

**BIMSTEC – Japan Economic Partnership:
Opportunities and Challenges**

Rahul Sen and Mukul G. Asher

CSIRD Discussion Paper: 14

February 2006



Centre for Studies in International Relations and Development (CSIRD)

167-B, S. P. Mukherjee Road, Kolkata 700026, India

Phone: (9133) 24630884, 22483769, Fax: (9133) 24630884

Email: membersecretary@csird.org.in, Website: www.csird.org.in

CSIRD Discussion Papers intend to disseminate preliminary findings of the research carried out for the institute to attract comments. The feedback and comments may be directed to the author(s). CSIRD Discussion Papers are available at www.csird.org.in

BIMSTEC – Japan Economic Partnership: Opportunities and Challenges

Rahul Sen* and Mukul G. Asher**

Abstract

The main objective of the paper is to explore opportunities for economic cooperation between Japan and the BIMSTEC countries. The paper analyzes the existing trade and investment relations, and some of the relevant regional and bilateral economic initiatives. It argues that there is a strong case for BIMSTEC members on the one hand and Japan on the other to broaden and deepen economic and political engagement with a view to enhancing strategic depth and leverage for each entity. The areas for win-win cooperation are many, ranging from energy security, tourism and risk management to taking advantage of the demographic complementarities between BIMSTEC and Japan. For Japan, the benefits will be widening of its economic space, and greater leverage. An important factor is that there is no historical bitterness between Japan and the BIMSTEC countries. BIMSTEC includes India, a country with economic potential to provide Japan and other BIMSTEC members with sustained economic opportunities and risk diversification. The BIMSTEC countries should make focused and sustained efforts at deepening economic cooperation among themselves and should focus on domestic reforms if they are to sustain Japan's interest and realize the potential of the partnership. BIMSTEC members need a more pragmatic mindset that does not regard economic cooperation as a zero-sum game. The analysis in the paper suggests that BIMSTEC-Japan cooperation could make a modest contribution to Asian integration. But this is contingent upon domestic reforms and constructive engagement among the members, and willingness of Japan to take a strong leadership role in part of Asia which welcomes it.

1. Introduction

The BIMSTEC (Bay of Bengal Initiative for Multi-Sectoral and Technical Cooperation) comprising Bangladesh, India, Myanmar, Sri Lanka, Thailand, Nepal and Bhutan is a sub-regional cooperation initiative formed in February 2004¹. The group involves some of the small, and less developed countries in Asia, as well as middle-income country (Thailand), and the second most populated country in the world (India). It therefore has the potential to broaden the network of Asia-wide cooperation. The heterogeneity of members however also poses challenges, particularly as some of the members (e.g. Nepal and Myanmar²), are also facing severe governance challenges. An important feature of this grouping is that currently

* Fellow, Regional Economic Studies (RES), Institute of Southeast Asian Studies (ISEAS), Singapore, e-mail: rahul@iseas.edu.sg (Corresponding Author). **Professor, Lee Kuan Yew School of Public Policy, National University of Singapore, e-mail: sppasher@nus.edu.sg. An earlier version of the paper was presented at the 1st International Conference on 'Towards BIMSTEC – Japan Comprehensive Economic Cooperation: Vision and Tasks Ahead', organized by the Centre for Studies in International Relations and Development (CSIRD), held at Kolkata during 16-17 December, 2005. The authors would like to thank Sanchita Basu Das for research assistance and Amarendu Nandy and Sadhana Srivastava for their comments and suggestions. The views expressed in this paper are entirely personal. The usual disclaimer applies.

¹ The predecessor organization set up in 1997 was known as BIMST-EC (Bangladesh-India-Myanmar-Sri Lanka-Thailand – Economic Co-operation). For details, see Reddy (2006), and www.bimstec.org. The current name is more generic and provides flexibility and continuity.

² See, Devare (2006). According to this study, governance challenges in Myanmar has a direct and considerable impact on vital security interests of other BIMSTEC members, particularly, India and Thailand.

all the members (except Sri Lanka³) are connected by land, providing a stronger potential for greater connectivity among them.

In February 2004, the members established a Framework Agreement for a Free Trade Area (FTA), which covers liberalization, promotion and facilitation of trade in goods, services and investments, as well as engaging in broader economic cooperation. Thus, BIMSTEC goes beyond trade.

The BIMSTEC grouping currently lacks a partner, which is economically and technologically advanced and is a significant capital exporter, as well as has been a significant contributor to official development assistance flows into the region. Japan is the second largest economy and stock market capitalization in the world after the US, and is a significant investor in the world, including in Thailand and India. It is also among the largest donors, bilaterally and multilaterally. Being a demographically mature country and with rapidly ageing population⁴, Japan is exploring partners which have complementary demographic profile and help expand Japan's economic space. Japan is also increasingly beginning to shed its low-key and passive diplomacy and strategic posture. It is therefore in Japan's interest to diversify its economic partners, and seek more unified large markets for its businesses located in the BIMSTEC region, particularly in Thailand and India. It is thus clear that BIMSTEC countries need Japan which is engaged, and economically strong, and confident of playing an active role in Asia and the world.

It is in the above context that this paper analyzes the opportunities and challenges in nurturing this economic partnership. The remainder of the paper is organized as follows. Section 2 provides a macroeconomic overview of BIMSTEC countries and Japan, and identifies some of the complementarities in their economic structure. Section 3 analyzes the existing bilateral trade and investment linkages between BIMSTEC and Japan. Section 4 analyzes the opportunities and challenges in their economic cooperation. The final section (Section 5) concludes the paper.

2. BIMSTEC and Japan: A Macroeconomic Overview

Selected domestic and external macroeconomic indicators for the six BIMSTEC members (henceforth BIMSTEC), viz. Bangladesh, India, Thailand, Sri Lanka, Nepal and Bhutan⁵ and for Japan are provided in Tables 1 and 2, on the basis of which the following observations are drawn.

First, BIMSTEC's total population is about ten times of that of Japan's population of 127.6 million. The two most populous and largest countries in BIMSTEC, viz. India and Bangladesh, together consist about 92 percent of BIMSTEC's population. Nearly three fourths (72 percent) of BIMSTEC's GDP was contributed by India, with BIMSTEC's total GDP of US\$ 795.1 billion being about 2.2 percent of the world GDP and about 20 percent of that of Japan.

However, in per capita terms, Japan's income in current prices at US\$ 33,705 is sixty times that of BIMSTEC economies. Its level of economic and technological development makes it a very valuable economic partner, provided BIMSTEC countries can provide profitable avenues and conducive business conditions.

³ The Sethusamudram canal project between India and Sri Lanka, one completed, is likely to reduce the travelling distance for ships from India to Sri Lanka, and will improve connectivity among Sri Lanka and other BIMSTEC members.

⁴ Japan has experienced below replacement level Total Fertility Rate (TFR) for a long period. TFR refers to number of children a woman produces in her lifetime. A TFR of 2.15 is needed for stable population. Japan's TFR in 2003 was only 1.29, while it also has among the highest life expectancy in the world (Takayama, 2005). In 2000-05, average life expectancy for men was 78 years and for women 85 years. By 2014, 25.3% of Japan's population will be above 65 years of age.

⁵ Myanmar is excluded because of the lack of comparable data.

