

**REPORT OF THE INDIA-JAPAN JOINT  
STUDY GROUP**

**JUNE 2006**

## PREFACE

1. H.E. Dr. Manmohan Singh, Prime Minister of the Republic of India and H.E. Mr. Junichiro Koizumi, Prime Minister of Japan agreed in November 2004 to set up an India-Japan Joint Study Group to give its recommendations for strengthening economic relations between the two nations.
2. During the visit of the Prime Minister of Japan to India in April 2005, the two leaders directed the Joint Study Group to submit its report within a year of its launch, focusing on measures required for a comprehensive expansion of trade in goods, trade in services, investment flows and other areas of economic relations between the two countries. The Joint Study Group was also tasked to consider the feasibility of the two countries moving towards a liberalized and upgraded framework for economic engagement, including an India-Japan economic partnership agreement.
3. The Joint Study Group, composed of government officials and representatives of business and academia from the two countries, held four meetings – first in New Delhi in July 2005, second in Tokyo in November 2005, third in New Delhi in February 2006 and the fourth and final one in Tokyo in June 2006. A wide range of areas and issues was covered in discussions during these meetings, which were supplemented by extensive exchanges between the meetings.
4. As a result of these detailed deliberations and studies, the Joint Study Group has concluded that there is a huge untapped potential to further develop and diversify the economic engagement between India and Japan. With the objective of bringing about a comprehensive expansion of bilateral economic and commercial relations, the Joint Study Group is making a series of recommendations, covering trade in goods, trade in services, investment flows, role of Japanese ODA in promoting economic partnership, and other areas of economic cooperation. The Group is also recommending that India and Japan launch inter-governmental negotiations to develop an Economic Partnership Agreement or Comprehensive Economic Partnership Agreement, within a reasonable period of time.
5. We, the Co-Chairs of the Joint Study Group, hereby submit our report to the Prime Ministers of India and Japan for their consideration.

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## **CHAPTER 1: OVERVIEW OF INDIA-JAPAN ECONOMIC AND COMMERCIAL RELATIONS**

### **Significance of strengthening Japan-India economic relations**

#### **Making Japan -India Partnership the driving force of Asia's prosperity**

**1.1** Asia is progressively emerging as a power centre of the world. The “Arc of Advantage” comprising Japan, India, the Association of Southeast Asian Nations (ASEAN) members, China, and the Republic of Korea (ROK) proposed by Prime Minister Manmohan Singh of India generates approximately 30% of the world income. In addition, countries in Asia have been strengthening their initiative for economic partnerships, namely, free trade agreements (FTA)/economic partnership agreements (EPA). A lot of new dynamism has been developing in Asia and in December 2005 the East Asia Summit was held to discuss regional cooperation from a strategic viewpoint.

**1.2** Japan and India are responsible and major players in Asia sharing strategic interests and upholding common values such as democracy, human rights and a market economy. With regard to the size of their economies, Japan has the second largest gross domestic product (GDP) in the world and India has the tenth largest GDP in the world. In particular, the strong economic growth of India is predicted to continue over the long-run and there are ever widening prospects for the country to become an economic power. Against this backdrop, both countries are expected to become the driving forces for further prosperity in Asia.

**1.3** Japan and India have continued to develop their friendly relations founded on a long history of exchanges. At the start of the 21st century, with a view to further enhance their friendly cooperative relations that had been nurtured historically, both the countries agreed to Japan-India Global Partnership in August 2000 on the occasion of Prime Minister Mori's visit to India. Furthermore, the two countries issued a joint statement called the “Japan-India Partnership in a New Asian Era” on the occasion of Prime Minister Junichiro Koizumi's visit to India in 2005. This joint statement was formulated taking into account the increasing further significance of the Japan-India Global Partnership and the surge of developments in Asia. In the Joint Statement, the two countries announced that they would give a new strategic focus to the Japan-India Global

Partnership, and, as responsible and major players in Asia, will expand their traditional bilateral relations to those promoting security, stability and prosperity of Asia as well as advancing international peace and equitable development and committed to work together to promote the vision of an East Asian community.

**1.4** Nevertheless, the current state of the economic relations between the two countries shows that their potential has not been fully harnessed when compared to the role they are expected to play. The Japan-India Joint Study Group (JSG) received a mandate to study specific areas that would realize the full potential of the economic relations between Japan and India and make the two countries the driving forces of prosperity in Asia. This report takes into account the existing ground realities in both countries and presents a wide range of measures as well as potential sectors and products that should be considered for strengthening Japan-India economic relations.

### **Japan and India – mutually complementary economies**

**1.5** Japan has advantages in terms of capital, technological skills, and product development. India has a huge market made up of approximately 1,100 million people as well as a large and high-quality labour force. In addition, a middle-class with strong purchasing power is emerging in India comprising approximately 200 million people. The country also has technical skills in new sectors such as Information Technology (IT) and Biotechnology.

**1.6** The rapidly growing IT industry of India hopes to see the Japanese companies with an edge in the hardware sector expand their businesses in India, which will enable India to enlarge its industrial structure into the hardware sector to supplement its software exports. In addition, the difference in the population dynamics of Japan and India, with the former having an ageing society and the latter a large younger population, is another dimension that makes the Japanese and Indian economies complementary. It is thus possible for both countries to enhance their mutually beneficial cooperative relations.

### **Further promotion of reforms in both Japan and India**

**1.7** Reforms are the key to further economic growth. Both Prime Minister Koizumi and Prime Minister Singh are actively engaging in reforms. The reforms in Japan include the privatization of the postal services, financial reform

and the promotion of special zones for structural reform, while the reforms in India include the easing of restrictions on foreign investment, development of agriculture, infrastructure development and refinements in the taxation system. Removing the impediments to Japan-India economic relations and advancing closer economic relations would further promote the reforms in both countries and contribute to create employment.

**1.8** Coupled with stronger Japan-India economic relations, it is expected that transfer of technology and mutual understanding of business culture would be advanced along with the expansion of trade and investment. In addition, both the countries should strengthen their exchanges and cooperative relations in a wide range of areas, including people-to-people exchanges, academic exchanges, IT, science and technology cooperation, and environmental and energy cooperation. The JSG has made it its mission to focus on policies needed to comprehensively expand trade in goods and services, investment and other areas of economic relations, as stated in the Japan-India Joint Statement.

## **Current status of domestic economies and foreign economic policies in Japan and India**

### **Japan**

#### **Current status of the Japanese economy**

**1.9** The Japanese economy has been making a modest recovery after a long period of recession. Considering that the current trend of recovery has been achieved by the private sector, driven by the progress of IT-related adjustments and the recovery of exports rather than by increasing public spending, and that the target for disposal of non-performing loans has now been reached, it can be said that Japan has already emerged from the long period of economic stagnation it suffered after the burst of the so-called bubble economy. According to government estimates, Japan will have a 1.9% real economic growth for FY2006. Nevertheless, Japan's public finances have been worsening since the late 1990s and its outstanding domestic long-term debt is expected to reach approximately 151% of GDP (605 trillion yen, FY2006 forecast). Fiscal structural reform is, therefore, a challenge.

**1.10** Under the policies of “without reform there will be no growth,” “leave to

the private sector what it can do,” and “leave to the localities what they can do,” Koizumi Administration aims to promote structural reforms covering finance, taxation, regulation and public expenditure to bring out the vitality of the private sector and the motivation of regions, overcome deflation and revitalize the economy. During the vital period up to FY2006, Japan will give priority to the following three challenges while accelerating structural reform: 1) to create a “small and efficient government;” 2) to create a strong foundation that will allow Japan to deal with the issues of declining birthrate, aging population and globalization; and 3) to overcome deflation and to make sure that the private demand-led economic growth continues.

## **Foreign economic policies**

**1.11** Japan is promoting EPA negotiations in an effort to complement its multilateral free trade structure centered on the World Trade Organization (WTO). In this respect, while Japan is advancing negotiations with the aim of realizing EPAs which are consistent with WTO agreements, Japan aims to strengthen comprehensive economic partnerships by promoting EPAs which include not only trade of goods and services but also investment, intellectual property, competition and development of business environment, with traditional bilateral FTAs consisting of tariff elimination and reduction at the core.

**1.12** In particular, Japan intends to strengthen its economic partnerships with Asian countries with which it has deep interdependent relations, not only through the expansion of trade, investment, etc. but also through the creation of common rules in various fields and facilitation of the movement of people. Japan aims to develop and strengthen the competitiveness of the entire Asian region.

## **India**

### **Current status of Indian economy**

**1.13** Indian economy has been posting an average 6% annual economic growth since its economic liberalization in 1991. There has been a further acceleration of the growth rates to over 8% during the past couple of years. In particular the IT industry has been expanding rapidly. For instance, its software

and service exports grew by a factor of roughly 40 over the last ten years. Furthermore, the share of primary industries has been overtaken by the share of secondary industries, and an economic structure tailored to achieve stable economic growth is being established.

**1.14** In view of the importance of agriculture, poverty reduction and employment initiatives, Indian Prime Minister has called for “economic growth accompanied by employment” and has announced the objective of achieving a 8-10% annual economic growth in a manner that generates employment. India has been steadily relaxing its regulations on foreign investment in various sectors while aiming at “economic reforms with a human face.” Meanwhile, factors constraining economic growth are emerging, and the Government of India has emphasized the fact that infrastructure sector will need US\$150 billion in foreign investment in the next few years. With the injection of public funds serving as the catalyst, the enormous infrastructure needs must be covered by private investment.

### **Foreign economic policies**

**1.15** India launched its “Look East Policy” in 1991 and is making efforts to strengthen its relations with Asian countries including members of ASEAN. India has signed an FTA framework agreement with Thailand and a Comprehensive Economic Cooperation Agreement (CECA) with Singapore, and is already implementing early harvest measures. With a view to protect foreign direct investment, India has also already concluded bilateral investment protection agreements with 48 countries and agreements are currently being negotiated with 30 additional countries.

### **Current status of economic relations**

#### **Trade**

**1.16** The total amount of trade between Japan and India has been rising since 2002, reaching approximately US\$6.8 billion in 2005. However, this figure is not commensurate with the two countries’ economic power and potential. The trade share and its relative importance between Japan and India are diminishing: Japan ranks 10th among India’s export destinations (share of 2.5%) and 10th among import sources (2.8%), and India ranks 26th among Japan’s export

destinations (0.6%) and 28th among import sources (0.6%). As for other comparable major economies in 2005, the trade value between Japan and China was US\$189.4 billion and between India and the US, US\$20 billion indicating a substantial potential for further expansion of trade between Japan and India.

**1.17** India's exports of software to Japan have grown dramatically in recent years, marking a 60% increase in the year 2004 alone. At the same time, there have been no changes in the traditional structure in which major exports are comprised of commodities such as gems, marine products and iron ore, making diversification of the trade structure a challenge. Manufactured goods such as automobile components still constitute a large proportion of India's imports from Japan. Japan and India should study the sectors in which India has expanded its trade volume with other countries, and consider if there is any scope for increasing the trade value in, for instance, IT, textiles and fiber products, or pharmaceutical products. Hence, bearing in mind these circumstances, the challenge is to diversify the trade structure.

## **Investment**

**1.18** Since 1991, Japan's cumulative direct investment to India totalled approximately US\$2.01 billion, making Japan the third largest provider of direct investment to India. Nonetheless, considering India's potential as an investment destination and Japan's economic size, the current situation is not entirely satisfactory. Also, the current Japanese investment in India concentrates on machinery and transport equipment, and most of the future investment is likely to come from expansion of the companies already operating in India. Thus, it is desirable that investment structure is diversified to cover sectors such as electricity and electronics, steel, infrastructure, pharmaceutical products, and development of urban infrastructure. It is noteworthy that the number of Japanese companies operating in India has surged in the past several years, currently standing at around 300. According to a study conducted by the Japan External Trade Organization (JETRO), about 75% of Japanese companies operating in India had positive operating profit in 2004. As for the operating profit outlook for 2005, India is ranked first in Asia in the survey, and nearly 70% of companies expect to see an "improvement" with the main reason being increased sales in India. A study conducted by Japan Bank for International Cooperation (JBIC) revealed that India ranked third after China and Thailand, as a promising country in which to expand business in the medium term, and

second after China in the long term. Thus there are high expectations for the future.

**1.19** Japan has requested India to develop an investment environment with the aim of further expanding and diversifying Japan's investment to India, and measures to this end include infrastructure development in India, further easing of restrictions on foreign investment in such areas as retailing, enhancing transparency of and simplifying investment approval procedures and reviewing the labour law. India has made steady progress in easing restrictions on foreign investment, and hopes that domestic and foreign companies will operate under similar conditions and take advantage of business opportunities in the future. In some cases, companies of other countries have made massive investments in India. Under these circumstances, it would be beneficial for Japan to locate sectors in which investment by Japanese companies hold promising potential.

**1.20** Japan's Official Development Assistance (ODA) has played an important role in India's infrastructure development and technological enhancement. Japan is India's largest bilateral donor and India was the top recipient of yen loans from Japan between FY2003 and FY2005. Delhi Metro is a "best practice" project which was assessed highly for introduction of a system allowing smooth and safe implementation of the project. This project symbolizes Japan-India friendship. It is desirable that similar high visibility projects are implemented in the days to come. On the other hand, unlike in East Asian countries, there are few investments by Japanese companies to date in infrastructure development. Thus, Japan could attach importance to improvement of the investment climate through infrastructure enhancement by ODA.

**1.21** The situation of Indian companies operating in Japan and their business circumstances indicate that they are not making the most of their potential, although major IT companies are operating in Japan. Japan has identified promotion of investment in Japan as the basis for structural reform and is aiming to double the flow of investment to Japan in the five years beginning in 2001. Japan is implementing the Program for the Promotion of Foreign Direct Investment in Japan step by step, including the establishment of a one-stop consolidated business consultation service point (Invest Japan) and intends to support further investment from India to Japan.

## **Other areas of cooperation**

**1.22** Under the Science and Technology Initiative noted in the Eight-fold Initiative for Strengthening the Japan-India Global Partnership, the 7th meeting of the Japan-India Joint Committee on Science and Technology Cooperation was held in November 2005 and the two countries decided to seek possible cooperation in areas such as biotechnology, nanotechnology, alternative energy sources and robotics.

**1.23** Japan and India are major energy consuming nations in Asia, and therefore, securing a stable supply of energy sources, promotion of energy-saving, and improvement of energy efficiency are critical policy agendas that are directly linked to the economic development of both countries. Minister of Economy, Trade and Industry of Japan and Minister of Petroleum and Natural Gas of India have already agreed to comprehensive energy cooperation, and signed the joint statement. It is expected that relations in the field of energy will be further strengthened on the basis of the joint statement. Director-General (Petroleum) in METI and Petroleum Secretary met in end of September 2005.

**1.24** The first Clean Development Mechanism (CDM) project that Japan registered with the United Nations (UN) as part of its efforts to reduce greenhouse gas emissions was a joint project conducted in India. It is hoped that India and Japan will initiate the second and third CDM joint projects.

**1.25** The language barrier is an obstacle to strengthening economic relations between Japan and India. When Prime Minister Koizumi visited India in 2005, the Government of India announced a plan to increase the number of people learning Japanese to 30,000 in five years and decided to adopt Japanese as an additional foreign language elective in secondary education from the next fiscal year. The Government of Japan intends to strongly support this plan through the Japan Foundation programs and by dispatching Japan Overseas Cooperation Volunteers (JOCV) to teach Japanese. It is expected that this plan will contribute to increase in the activities carried out by Japanese companies operating in India and help Indian companies enter the Japanese market. It is also desirable to see an increase in the number of Japanese and Indian students studying in each other's countries. In this regard, it is observed that in 2004 there were 410 students from India and 80,592 students from China in Japan. The Government of Japan has substantially increased the number of Indian participants in the

Japan Exchange and Teaching (JET) Programme with the aim of strengthening English language education in Japan and promoting internationalization of the local communities. It is expected that India will cooperate by sending many high-quality Indian teachers of English to Japan.

**1.26** As the birthplace of Buddhism, India is home to Buddhist ruins, with which Japanese people are familiar, and also many other famous world heritage sites. For this reason, India's tourism development is a sector where the potential of Japan-India cooperation is high. Japan, through ODA, is providing cooperation in the conservation of the ruins and development of tourism sites in India. It is expected that this assistance will serve to promote tourism cooperation between Japan and India and lead to the revival of the tourism industry in both the countries.

### **Multilateral Trade System**

**1.27** Japan and India both benefit greatly from the multilateral trade system and both countries recognize that an early conclusion of the WTO Doha Trade Agenda negotiation will be beneficial to the whole world. They also recognize the importance of working towards a final agreement.

### **Future prospects**

**1.28** The Japan-India economic relations are already on an ascending curve. It is vital to ensure that these trends continue, develop and further accelerate. In particular, diversifying the trade and investment structure is a challenge and the JSG's task is to present measures to consider the potential fields and products, with a view to strengthening Japan-India economic relations, taking into account the existing ground realities in the two countries.

**1.29** In order to strengthen economic relations between Japan and India, it is important to bolster comprehensive cooperative relations in a wide range of sectors that include not only trade and investment, but also IT, science and technology, energy, environment and people-to-people exchanges.

## **CHAPTER 2: TRADE IN GOODS**

### **Japan's and India's Global Trade in Goods**

**2.1** Trade in goods is at the heart of economic co-operation between any two societies. Japan is one of the major trading powers of the world, while India's unilateral trade liberalisation has steadily increased the trade intensity of the Indian economy. Yet trade between the two countries has stagnated. The Joint Study Group (JSG) has spent considerable time trying to understand the reasons for this state of affairs, so as to come up with practical and feasible solutions and suggestions.

**2.2** The general perspective was to look for measures that could result in the diversification of export baskets of both countries. Such diversification needs to take into account the dynamic factors shaping each country's trade with the other. In the case of Japan, its massive direct investment in other Asian countries, several of which are expected to conclude preferential trade agreements with India, will divert trade to exports by Japanese firms located in those markets and thereby erode potential or actual bilateral trade. Similarly, for India, preferential access by other countries to the Japanese market would tend to crowd out its potential or actual exports.

**2.3** While there is no question that, over the long run, trade is stimulated by investment, it is unrealistic to believe that investment will flourish in the absence of a prior, vibrant trade relationship. The JSG accordingly felt that, in order to be responsive to the political mandate given to it by the two Prime Ministers, it was necessary to be bold in testing the limits in both economies so as to allow bilateral trade to realise its full potential.

**2.4** With US\$ 565 billion of exports in 2004, Japan ranked 4<sup>th</sup> in world merchandise exports (Table 1). This follows upon a period of relative stagnation, until 2002. The United States, China, and the Republic of Korea, accounting for about 45 percent of Japan's exports and imports collectively, are Japan's most important trading partners. Table 1 also shows the sustained growth in India's trade. The EU, USA, China, UAE, Switzerland, and Korea are India's most important trading partners.

**2.5** In general trade in both economies has taken place under multilateral disciplines and both countries remain committed to the strengthening of a rules-based multilateral trading system. However, as increased resort is being made by other trading blocs to preferential bilateral agreements, India and Japan have both recently begun to conclude similar agreements to serve the goals of preserving market access and increasing competitive pressure in the domestic economy. There has also been a growing awareness of the significance of much greater economic integration within Asia, beginning with the financial crisis of 1997 and resulting in tentative steps such as the Asian Bond Market Initiative. India and Japan have also agreed to work together in building an East Asian community and have worked together in the East Asia Summit to foster regional economic integration in Asia.

**Table 1. Global Merchandise Trade: India and Japan**

Year	Japan			India		
	Expor t	Impor t	Tota l	Expor t	Impor t	Tota l
	US\$ billion					
1995	443	336	779	30	35	65
2000	478	380	858	43	50	93
2001	403	349	752	45	58	103
2002	417	337	754	51	65	116
2003	472	383	855	56	71	127
2004	565	455	1020	73	95	168

*Sources: 1. Direction of Trade Statistics Yearbook 2003, IMF. 2. UNCTAD Handbook of Statistics, 2004, UNCTAD, 3. World Trade Report, 2005, WTO*

### **Trends, Pattern and Potential for Bilateral Trade**

**2.6** India and Japan have enjoyed vibrant trading relations in the past. However, over the past decade, India-Japan trade has tended to stagnate and even decline, even as India's trade regime has become steadily more liberal. As is evident from Table 2, the turnover in bilateral trade declined to US\$ 3.7 billion in 2002/03 compared to \$ 4.04 billion in 1997/98. Over the past two years, however, this tendency toward stagnation was reversed, with total trade growing by 18% in 2003/04 and by 14% in 2004/05 to reach nearly \$ 5 billion.

The balance of trade has generally been in Japan's favour and the surplus crossed the US\$1 billion mark in 2004/05.

**2.7** Japan's share in total Indian exports has declined from 9.3 percent in 1990 to 2.5 percent in 2004 and in India's imports from 7.5 percent in 1990 to 2.8 percent in 2004. India's share in Japan's global trade accounts for less than 0.5 percent. Due to this decline in bilateral trade, Japan has slipped from the 3<sup>rd</sup> most important destination for exports for India until 1997 to 10<sup>th</sup> position in 2004. The stagnation of India-Japan trade is in sharp contrast with India's trade with other East Asian countries such as China, South Korea, and with the countries of ASEAN both of which have prospered. Underlying this buoyant growth in India's exports to these other Asian markets has been steady diversification of products.

