

India-Japan Relationship Becomes Comprehensive

By N. Chandra MOHAN



Author
N. Chandra Mohan

Landmark Pact

The Indo-Japanese relationship has entered a qualitatively new phase with the signing of a comprehensive economic partnership agreement (CEPA) on February 16, 2011 and its implementation from August 1, 2011. This is India's third CEPA after Singapore and South Korea and its first with a developed country. This agreement seeks to abolish import duties on most products, increase access for Indian professionals and contractual service providers to the Japanese market, and liberalize investment rules.

This landmark agreement became operational after seven years of patient negotiations - a period that has seen the terms of six prime ministers in Japan, from Junichiro Koizumi to Naoto Kan. While all of them extended their support to this agreement together with India's Prime Minister Dr Manmohan Singh, the roles played by the charismatic Koizumi and visionary Shinzo Abe were perhaps the most decisive. They wanted the relationship to go beyond economic cooperation to a strategic partnership.

Japan's youngest-ever prime minister, Shinzo Abe, has written in his book *Towards A Beautiful Society* that, he will not be surprised if, in 10 years' time, Japan-India relations overtake Japan-US and Japan-China relations. Abe visited India in September 2011 and in his address to the Indian Council of World Affairs in Delhi stated that he and Singh had no doubt that "the Japan-India relationship had the largest potential for development of any bilateral relationship, anywhere in the world."

The former Japanese prime minister's views on the bilateral relationship are clearly far-sighted as he added that, "We were also in perfect agreement that a strong India is in the best interests of Japan and a strong Japan is in the best interests of India. For our economic cooperation, the sky is the limit." With such a vision animating the CEPA, is it any wonder that it is off to a flying start? Indian diplomatic missions in Japan have issued more than 10,000 three-year work visas for Japanese corporate workers in the last two years.

In the first month of the CEPA, the number of certificates of origin issued by the Japan Chamber of Commerce and Industry (JCCI) amounted to 439. This is the largest number of certificates of origin issued in the first month of an economic partnership agreement concluded by Japan, stated Tadashi Okamura, chair of JCCI, in his address to India's Federation of Indian Chambers of Commerce and Industry. With such beginnings, trade will definitely be boosted to \$25 billion by 2014 from \$10.36 billion in 2009-10.

To fulfill CEPA's promise, however, both countries must exploit each other's complementarities. Japan is a "hard" power with world-

class manufacturing and technological prowess. India is a "soft" power in IT and services. Japan is short of natural resources. India has abundant raw materials. Japan has capital. India's strength is the availability of a skilled workforce with a strong engineering and scientific capability and not just low wages. Japan seeks markets. India has a flourishing domestic market.

Comprehensive Agreement

What is the CEPA? For starters, it grants greater market access for the products of both countries. Over the next 10 years, tariffs will be abolished on 97% of exports from India to Japan and 90% of exports from Japan to India or 94% of two-way trade, emphasized Okamura. India is required to eliminate tariffs on 17.4% of its total tariff lines after the agreement comes into effect. Meanwhile, Japan has agreed to eliminate tariffs on 87% of its tariff lines immediately.

CEPA thus brings gains to Indian exporters of textile and clothing products, seafood and spices, as Japanese duties on these products will be immediately eliminated. Indian textile exporters now can sell to Japan at zero duty, gaining an edge over rivals. Other sectors that gain from day one of this agreement include agricultural products such as mangoes, citrus fruit, spices, instant tea, spirits like rum and whisky, petrochemicals, chemical products, cement, and jewelry, according to an official release.

A big gainer is India's pharmaceuticals industry, which has proven world-class capability in the generics space - or cheaper versions of drugs that go off patent - as the Japanese government shall accord no less favorable treatment to the applications of Indian companies than it accords to applications of its own persons for drug registration. The Japanese company Daiichi Sankyo has already shown great interest in boosting its capability in generics by taking over Indian giant Ranbaxy Laboratories Ltd.

Benefits would, however, be much bigger for India's services sector, with Japan agreeing to liberalize temporary movement of yoga instructors, classical music and dance exponents, English language teachers and Indian cuisine masters. India's software professionals can also offer their services and contribute to Japan's IT sector. Contractual service suppliers, independent professionals such as accountants, market researchers and management consulting firms, too, can provide their services in Japan.

However, India's automobile and automobile parts industry has been shielded from tariff cuts by its inclusion in the negative list of items. But India has agreed to reduce tariffs on auto parts made of steel, which is a major gain for Japanese industry. Others that have

been excluded from the tariff elimination process are agricultural commodities like wheat, basmati rice and a sizeable proportion of processed products such as edible oils, plastic products and several categories of non-electrical machinery.

