Section 4 India’s economy achieves high growth

Since initiating its economic reform in 1991, India has continued its transition from a closed and planned economic policy toward a path of liberalization. As a result India has achieved stable economic growth averaging 6.0% annually, gradually enlarging its presence in the world economy. With high growth accompanying a rapid expansion of consumption especially after 2003, India has, following China, attracted considerable attention in Japan. However, India's economic growth displays a different character than that of other East Asian countries such as China which have realized strong economic growth.

This section brings these developments and related issues into focus by comparing the characteristics of India's economic growth with those of other East Asian countries. It then turns to the strengthening relationship between India and East Asian countries other than Japan as India opens its economy to the world and examines efforts aimed at building a mutually beneficial relationship between Japan and India.

1. Characteristics of India’s unique economic growth and related issues

The invasion of Kuwait by Iraq in 1990 plunged India into an international balance of payments crisis which depleted its foreign exchange reserves down to approximately a two week supply due to the impact of the sharp rise in crude oil prices and declining remittances from overseas workers in the Middle East. This event prompted India to initiate economic reforms in 1991 aimed at shifting to a path of liberalization. Specifically, India gradually relaxed domestic industrial regulations and liberalized trade and foreign investment, and thereby achieved high economic growth. This process of growth displayed a character different from that of East Asian countries up to now in that India rapidly expanded its presence in such high technology fields as software and IT services. The following discussion clarifies issues relating to the characteristics of India’s economic growth and its efforts to achieve sustainable growth.

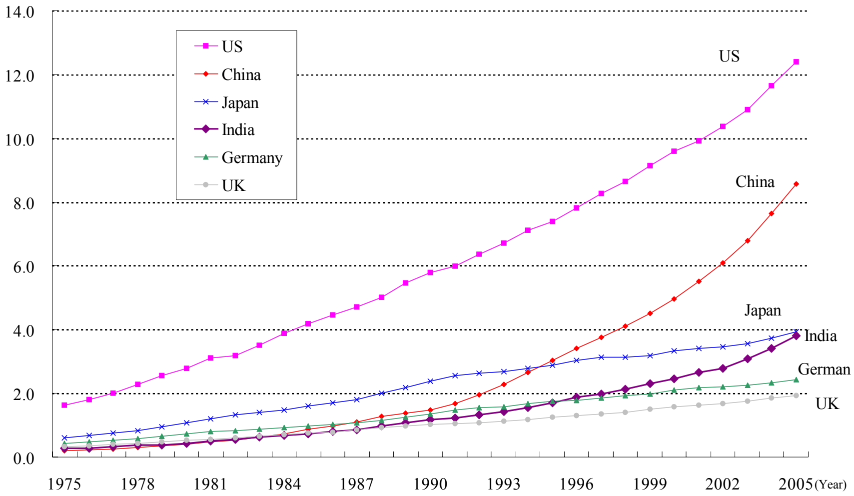
(13) The growing presence of India’s economy in the global economy

Since initiating its economic reforms in 1991, India has generally achieved high economic growth. The country’s nominal GDP in 2005 reached US$785.4 billion, which is 1/17 that of the United States and 1/6 that of Japan. Based on purchasing-power-parity,[79] however, India ranks fourth next to the U.S., China, and Japan (Figure 1-4-1).

---

[79] Purchasing-power-parity refers to the exchange rate revaluated based on the “law of one price” that equalize the price of an identical good or service, which allows the comparison based on each currency’s purchasing power. In order to compare nominal GDP, it is converted to US dollars using the nominal exchange rate. However, since the purchasing power of one US dollar varies depending on the country or region, the GDP of countries or regions with strong currencies is over valued. Therefore, GDP based on purchasing-power-parity has been used as much as possible in order to make comparisons based on purchasing power.

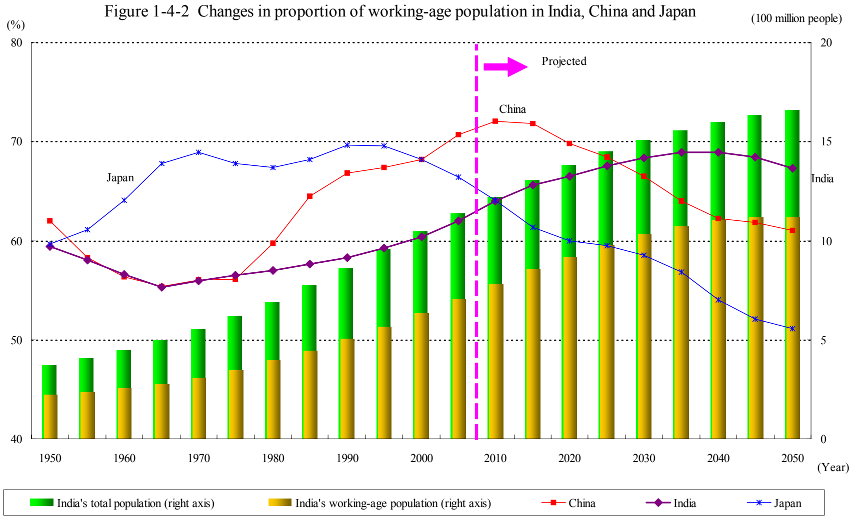
Figure 1-4-1 Changes in GDP of respective countries (purchasing power base)



Notes: GDP of purchasing power (dollar based) is used.
Source: *WDI* (World Bank).

According to United Nations statistics, India's population stood at 1.13 billion in 2005, accounting for 17.4% of the world's population and running second next to China's 1.31 billion. United Nation's Median Projection predict that India's population will grow to 1.447 billion by 2025, exceeding China's estimated population of 1.445 billion and accounting for 18.1% of world population. Moreover, compared with China's population, which is rapidly aging under the country's "one-child policy," India's population is aging at a more moderate pace (Figure 1-4-2). This means that the proportion of India's working population aged 15-64 will expand over the long term, and an abundant workforce will continue to be available, which should enlarge India's presence.

Figure 1-4-2 Changes in proportion of working-age population in India, China and Japan

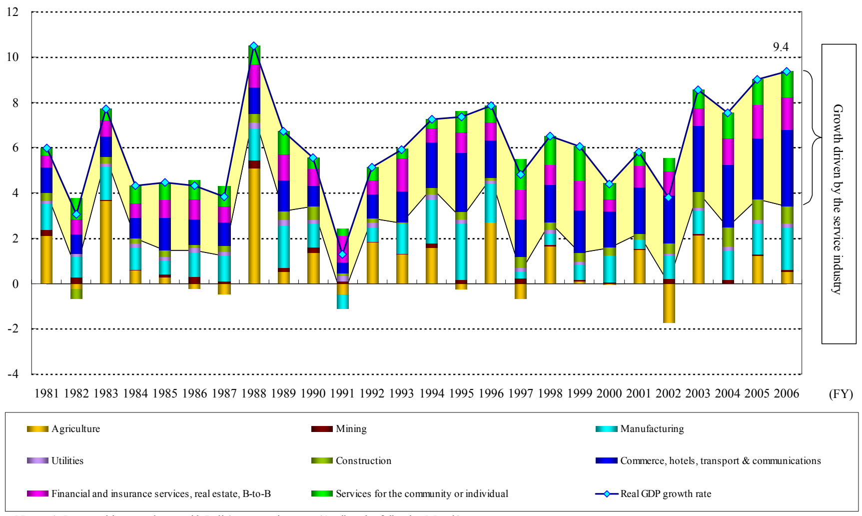


Notes: 1. Figures used are those for intermediate-level estimates.
2. Working-age population are people between 15 and 64.
Source: *World Population Prospect* (UN).

(2) India's economy achieves growth driven by the service industry

The relative contributions of various industries to India's economic growth reveal that the service industry, including commerce, transportation, finance, social services and services aimed at individuals, are leading the economy (Figure 1-4-3).

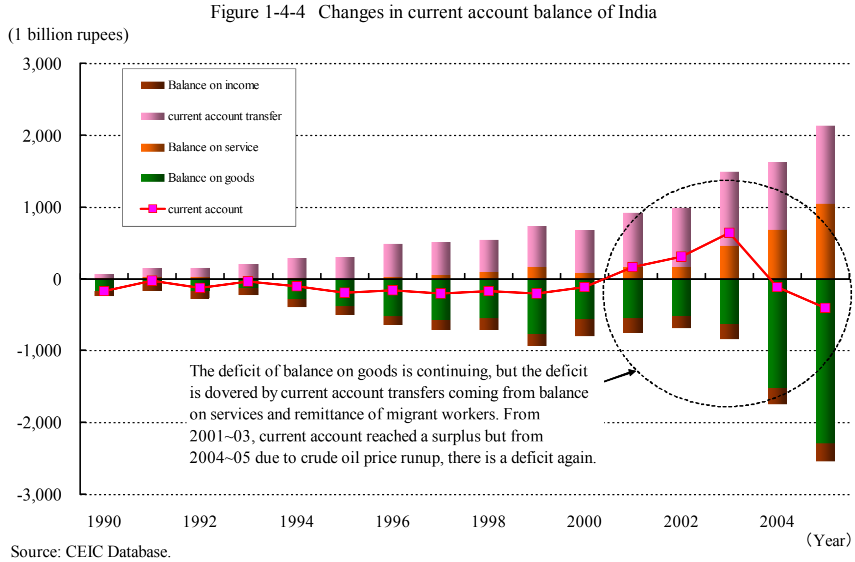
Figure 1-4-3 Changes in real GDP growth rate in India (degree of contribution by industry)



Notes: 1. Prepared in accordance with India's accounting year (April to the following March).
2. Figures from FY1981 to FY1999 use FY1993 prices, and figures for FY2000 onwards use FY1999 prices.
Source: Website of the Reserve Bank of India.

The development of the service industry is also reflected in India's current balance of accounts. While the trade balance remains in deficit, surpluses continue to grow in the current balance of services. This means that the service industry contributes to India's economy as a valuable method of acquiring foreign exchange, which compensates for the trade balance deficit (Figure 1-4-4).