**Table 2 A. India's Trade with Japan**

*(Value in US \$ million and growth rates)*

	<b>1997/ 98</b>	<b>1998/ 99</b>	<b>1999/0 0</b>	<b>2000/ 01</b>	<b>2001/02</b>	<b>2002/ 03</b>	<b>2003/ 04</b>	<b>2004/ 05<sup>P</sup></b>
India's exports to Japan	1898 - 5%	1652 -13%	1683 2%	1779 6%	1510 -15%	1864 23%	1709 -8%	1973 16%
India's imports from Japan	2144 - 2%	2466 15%	2536 3%	1833 -28%	2146 17%	1836 -14%	2668 45%	3006 13%
Total	4042 - 3%	4118 2%	4219 2%	3612 -14%	3656 1%	3700 1%	4377 18%	4984 14%
Balance of Trade	- 246	-814	-853	-54	- 636	28	-959	-1028

*Source* : Department of Commerce, Government of India, based on DGCIS.

*(P : Provisional )*

**Table 2 B. Japan's Trade with India**

*(Value in Japanese million yen and growth rates)*

	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
Japan's exports to India	314405 17%	275572 -12%	267940 -3%	233717 -13%	233872 0%	276339 18%	329081 19%	388228 18%
Japan's imports from	284798 -12%	255773 -10%	284200 11%	269299 -5%	261997 -3%	252132 -4%	282590 12%	352402 25%

India								
Total	599203 2%	531345 -11%	552140 4%	503016 -9%	495869 -1%	528471 7%	611671 16%	740630 21%
Balance of Trade	29607	19799	-16260	-35582	-28125	24207	46491	35826

*Source* : Ministry of Finance of Japan

**2.8** India-Japan bilateral trade is highly concentrated in a narrow range of products with India's exports dominated by raw materials and minerals and Japan's exports dominated by highly capital- and knowledge-intensive manufactured goods. The top five exports from India to Japan constitute 60 percent of India's total exports to Japan and include gems & jewellery (25 percent share), marine products (13 percent), iron ore (12 percent), cotton yarn, fabrics and made-ups (6 percent), and petroleum products (4 percent) (Table 3). Electronic goods, non-electrical machinery and transport equipment alone account for nearly half of India's imports from Japan. They have consistently ranked as the top imports from Japan in the last few years (Table 3).

**Table 3: Major items of India's Exports to Japan (2004-05):**

S.No	Items	Value in US \$ Million	% Share in Total Exports to Japan
1.	Gems & Jewellery	500	25
2.	Marine Products	254	13
3.	Iron Ore	234	12
4.	Cotton yarn fabrics, made-ups etc	121	6
5.	Petroleum products	84	4

**Major items of India's Imports from Japan (2004-05 )**

S.No	Items	Value in US \$ Million	% Share in Total Imports from Japan
1.	Machinery	743	25
2.	Electronic Goods	397	13
3.	Transport equipment	269	9
4.	Iron & Steel	241	8
5.	Professional instruments	255	8
6.	Organic chemicals	174	6

*Source* : Department of Commerce, Government of India, based on DGCIS.

**2.9** The stagnation of bilateral trade portrayed above, both as to quantity and as to composition is at least partly explained by the scale and type of Japanese foreign direct investment into India. Unlike Japan's investments in such Asian countries as China, South Korea, Thailand and Singapore, its investments in India seem to have focused primarily on supplying the Indian domestic market. The four countries named above accounted for substantial percentage of Japan's FDI in and its imports from Asia. While these issues are dealt with at length in the chapter on investment, it may be mentioned here that perceptions of Japanese investors are that, as far as supplying the Japanese market is concerned, India's relative labour costs are higher than those of its competitors, particularly when the greater distance and the relatively poor transportation infrastructure of India are taken into account.

### **Opportunities for Enhancing Trade in Goods**

**2.10** The Indian and Japanese economies are highly complementary. Japan is relatively labour-scarce but capital- abundant. India's endowments are the reverse. Such complementarity should provide for vibrant and fruitful trading opportunities. An Indian study using a gravity model predicts potential for India-Japan trade of around US\$ 14 billion (compared to the current level of US\$ 5 billion) keeping in mind the size of the two economies and other pertinent factors<sup>1</sup>.

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<sup>1</sup> A gravity model explains the volume of trade between a pair of countries as being a function of their economic mass and inversely of the distance between them among other factors.

**2.11** As revealed by the country's export performance in other markets, India's production structure and export base have changed radically in the last decade. Opportunities should therefore now exist for a shift from the traditional "vertical" trade (inter-industry trade) to "horizontal" trade (intra-industry trade). This would be greatly facilitated by a combination of enhanced Japanese investment and continued Indian trade liberalisation. This structural change could increase the volume of bilateral trade in capital goods, parts and related processed goods and value-added manufacturing goods such as pharmaceuticals, inorganic and organic chemicals, and auto components.

### **Commercial Policies**

**2.12** Indian average applied tariff rates in 2004 were 29.1 percent for all goods and 27.9 percent for non-agricultural goods. While these applied tariff rates have been decreasing they are still higher than those of other Asian developing countries such as China or Thailand. India is officially committed to further reductions in applied rates, even as it negotiates reductions in bound rates within the Doha negotiating round. The Indian average bound tariff rates are 49.8 percent for all goods and 34.3 percent for non-agricultural goods. These bound rates are also much higher than those of China and Thailand (See Table 4 below). One consequence of these relatively high tariff rates, particularly on machinery and parts, has probably been to discourage Japanese FDI into India as against these other countries (see Table 5).

**2.13** Japanese average applied tariff rates are 3.1 percent for all goods and 2.5 percent for non-agricultural goods in 2004. However these average tariff rates tend to mask high tariff peaks applicable to certain labour-intensive and other goods. Nearly 10 percent of the tariff lines in Japan are subject to peak tariffs of more than 15 percent. Indian side feels that commodities subject to high tariff rates in Japan include many products in which India has a comparative advantage. Table 6 shows some of the products which India could potentially export to Japan.

**Table 4: Bound/applied tariff rates comparison of India, China, Thailand and Japan**

	<b>India</b> All / Agr / Non- Agr	China All / Agr / Non-Agr	Thailand All / Agr / Non-Agr	Japan All / Agr / Non-Agr
<b>Binding coverage</b>	<b>73.8 / 100.0 / 69.8</b>	100.0 / 100.0 / 100.0	74.7 / 100.0 / 70.9	99.6 / 100.0 / 99.5
<b>Simple Average (WTO final bound tariffs)</b>	<b>49.8 / 114.5 / 34.3</b>	10.0 / 15.8 / 9.1	25.7 / N.A. / 24.2	2.9 / 6.9 / 2.3
<b>Simple Average (MFN applied tariffs)</b>	<b>29.1 / 37.4 / 27.9 (2004)</b>	10.4 / 16.2 / 9.5 (2004)	15.4 / 29.6 / 13.3 (2003)	3.1 / 7.3 / 2.5 (2004)

(WTO WTR2005)

**Table 5. Indian tariffs on select items**

<b>Product Description</b>	<b>India (Applied / Bound)</b>
<b>Non-agricultural goods</b>	
Machinery	<b>15 / 40</b>
Electrical Machinery	<b>15 / 40</b>
Vehicles (not railways) and parts	<b>15 / 40 (50 / Unbound for CBU passenger cars and two wheelers)</b>
Iron and steel	<b>15 / 40</b>
Optic	<b>15 / 40 (15 / Unbound for some items)</b>
Organic Chemicals	<b>15 / 40</b>
Plastic	<b>15 / 40</b>
Iron/steel products	<b>15 / 40 (15 / Unbound for some items)</b>
Photographic/Cinematographic	<b>15 / 40</b>
Rubber	<b>15 / 40</b>

Source: Customs Tariff (Arun Goyal: 2005-2006), ABS

**Table.6 Post-Uruguay Round Tariffs on Select Items**

Product name	Tariff Rate	
	India	Japan
Agricultural products		
Milk (>3% fat)*1	30%	21.3%-21.3%+114yen/kg
Milk in powder, with or without sugar	60%	0%-29.8%+396yen/kg
Yogurt and butter	30%	21.3%-29.8%+1,159yen/kg
Cereals and preparation	0-100%	0%-375 yen/kg
Groundnuts, shelled	100%	10%-617yen/kg
Cane sugar, raw and white	100%	35.3-103.1yen/kg
Grape juice	30%	19.1-29.8% or 23yen/kg, Whichever is greater
Coffee preparations*2	100%	0-29.8%+1,159yen/kg
Tea preparations, essences*2	100%	8.0-29.8%+1,159yen/kg
Industrial products		
Babies garments, knitted or crocheted synthetic fibres	30%	5.3-10.7%
Waterproof footwear	30%	6.7-27%
Footwear with leather uppers	30%	21.6-30% or 4,300yen Whichever is higher

Source: Web page of the Central Board of Excise and Customs (<http://www.cbec.gov.in/>)

“Customs Tariff Schedules of Japan 2004”

Note: \*1 Tariff rate for Japan is the figure for milk with 1 – 6 % fat.

\*2 Products with higher percentages of dairy ingredients have higher tariff rates.

**2.14** For a more rounded assessment of Japan’s trade policies toward developing countries, it should also be noted that Japan grants concessions under the Generalised Scheme of Preferences (GSP) to India, (as also other developing countries) for selected agricultural and fishery products<sup>2</sup>. In

<sup>2</sup> Intergovernmental negotiations held under the auspices of UNCTAD resulted in the adoption of the Generalised System of Preferences (GSP) in 1971, whereby preferential tariff treatment is granted on a non-reciprocal and non-discriminatory basis by most developed countries to exports from developing countries,

particular Japan grants GSP rates to as much as 90% of the agricultural imports (HS Chapters 1 to 24) from India. Japan has also made continuous efforts to expand the GSP scheme. In 2003, for example, GSP was extended to include an additional 118 agricultural products. Preferences are granted for all industrial products (HS Chapter 25 to 97), including forestry and mining products, with the exception of selected products. As in the case of other GSP schemes, Japan has reserved the right to suspend preferential treatment for products included in the scheme under certain circumstances. For goods exported from a preference-receiving country to be eligible for preferential tariff treatment, they must be recognised as originating in that country under the origin criteria for the Japanese GSP Scheme, and transported to Japan in accordance with its rules for transportation. The detailed GSP-related information in English is found at [www.mofa.go.jp/policy/economy/gsp/index.html](http://www.mofa.go.jp/policy/economy/gsp/index.html)

**2.15** The JSG noted as follows:

- (1) Japan is a net importer of foodstuffs and agricultural products and such food products account for around 12% of Japan's imports. Japan is the largest net food importing country in the world. Its current self-sufficiency rate is only 40% which is the lowest among major industrialized countries. India is one of the world's largest producer of food. However, India's share in imports of agriculture, forestry and fisheries products by Japan is miniscule. Except for marine products, there are no significant imports into Japan from India of any other agricultural product.
- (2) Expanded exports of such goods from developing countries such as India **contribute to** meeting the Millenium Development Goals to which Japan subscribes.
- (3) Recognising the importance of food security, which was underlined at the Rome Declaration on World Food Security, the Government of Japan has taken the decision to raise the self-efficiency ratio up to 45% by 2015.
- (4) The Government of Japan has been endeavoring to expand the exports of Japanese agricultural, forestry and fisheries products, and in 2005, the export increased by 12.1% from the previous year. Also

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with most-favoured-nation (MFN) duties reduced or eliminated. The effective period for Japan's extension of GSP is 1 August 1971 to 31 March 2011.

the exports of these products to India are increasing, due to high economic growth and an increasing interest for Japanese foods and cuisines.

**2.16** Japanese side stressed that it is essential to consider the following position regarding agriculture, forestry and fisheries industries and other industrial products with sensitivities. In particular, sensitivity of agriculture, forestry and fisheries products in terms of trade should be taken sufficiently into consideration.

- (1) It is important to secure the domestic agriculture, forestry and fisheries industries as a basis of food production, combined with appropriate trade in agriculture, forestry and fisheries. The importance of the multi-functionality of agriculture such as conservation of land, fostering of water resources and development of favourable landscape is worth noting.
- (2) Regarding forestry, it is important to note that further activities to promote sustainable forest management should be discussed. Regarding fisheries, it is necessary to avoid the negative effect from the trade of fishery products upon the fishery resource management in order to secure sustainable utilization of fishery resources.
- (3) Japan expects further expansion of exports of Japanese agriculture and fisheries products to India in order to meet the demand of Indian consumers for Japan's food.
- (4) Some other industrial goods such as leather and foot wear are sensitive not just because of economic reasons but also for historical and social reasons.

**2.17** The Indian side stressed that there is opportunity for Indian agricultural exports to Japan. India has a competitive edge in agricultural and food products and several items among Japan's agri imports are not produced locally but are imported from third countries. Accordingly, India is interested in expanding market access for such products.

**2.18** The JSG noted that there is opportunity for Indian agricultural exports to Japan, and Japan's agricultural exports to India.

**Suggestion:**

**2.19** Further tariff reduction and possible elimination, which is consistent with WTO provisions, will increase market access for both sides in both agricultural and manufacturing sectors. It will cut the procurement costs for the manufacturing sector, which in turn would contribute to promoting Japanese investment in India, and will increase export of agricultural products to each other. Further economic cooperation between Japan and India should be mutually beneficial. A practical and flexible approach should be adopted, respecting sensitivities of both sides.

**Trade Rules, Disciplines and Procedures****Customs Procedures**

**2.20** Both Japan and India have acceded to the World Customs Organisation's (WCO) revised Kyoto Convention<sup>3</sup>, which aims at simplifying and harmonising customs procedures. It provides the core principles for modern, efficient and effective customs procedures in the 21st Century. In accordance with international standards, a uniform system of customs valuation, duties and documentation may be evolved across all ports of entry in both the countries.

**2.21** India has made efforts over the past years to bring its customs procedures on par with best international practices backed by a computer-based system. Since 1998, India has set up a Fast Track Scheme under which certain categories of importers have been allowed to pay duty and clear the imported goods on a self-assessment basis. India also operates a electronic data interchange (EDI) system under which qualified importers, identified on the basis of past performance, are given a waiver of inspection of imported cargo through a "green channel" facility. At present, about 75 percent of India's international trade is covered by 23 automated customs stations. Other initiatives, like the installation of the Interactive Voice Response System (IVRS) and touch screen kiosks are designed to allow traders to ascertain the status of their documents. Yet, in the experience of Japanese shippers, some irritants remain, particularly in the area of documentation. The same point

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<sup>3</sup> The Kyoto Convention, formally referred to as the International Convention on the Simplification and Harmonization of Customs Procedures, was revised by WCO in 1999 (Revised Kyoto Convention), which was entered into force in February 2006.

applies here as made before: such procedures apply to all imports, and have apparently not impeded significant growth in imports from other countries.

**2.22** Japan also continues to make efforts to achieve the dual goals of proper Customs enforcement and prompt Customs clearance. These have included introduction of a single window system, updating the IT system and equipment, risk management system, pre-arrival examination system, and 24hours/7days office operation. With the single-window system, all the necessary import/export procedures and port-related procedures can now be completed in a single input and a single transmission. Drastic reductions in clearance time or dwell time of cargo are the results of such efforts.

**2.23** Japan has also implemented various measures to enhance transparency of Customs procedures and make information system user-friendly. The website today, being consistently maintained and upgraded, contains the most updated information on the tariff rates, trade statistics, customs-related laws and regulations, customs procedures and administrative rules, etc. For specific inquiries such as product classification and origin criteria, traders can utilize inquiry points and advance ruling system set up in each regional customs office. An appeal system is also available as a relief measure against unfair administration of customs-related procedures.

**2.24** Looking to the future, both countries face new challenges in customs administration and trade facilitation. These include reconciling greater security scanning with swift clearance of legitimate cargo, and enforcing complex rules of origin as the provisions of preferential trade agreements take effect. There is also always a risk that customs procedures can be a cause of unnecessary delays and restrictions on trade. Every effort should be made to streamline customs procedures to minimize time required at borders.

**Suggestions:**

**2.25** While improvement in customs administration is something that each country will pursue unilaterally, in conformity with international norms and codes, thought may be given to setting up a mechanism for facilitating to share experience of each side with the customs administration of the other, and developing a mechanism for resolving misunderstanding and disputes.

## **Inspection and Certification**

**2.26** Japan has a pre-certification system for imported products concerned with the Food Sanitation Law into Japan. Under this system the manufacturer/processor of the exporting country has to file an application through an official inspection agency of that country. In India the appropriate agency is the Export Inspection Council (EIC), the central inspection agency of the Government of India. EIC in turn transmits the applications to Japan's Ministry of Health, Labour and Welfare. In order to simplify and expedite the import procedures, the pre-certification system allows for confirmation and registration in advance of manufacturers and/or products of imported foods, etc. which are in compliance with the standards and specifications under the Food Sanitation Law. Registered products are exempted from inspections at the time of import for three years.

**2.27** Also, Japan's MHLW has another system for simplifying and speeding up of the import procedures, where the inspection at the quarantine station for a cargo may be exempted, provided that the cargo is inspected by a public inspection organization or laboratory in the exporting country prior to the export, and a report of the result from the inspection is attached to the cargo. Inspection results are accepted if they are carried out by designated public inspection organizations or laboratories which are recognized and registered in the list prepared by MHLW. India has 17 official agencies and laboratories already designated in the list, which includes regional Export Inspection Agencies (Mumbai, Kochi, Kolkata, Delhi, Chennai). Indian side stated that if EIC's system of export certification were to be similarly recognised by Japan, this would make the procedure even smoother. Indian side requested that the EIC be recognized as a public inspection organization by the Japanese authorities. The JSG recommends that India's requests for registration of EIC be considered favourably according to appropriate applications and procedures.

**2.28** The JSG recommends that both the countries will exchange information and explore ways of increased cooperation on all inspection and pre-certification issues and procedures relating to export of food-products.

## **Non-Tariff Issues**

**2.29** The Indian exports to Japan are affected by a number of issues which include SPS/TBT measures, and high transaction costs due to cultural and language differences among others. The relatively low level of trade and insufficient publicity in Japan to the rapid changes in Indian capacity and competitiveness means that outdated impressions of the quality of Indian products and the reliability of Indian suppliers continue to persist. Poor air links and connectivity and visa problems have also been mentioned.

**2.30** Large Japanese international companies have long experience in India's market and investment conditions. But there are a large number of SMEs in Japan who have the requisite technology and financial strength, and are exploring opportunities to relocate to combat the rising cost of manufacturing at home and also to take advantage of the growing markets in neighboring countries. These SMEs do not have much knowledge about the Indian market conditions, manufacturing base, availability of technically qualified manpower in India at competitive rates, taxation laws, judicial system, success stories of Japanese companies like Suzuki, Sony, etc in India. As a result these Japanese SMEs have not so far considered investments and re-location of their manufacturing base to India.

### **Suggestion:**

**2.31** JSG recommends setting up of an India-Japan Business Forum within an agreed time frame by JETRO for providing such information to Japanese enterprises especially SMEs on investment climate and opportunities in India in local language. It can also facilitate mediation and formation of joint ventures and partnerships between Japanese and Indian enterprises and development of business contacts between the two countries.

In respect of Registration and Documentation in English, JSG also recommends that Japan endeavour to make available in English such documents and questionnaires relating to relevant laws, rules and regulations including SPS and TBT measures, specifically for registration, anti-dumping and other measures identified in this report as are not available presently in English. Standards should be improved especially in the compatibility of health standards and certification practices.

## **SPS and TBT**

**2.32** SPS and TBT are WTO-sanctioned agreements. Standards regarding SPS measures are to be set by international bodies such as Codex for foods, through a consultative process where every member country and other interested parties get a chance to participate in the standard setting process. All WTO members are expected to accept such standards and shall base their SPS measures on international standards, guidelines or recommendations. However, in case a country wishes to set higher standards, it is permitted to do so if there is scientific justification.

### **Suggestion:**

**2.33** The JSG recommends that, while continuing cooperation through current mechanism, both countries explore the possibility of improving the current mechanism or replacing it with a new mechanism, as a way to promote further cooperation, including exchange of information and, if necessary, other measures on SPS related issues. For this purpose, the JSG also recommends that a joint consultation group of government officials will be set up within a reasonable time-frame.

## **Visa Facilities**

**2.34** Under the current Japanese system, APEC member nationals can get visa maximum for five years, and non-APEC member Asian nationals, including Indian nationals, can get visa maximum for three years with multiple entry. Furthermore an Indian company/individual traveling to Japan must get an invitation from Japanese counterpart except in some cases. No invitation is required if a Japanese has to come to India. Indian professionals and Indian businessmen, including employees of IT companies, usually get visas for a maximum of three years. By contrast, Indians get 10 year visas from the United States and five year visas from the UK. Indian side sought that issue of visas to Indian businessmen should be facilitated.

## **Constraints faced by Selected Indian Sectors**

**2.35** Japan is the world's second largest pharmaceuticals market with a turnover of about US\$ 52 billion and imports amounting to US\$ 6.2 billion.

The Indian exporters face a number of difficulties while exporting “Generic Formulations”. The Indian manufacturers reported that they faced great difficulty in product registration in Japan largely because the product registration guidelines are available only in Japanese language. The Indian manufacturers lose in terms of time and money to get the translation done in order to register their products. The Japanese side, however, noted that the requirements involved in product registration are applied not just to the Indian manufacturers, but equally to all domestic and other foreign applicants.

**2.36** The Indian pharmaceutical companies generally comply with "Committee for Proprietary Medical Products" (CPMP) guidelines that are followed in other markets such as the EU. The CPMP guidelines require the manufacturers to provide the data on two batches of the pharmaceutical products in some cases, and three batches in others. Indian side stated that Japan asks the data to be provided for three batches - additional data on one more batch, which leads to extra investment and time. Japanese side, however, stated that it follows three batch requirement as part of the ICH Harmonised Tripartite Guideline, which was made by Japan, US, and EU, and that Japan would not apply stricter testing criteria for Indian product than from other countries.

