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The Japan-India Economic Partnership

A Politically Driven Process

Céline PAJON

Isabelle SAINT-MÉZARD

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Ifri

27 rue de la Procession 75740 Paris Cedex 15 – FRANCE

Tel.: +33 (0)1 40 61 60 00 – Fax: +33 (0)1 40 61 60 60

Email: accueil@ifri.org

Website: Ifri.org

Authors

Céline Pajon has been a researcher and Japan specialist at Ifri Center for Asian Studies since 2008, where she analyses the evolution of Japanese foreign and defence policy, as well as following the major debates of Japanese political life. Her research also covers the international relations and geostrategy of the Asia Pacific region. She is an Associate Researcher at the Canon Institute for Global Studies (CIGS) in Tokyo. In 2016, she was a visiting researcher at the Japan Institute of International Affairs (JIIA).

Her latest publications include [with Rémy Hémez] "Japan-South Korea Security Cooperation: Sisyphus Getting Muscles?", *The Korean Journal of Defense Analysis*, Spring 2018; "Japan-Russia: The Limits of a Strategic Rapprochement", *Russie.NEI Visions*, Ifri, October 2017; "Japan's Security Policy in Africa: The Dawn of a Strategic Approach?", *Asie.Visions*, No. 93, Ifri, May 2017; and "Japan's Coast Guard and Maritime Self-Defense Force in the East China Sea: Can a Black-and-White System Adapt to a Gray-Zone Reality ?", *Asia Policy*, No. 23, January 2017, pp. 111-130.

Isabelle Saint-Mézard conducts research on India's external relations, defense policies and security issues. She also takes an interest in the geopolitics of the Indian Ocean and the larger Indo-Pacific region. She is assistant professor at the French Institute of Geopolitics, the University of Paris VIII, as well as associate research fellow at Ifri Center for Asian Studies.

Her latest publications include: "India's Energy Security: An Assessment of India's International Quest for Energy Sources"; S. Ganguly, M. Pardesi, N. Blarel, *The Oxford Handbook of India's National Security*, OUP, 2018; "The India-Japan Strategic Partnership: Implications for Regional Security", *Asia Trends*, Nov. 2017; "India's Act East Policy: Strategic Implications for the Indian Ocean", *Journal of the Indian Ocean Region*, No. 2, December 2016.

Executive Summary

In the last decade, the strengthening of the India-Japan strategic partnership has been primarily driven by geopolitical considerations, in an era of competing regional visions and influence. While bilateral relations have shown progress in terms of political values and interests, strategic convergence and military cooperation, their economic dimension has seemed to lag behind. While India has been one of the largest recipients of Japanese official development assistance (ODA) loans since 2003, it made up only 2.2% of Japan's total overseas direct investment (ODI) flows in 2016. Moreover, the volume of bilateral trade has remained surprisingly modest.

In other words, India and Japan still need to boost business links to give more substance to their bilateral partnership as well as support India's robust and long-term development and economic growth, as Japan needs a strong democratic partner in Asia. The objective is highly political. Japan and India are eager to develop their partnership as a balancing act vis-à-vis China. If they are to fulfill their ambitious geopolitical visions, they also need to promote cooperation in third countries.

Because of the strategic significance of the rapprochement, state actors (political leaders, ministries, governmental agencies, public banks) have been predominant in driving the India-Japan relationship, including in its economic dimension. Thus, this policy paper documents and analyzes the leverage that Japanese and Indian state leaders have exercised in boosting the bilateral economic partnership. It shows, in particular, that Japan's mobilization of its state actors and public funding to support India's economic development, to encourage Japanese private investments and to give concrete shape to its geostrategic vision for the Indo-Pacific region has been exceptional. This can be explained by the strategic importance of India as a future political and economic global power, the characteristics of India's political structure and business environment, which requires a high level of political commitment, and the unique leadership of the Japanese and Indian strongmen since 2014: Shinzo Abe and Narendra Modi. In many ways, the combination of the Modi and Abe leaderships since 2014 has provided the best political context ever to impart fresh momentum to bilateral economic relations.