Table 1: Domestic Macroeconomic Indicators of BIMSTEC Countries and Japan in 2003

Countries	Population	PPP GNI	GDP	GDP Growth	Per capita GDP	Savings	Investment	Agriculture	Industry	Services
	(mn.)	(US\$ bn.)	(US\$ bn.)	(%)	(US\$)	(% of GDP)				
Bangladesh	138.0	258	51.9	5.3	376.2	18	23.0	22.0	25.8	52.2
India	1073.0	3062	575.3	8.1	536.2	22	23.3	15.7	34.1	51.1
Sri Lanka	19.2	72	18.2	5.9	947.9	16	22.0	19.0	26	55.0
Thailand	64.0	462	143.2	6.7	2238.4	32	25.2	9.8	43.9	46.3
Nepal	24.6	35	5.9	3.1	239.8	14	26.0	40.6	21.4	38.0
Bhutan	0.9	na	0.6	6.7	667.0	na	53.0*	33.2	39.5	27.3
Japan	127.6	3629	4300.8	2.7	33705.8	26	24.0	1.3*	30.4	68.3*
BIMSTEC#	1319.7	3889	795.1	6.0	602.5					
World	6273.0	51401	36252.7	3.8	5683.0					

Notes: * 2002 Figures # Figures exclude Myanmar due to lack of data.

Source: Computed from World Bank (2005)

Table 2: External Macroeconomic Indicators of BIMSTEC countries and Japan in 2003

Countries	Merchandise Exports ^a	Merchandise Imports	Total Merchandise Trade ^a	Service Exports ^a	Service Imports	Total Services Trade ^a	Trade-GDP Ratio	Net FDI Inflows	Gross FDI-GDP Ratio
	(US\$ bn)						(%)	(US\$ mn)	(%)
Bangladesh	8.1	12.0	20.1	0.4	1.8	2.3	31.6	102.5	0.2
India	75.6	97.3	172.9	39.6	40.9	80.6	21.1	4270.0	0.8
Sri Lanka	5.7	8.0	13.7	1.5	1.8	3.3	65.0	228.7	1.4
Thailand	97.4	95.3	192.7	18.9	23.0	41.9	109.4	1949.2	1.7
Nepal	0.7	1.9	2.5	0.0	0.0	0.0	41.3	1.5	0.3
Bhutan	0.2	0.4	0.56	0.03	0.04	0.66	46.0*	0.2	na
Japan	566.0	454.5	1020.5	95.0	134.0	229.0	20.0	6238.3	1.0
BIMSTEC	187.7	214.9	402.46	60.4	67.5	128.76	na	6552.1	na
World	9153.0	9495.0	18648.0	2127.5	2094.5	4222.0	42.2	632600.0	1.5

Notes: ^a2004 Figures. Myanmar's total merchandise trade was US\$ 5.0 billion in 2004.

Sources: Computed from World Bank (2005); WTO (2004)

Second, as observed from Table 1, the growth rate of BIMSTEC economies was much higher than that of Japan in 2003. While BIMSTEC economies grew at an average rate of 6.0 percent, the corresponding growth rate for Japan was 2.7 percent, which was also lower than that of world as a whole.

Third, the economies of Japan and BIMSTEC share significant complementarities. While about 68 percent of Japan's GDP is contributed by the services sector, and the remaining by the industry, and with a minimal contribution by the agriculture sector, the agricultural sector continues to play a major role in BIMSTEC. Even though share of agriculture in Japan's GDP is comparatively small; Japan has shown considerable innovation in this sector. There are opportunities for BIMSTEC countries to seriously consider ways to partner Japan in modernizing their agriculture sector.

In terms of external sector comparisons, it is observed that in spite of being highly developed, the Japanese economy continues to be much less dependant on the external sector than the BIMSTEC economies, as indicated by its low merchandise trade to GDP ratio (Table 2). Among BIMSTEC members, the economies of Thailand and Sri Lanka are highly dependent on the external sector. India has pursued calibrated globalization since 1991 with a fair degree of success. Its current growth strategy is increasingly focusing on greater integration with the world economy. This is reflected in its recent National Foreign Trade Policy (2004-2009) that integrates foreign trade with broader economic growth and employment generation strategies. East Asian countries, including Japan, have pursued such policies successfully for several decades. India, therefore, has much to learn from East Asian countries⁶. India aims to double its share in global merchandise trade from 0.8 percent to between 1.5-2 percent by 2009, and to substantially increase its current 1.4 percent share in global trade in commercial services (Asher and Sen, 2005).

Fourth, in terms of FDI flows, Japan recorded a net FDI inflow of US\$ 6.3 billion, compared to about US\$ 6.5 billion for the BIMSTEC countries, out of which India alone attracted US\$ 4.3 billion, followed by Thailand (US\$ 1.9 billion) in 2003 (Table 2). While FDI has been one of the prime drivers of Japan's growth strategy due to its investments in East Asia in labour-intensive manufacturing exports through the flying geese model (FGP), it has not been the case for most of the BIMSTEC members, except for Thailand, which has been the only BIMSTEC country to be a part of the FGP model⁷. India's growth strategy has been built around relatively strong corporate sector and domestic demand talent, rather than relying primarily on FDI (Khanna and Huang, 2003). Nevertheless, India cannot sustain high growth without higher FDI.

Fifth, Japan is among major players in global merchandise and services trade. It ranks among the top 5 global exporters and importers of both goods and services. In contrast, two of BIMSTEC's largest economies, viz. India and Thailand were ranked below the top 20 countries in the world. It is however observed from the Table 2 that while Japan's total merchandise trade in 2004 (US\$ 1 trillion) was nearly two and a half times that of BIMSTEC (US\$ 400 billion), Japan's total services trade in 2004 (US\$ 229 billion) was less than twice that of BIMSTEC (US\$ 128 billion). This is largely due to India being increasingly becoming a significant player in global trade in commercial services.

India's total value of commercial services trade in 2003 was US\$ 80 billion in 2003, higher than that of all other BIMSTEC economies and about a third of that of Japan. Indeed, while not being as integrated with the world economy in conventional terms as East Asian economies, India is becoming the hub for outsourcing of software and business processes, with more than 100 of the Fortune 500 companies and European multinational corporations (MNCs) setting up Research and Development (R&D) centres in India. While detailed data on such service transactions remains unavailable, it is becoming clear that the impact of work

⁶ The art of lesson-drawing is however a difficult one. It requires rigorous analysis, understanding of domestic conditions and context, and sound judgment.

⁷ See, Yamazawa (1990) on the flying geese model.

done in India on global technological and other developments is not insignificant, and is expected to rise over time (Asher and Sen, 2005).

Sixth, BIMSTEC exhibited an overall deficit in both merchandise and services trade; Japan in contrast enjoys a surplus in global merchandise trade, while exhibiting a deficit in services. Thailand is the only BIMSTEC country to have exhibited a global merchandise trade surplus in 2004.

Seventh, India's total international trade in merchandise and services was US \$ 253.5 billion in 2003, while the corresponding figure for Thailand was US\$ 234.6 billion. These figures are dwarfed by Japan's total trade of US\$ 1249.5 billion. India plans to increase its total international trade to about US\$ 500 billion by the end of present decade. It aims to focus on manufacturing, agricultural, processing, and tourism services as additional areas for expanding her international trade.

3. Bilateral Trade and Investment linkages between BIMSTEC and Japan

Merchandise Trade

Bilateral merchandise trade linkages between BIMSTEC and Japan have been largely fuelled by Thailand and to a considerably lesser extent by India. In 2004, Japan was Thailand's second largest trading partner after the United States, and was also Thailand's biggest import source. Between 2000 and 2004, BIMSTEC's total merchandise trade with Japan increased from US\$ 29.8 billion to US \$ 42.0 billion, out of which nearly 85 percent was accounted for by Thailand-Japan trade alone (Table 3).