**2.37** Indian producers of essential oils and fragrances have reported strong resistance they have faced in the Japanese market due to strict approval requirements for chemical imports. Imports of cosmetics and beauty products into Japan require obtaining a license from the Ministry of Health and Welfare. The Ministry uses a pre-defined list of items that can be used as ingredients in the production of imported products. Given the large market for cosmetics in Japan and India’s strength in this area, efforts to access the market in Japan by Indian companies would be encouraged.

### **Constraints faced regarding Indian high-tech imports from Japan**

**2.38** The JSG notes that the present volume of high technology trade between India and Japan is rather miniscule, especially considering the core competence the two countries have in knowledge-based and technology-driven economy and their determination to develop a strategic relationship. The JSG suggests that the governments of India and Japan actively explore ways and means to utilize the potential and synergies, and boost high technology trade.

## **Trade Remedies**

**2.39** Both sides agreed on the importance of making efforts to prevent the abuse of anti-dumping measures and that they maintain mutual cooperation to achieve this goal in the WTO negotiations.

## **Rules of Origin**

**2.40** Preferential Rules of Origin is essential part of any PTA(Preferential Trade Agreement)/FTA/CECA between the Parties to these Agreements to facilitate trade between them and to prevent any possibility of trade circumvention from the Non-Parties. Such rules shall not impede trade. The Rules of Origin should be clear, transparent, user-friendly and easy to administer.

## **Other Issues**

### **Exchange Rate Risk**

**2.41** Japanese companies prefer to have price quotes for imports in Japanese Yen rather than in US dollar or Euros. In order to alleviate the possible impact from the volatilities in Yen-Rupee exchange rates on the Indian industries, both authorities shall encourage greater use of hedging measures in Yen-Rupee transactions.

## **IPR**

**2.42** The Japanese side requests improvement of insufficient protection of intellectual property rights in India. According to them, despite the introduction of the material patent system for pharmaceutical, food and chemical products in accordance with the TRIPs, there exist problems such as diffusion of infringing goods entering in India. Adequate and effective protection and enforcement of IPR are essential for fair economic activities by the industries of both countries.

## **Improved Infrastructure Links**

**2.43** JSG feels that increased frequency of direct shipping routes and reduced costs of transportation between the two countries need consideration. Direct banking links and bilateral confirmation of L/Cs by EXIM banks of India and Japan and other issues of cooperation in this field may be strengthened.

## **CHAPTER 3: INDIA AND JAPAN: TRADE AND INVESTMENT IN THE SERVICES SECTOR**

### **Context**

**3.1** The services sector is an important part of both the Japanese and Indian economies. It contributes over 50 per cent of GDP in India and above two-thirds in Japan. Trade in services confers benefits not only to the services sector itself, but to both the primary and secondary production sectors as well. Expanded services trade accordingly stands to improve the living standards and international competitiveness of both India and Japan.

**3.2** There are severe data difficulties in documenting trade in services in a fashion that is consistent with the negotiating framework of the WTO. On the basis of presentations made by the two sides, though, it seems obvious that India is an increasingly successful provider of business services to a broad range of developed countries, while Japan is importing such services from other nations, notably China. Japan is a significant global exporter of services, often linked with overseas investment, yet the presence of Japanese services and firms in the Indian market is much less than in other parts of Asia. Demographic trends in India and Japan also suggest significant potential complementarities between the two services sectors well into the future.

**3.3** Accordingly, the challenge facing the Joint Study Group is to identify the bilateral barriers that have prevented the two countries from expressing their respective comparative advantage in each other's markets, and to do so in an environment where the requisite data are presently unavailable. It could well be that the barriers have not only to do with market access and regulatory restrictions but broader cultural issues such as language and education. Such issues, covered elsewhere in this report, could, over time, make a major difference to growth of bilateral services trade. Equally, more intense interaction in the services area is more likely to deepen the human bonds between the two nations. For all these reasons, expanding trade in services deserves at least equivalent, and perhaps even greater, priority than enhanced trade in goods.

**3.4** It is also the case that, despite the advances made within the GATS, multilateral liberalisation of trade in services has proven to be even more

difficult than trade in goods. In addition the present Joint Study Group marks the first engagement of this kind between India and a major OECD economy. The attempt of the JSG has been to try to identify possible areas where improved bilateral market access on a “GATS-plus” basis could assist in improving the efficiency of the domestic sector in each country in a significant way.

## **Bilateral trade and investment in services**

**3.5** Japan has interests in both outward and inward foreign direct investment in services. While Japan is a major investor in many countries around the world, a growing chunk of its inward FDI has taken place in service sectors as against in manufacturing. The share of inward FDI in the manufacturing sector declined from 64 per cent in 1990 to 25 per cent in 2000.<sup>1</sup> The corresponding share of FDI in service-sectors has simultaneously been growing. Sectors like health-care, telecommunications and financial services are expected to attract larger inward FDI in Japan.

**3.6** Complementarities in the two countries’ GDP structures and the demographic profiles are immediately obvious. Japan needs services across a variety of sectors. India needs to be alive to this opportunity, being in a position to provide labour-intensive as well as skilled services to Japan. Not only that, it has the opportunity to assist Japan through its comparative advantage in the provision of high-quality, low-cost outsourcing options.

**Table 1: Exports of Commercial Services**

Year	\$ million			Share (percent)		Rank	
	Japan	India	World	Japan	India	Japan	India
<b>1997</b>	68137	8926	132570	5.14	0.67	6	31
<b>1998</b>	61795	11067	134410	4.60	0.82	6	26
<b>1999</b>	60313	14006	139240	4.33	1.01	6	25
<b>2000</b>	68303	17521	147940	4.62	1.18	5	22
<b>2001</b>	63671	20820	148610	4.28	1.40	5	19
<b>2002</b>	64909	23300	158640	4.09	1.47	5	12
<b>2003</b>	70624	25043	179650	3.93	1.39	9	21

Source: WTO, International Trade Statistics (various years)

<sup>1</sup> “Japan Warming to Inward FDI”, Marubeni Economic Reports, 2002.

**Table2: Share of Services in Total Exports (percent)**

<b>Year</b>	<b>Japan</b>	<b>India</b>	<b>World</b>
<b>1997</b>	13.9	20.3	19.2
<b>1998</b>	13.7	24.9	19.6
<b>1999</b>	12.6	28.2	19.6
<b>2000</b>	12.5	29.4	18.6
<b>2001</b>	13.6	32.6	19.3
<b>2002</b>	13.5	32.3	19.6
<b>2003</b>	13.6	30.4	19.5

Source: WTO, International Trade Statistics (various years)

### **Perceived Comparative Advantage in Trade in Services**

**3.7** One of the important tasks before the Joint Study Group (JSG) is to identify sectors / categories in which India and Japan visualise potential for trade, and the most essential steps to realise that potential. The fact that good past data on bilateral trade in services are not available makes the required analysis more difficult. Improving the data available according to international definitions indicated above is an important priority.

**3.8** In the absence of reliable data the JSG referred to an examination of offers made by each country as part of the Doha round in order to analyse bilateral “perceived comparative advantage” (PCA). Japan submitted its Revised Offer on services to the Council for Trade in Services of the WTO in June 2005 (TN/S/O/JPN/Rev.1). India submitted its Revised Offer in August 2005 (TN/S/O/IND/Rev.1). Both countries have liberalised their earlier offers conditional on other WTO Members making substantive and meaningful offers in return.

**3.9** Apart from putting up revised offers for liberalising trade in services within the multilateral trade regime under GATS, India and Japan have also made bilateral requests to each other. These requests are indicators of areas in which the two countries propose to increase their bilateral exports.

## **Objectives, Opportunities and Linkages**

**3.10** Services provide the connections, coordination and support for the manufacturing process and often generate demand for new industrial products. Service exports in turn are often stimulated by FDI in services, although in general some initial trade is probably a precondition for investment. With Indian firms also increasingly investing overseas, both countries have an interest in ensuring national treatment and transparency and stability of regulations affecting trade and investment.

**3.11** India's progress in this regard is indicated by the fact that India is rated among the top two countries with most positive investor outlook, likely first-time investments, and most preferred offshore investment locations for business processing functions and IT services (A T Kearney, October 2004). Compared to other large emerging markets, India is cited as one of the most attractive FDI destinations in the short-term (next three years) and well into the future, beating markets like Brazil, Mexico and Poland for medium-term attractiveness ten years out.

**3.12** In the discussions of the JSG, the Japanese side indicated its strong interest in manufacturing-related services, consumer-related services, and other supporting services. These services include financial services (banking, insurance, venture capital, etc), infrastructure-linked services (construction, engineering, architecture, etc), legal and accounting services, telecommunication services, advertisement services, transport services, tourism services. The opportunities in these sectors are sketched in the discussion below.

**3.13** Japan is especially interested in the current Indian discussion on the removal of restrictions in distribution services (wholesale and retail). Currently investment in the retail sector (sales company by manufactures, supermarkets, convenience stores, etc) is found to be extremely difficult. Relaxation and/or removal of foreign capital regulations in the distribution sector will contribute to the increase of investment in that sector and therefore, will result in job creation and expansion of Indian export destinations through the development of domestic retailing system in India. In addition, the Japanese side stressed the importance of the elimination of the no-objection

requirement (the so-called Press Note 18) which is one of the major barriers for Japanese service suppliers to operate in India. It was clarified by the Indian side that this requirement did not apply to new investments and that the recent amendment to the Press Note 18 had made it difficult for an Indian partner to oppose an investment by a Japanese partner.

**3.14** Global investors view India as the world's business process and IT services provider with longer-term market potential. India leads in IT, business processing and R&D investments. Investors favour India for highly educated workforce, management talent, rule of law, transparency, cultural affinity, and regulatory environment as highly favourable factors.

**3.15** The temporary movement of natural persons (including mode 4) enables business to have the highest productivity at a competitive cost. India, with its vast pool of skilled service providers would be ideally placed to provide services across a range of sectors. India would therefore like Japan to facilitate the movement of such service providers across borders. This can be done by removing barriers such as economic needs tests and disciplining domestic regulations, especially in the area of qualification requirements and procedures.

### **Principles for Expanding Services Trade**

**3.16** In view of the enormous potential in services trade between India and Japan both Governments need to take substantial measures to remove barriers to trade in services. Keeping this in view, the JSG recommends that future discussions respect the following broad four principles:

- a) All services sectors and all modes of supply in GATS should be covered;
- b) Commitments by both countries should cover a wide range of service sectors (both horizontal and sectoral);
- c) Special emphasis shall be given to the areas listed below, such as software and IT-related services, financial services, telecommunication services, construction services and transportation services; and
- d) Services liberalisation should be designed to enhance the competitiveness of each economy.

## **Sectors of Interest and Suggestions**

**3.17** JSG considers the following sectors should be particularly explored as potential areas where India-Japan bilateral trade in services could be particularly strengthened through enhanced cooperation and improved market access. Freer movement and the mutual recognition of qualifications and experience of professionals (through mutual recognition agreements –MRAs) as well as exchanges of experts and provision of training and educational opportunities would supplement both Governments' efforts to improve access to the other country's market. In this regard, special care should be taken of the sensitivity involved in the public policy needs in immigration, employment and public health and safety.

### **Information Technology and Communication**

**3.18** Information technology (IT) and software services provide crucial linkages for trade in services. Both India and Japan have strong ICT sectors and India's software skills and Japan's hardware expertise constitute strong mutual complements. India's exports of software services at above US\$ 17 billion in 2004-05 constituted 44 per cent of global outsourcing. India's offshore penetration of *Fortune 500* increased from 300 companies in 2003 to 400 in 2004. India has increasing expertise in more sophisticated applications such as financial institutions and stock exchanges which could assist Japan as its financial market recovers its international attractiveness. Japan has a strong comparative advantage in production and exports of computers and IT hardware. The current cooperation between Japan and India in the IT field, however, still remains at a low profile, relative to its great potential.

**3.19** India permits upto 74 per cent foreign equity investment for basic, cellular, value-added services and global mobile personal communications by satellite. Foreign investment up to 100 per cent is allowed for the ISPs not providing gateways (74 per cent for ISPs providing gateways), infrastructure providers providing dark fibre, electronic mail and voice mail. There is little cooperation between Japan and India in ITES (back-office) services which is growing even more rapidly than IT.

**3.20** Japan and India have made an arrangement for mutual recognition of Information Technology Engineers' Examinations. This enables smoother cross-border movement of both business and personnel and more active utilization of highly qualified technical personnel in both countries, since the arrangement makes it easier to assess the technical skill levels of the individual. Besides, the issue of multiple-entry visas valid for three years to Indian IT specialists also contributes to Indo-Japanese IT promotion and cooperation.

**Suggestions:**

**3.21** Both countries need to deepen bilateral cooperation by using IT-enabled services in sectors like banking and finance, research and development and creating new products with Japanese hardware and Indian software. Possibilities of business process outsourcing (BPO) to Indian service providers will help to make Japanese companies more competitive; effective use of information technology has been a significant element in the sustained growth of the U.S. economy for example. Further efforts for better cultural and linguistic understanding would facilitate such trade. The issue of movement of service providers needs to be eased through easy and business-friendly visa rules. The potential of bilateral trade in ICT can be exploited fully through different modes of transaction such as cross-border trade, commercial presence and TMNP. Exchanges among industries, academia and governments between Japan and India such as the recent ICT forum will be helpful to facilitate such transactions by creating mutual business opportunities.

**Architectural, Engineering and Construction Services**

**3.22** India has first-rate manpower trained in architectural and engineering services. It includes architects and civil engineers required for construction work. Japan has world-leading technology and experience in construction and related engineering industry. Japan also has first-rate manpower trained in architectural, engineering and other related services. The two countries seem to have immense potential for bilateral partnership.

**3.23** India has estimated that it needs foreign direct investment of the order of US\$ 150 billion to develop physical infrastructure over the next five years. Japanese service providers can contribute to the Indian market with their expertise. Under the current laws and regulations in India, up to 100 per cent FDI is permitted under the automatic route for building airports (though FDI

beyond 74 per cent requires government approval) and townships, housing, built-up infrastructure and construction development projects (subject to conditions and guidelines laid out in FDI Policy and Procedures, 2005).

**3.24** Indian laws and regulations are not well-understood by Japanese firms service providers and consequently the Japanese presence in this field has been relatively limited although there remains considerable interest in the Indian market. In December 2005, the Ministry of Land, Infrastructure and Transport of the Japanese Government, in collaboration of CIDC of India, held “Japan-India Construction Industry Conference” for the first time in order to introduce world-leading Japanese construction companies and to establish collaboration between the industries of the two countries.

**Suggestions:**

**3.25** Enhanced access by the Japanese service providers to the Indian market would allow India to benefit from the experience and capability that these firms possess. Therefore, the JSG suggests that India and Japan should keep and enhance collaborative relationships through the activities such as the conference mentioned above. Both sides agreed to exchange information of laws and regulations of construction, architectural, engineering and other related services and to examine the possibility of MRA in the future.

**Audio-visual and Entertainment Services**

**3.26** India is the third largest TV market after China and the United States. The total revenue earned by the Indian entertainment industry was US\$ 4.3 billion in India in 2004. This is expected to grow by more than 21 per cent per annum during the next four years and touch US\$ 9.4 billion in 2008. Such growth is propelled mainly by a rapid change in technology from cable to direct-to-home (DTH) TV services, use of digital technology for film distribution in semi urban and rural markets and the development of FM radio as a new medium.

**3.27** India permits 100 per cent FDI through the automatic route with no entry-level conditions for film production, TV software production, exhibition and distribution. In the case of satellite broadcasting, all TV channels, irrespective of national or foreign ownership, are permitted to up-link from India provided they undertake to comply with the broadcast code.

**Suggestions:**

**3.28** Despite language and cultural barriers, the two countries have much to gain from trade in audio-visual and entertainment services. India can learn from Japanese skills and technology and also use the audio-visual media to sell entertainment services to the Japanese as well as Indian audience in Japan. Screening of Indian cinema dubbed or subtitled in Japanese in Japan and Japanese cinema dubbed or subtitled in Hindi/English in India should be encouraged both through the trade route and through various channels including the Japan Foundation and the Indian Council of Cultural Relations.

**Health-care Services**

**3.29** Health-care is an important sector for every economy. Health-care services may be divided into two broad categories, namely professional services provided by medical and paramedical staff including doctors, nurses, midwives and physiotherapists; and hospital services provided by the physical infrastructure for inpatient care. While the services of medical professional staff are mobile, the hospital services are immobile.

**3.30** There is immense opportunity for private healthcare providers in India. Both India and Japan have mutually complementary health-care endowments. India has moved forward on private entry into the health-care industry during the last two decades. It would need new private domestic and foreign investments in infrastructure as well as technology. Japan also has an advanced medical equipment manufacturing industry. The growing health-care sector provides substantial opportunity for absorbing Japanese investments. As a complement, India has a large number of well-trained medical and paramedical professionals who have established their professional expertise in India and many parts of the world.

**Suggestions:**

**3.31** The JSG suggests that an expert committee from India and Japan look further into the potential of mutual cooperation in the area of health-care services. While Japan might be interested in commercial investments in health-care infrastructure in India, India would look forward to TMNP opening up by Japan which would make efficient and cost-efficient medical and paramedical services available to Japan.

## **Financial Services**

**3.32** Enhanced bilateral interaction on financial services would facilitate comprehensive exploitation of trade potential between India and Japan. India has opened up many of its financial services to FDI. The Insurance Regulatory and Development Authority (IRDA) opened up the state monopoly of domestic insurance market to private companies, including foreign companies, in 1999. The IRDA issued insurance licenses to fifteen private insurance companies in joint ventures with foreign insurance companies in December 2001. A Japanese insurance company has already entered the Indian private insurance market through a joint venture with an Indian company.

**3.33** Regulations on foreign and direct investment in the banking sector were liberalised in March 2001. Foreign investment of up to 74 per cent, including all sources, is now permitted in the private banking sector through the automatic route. FDI and portfolio investment in nationalised banks are subject to overall statutory limits of 20 per cent.

**3.34** In respect of non-bank financial institution (NBFCs) in India, 19 activity areas have been opened for FDI. These include portfolio management services, stock broking, credit rating agencies, housing finance and rural credit among others. Up to 100 per cent investment is permitted although the minimum capitalisation is regulated depending on the equity ratio.

**3.35** In the case of Japan, many foreign-owned financial institutions withdrew from the Japanese market after the 1997 financial crisis. In some instances, their Japanese offices were integrated following international mega-mergers. However, foreign-owned financial institutions have started entering again since the late nineties. This can be attributed to financial liberalisation and improved growth expectations.

**3.36** Japanese banks based in India primarily focus on supporting Japanese companies present there. We see the following vicious circle; Japanese banks are not motivated to enter India without a critical mass of Japanese companies. On the other hand, Japanese companies including the manufacturing sector are discouraged from making investment in India due to the very small presence of the Japanese financial sector there.

**3.37** In order to promote Japanese investment in India, an enlarged presence of the Japanese financial sector in India is crucial, and some suggestions to stimulate this process are detailed below. Japan notes the CECA between India and Singapore which became effective in August 2005. Under the CECA, three commercial banks from Singapore now have free access through the expansion of branch networks or through the establishment of 100%-owned subsidiaries. Singapore banks are permitted to invest in private sector banks up to 74% through FDI. Through bilateral negotiations, India and Japan could explore a high level of liberalisation in financial services.

**3.38** Other constraints in the financial services area which are currently perceived by Japanese institutions include the following:

- a. Japan attaches importance to commercial presence commitments, in particular, the abolition of limitations on foreign equity participation and forms of commercial presence, and the right of establishment.
- b. While the public monopoly in insurance has been eliminated, the limitation of 26% on foreign equity participation in insurance is felt to be restrictive compared to other Asian countries. Also, foreign insurance companies are not allowed to establish direct branches. Changes in both these regulations would facilitate a greater Japanese presence in the sector.
- c. In India, reinsurance risks in principle shall be retained by domestic re-insurers, and only risks which cannot be covered by domestic re-insurers may be ceded abroad. In addition, foreign insurers are not allowed to enter reinsurance market in India. Japanese insurance industry is interested in reinsurance services, Japan would like to request India to consider relaxing these restrictions.
- d. Foreign investment of up to 74% is currently permitted in the private banking sector. However, a Roadmap for Presence of Foreign Banks in India (“the Roadmap”) was published by the RBI on 28 February 2005. According to the Roadmap, foreign banks may operate a wholly-owned subsidiary. The Japanese side welcomed the clarification of policy that the Roadmap represents.
- e. Japanese banks operate their business in India through direct branches. There are some regulations which place burden on the operations of the Japanese banks, such as the lending limit for individual companies, discriminatory tax measures, restrictions on borrowing foreign banks

from their head offices, and lending requirements for the priority sectors. Since the banking sector is the basis of the overall economy, the improvement of business environment in the banking sector would contribute to attracting foreign direct investment. Therefore, Japan is interested in not only the entry into the Indian market of Japanese financial institutions, but also the relaxation of the above restrictive measures in the post-entry operations.

- f. Japan is interested in the cross-border supply (mode 1 & 2) of reinsurance and MAT(Maritime Aviation Transportation) insurance.

### **Suggestions:**

**3.39** The JSG suggests that India and Japan engage themselves bilaterally to augment their financial markets interaction. Each country should make efforts to make adequate presence of service providers in other country's financial sector. The reciprocal presence of banking, non-banking and insurance services of India and Japan would be required by and for trade in goods and other services. Such services should also be encouraged concomitantly to subserve the interests of growing trade in goods and other services. In particular, both parties could collaborate in the field of financial services with a view to promoting regulatory co-operation and share related experiences to facilitate the development of the financial market and improve the financial market infrastructure. Recognising that improving the efficiency and competitiveness of the financial markets of the two countries is of great significance in creating environment for mutual cooperation and economic development, it is also recommended that both countries give favourable consideration to the financial guarantee of the state run banks such as EXIM banks for business activities between the two countries, endeavour not to apply any restrictions for transfer of earnings; and work towards meaningful commitments for commercial presence in financial services. It is recommended that the Financial Services authorities of both sides enter into mutual consultations with a view to increasing cooperation in this area.