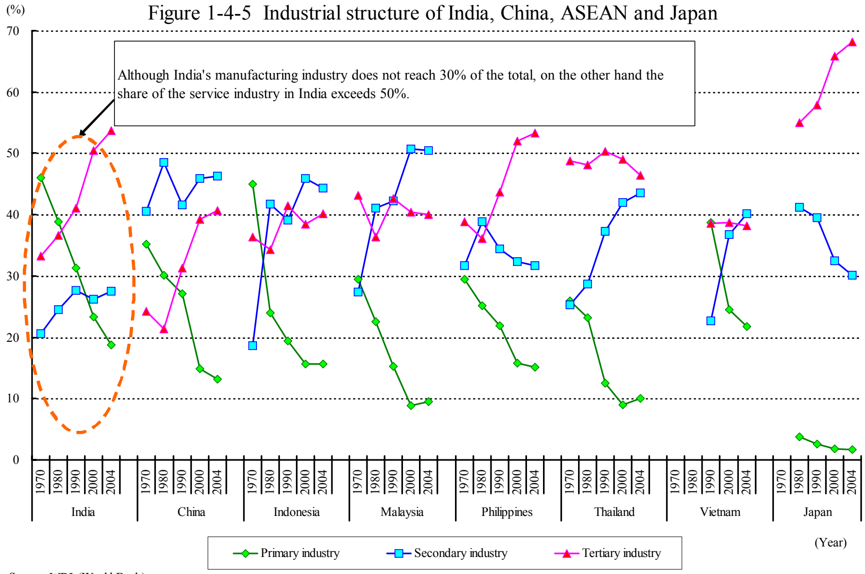
Figure 1-4-4 Changes in current account balance of India



Source: CEIC Database.

A comparison of the industrial structure of India, which has achieved economic growth centered on the service industry, with that of other Asian countries shows that the proportion accounted for by the mining and manufacturing sector in the economies of China and ASEAN is gradually increasing while the proportion accounted for by agriculture, forestry and fisheries for the most part declines. In contrast, the proportion accounted for by the mining and manufacturing sector in India’s economy remains at the 20% level. The service industry, meanwhile, accounts for more than 50%, which makes India’s industrial structure unique among developing countries (Figure 1-4-5).

Figure 1-4-5 Industrial structure of India, China, ASEAN and Japan



Source: *WDI* (World Bank).

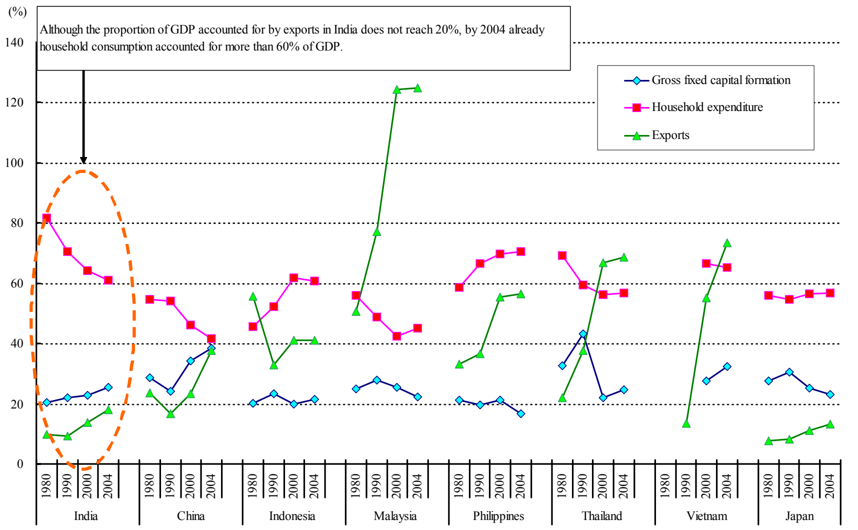
(3) Economic growth led by domestic demand

(India’s domestic demand-led economy stands in contrast to China and ASEAN, whose economies are driven by external demand and investment)

An analysis of India’s economic growth by demand category shows that since implementing economic reforms beginning in 1991, exports and total fixed capital formation relative to GDP increased, but in 2004, household consumption accounted for 61% of GDP, marking a shift to growth led by domestic demand (Figure 1-4-6).

This stands in contrast to China, whose exports and total fixed capital formation stood at 37.6% and 38.5% of GDP, indicating that it has achieved growth led by external demand and investment. India’s demand breakdown also stands in contrast to ASEAN, which, as total fixed capital formation stagnated at around 20% due to the impact of the currency and financial crisis, maintained exports at about 40% of GDP, achieving growth led by external demand.

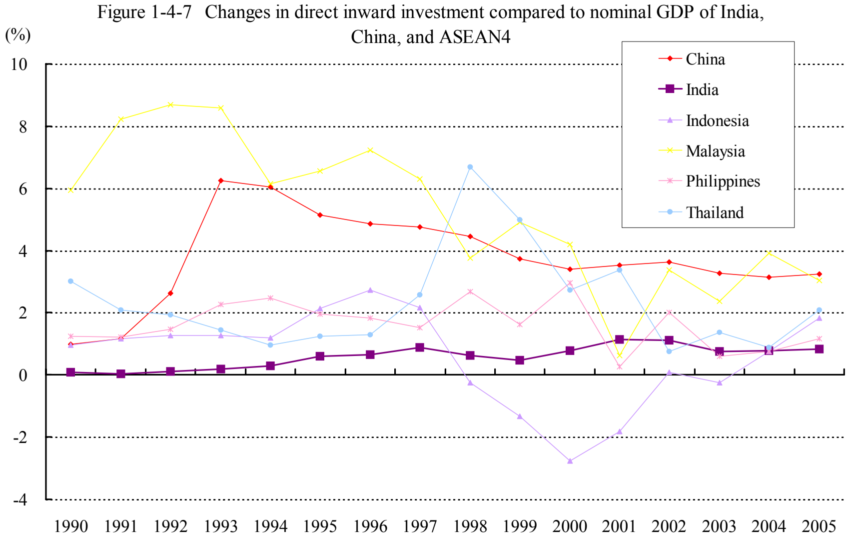
Figure 1-4-6 Changes in household expenditure, fixed capital formation and exports as a proportion of GDP in India, China, ASEAN and Japan



Source: *WDI* (World Bank). (Year)

Furthermore, in comparison with China and ASEAN4, which aggressively accumulated foreign exchange in the process of achieving economic growth, India's foreign exchange reserves are low relative to the size of its economy, although the country has increased its acceptance of direct investment as it opens its markets to foreign investment (Figure 1-4-7).

Figure 1-4-7 Changes in direct inward investment compared to nominal GDP of India, China, and ASEAN4



Source: *World Investment Report 2006* (UNCTAD), *WDI* (World Bank). (Year)

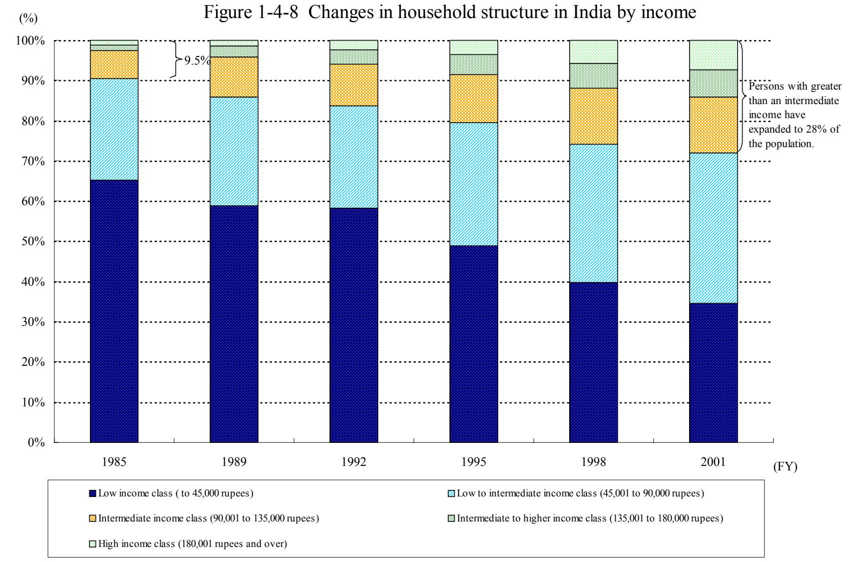
(Market expansion with economic growth)

With respect to the expansion of the segment of consumers who have supported economic growth led by domestic demand, the proportion of middle-income earners and up whose yearly household incomes now exceed 90,000 rupees (approximately US$1,850)[80] thanks to economic growth expanded from 9.5% in FY1995 to 28% in FY2001, indicating that the middle class is growing

[80] The US dollar-rupee exchange rate was recorded at US$1 = 48.7 rupees on March 29, 2002.

(Figure 1-4-8).

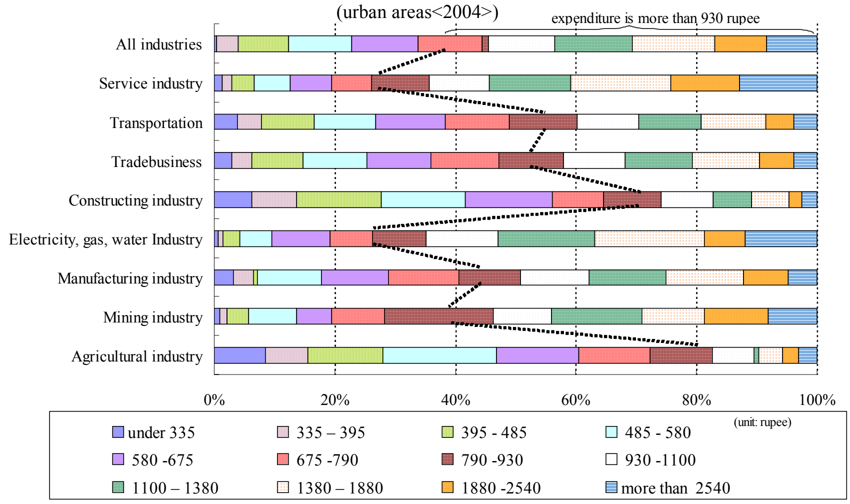
Figure 1-4-8 Changes in household structure in India by income



Source: *India Market Demographics Report 2002, The Great Indian Middle Class* (NCAER).

A distribution of per-capita monthly consumption expenditures in FY2004 by urban households broken down by industry sector was examined in order to determine which segment is driving the expansion in consumer spending that has accompanied income growth. It shows that the proportion accounted for by households employed in the service sector, especially IT-related industries, and in the manufacturing sector is relatively high, and that workers in these sectors are fueling consumption (Figure 1-4-9).