The voluntarism displayed by Abe and Modi has paid off to some extent. India and Japan have focused on infrastructure development as a strategic area of cooperation, and Japanese ODA loans have played a pivotal role in the process. State actors are playing an important role in launching initiatives, building up industrial corridors (Delhi-Mumbai Industrial Corridor and the Chennai-Bengaluru Industrial Corridor) and industrial townships. These are designed to remove some of the traditional roadblocks for Japanese ODI and support India's economic growth. On the Indian side, a number of dedicated measures to grant preferential treatment and encourage Japanese public and private investments have been implemented, both at the central and state level.

Japanese ODI in India has increased (albeit at an irregular pace) and diversified from a sectoral and geographical point of view. While Japanese companies have strong interest in the Indian market, it takes a long time (five to ten years) for them to actually implement an investment project. Administrative hurdles and local business conditions are still putting brakes on Japanese projects, and the "Make in India" policy has introduced new constraints. Despite good prospects for profitability, India stands as one of the toughest markets in Asia for Japan.

The agenda of Japan and India on promoting infrastructure building to enhance connectivity, both within India and within the greater Indo-Pacific region, has been converging. It supports the strategic goal to help India to reintegrate East Asia while counterbalancing growing Chinese influence in the region – especially through its infrastructure-funding Belt and Road Initiative (BRI) – through three pillars: growing synergies between Indian and Japanese grand visions for the region; promotion of Japanese investments in strategically sensitive Indian states and territories, and efforts to encourage joint investments in third countries, especially in Africa. The Japanese infrastructure funding in India's Northeast is a test case for Tokyo's political commitment, as the security situation and China's interests in the region make it a complex area for investments. The Andaman and Nicobar Islands are even more sensitive and, despite much speculation, Japanese engagement is likely to remain low. Interestingly, the Asia Africa Growth Corridor project results from the convergence of a bottom-up and top-down process, as the Japanese business interest in using India as a springboard to Africa met the need to provide a geopolitical alternative to China's BRI by improving interconnectedness between Asia and Africa.

The bilateral rapprochement has thus been accelerated under Abe and Modi, but one should also underline that previous governments, both in Japan and in India, consistently supported the building of a strategic partnership. Therefore, for the time being, Japan's ODA and ODI disbursement to India should be set on a sustainable upward trend.

Résumé

Au cours de la dernière décennie, le renforcement du partenariat stratégique Inde-Japon a été principalement dicté par des considérations géopolitiques, dans un contexte de lutte d'influence et de visions régionales concurrentes. Si les relations bilatérales ont progressé en termes politique, stratégique et de coopération militaire, leur dimension économique semble avoir pris du retard. Bien que l'Inde ait été l'un des principaux bénéficiaires des prêts japonais au titre de l'Aide publique au développement (APD) depuis 2003, elle ne représentait que 2,2 % des flux d'investissements directs étrangers (IDE) japonais en 2016. En outre, le volume des échanges bilatéraux est resté étonnamment modeste.

En d'autres termes, l'Inde et le Japon doivent encore renforcer leurs liens économiques pour donner plus de substance à leur partenariat bilatéral et pour soutenir une croissance et un développement indiens solides et durables, le Japon ayant besoin, en l'occurrence, d'un partenaire démocratique fort en Asie. L'objectif est hautement politique. Le Japon et l'Inde sont désireux de développer leur partenariat comme contrepoids face à la Chine. Afin de réaliser leurs ambitieuses visions géopolitiques, ils doivent également promouvoir la coopération dans les pays tiers.

En raison de la portée stratégique du rapprochement, les acteurs étatiques (dirigeants politiques, ministères, organismes gouvernementaux, banques publiques) ont joué un rôle prépondérant dans la conduite des relations entre l'Inde et le Japon, y compris dans leurs dimensions économiques. Ainsi, cette étude met en lumière et analyse l'effet de levier que les dirigeants des États japonais et indiens ont exercé pour stimuler le partenariat économique bilatéral. Il montre, en particulier, que la mobilisation par le Japon de ses acteurs étatiques et de ses financements publics pour soutenir le développement économique de l'Inde, encourager les investissements privés japonais et concrétiser sa vision géostratégique pour la région indo-pacifique a été exceptionnelle. Cela peut s'expliquer par l'importance stratégique de l'Inde en tant que future puissance politique et économique de rang mondial, mais aussi par les caractéristiques de sa structure politique et de son environnement des affaires, qui exigent un engagement politique élevé. À cela s'ajoute, depuis 2014, le leadership propre aux deux hommes forts que sont Shinzo Abe et Narendra Modi. À bien des égards, la combinaison Modi-Abe depuis 2014 a fourni le

meilleur contexte politique possible pour donner un nouvel élan aux relations économiques bilatérales.

