Chapter 5

Making India's Trade Relations with Japan More Favourable

Danish Hashim

This chapter should be cited as:

Hashim, D. (2025), 'Making India's Trade Relations with Japan More Favourable', in A. Prakash (ed.), India–ASEAN–Japan Cooperation for Diversified and Resilient Supply Chains. ERIA Research Project Report FY2025 No. 16, Jakarta: ERIA, pp.85-99.

Chapter 5

Making India's Trade Relations with Japan More Favourable*

Danish Hashim

Introduction

Economic cooperation between India, the world's fifth largest economy, and Japan, the fourth largest (Forbes India, 2025), has traditionally been strong, and has been given high importance on both sides. The two countries share a long-standing, harmonious relationship (dating back to the significant year of 1952 when both signed a Treaty of Peace) that is based on mutual respect, democratic values, and a commitment to economic and technological growth. Economic reforms introduced in India since the early 1990s have provided further impetus to the economic cooperation between the two countries. India's 'Act East Policy', launched in 2014 (replacing the earlier 'Look East Policy'), aims at fostering stronger economic, strategic, and cultural ties with countries in the Asia-Pacific region. Japan's 'Free and Open Indo-Pacific' vision, with an overreaching objective to promote and establish the rule of law, freedom of navigation, and free trade with countries in the Indo-Pacific region, has further augmented the scope of economic cooperation (Embassy of India, 2024; Ministry of External Affairs, Government of India, 2017).

A major breakthrough in the India–Japan partnership came in 2011 when the two countries signed the Comprehensive Economic Partnership Agreement (CEPA) to strengthen bilateral engagements and subsequently worked towards eliminating tariffs on 90% of Japanese exports to India (such as auto parts and electrical appliances), and 97% of imports from India (including agriculture and fisheries products) by 2021 (ORF, 2014).

Even as India and Japan have laid great emphasis on promoting economic engagement through a plethora of initiatives, trade relations between them continue to offer much scope for improvement. This is clear given that their individual trade engagement with the rest of the world has prospered more than the trade engagement between themselves, despite numerous initiatives, including the signing of CEPA in 2011. Between 2011 and 2022, India's imports from Japan grew at 3.1% (compound annual growth rate) (World

* The signing of the Comprehensive Economic Partnership Agreement between India and Japan in 2011 and numerous other initiatives were expected to provide momentum to trade relationships between the two countries. The actual performance has, however, fallen short of expectations from India's point of view, which has witnessed a rising trade deficit with Japan. Given the strong complementarity that they enjoy, there is a potential to turn the trade in India's favour as well, by unlocking its potential in global value chains with Japan.

Bank, n.d.), even as its total imports from the world grew at a much faster rate of 4.2%. Similarly, India's exports to Japan in this period expanded by a mere 0.2%, much slower than the pace of its exports to the world at 3.7%. Japan, however, saw its exports to India rising to around 3.0% even when its exports to the world contracted to 0.9% during the period. Japan and India's imports from the world grew negligibly during the period. As a net outcome, India has witnessed deterioration in its trade balance with Japan post signing of CEPA, necessitating a review of the agreement to ensure that it benefits both partners by harnessing their complementarity. Efforts are underway to review the terms of CEPA to give a boost to bilateral trade (Kesavan, 2020).

Making the trade balance more favourable to India is central to promoting economic relations between India and Japan. This can be done by unlocking the potential of India's global value chains (GVCs), leveraging the high degree of complementarity between the two economies. Both countries have unique strengths in different areas. This can be utilised to enhance India's GVC participation which stood at 34.9% in 2020 and was lower than Japan's, which stood at 39.7% (OECD, n.d.). While India has been the fastest-growing major economy in the world over the past several years, Japan has a distinct advantage in advanced technology. With global supply chains becoming increasingly interconnected and technology-driven, India and Japan have been positioning themselves as critical players in driving innovation, investment, and economic integration across the Indo-Pacific. India, with its expanding industrial capabilities, large consumer base, and rapidly growing economy, offers vast opportunities for Japanese companies seeking to diversify supply chains and access emerging markets. Japan, on the other hand, brings expertise in advanced technology, high-quality manufacturing, and a larger share in cutting-edge industries, which, in turn, complements India's potential. Together, the two nations have significant scope to leverage their synergies, advancing resilient and sustainable growth.