### **Tourism and Travel Related Services**

**3.40** Tourism in India is another area where both the need and the scope for Japanese investment are very large. Tourism and hospitality infrastructure is open to 100% FDI on the automatic route. Japanese investments can focus on such internationally renowned tourism circuits in India's as the Golden

Triangle, the Golf circuits, the sub-Himalayan tourist circuits in North India and the sea beach circuits in South India. These can be value-added with optimal connections with places of Buddhist interests like Bodh Gaya, Sarnath, Sanchi, Ajanta and Ellora.

Secondly, total Japanese tourist arrival in India was about 68,000 in 2003, which was less than 3 per cent of the overall foreign tourist arrival in India. JSG is of the view that there is a tremendous scope for activities aimed at increase in tourist arrivals from Japan.

**3.41** Japan also offers a number of tourist attractions for Indian tourists. The increasing disposable incomes of Indian citizens are propelling them out of their own country for spending vacations as tourists. The figures for Indian outbound tourists have been growing exponentially and outnumber inbound tourists. However, even as a substantial share of Indian outbound market is for destinations in South East Asia, Japan has not yet become a popular or accessible destination due to a variety of reasons. Increased two-way visits by tourists would facilitate better understanding of each other's society and culture. This would also facilitate people-to-people contacts and the two-way tourism envisioned in the Joint Statement of the two Prime Ministers of April 2005. The Study Mission due from Government of Japan in 2005 to explore strengthening of tourism between India and Japan, as stated in the said Joint Statement, would throw up concrete, actionable steps in this direction.

### **Suggestions:**

**3.42** The JSG suggests that the two governments should encourage travel and tourism agencies of the two countries to interact more intensively. India and Japan should consider adopting a more facilitated regime in favour of granting more Visas to genuine tourists. Bilateral tourism, along with increasing business potential, would also accelerate demand for learning of the Japanese language in India and of English and other Indian languages in Japan.

### **Maritime Services**

**3.43** India and Japan were among a group of developed and developing WTO member countries, which submitted a *joint statement* on maritime transport services in March 2003 to the GATS Council of Trade in Services (TN/S/W11). Maritime transport is an important facilitator of world trade. Four-fifths of world trade by volume is carried by sea. Maritime trade is

continuing to expand at about 9 per cent for containerised cargoes annually. More than purely a facilitator, maritime transport is also a significant exportable service in many countries, making direct contributions to national GDP. In view of its importance, binding substantive liberalisation of the maritime transport service sector is crucial to ensuring the overall success of this current round of trade negotiations.

**3.44** The *joint statement* noted that access to a global network of reliable, efficient and cost effective maritime transport services is beneficial to all Members, including developing and least developed Members whose trade in price-sensitive goods often comprises a significant component of their economies. Restrictions on maritime transport services can adversely affect a number of economic factors, including export and import prices, and the location of foreign direct investment. Liberalisation is the key to reducing maritime transport costs, providing greater choices to shippers, and ensuring fast and efficient deliveries. Liberalisation in this sector will also encourage foreign investment, which will not only enhance employment opportunities within the sector itself, but will also promote the growth of other related service sectors. The multiplier effect of the maritime transport service sector extends to ship repair/maintenance, ship classification, distribution, professional services, communications, banking and insurance services, etc.

**3.45** The *joint statement* called for the active participation of all Members in the on-going negotiations with a view to achieving meaningful liberalisation of the maritime transport service sector, consistent with sustainable development, security and safety, and thereby securing broad coverage of this sector in the multilateral trading system and the GATS framework.

**3.46** The liberalization of mode 1 is important for the overall liberalisation of Maritime Transport Services in particular. In mode 1, India has lots of regulations, therefore the Japanese side requested India to review the reservation for national flag vessels, reservation of government owned / controlled cargo and restriction on LNG.

**Suggestions:**

**3.47** The JSG recommends that India and Japan should make decisive use of their commitments stated in the Joint Statement of April 2005 after the visit of

Japanese Prime Minister Koizumi to India, and move forward on a bilateral basis to increase each other's participation in maritime transport services.

### **Other Business Services**

**3.48** With increasing bilateral cooperation in trade and investment, other business services including accounting, R&D, management consulting, etc. would increasingly become tradable between India and Japan. Both countries have deep pools of qualified professionals in these services.

#### **Suggestions:**

**3.49** The JSG suggests that India and Japan should discuss possibilities of freer trade in these services. Bilateral cooperation in these areas would facilitate bilateral trade and investment in many other sectors of mutual interest.

### **Temporary Movement of Natural persons**

**3.50** Japan and India acknowledge that enhancing the movement of natural persons is of great importance for the globalization of economic activities, technology development and the promotion of services provided by highly skilled professionals and would contribute to strengthening economic ties between two countries. Japan is prepared to accept foreign workers in technical or professional fields including in IT and education, while India has interests in TMNP for such categories as contractual service suppliers and independent professionals, delinked from commercial presence.

**3.51** Population in Japan will reach its peak in 2006 and then start declining. Without further integrating aged persons, youth and women into workforce, this might lead to a sharp increase in the dependency ratio and a corresponding sharp decline in the working-age population. In contrast, India is a country that has a growing work-age population. It was therefore suggested that both sides may study appropriate ways and means to realize temporary movement of professionals in some sectors between Indian and Japan to facilitate growth in Japan's productivity.

**3.52** As for mutual recognition of qualifications and certificates, there usually exist license schemes in professional services that deal with people's physical

and mental health such as medical, welfare and healthcare services. It is recognised by both sides that licensing and regulatory regimes of the country where the service is practiced need to be respected.

**Suggestions:**

**3.53** The JSG suggests that sector specific discussion would be needed when considering possibilities of TMNP, taking into account difficulties and sensitivities in each service sector.

**Constraints and Impediments**

**3.54** Despite ongoing liberalisation of trade in goods and investment barriers by India and Japan during the last decade, the barriers to trade in services still exist in various forms. These include domestic laws and regulations, impediments to producers and consumers to interact across borders, movement of skilled persons, etc.

**3.55** Language is a major barrier and restricts easy and fluent interaction between the business representatives of India and Japan.

**3.56** There is a lack of knowledge, awareness and information about each other's markets. It is further complicated by the lack of knowledge of any existing data on bilateral trade in services.

**3.57** Some other impediments include:

- a. burdensome registration and establishment procedures for companies in India and Japan;
- b. counter-guarantees required by the banks;
- c. restrictions on establishment of branches of foreign service providing companies;
- d. screen quotas in the entertainment industry in India;
- e. restrictions on the movement of natural persons through Visa restrictions, qualification recognition for professionals, licensing and certification requirements for intra-company transferees;
- f. restrictions on banks and foreign exchange regulations; and
- g. restrictions on foreign vessels

## **Early-Harvest Fast-Track Priority Steps**

**3.58** JSG recommends prioritizing on working out some of the facilitation steps so as to make the trade in services between India and Japan touch significant levels in the near future. Such steps could include:

- a. Establishing representative contact offices of Indo-Japan Coalition of Service Traders in New Delhi and Tokyo;
- b. Facilitating bilateral academic exchanges through short and medium-term language courses in India and induction of English-medium Indian teachers in Japanese educational institutions;
- c. Facilitating Visa procedures on the movement of tourist, business, and student travellers;
- d. Enhancing cultural exchange to increase the profile and visibility of the two countries among their respective peoples through increased activities of the Japan Foundation in India and the ICCR in Japan; through Mixed Cultural Commissions; establishment of a Japan Cultural Centre in New Delhi and an Indian Cultural Centre in Tokyo. Reciprocal screening of cinema with socio-economic and cultural contents would also enhance appreciation of cultures by respective peoples.

## **CHAPTER 4: INVESTMENT**

### **Introduction**

**4.1** Investment, particularly gross fixed capital formation, is critical for improving productivity and enhancing growth and employment in any economy. Traditionally, domestic savings fall short of the enormous need for capital formation in a developing economy. Foreign Direct Investment assists in bridging the gap between domestic savings and capital formation besides encouraging technology up-gradation and inducting international best practices. The investment climate globally has witnessed a huge resurgence with significant participation by Asian countries in the globalisation process.

### **Inward FDI Policy**

#### **India**

**4.2** The Government of India has put in place a liberal, transparent investment regime and an investor-friendly FDI policy wherein FDI up to 100 percent is allowed under automatic route for most of the sectors. FDI is prohibited for Retail trade, Atomic energy, Lottery business, Gambling and betting, Housing and real-estate business except construction development projects and development of integrated townships, and Agriculture plantations. Caps on foreign equity remain in a few sectors such as Domestic airlines, Broadcasting, Telecommunication, Defence production, etc. Details of sectors prohibited and sectors attracting equity caps are at Annex-I.

**4.3** Entry route for FDI – Most of the sectors are open to FDI under the automatic route which only requires notification to the Regional office concerned of the Reserve Bank of India (RBI) within thirty days of the receipt of inward remittance and file the required documents with that office within 30 days of issue of shares to foreign investors.

**4.4** Under the FDI policy, prior Government approval for FDI is required in the following cases:

- i) manufacture of cigars & cigarettes; and defence items; and for FDI beyond 24% for manufacture of items reserved for small-scale industries

- ii) where the foreign collaborator had an existing venture or technology transfer/trademark agreement; and
- iii) where the sectoral policy governing the activities provide for either equity limit and/or prior Government approval or where FDI is prohibited

Proposals involving FDI requiring prior Government approval are considered by the Foreign Investment Promotion Board (FIPB) in a time-bound manner. FDI is subject to the applicable laws and regulations.

### **Services:**

**4.5** Services sectors where FDI is permitted up to 100% under the automatic route include Advertising and Films; Computer related Services; R&D services; Construction and related Engineering services; Health related services; Road transport services; Pollution Control & Management Services; Maritime transport services. Services sectors which attract either an equity cap or where prior Government approval is required include Broadcasting; Establishment and operation of satellites; trading; telecommunication; Courier services; and domestic airlines.

### **Industry:**

**4.6** Most of the manufacturing activities are open to FDI up to 100% on the automatic route except those where an industrial license is required in terms of the Industries (Development & Regulation) Act, 1951.

### **Foreign Technology Collaboration Policy**

**4.7** India's policy on foreign technology transfer, included in the FDI policy, is liberal and freely permits technology collaborations. Lump-sum payments not exceeding US\$2 million and royalty at the rate of 5 percent on domestic sales and 8 percent on exports are allowed under the automatic route. There are no limits on the duration of royalty payments. Payment of royalty up to 2% on exports and 1% on domestic sales is also allowed under the automatic route for use of trademark and brand name of the foreign collaborator without technology transfer. Beyond the limits allowed under the automatic route, approval of the Government is required.

## **Japan**

**4.8** In Japan, by and large, all sectors are open to foreign investors. However, there are a few exceptional sectors which are open only to Japanese such as broadcasting industry. Prior notification to Finance Minister and Relevant Ministers through Bank of Japan is required for inward investment in some sectors at least three months ahead of contract or implementation. When prior notification is submitted, the documents will be circulated to relevant authorities in the Japanese Government. Unless there is any comment from the authorities concerned within 30 days after the submission of prior notification, the investment can proceed. If there is any objection or a request for alternations in the relevant plans, reasons for them would be explained to the investor concerned, while the relevant procedures are not stipulated in the legislation. In the sectors where prior notification is not required, the investors are asked to submit ex post-facto reporting. Details of sectors which have restrictions and prior notification obligation are attached as Annex-II.

**4.9** Japanese foreign technical collaboration policy is liberal with the exceptions of “designated technology” for aircraft, weapon, gunpowder, nuclear energy and space development. Prior notification to Finance Minister and Relevant Ministers through Bank of Japan is required for collaboration relating to these technologies at least three months ahead of conclusion or change of contract.

## **Outward Investment Policy**

### **India**

**4.10** Policy on Indian investment overseas has been progressively liberalized since its initiation in 1992. Basic rationale for opening up the regime of Indian investments overseas has been the need to provide Indian industry access to new markets and technologies with a view to increasing their competitiveness globally and help the country’s export efforts. The policy has been substantially liberalized over the past three years and investments are allowed on the automatic route as under:

- a. Automatic Route: Indian corporates/ registered partnership firms are allowed to invest in entities abroad up to 200% of their net worth in a

year under automatic route, i.e., no approval is required and only post facto intimation to RBI is sufficient.

- b. RBI Approval Route: Proposals not covered under the automatic route are considered by the Special Committee on Overseas investments in the RBI. Applications are required to be made to the Exchange Control Department of RBI.

## Japan

**4.11** Japanese outward FDI policy is also liberal with the exceptions of “designated industry” which are fishery (capture of fishery animals and plants) and manufacturing industry such as leather and leather products, weapon, facilities for weapon manufacturing and narcotics. Prior notification to Finance Minister through Bank of Japan is required for outward investment in these industries at least two months ahead of implementation of outward investment.

### Recent trends in investment

**4.12** According to the United Nations Conference on Trade and Development’s (UNCTAD’s) World Investment Report, 2005, Global FDI inflows rose from US\$ 632 billion in 2003 to US\$648 billion in 2004. According to UNCTAD estimates, FDI inflows have further risen to US\$897 billion in 2005. The growth reflected increased flows to developing countries as well as to South-East Europe and the Commonwealth of Independent States (CIS) and a decline in flows to developed countries. FDI inflows into Asia and the share of FDI into India and Japan are given in the following Table:

Table 4.1

	<u>Amount in US\$ billion</u>			
	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
World	716	632	648	897
Asia	92	101	147	172
Japan	9.2	6.3	7.8	9.4
India	3.5	4.3	5.3	6.0

## India

### FDI inflows

**4.13** Cumulative FDI inflows into India during 1991-2005 (up to December, 2005) were US\$ 37.05 billion, with Mauritius (37%); USA (16%); Japan (6.8%); Netherlands (6.7%); UK (6.3%) being the top five investing countries. Five sectors receiving maximum FDI were Electrical Equipments (16.50%); Transportation (10.34%); Services Sector (9.64%); Telecommunications (9.58%); and Fuel & Power (8.41%).

**4.14** FDI inflows into India, as above, represent only the equity component and does not include the other 2 components, i.e., the 're-invested earnings' and 'other capital'. According to international practices, FDI comprises of capital provided by a foreign direct investor, either directly or through other related enterprises, to an FDI enterprise. Consequently, there has been an under-reporting of India's FDI statistics. An exercise for adopting international practices in compilation of FDI statistics was undertaken and the Reserve Bank of India has revised the FDI statistics beginning 2000-01. FDI inflows into India, as per the international practices, are about 50-80% higher than previously reported figures which included only the fresh equity component. Reinvested amounts emerge as a major source. The following table shows the FDI figures as per internationally accepted practices:

Amount in US\$ billion

Year	FDI (Equity Component *)	FDI as per revised data
2000-2001	2.90	4.029
2001-02	4.22	6.130
2002-03	3.13	5.035
2003-04	2.63	4.673P
2004-05	3.75	5.535P
2005-2006 up to (December )	3.70	4.719

\*As per Secretariat for Industrial Assistance data

P: Provisional

## Overseas Investment

**4.15** With strong economic performance and growing competitiveness of industry, India is emerging as an investing country as well. Indian investments overseas has witnessed a quantum jump from US\$205 million in 1996-97 to US\$1.32 billion in 2003-04 and further to US\$2.39 billion in 2004-05. US\$6.15 Million has been invested in Japan from India between April, 1996 and August, 2005.

## Japan

### FDI Inflows

**4.16** The amount of inward direct investment in Japan was \$37.45 billion in 2004, This was the largest figure ever, and indicated that the volume of inward investment exceeded that of outward investment for the first time after statistics was made available in 1961. The figure was equivalent to 0.8% of Japan's GDP in 2004. The share of manufacturing industry and non-manufacturing industry in the FDI inflows into Japan is given in the following table:

#### Inward investment to Japan

(Amount: in US\$ million, Number: number of investment cases, Fiscal year basis)

		2002	2003	2004	Cumulative amount, 1989 to 2004
Manufacturing industry	Amount	6,749	4,310	952	49,192
	Number	255	205	226	
Non-manufacturing industry	Amount	11,186	14,412	36,507	140,081
	Number	1,210	1,226	1,365	
Total	Amount	17,935	18,722	37,459	189,273
	Number	1,465	1,432	1,591	

**4.17** The amount of Japan's outward investment (report-based) was \$35,500 million in 2004, a 1.5% decrease from the previous year. However, the number

of investments has increased up to 2,733 in the last four years. In the period between 2002 and 2004, the number of investments in the non-manufacturing industry increased from 1,802 to 2,083, and also in the manufacturing industry, from 603 to 649.

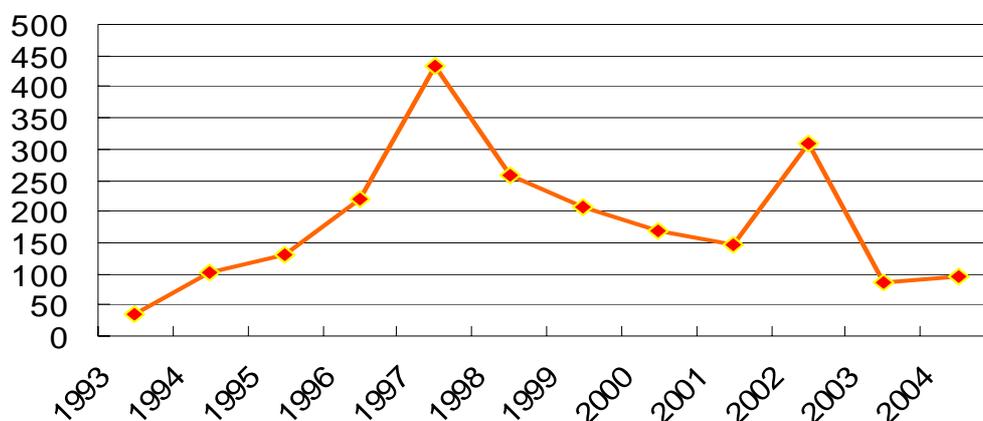
**4.18** Out of the total outward investment of around US\$35 billion in 2004, European Union, Asia, Latin America and USA received US\$12.96 billion; US\$9.38 billion; US\$6.37 billion and US\$4.67 billion respectively. 20% of Japan's outward investment was in the transportation industry, with iron & steel, electrical machinery, retail and food being other main sectors. Japan's outward investments include US\$13.75 billion in manufacturing activities and US\$21 billion in non-manufacturing activities. Japan's FDI into India during 2004 was only US\$116 million.

### **Bilateral Investment flows**

**4.19** According to the FDI inflow data maintained by the Government of India, which is based on the FDI in equity only, Japan with inflows of US\$ 2.01 billion since 1991 ranks 3<sup>rd</sup> in terms of inflows received. Transportation Industry (60.36%), Electrical Equipments (including computer software & electronics) (7.23%), Services Sectors (financial & non-financial) (3.65%), ceramics (2.20) and Textiles (2.18%) were the top sectors receiving FDI from Japan

**4.20** However, according to the data maintained by the Japanese Government, cumulative amount of Japanese direct investment in India is \$2,518 million. Direct investment in India is on a decrease after reaching a peak of \$434 million in 1997. Japanese investment in India was \$97 million in 2004, which accounted for 0.27% of the total volume of Japanese FDI overseas, and comprised only 3.1% of the total volume of direct investment to India.

Chart 4.1  
Japan FDI in India (Fiscal Year Basis)



## Technical collaborations between Indian and Japan

**4.21** During the last fourteen years total (overall) technical collaborations entered into by Indian companies have been 7,736. Out of these, companies from Japan have been granted 837 technical collaborations (10.82% of the total) since, 1991. Top five sectors attracting technology transfer from Japan are – Transportation Industries (233 nos.), Electrical Equipments (including computer software & electronics) (195 nos.), Chemicals (other than fertilizer) (75 nos.), Misc. Mech. Engg. (52 nos.) & Industrial Machinery (47 nos.).

## Existing Mechanism for Investment Cooperation between Japan and India India-Japan Investment Dialogue:

**4.22** The Japan-India Investment Dialogue is a public-private forum through which both sides discuss the measures aimed at promoting investment and to resolve specific problems faced by the Japanese companies, including barriers to investment in India. Ministry of Economy, Trade and Industry of Japan (METI), Department of Industrial Policy and Promotion, Ministry of Commerce & Industry of India, JIBCC(Japan-India Business Cooperation Committee) and IJBCC(India-Japan Business Cooperation Committee) are represented in the IJID. The scope of the dialogue covers (a) general issues relating to investment promotion and smooth implementation of investment; (b) specific impediments to investment and vitalisation of economic interaction; (c) promotion of inter-enterprise industrial cooperation between India and Japan.

The meetings of the dialogue are held on an annual basis alternatively in India and Japan.

### **Japan-India Policy Dialogue (JIPD)**

**4.23** Japan-India Policy Dialogue (JIPD) was established by Minister of Economy, Trade and Industry of Japan (METI), and Minister of Commerce and Industry of India (MOCI), on the occasion of the visit of Minister of Economy, Trade and Industry of Japan to India in August 2004. This is a counterpart talk between METI and MOCI for strengthening economic relations between the two countries. The Terms of Reference of JIPD include identification of constraints and barriers to growth of trade between the two countries; to draw up a programme for increasing investment flows between Indian and Japan and suggest steps to remove impediments to investment flows; identify problems and difficulties faced by the business community in conducting their business in each other's country and recommend measures for improvement of business environment. The first JIPD was held in April 2005, and it was agreed to set up a working group (WG). At the first WG in October 2005, both sides discussed ways to disseminate the information about India, including establishment of a Trade and Investment Promotion Desk in METI and its cooperation with Japan cell in MOCI, and ways to supply opportunities for business matching between Indian and Japanese companies, including as support for Indian seminars and trade fairs held in both countries, Both sides will continue to discuss more useful ways to strengthen their relationship in trade and investment.