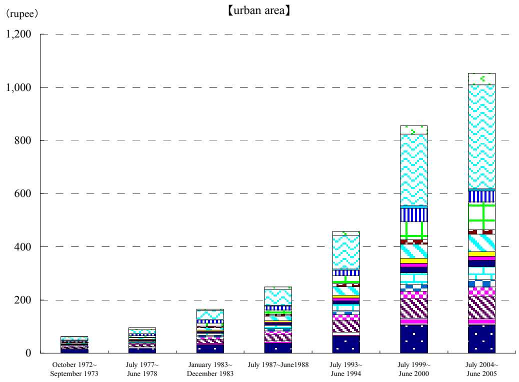
Figure 1-4-9 Monthly expenditure per household by business category in India
(urban areas<2004>)



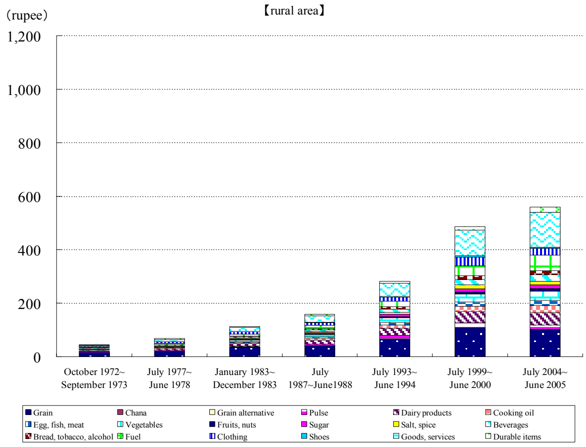
Source: *NSS Report No.515: Employment and Unemployment Situation in India, 2004-05* (Ministry of Statistics and Programme Implementation).

In addition, a breakdown of consumer spending suggests that the consumer market for goods and services, particularly in urban districts, is expanding (Figure 1-4-10).

Figure 1-4-10 Changes in monthly spending per capita in India

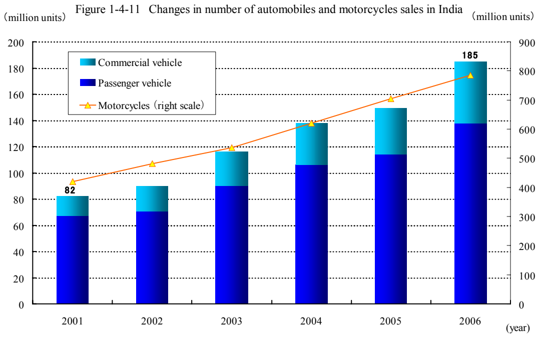


Source: *NSS Report No. 508: Level and Pattern of Consumer Expenditure, 2004-05* (Ministry of Statiscs & Programme Implementation).



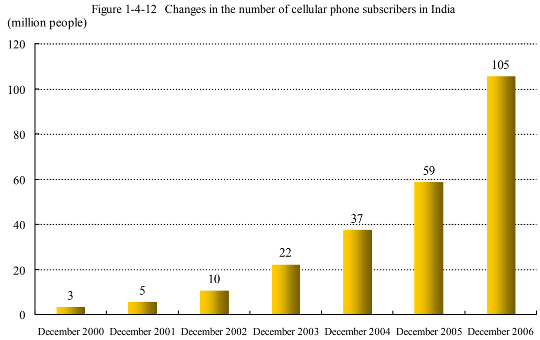
Furthermore, the expansion of the consumer market is reflected in increased sales of automobiles and motorbikes and the recent rapid expansion of cellular phone subscribers in India (Figure 1-4-11 and Figure 1-4-12). Specifically, domestic sales of automobiles in India increased from the 820,000 level in FY2001 to 1.85 million in FY2006, a two-fold increase. India also has one of the world's leading cellular phone markets. In December 2006, the number of cellular phone subscribers hit the 100 million level, ranking India third after China and the United States.

Figure 1-4-11 Changes in number of automobiles and motorcycles sales in India



Source: Website of Society of Indian Automobile Manufacturers.

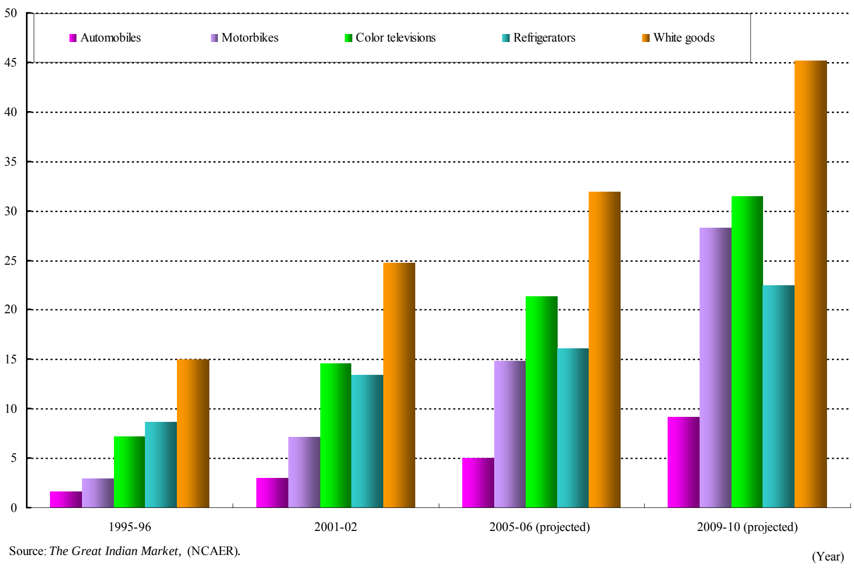
Figure 1-4-12 Changes in the number of cellular phone subscribers in India



Source: CEIC Database.

Meanwhile, the percentage of households owning consumer durables is steadily expanding. However, the ratio of ownership remains low, with about 5% owning cars and 20% color television sets in FY2005, and thus the potential for market expansion is considerable (Figure 1-4-13).

Figure 1-4-13 Changes in no. of households owning consumer durables in India (per 100 households)



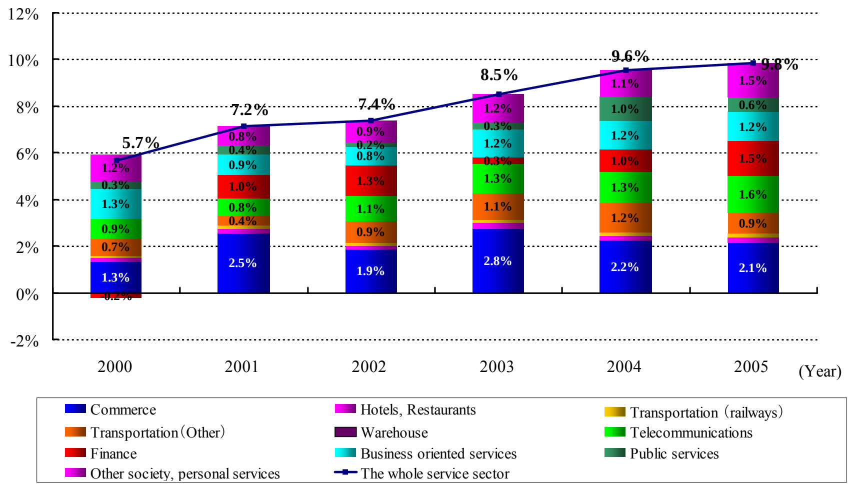
Source: *The Great Indian Market*, (NCAER).

(4) Growth in the service sector by industry

(Every industry contributes to growth)

The service sector is powering growth of the Indian economy. An analysis of the contributions to economic growth of the various industries reveals that every industry, with some rare exceptions, has consistently contributed to growth since FY2000, especially commerce, transportation, telecommunications, and business-oriented services (Figure 1-4-14).

Figure 1-4-14 Changes in sector based contributions towards GDP growth of tertiary industries in India

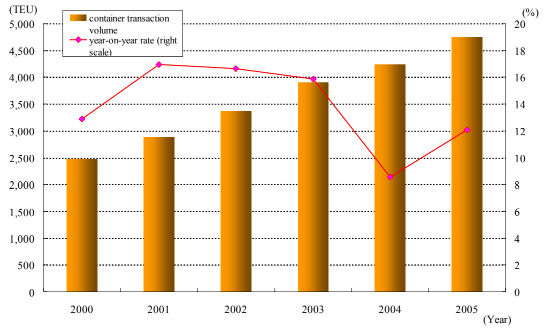


Source: CEIC Database.

(Demand for services expands with economic growth)

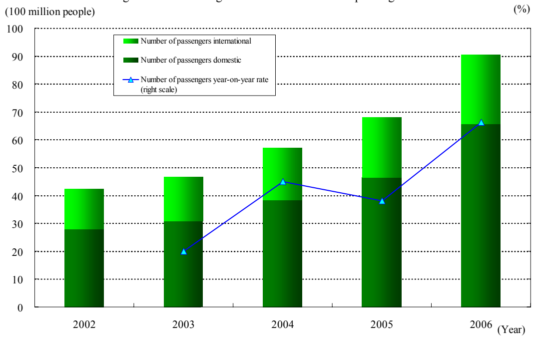
The factors involved in growth of the service industry include, on the demand side, the expansion of trade accompanying economic growth and increased movement of people in India and overseas. Demand for transport-related services has also markedly expanded, with a annual average increase of 13.8% in container handling volume in ports since 2000 and a 21.1% average annual increase in the number of airline passengers since 2002 (Figure 1-4-15 and 1-4-16).

Figure 1-4-15 Changes in India's port container transaction volume



Note: TEU is the unit for expressing the carrying capactiy of the container vessel. (1 TEU=1 20 feet container).
Source: CEIC Database.

Figure 1-4-16 Changes in the number of airline passengers in India

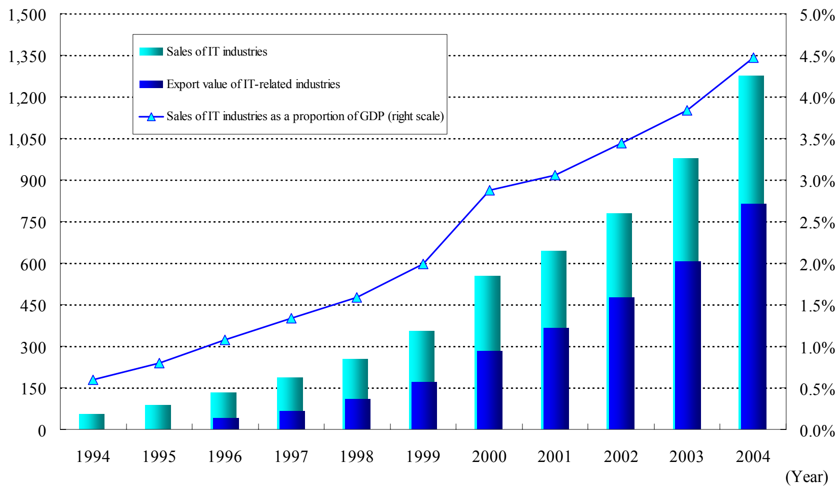


Source: CEIC Database.