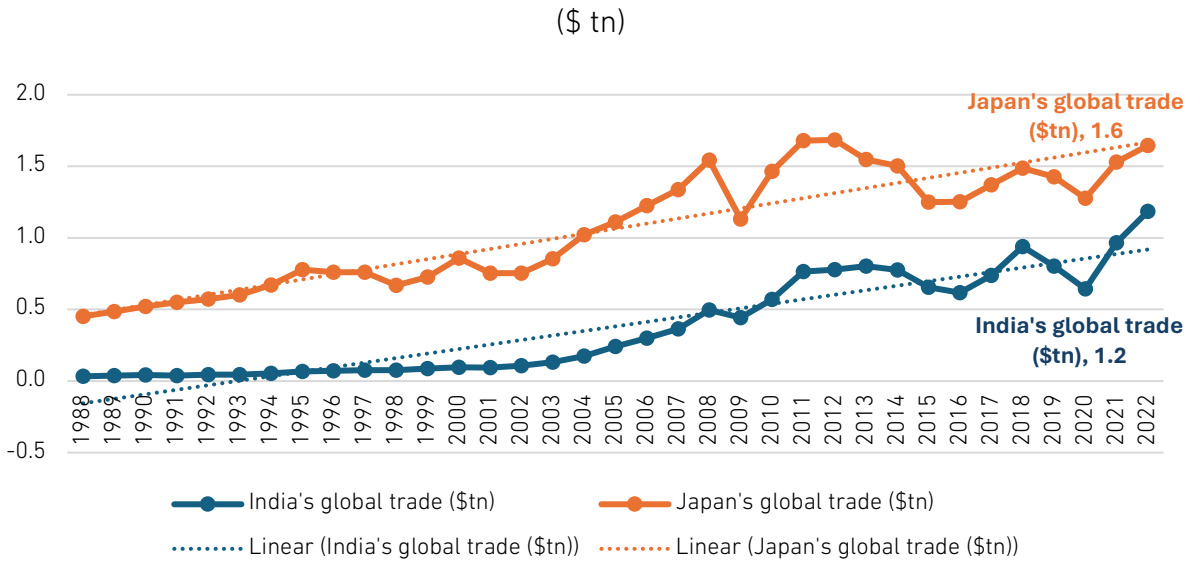
The present article aims to explore the potential of furthering India–Japan trade relations in a way that both the partners complement each other and reap shared benefits. Trade opportunities are discussed in a framework of promoting India's participation in GVC with Japan, critical for promoting a trade balance between the two partners on a sustainable basis.

The next section examines the past trends and major policy initiatives that have shaped the trade cooperation between India and Japan. The third section analyses India's GVC participation in select sectors, compared to its peers, followed by a section on key policy suggestions. The last section concludes.

India–Japan Trade Relations

It would be instructive to view the trade relations between India and Japan in the context of their global participation, where they are important players. In 2022, India's global trade was $1.2 trillion whereas that of Japan was $1.6 trillion (Figure 5.1). India stood in 20th position, accounting for 2% of global exports, while Japan ranked 5th with a 3.3% share in global exports. Interestingly, trends in the two countries' global trade, recorded since 1988, appear similar in the 2000s. Unlike Japan, India's trade in the 1990s remained low and grew at a negligible pace (World Bank, n.d.).

Figure 5.1: Trends in the Global Trade of India and Japan



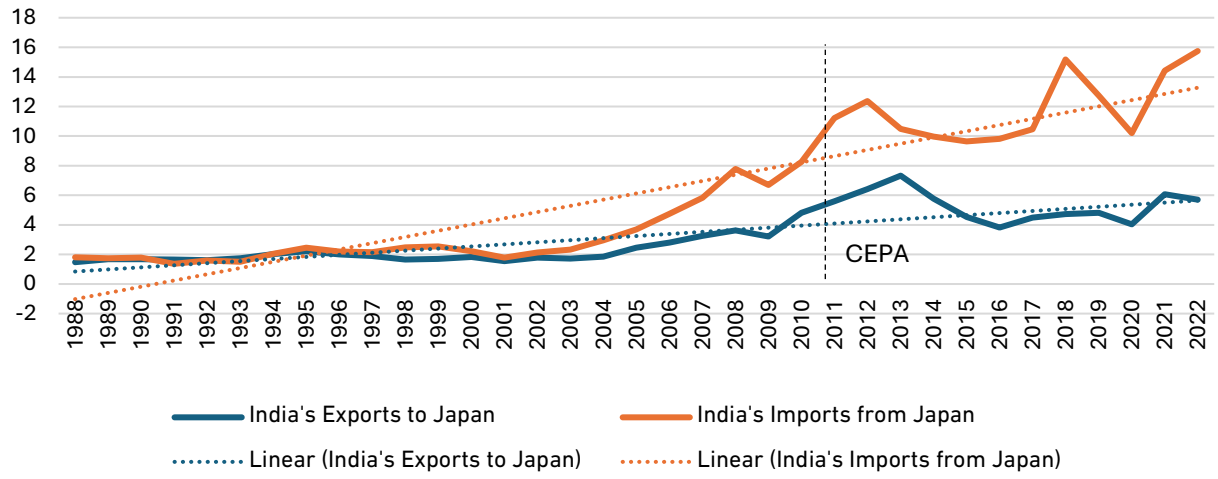
$ = US dollar, tn = trillion.
Source: World Bank (n.d.).