As shown in Table 3, the growth of BIMSTEC's imports from Japan, as compared to merchandise exports, has been much more rapid resulting which BIMSTEC's trade deficit with Japan became more than doubled between 2001 and 2004. During 2000-2004, Japan's share in BIMSTEC's total exports declined from 10.2 percent to 8.4 percent, while its share in total BIMSTEC's imports declined from 14.7 percent to about 12.0 percent.

India constituted about 12 percent of BIMSTEC's total merchandise trade with Japan. It also experienced an increasing bilateral trade deficit with Japan over the 2000-04 periods. While India's merchandise trade with other East Asian countries have been increasing rapidly in recent years, its trade with Japan has been relatively stagnant at around US\$ 5 billion since 1997-98 (Asher and Sen, 2005)⁸. Both sides are aware of this trend, and are taking steps to reverse the stagnation⁹.

It is however pertinent to note that trade flows are understating the role that Japanese companies play in economic development of BIMSTEC members. This is because significant proportion of exports of some of the BIMSTEC members is by affiliates of Japanese companies located in BIMSTEC region. Examples in particular include Japanese investments in automobile industries in Thailand and in India, wherein it is using both countries as a production base for its global exports.

Services Trade

An important component of BIMSTEC-Japan relationship is the increasing role of services trade in these countries and their expanding bilateral linkages. Unavailability of data in BIMSTEC countries on bilateral services trade severely hampers the analysis of such

⁸ The bilateral export intensity between India and Japan, which is a relative measure of trade linkages has declined from about 1.3 in 1993 to about 0.5 by 2003, indicating that relative to India's trade with the ROW, There has also been a decline in India's bilateral import intensity with Japan.

⁹ In January 2006, Japan's Counsel General in Mumbai spoke optimistically about at least doubling bilateral trade by 2010 to US\$ 10 billion.

linkages¹⁰. However, following observations may be made from the available data from the Organization for Economic Cooperation and Development (OECD) sources concerning Japan's commercial services trade with two major BIMSTEC economies, i.e. Thailand and India (Figures 1 to 3).

Table 3: Trends in BIMSTEC-Japan Merchandise Trade: 2000-04

Particulars	2000	2001	2002	2003	2004
BIMSTEC Exports to Japan (US\$ billion)	12.1	11.8	12.0	13.4	15.7
BIMSTEC Imports from Japan (US\$ billion)	17.7	17.0	17.5	21.9	26.3
Trade Balance (US \$billion)	-5.6	-5.2	-5.5	-8.6	-10.6
Thailand's Exports to Japan (US\$ billion)	10.3	9.9	9.9	11.4	13.5
Thailand's Imports from Japan (US\$ billion)	15.4	13.8	14.8	18.1	22.3
Trade Balance (US \$billion)	-5.1	-3.8	-4.9	-6.7	-8.8
India's Exports to Japan (US \$billion)	1.8	1.5	1.9	1.7	2.0
India's Imports from Japan (US \$billion)	1.9	2.2	1.8	2.6	3.1
Trade Balance (US \$billion)	-0.1	-0.6	0.03	-0.9	-1.1
Japan's Share in BIMSTEC Exports (%)	10.2	9.8	9.2	8.7	8.4
Japan's Share in BIMSTEC Imports (%)	14.7	13.3	12.5	13.0	12.0
BIMSTEC Total Exports (US\$ billion)	119.1	119.8	130.6	154.0	187.7
BIMSTEC Total Imports (US\$ billion)	120.4	127.5	140.3	168.2	219.0
Share of Thailand in BIMSTEC Exports to Japan (%)	84.9	84.5	82.9	85.0	86.0
Share of Thailand in BIMSTEC Imports from Japan (%)	86.7	81.1	84.4	82.4	84.8
Share of India in BIMSTEC Exports to Japan (%)	15.0	13.0	15.5	12.6	12.8
Share of India in BIMSTEC Imports from Japan (%)	10.6	12.8	10.4	12.0	11.9

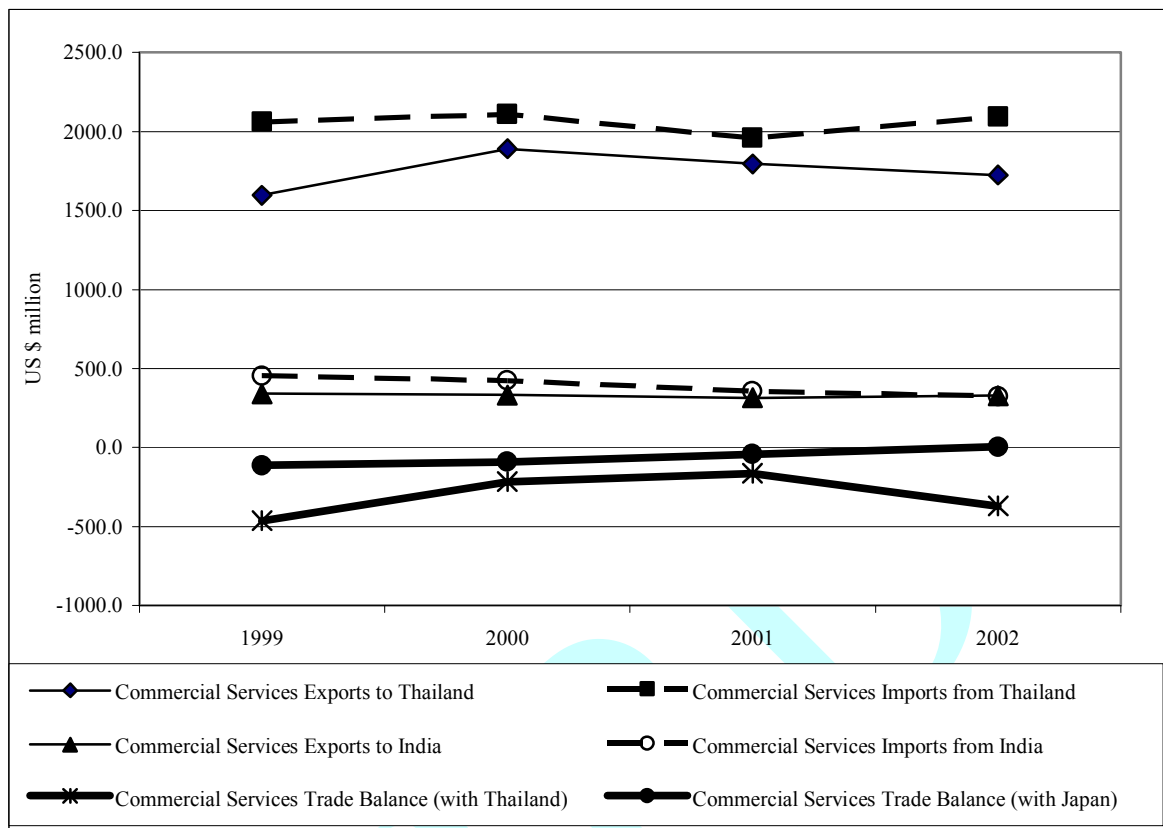
Sources: Computed from UN Comtrade Database and Thailand Customs Department, 2005

Figure 1 provides the trends in Japan's commercial services trade with Thailand and India over the period 1999-2002, the latest period for which the data are available. Japan's total commercial services exports to India in 2002 were US\$ 0.3 billion, while the corresponding figure for Thailand was US\$ 1.7 billion, almost six times that of India. However, given that Japan's total commercial services exports were worth US\$ 66 billion in the same year, the two BIMSTEC countries had a miniscule combined share of 3 percent. For the 1999-2002 period, the volume of commercial services trade of Japan with these two countries has been nearly stagnant at about the US\$ 2 billion (Figure 1). However, while Japan recorded a net deficit in services trade with Thailand over this period, the same with India has declined continually, and Japan registered a trade surplus in commercial services with India in 2002.