The increased procurement from India principally by major Western countries has seen rapid growth in sales in business process and outsourcing services, such as call centers, and IT-related industries such as the outsourcing of software development. Although IT-related industries recorded 4.5% sales relative to GDP in FY2004, these industries have served as a precious source of foreign exchange, accounting for around one-fourth of exports of goods and services. The expansion of sales in IT-related industries is also contributing to the expansion of demand in the telecommunications field (Figure 1-4-17).

Figure 1-4-17 Changes of sales of IT industries as a proportion of GDP in India

(in 1 billion rupees)



Source: CEIC Database.

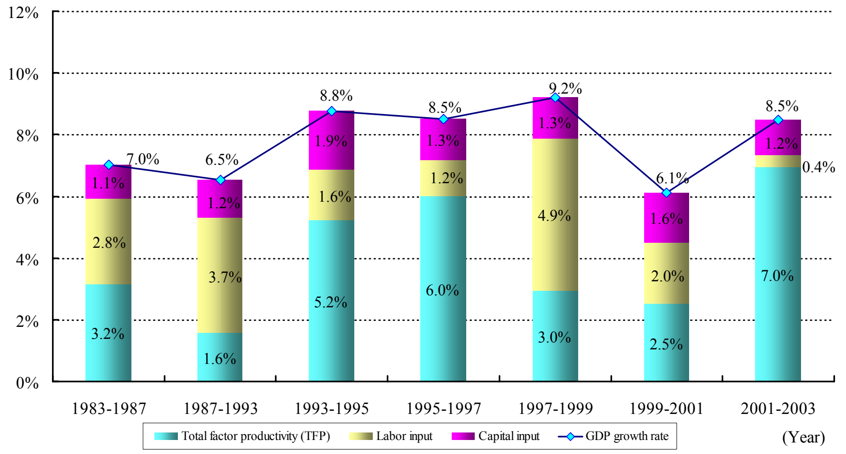
In addition, the expansion of corporate demand for services has been accompanied by the aforementioned increase in household demand for goods and services due to the increase in income, which is contributing to growth in commerce and services for individuals. In recent years, India's retail industry, which accounts for the majority of small businesses, has seen the establishment of large-scale shopping malls in such major cities as Delhi and Mumbai, heralding the birth of new types of services and offering a picture of the development of the commerce field.

(Improved efficiency in the service sector)

Next is a discussion of the contributions such as deregulation that improved supply efficiency brought on by the growth in the service sector, along with the expansion of demand.

Dividing growth in the service sector into the capital input, and the labor input and total factor productivity (TFP) and looking at trends in each reveals that TFP has markedly improved and that progress in deregulation and the accompanying introduction of new types of services are most likely contributing to growth (Figure 1-4-18).

Figure 1-4-18 Analysis of factors affecting service industry growth in India



Notes: Due to the limitation of statistics, the labor input of the service industry uses a surrogate variable found by the working age population (15-64) multiplied by the employed ratio.
Source: GDP, labor input from Central Statistical Organisation, working age population from *WDI* (World Bank), Industry based ratio from *National Sample Survey Report* (Ministry of Statistics & Programme Implementation)

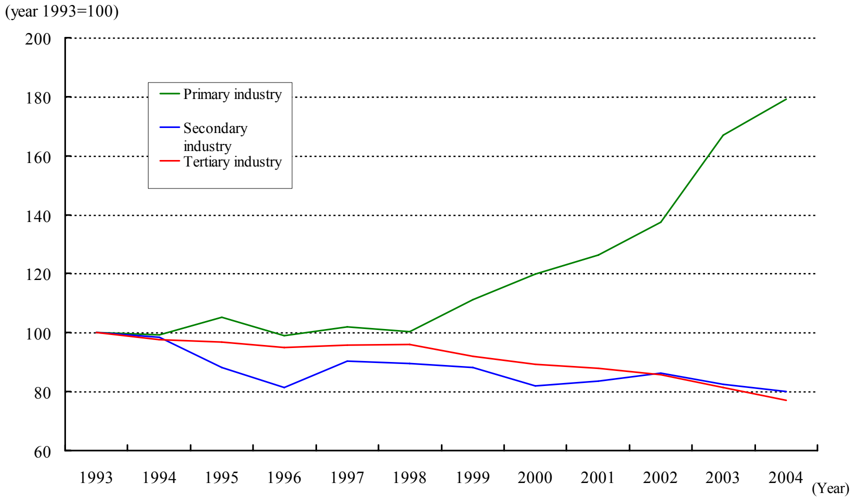
For example, although the telecommunications field was formerly operated as a state-run corporation, a series of deregulation measures have since been implemented, with participation by private-sector companies allowed in the cellular phone market[81] in 1994 and in the Internet market[82] in 1998. As of the end of April 2006, 10 private-sector companies, including foreign-affiliated firms, and two state-owned firms were providing services in the cellular phone market. With newly participating companies actively expanding operations, cellular phone service charges have practically been reduced to a level of one cent per one-minute call, causing the monthly increase is user contracts to jump to 6.8 million in November 2006, the largest such increase in the world. As a result, the number of subscribers reached 149.5 million as of the end of 2006. The Indian government is aiming to increase the number of subscribers to 500 million by 2015.

Thanks to deregulation, the proportion of GDP accounted for by the public sector in the service industry has declined year by year, and the decline in the public sector's proportion of GDP in FY2004 in comparison with FY1993 was more prominent than in primary and secondary industries (Figure 1-4-19). This is the result of the privatization of inefficient state-run companies and the participation of private-sector companies made possible by deregulation. These developments are probably leading to increased efficiency and improved productivity in the service industry.

---

[81] Participation by private-sector companies (maximum of 49% foreign capital) was allowed under the National Telecom Policy 1994 (NTP). Regulations governing foreign participation in telecommunications businesses were subsequently relaxed, and in 2005, the maximum was changed from 49% to 74%.
[82] The 1998 Internet Service Provider Policy allowed new participation in the Internet market and abolished monopolies by state-owned companies.

Figure 1-4-19 Changes in shares of public sectors by industry in India



Source: Website of statistic bureau of India.

(5) Trends in India's manufacturing sector

(Causes of stagnant growth in the manufacturing sector)

As mentioned previously, India has realized high economic growth despite the low proportion of GDP accounted for by the manufacturing sector compared with other East Asian countries. Some have indicated that this is attributable to the substantial influence of India's rigid industrialization policy led by the public sector based on import substituting industrialization under the mixed economic system[83] which continued until 1991. While large private-sector companies were subject to a rigid and severe license administration under the industrial license system, small scale industries (SSI)[84] were not and received preferential treatment including tax breaks, government procurement contracts, and financial advantages. Under the "reserve system," moreover, only SSIs were designated to produce specified products, and participation by large-scale companies was eliminated. These rigid regulations that gave priority to SSIs distorted growth by large private-sector companies while at the same time undermined the incentives SSIs had to expand production and improve productivity by enabling over-protected SSIs to implement capital investment exceeding the upper limit on capital.

(Growth rate in the manufacturing sector rebounds)

Economic reforms since 1991, including the abolition of the industrial licensing system, liberalization of imports and exports, and relaxation of regulations on foreign participation relating to internal investment, have also enabled the manufacturing industry to increase investment, especially in industries producing consumer durables, and achieve high growth. However, in the latter half of the 1990s, the impact of disappointing domestic sales resulted in excess equipment, and subsequently the growth rate declined (Figure 1-4-20 and 1-4-21).

As mentioned previously, however, the steady expansion of the consumer market and further liberalization in recent years has enabled the manufacturing sector to resume investment since

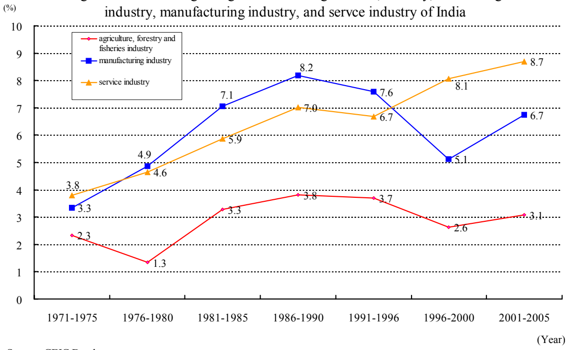
---

[83] "Mixed economic system" refers to India's economic system at the time, which the government actively intervene to large extent into the market economy while fundamentally maintaining a market economy.
[84] In India, companies that invest less than 10 million rupees in plant and equipment are classified as SSIs.

FY2002 and thus to increase production capacity, stimulating the growth rate to rise once again. This has resulted in the emergence of internationally competitive companies in the pharmaceuticals, biotechnology, steel and other industries.

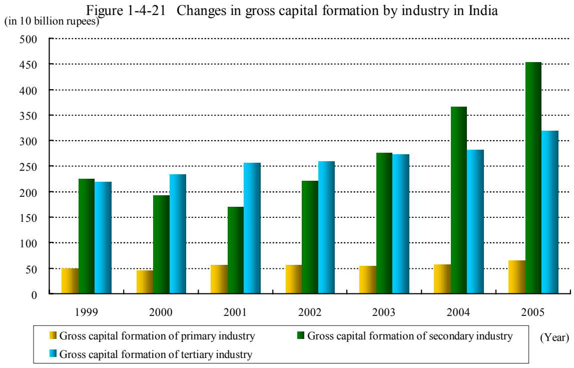
In addition, the Indian government is implementing industry promotion policies aimed at strengthening the manufacturing sector. It has made reference to promoting the establishment of a special automobile parts industrial park and special economic zones (SEZ) in the Automotive Mission Plan 2006-2016 announced in January 2007. It also mentioned an amendment to the Labor Act aimed at realizing flexible employment schemes. Moreover, in March 2007, the government officially announced special preferential treatment measures such as the undertaking of 25% of the total cost of a semiconductor manufacturing project (20% if sited in SEZ) initially over a period of 10 years.

Figure 1-4-20 Changes in growth rate of agriculture, forestry, and fishing industry, manufacturing industry, and servce industry of India



Source: CEIC Database.

Figure 1-4-21 Changes in gross capital formation by industry in India



Source: CEIC Database.

(6) Issues for the sustainable growth

This section has presented an overview of India's high economic growth since implementing economic reforms. However, there are various issues that must be resolved in order to sustain this high growth. The following is a discussion of three issues: (a) the business environment, (b) poverty and (c) fiscal deficits.

(a) Issues relating to the business environment

In order to achieve further growth in India's manufacturing and service sectors, it is important to attract foreign-affiliated companies that bring new technologies and management techniques, but India, it is argued, faces various problems concerning its business environment. Inquiring into the specific problems that Japanese companies face, half mention the lack of infrastructure development, while others point to problems with legal systems and labor (Figure 1-4-22).