### **Business to Business Dialogue - Joint Meeting of the India-Japan Business Cooperation Committees**

**4.24** The business-to-business dialogue between JIBCC and IJBCC is held annually, with a view to expanding economic exchanges between the two countries. The meeting focuses on promotion of industrial cooperation in the fields of infrastructure and IT in a concrete manner. The content of the discussions held in this framework may be shared with the India-Japan Investment Dialogue based on request from the business parties of both countries.

### **FDI Promotion Measures**

## **Initiatives taken by Indian Government for promoting FDI**

**4.25** The Indian Government has taken major initiatives such as industrial de-control, simplification of investment procedures, liberalization of trade policy, full commitment to safeguarding intellectual property rights, financial sector reforms, liberalization of exchange regulations etc., in order to provide a liberal, attractive, and investor-friendly investment climate.

**4.26** The Government of India extends investment guidance through the Secretariat for Industrial Assistance in the Department of Industrial Policy & Promotion. To facilitate easy availability of information to the investors and provide information about the investment climate in the country, the department hosts an investor-friendly web site [www.dipp.gov.in](http://www.dipp.gov.in). The web site has the facility of on-line chat where investors can ask any question relating to FDI policy and related issues. The web site also has provision of bulleting board service.

**4.27** For Investment Promotion, the Government of India holds Destination India events and road-shows in potential countries. The Government of India has also established the Foreign Investment Implementation Authority (FIIA) to facilitate the implementation of FDI projects by assisting investors in obtaining requisite approvals and in resolving other operational difficulties at the central, state and local government level. The FIIA has been interacting at regular intervals with investors and has emerged as an effective problem-solving platform.

**4.28** The Indian Government has recently undertaken a series of measures to promote investments: the FDI cap in the domestic airlines sector has been increased from 40% to 49%; FDI up to 100% has been allowed in construction development projects/housing and township projects on the automatic route; FDI up to 74% has been allowed with prior Government approval in Telecommunication services; procedure for transfer of shares from resident to non-residents has been simplified and would be now on the automatic route subject to policy for FDI in the concerned sectors. The Government of India has set up a dedicated 'Japan Cell' in the Department of Industrial Policy & Promotion to promote and facilitate Japanese investments in India.

## **Initiatives taken by Japan Government for promoting FDI**

**4.29** The Government of Japan holds seminars to introduce the foreign investment climate and economic incentives to Japanese companies. JETRO organizes the dispatches of overseas investment missions to all parts of the world, especially to countries which have a high potential for receiving foreign investment, in order to offer opportunities to study investment environment and overseas market. Investment advisors and JETRO staff members provide necessary information and counsel for setting up of business activities successfully overseas. Necessary data and information are collected from the 74 JETRO offices located all over the world.

**4.30** Also the following missions were dispatched in order to investigate a business matching and investment environment with the India companies.

- (1) KEIDANREN Mission on Nov, 2005.
- (2) The Japan - India Business Co-operation Committee (JIBCC) Mission on Jan, 2006.
- (3) METI - JETRO India Investment and Business Promotion Mission on Feb, 2006.
- (4) Tokyo Small and Medium Business Investment & Consultation Co., Ltd (SBIC) • Organization for Small & Medium Enterprise and Regional Innovation, Japan (SMRJ) mission from end of Feb to Mar, 2006
- (5) Japan Finance Corporation for Small and Medium Enterprises (JASME) Investment Promotion Mission to India on May, 2006

**4.31** Japan has entered into bilateral investment treaties (BITs) with various countries in order to protect Japanese investors and investments abroad, and promote investment liberalization. There is a clear tendency in the recent BITs such as those with Korea and Viet Nam to put a greater emphasis on the liberalization of investment in addition to investment protection. Furthermore, Japan's Economic Partnership Agreement EPA with Singapore, Mexico and Malaysia, and the currently negotiated FTAs/EPAs with Thailand, Philippines, and Indonesia all include a chapter on investment.

**4.32** Insurance for investment has an important role to play in promoting the business activities of Japanese company overseas. The insurance covers losses by Japanese companies which have established subsidiaries or joint ventures overseas, when they are forced to discontinue their activities because of war,

terrorism, natural disaster or suspension of remittance to Japan.

### **Initiative taken by both governments for promoting FDI**

**4.33** The Government of Japan and the Government of India signed the protocol amending the current Income Tax Convention in Tokyo on February, 24, 2006. It will enter into force from June 28, 2006, and once entered into force, it will reduce the withholding tax rates to 10% on dividends, interest, royalty and fees for technical services pay between the two countries. It is expected that this would promote greater investment between the two countries.

### **Impediments to Investments**

**4.34** JSG noted that the inclination of the Japanese to do business in the Indian market is increasing rapidly. The reasons for the strong interest of Japanese enterprises includes, the prospects of future development of local market, low labour costs and availability of skilled workforce. The JSG also took note of the fact that the Japanese businesses have cited high tariff rates; lack of necessary infrastructure;; information on investment regulations and opportunities and transparency in the application of laws and administrative procedures; and regulations on labour and worker welfare as impediments to greater investment flows. It was also noted that other issues often raised by Japanese investors as factors of low levels of investments were regulations concerning the No-Objection Certificate (NOC); improvements required in the Intellectual property system; restrictions on foreign investment especially in the retail sector; regulations on remittances including transfer of royalties.

**4.35** JSG took note of the number of measures taken by the Government of India for the improvement in physical infrastructure where major initiatives to upgrade roads, ports and power sector have been undertaken. The Government of India has also introduced a novel scheme of Public Private Partnership wherein the Government would provide the viability gap funding to help infrastructure projects become financially viable. The JSG also noted that the new law on Special Economic Zones enacted in 2005 provides for a attractive set of incentives for both the developer of SEZs as also for the units to be set up in such SEZs. The JSG feels that while the results of the measures taken up by the Government of India would be visible in the next few years, the infrastructure sector offers considerable investment opportunities for the

Japanese investors. The Prime Minister of India has stated that Infrastructure sector alone can easily absorb up to US\$150 billion investment in the next few years.

**4.36** Indian side stated that the Government of India had amended its Patents Act in 2005 and the Act is fully compliant with the international commitments. A major programme of modernisation of Patents Administration has been undertaken and fully computerised Intellectual Property Offices have been established at New Delhi, Kolkata and Chennai. The JSG also took note of the fact that the Government of India has recently undertaken a major review of its FDI policy and FDI up to 51% has now been allowed in the retail trade of 'Single Brand' products.

**4.37** The JSG also noted that the guidelines pertaining to new ventures when the foreign investor had an existing venture in the same field were reviewed in January 2005 and prior Government approval was now required only in cases where the foreign investor had an existing joint venture or technology transfer/trademark agreement in the same field. All future cases would be governed by their contractual arrangements. The JSG also took note of the fact that there was no requirement of furnishing a NOC from the foreign investor and the investor was only required to obtain prior Government approval if a joint venture or technology transfer/trademarks agreement existed in the same field.

**4.38** The JSG took note of the fact that there were no restrictions on remittance of either profits or royalties in India. In fact the original investment is also freely repatriable except in the few cases where there were requirements of investment to be kept for a certain period.

### **Investment Opportunities**

**4.39** The economies of India and Japan are highly complementary in terms of factor endowment, capabilities and specializations. JSG suggests that working age population, cost-effective human resources; strengths in IT hardware and computer software services, vast investment opportunities available, technology strengths of Japanese companies; are factors which need to be utilized to their full potential for increasing investment flows between the two countries.

**4.40** While expansion in trade and investment flows would be facilitated by the availability of infrastructure and socio economic services; growth in trade and investment would in turn offer tremendous opportunities for investment in infrastructure development and other related socio economic services.

**4.41** Tremendous investment opportunities exist in India in almost all fields – Infrastructure, the Services sector and the Manufacturing sector. The infrastructure sectors, such as power, telecommunications, roads, ports, shipping, and civil aviation, are fast-growing capital-intensive sectors providing investment opportunities to foreign investors.. The Government of India has established a Special Purpose Vehicle for financing of Infrastructure Projects. An innovative scheme for encouraging Public Private Partnerships has been put in place. The total investment requirement for infrastructure sector is estimated at US\$150 billion over a period of 5 years. In the manufacturing sector, automobiles, textiles, pharmaceuticals, gems & jewellery and leather are some of the promising sectors for investment.

**4.42** Indian companies are operating in Japan in the sectors of Gems & Jewelry, Marine imports, Tourism, Restaurants and IT. However, business circumstances indicate that these Indian companies operating in Japan are not making the most of their potential, although many major IT companies are expanding their businesses in Japan. It is desirable that Indian investment structure should be diversified to cover sectors which India has comparative advantages, such as IT and business process outsourcing. In these sectors, there will be huge opportunities of investment in Japan for Indian companies.

### **Recommendations:**

**4.43** Brief account of India-Japan investment links shows that the magnitude of economic cooperation resulting from bilateral investments between the two countries has grown substantially over the past few decades. The fact that the bilateral investment is steadily growing and yet the investment shares are rather small suggests that there is a huge potential for expansion of bilateral investment. The challenge is not only to exploit this potential but also to make investment more broad based and diversified in favour of the high technology manufactured goods. The JSG recommends that:

- a. Bilateral investment flows between the two countries can also be

promoted fruitfully by both business chambers and government agencies through organized institutional promotion campaign, viz., successful business missions between Japan to India to explore the potential of business collaboration and investments, especially for Japanese SMEs, and organizing investment seminars and expositions focusing on products and technologies.

- b. Systems should be established to provide, on a continuing basis, accurate information to investors relating to the foreign investment laws and regulations, market information and business matching. Links between websites dealing with the foreign investment laws and regulations, policies and market information should be established.
- c. There is a felt need for greater interaction between the representatives of business and industry of the two countries. To increase mutual contact, institutional mechanism between the Chambers of Commerce of India and Japan should be strengthened.
- d. Conclusion of an investment agreement should be considered to address wide varieties of issues, including, among others, National Treatment; transparency; promotion, facilitation; investment protection and dispute settlement.
- e. Both countries should consider maximizing the investment opportunities in sectors with a competitive edge. Sector-specific cooperative measures, such as Japan's investment and technical collaboration in India's infrastructure sector, could be taken as one of the most important options. The Indian Government's "National Common Minimum Program" put the highest priority on the development of infrastructure. In this regard, major construction companies with expansive overseas experience could participate in India's projects for building infrastructure. As the successful technological collaboration in Delhi Metro project has shown, Japanese ODA can continue to play an important role in developing infrastructure and the STEP formula (Special Term for Economic Partnership) can contribute to further utilization of Japanese technology in infrastructure development in India.
- f. The JSG suggests that, as part of outward investment strategies of both countries, investment to each other's market be supported by a joint investment promotion mechanism as the key institutional arrangement for investment promotion, promotion of greater flow of investments, dissemination of information on investment opportunities,

identification of new areas of collaboration and facilitation of investment implementation.

**Sectoral Restrictions under the FDI Policy in India**

**❖ Sectors prohibited for FDI:**

- i. Retail trading except for retail trade of 'Single Brand' products
- ii. Atomic energy
- iii. Lottery business
- iv. Gambling and betting sector

**❖ Sectors where equity cap apply:**

**I. Sectors where FDI up to 26 % is allowed**

- i. FM Broadcasting – FDI +FII investment up to 20% with prior Government approval
- ii. Print media: Publishing newspaper and periodicals dealing with news and current affairs – foreign investment up to 26% with prior Government approval
- iii. Defence industries - FDI up to 26% with prior Government approval
- iv. Insurance - Foreign equity (FDI+FII) up to 26% under the automatic route

**II. Sectors where FDI up to 49 % is allowed**

- i. Broadcasting
  - a. Setting up hardware facilities such as up-linking, HUB, etc.- FDI+FII equity up to 49% with prior Government approval
  - b. Cable network- Foreign equity (FDI+FII) up to 49% with prior Government approval
  - c. DTH - Foreign equity (FDI+FII) up to 49% with prior Government approval. FDI can not exceed 20%.
- ii. Investing companies in infrastructure/service sector – FDI up to 49% with prior Government approval
- iii. Domestic airlines - FDI up to 49% under the automatic route with no direct or indirect participation of foreign airlines

**III. Sectors where FDI up to 51% is allowed**

- i. FDI up to 51% with prior Government in retail trade of 'Single Brand' products

**IV. Sectors where FDI up to 74% is allowed**

- i. Telecommunication services: basic and cellular – Foreign investment up to 74% permitted. FDI beyond 49% requires prior Government approval.
- ii. ISP with gateways, radio-paging, end-to-end bandwidth – FDI up to 74% with FDI beyond 49% requiring prior Government approval
- iii. Establishment and operation of satellites - FDI up to 74% with prior Government approval
- iv. Atomic minerals - FDI up to 74% with prior Government approval
- v. Private sector banks - Foreign equity (FDI + FII) up to 74% under the automatic route

**V. Sectors where FDI up to 100 % allowed subject to conditions**

- i. Development of existing Airports - FDI beyond 74% requires Government approval
- ii. Petroleum sector: : Minimum 26% Indian equity within 5 years for actual trading and marketing.
- iii. Trading: Test marketing and/or sourcing of goods from the small-scale sector : FDI up to 100% with prior Government approval
- iv. Courier services- prior Government approval
- v. Tea Sector, including tea plantation – prior Government approval subject to divestment of 26% equity within five years
- vi. ISP without gateway, infrastructure provider providing dark fibre, electronic mail and voice mail – FDI up to 100% allowed subject to divestment of 26% equity in 5 years if the investing companies are listed in other parts of the world.
- vii. Non Banking Finance Companies – FDI up to 100% under the automatic route subject to minimum capitalization norms
- viii. Domestic airlines – NRI investment up to 100% permitted under the automatic route with no direct or indirect participation of foreign airlines.

## **Sectoral Restrictions under the FDI Policy in Japan**

### **I. Foreign Investment Restrictions**

- ◆ Mining : Open only to Japanese national or company established under Japanese law
- ◆ Broadcasting : Open only to Japanese
- ◆ NTT : Foreigners are not allowed to own more than 33% of shares
- ◆ Ownership and operation of Japanese nationality vessels :

Japanese nationality is given to a ship whose owner is a Japanese national, or a company established under Japanese law, of which all representatives and not less than two-thirds of executives administering the affairs are Japanese national

(Note) Cabotage transport is permitted only to ships of Japanese nationality

- ◆ Ownership and operation of Japanese nationality aircraft :

Japanese nationality is given to an aircraft whose owner is a Japanese national, a company established under Japanese law, or a company of which all representatives and not less than two-thirds of executives administering the affairs are Japanese national

(Note) Cabotage transport is permitted only to aircrafts of Japanese nationality

#### **Air Transport**

A permission of the Minister of Land, Infrastructure and Transport for conducting air transport businesses as a Japanese air carrier (or aerial work business) is not granted to following natural persons or entities applying

for the permission:

- (a) a natural person who does not have Japanese nationality;
- (b) a foreign State, or a foreign public entity or its equivalent;
- (c) a legal person or other entity constituted under the laws of any foreign State; and
- (d) a legal person represented by natural persons or entities referred to in subparagraph (a), (b) or (c); a legal person of which more than one-third of the members of the board of directors are composed of natural persons or entities referred to in subparagraph (a), (b) or (c); or a legal person of which more than one-third of voting rights are held by natural persons or entities referred to in subparagraph (a), (b) or (c).

In the event an air carrier (or a person conducting aerial work business) becomes a natural person or an entity referred to in subparagraphs (a) through (d), the permission will lose its effect. The conditions for the permission also apply to companies, such as holding companies, which have substantial control over the air carriers (or a person conducting aerial work business).

- Freight Forwarding Business (excluding freight forwarding business using air transportation)

The following natural persons or existing entities are required to register with, or to obtain permission or approval of, the Minister of Land, Infrastructure and Transport for conducting freight forwarding businesses using. Such registration shall be permitted, or such permission or approval shall be granted, on the basis of reciprocity to:

- (a) a natural person who does not have Japanese nationality;
- (b) a foreign State, or a foreign public entity or its equivalent;
- (c) a legal person or association constituted under the laws of any foreign State; and
- (d) a legal person represented by natural persons or entities referred to in subparagraph (a), (b) or (c); a legal person of which more than one-third of the members of the board of directors are composed of natural persons or entities referred to in subparagraph (a), (b) or (c); or a legal person of which more than one-third of voting shares are held by natural persons or entities referred to in subparagraph (a), (b) or (c).

- Freight Forwarding Business (only freight forwarding business using air transportation)

(1)The following natural persons or entities may not conduct freight forwarding businesses using air transportation between any points in Japan:

(a) a natural person who does not have Japanese nationality;

(b) a foreign State, or a foreign public entity or its equivalent;

(c) a legal person or association constituted under the laws of any foreign State; and

(d) a legal person represented by natural persons or entities referred to in subparagraph (a), (b) or (c); a legal person of which more than one-third of the members of the board of directors are composed of natural persons or entities referred to in subparagraph (a), (b) or (c); or a legal person of which more than one-third of voting shares are held by natural persons or entities referred to in subparagraph (a),(b) or (c).

(2)The natural persons or entities referred to in subparagraphs 1 (a) through (d) are required to register with, or to obtain permission or approval of, the Minister of Land, Infrastructure and Transport for conducting freight forwarding businesses using international air transportation. Such registration are shall be permitted, or such permission or approval are shall be granted, on the basis of reciprocity.

## **II. Prior Notification Obligations**

- ◆ Heat Supply
- ◆ Telecommunications and Internet Based Services
- ◆ Drugs and Medicines Manufacturing
- ◆ Leather and Leather Products Manufacturing
- ◆ Oil Industry
- ◆ Agriculture, Forestry and Fisheries, and related services

- ◆ Security Guard Services
- ◆ Energy
- ◆ Arms and Explosives Industry
- ◆ Aerospace Industry
- ◆ Broadcasting Industry
- ◆ Transport
  - Railway Transport
  - Road Passenger Transport
  - Water Transport
  - Air Transport
- ◆ Water Supply and Waterworks

## **CHAPTER 5: ROLE OF JAPAN'S ODA IN PROMOTING ECONOMIC PARTNERSHIP**

### **Introduction**

#### **Overview of Japan's ODA to India**

**5.1** Japan has been extending bilateral economic assistance to India since 1958. Japan is at present the largest bilateral ODA partner of India. The cumulative ODA loan commitment from Government of Japan till March 2005 has reached 2,097 billion yen. The cumulative disbursement so far amounts to 1,575 billion yen. Japan has funded 165 projects through ODA loans till date, out of which 36 projects are currently ongoing.

**5.2** Japan's assistance to accelerate economic development of India is highly appreciated. Japan's assistance has been particularly helpful in the infrastructure sectors such as power, urban transportation, urban water supply and sanitation, water management, seaports, and tourism. Japan has also supported India in health and the environment and forests sectors. A new dimension to India-Japan development cooperation was introduced during the Prime Ministerial meeting at New Delhi in April 2005 whereat India has indicated its willingness to receive STEP loans for a large infrastructure project in the railway sector. Japan is currently implementing the feasibility study for this project through JICA.

**5.3** Grant assistance has also played its part by way of technical assistance for the enhancement of knowledge and skills of Indian nationals, development studies and grant-aid projects, such as improvement of hospitals and development of ground water. Japan's cultural grants have also been beneficial in ensuring greater appreciation of Japanese culture among Indians by promoting Japanese language and culture in India.

#### **Recent trend of Japan's ODA to India**

**5.4** India-Japan bilateral development cooperation has experienced positive development in recent years. India was the largest recipient of Japan's ODA in FY 2003, wherein Japan was committed to ODA loans of 125,004 million yen for development projects in India, which was 20% of the total Japan's yen loan

commitments. It accounted for 17.5% of all external assistance received by India in FY 2003. India continued to be the largest recipient of Japan's ODA with Japan committed to 134,466 million yen under FY 2004 ODA package. This was by far the largest ODA loan commitment of Government of Japan to India in a single fiscal year and it amounted to 24.7% of all external loan commitments to India in FY 2004 and 19.2% of Japan's global yen loan commitments in the same year. With regard to FY 2005 yen loan package, Japan has committed to ODA loans of 155,458 million yen for development projects in India, which made India the largest recipient of Japan's ODA in 2005 as well. It accounted for 24.7% of all external assistance received by India in FY 2005 and 27.4 % of Japan's global yen loan commitments in FY 2005.

**5.5** However, it is also observed that the net balance of payments on the ODA account has been negative for India. For the FY 2004, the gross inflow of loans and grants from Japan to India amounted to Rs 25.96 billion, whereas debt servicing to Japan accounted for Rs 32.94 billion. The net fund flow on account of ODA, therefore, was (-) Rs 6.97 billion in FY 2004. Similarly, for the first two quarters of FY 2005, the gross inflow on account of ODA loans and grants to India stood at Rs 9.32 billion, whereas debt servicing accounted for Rs 15.72 billion. Thus, the net fund flow of ODA to India in the first half of FY 2005 is (-) Rs. 6.40 billion. In fact, from the FY 2000 till date, except for the FY 2001, there has been a net outflow of funds from India to Japan on account of ODA. The total net outflow in the period is over Rs 14 billion as can be seen from the table at Annex.