Figures 2 and 3 provide the composition of Japan's commercial services trade with India and Thailand, respectively. It may be observed that Other Commercial Services, which include communication and computer related services, software and offshoring activities and professional business services, constituted nearly 63 percent of Japan's total commercial services exports to and about 55 percent of its commercial service imports from India in 2002. This was followed by transportation services (Figures 2a and b). A similar trend is also observed in case of Japan's commercial services exports to Thailand (Figure 3a), but in case of imports (Figure 3b), travel services (including tourism) constituted nearly half of the share, followed by other commercial services. This indicates the importance of tourism flows between Thailand and Japan. India should consider ways to energize its tourism sector and thereby attract larger tourist flows from Japan.

¹⁰ Unlike the OECD countries, the Asian countries do not publish the relevant data, which are comprehensive, detailed, timely and internationally comparable. India, in particular, should seriously consider developing a robust database for its international trade in services.

Figure 1: Japan's Commercial Services Trade with BIMSTEC Countries: 1999-2002



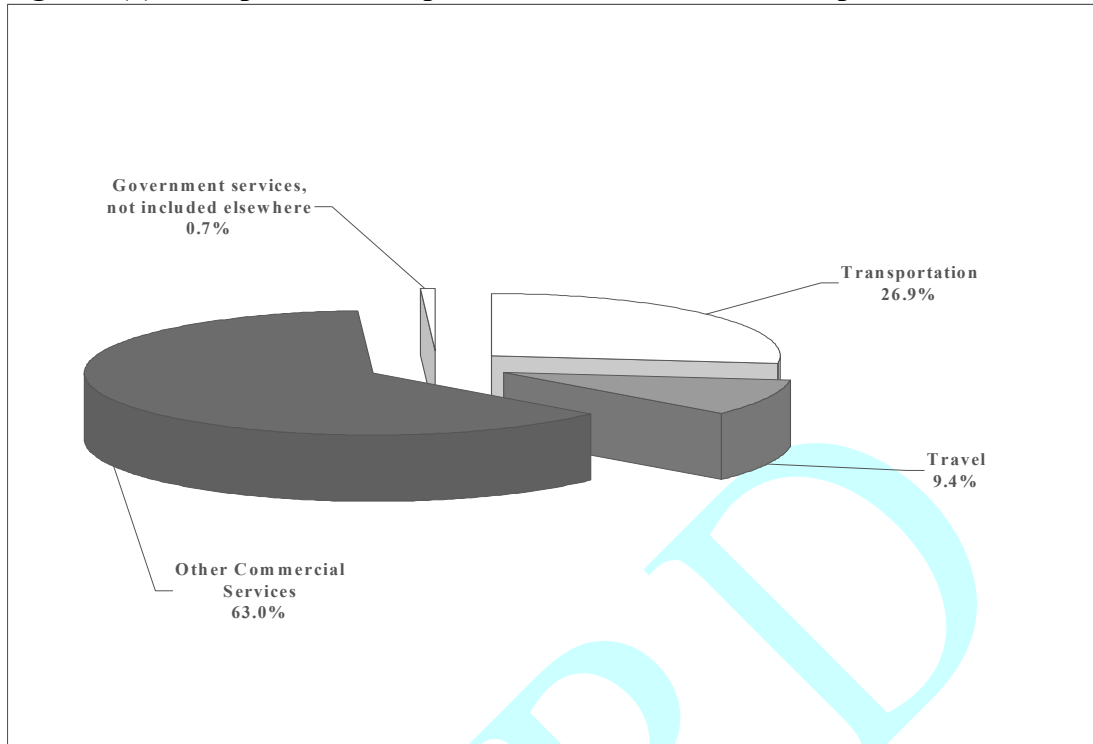
Source: OECD (2004)

The possible avenue for trade expansion concerns trade-related investments. This is particularly important in case of India. A significant proportion of foreign investments has been in the R&D and service sector facilities, which do not require large investments, but the linkages and employment multiplier impact of such FDI is higher per each million dollar of FDI as compared to the situation where most of the FDI is in capital intensive manufacturing and other activities.

India is also beginning to be a destination for outsourcing of manufactured products for many multinational companies. The Confederation of Indian Industry (CII, 2004) estimates that manufactured product outsourcing, mainly in auto components, consumer electronics, pharmaceuticals and others, could touch US\$ 10 billion by 2007 and US \$ 50 billion by 2015.

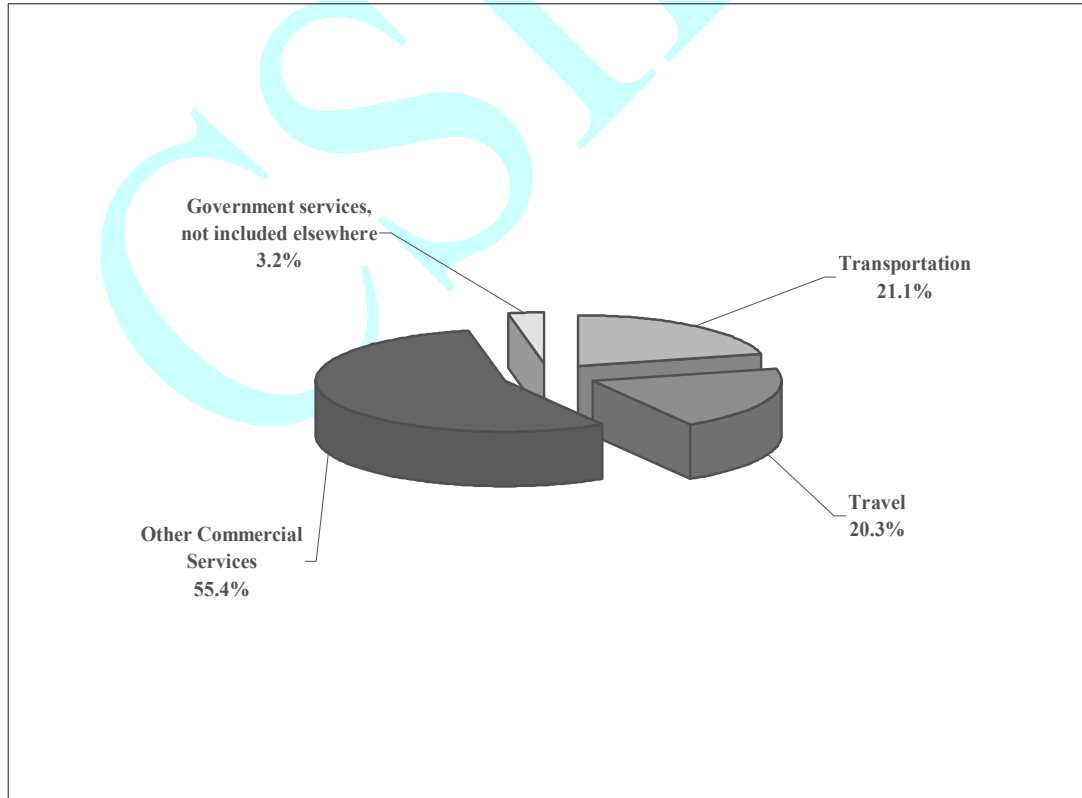
In the past, Japanese business organizations have not exhibited a mindset to purposefully benefit from offshoring activities to India, the way their American and European counterparts have done. There are indications of some progress in changing this mindset, but much more need to be done.