Table 1-4-22 Challenges for India's business environment

No.	Challenges	No. of companies	Share
1	Incomplete infrastructure	89	50.0%
2	Opaque application of legislation	55	30.9%
3	Lack of investment information	48	27.0%
4	Unease about law and order, public situation	46	25.8%
5	Severe competition with other companies	45	25.3%
6	Labor issues	43	24.2%
7	Opaque application of tax system	39	21.9%
8	Underdeveloped supporting industries	33	18.5%
9	Lack of legislation	27	15.2%
10	Complex tax system	26	14.6%
⋮			
18	Insufficient IP protection	16	9.0%

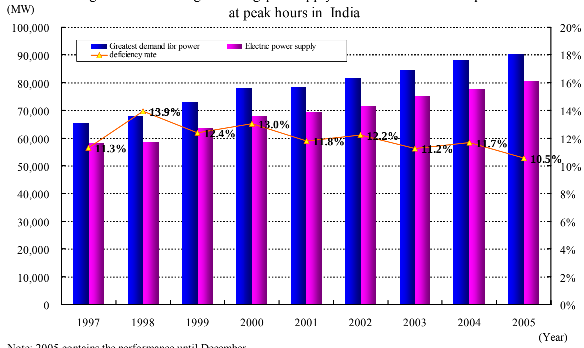
Note: n=178 companies, multiple responses.

Source: *FY2006 Survey on Foreign Direct Investment (18th survey)*, (JBIC).

(Lack of infrastructure development)

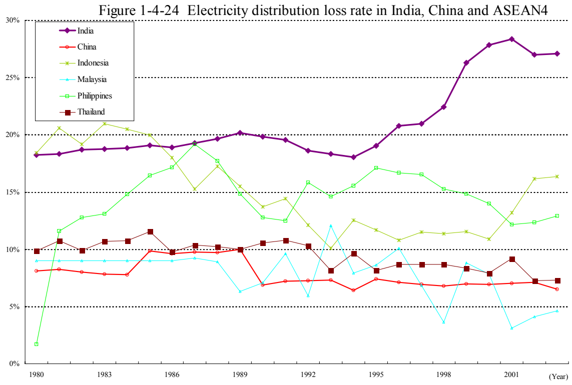
Regarding electric power, problems include the high cost of power and the shortage of electric power supply itself. Looking at the gap between electric power supply and demand during peak hours, there has been a trend toward improvement in recent years. However, the rate of shortage in December 2005 reached 10.5% and supply has failed to keep pace with the increase in demand that has accompanied economic growth (Figure 1-4-23). In addition, one of the causes of unstable electric power supply is "transmission loss." Due to the aging of transmission line networks and other reasons, transmission/distribution loss has reached 30%. An important issue, then, is improving supply capacity and restoring aging facilities (Figure 1-4-24).

Figure 1-4-23 Changes in the gap of supply and demand of electric power at peak hours in India



Note: 2005 contains the performance until December.
Source: *Annual Report 2005-2006* (India Ministry of Power).

Figure 1-4-24 Electricity distribution loss rate in India, China and ASEAN4



Source: *WDI*, (World Bank).

Road transport in India is the most widely used means of transportation, carrying about 65% of freight and 80% of passengers.[85] With a total distance of 3,316,452 km, India boasts the second most extensive road system in the world. However, the number of lanes is generally small and maintenance

[85] National Highway Authority of India Website.

is a major problem (Table 1-4-25). The Indian government is taking steps to increase the number of lanes under three projects aimed at linking the major cities: Golden Quadrilateral,[86] the North-South Corridor, and the East-West Corridor[87]. However, the number of lanes remains inadequate to support growing distribution demand.

Table 1-4-25 Number of lanes in highways of India

Type of lane	Percentage
one way lane	35%
two-lanes	55%
more than four-lane	10%

(Problems associated with legal systems)

One issue associated with legal systems is the Non Objection Certificate (NOC) regulation. This regulation provides that when a foreign company which has previously merged, formed a technical tie-up, or concluded a trademark agreement with an Indian company establishes a new company in the same sector or when it concludes a new agreement, the consent of the counterparty is required. As a result of an amendment in January 2005, certain improvements were provided for, such as one that stipulates that in the case of a foreign company newly entering the Indian market, NOC does not apply unless a consent clause appears in the agreement. However, some argue that NOC offers no advantages to previously established companies and obstructs business activities by foreign-affiliated companies in India.

Another problem is the rigid legal system pertaining to labor. Specifically, under current Indian labor laws, if a company that employs 100 or more staff closes its business office, it is required to obtain a permit from the state government. This requirement causes concern when a company is considering entering the Indian market because of the difficulty that would be faced when withdrawing from the market, and works to hinder aggressive market entry.

(b) Elimination of poverty

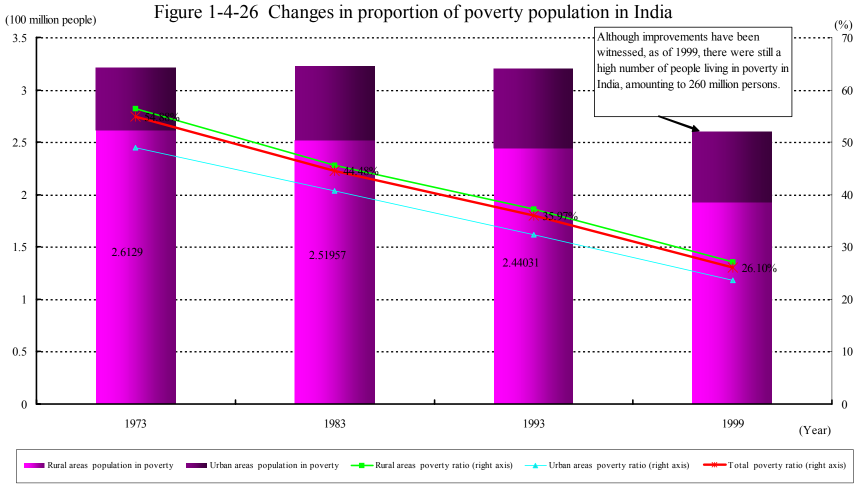
In order to expand domestic demand in a sustainable manner, poverty in India must be eliminated. Although India’s poverty rate has steadily declined with economic growth, the poverty rate remains extremely high, with approximately 260 million people, or 26.1% of the population, still in poverty as of FY1999 (Figure 1-4-26).

---

[86] A 5,846km multi-lane expressway project linking the four major cities of Delhi, Kolkata, Chennai and Mumbai.

[87] A 7,300 multi-lane expressway project consisting of the North-South Corridor (Srinagar, Kashmir State – Komorin Point, Tamil Nadu State) and the East-West Corridor (Porbandar, Gujarat State – Silchar, Assam State).

Figure 1-4-26 Changes in proportion of poverty population in India



Notes: The definition of population in poverty in India is stipulated thus: the poverty line is described as the per capita monthly consumption volume of persons who reach a certain calorific intake (2,400kcal for urban areas, 2,100 kcal for rural areas). Changes in prices are also taken into account and in FY1973 the poverty line was drawn at 56.76 rupees for urban areas and 49.63 rupees in rural areas. In FY1999 the same figures were 454.11 rupees for urban areas and 327.56 rupees for rural areas.
Source: Reserve Bank of India website.

In addition, many impoverished people live in farming communities, and the majority of employed persons in farming villages work in agriculture. The labor productivity of India's agriculture is low compared with other Asian countries. To eliminate poverty, then, reforms must be implemented in agricultural sectors where efficiency is low in order to raise productivity and improve income (Table 1-4-27).

Table 1-4-27 Characteritics of Indian agriculture seen under international comparison (2002)

	Per-capita cultivated acreage (ha)	Cultivatd acreage per farmer (ha)	Rates of people in farming business (%)	Self-sufficiency rates for grain (%)	Grain production (1,000 tons)	Labor productivity (tons/per capita)	Land productivity (tons/ha)
India	0.15	0.29	52.74	92.4	206,570	0.37	1.28
China	0.11	0.17	65.46	101.0	399,998	0.47	2.80
Japan	0.03	1.01	3.44	24.0	12,184	2.78	2.76
South Korea	0.04	0.46	7.72	26.6	7,083	1.94	4.21
Thailand	0.25	0.54	47.38	151.4	30,512	1.03	1.92
Indonesia	0.10	0.22	42.78	84.2	61,144	0.67	2.98
Malaysia	0.08	0.46	16.31	21.9	2,267	0.58	1.26
The Philippines	0.07	0.19	38.14	78.7	17,590	0.59	3.09
US	0.61	29.12	2.09	118.9	297,121	49.16	1.69

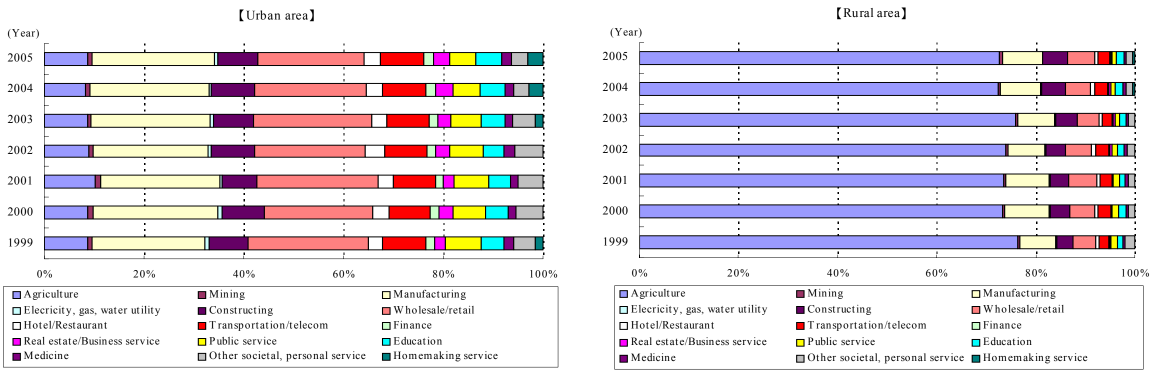
Note: Labor productivity and land productivity are calculated having the amount of grain production divided by the number of people in farming business or cultivated acreage. It is necessary to note that people in farming business include those engaging in production of non-grain items, such as forestry.

Source:Website of U.N. Food and Agriculture Organization based on *White Paper on International Economy and Trade 2006* (METI), *World Statistics* (Ministry of Internal Affairs and Communications).

In parallel with efforts to raise the productivity of the agricultural sector, the surplus labor generated in this process must be absorbed by the service sector and manufacturing sector. However, the changes in number of workers by sector in India up to now indicates that the number of workers in each sector has largely remained constant, and it is considered that an appropriate movement of labor between sectors has not taken place (Figure 1-4-28).