Bilateral trade between India and Japan, captured through India's imports from, and exports to, Japan since 1988, as shown in Figure 5.2, show a noteworthy trend. India's exports and imports from Japan measured around the same level and largely remained stagnant until around 2001. This was when India's overall trade was also low and registered global expansion. Once India's global trade started picking up post 2001, its imports grew much faster than its exports to Japan and the gap has continued to widen over the years. In 2022, India imported around three times more than its exports to Japan.

Another notable emerging trend is that the trade between the two countries had started to pick up a few years prior to the signing of CEPA in 2011. Barring a few years, there is not much evidence to show that CEPA has been particularly successful in bringing about incremental change in bilateral trade, at least from India's point of view. This is also evident because India's exports to Japan as a share of its global exports has assumed a sharp declining trend in the post-CEPA years, as can be seen in Figure 5.3. On the other

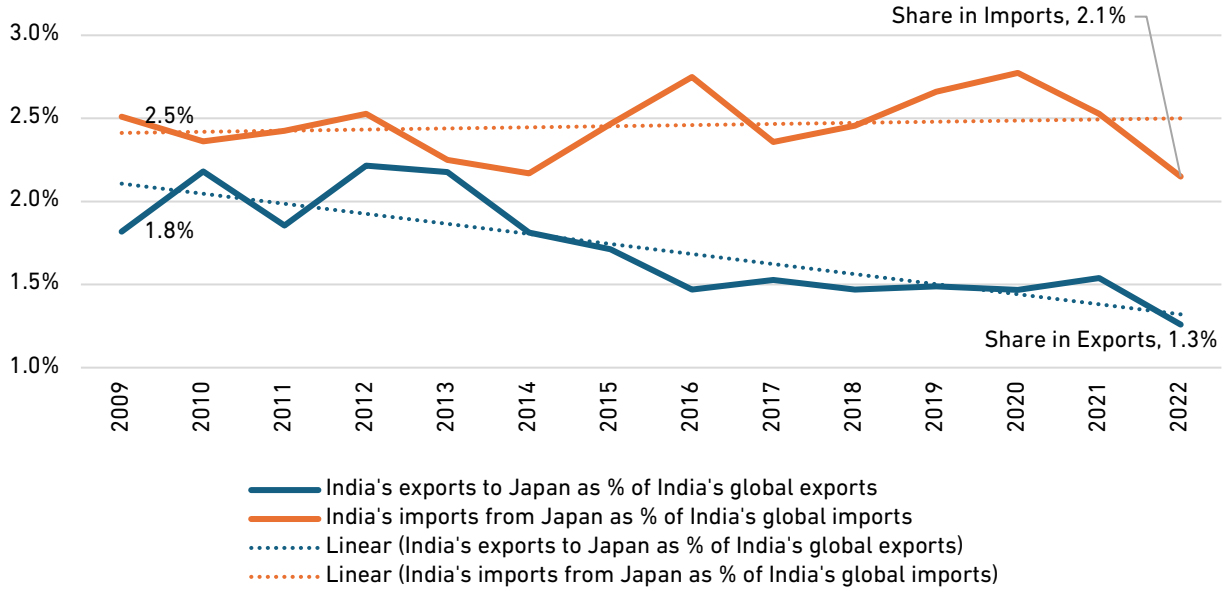
hand, there is a marginal upward trend in imports from Japan, as a share of its total imports, a part of which could possibly be attributed to CEPA.

Figure 5.2: Bilateral Trade between India and Japan ($ billion)



$ = US dollar, CEPA = Comprehensive Economic Partnership Agreement.
Source: World Bank (n.d.).

Figure 5.3: Share of Japan in India's Global Exports and Imports (%)



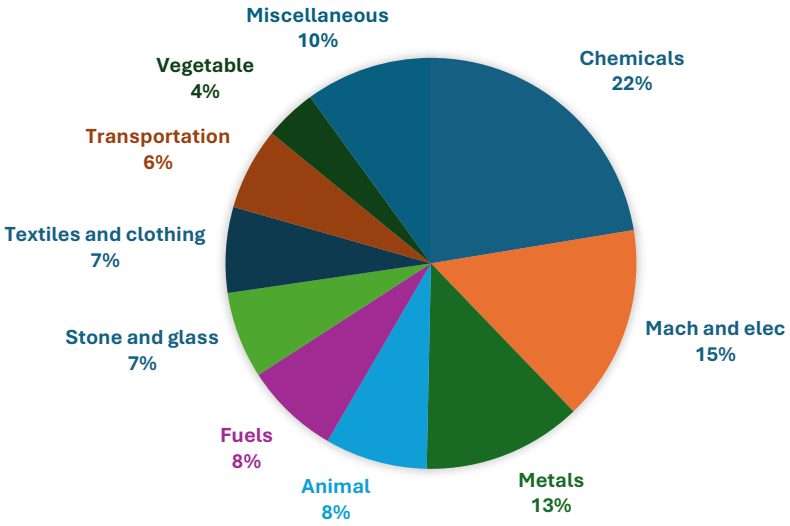
% = percent.
Source: World Bank (n.d.).

