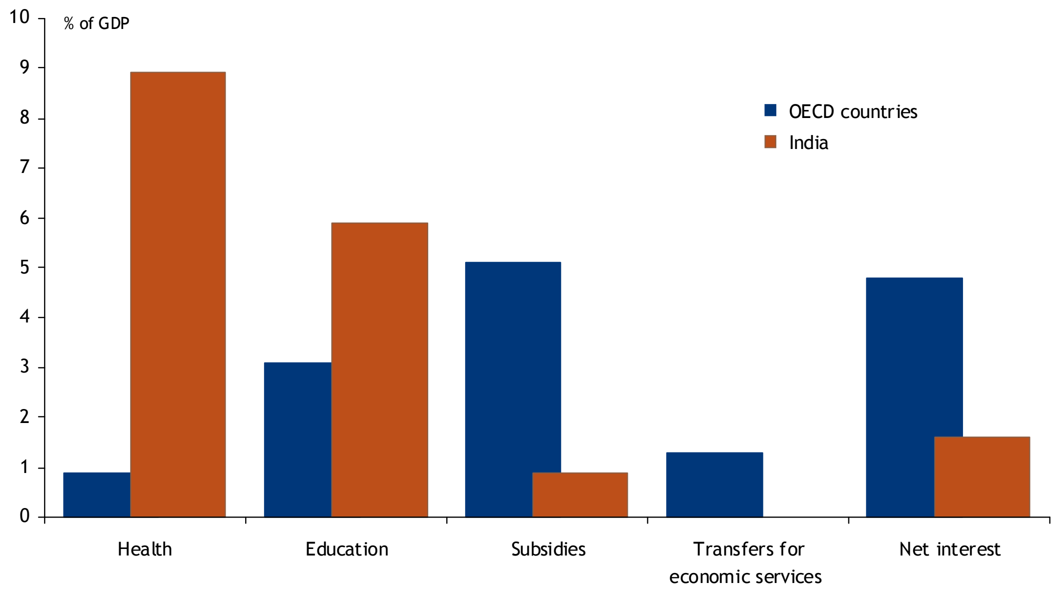


Source: IMF (2012).

That wouldn't be a problem if spending of that magnitude were clearly achieving worthwhile objectives, and if it were more fully paid for by government revenues (instead, 'general government' revenues absorbed only 18.5% of India's GDP last year, leaving a deficit of 9.5% of GDP which, again, is very high by contemporary 'emerging' economy standards – cf. China 1.3% of GDP, Indonesia 1.6% of GDP, the Philippines 1.9% of GDP, and Brazil 2.1% of GDP).

However, much of India's public spending is misdirected. I've already mentioned that India doesn't spend enough on education and health – indeed, the OECD's most recent survey of India notes that only seven countries in the world have lower public outlays on health care relative to GDP than India (OECD 2011: 7).

Chart 16: Government spending on selected functional areas, 2008



Source: OECD (2011, p. 8.

India has also been particularly reticent about making conditional cash transfers to people below the poverty line (conditional, for example, on children's school attendance), which "experience in Brazil and Mexico, among others, suggests … can be an effective way to assist the neediest" (OECD 2011: 6).

India has instead used a guarantee of 100 days per annum of government-funded work for all rural residents – a scheme which isn't restricted to the poorest, and which doesn't embody effective means of ensuring that "infrastructure funded under the scheme provides genuine benefits to local communities".

On the other hand, India spends the equivalent of 5.7% of GDP subsidizing food, fertilizers, irrigation, and electricity – money which could be far more productively and equitably spent on health, education, infrastructure or cash transfers to the poor – and in addition foregoes revenue equivalent to some 3% of GDP by forcing publicly owned oil and gas producers to sell their output to refiners at below-world-market prices and holding the rate of return on state-owned enterprises below their cost of capital (OECD 2011: 8).

More broadly, a surprisingly high proportion of Indian industry – 20% of non-farm business sector output – remains in public sector hands: in eight sectors (including shipbuilding, electric motors, stainless steel and chemicals) the public sector accounts for more than 50% of total output (Dougherty et al 2008: 19).

Given that India is not a Communist dictatorship, it is surprising that so much of the 'commanding heights' of Indian industry remain in State hands. It is also detrimental to India's overall economic performance.

I have spent longer than I really meant to in talking about India's economic performance – and although in much of this I may appear to have been critical of various aspects of India's performance, I don't want to deny the great economic and social progress that India has made over the past two decades.