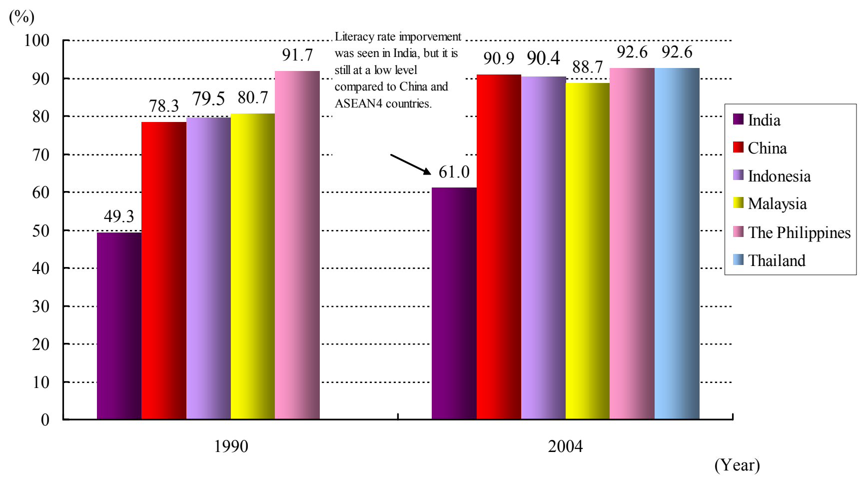
In order to promote movement of labor between sectors, surplus labor must be absorbed through an expansion of the service and manufacturing sectors as mentioned above. At the same time, a flexible labor market must be built, which would be predicated on an overall improvement in educational levels. While one of India's strengths is a highly educated workforce, the literacy rate of the population overall is low compared with other Asian countries (Figure 1-4-29). Given that Asian countries have promoted movement of labor between sectors as they have improved their educational levels, raising the literacy rate through improvement in education is probably an important element in encouraging movement of labor between sectors in India.

Figure 1-4-28 Changes in ratio of labor force employed by industry in India



Source: *NSS Report No.515: Employment and Unemployment in India,2004-05* (Ministry of Statistics and Programme Implementation).

Figure 1-4-29 Changes in literacy rate of India, China, ASEAN4

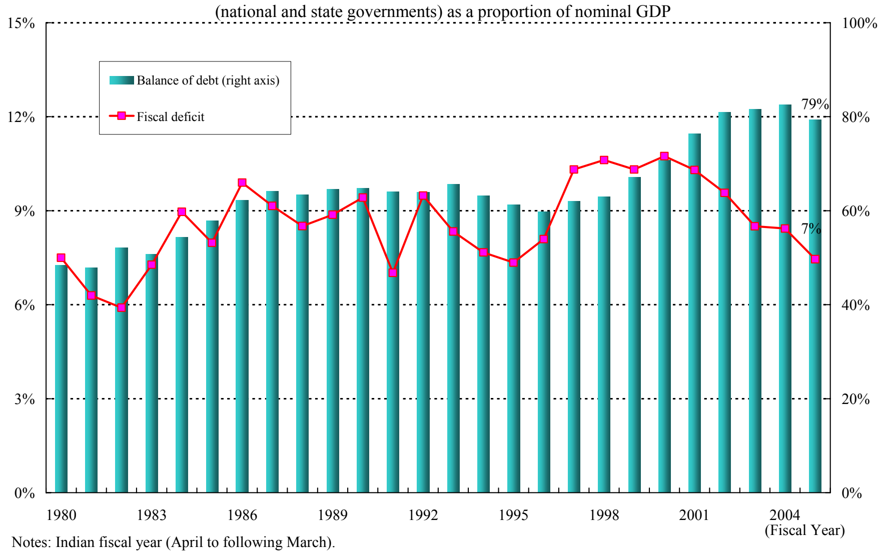


Note: The data for 1990 Thailand is missing.
Source: *WDI* (World Bank).

(c) Fiscal deficits

In the course of implementing various policies aimed at developing infrastructure and eliminating poverty, one important source of funding is government public finance, but in India fiscal deficits persist. Although the combined fiscal deficits of the national and state governments have tended downward in recent years, the ratio relative to nominal GDP remains high at 7%, and the balance of debt relative to nominal GDP is also high at 78% (Figure 1-4-30). In order to bear these fiscal deficits, domestic commercial banks are required to maintain a statutory liquidity ratio (SLR) whereby they must allocate 25% of their total deposits to the purchase of public bonds. These fiscal deficits probably lead to restraints on public investment for infrastructure development, and because SLR curbs funding to the private sector, the necessary private sector investment most likely cannot be implemented. As a result, some have pointed out that improvements aimed at further growth of India's economy are necessary. In response, the Indian government implemented the Fiscal Responsibilities and Budget Management Act in 2004, which aims to reduce the fiscal deficit of the central government to 3% of GDP by FY2007 and eliminate the current account deficit by FY2008.

Figure 1-4-30 Changes in the fiscal deficit and balance of debt for the unified Indian government (national and state governments) as a proportion of nominal GDP



Notes: Indian fiscal year (April to following March).
Source: Website of Reserve Bank of India.

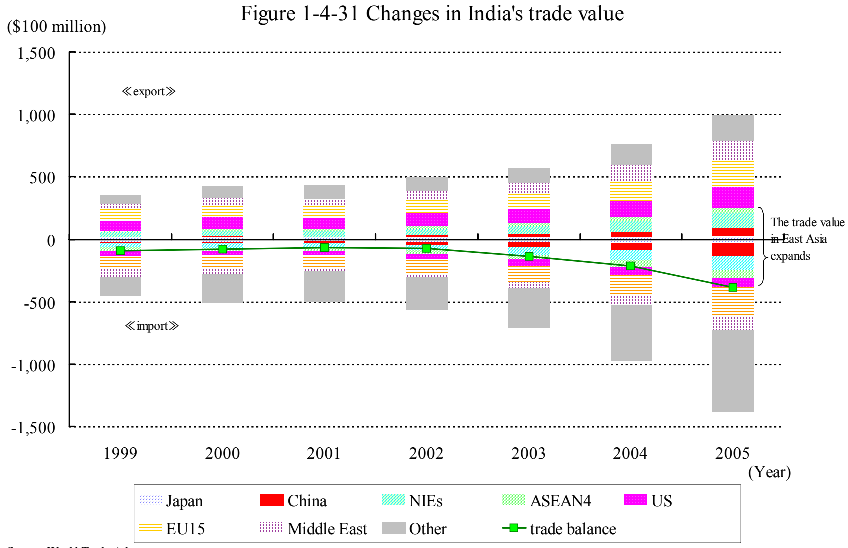
2. East Asian countries deepen ties with India while India opens its markets to foreign participation

As mentioned previously, India is gradually opening its markets to foreign participation through measures such as the liberalization of trade and foreign investment. Amid these efforts, India is moving to strengthen relationships not only with major Western countries but also with East Asian countries such as Singapore, Thailand, South Korea, and China.

(1) Changes in India's trading partners

It has been mentioned that the ratio of India's imports and exports relative to nominal GDP is still low compared with other East Asian countries. India is moving to open its markets to foreign participation and is gradually expanding trade volume. While the volume of trade is highest with the United States and the EU15, in recent years the volume of imports from China, ASEAN and other East Asian countries has been expanding (Figure 1-4-31). India imports intermediate goods and finished goods from China and ASEAN, and the volume of both is growing (Figure 1-4-32 and 1-4-33). This probably indicates that India is also being incorporated into the widely expanding production and sales networks of East Asia.

Figure 1-4-31 Changes in India's trade value

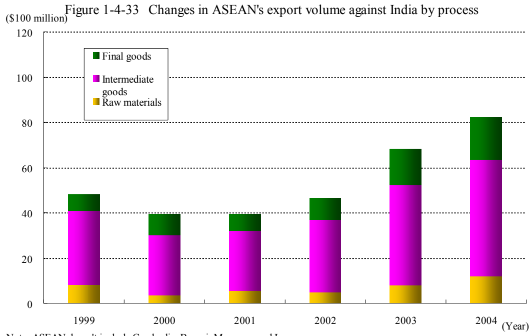


Source: World Trade Atlas.

Figure 1-4-32 Changes in China's export volume against India by process

Source: *RIETI-TID2006* (RIETI).

Figure 1-4-33 Changes in ASEAN's export volume against India by process

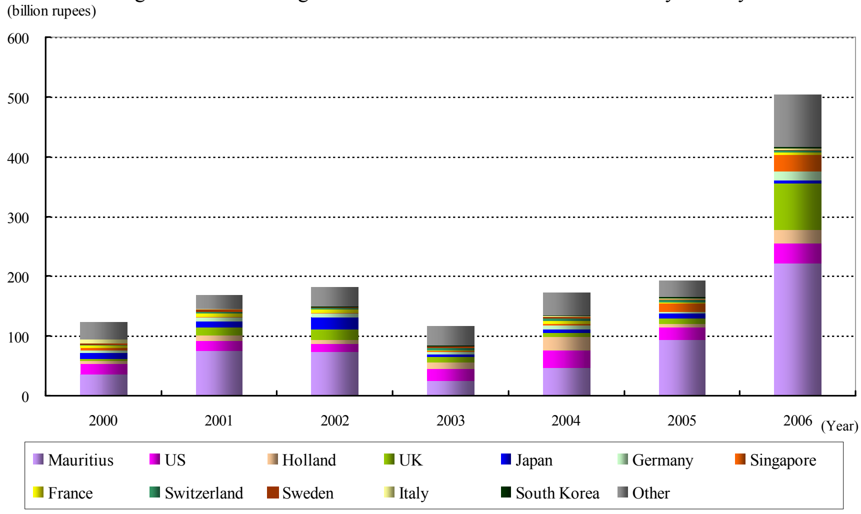


Note: ASEAN doesn't include Cambodia, Brunei, Myanmar, and Laos.
Source: *RIETI-TID2006* (RIETI).

(2) Foreign direct investment in India

The foreign direct investment in India shows that investment entering via Mauritius is growing at an overwhelming rate to capitalize on the benefits of tax treaties between India and Mauritius (Figure 1-4-34). Although the proportion of investment from the U.S., the U.K. and other European countries is large, it is estimated that the amount of investment from East Asian countries will expand, as seen in the rise in investment from Singapore in recent years.