India's top exports to Japan in 2022 included chemicals (22%), machinery (15%), metals (13%), animal products (8%), and fuels (8%), whereas its major imports from Japan included machinery (27%), chemicals (22%), and metals (20%) (Figures 5.4 and 5.5) (World Bank, n.d.). This highlights the complementary nature of the trade relationship, while also

showcasing opportunities for India to increase its high-value and technology-driven exports.

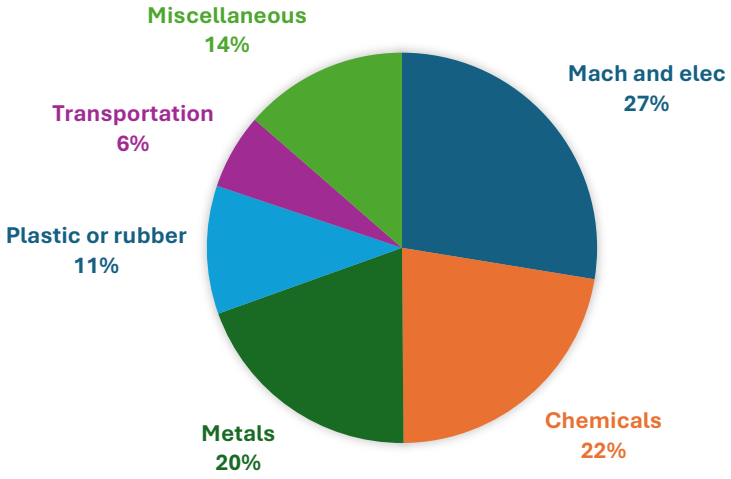
Figure 5.4: India's Exports to Japan in 2022

(%)



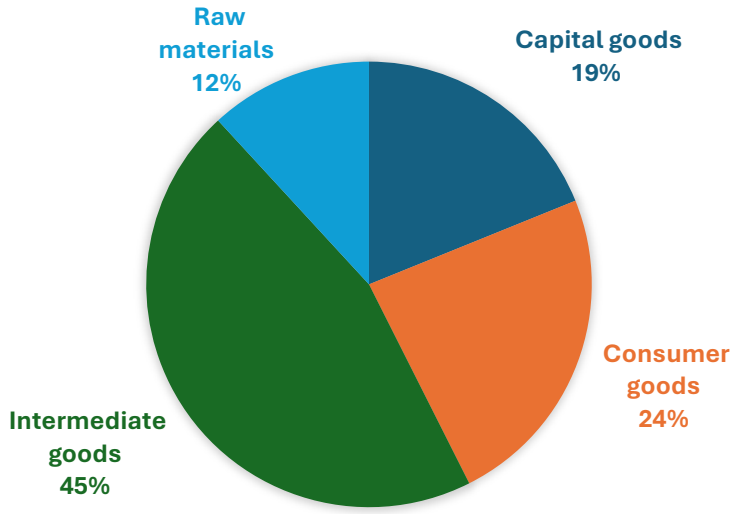
% = percent, Mach and elec = machinery and electrical equipment (includes electronics).
Source: World Bank (n.d.).

Figure 5.5: India's Imports from Japan in 2022 (%)



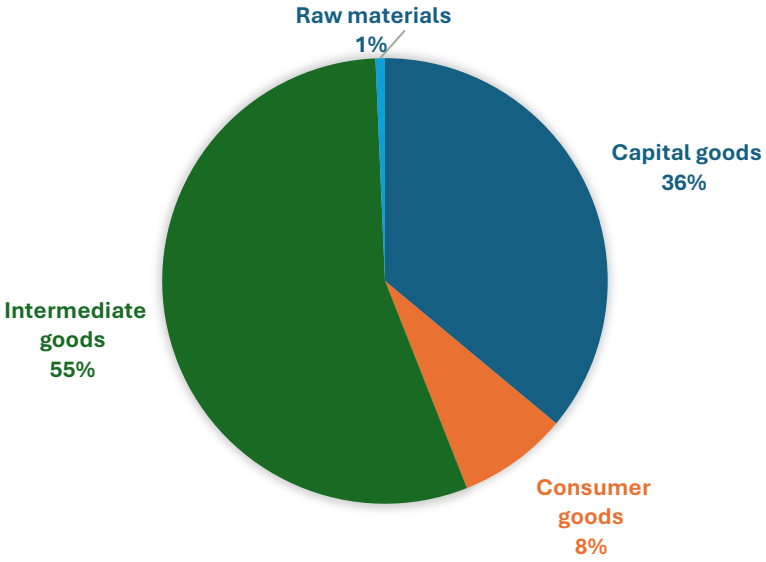
% = percent, Mach and elec = machinery and electrical equipment (includes electronics).
Source: World Bank (n.d.).