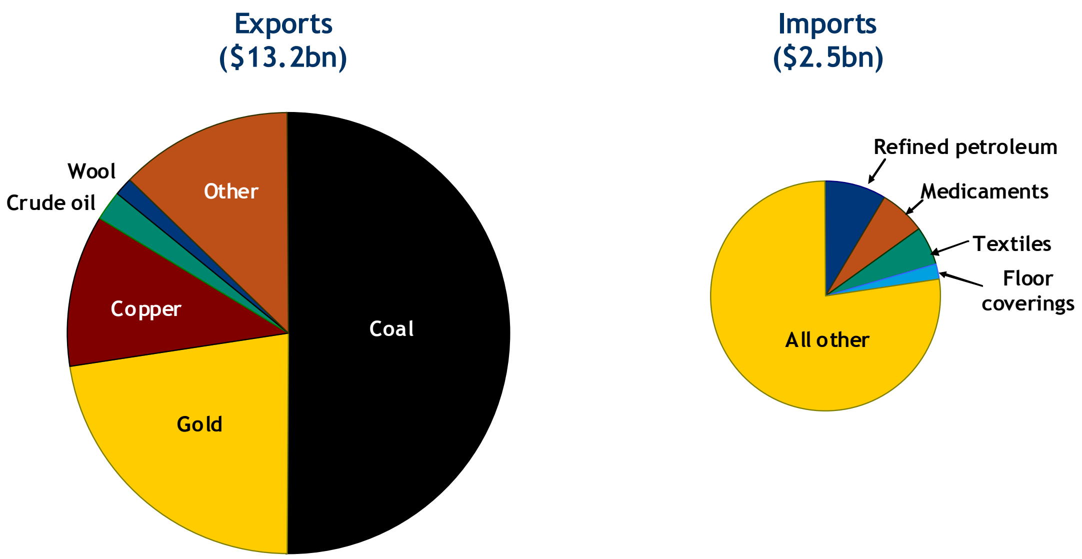
Rather, what I have been seeking to emphasize is that India could do even better – and needs to do better if its people are to live, as Armatya Sen puts it, "lives that people have reason to value" (1999: 87).

However, let me now turn to what was the advertised topic for tonight's talk, which is Australia's relationship with India.

Given that India has risen from being the world's 9th largest economy in 1990 to being its 3rd largest in 2012, it shouldn't be any surprise that it has gone from being our 17th largest export market, accounting for just 1.3% of our merchandise exports in 1990, to being our 5th largest, accounting for 5% of our exports in 2012 (ABS 2013b).

What is surprising is that the trading relationship between Australia and India has remained so narrowly based (Chart 17).

Chart 17: Australia's merchandise trade with India – 2011-12



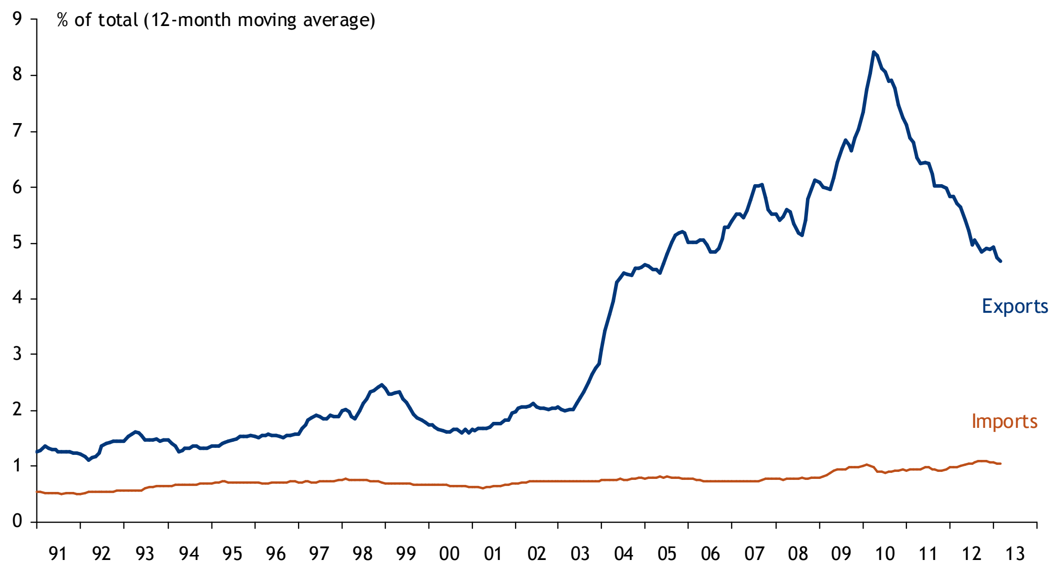
Source: Australian Department of Foreign Affairs and Trade (2013).