Figure 2(a): Composition of Japan's Commercial Services Exports to India in 2002



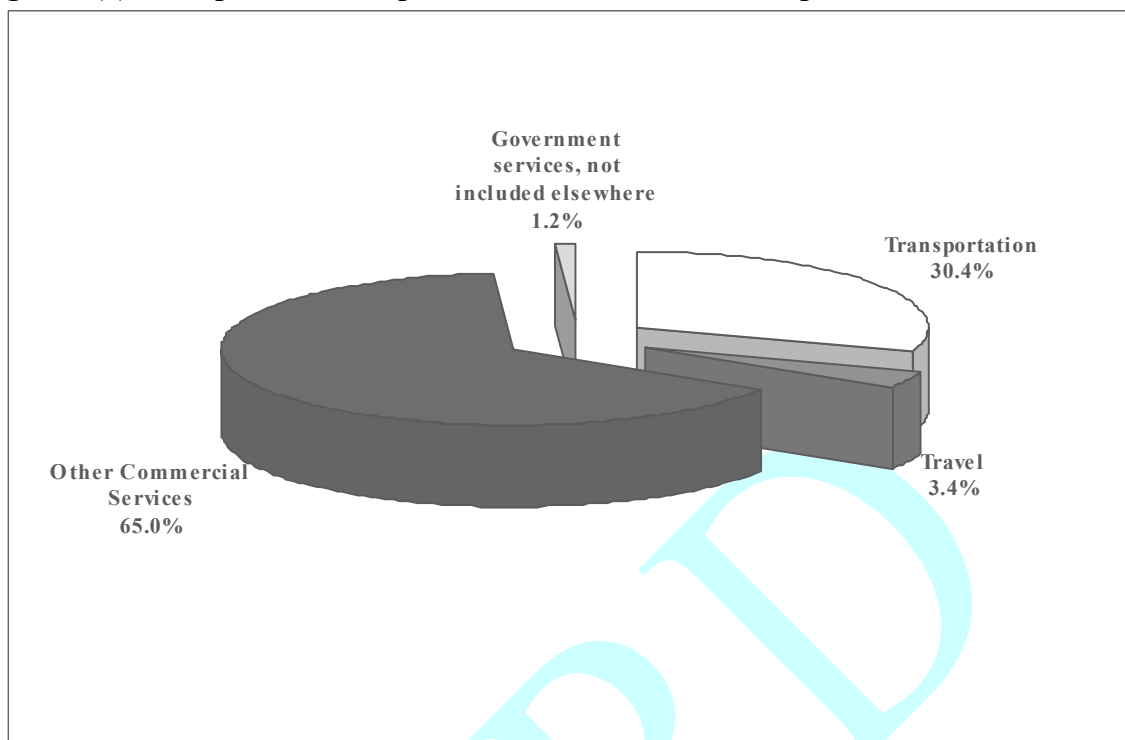
Source: OECD (2004)

Figure 2(b): Composition of Japan's Commercial Service Imports from India in 2002



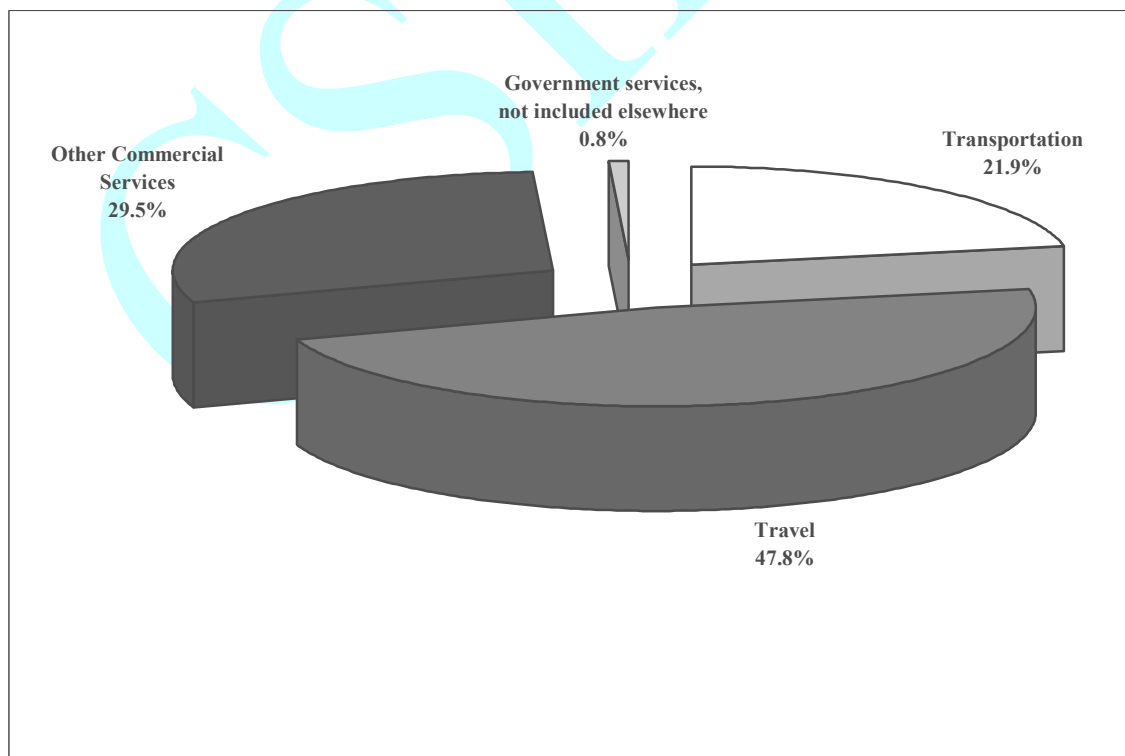
Source: OECD (2004)

Figure 3(a): Composition of Japan's Commercial Service Exports to Thailand in 2002



Source: OECD (2004)

Figure 3(b): Composition of Japan's Commercial Service Imports from Thailand in 2002



Source: OECD (2004)

Investment Linkages

In the area of investment flows, Japan has been a major source of both foreign direct investment (FDI) and official development assistance (ODA) for BIMSTEC countries, particularly for Thailand. Japan has been the largest donor country for Thailand in the midst of the economic crisis, and providing financial and technical support to Thailand, totaling more than US\$ 12.6 billion. Apart from a US\$ 4 billion loan provided to Thailand in August 1997 under the IMF's support package, Japan has agreed to provide aid to the tune of US\$ 8 billion for trade insurance aimed at export promotion and two-step loans for Thailand's export-related companies. It has also dispatched 1,000 experts for further improving long- and mid- term economic structure. In addition, Japan's support measures in Thailand have also included an emergency grant aid of US\$ 950,000 for Thai students studying in Japan¹¹.

During 1997-2004, Japan's outward FDI in BIMSTEC were valued at US\$ 10.4 billion, out of which US\$ 8.2 billion was invested in Thailand and about US\$ 1.7 billion in India (Table 4). As compared to 1997, the share of BIMSTEC in Japan's total outward FDI and to Asia, has declined in 2004 to about 3.6 percent and 13.6 percent, respectively. This is largely due to decline in Japanese investments in both Thailand and India. There is thus an urgent need to revive the flow of FDI from Japan into the BIMSTEC countries, and particularly into India and Thailand.

