India-Japan Economic Partnership: Beginnings of a New Era

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On August 1, 2011, India-Japan economic relations reached a new milestone as the governments of the two countries agreed to implement the Comprehensive Economic Partnership Agreement (CEPA) that was concluded at the beginning of the year. Although the CEPA materialised nearly seven years after the negotiations began in 2004, both countries should be encouraged by the fact that they have succeeded in putting together an agreement that sets sights on a more enduring economic relationship between them.

The India-Japan CEPA is the third CEPA that has been concluded by India (similar agreements were signed with Singapore in 2005 and with Korea in 2009); they cover not only the goods and services trade but also areas like investment, competition policy, intellectual property rights and government procurement. However, this agreement assumes more significance since it has two firsts for India: one, it is the first time that India has concluded a bilateral free trade agreement with an industrialized country; and two, it is also the first truly comprehensive agreement concluded by India, given the wide range of issues it covers.

Features of India-Japan CEPA

In terms of granting market access opportunities, the CEPA requires India to eliminate tariffs on 17.4% of its total tariff lines immediately after the agreement comes into effect. Within a period of 10 years, India will eliminate tariffs on nearly 86% of its tariff lines. Meanwhile, Japan has agreed to eliminate tariffs on 87% of its tariff lines immediately. Over the next decade, Japan will have removed import tariffs on nearly 97% of the tariff lines. Benefiting from the tariff elimination commitment made by Japan will be marine products, fruit, alcoholic beverages, and textile and clothing products. Many of these products have had higher tariffs in the past, thus impeding access to the Japanese market.

With the coming into effect of the CEPA, Japan will immediately give duty-free access to Indian products in a wide range of sectors. The more prominent products that will benefit from the tariff elimination initiative are fruit and marine products, chemicals, and clothing. Japan has proposed that immediately after the CEPA is implemented, tariffs will be eliminated for seafood, spices, fruit such as mangos and lemons, and spirits. The inclusion of seafood in the list of tariff-free items is particularly noteworthy for these products, which were once India's largest export item to Japan but have faced a steady erosion of their share over the past decade. In the year 2000, more than a quarter of India's exports to Japan was accounted for by seafood, but by 2005, the share of seafood declined steeply to just above 10%. The declining trend continued, albeit slowly thereafter: in 2009, the share of seafood was only 6% of India's exports to Japan. Exporters of fruit from India should also feel encouraged by the elimination of tariffs on a number of important products. But at the same time, they surely hope that India and Japan will be able to resolve some of the irritants caused by the strict application of the food safety standards by the latter, which had, until recently, impeded exports of mangos to Japan.

Equally important is Japan's decision to remove tariffs on apparel, a product group in which India was the largest exporter (EU-27 counted as a single country) in 2009, its exports reaching US$11.5 billion. Japan, on the other hand, is among the largest importers of apparel products. In 2009, its imports amounted to around US$26 billion, making Japan the fourth-largest importer of apparel products, with a share of nearly 8% of global imports. Apparel products have a significant share of almost 5% in Japan's total import basket and India is the sixth-largest supplier of apparel to Japan. However, India's share in the total imports of apparel by Japan stood at 0.8% in 2009, which dwarfs in comparison with China's share (nearly 80%) and is low in comparison even with other competitors like Vietnam and Thailand. In the case of knitted apparel, which accounted for a 50% share in Japan's total garment imports, India has a much smaller share compared to countries like Bangladesh. It is expected that the removal of tariffs on apparel will provide added incentives to exporters from India to meet the needs of the relatively large market for these products that Japan offers.

India, on its part, has offered Japan additional market access in sectors such as cement, capital goods, energy fuel, cotton fabric, and machinery as part of its commitments under the CEPA. Machinery, both electrical and non-electrical, has remained the largest component of India's imports from Japan. The share of this product category in India's total imports from Japan increased from nearly 37% in 2000 to 44% in 2009. This signifies the extent of the dependence that India has on Japan in regard to imported machinery, and therefore, the move to liberalize trade in this sector will help the users of these products in India to get easy access to a more sophisticated range of products.

As in the case of machinery, reduction of tariffs on cement will benefit the actual users in India since India has been getting ever more dependent on Japan to meet its growing need for this product. In 2009, India's imports of cement from Japan exceeded US$18 million.