**5.6** Indian side suggested that the duration of the project appraisal cycle could be reduced. Indian side also suggested further enhancement of annual commitment of ODA by Japan. The Japanese side explained that procedures for project appraisal are necessary to ensure the quality and transparency of projects, but that the process of project appraisal would be accelerated through introduction of the mechanism of Rolling Plan. The Japanese side also explained that annual commitment of ODA by Japan is decided after appraising each proposed project individually and thus it is difficult to commit further enhancement at this juncture.

**5.7** The resumption of Japan Overseas Cooperation Volunteers Scheme in India in August 2005 also contributes to enhancing cooperation and

understanding between India and Japan. Through this scheme, India intends to promote especially the teaching of Japanese language and the unique skill of Judo among Indian people and other areas to be mutually agreed.

### **Japan's ODA policy**

**5.8** The Government of Japan has undertaken a serious review of its ODA policy over the last three years. The outcome of this exercise are two epoch-making documents, namely Japan's ODA Charter which was approved by the Japanese Cabinet in August, 2003 and Japan's Medium-Term Policy on ODA adopted in February 2005.

**5.9** The ODA Charter has clearly defined the objective of Japan's ODA. These objectives are to contribute to the peace and development of the developing countries and thereby to help ensure Japan's own security and prosperity. Japan has been implementing and planning ODA policy in a strategic and flexible way as part of Japan's foreign policy. The Charter also identifies four priority issues of Poverty Reduction, Sustainable Growth, Addressing Global Issues like global warming and infectious diseases, and Peace-building. At the same time, the Charter refers to the importance of the perspective of Human Security.

**5.10** The Charter and the Mid-Term Policy reiterate that the most important philosophy of Japan's ODA is to support the self-help efforts of developing countries based on good governance, by extending cooperation for their human resource development, institution building including development of legal systems, and economic and social infrastructure development. Accordingly, Japan respects the ownership of developing countries, and places priorities on their development strategies. Japan believes that the goal of the development will be achieved in conjunction with the ownership of developing country and partnership of developed country.

**5.11** The Charter and the Mid-Term Policy also places an emphasis on formulation of Country Assistance Programs for the recipient countries which specify the direction, priority sectors and priority issues of Japan's ODA for a period of about five years based on a clear understanding of the development needs of the recipient countries.

Japan has an intention to address various global challenges to achieve MDGs, fight against terrorism, and consolidate the peace through contribution by ODA in specific policies.

## **India's Policy for receiving ODA**

### **Principle**

**5.12** India has reviewed its policy of bilateral development co-operation in 2005. In principle, bilateral development assistance (including grants) from all G8 countries, namely, Japan, USA, UK, Germany, France, Italy, Canada and the Russian Federation as well as from the European Commission will be availed by the Government of India and its subordinate and attached agencies (societies, trusts, boards, companies, corporations, parastatals, etc) where the Government has substantial control. European Union countries outside the G8 are also welcome to provide bilateral development assistance to India provided that they commit a minimum annual development assistance of USD 25 million to India.

**5.13** India has reaffirmed its policy regarding non-acceptance of tied aid. However, in view of the close relations between India and Japan, India has decided to continue receiving tied grant assistance from Government of Japan, and also STEP loan, which is partially tied, for a particular large infrastructure project.

**5.14** Bilateral assistance will also be welcome if it is in form of Technical Assistance that aims at enhancement of knowledge/skills of Indian nationals.

**5.15** Bilateral development assistance can also be received by the Government, if the assistance is routed through or co-financed with a multilateral agency and the proposed programme/project is to be implemented by the multilateral agency under its own rules and procedures. Such arrangements should be evolved between the participating multilateral and bilateral agencies as part of their policies. Such co-financed programmes or projects would be governed by the procedures applicable to the multilateral agency spearheading the programme/project.

## **India's priorities for ODA**

### **Overall priorities**

**5.16** India has embarked upon a journey of accelerated development and growth. The process of liberalization and reform has already started yielding results. However, it is clear that for sustainable growth of high order, India needs to make massive investment in physical and social infrastructure. Suitability of any source of finance for physical or social infrastructure has to be decided on the basis of proportion available as grants-in-aid and the terms and rates of interest for the loan. On this basis, ODA from Japan appears better suited for physical infrastructure. This can also act as prelude to Japanese FDI in infrastructure.

India requires enormous investment in infrastructure sector to compete internationally in today's rapidly globalizing world, and to sustain high domestic economic growth. A Committee on Infrastructure has been constituted under the chairmanship of the Prime Minister to focus on the 'Infrastructure Deficit' and to remedy it in a time-bound manner. The Committee has estimated an investment requirement of Rs. 1720 billion in the Highway sector alone by 2012. In addition, under the programme of "Bharat Nirman", a four-year effort to be completed by 2008-09 has been mounted. Fund requirement for this effort is estimated as Rs. 713 billion. Out of this, Rs 475 billion is required for the roads sector, Rs 233 billion for rural electrification and Rs 4.5 billion for technology sector. The additional fund requirement for accelerated infrastructure development is proposed to be met through an appropriate mix of beneficiary contribution, budgetary support, external assistance and market borrowing.

**5.17** It has been proposed to mobilize funds for creating urban infrastructure facilities through Public-Private Partnership and Special Purpose Vehicles. A scheme of financing viable infrastructure projects through a Special purpose Vehicle has been finalized for the following sectors:

- Roads and bridges, railways, seaports, airports, inland waterways and other transportation projects
- Urban transport, water supply, sewage, solid waste management and other physical infrastructure in urban areas
- Gas pipelines

- Infrastructure projects in Special Economic Zones
- International convention centres and other tourism infrastructure projects.

### **Expected Role of Japan's ODA and other donors' assistance**

**5.18** Infrastructure projects have long gestation periods and, in most cases, are not financially viable on their own. They are also characterized by low rates of return. While the Government investment in infrastructure would continue, it is not feasible to fund very large investment requirements of these projects fully from the budgetary resources of the Government. Therefore, a conscious effort is being made by the Government of India to encourage private sector to come forward in this area.

**5.19** The role of Japan's ODA is expected to be seen in this context. Quite clearly, Japanese support to various projects taken up by the Government of India and State Governments and their agencies will continue to be welcome. A new dimension can be added to this by exploring ways of leveraging the Official Development Assistance funding with the new concepts like viability gap funding, Infrastructure fund, etc. Japan's ODA can also play an important role in becoming precursor to FDI from Japan by promoting infrastructure development focused on future FDI. Finally, Japan's ODA can play a major role by building capacities to induce new technologies and ideas, not only in project formulation and implementation, but also in financial architecture of it. The Government involvement generates confidence in other players. In order to develop a robust infrastructure investment model, the Government of India has introduced Public-Private Partnership and Special Purpose Vehicle mechanisms as composite methods of funding infrastructure. From the FY 2005, India has also offered a scheme for Viability Gap Funding under which private sector-promoted infrastructure projects can approach the Government for critical viability gap funding up to 20% of the project cost.

**5.20** Viability Gap Funding mechanism has enormous potential. The potential synergy between this infrastructure-funding device and Japan's ODA could be considered. As the concept of Public-Private Partnership strikes root, the necessity of enlarging the provision of Viability Gap Funding will also become acute. ODA could be considered as a means to contribute to infrastructure funding through the mechanism of Viability Gap Funding. In other words,

ODA could be considered to contribute to augment the Viability Gap Fund so that more infrastructure projects can concomitantly be taken up through the PPP route. This would be useful in bridging the gap between financial and economic rates of return that has typically deterred private investment in infrastructure. The advantage of long term and low interest of Japan's ODA would be considered to greatly help in augmenting the Viability Gap Fund base for assisting accelerated pick-up of infrastructure projects by the private sector.

**5.21** Japan attaches importance to Indian view of PPP establishment, considering the significance of utilization of private sector investment for infrastructure development in India. It will be useful to have an exchange of views with India on design of institutional arrangement and operation of Viability Gap Funding, which is a significant method for infrastructure development. Japan will explore the possibility of utilizing Japan's ODA for Viability Gap Funding based upon the result of consultation between Japan and India.

**5.22** At the present stage of development, India requires investment at the rate of 30-35% of GDP. India also requires substantial step up in the investment for physical and social infrastructure. ODA funds should preferably be used for major infrastructure projects, in conjunction with private finance, multilateral finance and Government's own resources.

**5.23** ODA can support infrastructure development in the following ways:

1. Directly supporting infrastructure projects;
2. Indirectly supporting infrastructure projects by funding IIFCL (Indian Infrastructure Finance Corporation Limited) or through Viability Gap Funding after examining the effectiveness of these instruments;
3. Establishing SEZ and providing off-site infrastructure.

**5.24** The need for qualitative improvement in urban transport is concomitant with the rapid urbanization of Indian cities. The Government of India, as a policy, is encouraging MRTS Projects as per requirements. Rail-based mass transit systems are highly capital intensive, have long gestation periods, and, therefore, are characterized by low financial rates of return although the economic benefits to the society are immense. Mass transit systems all over

the world have had an element of initial capital cost contribution from the respective Governments. Large infrastructure projects like Delhi Metro have a demonstration effect of Japan's assistance to India. ODA can be a very useful source of funding for such projects, which also stand out as visible symbols of India-Japan friendship.

**5.25** While focus on existing sectors could continue with greater emphasis on expansion of metro rail network in Delhi and other metropolitan centres, the ODA would need recasting and fine tuning to play a more important role in infrastructure development. Some important sectors where ODA funding would be accorded higher priority by the Government of India are: Railways, Roadways, Urban Infrastructure (Transport, such as Metro Transport; Water Supply and Sanitation), Airports (apart from ODA, FDI also can play a role), Sea Ports and Power and Energy (specially LNG). Development of SEZs is one of the areas where Japanese ODA can be used to create economic infrastructure that can be subsequently utilized by Japanese direct investments. Through ODA, India can be developed as a manufacturing hub for the Indian market as well as for third-country exports operations of Japan's investments. Japan's ODA can be considered for widening the scope of cooperation in soft infrastructure sectors like software/intellectual property sector/Information Technology. Environment and Tourism also comprise promising sectors of development cooperation and there is a need to sharp-focus potential tourist circuits for development in north and south India. Concessional ODA should also be directed with precision for the environmental improvement of the fragile river basins and eco-systems.

### **Priority Areas of Japan's ODA to India**

**5.26** Japan's Country Assistance Program for India, which was formulated in May 2006, identifies the following three priority areas for Japan's ODA to India.

#### **(1) Promotion of Economic Growth**

Poverty reduction is a key development goal as mentioned in Japan's ODA Charter. Poverty reduction in India is extremely important for achieving the MDGs. Japan's basic approach to the poverty issue takes the pursuit of "poverty reduction through economic growth."

One of the biggest bottlenecks in realizing economic growth in India is the shortage of infrastructure. Japan intends to assist infrastructure development, from medium and long term perspective, which could contribute to private investment oriented economic development through improving India's investment climate. Specifically, Japan will place priority on infrastructure such as the electric power and transport sectors, including the support for soft aspects, i.e. organizational capacity building, with a hope that these supports in infrastructure sectors could further promote Japanese FDI to India.

## (2) Poverty Reduction and Improvement of Environmental issues

While economic growth is essential for poverty reduction, it should make sure that it benefits the socially vulnerable people including the poor, women and disabled. It is necessary to support areas like health and sanitation, local development, disaster prevention and tourism development for employment creation to improve their living condition and environment. Japan intends to assist the sectors of the water supply and sewerage systems, forestry, renewable energy and energy saving, urban environment development, and environment conservation of rivers and lakes.

## (3) Expansion of Human Resources Development and Exchange

One of the goals of Japan's ODA to India is the development of human resources and the promotion of mutual understanding between the two countries. It will require the substantial increase in exchange of human resources between the two countries. The focus will be particularly placed on technology development in various areas. Japan will implement assistance in collaboration with private sector in the following areas; human resources development and human exchange, technical assistance for investment environment development, and India-Japan intellectual exchange. The resumption of Japan Overseas Cooperation Volunteers (JOCV) Scheme signifies increasing cooperation and understanding between the two countries.

## **The way forward**

### **Improvement of investment climate**

**5.27** India has liberalized its FDI policy at a very fast pace; this would help Japanese investors in selecting India as a profitable investment destination. FDI is definitely an instrument for economic development as it fills up the crucial resource gaps and brings in new technology through non-debt creating inflows. However, while India has now become the largest recipient of Japan's ODA, Japan's FDI has paradoxically constituted only around 7% of the total FDI flow to India. This is far less than the actual potential.

Japan is the third-largest Investor in India and FDI inflows from Japan have been US \$2.01 billion since 1991. The main sectors receiving investment from Japan are Transportation Industry, Electrical equipment (including computer software & electronics), Services sector, Ceramics, and Rubber goods. FDI from Japan during the year 2004 was US \$ 116 million as against the inflows for 2003 at US \$ 94.4 million. Flow of FDI from Japan has been limited to select sectors. Top sectors attracting FDI approved (from August 1991 to March 2005) from Japan are Transportation Industry (33.00%), Telecommunications (14.99%), Fuels (power & oil refinery) (11.36%), Chemicals (other than fertilizer) (10.25%) & Electrical Equipments (including computer software & electronics) (6.40%).

There is need for greater Japanese FDI in infrastructure sectors like roads, ports and airports etc. Telecom, Power, Ports, Roads, Urban Infrastructure, Auto Component Industry, Food Processing, Biotech and Pharmaceutical sectors are some of the sectors that are potentially attractive for FDI. With the passage of the new SEZ Act, 2005, Japanese investors may wish to establish and develop SEZs providing world-class infrastructure that suitably attracts Japanese investment into such SEZs. Such equity participation would complement ODA financing, and greatly help India's efforts in providing internationally competitive infrastructure. Infrastructure is closely related to FDI both as its pre-requisite and also as a sector for absorbing FDI gainfully. Thus, ODA can also be used to encourage FDI through improvement of infrastructure and innovatively utilized to leverage private sector or PPP promoted projects, apart from the standard utilization of ODA for creation of infrastructure in the public sector.

### **Finding best practices**

**5.28** It is desirable for both Japan and India to be more accommodative in selection of projects whereby introduction of best practices in terms of

management and technology from Japan to India is facilitated. Such coordination would trigger technology transfers, assist human capital formation, contribute to international trade integration, particularly exports, help create a more competitive business environment, enhance enterprise development, increase total factor productivity and more generally, improve the efficiency of resource use for mutual benefit.

Some illustrative examples of sectors in which ODA can be focused to bring in international ‘best’ practices are urban transportation, railways, seaports, airports, power generation and urban water supply and sanitation. Novel community-based tourism promotion concepts that have been pioneered in Japan like Michino-eki can also be replicated in India as ‘best’ practices to improve social relevance of the tourism sector.

**5.29** Delhi Metro, funded by Japan’s ODA, is used by citizens of Delhi as a new transportation mode since 2002. This project can be cited as an excellent example of the best practice in transportation technology project management and safety-first principle in operation. Another example of best practice is West Bengal Transmission System Project. In this project, the power grid across the State of West Bengal has been enhanced and expanded by yen loans, increasing the capacity of electricity transmission facilities and reducing the rate of transmission loss. “Soft” assistance has also been provided under this project to build organizational capacity.

### **Expansion of human exchange**

**5.30** Expansion of human exchange and improvement of mutual understanding is one of the areas to be promoted between the two countries. As mentioned before, one of the priority areas of Japan’s ODA to India is the expansion of human resources development and human exchange. Active human exchange will greatly improve the level of understanding of Japan’s private sector about India, which could lead to increase in private investment. The resumption of JOCV scheme is regarded to be a positive step. Young people’s interaction through JOCV scheme in expanded areas is essential to promote mutual understanding.

### **Assistance efficiency and Implementation system**

**5.31** For effective and efficient implementation of projects, it is recommended that synergy of financial and technical cooperation be utilized wherever possible. Furthermore, the technical cooperation component should be introduced wherever appropriate at an early stage of designing the framework for financial cooperation assistance.

**5.32** India pointed out that the existing procedure for management of ODA involves lengthy cycle of project appraisal and, in the present scheme, project proposals not picked up remain on the carry over list indefinitely. In order to address these challenges, it is desirable to introduce mechanism of the Rolling Plan, which must remain an organic list of candidate proposals through constant and regular updating by way of insertion of priority proposals and removal of de-prioritized proposals decided upon through mutual consultation between the two Governments. The introduction of Rolling Plan could contribute to accelerating the process of project appraisal. Furthermore, Japan and India need to formulate favorable projects by strengthening policy dialogue and make joint efforts for efficient implementation of the projects. This policy dialogue could also encourage better coordination between different schemes, such as development study and yen loans.

### Net Flow of Japan's ODA to India during 2000-2004

(Net Disbursements: Million US Dollars)

Calendar Year	Extended by Japan			Received by Japan	Net Flow
	Loan	Grant	Total	Total	
2000	630.64	24.85	<b>655.49</b>	<b>287.34</b>	368.16
2001	814.84	23.34	<b>838.18</b>	<b>309.32</b>	528.87
2002	825.05	19.34	<b>844.39</b>	<b>350.76</b>	493.64
2003	671.07	21.13	<b>692.2</b>	<b>366.41</b>	325.79
2004	688.59	27.32	<b>715.91</b>	<b>797.95</b>	-82.05
	<b>3630.19</b>	<b>115.98</b>	<b>3746.17</b>	<b>2111.78</b>	<b>1634.41</b>
Grant includes grant aid and technical cooperation.					

### Net Flow of Japan's ODA to India during 2000-2001 to 2005-2006(Upto 30/11/2005)

(Rs. In Crores)

Fiscal Year	Received by India			Repaid by India			Net Flow
	Loan	Grant	Total	Principal	Interest	Total	
1	2	3	4	5	6	7	8
2000-2001	2364.08	15.82	<b>2379.90</b>	1457.00	1038.68	<b>2495.68</b>	-115.78
2001-2002	2992.26	22.95	<b>3015.21</b>	1604.02	978.19	<b>2582.21</b>	433.00
2002-2003	2703.89	9.51	<b>2713.40</b>	1723.11	1058.26	<b>2781.37</b>	-67.97
2003-2004	2861.86	2.54	<b>2864.40</b>	2247.07	1078.77	<b>3325.84</b>	-461.44
2004-2005	2533.12	63.42	<b>2596.54</b>	2194.93	1099.15	<b>3294.08</b>	-697.54
2005-2006 (Upto 30/11/2005)	1172.35	18.93	<b>1191.28</b>	1211.04	557.74	<b>1768.78</b>	-577.50
	<b>8060.23</b>	<b>133.17</b>	<b>14760.73</b>	<b>10437.17</b>	<b>5810.79</b>	<b>16247.96</b>	<b>-1487.23</b>

(Payments of Interest included, Technical Assistance excluded)

## **CHAPTER 6: OTHER AREAS OF ECONOMIC COOPERATION**

### **Introduction**

**6.1** Study and realization of bilateral cooperation in possible and potential areas are important for further expansion of trade and investment as well as identification and solution of problems between Japan and India. Further expansion of people-to-people exchanges in broad areas is significant to promote business activities.

**6.2** In the “Eight-fold Initiative” issued during the visit of Mr. Koizumi, Prime Minister of Japan, to India in 2005, it was decided that Japan and India would implement several measures for further strengthening the relations between the two countries. One of the important pillars in the “Eight-fold Initiative” is broadening and deepening economic and trade cooperation. As economic relations have strong linkage with other fields of cooperation, people-to-people exchanges should be further strengthened for the promotion of business activities.

**6.3** The current situation of the economic relations between the two countries shows that their potential has not been fully harnessed when compared to the role they are expected to play for the stability and prosperity in Asia. As Japan-India economic relations are complementary, it is possible for both countries to enhance their mutually beneficial cooperative relations. The JSG is requested to study specific areas that would realize the full potential of the economic relations between Japan and India and make the two countries the driving force of prosperity in Asia.

### **Areas of Economic Cooperation**

#### **Air Transportation Connectivity**

**6.4** Strengthening air connectivity between the two countries will have a significant effect on the trade and investment relationship. Five non-stop flights (i.e. Delhi -Tokyo) and five indirect flights (i.e. Mumbai-Delhi-Bangkok-Tokyo, Mumbai-Delhi-Hong Kong-Osaka) per week are being operated between the two countries. In view of the potentials of economic relations between the two countries, improvement of air linkage between the

two countries is important. Air Services Agreement was signed between India and Japan in November 1955 and the air transportation between the two countries should be managed through consultation between the civil aviation/air transportation authorities of the two governments, in accordance with the Agreement. The last bilateral consultations were held in June 1993 in Tokyo. It is expected that holding the consultations at appropriate time would address various issues relating to air connectivity.

**Suggestion:**

**6.5** The JSG suggests that relevant authorities in the two countries will work to strengthen the air connectivity between the two countries.

**Infrastructure Development**

**6.6** There is substantial unmet demand in India's infrastructure sector where Japan with its superior technology and resources can play a major role. Due to growing demand, India has the potential to absorb over US\$ 150 billion of FDI in the next few years in the infrastructure sector alone. Opportunities include in (i) setting up special economic zones (SEZs), (ii) modernization of existing airports and civil aviation facilities, (iii) development of new airports, (iv) expressways, (v) mass rapid transit systems, (vi) development and modernization of ports and shipping, (vii) high speed railway corridors, (viii) mega industrial complexes, etc. Major Japanese construction companies with overseas experience could participate in India's projects for building physical infrastructure and special economic zones. In Chapter 5, the JSG examined the possibility of utilization of Japanese ODA for Viability Gap Funding in infrastructure projects through Public – Private Partnership (PPP) mechanism.

**Suggestion:**

**6.7** The JSG suggests that both the Governments would consider an appropriate mechanism to identify viable projects for development that could be undertaken within the framework of India-Japan cooperation.