Figure 1-4-34 Changes in direct inward investments to India by country



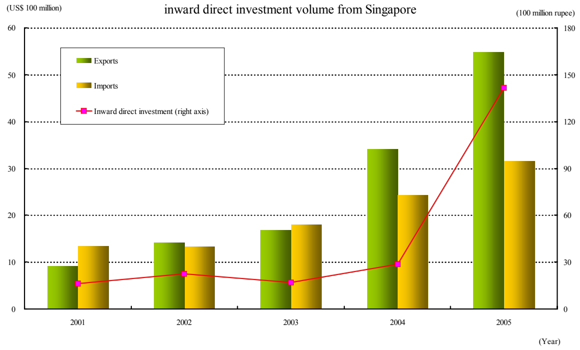
Source: CEIC Database.

(3) Efforts aimed at strengthening the relationship between East Asian countries and India

(Efforts by Singapore and Thailand)

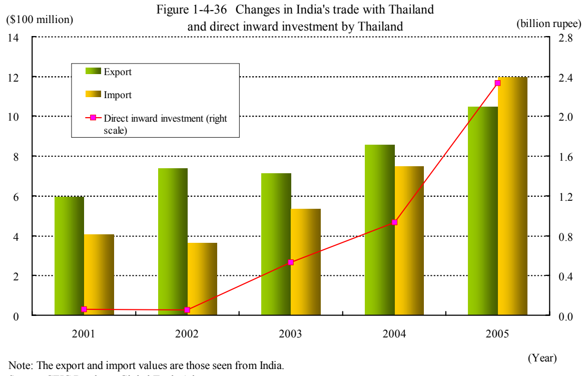
Singapore and Thailand are strengthening their relationship with India through FTAs and other agreements. They are also promoting their own growth by functioning as a contact outlet for fast-growing India. Specifically, Thailand implemented a measure to swiftly reduce tariffs in 2004[88] based on an FTA Framework Agreement concluded in 2003. In addition, Singapore concluded the Comprehensive Economic Cooperation Agreement (CECA) at the end of June 2005, thereby rapidly expanding trade and investment relations with India (Figure 1-4-35 and 1-4-36).

Figure 1-4-35 Changes in India's trade with Singapore and inward direct investment volume from Singapore



Note: Export and import figures are as viewed from the Indian side.
Source: CEIC Database, Global Trade Atlas.

Figure 1-4-36 Changes in Indian's trade with Thailand and direct inward investment by Thailand



Note: The export and import values are those seen from India.
Source: CEIC Database, Global Trade Atlas.

(Efforts by South Korea)

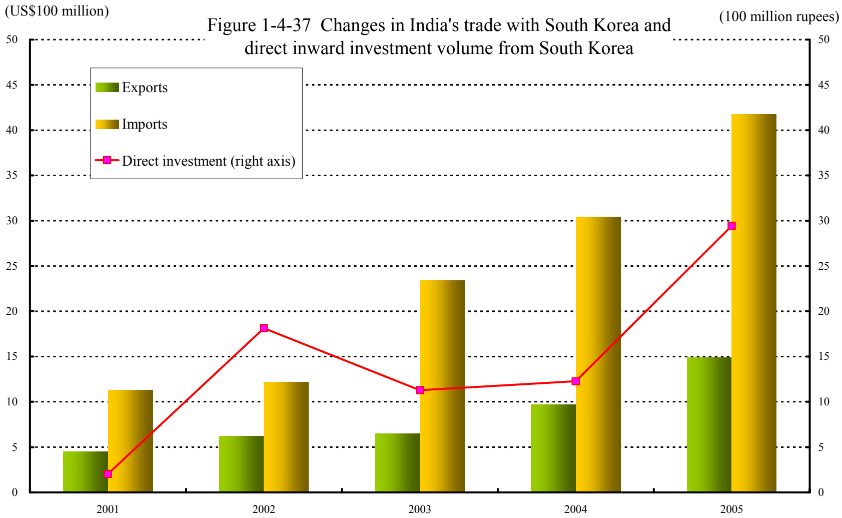
South Korea has been working to strengthen its relationship with India. As a result of a summit conference held on October 5, 2004, it adopted a joint South Korea-India declaration covering 30 items and agreed with India to begin work on concluding a comprehensive economic partnership

---

88 Applying to 82 product categories including television sets and air conditioners since September 1, 2004, this measure implemented a staged elimination of tariffs by September 1, 2006.

agreement. In addition, South Korean firms are moving to increase their presence in the Indian market: Samsung and the LG Group are expanding their market shares in the electrical appliance field, while Hyundai Motor Co., is doing the same in the automobile industry. This lively corporate activity has led to an expansion of trade and direct investment in recent years (Figure 1-4-37).

Figure 1-4-37 Changes in India's trade with South Korea and direct inward investment volume from South Korea



Notes: Export and import figures are as viewed from the Indian side.
Source: CEIC Database, Global Trade Atlas.

3. Building a mutually beneficial relationship between India and Japan

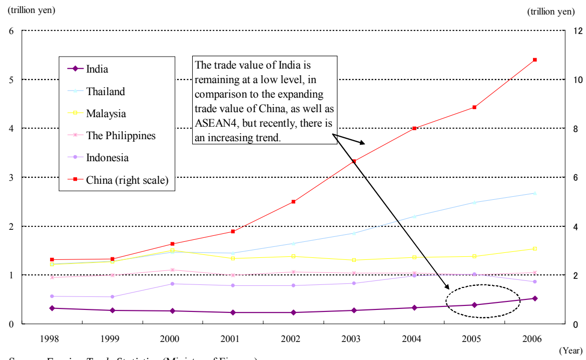
It has been pointed out that Japan has started late in expanding into India compared with other countries. As attention increasingly focuses on India, Japanese companies are strengthening their efforts aimed at expanding into India. At the same time, they want to build a mutually beneficial relationship with India through efforts including collaboration with existing bases in East Asia.

(1) Current status of relations between Japan and India

(Relationship between Japan and India in trade and investment)

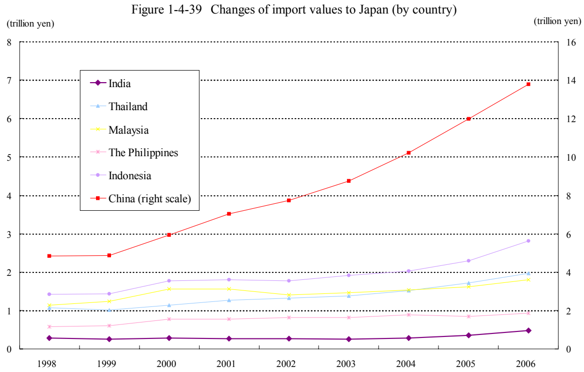
An analysis of Japan and India’s economic relationship in terms of imports and exports shows that the volume is low compared not only with China, which is dramatically expanding trade, but also with ASEAN4. In recent years, however, imports and exports have been moving upward (Figure 1-4-38 and 1-4-39).

Figure 1-4-38 Changes of export values from Japan (by country)



Source: *Foreign Trade Statistics* (Ministry of Finance).

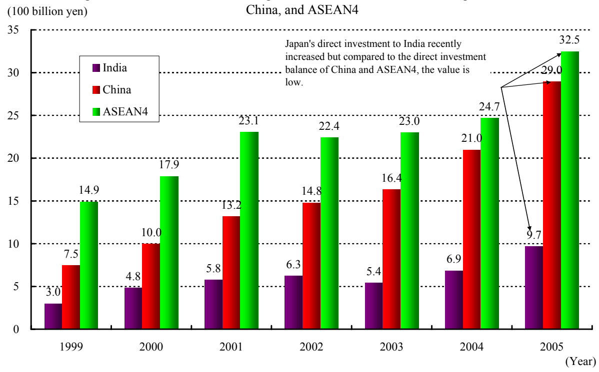
Figure 1-4-39 Changes of import values to Japan (by country)



Source: *Foreign Trade Statistics* (Ministry of Finance).

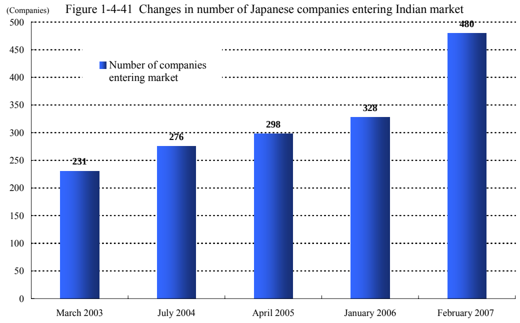
Moreover, Japan's balance of direct investment in India is still low compared with ASEAN4, which has long attracted abundant investment, and with China, which is rapidly expanding; however, direct investment has been steadily growing in recent years (Figure 1-4-40). As a result, the number of Japanese companies which have expanded into India was 480 as of February 2007 (Figure 1-4-41). In recent years, transportation equipment has accounted for a major proportion of direct investment. Taking into account the aforementioned growth of the automobile market in India, the expansion of Japanese companies into India centering on the automobile industry is probably growing robustly (Figure 1-4-42).

Figure 1-4-40 Fluctuations in foreign direct investment balance from Japan to India, China, and ASEAN4



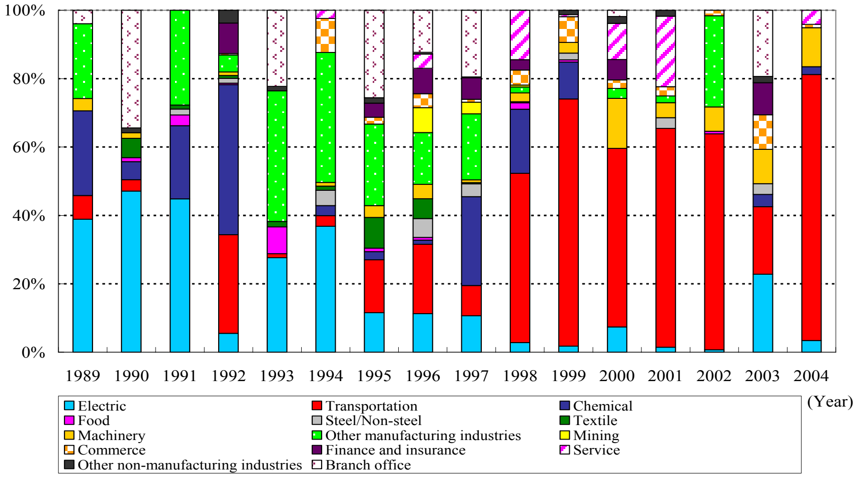
Source: Ministry of Finance, *International Investment Position* (Bank of Japan)

Figure 1-4-41 Changes in number of Japanese companies entering Indian market



Notes: Information provided by the three consulates in India (Mumbai, Chennai, Kolkata), Japanese Chambers of Trade and Commerce in each region, and other related organizations, and collated by the Embassy of Japan in India.
Source: Website of the Embassy of Japan in India.