From India's point of view, the agreement in the CEPA on the regulatory approval process required for marketing generic

India's Trade with Japan

Years	Exports			Imports		
	Value (US$ million)	Share in total	Rank	Value (US$ million)	Share in total	Rank
1999-2000	1,685.4	4.6	6	2,535.8	5.1	6
2000-01	1,794.5	4.0	7	1,842.2	3.7	6
2001-02	1,510.4	3.5	7	2,146.4	4.2	6
2002-03	1,864.0	3.5	7	1,836.3	3.0	9
2003-04	1,709.3	2.7	11	2,667.7	3.4	9
2004-05	2,127.9	2.5	10	3,235.1	2.9	12
2005-06	2,481.3	2.4	10	4,061.1	2.7	12
2006-07	2,868.1	2.3	10	4,599.5	2.5	15
2007-08	3,858.5	2.4	11	6,325.9	2.5	13
2008-09	3,025.7	1.6	15	7,886.3	2.6	12
2009-10	3,629.5	2.0	13	6,734.2	2.3	14
2010-11	5,211.7	2.1	12	8,151.4	2.4	16

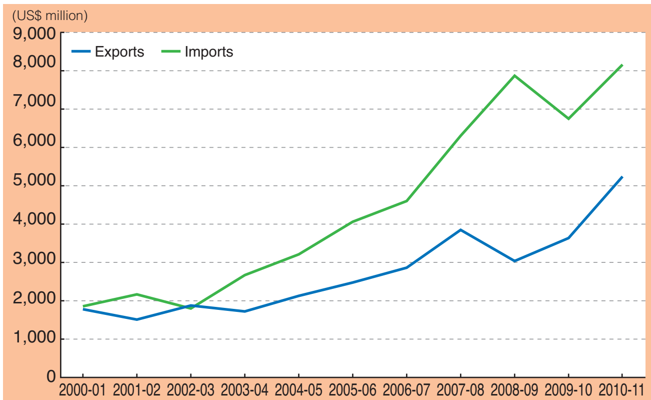
Source: Department of Commerce, Government of India

pharmaceutical products is particularly satisfying for it opens up the possibilities of exports of these products to Japan. This is an area in which the Indian industry has considerable strengths, which can be harnessed further through the opportunities available in a large market like that of Japan's. The existence of differences in the regulatory framework proposed by Japan was a major hurdle towards concluding the deal but this was resolved as Japan agreed that applications seeking market approval shall be accorded a no less favourable treatment than that accorded to like applications from its own companies provided they fulfil all the requirements under the laws and regulations existing in India. It was also agreed that the approval process would be completed within a reasonable period.

While the partners provided additional market access in areas they stand to benefit from as part of their CEPA commitments, India and Japan have also excluded several products from the tariff-reduction exercise because of domestic sensitivities. Prominent product groups that have been excluded are agricultural commodities and a sizeable proportion of processed products, plastic products, and several categories of non-electrical machinery and auto and auto components. This implies that most of the product sectors in which India needs to protect the interests of domestic producers will continue to be shielded from import competition.

The inclusion of the services sector in the CEPA provides opportunities for service providers, including individual service providers covered under Mode 4, from India to establish their presence in the Japanese market. In sectors like architectural services and computer and related services, Japan has gone beyond the offers it had made in the ongoing Doha negotiations for opening its markets. Particularly significant for India is that professionals will benefit from the ease of access to the Japanese market as a result of

Trends in India's Trade with Japan



Source: Department of Commerce, Government of India

the CEPA. On its part, India has allowed access to employees of a Japan-based company or partnership who travel to India temporarily for short periods of up to one year or the duration of the contract in order to perform a service pursuant to a contract between their employer and a client or clients located in India or to fulfil qualification and licensing requirements where their presence in India is an essential condition for the fulfilment of these requirements.

The services agreement is also significant in that it paves the way for the establishment of rules, by mutual consent, covering vital components of services rules such as domestic regulation, mutual recognition and subsidies. An early engagement on these issues would help in bringing the services sectors of the two countries closer, for their mutual benefit.

CEPA Breaks Lockjam in India-Japan Trade Relations

While reduction in the barriers to trade in both goods and services will bring advantages for both India and Japan, the biggest change that the CEPA ushers in is the change in perceptions regarding the bilateral economic engagement between the two countries. Over the past decade and a half, India-Japan trade has been low-key, and as a result, the relative significance of Japan as a trade partner has declined quite rapidly. In 1996, Japan was India's fourth-largest trade partner, but by 2010, it was not even among the top 10. The declining importance of Japan as a trading partner meant that India was unable to register its presence in what was until recently the world's second-largest economy.