Over 83% of Australia's merchandise exports to India are accounted for by just three commodities – coal (which alone accounts for 50% of our exports to India), gold (a further 23% of the total) and copper ores and concentrates. Our agricultural exports to India amounted to less than $500mn in 2011-12, less than one-tenth of the value of our agricultural exports to China. We sold less than $300mn worth of manufactured goods to India in 2011-12, compared with over $1.5bn worth to China (DFAT 2013).

The relationship is also rather lopsided. We imported less than $2.5bn worth of merchandise from India in 2011-12, of which the biggest single component was petroleum, valued at $221mn. By contrast, we imported over $43bn of goods from China in that year.

Also surprising is that the relationship has gone into reverse in recent years (Chart 18). Australia's merchandise exports to India fell by almost 26% between 2010 and 2012. While some other countries bought less from us last year than they did in 2010, with no other trading partner have our exports fallen by as much over the past two years by as much as they have to India: and our total exports have risen by 7.3% over this two-year period. Put differently, although India's share of Australia's merchandise exports is still a lot larger than it was 22 years ago, it has actually fallen from a peak of 7.4% in 2009 to (as I mentioned a moment ago) just below 5% in 2012.

Chart 18: Australian merchandise trade with India as percentage of total trade



Source: ABS *International Trade in Goods & Services* (5368.0).

Not all of these developments are of Australia's 'doing'. Some of it is the result of lower prices, especially for coal, which as noted earlier accounts for more than half of Australia's total merchandise exports to India. In addition, India continues to maintain very high barriers to imports of agricultural products (which of course is at the expense of Indian consumers, as well as Australian farmers), and to imports of many manufactured goods.

And India's economy has slowed more markedly than China's, from a China-like growth rate of 8.9% in 2010 to a rather less spectacular 5.1% (the slowest in 11 years) in 2012.

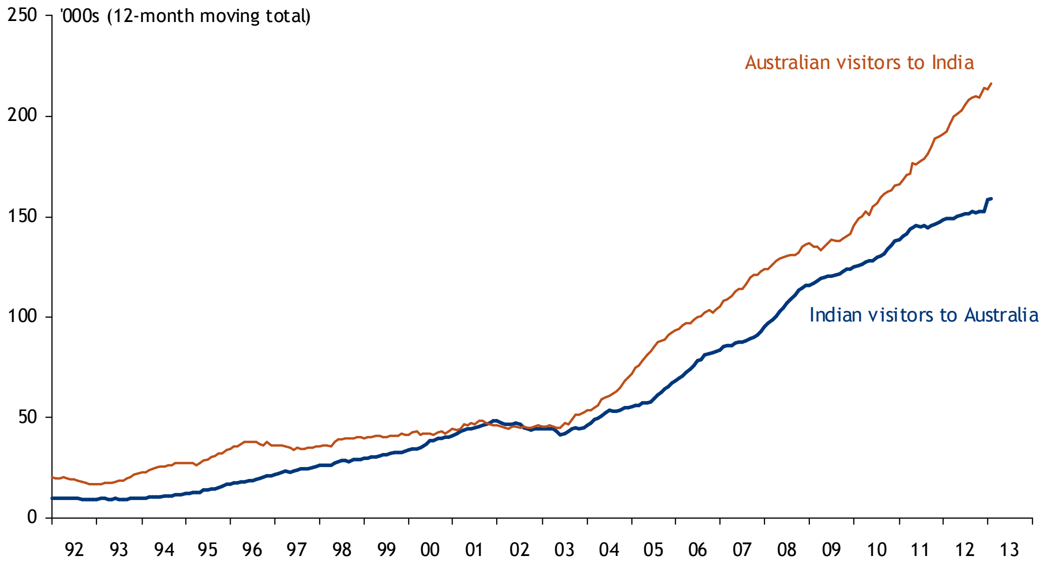
However, something similar has happened to our services trade with India. Although the number of Indian tourists coming to Australia has continued to rise, it has done so at a slower rate, of less than 7% per annum over the past two years, down from an average of 13% per annum over the preceding decade. By contrast, the number of Chinese tourists visiting Australia has risen by over 18% per annum over the past two years, up from an average of 14% per annum over the preceding decade (ABS 2013a).

