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Deepening the Japan-India Economic Partnership and Mutual Prosperity

Working Paper

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Introduction

Today, far more than ever before, there is clarity on the scope of common areas of interest between Japan and India. In the past four decades, global economic relations have become more complex, and India and Japan, the world's third and fourth largest economies respectively (in PPP terms) have an immense range of common interests on which to join hands in order to provide synergies for each other's prosperity.

The Japan-India relationship was given important focus, clarity, and resolve at the September 2014 meeting between the countries' Prime Ministers in Tokyo. In their joint Tokyo Declaration, Prime Ministers Shinzo Abe and Narendra Modi stated that they "looked forward to enhanced trade and collaboration in high technology ... decided to work closely towards further expanding bilateral trade relationship to the next stage ... decided to further deepen bilateral economic and financial cooperation."¹

The Declaration further states that: "The two Prime Ministers announced the India-Japan Investment Promotion Partnership under which [they] decided to set a target of **doubling Japan's foreign direct investment and the number of Japanese companies in India within five years** as an objective to be jointly achieved. ... Prime Minister Abe expressed his intention ... to finance appropriate public and private projects of mutual interest including in the **areas of next generation infrastructure, connectivity, transport systems, Smart Cities, rejuvenation of Ganga and other rivers, manufacturing, clean energy, skill development, water security, food processing and agro industry, agricultural cold chain, and rural development**. ... The two Prime Ministers welcomed the **public-private initiatives between the two countries to set up Electronics Industrial Parks in India**. They also shared the intention to develop '**Japan Industrial Townships**' and **other industrial townships** ... They decided to explore ways to enhance Japanese and Indian participation in appropriate infrastructure projects in India. ... [and] welcomed the progress in the **ongoing flagship projects of India-Japan economic partnership** Prime Minister Modi **invited Japanese investments in the**

¹ Tokyo Declaration between India and Japan, 1st September 2014, paragraphs 20 and 23

development of new smart cities and industrial parks along these corridors”²
(emphasis added).

This declaration shows considerable progress for the Japan-India partnership, which needs to be taken forward with more comprehensive content and a positive trajectory. This short paper seeks to provide some of the necessary direction.

(1) A changed perspective required for both India and Japan

Most of the schemes envisaged for the India-Japan partnership involve Japan as the “senior economic partner” helping India address its problems in relation to infrastructure, technology, smart cities, etc. Considered at an aggregate level, this is a valid proposition. However, India at a dis-aggregated level has several different complex activities, which are combined with a dynamic and fast-growing economy whose growth provides a wider scope of partnership with Japan. An indication of this can be seen from the fact that at present, Japan’s exports are about double those of India, but after about 15 years India’s exports are likely to be about US\$ 1 trillion more than those of Japan.³

Bearing these factors in mind, both Japan and India need to move from a hub-and-spoke approach and consider other possibilities. At present, any consideration of India’s strength would have to look at information technology (IT), and also the possibility of investment in India as a launch pad for seeking other markets. For instance, the Japan External Trade Organization (JETRO) has mentioned that India is well placed for trade and investment with the Middle East and Africa.⁴ India has developed a strong base of science and technology and industrial structure that can become a platform for complementarity with Japan. Thus, Japan would need to broaden its perspective and move towards such activities, including research and development (R&D) in emerging economies such as India.

² Paragraphs 23 and 27.

³ Figure 40 of Buiter, W. and E. Rahbari, 2011, “Trade Transformed. The Emerging New Corridors of Trade Power”, Citi GPS: Global Perspectives & Solutions, 18 October 2011.

⁴ Page 33 of <https://www.jetro.go.jp/en/news/releases/20140807856-news/overview.pdf>

Another relevant area is outward investment from India. Reciprocal facilities may be provided by Japan, as are being provided through a special high-level cell to facilitate Japanese investment into India. Something similar may be developed in Japan to address Indian concerns, including the issue of standards and mutual recognition of pharmaceuticals, which has limited market access for Indian pharmaceuticals under the Comprehensive Economic Partnership Agreement (CEPA). A possible solution could be to assist India in developing the standards through which mutual recognition would become possible for such products.

(2) Such a perspective is easier in a world with global value chains

Global value chains show the complementarity of goods, services, and technology working together and involving multiple nations: partnerships and Japanese contributions to the Indian economy can take place in each of these three phases of the value chain. Like the facilitating focus on goods that is encompassed in India's Make in India scheme, India needs to have a similar thrust for services and technologies as well. Japanese foreign direct investment (FDI) in China (Shanghai) for example has gone to the services sector. Indian healthcare, accounting, IT, education, legal services, R&D, and data management are examples of areas where Japan and India could examine the possibility of working together in each of the two countries or in third countries.

Another important aspect to recognize is that domestic value chains underpin global value chains, and vice versa. This inter-linkage, in fact a mutually dependent relationship, should be kept in mind in order to achieve sustained progress through trade and investment policy.