The retrogression in India-Japan trade links that has occurred over the past decade is quite obvious from the table. Japan was the sixth-largest export destination of India at the end of the 1990s but in less than a decade the relative importance of the country declined quite appreciably. The situation was worse on the import side, where Japan slid from being the sixth-largest destination in 1999-2000 to a lowly 16th in 2010-11. The relative decline of Japan as a source of imports for India becomes more evident from the fact that in recent years, countries like Iraq and Belgium have improved their positions as import sources for India.

It may be argued that the lack of buoyancy in the trade relations between India and Japan during the past decade also meant that India did not appear prominently on the radar screen of Japanese investors. Until very recently, inflows of foreign direct investment (FDI) of Japanese origin were less than US$1 billion. It is only during the past two years that some increase has been registered: during 2010-11, the magnitude of Japanese FDI was about US$1.6 billion, which is extremely modest compared to those that several emerging economies, in particular the members of the Association of South East Asian Nations (ASEAN), were able to attract.

The major advantage for the ASEAN members resulting from the increased levels of Japanese FDI that they were able to attract was that these countries became part of the global value chains (GVCs) that developed as Japanese firms modified their business strategies. The GVCs not only allowed the countries to focus on activities in which they had a comparative advantage, they also brought with them two large pay-offs. In the first place, the GVCs necessitated development of high-quality infrastructure that would enable adherence to the "just-in-time" practice of the Japanese investors. This development led to the second pay-off, namely, the closer economic integration of the region, which has largely been instrumental in transforming ASEAN into one of the growth poles of the global economy.

Larger Benefits of Closer India-Japan Economic Integration

However, the most significant impact of this economic entente between India and Japan is likely to be the development of a dynamic Asian region through the East Asia Summit process. The East Asian Summit, which from 2005 has brought ASEAN and six other countries, namely, India, Japan, China, Korea, Australia and New Zealand together, with a vision to develop closer integration between the member countries, depends critically on India and Japan to provide the strategic balance to the grouping in the face of the steadily increasing economic influence of China. Adding substance to the East Asia Summit process was the report on the Comprehensive Economic Partnership for East Asia (CEPEA), which argues that economic cooperation, facilitation of trade and investment, and liberalization of trade and investment would provide the wherewithal for deepening economic integration, narrowing development gaps, and achieving sustainable development. With the Western economies facing an uncertain future, the CEPEA has become ever more relevant. Successful implementation of the India-Japan CEPA should therefore be seen as the much-needed fillip for setting the CEPEA in motion.

Growing cooperation between India and Japan can play a key role in moving the process of integration between countries of the Asia-Pacific region if India is able to participate more actively in APEC. India will make its first appearance in the APEC Summit to be held in Hawaii in November 2011 as an observer and this development could stimulate discussions that are already going on among the APEC members to expand the membership of the grouping, which was frozen until the end of 2010.

India's interest in joining APEC will of course be rekindled by the fact that the leaders of the member countries decided to take concrete steps toward realization of a Free Trade Area of the Asia-Pacific (FTAAP) in adopting the Declaration, "The Yokohama Vision - Bogor and Beyond," at the conclusion of the Summit in 2010. According to the leaders, the FTAAP, which is a major instrument to further APEC's regional economic integration agenda, "should be pursued as a comprehensive free trade agreement by developing and building on ongoing regional undertakings, such as ASEAN+3, ASEAN+6, and the Trans-Pacific Partnership, among others." Towards this end, APEC is being seen to be making important and meaningful contributions "as an incubator of an FTAAP by providing leadership and intellectual input into the process of its development, and by playing a critical role in defining, shaping, and addressing the "next-generation" trade and investment issues that FTAAP should contain." As stated above, India is an integral part of the ASEAN+6 process of economic integration and the country should therefore see a major role for itself in the formation of regional integration arrangements that are using this formation as one of the building blocks. Besides, India has established close economic links with ASEAN as a grouping through an FTA that is being implemented and is also seeking to formalize broad-based CEPAs with several of the prominent members of the grouping. JS

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