Figure 5.6: India's Export to Japan in 2022, Category Share (%)



% = percent.
Source: World Bank (n.d.).

Figure 5.7: India's Import from Japan in 2022, Category Share (%)



% = percent.
Source: World Bank (n.d.).

Global Value Chain Participation

Discussion in the previous sections indicated that signing CEPA did not have much benefit for India's exports to Japan, whereas its imports from Japan increased at a reasonably good pace. Many of the imports from Japan, however, were intermediate goods (followed by capital goods), which could have directly and indirectly influenced India's higher participation in GVCs, thereby promoting its manufacturing capabilities, increasing gross domestic product and job creation, and unlocking export potential. India has increasingly been both importing and exporting intermediate goods to Japan (Figures 6 and 7), which needs to be expanded to foster GVCs linkages. Interestingly, on the export front, capital goods have a share below 20%, which must be enhanced for India to move up and lead at upper ends in GVCs. Imports of capital goods are a good proxy indicator for promoting rapid economic development, especially when a country is at its lower stages. However, this aspect needs to be streamlined for India to capture higher rents in GVCs, using more research and development and a stronger innovation ecosystem, amongst other things.

GVCs provide linkages of production and distribution involving multiple countries and firms, encompassing various stages of value addition. GVCs drive efficiency through specialisation, facilitate technology transfer, promote productivity, and create employment. Linking into GVCs could either be through forward linkages (where a country provides inputs into the exports of other countries) or through backward linkages (where a country imports intermediate products to be used in its exports).

The participation of a country in GVCs can be measured through a sequential production process. It can be measured as the sum of 'foreign value-added in its gross exports' (backward linkages, or imports of foreign value-added) and its 'domestic value-added that contributes to other countries' gross exports' (forward linkages, or exports of domestic value-added). A country's share of the total value-added created through both forward and backward linkages in GVCs (i.e., summed across all countries) provides a measure of the extent of its participation and the relative gains it derives from GVCs (Banga, 2013). The combined estimates of backward linkages and forward linkages can be represented through the GVC Participation Index to facilitate comparative analysis. The value of the index lies between 0 and 100, indicating a range of least to maximum integration in GVCs.

The GVC Participation Indices for India and Japan for 2020 have been estimated at sectoral as well as aggregate levels, and the findings are reported in Table 5.1. While focusing on bilateral trade, India and Japan stand to benefit from building linkages through the Association of Southeast Asian Nations (ASEAN) region and Australia. We have, therefore, also estimated and reported GVC indices for ASEAN and Australia in the table.

At the aggregate level, India's index measured 34.9%, lower than the values of ASEAN at 45.7% (resulting from deep integration amongst the participating economies across sectors), Japan's index stood at 39.7% (with strong manufacturing and technology prowess), and Australia's was 35.0% (reflecting its resource-export-driven economy) (OECD, n.d.).

India's participation in GVCs through backward linkages is estimated to be 17.2%, higher than the corresponding values of Japan (13.3%) and Australia (9.4%) but lower than the value of ASEAN (30.9%). India must continue to strengthen its backward linkages as it is found to be especially useful for developing countries in promoting exports, domestic value-added, and employment (Veeramani and Dhir, 2022).

India's forward linkages stood at a mere 9.5%, behind both Japan's 18.9% and ASEAN's 10.6% (OECD, n.d.). This suggests that India's exports are less embedded in advanced value chains, underscoring the need for a focus on high-value goods and technology-driven industries.

India's manufacturing sector shows strong backward linkages of 27.0%, much better than Australia (14.1%) and Japan (16.8%). However, the forward linkages cause concern. Their value is only 9.5% as against the figures of 21.0% (Australia) and 18.8% (Japan). The country must work towards promoting its exports of intermediate goods to be better connected in GVCs. Japan and Australia have demonstrated stronger forward linkages indices, leveraging advanced manufacturing and high-value exports.

India's GVCs performance in the service sector is comparable to Australia and Japan in both backward and forward linkages, reflecting its competitive strength in information technology and business process outsourcing sectors. The country's forward linkages and backward linkages in services measured 7.1% for information technology and 8.2% for business process outsourcing. ASEAN's superior integration in backward linkages at 27.7% could perhaps be taken as a benchmark for India to aspire to, especially given the growth of Global Capability Centres in the country.