And the number of Indian students undertaking higher education in Australia has fallen from nearly 28,000 in 2009 to less than 15,000 in 2011 (Department of Innovation etc. 2013). We know that there were particular factors behind this trend, and it is to be hoped that the efforts which have been made to repair the damage caused by that spate of attacks in Indian students in Australia will bear fruit over the years ahead.

At least in this case the flow in the opposite direction hasn't experienced the same fate (Chart 19). It remains the case that more Australians visit India than Indians visit Australia: and over the past two years, the number of Australians visiting India has risen at an average annual rate of 13.5%, little changed from the 14.1% average annual growth rate of the preceding decade.

While some of that almost certainly represents growth in business travel to India, and another part of it return visits by people of Indian origin now residing in Australia, it also speaks to the continuing appeal which India's history, geography and culture have to hundreds of thousands of Australians – something which is also evident in the greater appeal of 'Bollywood' movies to Australian audiences.

Chart 19: Australia-India tourist traffic



Source: ABS (2013a).

Permanent movements of people – at least from India to Australia, if not the other way round – are also becoming an increasingly important part of the relationships between Australia and India. For the past four years, India has been Australia's third largest source of migrants, after New Zealand and China but – since 2009 – ahead of Britain.

At the time of the 2011 Census, there were 295,362 people living in Australia who were born in India, representing 1.4% of Australia's total population – more than any other country except for England (4.2%), New Zealand (2.2%) and China (1.5%).

None of this may count for much in the absence of a strong commitment to building the relationship at the government-to-government level.

After all, Australia still trades a lot in both goods and services with the UK (albeit much less than we used to), more Australians claim British ancestry than that of any other country, we still have the British flag in the corner of ours and we continue to profess undying allegiance to Her Majesty the Queen: yet as soon as you arrive at Heathrow you are immediately reminded of just how much that counts with the British. Similarly, the fact that Australia is the only country to have fought alongside the United States in every war the Americans have engaged in since World War I counts for precisely zilch when we land at LAX, in getting our sugar and lamb into the American market, or in the prices we pay for downloading software from Adobe or apps from Apple.

It used to be that Australia and India had few interests in common apart from our membership of the British Commonwealth and our love of cricket. Over the past two decades, India's need for the resources with which the Australian continent has been richly endowed, and our shared apprehension as to some of the possible consequences of the growth of China's economic and military power, exercised as it is (and for the foreseeable future will be) by a very different political system from the one which we share, has brought our two countries closer together.

We have managed to remove some of the long-standing irritants from that relationship – for example, the ludicrous position that we would sell uranium to China, because it has signed the Nuclear Non-Proliferation Treaty even though they have breached it (not least by proliferating nuclear materials and technology to Pakistan, North Korea and possibly Iran), but (until recently) wouldn't sell it to India because it hadn't signed the NPT, even though it has never proliferated nuclear materials and technology to anyone.

But we've continued to be unenthusiastic about India's participation in APEC, and we've not taken anything like the strategic interest in the Indian Ocean that we have in the Pacific – other than, perhaps, as a source of (or place to put) asylum-seekers.

Michael Wesley, who is now Professor of National Security at the Australian National University, captured the essence of the difficulties now facing Australia-India relations in an article he wrote just over a year ago, when he was still at the Lowy Institute:

> "In many ways, engaging with a rising India presents Australia a much more complex task than engaging with a rising China. For all the opacity of its strategic culture, China's interests are not hard to work out; nor are its actions particularly hard to interpret. A powerful India may be more benign than China or it may not, but it will be much harder to read or anticipate.
>
> And Australia will always be neither fish nor fowl for India. The only western country in India's strategic orbit, it will be moralizing or pragmatic by unpredictable turns …

> Ultimately, then, transcending their troubled history and ill-matched personalities is more than a diplomatic challenge for Australia and India. It will be a test of character and commitment – and ultimately of understanding and adaptability – on both sides" (Wesley 2012).

That's a test that both sides will need to work hard for, if we are each to pass the other's hopes and expectations.

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