**Information and Communication Technology (ICT)**

**ICT Cooperation**

**6.8** Japan has strengths in manufacturing, product development, and marketing ICT hardware and service, while India has developed strong capabilities for software development, embedded software, R&D and related services. Together, both countries can achieve global leadership in product designing, involving integration of both hardware and software, for instance, chip design or embedded software and knowledge-based manufacturing given the abundance of low cost trained manpower in India. Transitional expansion of production in order to economize on domestic cost of production has become imperative for Japan in view of limitations of land, shortage of manpower and consequent increase in cost of wages. India appears to be the logical choice, given the vast reservoir of technical personnel, huge demand for electronic goods, and relocation friendly policies of the Government of India. Japanese companies may be encouraged to invest in hardware manufacturing in India for exploiting the respective strengths for global sourcing.

**6.9** The Electronics and Software Export Promotion Council of India (ESC) and Japan System House Association (JASA) signed an MOU in August 2000 for cooperation in IT sector for exchange of information, human resource development, technical cooperation and organization of IT seminars etc.

**6.10** The Japan-India ICT Forum was started in August 2005 to enhance the ICT cooperation and business tie-ups between the two countries. The Forum agreed to the establishment of Working Groups in six areas to discuss specific cooperation activities. These six areas consist of Broadband, Mobile Communications, e-Governance, Research and Development, Information Security and Ubiquitous Network. The Joint Task Force, which is to function as the steering body of the Forum, held its first meeting in January 2006, and decided to organize coordinators' meetings of all six Working Groups in 2006. The meetings will exchange information on interests in cooperative activities between both sides, and discuss how to find partners in business and other activities. It is expected that some of the members may be able to find partners in each group, and to create mutual chances for ICT business and cooperation. The 2<sup>nd</sup> meeting of the Forum is expected to be convened later in 2006.

**6.11** For facilitating the production networking to exploit synergies of the two countries in the ICT, Indian side suggests that discussions are initiated for

setting up a special economic zone exclusively for Japanese enterprises in India for ICT manufacture for global sourcing.

**6.12** (i) In so far as the 'India-Japan ICT' forum is concerned, the WGs meeting was held recently on April 17-18, 2006 at Tokyo during which the interactions and discussions between the Government and participating industries from both sides were held.(ii)The next meeting is expected shortly in India during which possible programmes/projects would be identified as agreed upon by the participating companies from both sides.

**Suggestion:**

**6.13** The JSG suggests that ICT cooperation and business tie-ups between Japan and India should be further strengthened especially by utilizing ICT forum.

**IIIT-J**

**6.14** The "Eight-fold Initiative" issued during the visit of Mr. Koizumi, Prime Minister of Japan to India, Japan and India have decided to make every effort to collaborate towards the development of the Indian Institute of Information Technology for Design and Manufacturing at Jabalpur, India (IIIT-J). Education of IT design and manufacturing at IIIT-J is expected to contribute towards strengthening of manufacturing industry in India.

**6.15** IIIT-J was opened in February 2006. It may take a few years to make the university full-fledged. In September 2005, an Indian delegation visited Japan to exchange views with Japanese counterparts. On that occasion, both sides agreed that the IIIT-J project should be developed primarily by the Indian Initiative, and that Japanese cooperation would be considered, mainly in the area of expertise, once the project blueprint is clarified by the Indian side. Based upon the aforementioned discussion between the two countries, Indian side is drafting a multi-phase blueprint with specification of the educational programs to be developed over the coming years and requirement of expertise and teaching materials needed in each of the development phases. A group of Japanese professors visited IIIT-J to exchange views on the aforementioned blueprint in March 2006. The visit will be followed by the dispatch of Indian professors to Japan for further discussion.

**Suggestion:**

**6.16** JSG believes that IIT-J (Indian Institute of Information Technology for Design and Manufacturing, Jabalpur) is a promising project where the initiatives by the Indian side and the expertise from the Japanese side will be combined. JSG suggests that a regular review should be conducted by a joint meeting of both sides to ensure steady progress in the project.

**IT Education and Training**

**6.17** The two countries can also cooperate in the fields of IT education and training. Indian IT education companies have developed a wide network of training institutions that impart world-class IT training. These companies have been successful not only within India but have a strong presence in other parts of the world. Furthermore, the two countries could seek to launch a joint workforce development program by forming a consortium for workforce training. Both the countries should take adequate steps to utilize the MOUs signed recently between NICT, Japan and C-DAC, C-DOT, IIT Guwahati, for IT education and training.

**Suggestion:**

**6.18** The JSG suggests that internship programs offered by some Indian IT companies to Japanese students should be better publicized in Japan so that many Japanese students may apply for such programs to gain useful experience of working in Indian companies. JSG further suggests that the companies in Japan may also offer internship programmes to Indian students. To facilitate this exchange, it is suggested that Centres for teaching Japanese language in IITs may be explored.

**Sharing Quality and Management Techniques**

**6.19** Quality management has been an area of strength of the Japanese industry. India-Japan cooperation in the area of quality management has involved the CII, which has been taking missions of top CEOs and managers to the Union of Japanese Scientists & Engineers (JUSE) since 1989, following an agreement in 1988. It has facilitated adaptation of the Japanese management methods to Indian enterprises including such Japanese concepts in quality such as 5S, kaizen and poka-yoke. CII has been involved in developing

competitiveness of Indian industry, especially SME units, through a unique cluster approach since 1998 under the guidance of Professor Y. Tsuda from Japan. The Japan Institute of Plant Maintenance has also supported the Total Productive Maintenance (TPM) Club India. These arrangements have helped 16 Indian companies winning the Deming Award till 2005.

**6.20** In the above direction, Indian side suggests the following measures:

- An institutional mechanism to invite industry/technology/management experts from Japan to India regularly in order to bring the newest ideas to industry.
- An India Japan Quality Workshop should be held at predetermined intervals.
- An institutional mechanism to train ‘Trainers’ and ‘Experts’ in India through long term assignments. Today, the training of a quality counsellor in India requires conducting specific assignments over a duration of six months to three years. Japan could either sponsor Indian counsellors for training at institutes in Japan or could consider establishment of a ‘signature’ venture, termed India Japan Management Initiative, for this in India.
- Japan could aid in capacity-building in IITs, regional engineering colleges and ITIs to help structure an adequate manpower profile for the expected manufacturing sector demand.
- A special thrust could be given for SME competitiveness in order to build world-class enterprises as a foundation for future corporate excellence.
- High-technology in particular could be emphasized. India’s strengths in design, R&D, engineering etc need to be boosted and Japan’s expertise could be effectively implemented.
- Champion projects to demonstrate success of this arrangement could be identified, and quantified aims and targets put in place. Deliverables of this work would be measured in terms of R&D spend increases by

Indian companies, growth in turnover of Indian companies, brand-building of Indian products, upgradation of the skills of workforce, and others. The visibility of Japanese management practices would substantially gain from such a joint exercise, building greater confidence among Japanese companies planning to do business in India.

**Suggestion:**

**6.21** The JSG suggests that Japan and India need to scale up efforts to share quality and management techniques.

**Small and Medium Enterprises (SMEs)**

**6.22** The worldwide trend among large corporations to outsource their requirements to small and medium enterprises (SMEs) suggests vast scope for cooperation in the outsourcing business. Indian SMEs can find synergy with their Japanese counterparts by entering into subcontracting arrangements with large and highly successful automobile and electronic companies of Japan. The possibilities can also be explored for vertical integration between Indian SMEs and their Japanese counterparts.

**6.23** The SMEs sector has played important roles for the development of Japan. As most of the Japanese companies operating in India are large enterprises, it is expected that more SMEs with expertise and experience to operate in India are likely to expand business activities especially in manufacturing industry. The JSG appreciates that JETRO mission of 70 SMEs specializing in IT and auto components was dispatched to India in 2006 in order to familiarize with investment environment as well as for business talks with their counterparts. In view of rising Japanese interest in Indian SMEs sector, following missions also visited India very recently: (i) Tokyo Small and Medium Business Investment & Consultation Co., Ltd (SBIC) (ii) Organization for Small & Medium Enterprise and Regional Innovation, Japan (SMRJ), and (iii) Japan Finance Corporation for Small and Medium Enterprises (JASME) Investment Promotion mission. Since Government of Japan has implemented a variety of measures to support business activities of SMEs, exchange of related information and experiences with Indian counterparts will be useful.

**Suggestion:**

**6.24** The JSG suggests that both Governments should play an active role in moving forward India-Japan cooperation and exchange in the area of SMEs, as strengthening cooperation, promotion and exchanges could be of great significance to the two countries.

**6.25** In order to deepen cooperation in SMEs sector, the JSG makes the following suggestions: First, successful experiences in the development of SMEs should be shared, including government policies, management systems, laws and regulations. Second, the governments should create favorable conditions for SMEs of the two countries to cooperate with each other; for example, by holding exhibitions and disseminating information of the products of SMEs and encouraging the enterprises to communicate and cooperate with each other. Third, there is immense scope for Indian companies to improve productivity by forming alliances with their Japanese counterparts towards establishing energy-efficient and environment-friendly projects.

**6.26** The JSG recommends that the relevant institutions of the two countries should activate MOUs to contribute towards strengthening commercial relations by expanding and deepening economic, trade, and investment cooperation between SMEs of India and Japan.

### **Science and Technology (S&T)**

**6.27** There are ample opportunities for bilateral cooperation in the field of science and technology (S&T) sector between India and Japan. The synergy between the two countries can be maximized, if India's abundant resources are combined with Japanese know-how in the development of resources. Opportunities include (i) Nano Science & Technology, (ii) Biotechnology, and (iii) Information Technology. Cooperative activities would include, among others, (i) Mutual visits of technical missions; (ii) Holding academic meetings (seminars/workshops/forums etc.), (iii) Joint Research and sharing of costs, (iv) R&D initiatives, and (v) holding a workshop on the new S&T Initiative to identify areas and projects to cooperate. All these efforts will not only encourage the enterprises to take advantage of improved S&T environment but will also facilitate strengthening of India - Japan economic ties.

**6.28** Cooperation in S&T between India and Japan is presently being pursued through two mechanisms. One is India Japan Science Council (IJSC) under

which Japan Society for the Promotion of Science and the Department of Science & Technology, India meet alternately in India and Japan once in two years. The 7<sup>th</sup> meeting of IJSC was held in New Delhi during 19-20 September, 2003 and the 8<sup>th</sup> meeting of this council was held in Tokyo during 26-29, January, 2005. There is an Intergovernmental S&T programme of cooperation under the Joint Committee on India-Japan Cooperation in S&T. The “Eight-fold Initiative” issued, during the Japan-India summit meeting in April 2005, stated that Japan and India would reinvigorate the Japan-India Joint Committee on Science and Technology Cooperation and discuss the modalities and implementation of the new Science and Technology Initiative. In November 2005, the 7<sup>th</sup> meeting of Japan-India Joint Committee on Science and Technology Cooperation was held in New Delhi for the first time in the last six years, where both sides reviewed the current situation of cooperation and discussed how to strengthen their collaboration. Besides, both sides agreed to have a workshop in Japan for materialization of new Science and Technology Initiative.

**6.29** Given that the Japanese Government has also earmarked biotechnology as the next engine of growth, there is a great scope for bilateral cooperation in this area. A number of Indian institutions are engaged in promotion of biotechnology research such as Department of Science and Technology (DST), Council of Scientific and Industrial Research (CSIR) and Department of Biotechnology (DBT), etc.

**6.30** Pharmaceutical industry is an area where both the countries could engage in mutually beneficial cooperation. India and Japan could explore joint ventures in the supply of generic drugs and anti-retroviral drugs.

**6.31** Other potential areas of cooperation between the two countries include IT training, biotechnology and Research and Development in natural sciences.

**Suggestion:**

**6.32** The JSG suggests that both governments should continue to encourage research communities to deepen mutual contacts and to explore possibilities of cooperative activities in science and technology. Further, the JSG suggests that both sides should hold the first workshop in science and technology at the earliest, with participation of private sectors of Japan and India.

## **Energy**

**6.33** India has faced difficulties of shortage of energy in proportion to population growth and economic development. Quality and reliability of supply needs to be improved significantly for facilitating industrial development of India. As Japan and India are mass consumers of oil, securing stable supply of energy sources and improvement of energy efficiency are significant policy agendas, which are directly linked to the economic development of both countries.

**6.34** Japan's Ministry of Economy, Trade and Industry and India's Ministry of Petroleum and Natural Gas have agreed to comprehensive energy cooperation, including petroleum and natural gas, energy conservation, and new energy. Mr. Nakagawa, then Minister of Economy, Trade and Industry and Mr. Aiyar, then Minister of Petroleum and Natural Gas signed a joint statement to this effect in September 2005. In particular, both sides agreed to enhance cooperation, based on the joint statement, in the following areas: oil stockpiling, exploration and production (E&P) in third countries, R&D in gas hydrates, joint research and study on developing an Asian crude oil and petroleum products market and measures to stabilize the Asian oil market, energy efficiency and conservation. The extant institutional arrangement for cooperation in the field of energy has been India-Japan Energy Dialogue, a mechanism between the India's Ministry of External Affairs and Japan's Ministry of Foreign Affairs. The first round of dialogue was held on March 7, 2000 in New Delhi and the second round of dialogue took place on May 10, 2002 in Tokyo. Both the sides should meet more frequently to enhance the cooperation between the two countries in the field of energy.

**6.35** India and Japan being two large energy consumers in Asia, cooperation in this sector is thus an important element to deepen economic engagement between the two countries. The two countries have several options towards broader regional cooperation in energy security involving development of an Asian Energy Market, management of energy resources and coordinate research in hydrogen fuel and gas hydrates.

**6.36** Joint collaboration in the field of exploration of hydrocarbon resources between India and Japan would lead to a win-win situation for both sides. In this regard, the Indian government suggests that the existing collaboration for

joint energy development and setting up of joint commercial enterprises in third countries should be encouraged.

**6.37** The relevant Ministries of the two countries could consider establishing an institutional mechanism aimed at promoting joint efforts in sourcing energy supplies including petroleum and natural gas from third countries as also commercial exploitation of other energy resources in third countries. The two countries could enter into a comprehensive Hydrocarbon Agreement for closer cooperation in the Hydrocarbon sector. The Japanese side could assist the Indian side to set up strategic oil resources in India based on the Japanese experience and take part in exploration and production sectors through bidding in the New Exploration Licensing Policy (NELP) rounds. There exist opportunities of joint ventures between the energy companies of the two countries in exploration and production of energy resources.

**6.38** The two countries can also cooperate in exchanging experiences in energy management. Relevant Government departments should conduct research, formulate policy and take measures to encourage Indian and Japanese business enterprises to strengthen their investments and cooperation in mining of energy rich mineral resources like coal. Both the countries can encourage their respective institutions to exchange the information as part of cooperation in new and renewable energy resources, which is mentioned in the joint statement of September 2005.

**6.39** Indian power sector would need investments of about US\$ 20 billion per year because of additional demand of power of around 12,000 MW per year over the next ten years. Japanese assistance would be useful for India to upgrade and modernize its distribution network for bringing down distribution losses and increasing reliability of supply and promoting Japanese FDI in Indian power sector.

**Suggestion:**

**6.40** JSG suggests that cooperation in the field of energy should be strengthened. Upgradation and modernization of electricity distribution network for reducing losses and increasing reliability of supply, enhancing efficiency of thermal power generation, improving energy efficiency in end use would be the focus areas. The Joint Statement concluded in Sept. 2005 would be the basis for cooperation in the petroleum & natural gas sector.

## **Environment**

**6.41** Both the countries realize their responsibility in preserving and protecting global environment. The two countries can cooperate in sharing technologies for environment protection and promote renewable energy. Sharing experiences in environment management would pave the way for better understanding towards environmental risks and their mitigation. Each Government should conduct research, formulate policy and take measures to promote environment friendly business activities.

**6.42** Global warming is an issue which affects present and future generations. In this area, India and Japan are eagerly cooperating with each other, especially on the implementation of CDM projects. It should be noted that the first UN-registered CDM project for Japan was a joint project in India. At COP 11 and COP/MOP1 in Montreal, the Parties agreed to start a dialogue on long-term cooperative action to address climate change by enhancing implementation of the Convention. In addition, in London, November 2005, G8 countries and other interested countries with significant energy needs including India held the first Ministerial meeting of the Dialogue on Climate Change, Clean Energy and Sustainable Development, launched at the G8 Gleneagles Summit. Moreover, six Asia-Pacific countries, including India and Japan held the inaugural ministerial meeting on the Asia-Pacific Partnership on Clean Development and Climate in Sydney in January 2006, in order to meet increased energy demands and to address air pollution, energy security, and climate change through development, diffusion, development and transfer of existing and emerging cost-effective, cleaner technologies and practices. Progress of concrete cooperation is expected under public-private partnership.

**6.43** Recycling is a sophisticated, globally competitive, high tech and specialized industry. It is governed by stringent quality standards, regulations and legal provisions. The Japanese Government has been promoting measures to create a sustainable society emphasizing 3 Rs (Reduce, Reuse and Recycle). It is understood that re-cycling is a trillion dollar Industry in Japan. It has been possible to develop recycling industry through policy and legislative support. Japan has revised Waste Management and Public Cleaning Law (2005), Utilization of Recycled Resources (1991), Containers and Package Recycle Law (1995), Home Appliance Recycling Law (1998), Fundamental Law for

Establishing Sound Material – Cycle Society, Law for Promotion of Effective Utilization of Resources, Construction Materials Recycling Law, Green Purchasing Law, Food Recycling Law (2000) and End-of-Life, Vehicles Recycling Law (2002). These efforts not only mitigate the environmental burden but also significantly contribute to competitiveness of Japanese industry. It would be of immense benefit to India if Japan could agree to share its experience and help India to evolve similar best practices.

**Suggestion:**

**6.44** The JSG suggests that Japan and India should actively participate in international efforts to tackle climate change in accordance with the principles of the United Nations Framework Convention on Climate Change (UNFCCC) and its Kyoto Protocol. The two governments should maintain mutual cooperation to develop more CDM projects and to attain concrete achievements under the newly established Asia-Pacific Partnership and other fora.

**6.45** The JSG also suggests that Japan and India cooperate in sharing experiences in environmental policies such as concerning recycling and air/water pollution.

**Education and People-to-People Exchanges**

**Aso Programme**

**6.46** During the visit of Japanese Foreign Minister Mr. Aso to India in January 2006, Japanese side announced launching of the "Aso Programme" which aimed to realize exchanges of about 4000 persons over the next three years in the fields of the Japanese language, technology, youth interaction etc. Funding or facilitation would be done by the Japanese Government. Indian side welcomed this initiative. It is desirable that "Aso Programme" would be implemented steadily because people-to-people exchanges would play an important role to establish long-term and strategic relations between the two countries.

**6.47** Although the number of Indian students studying in Japan is increasing (410 students in 2005), the number remains quite small compared to that of Indian students studying in the US (75,000 students) or the UK (15,000

students). About 75% of Indian students in Japan are postgraduate students, because now a number of postgraduate courses in Japan are offered in English. The most popular discipline among Indian students in Japan is engineering and about 25% of Indian students have specialized in this subject alone.

**6.48** As the global economy is increasingly driven by knowledge, dynamic linkages of business and industry with scientific and technical institutions and academia become vital. Close cooperation and exchanges among educational institutions of the two countries are important. One way of facilitating exchanges of human resources can be to recognize the degrees awarded by accredited and registered educational institutions in India and Japan. In this regard, an effort to share information on each country's institutions and their educational programs can be taken up at various levels.

**Suggestion:**

**6.49** The JSG suggests that both the governments should promote the infrastructure to accept students from the other country and support the efforts by universities and colleges for enriching their exchange programs which would contribute to educational and scientific accomplishment in universities and colleges in both countries. Relevant institutions of the two countries are encouraged to make efforts to share information on each other's institutions and their educational programs.

**6.50** The JSG also suggests that both governments should work together for the promotion of the Japanese language learning, especially at the secondary education level in India, in order that those Indian students who wish to study in Japan could overcome the language barrier.

**The JET Programme**

**6.51** India can provide Assistant Language Teachers for Japanese local schools through the Japan Exchange and Teaching (JET) Programme. The "Eight-fold Initiative" recommends the exchange of younger generation in both countries through youth invitation programmes, including the JET Programme. The JET Programme invites foreign university graduates on a contractual basis to participate in international exchange and foreign language education in local government organizations as well as at public and private junior and senior high schools.

**6.52** The number of Indian youths who participated in the JET programmes is very small; only one person in 2004 and two persons in 2005. Japanese side assures that starting from the year 2006, India will become one of the priority countries and Indian applicants will be treated as equivalent to native English speakers at the selection of Assistant Language Teacher (ALT) for Japanese local schools.

**Suggestion:**

**6.53** The JSG suggests that Japanese local governments should be encouraged to receive more Indian youths as ALT and that the Government of India will make the best effort possible to cooperate with the Japanese government in recruiting competent and enthusiastic Indian youths for ALT.

**Japanese Language Training**

**6.54** In the “Eight-fold Initiative”, Japan and India agreed to work together for the promotion of the Japanese language education in India, with a target of 30,000 learners at different levels by 2010. According to the survey by the Japan Foundation, the number of Indian learners is about 5,000 at present. As India recognizes the potential of IT market in Japan, enthusiasm for studying Japanese among Indian students is increasing. Some of the Indian IT companies have started Japanese language training for their employees.

**6.55** About 50 secondary schools in India are showing interest in introducing the Japanese language as an optional foreign language. Curriculum and teaching materials are being prepared mainly by the Central Board of Secondary Education (CBSE) and the Japan Foundation. In this regard, the first meeting of All Indian Conference of Japanese Language Education was held in February 2006 to discuss measures to overcome the shortage of Indian teachers in Japanese language for further expansion of Japanese language. Besides, the Government of Japan will also dispatch Japanese teachers to India through JOCV (Japan Overseas Cooperation Volunteers) programme.