Table 5.1: Linkages in Global Value Chains – Comparison of India, the Association of Southeast Asian Nations, Japan, and Australia in 2020(%)

Country/region	All sectors	Agriculture	Mining	Manufacturing	Construction	Services
GVCs Participation Index						
Australia	35.0	11.1	8.4	35.1	13.8	12.0
Japan	39.7	11.6	15.1	35.7	0.0	14.4
India	**34.9**	**3.1**	**14.5**	**36.5**	**0.0**	**15.3**
ASEAN	45.7	16.8	15.7	45.5	22.6	31.3
Backward Linkages in GVCs						
Australia	9.4	10.9	7.9	14.1	13.8	8.3
Japan	13.3	11.4	14.4	16.8	0	7.8
India	**17.2**	**2.8**	**13.7**	**27**	**0**	**8.2**
ASEAN	30.9	16.6	15.2	34.9	22.6	27.7

Forward Linkages in GVCs						
Australia	25.6	0.2	0.5	21	0	3.7
Japan	26.4	0.2	0.7	18.9	0	6.6
India	**17.7**	**0.3**	**0.8**	**9.5**	**0**	**7.1**
ASEAN	14.8	0.2	0.5	10.6	0	3.6

% = percent, ASEAN = Association of Southeast Asian Nations, GVCs = global value chains.
Source: OECD (n.d.).

To explore opportunities for India in GVCs, we examine the performance of the country in a few select manufacturing sectors and make a comparison with Japan, Australia, and the ASEAN region. Key features emerging from the trends, shown in Figures 5.8–5.12, are the following: (i) In all the select sectors, India's performance in backward linkages is much better than that in forward linkages. This is in consistent with expectations as there is abundant comparative advantage for the country in numerous sectors where it can import cheaper raw materials and intermediate goods, process them, and export. (ii) In all the sectors and in virtually all years, India's backward linkages have remained well below the levels of Japan, Australia, and ASEAN. There is, thus, a significant potential for India to improve its performance in backward linkages by leveraging high-technology imports of intermediate goods, which can be obtained at potentially lower costs. Achieving cost-effective intermediate goods is crucial for India to competitively process these intermediates and export the resulting finished products to the global market.. (iii) Even though the value of forward linkages across sectors are low, India has done well when compared with other economies within the sample. There is, however, potential for India to do better by focusing more on exports of high-value, intermediate goods. The country has a vast potential to boost its exports at the higher ends of many services and high-value manufacturing products, rather than remaining confined to the exports of basic raw materials and low-value manufacturing products. Addressing these gaps is crucial for India to move up the value chain and capture a larger share of higher-value goods in global markets.

Figure 5.8.a. Backward Linkages in Transport Equipment (%)

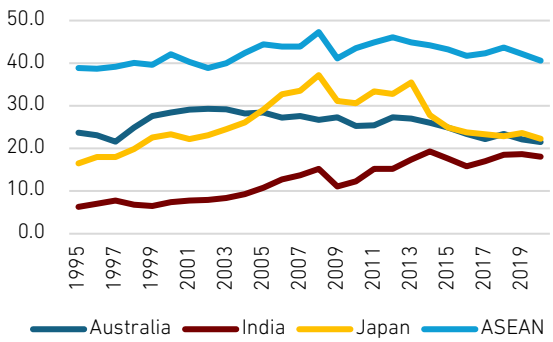


Fig 5.8.b. Forward Linkages in Transport Equipment (%)

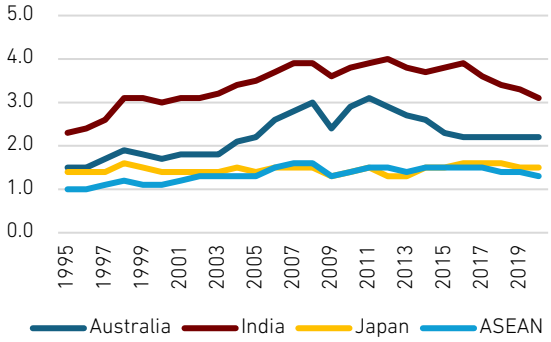


Figure 5.9.a. Backward Linkages in Electronics (Computers, Electronics and Electrical Equipment) (%)

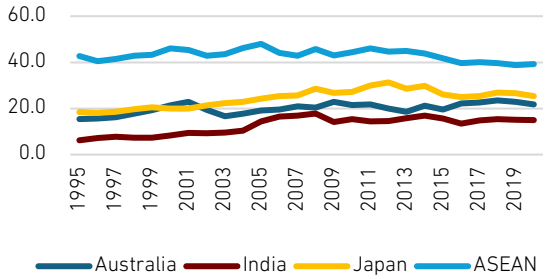


Figure 5.9.b. Forward Linkages in Electronics (Computers, Electronics and Electrical Equipment) (%)