Le volontarisme affiché par Abe et Modi a porté ses fruits à des degrés divers. L'Inde et le Japon ont ciblé le développement des infrastructures comme enjeu stratégique de coopération et les prêts japonais ont joué un rôle central en la matière. Les acteurs étatiques ont aussi un rôle important dans le lancement et le développement d'initiatives, telles les couloirs (couloirs industriels Delhi-Mumbai et Chennai-Bengaluru) et cités industrielles, qui visent à éliminer certains des obstacles traditionnels qui entravent les investissements japonais et à soutenir la croissance économique de l'Inde. Du côté indien, des mesures spécifiques de traitement préférentiel et d'encouragement des investissements publics et privés du Japon ont été mises en œuvre, tant au niveau central qu'au niveau des États. Les IDE japonais en Inde ont ainsi augmenté (à un rythme irrégulier toutefois) et se sont diversifiés d'un point de vue sectoriel et géographique. Mais, alors que les entreprises japonaises s'intéressent fortement au marché indien, il leur faut beaucoup de temps (cinq à dix ans) pour mettre en œuvre un projet d'investissement. Les obstacles administratifs et l'environnement local des affaires freinent encore les projets japonais. En outre, la politique du « Make in India » a introduit de nouvelles contraintes. Malgré de bonnes perspectives de rentabilité, l'Inde reste, pour le Japon, l'un des marchés les plus difficiles d'Asie.

Les objectifs du Japon et de l'Inde en matière de promotion des infrastructures et d'amélioration de la connectivité, tant en Inde même que dans la grande région indo-pacifique, convergent. Le but, sur le plan stratégique, est d'aider l'Inde à réintégrer l'Asie orientale, tout en contrebalançant l'influence croissante de la Chine dans la région, à travers trois piliers : accroitre la synergie entre les ambitions régionales indienne et japonaise ; promouvoir les investissements japonais dans les États et territoires indiens stratégiquement sensibles ; et encourager des investissements conjoints dans des pays tiers, en particulier en Afrique. À ce titre, le financement des infrastructures japonaises dans le nord-est de l'Inde est un test pour l'engagement politique de Tokyo, car la situation sécuritaire et les intérêts chinois dans la région compliquent singulièrement les perspectives d'investissements. Les îles Andaman et Nicobar sont encore plus sensibles et, malgré de nombreuses spéculations, l'implication du Japon devrait y rester faible. Quant au projet « Asia Africa Growth Corridor » (AAGC), il est animé par des logiques à la fois *bottom-up* et *top-down*, l'intérêt des entreprises japonaises à utiliser l'Inde comme un tremplin vers l'Afrique se doublant d'une volonté politique de proposer une alternative géopolitique à l'initiative chinoise des nouvelles routes de la soie, cela en améliorant la connectivité entre l'Asie et l'Afrique.

Le rapprochement bilatéral s'est donc accéléré sous Abe et Modi. Mais il convient aussi de rappeler que les gouvernements précédents, au Japon et en Inde, ont toujours soutenu la construction d'un partenariat stratégique. Par conséquent, pour l'instant, les versements d'APD et d'IDE du Japon à l'Inde devraient s'inscrire dans une tendance à la hausse durable.

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Introduction

From 2008 and the lyrical speech of Prime Minister Shinzo Abe (under his first mandate) referring to the "confluence of the two seas", to 2017 and the joint statement of Abe and Prime Minister Narendra Modi emphasizing a "Free, Open and Prosperous Indo-Pacific", the strengthening of the India-Japan strategic partnership has been primarily driven by geopolitical considerations, in an era of competing regional visions and influence.[1]

Accordingly, political and military cooperation has made important progress. Tokyo and New Delhi elevated their relations to the level of a "Special Strategic and Global Partnership" in 2014. Two years later, Japan's conclusion of a civil nuclear cooperation agreement with India – a country not party to the Non-Proliferation Treaty – was an exceptional political move for Tokyo that highlighted the strategic importance of the partnership. In the defense domain, interactions intensified: a "2+2 Dialogue" at ministerial level between the foreign and defense ministries was set up in 2010, and regular maritime exercises between the coast guards since 2000 were supplemented in 2012 by naval maneuvers. In 2015, Japan became a permanent member of the Malabar exercises held annually between the Indian and US navies. The two countries also established a legal framework to allow defense technology cooperation, with the pending sales of 12 Shinmaywa US-2i amphibious search-and-rescue/maritime surveillance aircraft to the Indian Navy.

