

Read. Lead. Succeed. ET Prime - For Members Only

• Sharp Insight-rich, In-depth stories across 20+ sectors • Access the exclusive Economic Times stories, Editorial and Expert opinion

START YOUR MEMBERSHIP

ETPrime

Even after a decade, the India-Japan free trade deal has not worked. Why?



In May, on the sidelines of a **G7** summit in Hiroshima, Prime Minister Narendra Modi discussed with his Japanese counterpart Fumio Kishida ways to boost bilateral cooperation in various areas. One subject that warrants discussion is the Comprehensive Economic Partnership Agreement (**CEPA**) between the countries.

This **free trade agreement** (FTA), signed in 2011, aims to eliminate tariffs on 90% of Japanese exports to India (such as auto parts and electric appliances) and 97% of imports from India (like agricultural and fisheries products). The pact was aimed to significantly increase bilateral trade. According to the latest commerce ministry data, the **trade** between India and Japan in the financial year 2021-22 hit a decadal high of \$20.57 billion. This indicates the CEPA was a success. However, on closely analysing the data, the narrative changes drastically. In the financial year 2022, India's exports to Japan stood at \$6.18 billion, while imports were \$14.39 billion. This shows India's exports have not gained as much as its imports.

According to data from the United Nations Conference on Trade and Development (UNCTAD) compiled by international trade promotion organisation MVIRDC, the share of India's exports in Japan's merchandise imports has marginally improved from 0.71% in 2011 to 0.85% in 2021 since the implementation of the CEPA. On the other hand, India's share of exports to other G7 members stood at 1.35% for Italy, 0.87% for France, 1.50% for the UK and 2.47% for the US in 2021.

This leads to the argument that India has not gained as much as it should have from the deal with Japan.

Notably, Japan is the only country with which India has a special trade agreement in the G7 group. The 2011 FTA covers trade in goods, services, investments, intellectual property rights, custom procedures and other trade issues.



Indian Prime Minister Narendra Modi, and Japan's Prime Minister Fumio Kishida shake hands before their bilateral meeting at the G7 Leaders' Summit in Hiroshima, Japan.

In May, there were reports that New Delhi's representatives had raised concerns about Tokyo's restrictive policies at a trade policy review carried out by the World Trade Organization (WTO). The restrictions, according to the representatives, have led to an increased cost burden and barriers to exports from India to Japan and created hurdles in the growth of the bilateral economic partnership.

Quality standards

"Stringent quality standards and non-tariff barriers have hindered India's exports to Japan over the years," says Vijay Kalantri, Chairman, MVIRDC World Trade Center Mumbai. Other experts agree with this view.

Other than technical barriers to trade, Japan has advanced product-specific and technical standards for the products it imports. Many small and medium enterprises in India are not able to manufacture such high-quality products, say trade experts. So, they face difficulties in exporting products to Japan.

Industry stakeholders say that India's exports to Japan are low-value items, while its imports are high-value products, contributing to a trade deficit. While India's exports to Japan stood at \$5.18 billion, imports from Japan were \$11.97 billion in the financial year 2022-23, according to the commerce ministry data. The imports grew at a compound annual growth rate (CAGR) of 1.6%, while the exports saw a fall of 0.3% between 2011-12 and 2021-22.

The gap in trade has grown unfavourably for India, not just because of manufacturing inefficiencies, but also due to the absence of an ecosystem to nurture the required abilities.

Surendar Singh, Associate Professor, FORE School of Management, uses the example of India's toy industry to illustrate how the country has not been able to make use of the CEPA. "Under Japan Food Sanitation Law (JFSL), lab-verified compliance with Sections IV and V of the JFSL is mandatory for applicable children's products before they can enter the Japanese market. In addition, all compliant toys must display the Safety Toy Mark (ST Mark). Japan Toys Association has nominated agencies to test and certify toys meant for their market. Unfortunately, no agencies or labs in India are accredited to carry out such tests."

India's top 5 exports to Japan

S. No.	HS Code	Commodity	2021-2022 (in \$ million)
1	29	Organic chemicals	696.05
2	3	Fish and crustaceans, molluscs and other aquatic invertebrates	433.24
3	84	Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	478.85
4	87	Vehicles other than railway or tramway rolling stock, and parts & accessories thereof	328.71
5	27	Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes	981.8

Source: Department of Commerce

BCC

ET Rise



Such a gap in the market means no Indian company, especially MSMEs, was able to get guidance to develop the required capabilities.

Due to this, toy manufacturers have to send their entire consignments to Japan for lab testing and certification, resulting in avoidable delays and high additional costs to exporters, he says. This also means that if the consignment gets rejected there, the manufacturer or exporter would have to bear the burden.

This is a pain point as India's toy exports had increased by 61% in three years — from \$202 million in FY19 to \$326 million in FY22. But the country has not been able to leverage this with Japan. Commerce and Industry Minister Piyush Goyal had tweeted on February 11 that India's toy exports rose more than 6 times in April-December 2022 when compared with the corresponding period of 2013.

Competitiveness of India's exports

Experts say that India's exports to Japan are not as competitive as other major exporters such as China. This is primarily because of higher primary input costs in India. High logistics, power and capital costs add to the burden of exporters.