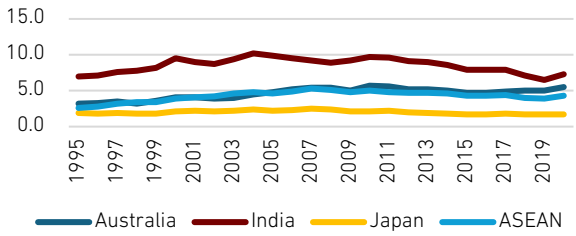


Figure 5.10.a. Backward Linkages in Pharmaceuticals (%)

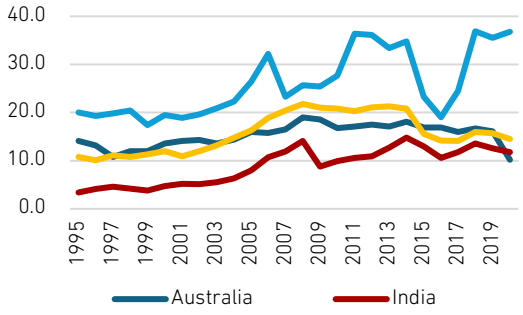


Figure 5.10.b. Forward Linkages in Pharmaceuticals (%)

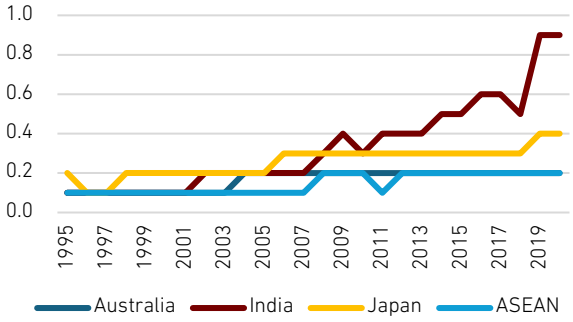


Figure 5.11.a. Backward Linkages in the Chemical Sector (%)

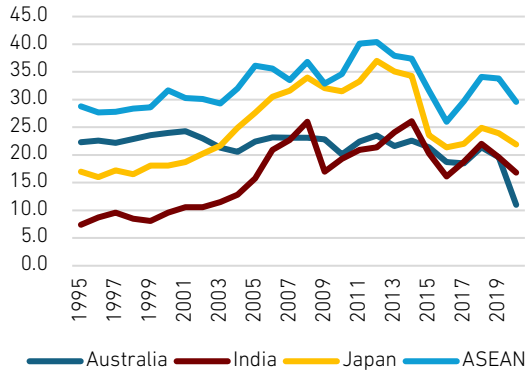


Figure 5.11.b. Forward Linkages in the Chemical Sector (%)

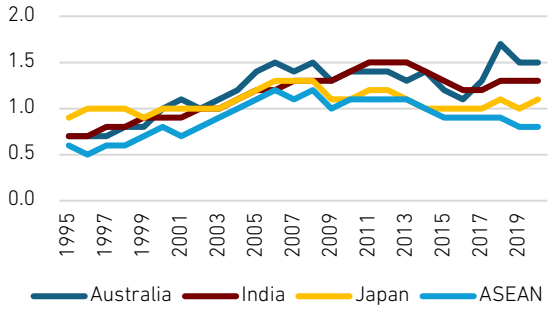


Figure 5.12.a. Backward Linkages in Textiles, Wearing Apparel and Leather Products (%)

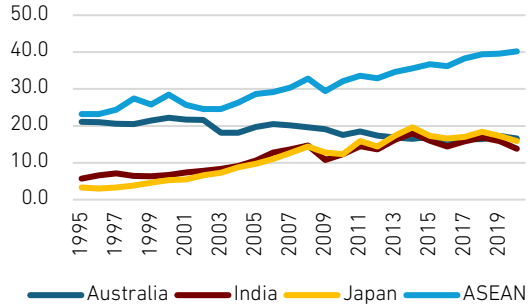
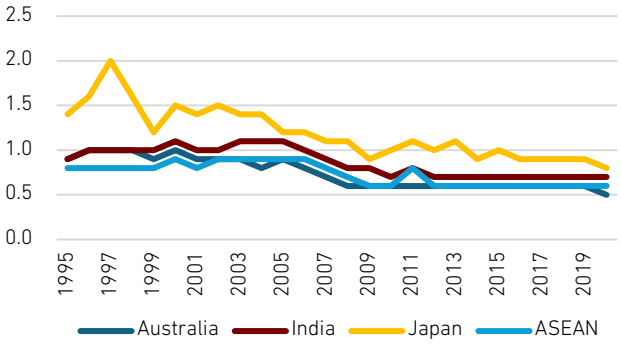


Figure 12.b. Forward Linkages in Textiles, Wearing Apparel and Leather Products (%)



% = percent, ASEAN = Association of Southeast Asian Nations, GVC = global value chain.
Source: OECD (n.d.).