Table 4: Japan's Outward FDI to BIMSTEC Countries

Fiscal Year	1997	1998	1999	2000	2001	2002	2003	2004	Cumulative (1997-2004)
	(US \$ million)								
Myanmar	4	2	10	10	-	-	-	-	27
Sri Lanka	270	36	19	11	13	23	-	-	372
India	434	259	208	168	145	310	87	97	1,708
Thailand	1,867	1,405	837	932	884	504	629	1,184	8,242
Nepal	-	-	-	-	4	-	-	-	4
Bangladesh	6	3	-	8	-	-	-	-	18
Bhutan	-	-	-	-	-	-	-	-	-
BIMSTEC	2,582	1,706	1,074	1,129	1,046	838	716	1,281	10,371
Asia	12,187	6,682	7,348	6,006	6,639	5,669	6,399	9,388	60,318
Total	53,977	41,228	67,502	49,034	32,297	36,858	36,092	35,548	352,536
BIMSTEC/Asia	21.2	25.5	14.6	18.8	15.8	14.8	11.2	13.6	17.2
BIMSTEC/Total	4.8	4.1	1.6	2.3	3.2	2.3	2.0	3.6	2.9

Note: "-" indicates no investment recorded during the corresponding period.

Sources: Prepared by JETRO from Ministry of Finance (MOF) statistics for Japan's inward and outward FDI, MOF Policy Research Institute Monthly Finance Review, and Bank of Japan foreign exchange rates. Available at <http://www.mof.go.jp/english/e1c008.htm>

As observed by Asher (2005), there were 265 firms from Japan in early 2005, which had invested in India, with total FDI stock of close to US\$ 2 billion. This is in sharp contrast to Japan's FDI stock of US\$ 50 billion in Southeast Asia, and US\$ 40 billion in China. This large imbalance cannot be solely explained by objective factors¹².

India has demonstrated capacity to compete in the 21st century. It ranked second in the world in 2005, according to AT Kearney's FDI attractiveness index. Over 80 percent of foreign ventures in India are profitable and most are earning above average returns. These trends indicate that investments in India will provide opportunities for Japanese business to

¹¹ <http://www.mofa.go.jp/region/asia-paci/thailand/>

¹² The press reports suggest that by end 2005, there were 330 firms from Japan. The number of economic delegations, some seeking inward Indian investments to Japan, visiting India has also increased significantly. But this does not alter the significance of the point being made here.

participate in a mega market. Before the end of this decade, India's GDP in current terms is set to exceed US\$ 1.0 trillion, and its international trade in goods and services is expected to be around US\$ 500 billion. FDI has a critical role to play in India's growth strategy. FDI, particularly from the US, EU, South Korea, Singapore, and China is already doing so. This implies that the longer the Japanese companies defer their decisions to invest in India, the greater will be the opportunity costs of the delay.

Asher (2005) notes:

“The presence of Japanese financial institutions in India's increasingly sophisticated and competitive financial and capital markets is relatively limited. Foreign Financial Institutions (FII's) have invested about USD 70 billion in India's stock markets alone. Japanese presence in venture capital and private equity funds in India is also limited. There are many small and medium size Indian companies and startups in high technology areas, which provide substantial opportunities for private equity and venture capital firms”.

Several international fund houses, such as Fidelity, have launched India dedicated funds in Japan. As Japan progresses further towards Anglo-Saxon economic model, it will find India increasingly more conducive, reliable, and profitable place to invest its large financial savings. The two sides have also established India-Japan Joint Study Group (JSG) to explore the possibility of a comprehensive economic partnership agreement to enhance bilateral economic cooperation in the area of trade, investments and other strategic areas (Rama Rao, 2005).

India's outward flow of FDI has been increasing in recent years. The total outward FDI stock is about US \$ 10 billion, with India's corporations aggressively investing around the world. In recognition of this trend, the Kobe Chambers of Commerce and Industry (KCCI), in January 2006 visit to India, made a bid to attract Indian investments to Kobe in the area of medical projects, robotics, fashion and healthcare. This is a gesture India's BIMSTEC partners may consider emulating. They could consider setting investment promotion agencies of their respective countries in India.

Bilateral investment linkages between Japan and Thailand are expected to be strengthened with the possibility of the two entering into a bilateral economic partnership agreement known as the JTEPA. This agreement is expected to broaden and deepen the already strong economic linkages between the two countries and foster mutually beneficial cooperation by improving the investment climate, and generating greater business opportunities through cooperation, liberalization and facilitation in trade and investment between the two countries. The JTEPA is expected to have a comprehensive coverage of economic activities including enhancement of the business environment, intellectual property, bilateral cooperation in agriculture, forestry and fisheries; trade and investment promotion; education and human resource development; information and communication technology; science, technology, energy and environment; small and medium enterprises; tourism; financial services; energy conservation, value-creation economy and public-private partnership¹³.

4. Opportunities and Challenges in Economic Cooperation

Opportunities in Economic Cooperation

First, there are no historical legacies between BIMSTEC and Japan. BIMSTEC countries positively welcome Japan's leading role in their development. This is in contrast to the situation in East Asia, wherein Japan's relations with South and North Korea, particularly with latter having acquired nuclear capability, and with China, remain uneasy. Stronger

¹³ See http://www.mfa.go.th/jtepa/asset/jtepa_info_30sep2005.pdf

partnership with BIMSTEC countries could enhance Japan's strategic leverage with other major Asian entities, enabling Japan to play a more assertive role in Asia and in the world, which is commensurate with its economic and technological strengths.

Second, Japan being an OECD member and an economy with strong technological expertise, could assist BIMSTEC countries with the financial and technical expertise to meet the challenges from globalization. From Japan's perspective, its excess savings can find an attractive avenue in BIMSTEC economies, permitting reduction in Japan's overall global portfolio risk. The fact that India is the single largest recipient of Japanese ODA is a strong signal from Japan. But this needs to be complemented by more robust economic and political relations to achieve the strategic engagement. There are indications that significant section of business and political establishment in Japan is positive about such a strategic partnership.

Third, the demographic dynamics of the two entities also entails complementarities. Japan's population in absolute terms will begin to decline by the end of this decade and median age of its population will continue to increase due to individual ageing¹⁴. Key BIMSTEC economies such as India in contrast are entering a demographic gift phase resulting in rising proportion of population in the working age group.

India is expected to have nearly 50 million internationally competitive persons to assist countries or regions experiencing rapid individual and population ageing. In addition to Japan, these include countries in the EU, US, South Korea, Taiwan, Hong Kong, Australia Singapore and others. These complementarities provide a strong reason for Japan to utilize India's knowledge-based human resources without having to consider long-term immigration, and thereby extend its economic space.

It is noteworthy that the businesses from OECD countries, which have already experienced rapid ageing, are already substantially enhancing their competitiveness by partnering India in variety of knowledge-intensive service activities (Farrell, 2004). Singapore, whose population is also rapidly ageing and which faces a similar shortage of skilled manpower, has already entered into a comprehensive economic partnership agreement (CECA) with India to enjoy preferential access to such a pool of manpower¹⁵. India and Japan are also considering such bilateral comprehensive agreement. This should have a positive impact on taking advantage of demographic complementarities. Thailand also has a below replacement level total fertility rate of 1.8. So, it will also experience more rapid ageing than India. This suggests possibility of leveraging demographic complementarities between the two important BIMSTEC members.