While bilateral relations have shown progress in terms of political values and interests, strategic convergence and military cooperation, their economic dimension has seemed to lag behind. The brightest part has been the high level of Japanese overseas development assistance (ODA) disbursements, with India emerging as one of the largest recipients of Japanese ODA loans since 2003. But Japan's ODI flows, while globally on the rise, have displayed fairly irregular trends and, as of 2016, India made up only 2.2% of Japan's total ODI flows, more or less the same as Thailand, while China accounted for 5%.[2] Moreover, despite the conclusion of the Comprehensive Economic Partnership Agreement (CEPA) in 2011, the volume of bilateral trade has remained surprisingly modest, accounting for

1. P. Jain, "Modi-Abe Love Affair Drives India and Japan Closer", *East Asia Forum,* 21 September 2017.
2. JETRO, *Global Trade and Investment Report 2017*, available at: www.jetro.go.jp.

only 1% of Japan's and hardly 2.5% of India's total trade.[3] In other words, India and Japan still need to boost business links to give more substance to their bilateral partnership. They also need to promote cooperation in third countries if they are to fulfill their ambitious geopolitical visions.

Because of the strategic significance of the rapprochement, state actors (political leaders, ministries, governmental agencies, public banks) have been predominant in driving the India-Japan relationship, including in its economic dimension. Thus, this policy paper aims to document and analyze the leverage that Japanese and Indian state leaders have exercised in boosting the bilateral economic partnership. It shows, in particular, that Japan's mobilization of its state actors and public funding to support India's economic development, to encourage Japanese private investments and to give concrete shape to its geostrategic vision for the Indo-Pacific region has been exceptional, even in comparison with other cases, including some Southeast Asian countries.[4] This can be explained by the strategic importance of India as a future political and economic global power, the characteristics of India's political structure and business environment, which requires a high level of political commitment, and by the unique leadership of the Japanese and Indian strongmen since 2014: Shinzo Abe and Narendra Modi. Indeed, Modi came to power in May 2014 with a large majority in the lower house, while Shinzo Abe's term was extended by four years after the calling of an early election in December 2014. Moreover, Abe and Modi have been determined to boost economic links between their countries. In many ways, the combination of the Modi and Abe leaderships since 2014 has provided the best political context ever to impart fresh momentum to bilateral economic relations.

The first part of this paper provides an overview of the political and strategic dimensions of the Indo-Japanese economic partnership, highlighting the role of state actors. The second part looks at the recent positive evolution of bilateral economic flows, in terms of investment, while taking stock of the remaining obstacles to their rapid growth. Finally, the third part highlights Japan and India's joint efforts to develop a common agenda under their respective Free and Open Indo-Pacific Strategy and Act East policy.

3. Ficci, *India-Japan – Roadmap Towards Realising Vision 2015: A Knowledge Report*, January 2018.
4. See F. Nicolas, "Catching up or Staying Ahead: Japanese Investment in the Mekong Region and the China Factor", *Asie.Visions*, No. 99, Ifri, May 2018, available at: www.ifri.org.

The Indo-Japanese economic partnership: the leading role of political and institutional actors

Economic diplomacy can be said to have two objectives: the "business end", which seeks public-private partnership to advance commercial interests, and the "power-play end", which seeks to promote political objectives and ensure a favorable international environment.[5] In the first case, the profitability calculation follows a purely economic logic; in the second, political logic and interest lead the decision whether to invest or commit, or not. Japan's economic diplomacy in India meets the two ends: while it seeks to open a way for Japanese goods and technologies to enter the growing Indian market, Japanese public investments also seek to strengthen strategic links with India to balance China's regional influence.