Some Key Suggestions

India and Japan are well-positioned to emerge as pivotal players in the global economy, leveraging their complementary strengths through strategic partnerships. To further enhance trade cooperation, the following measures are suggested.

- **Diversification of trade baskets.** India and Japan should diversify their export and import baskets by focusing on sectors like chemicals, pharmaceuticals, automobiles, critical minerals, and services. This diversification can be achieved by identifying a wider range of potential products/segments in these sectors and increasing the trade volume of existing ones. This, in turn, would require India to further build its productive capabilities, including infrastructure, human capital, and technological advancements.

Expanding trade into these sectors will not only reduce dependency on traditional commodities but will also enhance their overall bilateral trade.

- Addressing India's unfavourable trade balance. To address the trade deficit in favour of Japan, it should facilitate easier access to its markets for Indian goods and services. Reducing tariffs and non-tariff barriers, coupled with targeted promotional campaigns for Indian products, can help level the trade dynamics. Such measures will help Indian exporters to compete more effectively in Japan's highly regulated and competitive market.
- Tackling key non-tariff barriers. Japan should support India to resolve challenges posed by key non-tariff barriers, such as stringent standards and sanitary and phytosanitary regulations.
- Enhancing trade facilitation. Both nations should work towards simplifying border procedures, such as reducing customs delays, enhancing digitalisation, and creating seamless logistics networks to ensure efficient movement of goods across borders. Further, there is a need to harmonise standards and regulations between India and Japan. Mutual recognition agreements on standards will greatly encourage smoother trade. Additionally, enhanced customs cooperation between India and Japan will greatly help to reduce border procedures and eliminate bottlenecks. Joint efforts to implement advanced technologies and data-sharing platforms can expedite customs clearance.
- Simplifying rules of origin. Japan should address the issues faced by exporters in India due to the complexity of rules of origin criteria.
- Utilising foreign direct investment for export growth. Foreign direct investment into India is generally market seeking rather than export oriented. Japan's foreign direct investment should be strategically channelled to bolster exports by creating globally competitive production hubs. By leveraging Japanese investments in high-value sectors, India can build robust supply chains and scale up export-oriented manufacturing.
- Increasing economic and technical cooperation in manufacturing. Economic and technical collaboration between India and Japan in manufacturing can boost industrial growth and innovation. Joint ventures and technology transfers in critical sectors such as electronics and automotive manufacturing will greatly enhance productivity and competitiveness.
- Developing intra-regional supply chains. Identifying and developing intra-regional supply chains connecting ASEAN, Australia, India, and Japan is crucial for greater economic integration. Some of the recent initiatives include the signing of the Supply Chain Resilience Initiative in 2021 amongst India, Australia, and Japan, as well as the launch of the Indo-Pacific Economic Framework for Prosperity in 2022, which also

involves ASEAN and other countries. Their progress needs to be closely monitored and effectively leveraged to enhance integration. Furthermore, collaborative efforts in sectors like electronics and food processing can strengthen regional resilience and unlock new trade opportunities.

- Collaboration with local firms. Japanese companies can enhance their impact by collaborating more with local Indian firms in the production process. This can be achieved through various means, including organising sourcing fairs along with the Government of India to connect Japanese companies with potential Indian suppliers, providing industry development assistance programmes to help Indian firms meet Japanese quality standards and integrate into supply chains, amongst others. This will help to boost the quality and competitiveness of locally made products while also encouraging knowledge transfer and skill development.

Conclusion

Historically, the economic partnership between India and Japan has been strong and strategically important for both nations. A significant milestone in this relationship was the signing of the CEPA in 2011, aimed at deepening bilateral trade and investment ties. While trade between the two countries had been on an upward trajectory prior to the CEPA, the post-agreement period has not yielded the anticipated benefits for India in terms of export growth. On the contrary, India's exports to Japan have declined, whereas imports from Japan have increased modestly, contributing to a widening trade deficit. More positively, India's imports from Japan have largely been of intermediate goods, which could be considered favourable for enhancing India's participation in GVCs.

Despite these developments, India's overall participation in GVCs remains limited compared to Japan. India demonstrates stronger integration through backward linkages than forward linkages, particularly in key sectors such as automobiles, electronics, pharmaceuticals, chemicals, and textiles and leather products. Nevertheless, while working to improve performance in forward linkages, special efforts must be made to further enhance India's participation through backward linkages. Amongst various key measures, the country should look at diversifying its trade basket, reducing tariff and non-tariff barriers, improving trade facilitation, fostering intra-regional supply chain linkages, and achieving greater collaboration between Japanese firms and local Indian firms.

In conclusion, India and Japan must now focus on leveraging their economic complementarities more strategically, transforming their trade relationship into a more balanced and forward-looking partnership. With continued collaboration in technology, innovation, and supply chain resilience, the two countries can redefine their bilateral trade trajectory in a way that it is mutually beneficial to both the partners.

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