Other examples emerge, for instance, from JETRO's emphasis on business innovation in Japan through the promotion of "brain circulation" between Japan and Silicon Valley and the promotion of "diversity in business", where foreign students and those with diverse backgrounds and abilities can perform at their full potential to

create innovation.⁵ A collaborative framework for the India-Japan partnership would expand the scope of such activities as well.

Some additional features of mutual support could emerge from the CEPA between Japan and India. Examples include suggestions like the creation of a list of issues to address, with solution-oriented and timely actions encouraged for both countries to address these concerns. A special visa could be provided for business, similar to the best treatment given by either country to others. Likewise, closer links between digital trade, audio-visual, and health services could be developed within the CEPA or other co-operative frameworks. Areas in the CEPA that could be implemented earlier than envisaged could be considered. An example is the recent discussion on the CEPA where India requested more market access for its pharmaceuticals, but the request has yet to be fully addressed.

Interestingly, the India-Japan Business Forum has decided to form joint groups to take up some specific issues in the areas of infrastructure, energy, skill development, innovation and intellectual property rights- (IPR) related matters, so that focused attention could be provided to them.⁶ This initiative could be further expanded and strengthened by substantive government and business participation.

(3) More comprehensive list of sectors

Priorities identified in the Tokyo Declaration mentioned above can be supplemented by specific activities addressing infrastructure constraints, nurturing and developing value chains and industrial corridors domestically or internationally, establishing new clusters or enhancing existing ones to better link with FDI from Japan, and developing high-level horizontal and consistent services for clusters and smart cities. The list of such diverse sectors would include *inter alia* automotive, railways and public transportation and people-moving systems for urban India, ship-building, heavy industry for energy (low emission, high efficiency), consumer electronics and chips, education, skill development, transportation, energy, facilitating business,

⁵<https://www.jetro.go.jp/en/news/releases/20140807856-news/overview.pdf>

⁶http://articles.economictimes.indiatimes.com/2014-09-04/news/53563965_1_forum-meeting-baba-kalyani-prime-minister-narendra-modi

reducing red tape, general machinery, electric machinery, transport equipment, precision machinery, railways, smart city projects, biotechnology, clean energy, electronics and the overall infrastructure space, bilateral energy cooperation on a commercial basis,⁷ automobiles, machinery, chemical, cutting-edge technologies in such areas as electronic hardware, telecommunication equipment, heavy industries, rail transport management systems, and technological exchanges in agriculture and environmental management.⁸

Other possibilities emerge from additional areas covered by the "Make in India" initiative, sectors where Japan has invested in recent FTAs or free trade zone initiatives, including services and the nuclear sector, an area in which Japan seems to have an interest but not much movement has taken place yet.

A specific priority focus amongst these sectors could be determined considering those products whose trade is expected to grow most rapidly during the next decade like tourism, industrial equipment, aerospace and defense, chemicals, transport equipment, household electrical appliances, information and communications technology (ICT), organic food, transport, medical, and pharmaceuticals.⁹

(4) Need to understand the way global markets are changing due to evolving trade and investment regulations

Global trade and investment regulations and economic relations are likely to change through mega-regional trade negotiations such as Trans Pacific Partnership (TPP), Transatlantic Trade and Investment Partnership (TTIP), and Regional Comprehensive Economic Partnership (RCEP). India is part of RCEP, while Japan is part of both RCEP and TPP.

The United States is part of TPP and TTIP, which together account for about half of world trade. The standards of these trade regimes are expected to be higher than

⁷ A specific focus of the Japan-India Business Leaders Forum

⁸ The Forum's Joint Report, section on "Strengthening Co-Operation in Strategic Areas" will provide additional ideas for further initiatives.

⁹ Ernst & Young, Trading Places. <http://emergingmarkets.ey.com/trading-places-the-emergence-of-new-patterns-of-international-trade/>

RCEP, with the US being a dominant economic presence in both. Thus its mandatory and private standards will be most significant in the mega-FTA markets. The US standards largely reflect private standards, incorporating sustainable development standards and social standards. The private standards are usually higher than mandatory standards and they keep evolving over time with higher requirements embodied in them. India would have to upgrade its capacities to meet these standards so as not to lose market share in TPP markets or to stay connected with the value chains in the economies of TPP. This is one area where cooperation with Japan could be focused on ways to improve Indian standards to be in line with those emerging in the largest FTA markets. An important practical step could be to help implement the recent standards roadmap developed by India's Department of Commerce and the Confederation of Indian Industries.

Other areas in the TPP would also imply a need to consider the extent of upgrades that may be required in Indian systems. These include, for instance, IPRs and digital trade, especially data transfer issues. It is noteworthy that to give effect to trade in IT services, international data transfers become essential.

(5) Policy requirements

It is useful also to consider policy areas emphasized by Indian and Japanese industries.