Targeting ambitious objectives: the India-Japan Investment Promotion Partnership

Prime Ministers Abe and Modi have shared a personal connection for more than a decade. Their first official meeting goes back to 2007 when Abe was Prime Minister (for a brief stint) and Modi was Chief Minister of Gujarat. As Prime Ministers (since 2012 for Abe and 2014 for Modi), they have both displayed strong nationalist leanings, while promising much to their respective electorates on the economic front. They also quickly engaged with each other and expressed their ambition to boost the Indo-Japanese relationship. As proof of their determination, they launched the India-Japan Investment Promotion Partnership (IJIP) in September 2014. Under this partnership, Japan committed USD 33.5 billion of private and public investment as well as overseas development assistance (ODA) by 2019. IJIP also set the objective of doubling the number of Japanese companies operating in India. While these targets may be aspirational, they give a

5. See M. Okano-Heijmans, *Economic Diplomacy: Japan and the Balance of National Interests*, Leyde, Martinus Nijhoff Publishers, 2013, pp. 17-51.

strong signal of the special importance of India in Japan's overseas business strategy. The objective is highly political: Japan and India are eager to develop their partnership as a balancing act vis-à-vis China. Deepening economic ties serve to give much-needed substance to the bilateral partnership as well as to support India's robust, long-term development and economic growth, as Japan needs a strong democratic partner in Asia.

To implement this objective, both administrations have designed special measures and established useful public institutions. On the Indian side, the Modi government has created a Japan Plus Team, in order to facilitate Japanese investment projects and support Japanese companies already operating in India. The entity, established in early October 2014 (just a month after the IJIP was announced), has been based in the Department of Industrial Policy & Promotion (DIPP) of the Ministry of Commerce. It includes representatives from the Indian government as well as an official from Japan's Ministry of Economy, Trade and Industry (METI). Japan was the first country to have a representative working directly in an Indian Union ministry (a "Korea Plus team" was launched in 2016 in the same department).[6] Moreover, Invest India, an investment promotion agency in which the government has 49% equity, has set up a special desk for Japan. Along with Russia, Japan is the only country to have such a dedicated desk in this body.

On the Japanese side, the promotion of investment and infrastructure export has been facilitated by institutionalized partnerships between government agencies and business associations for activities in India.[7] The main institutions that have played a pivotal role in implementing the vision of Prime Ministers Abe and Modi have been the Ministry of Foreign Affairs (MOFA), the Japan International Cooperation Agency (JICA), the Ministry of Economy, Trade and Industry (METI), Japan Bank for International Cooperation (JBIC) and the Japan External Trade Organization (JETRO).

MOFA is responsible for development assistance policy, implemented by JICA, and mobilizes its diplomatic network accordingly. JICA, which manages Japan's bilateral aid, has seen the scope of its operation expanding since the early 2000s. In 2015, half of the Japanese ODA budget went to Asia, with India (USD 1.54 billion) and Vietnam (USD 1.42 billion) as the two top recipients.[8]

6. Dipp, *Japan Plus*, available at: http://dipp.nic.in.

7. H. Yoshimatsu, "Japan's Export of Infrastructure Systems: Pursuing Twin Goals Through Developmental Means", *The Pacific Review*, Vol. 30, No. 4, 2017, p. 7.

8. *White Paper on Development Cooperation 2016*, 6 September 2017, available at: www.mofa.go.jp.

In the postwar period, Japan has extensively used economic diplomacy, and especially its ODA, as a political means to strengthen its regional influence.[9] While the ODA budget is experiencing a structural decline, ODA is today used in a more "strategic" way, with greater focus on Japan's national security interests. Indeed, the 2015 new Development Cooperation Charter clearly states that ODA is a tool for Japan's international proactive contribution to peace (the keyword of Japan's first-ever National Security Strategy, published in 2013). It describes ODA as a catalyst for mobilizing a wide range of resources – both private and public – and underscores the political dimension of ODA disbursement. With respect to South Asia, the charter states that Japan's cooperation priority is "on improving the trade and investment climate, especially by developing infrastructure and strengthening connectivity in the Asian region".[10] In India's case, the provision of ODA is also meant to demonstrate Japan's interest in building up the relationship to raise its profile in Asia (see later part of this report).[11]

METI is at the forefront of advocating Japan's economic interests and is designing the investment and export support policy. It has also been much involved in developing ties with India. Between August 2014 and August 2018, METI senior officials – at minister or state minister levels – visited India 13 times.[12] As for JETRO, which implements METI's directions, it has strengthened its network in India, with the opening of a fifth representative office in Ahmedabad, Gujarat, in November 2017. The decision to create this new office – in addition to those in New Delhi, Mumbai, Bengaluru and Chennai – reflects India's high level of priority for JETRO. By way of comparison, only China and the US have a larger number of offices, with the former hosting seven offices and the latter six.