**Suggestion:**

**6.56** The JSG considers that promotion of teaching Japanese language in India forms a basis for strengthening long-term relations between Japan and India, and

suggests that both sides cooperate with each other at various levels to spread Japanese language in India, especially with regard to training of Indian teachers.

### **Cooperation at the Local Level**

**6.57** The Joint Statement between Japanese Foreign Minister and Indian Minister of State for External Affairs encouraged further exchanges at the local level. Cooperation at the local level could deepen the bilateral relations with the participation of various local citizens.

**6.58** JSG noted that some prefecture/state governments have already initiated exchanges, in this regard, with a view to deepening and broadening friendship and cooperation at local level.

**6.59** JSG welcomes the fact that Government of India has recently framed guidelines for twinning arrangements for cooperation at state/municipal government level. JSG also noted the forward-looking vision and initiative of some local leaders from both India and Japan to foster such cooperation.

### **Suggestions:**

**6.60** JSG suggests that both Japan and India should strive actively to further strengthen the cooperative arrangements and thereby increasing exchanges and expanding friendship and cooperation at local level.

### **Tourism**

**6.61** Japan and India have stressed the importance of tourism in enhancing the growth of each economy. The number of Japanese tourists in India reached approximately 97,000 in 2004, 24% increase compared to 2003, and the number of Indian tourists who visited Japan in the same year reached approximately 53,000, 12% increase compared to the previous year. The bilateral flow of tourists between the two countries has reached approximately 150,000 in 2004, the highest record until now.

**6.62** On December 2005, Japanese Ministry of Land, Infrastructure, Transportation, dispatched a study mission for the promotion of two-way tourism between India and Japan in accordance with the “Eight-fold Initiative” for strengthening Japan-India global partnership, agreed upon between the

Prime Ministers of two countries in April 2005. The mission confirmed the need for further promotion of tourism between the two countries. In the past, Government of Japan has provided India with official development assistance for projects including the preservation of World Heritage monuments in Ajanta and Ellora and its related infrastructure improvement, as well as projects for tourism development with regard to Buddhist monuments in Uttar Pradesh.

**6.63** In order to promote cooperation in tourism sector, the Indian side suggested the followings: (i) to further increase cooperation in tourism for the benefit of both countries, familiarization trips can be organized for leading tour operators, travel agents, travel writers, and media, (ii) to provide an exposure to the various tourism products of both countries, (iii) in order to attract Japanese tourists in India, business enterprises in India and Japan can take commercial initiatives to strengthen tourism infrastructure in India and therefore cooperation in development of tourism infrastructure is called for, (iv) there is a growing demand for eco-tourism in India and Japan. Cooperation between the two countries can lead to increased eco-tourism and (v) exchange of information between tourism bodies of the two countries is very essential.

**Suggestion:**

**6.64** “India and Japan should increase cooperation in the field of tourism to give impetus to tourism flows between the two countries. Emphasis should be laid on people to people contacts to develop greater understanding between India and Japan. Initiatives such as home stay and exchange Programmes for students may be encouraged to generate goodwill and friendship between the peoples of India and Japan.

**Other Areas of Cooperation**

**Cultural Exchange**

**6.65** Cultural exchange is one of the best avenues to enhance mutual understanding and provides incentives to promote people-to-people contacts. India-Japan Mixed Cultural Commission is important in promoting cultural relations between India and Japan, which was formed as per the agreement between the Government of India and Japan in Tokyo on 29 October 1956. The last meeting of the Commission was held on 8<sup>th</sup> February, 2005. The

function of the commission is to enhance cultural relations between the two countries by promoting cultural events in Japan and India, distinguished visitors programme, exchanges of scholars and artists, JET programme, etc. In the “Eight-fold Initiative”, it was decided that the two Governments should also organize a Festival of Japan in India and a Festival of India in Japan in 2007/2008 to commemorate the 50<sup>th</sup> anniversary of the Cultural Agreement between the two countries.

### **Suggestion:**

**6.66** The JSG suggests that both sides should fully utilize the occasion of Festival of Japan in India and Festival of India in Japan in 2007/2008 for further expansion of people-to-people exchanges at grass root level.

### **Others**

**6.67** Both the countries should facilitate greater interaction between media of India and Japan for reducing the information gap. There is very little reporting on India in the Japanese media and vice versa. To bridge this gap, some exchange fellowships for media persons and journalists could be set up to allow Indian journalists to spend some time in Japan and vice versa. Media houses and news agencies from India and Japan may be encouraged to station their representatives in the other country.

**6.68** To promote people-to-people contacts and also to share and learn from the development experience as well as the process of policy making, an India-Japan Forum of Parliamentarians may be considered. The heightened interest in developing closer relations with India gets reflection in frequent exchanges of Parliamentarians. After a gap of 14 years, a parliamentary delegation from India went to Japan in November 2004. Exchange of visits by Japanese Diet Members and Indian Parliamentarians should be organized more frequently.

**6.69** Considering the high hotel tariff in India, organizing home stay facilities for visitors from Japan is likely to make India an attractive destination. Home stay will also enhance people to people relations and mutual cultural awareness, which further stimulates tourism. Japan may consider sending student groups as volunteers for social service and for giving vocational training in villages in India. Periods of service usually vary from six months to one year and the goodwill generated in the target communities is enormous

and long lasting. India also might consider such initiatives to promote interaction between youth in India and Japan.

**6.70** Japan offers excellent locales for film shooting and also technical know-how. However, due to heavy costs, Indian film industry was forced to avoid Japan from shooting films. Mutual cooperation in the entertainment industry between the two countries will facilitate shooting and screening Indian films in Japan and vice versa. Given the fact that Indian films are popular in Japan, such initiatives will provide further demand for Indian films. TV and Radio broadcasting companies between the two countries could join hands to promote each other's entertainment industry. This by itself might facilitate greater integration of media groups between the two countries.

**6.71** India and Japan can also cooperate on compilation of national accounts and industrial statistics. Jointly both the countries can develop a framework for capacity building in relation to IT integration with statistical system.

#### **Suggestions:**

**6.72** JSG suggests that both India and Japan should actively strive to promote exchanges at political and civil society level. It is also suggested that further expansion of cooperation between the mass media – including the film industry, would bring the two countries close and develop mutual understanding.

### **Cooperation in Multilateral Forums**

#### **WTO**

**6.73** India is the founding Member of GATT as well as the WTO. Japan joined GATT in 1955 and is also a founding Member of the WTO. Both India and Japan have enjoyed a close working relationship between the two delegations in Geneva and at the capital level. The co-operation between our two countries in the WTO is underpinned with the strong commitment to free, fair and equitable multilateral trading system, coupled with regional processes to promote trade and investment. India and Japan are committed to the successful outcome in the Doha round of trade negotiations in line with Doha Ministerial Conference and as elaborated in the “July Framework” decision of the WTO General Council and the Hong Kong Ministerial Declaration. India

and Japan acknowledge the importance of pro-development dimension of the Doha Round of negotiations, taking fully into account the needs and interests of developing countries. In the context of ongoing WTO Trade negotiations, the contacts between Japan and India encompass areas such as agriculture, non-agricultural market access (NAMA), services, trade facilitation, rules, special and differential treatment and implementation issues as well as environment and TRIPS related issues.

**6.74** While both countries hold different positions on some issues in line with their own trade interests and sensitivities, India has some common areas of interest with Japan in the ongoing WTO negotiations. In agriculture, India is pursuing a collaborative strategy in a broad coalition of developing countries in the G20 and G33, while keeping channels open with other groupings (including G10 of which Japan is a member) and countries. Japan, on the other, has taken the lead in formulating G10 positions from the perspective of largely developed, net food importing countries. Despite their different footing in agricultural negotiations, India and Japan share a view that the disciplines on such policy tools like special products (SP) and special safeguard mechanism (SSM) should address the food security, livelihood security and rural development needs of developing countries, and that the disciplines on sensitive products should also not be overly restrictive, in order to give adequate flexibilities to the Members in carrying out necessary policy reform. In NAMA, Japan's position is that improvement of real market access opportunity best serves the development objective of the Doha Round. India is working with other like-minded developing countries to address special needs and interests of developing countries. Both India and Japan are committed to have modalities, which would contribute to development objective of the Round. In services negotiation, there is some potential for cooperation between India and Japan in energizing the services negotiations. In Rules negotiation, there is scope for mutual cooperation to prevent abuse of anti-dumping measures. India and Japan have also been playing active role in taking the overall negotiations, in various formats, forward and to achieve balanced outcome at different stages of negotiations.

**6.75** The centrality of the objective of development has been emphasized in the Doha Declaration, Framework Agreement, as well as Hong Kong Ministerial Declaration. India and Japan should work towards achieving this

objective and to conclude the ongoing negotiations by end 2006 as agreed by Ministers at Hong Kong.

**Suggestion:**

**6.76** The JSG suggests that the two countries should intensify interaction with each other in order to further liberalize trade and foster economic growth recognizing each other's interests and sensitivities.

**EAS**

**6.77** During the last decade, East Asia has rapidly developed a variety of regional cooperation mechanisms for furthering regional prosperity, stability and harmony, with a view to building an East Asian community in the future. India has become increasingly involved in this course and its contribution to these concerted efforts is now indispensable for the region.

**6.78** Japan has consistently welcomed India's commitment to promoting peace and prosperity in East Asia. In this regard, Japan has supported India's participation in the East Asia Summit (EAS), fully recognizing constructive input India has been making to regional cooperation. India and Japan worked together closely for the success of the inaugural East Asia Summit held in Kuala Lumpur in December 2005, especially to attain a consensus among the participating countries on the point that the EAS could play a significant role in community building in the region and that the members of the EAS should strengthen global norms and universally recognized rules.

**6.79** A major task for the EAS members now is to demonstrate that the EAS is genuinely instrumental to community building in East Asia. An essential prerequisite to attain this goal is to develop actual cooperation among the sixteen EAS countries in tackling the common challenges the region is facing such as energy and the environment, terrorism, piracy and infectious diseases.

**6.80** India and Japan agree to work together towards realization of a dynamic, open and inclusive economy in Asia, through which people, goods, services and ideas travel easily across the borders and thus create 'one economic space' across Asia. In the direction of building a pan-Asian cooperative architecture, holding of the first East Asia Summit in Kuala Lumpur in December 2005 was an important initiative. India and Japan also agree to coordinate their positions

at future EAS sessions to make it an effective forum for furthering economic ties in the region for shared prosperity, peace and development.

**6.81** India is now addressing reform of its domestic bond markets to diversify fund raising methods for the development of infrastructure. Against this background, Japan could consider sharing with India its experience to have improved domestic bond markets and information on the development of the Asian Bond Market Initiative. Both countries recognize the importance of sharing information and exchanging views in the area of financial cooperation in East Asia.

**Suggestion:**

**6.82** The JSG recommends that India and Japan continue to closely coordinate their policies to further substantiate the EAS by jointly advancing such cooperation with active participation, whenever possible, by other members including ASEAN countries.

**SAARC**

**6.83** At the 13<sup>th</sup> South Asia Association for Regional Cooperation (SAARC) Summit Meeting, which was held in Dacca, Bangladesh on 12<sup>th</sup> and 13<sup>th</sup> November 2005, Japan's observer participation was agreed in principle. Japan has supported SAARC's activities through the Japan-SAARC Special Fund, amongst other means, on the understanding that SAARC is contributing to regional stability and development in South Asia, which in turn is integral to Asia in its entirety. While SAARC is considering the modalities of Japan's observer status, Japan remains committed to strengthening its relationship with SAARC, through the observer participation.

**Suggestion:**

**6.84** The JSG suggests that Japan and India will have close consultations and coordination with a view to further strengthening Japan-SAARC cooperation.

## **CHAPTER 7: FRAMEWORK FOR FUTURE ECONOMIC PARTNERSHIP**

### **Introduction**

**7.1** The JSG had detailed and meaningful discussions to assess the status of the bilateral economic relations between India and Japan and to evaluate its future potential. The study group has also studied the impediments which were noticed in the past and the possible remedies which will help to create an upgraded architecture of bilateral economic engagement. This chapter now analyses the feasibility of an Economic Partnership Agreement (EPA)/Comprehensive Economic Partnership Agreement (CEPA) between India and Japan and desirable constituents of such an agreement.

**7.2** The total amount of trade between Japan and India has been rising since 2002, reaching approximately US\$6.8 billion in 2005. However, this figure is not commensurate with the two countries' economic size and potential. Japan ranks 10th among India's export destinations (share of 2.5%) and 10th among import sources (2.8%), and India ranks 26th among Japan's export destinations (0.6%) and 28th among import sources (0.6%). As for other comparable major economies in 2005, the trade value between Japan and China was US\$189.4 billion and between India and the US, US\$ 20 billion indicating a substantial potential for further expansion of trade between Japan and India.

**7.3** Since 1991, Japan's cumulative direct investment to India is approximately US\$2.01 billion, making Japan the third largest provider of direct investment to India. Nonetheless, considering India's potential as an investment destination and Japan's economic size, this situation is also not entirely satisfactory.

**7.4** During the deliberations of the JSG, it was noted that Japan and India have great potential for economic cooperation between the two countries deriving from their complementary endowments in agriculture, trade and industry; levels of economic development; a shared vision for Asian economic integration; cultural and historical links; etc. The economies of India and Japan are highly complementary in terms of factor endowments, capabilities, demographic profiles, convergences and specializations. India's cost-effective human resources may complement growing labour scarcity and rising wages in Japan. Japan's strong capacity in IT hardware is complemented by India's software

proWess. India's capabilities in pharmaceutical industry, biotechnology, and auto components usefully complement Japanese competence in heavy engineering, automobiles, machinery and chemical industry. While there is substantial unmet demand in India's infrastructure sector, Japan has cutting-edge technology and underutilized supply side capacity in infrastructure sector. India has made significant strides in the agricultural sector and now its trade surplus in agriculture is over US \$ 2.5 billion. Japan imports more than 50% of its food requirements. Thus there is natural complementarity between the two countries in this sector. India has potential to absorb more than US\$ 150 billion of foreign direct investment (FDI) in infrastructure development alone. Presence of vibrant entrepreneurial class in both countries is also the key to facilitating trade, investment and technology transfer between them. The huge size of the market and skilled manpower available in India can provide a fertile ground for FDI by the capital abundant economy of Japan.

**7.5** Major findings of the JSG in the preceding chapters are summarized below.

### **Trade in goods**

**7.6** Bilateral trade in goods between India and Japan has stagnated in recent years despite unilateral trade liberalization in India and economic recovery in Japan. The JSG is convinced that, given the complimentary endowments of the two economies and the current heavy concentration of bilateral trade on a narrow range of products, there is a great deal of potential for expanding bilateral trade in goods.

**7.7** On tariff issues, the JSG noted relatively high average tariff rates in India and comparatively high tariff peaks in Japan, and suggests that tariff reduction and possible elimination, which is consistent with the WTO provisions, will increase market access opportunities for both countries, while a practical and flexible approach should be adopted, respecting sensitivities of both sides.

**7.8** With regard to agricultural, forestry and fisheries products, the Japanese side referred to the need for consideration of food security, multi-functionality and sustainable resources management in those sectors. The Indian side expressed strong interest in the expansion of market access for the agricultural and food products in which India has competitive edge. The JSG noted that there is opportunity for agricultural exports in both directions.

**7.9** The JSG is of the view that, in order to realize the potential mentioned above, both countries could do the following;

- (a) setting-up mechanism to facilitate customs cooperation
- (b) considering the possibility of more active use of the Export Inspection Council (EIC) of India
- (c) exploring ways to further expanding promotional activities
- (d) exploring the possibility of improving current mechanism or replacing it with a new mechanism on SPS-related issues in a joint consultation group to be set up within a reasonable time-frame.
- (e) finding solutions to some sector-specific issues.

## **Trade in Services**

**7.10** The services sector is an important part of both the Japanese and Indian economies. It contributes over 50 per cent of GDP in India and above two-thirds in Japan. Trade in services confers benefits not only to the services sector itself, but to both the primary and secondary production sectors as well. Expanded services trade accordingly stands to improve the living standards and international competitiveness of both India and Japan.

**7.11** In view of the enormous potential in services trade between India and Japan both governments need to take substantial measures to remove barriers to trade in services. Keeping this in view, the JSG recommends that future discussions respect the following four broad principles:

- (a) All services sectors and all modes of supply in GATS should be covered;
- (b) Commitments by both countries should cover a wide range of service sectors (both horizontal and sectoral);
- (c) Special emphasis shall be given to the areas, such as software and IT-related services, financial services, telecommunication services, construction services and transportation services; and
- (d) Services liberalisation should be designed to enhance the competitiveness of each economy.

**7.12** The JSG specifically covered the issues relating to services in IT sector, architecture, engineering & construction services, entertainment & health care

services, financial services, maritime services, tourism & travel related services and issues related to temporary movement of natural persons.

## **Investment**

**7.13** Investment is critical for improving productivity and enhancing growth and employment. FDI assists in bridging the gap between domestic savings and capital formation besides encouraging technology up-gradation and inducting international best practices. Economic cooperation resulting from bilateral investments between the two countries has begun to grow recently.

**7.14** The JSG noted the presence of tremendous investment opportunities in India in almost all areas of economic activities, including infrastructure, manufacturing and services sectors. For example, infrastructure like power, telecommunications, roads, ports, etc. is fast growing and is capital intensive. Infrastructure alone is estimated to be able to absorb an investment of \$150 billion over a period of next five years.

**7.15** To encourage and enhance bilateral investment between Japan and India, the JSG recommends the following measures: interaction between government, business and industry on an institutional basis; exchange of information on foreign investment laws and regulations; sector-specific cooperation measures for investment and technical collaboration in infrastructure sector and establishment of a Joint Investment Promotion mechanism. The JSG also recommends conclusion of an investment agreement to address a wide variety of issues including National Treatment, transparency, facilitation, investment promotion, protection and dispute settlement.

## **Role of Japan's ODA in Promoting Economic Partnership**

**7.16** Japan has been extending bilateral economic assistance to India for its sustainable economic development. Japan is at present the largest bilateral ODA partner of India. Japan's assistance to India is highly appreciated by India.

**7.17** India requires enormous investment in physical and social infrastructure sector for its sustained growth. A new concept of PPP including Viability Gap Funding was suggested by India in order to meet massive demand of infrastructure.

**7.18** For better development cooperation, the JSG suggests the following:

(i) ODA can be utilized to encourage FDI through improvement of infrastructure.

(ii) It is desirable for both Japan and India to be more accommodative in selection of projects whereby introduction of best practices in terms of management and technology from Japan to India is facilitated. Delhi Metro, funded by Japan's ODA, can be cited as an excellent example of the best practice.

(iii) Expansion of human exchanges and improvement of mutual understanding is one of the areas to be promoted between the two countries.

(iv) For effective and efficient implementation of projects, it is recommended that synergy of financial and technical cooperation be utilized wherever possible.

### **Other Areas of Economic Cooperation**

**7.19** Expansion of trade and investment could be further promoted by undertaking bilateral cooperation in the broadest possible areas. JSG noted that there exists complementarities and opportunities for cooperation between the two countries in many areas. That will include, for example, synergy between Japanese manufacturing technique and Indian software expertise in ICT sector; Japanese technology and resources and Indian huge infrastructure and energy needs. People-to-people exchanges should also be enhanced, as it will provide a basis for stronger bilateral economic ties.

**7.20** In this context, the JSG recommends that the two governments examine every possible measure to strengthen bilateral cooperation across a broad spectrum of areas.

### **EPA/CEPA Framework and Scope Envisaged**

**7.21** In the light of these factors the JSG has come to the conclusion that proper architecture for the bilateral economic engagement of the two countries

would be an EPA/CEPA. Liberalization of trade in goods under the EPA/CEPA would improve trade flow between the two economies and promote further intra-industry and inter-industry trade. Efficiency in the services sector is critical for the further economic growth of both Japan and India, which can be achieved through liberalization of trade in services. To accelerate further bilateral investment flows, the two countries are required to improve their investment environments by removing constraints to foreign investment on an institutional basis. An EPA/CEPA will also serve as a building block for an even larger regional economic integration.

**7.22** The EPA/CEPA should be defined as a framework of institutional arrangements that focuses much deeper than a simple FTA, encompassing all aspects of bilateral economic relations by including the liberalization of trade in goods and services, investment, economic cooperation and other areas of cooperation for mutual benefit.

**7.23** The case for a Japan-India EPA/CEPA essentially rests on complementarity of the partner economies. The differences in economic strengths, resources as well as the synergies in many areas offer enormous scope and hope for the two economies to complement each other.

## **Recommendations**

**7.24** In view of the above considerations, the JSG recommends that the Governments of Japan and India launch an inter-governmental negotiation to develop an Economic Partnership Agreement (EPA)/Comprehensive Economic Partnership Agreement (CEPA), within a reasonable period of time. The EPA/CEPA needs to be consistent with WTO provisions, while sensitive sectors should be treated with flexibility and practicality.

**7.25** The JSG recommends that the negotiations for an India-Japan EPA/CEPA may cover, but may not be limited to:

- (a) Trade in goods
- (b) Trade in services
- (c) Measures for trade promotion
- (d) Promotion, facilitation and liberalization of investment flows
- (e) Measures for promoting economic cooperation in identified sectors;  
and

- (f) Other areas for a comprehensive economic partnership between India and Japan;

**7.26** The JSG recommends that negotiations on the proposed EPA/CEPA be conducted in a specially-constituted Joint Task Force, or another mutually agreed suitable mechanism, consisting of government officials. The Joint Task Force may consult with the representatives of the business community whenever necessary. This Joint Task Force would bring specific recommendations on each of the constituent elements of the EPA/CEPA for adoption by the two governments.