Figure 1-4-42 Changes in ratio of direct investment from Japan to India by industry type



Source: *Inward and Outward Foreign Direct Investment* (Ministry of Finance, Japan)

(Business with India is increasingly attracting interest)

Although Japan's relationship with India in the area of trade and investment is not as close as it is with China and ASEAN4, with the steady growth of India's economy in recent years, the interest of Japanese companies in doing business with India is rapidly growing. According to a questionnaire survey by the Japan Bank for International Cooperation, India's ranking as a promising business location in the medium to long term has moved upward from 6th in FY2002 to 2nd in FY2006 (Table 1-4-43). This increasing interest in India is evident from the abovementioned uptrend in the volume of trade and investment and the growing number of companies expanding into India in recent years.

Table 1-4-43 Changes in promising markets and business locations in the mid-long term for Japanese companies

	FY2002	FY2003	FY2004	FY2005	FY2006
1st	China	China	China	China	China
2nd	Thailand	Thailand	Thailand	**India**	**India**
3rd	USA	USA	**India**	Thailand	Vietnam
4th	Indonesia	Vietnam	Vietnam	Vietnam	Thailand
5th	Vietnam	**India**	USA	USA	USA
6th	**India**	Indonesia	Russia	Russia	Russia
7th	Korea	Korea	Indonesia	Korea	Brazil
8th	Taiwan	Taiwan	Korea	Indonesia	Korea
9th	Malaysia	Malaysia	Taiwan	Brazil	Indonesia
10th	Brazil	Russia	Malaysia	Taiwan	Taiwan

Source: *FY2006 Survey on Foreign Direct Investment (18th survey)* (JBIC).

One example of efforts aimed at expanding into the Indian market is to supply products to India through bases in ASEAN countries such as Singapore and Thailand, which have close relationships with India, taking advantage of the abundant reserves of capital Japanese companies have accumulated. This strategy expands the business network of Japanese companies to East Asia by including India in the China-ASEAN region.

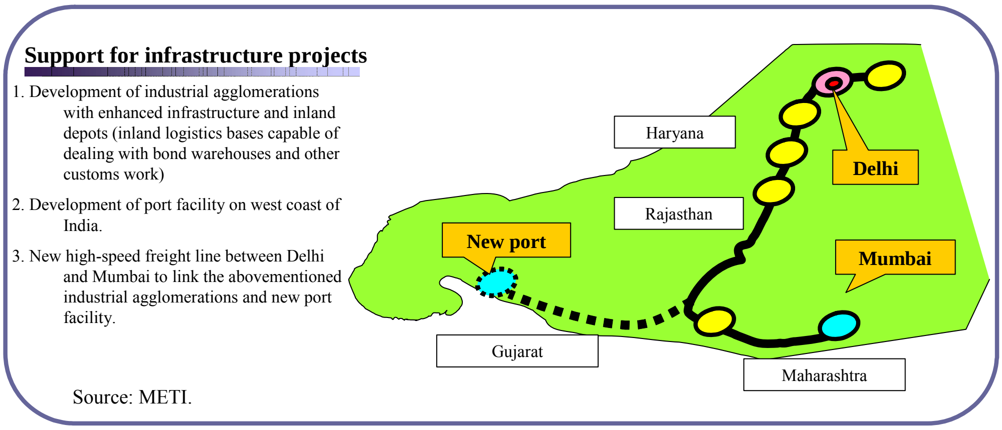
A specific example is that of Company A, an electrical equipment manufacturer, which suspended local production in July 2004 in connection with the sale of television sets in India, and then switched over to exporting from a production base in Thailand. As a result, Company A was able to reduce sales prices by taking advantage of low tariffs using an India-Thailand FTA and avoiding the high cost of domestic distribution in India. Company A also increased sales by selling models that were not produced in India. Such efforts by companies to strategically readjust their business networks should become increasingly important for Japanese companies.

(14) Deepening the relationship between Japan and India

(Efforts aimed at developing the environment for deepening the relationship between Japan and India)

In order to deepen the relationship between Japan and India and achieve growth in a mutually beneficial arrangement between the two countries, efforts have been launched to develop and improve India's business environment as part of the Special Economic Partnership Initiative (SEPI) signed in a Japan-India summit held in December 2006. For example, Japan and India will jointly prepare a basic plan to serve as a guideline for the development of a region between the two major economic zones of Delhi and Mumbai (Delhi-Mumbai Major Industrial Corridor). Preparation of the plan will include discussions regarding the necessary infrastructure that must be developed in the future in addition to the large-capacity freight railroad provided for in the plan, based on an understanding of the overall state of infrastructure in the region (Figure 1-4-44).

Figure 1-4-44 Delhi-Mumbai Industrial Corridor Project overview



In addition, the Japanese government began Japan-India EPA negotiations in January 2007 aimed at deepening the trade and investment relationship between Japan and India, and also called for the initiation of research by East Asian private sector experts, which will take into its purview the aforementioned collaboration by Japanese companies with the bases of China and ASEAN.

The above efforts are linked to the further expansion of Japanese companies into India and participation in India through growing international production and distribution networks in East Asia, and as a result they are expected to contribute to India's economic growth.

(Strengthening the relationship based on the attractiveness of India)

The Indian economy as described above has achieved high growth in recent years through liberalization and by strengthening ties with the world economy and with the economies of the East Asian region. In comparison with China, which has also achieved high growth, the timing of India's shift onto the path of economic liberalization differed, and as a result, India's economic indicators are not on par with China's (Table 1-4-45). In contrast to the Chinese economy, which centers on manufacturing, investment and external demand, India's economy is driven by the service industry and internal demand, and has the following characteristics: (a) a potentially huge market that has just started to achieve high growth; (b) development of the IT, pharmaceutical and biotechnology technologies on the strength of a large, highly educated workforce; (c) a stable business environment in which certain intellectual property rights are assured under a comparatively developed legal system, although it is known to be complicated and to suffer from administrative problems; and (d) India has close relationships with Europe owing to historical and geographical factors.

In addition, in order that the Japanese economy can achieve sustainable growth, a vigorous Indian economy, which has achieved high growth on the basis of the above characteristics, is essential, quite same as is growth of the economies of China, ASEAN and NIEs. Ties with these economies must be strengthened, which includes the use of the expanding business bases elsewhere in East Asia.

Table 1-4-45 Comparing principal economic indicators of China and India

	Item	Unit	Period covered	India	China	India/China (%)
Stage of development	As of 1979, real GDP per capita was nearly the same level, but with the rapid economic growth of China, in 2005 the gap between China's $1445 and India's $586 expanded to 3 times as much. India also had a low literacy rate level of 61%, which needs to be improved in order to resolve poverty issues essential for economic growth.					
	Real GDP per capita	Dollar	2005	586	1,445	40.6
	Human development index	World rank	2004	126	81	-
	Literacy rate	%	2004	61.0	90.9	67.1
Market Size	China's nominal GDP in 2005 was $2.2 trillion, reaching fourth in the world after US, Japan, and Germany, but India was 1/17 of the US, and only 1/6 of Japan. However looking from a purchasing power base, India is reaching a scale following the US, China, and Japan. In addition, the population is first or second in the world, and the market's attraction for economic growth is growing.					
	Nominal GDP	$100 million	2005	7,854	22,288	35.2
	Real GDP	$100 million	2005	6,419	18,847	34.1
	Population	million people	2005	11.3	13.1	86.3
Growth potential	From 1979 to 2005 China has achieved an average high growth rate of 9.7% per year, which highly exceeds the 6% for India after it oriented towards liberalizing its economy in 1999. But after 2003, India has recorded a growth rate of 8.4%, attaining a high growth.					
	Real GDP growth rate	%	1979-2005	5.5	9.7	57.1
		%	1991-2005	6.0	9.7	61.2
		%	2003-2005	8.4	10.0	84.5
Industrial structure	China has decreased its portions of primary industries, while increasing secondary industry portions. On the other hand, secondary industries in India has remained at 20%, tertiary industries exceeding 50%. Differing from other developing countries, by drawing tertiary industries, India has achieved growth.					
	GDP share compared to primary industry	%	2004	18.8	13.1	-
	GDP share compared to secondary industry	%	2004	27.5	46.2	-
	GDP share compared to tertiary industry	%	2004	53.7	40.7	-
Structure of demand	After India's economic reform, exports and gross fixed capital formation against GDP has increased, but as of 2004 household consumption accounts for 61% achieving an economic growth centering domestic demand. This is a contrast to the high growth achieved in China centering around investment and exports.					
	gross fixed capital formation compared to nominal GDP対	%	2004	25.5	38.5	-
	Household consumption compared to nominal GDP	%	2004	61.0	41.7	-
	Exports compared to nominal GDP	%	2004	18.0	37.6	-
to international relations	India's trade value has firmly increased due to progress towards liberalization, but compared to China it is still at a low level. In addition, direct internal investment from overseas has expanded in China, which has achieved economic growth, but the direct internal investment value of India is still low. For India to achieve a high economic growth in the future, new technology, and management methods must be provided from actively inviting foreign investment.					
	Total trade	$100 million	2005	2,080	15,853	13.1
	Total exports	$100 million	2005	1,108	9,807	11.3
	Total imports	$100 million	2005	972	6,046	16.1
	Direct inward investment from the world (flow)	$100 million	2005	66	724	9.1
	Direct inward investment from the world (stock)	$100 million	2005	452	3,178	14.2
	Foreign reserves	$100 million	2006	1,701	10,663	16.0
	Exchange	-	2006	Float system	Controlled float	-
to relations with Japan	The trade and investment relations of Japan and India, in comparison to Japan and China remains at a low level but, due to India's high growth, attention from Japanese corporations is quickly increasing. Recently, there are increasing trend towards trade and investment values.					
	To Japanese exports	$100 million	2005	32	1,084	2.9
	To Japanese imports	$100 million	2005	35	800	4.4
	Direct inward investment from Japan (flow)	$100 million	2005	2.7	83.6	3.2
	Direct inward investment from Japan (Stock)	$100 million	2005	17.9	244.1	7.3
Investment environment	There are various challenges mentioned for China, but many business environment challenges such as infrastructure aspects and complicated and legal structures are mentioned for India, expected to be improved. As mentioned above, in order for a persistent growth to take place, upon actively inviting foreign investment, improving such business environments becomes important.					
	Business environment evaluation	World rank	2006	134	93	-

Source: *WDI* (World Bank), *Doing Business*, *World Investment Report2006* (UNCTAD), *World Population Prospect*, *DOT* (IMF), *IFS*, Website of JETRO Trade, Investment, Balance of Payments Statistics.