India needs to work on improving the quality of exported products to penetrate advanced markets like Japan, says Singh.

According to WTC Mumbai's research report, India's export growth to Japan was the slowest when compared with the numbers of G7 countries — growing by just 8.7% from \$5.6 billion in 2011 to \$6 billion in 2021 with a CAGR of just 0.76% in the last decade.

High most favoured nation (MFN) tariffs are one of the main reasons for the slow growth of the Indian exports, says Anurag Sehgal, Executive Director, Price Waterhouse & Co LLP. FTA nations levy lower tariffs on each other's imports. "India's MFN tariff is around 15% on an average, while Japan's MFN tariff is around 3.5% and there was already a bilateral trade between both. Now, as soon as Japan reduced the tariffs to zero, India's exporters gain 3.5%, but they will not be able to flood the market to make the most of it. On the other hand, 15% is a comparatively big barrier for Japanese exporters. They could flood the market with products as soon as India's tariffs became zero," Sehgal says.

Know the need first

Ajay Srivastava, a former Indian Trade Service officer, says there was poor understanding of what the Japanese wanted and so certain export segments could not make use of the trade opportunity. He uses the example of textiles, where India is a global leader, to show how the opportunity was squandered away.

"Both India and Japan eliminated duties on all apparel from day one of the FTA. India expected a jump in exports, but it did not happen. India's apparel exports during 2007-09 and 2019-21 increased from \$121 million to just \$197 million. Exports did not pick up despite the FTA," says Srivastava, who is the co-founder of economic think tank GTRI.

While buyers from the EU or the US look at Indian firms that are compliant with their laws, the Japanese concentrate on process improvement at the supplier's shop floor, he says.

Most Indian exporters didn't find it worthwhile to meet the requirements of prospective Japanese buyers as the market is small, says Srivastava, adding that enough research wasn't done on the requirements of Japanese buyers and zero duty was seen as a "good enough" advantage.



Panoramic view over the Port of Tokyo container dock harbour.



Indian exporters have traditionally focussed more on the western market, so they were unable to increase their footprint in Japan even when there was an opportunity. “Now, China and ASEAN have already captured the Japanese market,” Kalantri says.

Untapped export potential

The WTC research points out that India has an untapped export potential opportunity of \$20 billion in Japan. “Theoretically, under the current trade agreement, India has an untapped export potential of \$119 billion to Japan. This is the excess import of Japan from other countries over what is supplied by India. However, more realistically, India’s true untapped export potential may be computed at around \$20.5 billion for 474 commodities that India can explore in the short to medium term,” the WTC research states.

Textile, clothing and apparel sectors have the highest untapped export potential of \$7.2 billion, followed by chemicals and pharmaceuticals (\$4.6 billion) and energy (\$3.4 billion). The report says that India has a proven global competitiveness in these commodities with over 5% global share in each of these 474 commodities.

Experts say that there is a need to re-look at the **India-Japan** CEPA. Policymakers have to undertake comprehensive manufacturing reforms pertaining to land, labour and capital to address supply-side rigidities to make India’s export competitive globally, they say.

When the trade agreement was introduced in 2011, it covered nearly 1,962 tariff lines from India that were eligible for zero import duty. The number of tariff lines under the zero-duty bracket increased 13% from 1,962 to 2,218 in 2021. However, the significance of the commodities covered under the zero-duty bracket has reduced over the decade.

The share of these 2,218 tariff lines in India’s global merchandise exports fell 10.9% from 47% in 2011 to 36.1% in 2021. Their share in Japan’s global import basket has also slipped 4.8% from 20.6% to 15.7% in the period.

India needs to identify areas where Japan’s imports are increasing and then examine how to promote such products, experts say. “One way is for export promotion councils to work with domestic manufacturers to understand various aspects of product, quality and the specifications of Japanese buyers,” says Singh. “There should also be targeted intervention in these product items. The councils should take product-specific delegation to Japanese to market the products more aggressively. This can be supplemented by programmes such as exhibitions and trade fairs. Such moves can create opportunities for Indian exporters.”

Policy focus

Experts suggest that more and more industry associations at the district levels should take a lead and send delegations to Japanese companies. MSMEs should take a lead in tapping the needs of Japan, says Kalantri. “There is a big scope in commodities such as marine products, textiles, spices, rice, and iron and steel products,” he says.

Industry observers also point out that India will be better off by making some policy tweaks. Srivastava uses textiles as an example to elucidate this point: “The duty drawback benefits allow firms to export at a price that is lower than what is available in the domestic market. This reduces the availability of inputs for high-value-added apparel exports. Remove all incentives from exports of low-value-added inputs. Make more factories fast fashion industry (FFI) compliant. India has 1,200 compliant factories supplying cotton products to FFI and other large buyers. Aim to make more units FFI compliant as they seize most orders.”

The Japan CEPA offers lessons for policymakers on what we should not ignore while signing FTAs. If these learnings are ignored, a bilateral agreement would only have a unilateral beneficiary.

*Edited by Ram Mohan. Illustrations by Mohammad Arshad.
(Originally published on Jun 15, 2023, 10:01 AM IST)*