All of this is not to suggest that CEPA's gains are largely India's. Far from it! Japan will also be able to export consumer durables, such as electronics, more cheaply to India, but tariff reduction by India will happen in phases over 10 years. Japan's major gain is in investments, as India has agreed to give national treatment to both pre- and post-investment from that country. India also hopes to gain from greater access to Japanese technology and its world-class management practices that have been adopted in many countries.

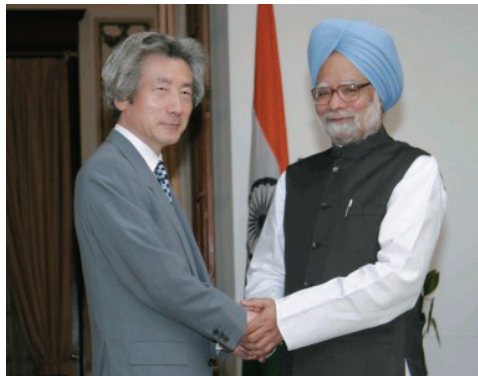
More Japanese Investments

Clearly, more of Japan's investments will now head India's way, thanks to the former's ill-fated romance with China. The CEPA will accelerate this trend. For long, there has only been talk that the level of Indo-Japanese trade and investment is far from exploiting the vast potential. Over the years, many Japanese trade missions visited India but they were largely fact-finding in nature. They observed that the investment climate in India was not good enough due to poor infrastructure, labor problems and inadequate reform.

But the India of 20 years ago is not the same as the India of today. If the Japan-India relationship is to blossom and overtake those of Japan-US and Japan-China in 10 years' time, this vast potential must be harnessed. To be sure, Japan's gaze is turning towards India belatedly. The current prospect is one where 90% of multinationals (MNCs) - including Japanese - are making profits in India compared to 45-50% in China. Many MNCs are also reporting higher profitability in India than they do globally.

But Japan's investments in India so far amount to only \$1.2 billion in 2010 - that is a fraction of its exposure to China and ASEAN. From April 2000 to July 2011, around 4% of India's foreign direct investment (FDI), especially equity inflows, came from Japan, compared to 7% from the US and 6% from the UK. Japan's contribution is also concentrated "almost exclusively" in transport-related industries, with 27% of FDI inflows going to the automobile

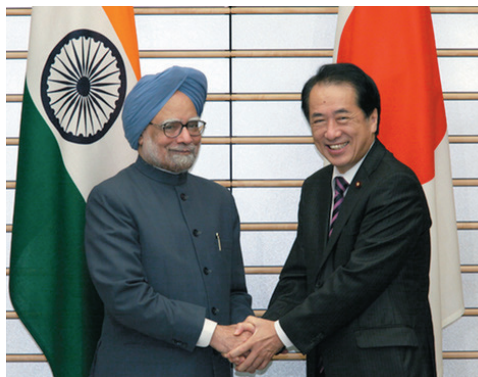
Photos: Cabinet Office



Junichiro Koizumi met with Manmohan Singh, the Prime Minister of India, in April 2005.



Shinzo Abe held a meeting with Manmohan Singh, who was visiting Japan as an official guest, at the Prime Minister's Official Residence on Friday, December 15, 2006.



Former Prime Minister Kan shaking hands with Prime Minister Singh on October 25, 2010.

sector from April 2000 to January 2011.

The ultimate synergy is when "hard" power trucks with "soft" power. This will be in the area of services where India is fast emerging globally as a major knowledge power. Many MNCs from the developed nations have set up R&D facilities in the country to tap its vast pool of scientists and engineers. But Japan has 30-times more such skilled people and it will be truly befitting if it becomes a partner and shares its expertise with India in high-end R&D by shifting some of its facilities to the country in the future.

Pan-Asian Integration

Manmohan Singh, for his part, is a visionary like Abe as he envisages a broader pan-Asian community encompassing ASEAN, China, Japan, South Korea and India, and rivaling NAFTA and the EU. Such a bold concept is bound to strike a deep chord in Japan, which similarly conceives of a vast East Asian economic free trade zone that includes China, India, ASEAN, Australia, Japan, New Zealand and South Korea. CEPA clearly is an integral part of this Look East policy that is truly one of Singh's achievements.

With the shadow of China looming over Asia, both countries also feel that they have to defend their turf by concluding bilateral agreements with countries in the region like Thailand and Singapore, especially at a time when multilateral trade negotiations to conclude the Doha Round are headed nowhere. While regional trade

agreements are a second-best alternative to a multilateral deal like at the World Trade Organization, there is no doubt that a pan-Asian economic community is definitely compatible with the latter.

From a strategic perspective, the CEPA clearly is an important building block for this pan-Asian vision in the 21st century. Once big-ticket Japanese investments head towards India, bilateral trade is bound to explode beyond the anticipated level of \$25 billion by 2014. The stakes in the Asian century are high indeed, as both India and Japan engage each other on the economic cooperation front by leveraging their strengths and complementarities. **JS**

N. Chandra Mohan is an economics and business commentator based in New Delhi.