Fourth, Japan's energy security and trade flows are heavily dependent on secure routes through the Indian Ocean and the Bay of Bengal. Since most BIMSTEC countries border the Bay of Bengal and have common interests with Japan in keeping this vital sea route secure, there is a need to develop capability to constructively cooperate with Japan in this area. Such cooperation will also be welcomed by the US, thereby fulfilling a key requirement for Japan's engagement.

Fifth, on a sectoral basis, Japan can substantially extend its economic space and its technological capabilities and capacities through partnership with firms in BIMSTEC countries, particularly in knowledge-intensive areas such as biotechnology, pharmaceuticals IT, space and certain manufacturing areas such as auto design. Such partnerships will permit Japan to access knowledge professionals from these countries. Japan would thus be able to extend its economic opportunity set and diversify global business risk.

Sixth, with some of the BIMSTEC countries viz. India, there are also opportunities for Japan to cooperate on space and defence related activities and civilian and nuclear energy and its applications for development purposes¹⁶. Japan's ambitious space programme has

¹⁴ See, Note 2 of this paper.

¹⁵ See, Sen and Nandy (2005)

¹⁶ India and Japan also have opportunities in nuclear energy. Both also belong to a consortium of countries researching on hydrogen as future substitute for fossil fuel. India and Japan are considering regular high-level dialogue on nuclear and defence issues in recognition that deeper bilateral engagement could bring considerable non-economic benefits as well.

experienced its share of challenges. Despite a budget of only US\$ 450 million a year, which is about one-thirtieth of NASA's annual budget, India has sent 13 satellites in orbit, produced some of the world's best remote imaging satellites and has plans to send a satellite to the moon by 2007 or 2008 (Rhode, 2004). It is using satellite technology to reclaim farmland, bring medical care to remote villages, as well as predict natural disasters. Apart from Japan, other BIMSTEC members stand to gain by cooperating with India in gaining expertise in applying satellite technology for development purposes.

Seventh, Japan's role in assisting India in urban mass transport (such as Delhi Metro) is considerable and highly appreciated. India is eager to learn and cooperate with Japan in developing integrated urban transport network, and in inter-city rail travel. This is an area of potential high commercial as well as developmental benefit. Japan's assistance to Kolkata in this area could help in promoting it as a location from which India can more purposefully cooperate with BIMSTEC countries and with Japan.

Eighth, Japan could consider cooperating with BIMSTEC countries in meeting important health sector challenges. Given the rapidly rising health care costs in Japan due to population and individual ageing opportunities exist for mutually beneficial cooperation in health care activities, and in generic and other drugs, including sourcing for HIV-AIDS drugs. Entertainment and multimedia sector also provides opportunities for mutually beneficial cooperation. Firms from Japan and BIMSTEC countries could consider joint production of films, television programs, and Internet content for both domestic and international audiences.

Finally, areas such as tourism, culture and education and research collaboration also offer significant opportunities for mutual cooperation. Given that Buddhism is the dominant religion in both Japan and a BIMSTEC country, i.e. Thailand, and is also an important religion in India, shared religious and cultural ties can provide the basis for expansion of bilateral economic cooperation in the areas of tourism and culture.

There are also significant opportunities for fostering greater linkages among educational institutions and institutions of higher learning between the two economic entities. Rigorous empirical based research is required further to strengthen BIMSTEC-Japan cooperation, and such links can help link the research institutes and capabilities of Japan with those of BIMSTEC members, and foster greater exchange of students, ideas and intellect among them.

It needs to be increasingly realized that non-economic areas have significant impact on quality of life and satisfaction experienced by people, and both BIMSTEC and Japan would need to focus their energies on developing closer cooperation in such areas. Japan has traditionally not sufficiently encouraged educational exchanges of students and faculty with India. This area requires further attention of both countries. Japan may also consider significantly expanding Japanese language training programmes in India; while India should consider encouraging establishment of cultural centres and Hindi language training opportunities in Japan.

Challenges

The numerous opportunities for bilateral cooperation notwithstanding, there are important challenges to overcome. The major challenges in this context are within BIMSTEC itself. This is to ensure that there is greater economic engagement within the grouping itself. This requires a mindset, which prepares them for being net winners in globalization through pursuing competition and cooperation simultaneously. Comfort levels among the BIMSTEC members need to be enhanced, with greater focus on livelihood generation and protection. The focus should not be on aid but on enhancing capacities and improving governance.

In the current globalization phase, non-exploitation of land connectivity remains an important bottleneck for the BIMSTEC countries¹⁷. To improve land connectivity between

¹⁷ Bangladesh is an impediment to economically efficient land connectivity among BIMSTEC members. Its inexplicable refusal to have deeper road and rail linkages with India; and its reluctance to permit gas pipeline between Myanmar and India to pass its territory are indications of a mindset which

India, Myanmar and Thailand, BIMSTEC members have launched a trilateral transport corridor. A multi-nodal transportation development, particularly the Trans-Asian Railway and the Trans-Highway networks is also envisaged¹⁸. There have also been discussions to set up BIMSTEC air connections, covering capitals and important cities of the member countries.

India is the BIMSTEC member which shares its international borders with all BIMSTEC countries (except Thailand). It has already accorded priority to making its North Eastern Region (NER) as an important economic link with the BIMSTEC members. India hopes that NER could become India's economic link to BIMSTEC and to Association of Southeast Asian Nations (ASEAN) countries. The first ASEAN-India Car Rally, organized in 2004 which originated in India's NER, was meant to convey this message.

Initial steps in the direction of improving connectivity and infrastructure among BIMSTEC economies have been initiated. The real test, however, lies in the speedy implementation of these projects, requiring a high degree of constructive cooperation among the BIMSTEC members. A well-connected and coordinated BIMSTEC grouping would certainly be in a better position to reap the fruits from economic cooperation with Japan, and also increase its investment attractiveness for global investors, not just only from Japan¹⁹.

Finally, BIMSTEC members have already entered into a Framework Agreement for establishing a comprehensive free trade agreement (FTA) by 2017. This agreement is expected to strengthen economic cooperation among BIMSTEC members by providing preferential market access to member countries in their respective goods and services markets, and also facilitating and promoting trade and investment cooperation. This FTA not only envisages elimination of tariffs on trade in goods among BIMSTEC members, but also a progressive elimination of all discrimination among member countries except for measures permitted under Article V(1)b of the WTO General Agreement on Trade in Services, as also strengthening and transparency of investment rules and regulations by agreeing on: (1) Mutual Recognition Agreements (MRAs), conformity assessment, accreditation procedures, standards and technical regulations; (2) Customs cooperation; (3) Trade finance; (4) E-Commerce and (5) Business visas and travel facilities. It also hopes to provide an institutional arrangement in the form of a BIMSTEC Trade Negotiating Committee (BIMSTEC TNC) to report to the BIMSTEC on the progress of negotiations among member countries. All BIMSTEC members have already agreed to implement the FTA on trade in goods from July 2006, with negotiations so far having been completed on provisions related to the safeguards and anti-dumping measures, and yet to be finalized on the issues of sensitive lists, lists of products to be opened under the fast track of trade liberalization and rules of origin. Besides FTA on trade in goods, the BIMSTEC members have agreed to enforce the FTA agreement on trade in services and investment from July 2007.