In general, policies emphasized by Japanese industry include IPR, competition policy, government procurement, and implementation of trade and FDI facilitation measures. The latest survey by the Japan Bank for International Cooperation¹⁰ ranks India as the top preference for investment by Japanese investors, and also provides the top concerns of Japanese industry with respect to the operational conditions in India, namely, under-developed infrastructure, intense competition with other companies, unclear execution of the legal system, the complicated tax system, labour problems, and security and social instability.

¹⁰ http://www.jbic.go.jp/wp-content/uploads/press_en/2014/11/32994/20141128English1.pdf

For the Indian market, Japanese and Indian companies emphasize policies that make it easier to do business (particularly processes for land acquisition, starting a business, taxation, and contract enforcement), help to provide commercial opportunities through value chains, enhance legal certainty with stability of economic conditions, and reduced labour problems. Indian industry gives importance to ongoing global developments and recommends *inter alia* policy steps such as ensuring that taxation does not hinder the free flow of goods; entering more international treaties for increasing “reciprocal territories;” updating antiquated laws; that Government recognize and update laws keeping in mind the trends of higher technology; more trade based on IPR; and greater participation in global trade.¹¹

It is interesting to note that experts who examined the Japanese markets to suggest possible policy improvements that would encourage FDI to Japan came up with a number of features which are similar to those relevant for India. For example, their suggestions include addressing high tax rates and business costs, restrictive labor regulations, unique characteristics of Japanese markets, difficult regulatory and administrative procedures, policy instability, and securing appropriate human resources.¹² Other suggestions include social security and tax reform; greater reliance on savings or investment from abroad, and benefiting from global trade and investment opportunities; increasing productivity through structural reforms and market opening; and participating in TPP and other Free Trade Agreements.¹³ Others also suggest providing financial and technical assistance to improve infrastructure and human resources in India, using Japanese soft loans to develop investment projects in India, encouraging Japanese pension funds to invest in India, enhancing swap arrangements, and deepening Indian financial markets.¹⁴

¹¹ <http://www.kpmg.com/IN/en/IssuesAndInsights/ArticlesPublications/Documents/KPMG-CII-Ease-of-doing-business-in-India.pdf>

¹² JETRO 2014 Global Trade and Investment Report, pages 38 and 39.

¹³ Shujiro Urata and Mitsuyo Ando, “In Search of Mutually Beneficial Economic Strategies for Japan and India: A Japanese Perspective,” in *Deepening the Japan-India Partnership: Strategies for the Asian Century* (New Delhi: Oxford University Press, forthcoming).

¹⁴ Devesh Kapur and Rohit Lamba, “Strengthening The Japan-India Economic Partnership,” in *Ibid.*

To enhance productive capacities, lessons from industrial policy experience become relevant. Namely, much more important than restrictive policies are policies to upgrade facilities and capacities, making systemic improvements and facilitating entry of products and operations of business. These policies help with the timely movement of parts of a value chain and to meet the relevant standards. Without such policies, the positive impact of other policy initiatives would tend to dwindle over time.

An often overlooked area is Track 2 initiatives between business and business, with informal government support. Such links must also be augmented and taken forward within a well-formulated program for building upon the facilitating policy steps taken by the Indian government. New ideas must be tested. For example, those Japanese firms that have ranked India as the most attractive country in the JBIC Survey could be contacted by the Indian government and businesses to help create business partnerships. The focus could include both how to address each other's concerns but also how to collaborate and build upon each other's strengths.

The two governments have started implementing several of these policies. For example, Prime Minister Modi has emphasized a wide range of reform measures focused on improving the business environment in India, including through tax, administrative and financial regulations; facilitating policies as part of the "Make in India" programme; labor reforms, some of which have already begun; and a special focus on macro-economic stability.

India's high-level initiative to facilitate Japanese investment in India is particularly significant. In addition to new areas, the ongoing initiatives could be considered for wider application. An example of such an initiative is the VLFM (Visionary Leaders for Manufacturing) program,¹⁵ which involves Japanese and Indian entities. Based on Japanese expertise, the Confederation of Indian Industry (CII) also has training programs, including the Kaizen program to upgrade firm-level productivity in India¹⁶.

¹⁵ <http://www.jica.go.jp/india/english/activities/activity19.html>

¹⁶ <http://cii.in/AwardsDetail.aspx?enc=a1thlFAxFN2fZw+Lhx8W48NNyh4tF8QwU282LCa4PmjNFzFcAV2w24BGC5JofMJZwXaWjrbPnOGSKt6ECjcopw==>

Conclusion

Business to business activities and a policy-level partnership between India and Japan would help achieve several larger goals such as development co-operation. These include sustainable development, improving production capacities and skills, infrastructure development, education, health, waste management, renewable energies, science and technology, innovation, and initiatives to develop policies that help upgrade value-added activities.