The challenge would be to successfully implement all the above mentioned elements of this FTA, which would also improve the general business environment in BIMSTEC and encourage Japan to engage into a comprehensive economic partnership encompassing several of the above elements. It is however noted that the above initiative would involve a high level of transaction costs in its implementation, and would need to be perceived as business friendly by the businesses in BIMSETC in order to be encouraged to utilize the FTA. Implementation integrity by all members would therefore be crucial for success of the BIMSTEC FTA, and achieving it would especially be a challenge, given the differences in the economic growth strategies among BIMSTEC members. Further, in the light of demands for compensation due to loss of tariff revenues by certain member countries in BIMSTEC, there

does not accept the need to manage globalization, and to focus on maximizing opportunities to improve the material conditions of its people.

¹⁸ [http://www.mfago.th/internet/ACD/ACD%20Singapore-spe\[1\].doc](http://www.mfago.th/internet/ACD/ACD%20Singapore-spe[1].doc)

¹⁹ Dealing with BIMSTEC members who have a revealed preference for impeding the group's objectives is an issue which must be addressed collectively. BIMSTEC wants to encourage Japan to take it seriously, and therefore addressing the above issue has become even more urgent.

have been some coordination problems²⁰, which should not recur in future if the grouping is to seriously contemplate economic integration. The enlightened self-interest of BIMSTEC members requires constructive cooperation for managing globalization and other challenges, and the BIMSTEC FTA is an important step towards that end.

5. Concluding Remarks

The analysis in this paper indicates that there are important areas in which mutually beneficial cooperation arrangements between BIMSTEC and Japan can be pursued. These include not just trade and investment cooperation, but energy security, movement of professionals, healthcare and education services, science and space technology, urban and intercity-travel, media and entertainment, and tourism and culture. Strategically, BIMSTEC-Japan cooperation has the potential to constitute an important pillar among the initiatives for Asia-wide cooperation arrangements currently being pursued. It is also consistent with formation of an Asian Economic Community, which in the initial stages would involve Japan, ASEAN, China, India and South Korea (Kumar, 2006).

Engaging Japan will provide BIMSTEC members with a vital partner who can act as a catalyst for sustaining economic growth. As observed by Chandra Mohan (2004), current levels of economic cooperation among BIMSTEC are too insignificant to have any credible impact on improving the overall economic growth prospects of the grouping. Most BIMSTEC members need to concomitantly pursue domestic reforms to improve upon their growth prospects, and on mindsets which is conducive to emerging as net winners from the globalization process. They should not focus their energies only on the FTAs, which at best lead to partial liberalization and to limited welfare gains in the external sector of these economies in the short run (Sally and Sen, 2005).

In conclusion, a BIMSTEC-Japan economic partnership can provide significant mutual gains for both parties and deserves to be seriously explored. This opportunity should be grasped, particularly by BIMSTEC members who are not participating in other strong regional cooperation agreements. The expectations from BIMSTEC should be modest.

²⁰ Bangladesh, initially demanded compensation to operationalize the FTA. This is contrary to the widely accepted practice of regarding regional FTAs as net win-win situations and signified Bangladesh's unwillingness to meaningfully participate in regional co-operation. It subsequently dropped this demand and signed the agreement during the July 2004 summit (Reddy, 2006). Whether Bangladesh actually implements the FTA in spirit in which it is intended remains to be seen. Recent levying by Bangladesh of substantially higher duties on oranges from India's Northeast as compared to oranges from Bhutan, thus injuring local economy in India's Northeast violates the BIMSTEC cooperation spirit, as well as the spirit of SAFTA (South Asian Free Trade Agreement). Such actions and more importantly mind-set behind them represent a major hindrance to regional cooperation.

References

- Asher, M.G (2005) "India and Japan should Deepen Strategic Engagement", *The Financial Express*, February 12.
- Asher, M.G and Sen, R. (2005) "India-East Asia Integration: A Win-Win for Asia", *Economic and Political Weekly*, Vol. XL, No. 36, September 3.
- Chandra Mohan, N. (2004) "Long Road from BIMSTEC to BOBCOM", *The Financial Express*, August 5, available electronically at http://fecolumnists.expressindia.com/full_column.php?content_id=65121
- Devare, S. (2006), *India and Southeast Asia: Towards Security Convergence*, Institute of Southeast Asian Studies (ISEAS), Singapore
- Farrell, D. (2004) "Offshoring is the Way to Go", *International Herald Tribune*, February 7-8
Financial Express, August 31, available electronically at http://www.financialexpress.com/print.php?content_id=100950
- Khanna, T and Huang, Y. (2003). "Can India overtake China?", *Foreign Policy*, December, 8.
- Kumar, N. (2006) "Longer Term Vision of India-ASEAN Partnership: Towards an Asian Economic Community", in N. Kumar, R. Sen and M. Asher (ed.) *India-ASEAN Economic Relations: Meeting the Challenges of Globalization*, Research and Information Systems for Developing Countries (RIS), New Delhi and Institute of Southeast Asian Studies (ISEAS), Singapore.
- Organization for Economic Cooperation and Development (OECD) (2004) *OECD Statistics on International Trade in Services, Detailed Tables by Partner Country 1999-2002*, OECD: Paris.
- Rajan, R.S. and Sen, R. (2005) "The New Wave of Free Trade Agreements in Asia: With Particular Reference to ASEAN, China and India", in ADB Volume on *Asian Economic Cooperation and Integration*, Asian Development Bank, Manila.
- Rama Rao, M. (2005) "India, Japan Identify Eight-fold Initiative for Strategic Partnership, Resolve to Launch a Gas and Oil cooperation Dialogue" *Asian Tribune*, April 30.
- Reddy, K.R (2006) "Sub-Regional Economic Cooperation between India and ASEAN" in N. Kumar, R. Sen and M. Asher (ed.) *India-ASEAN Economic Relations: Meeting the Challenges of Globalization*, Research and Information Systems for Developing Countries (RIS), New Delhi and Institute of Southeast Asian Studies (ISEAS), Singapore.
- Rhode, D. (2004) "India's Lofty Ambitions in Space Meet Earthly Realities", *New York Times*, January 24.
- Sally, R. and R. Sen, (2005) "Whither Trade Policies in Southeast Asia? The Wider Asian and Global Context", *ASEAN Economic Bulletin*, Vol. 22, No. 1, pp.92-115.
- Sen, R. (2005) "New Regionalism" in Asia: A Comparative Analysis of Emerging Regional and Bilateral Trading Agreements involving ASEAN, China and India", Paper presented at the CESifo Workshop on Global Economic Negotiations, Venice, Italy, July 20-21.
- Sen, R. and Nandy, A. (2005) "Bilaterally Negotiating Temporary Entry" *Financial Express*, August 31, available electronically at http://www.financialexpress.com/print.php?content_id=100950
- Takayama, N. (2005), "Reforming Social Security Pensions in Japan: A Balance Sheet Approach", in N. Takayama (ed.) *Pensions in Asia: Incentives, Compliance, and their Role in Retirement*, Tokyo: Maruzen co., pp. 121-33.
- United Nations, (2004) *UN Com-Trade Database*, United Nations: New York.
- World Bank, (2005), *World Development Indicators 2005*, World Bank, Washington D.C.
- World Trade Organization (WTO), (2004) *International Trade Statistics 2004*, WTO, Geneva.
- Yamazawa, I. (1990), "Gearing the Japanese Economy to International Harmony", *The Developing Economies*, Vol.28, No.1, pp.3-15.