Another powerful institutional tool is JBIC, a government export credit agency that promotes the acquisition of significant resources overseas (energy, raw materials), works to strengthen the international competitiveness of Japanese industry (especially in infrastructure markets), and provides complementary financing to support the activities of Japanese firms abroad (export and import loans), as well as guarantees. Its role has been growing as Japan has implemented a "whole of government" approach and aimed to coordinate all resources available – public and private – to support Japanese economic cooperation.

9. D. Arase, *Buying Power: The Political Economy of Japan's Foreign Aid*, Lynne Rienner Publishers Inc., 1995.

10. *Development Cooperation Charter*, 2015, p. 8.

11. P. Jain, "Twin Peaks: Japan's Economic Aid to India in the 1950s and 2010s", *JICA-RI Working Paper*, No. 139, JICA Research Institute, February 2017.

12. *METI's Officials Visits/Meetings*, available at: www.meti.go.jp (accessed 20 August 2018).

All these actors have been engaged in India to support mega-projects such as industrial corridors and townships. These projects aim at removing some of the traditional roadblocks for Japanese ODI and supporting India's economic growth.

Industrial corridors: transforming India's infrastructure landscape

Japanese firms have for long cited India's deficient infrastructure as a major obstacle to expanding their business. As a result, India and Japan have focused on infrastructure development as a strategic area of cooperation, and Japanese ODA loans have played a pivotal role in the process. Japan has been especially proactive in the transport sector. It accounted for 62% of its ODA loans to India between 2007 and 2017.[13] Moreover, through its ODA loans, Japan has been involved in two mega infrastructure projects: the Delhi-Mumbai Industrial Corridor (DMIC) and the Chennai-Bengaluru Industrial Corridor (CBIC). In both cases, the objective is to create large industrial belts connecting industrial parks and ports across several Indian states.

While both DMIC and CBIC were initiated before their advent to power, Prime Ministers Modi and Abe have made them a priority. Indeed, Narendra Modi has dedicated his tenure to the acceleration of India's economic growth and development, with a focus on infrastructure development. As for Shinzo Abe, since coming to power in late 2012, he has made the export of infrastructure systems a priority. More precisely, under Abe, infrastructure export has had the dual purpose of fueling economic growth by supporting the domestic industrial base, while also promoting Japan's greater contribution to international prosperity and stability, as the Free and Open Indo-Pacific Strategy clearly demonstrates.[14] The strategic importance of infrastructure export led to the establishment in March 2013 of a Ministerial Meeting on Strategy relating to infrastructure export and economic cooperation, in the cabinet office to coordinate the whole-of-government approach. Beyond Japan's own expectations on expanding its presence and market share in India, the political will to forge and institutionalize a strategic and global partnership has therefore been instrumental in enabling such huge projects as DMIC to take place.[15]

13. JICA, *Operations and Activities in India*, January 2018.

14. See "Priority policy for Development Cooperation, FY 2017", International Cooperation Bureau, MOFA, April 2017, available at: www.mofa.go.jp.

15. M. Kojima, "The Evolution of Japan-India Economic Relations", in: S. Goto (ed.), *The Rebalance within Asia: The Evolution of Japan-India Relations*, Wilson Center, October 2014, p. 14.

Sometimes described as one of the largest infrastructure projects in the world, DMIC stretches over nearly 1,500 km across six states and aims to build 24 industrial cities with world-class infrastructure. By the time of its completion in 2040, it is estimated that the total cost will reach USD 100 billion. DMIC also stands as the flagship project in Indo-Japan cooperation. Japan has been involved in it right from the conceptual stage in the 2000s, providing technical support.[16] Following the launch of the project in 2007, it has extended ODA loans for the construction of the logistical backbone of DMIC – i.e. a freight rail line linking Mumbai to Delhi – as well as the procurement of 200 electric locomotives. It has also been financially involved, with JBIC currently holding a 26% stake in the Delhi-Mumbai Industrial Corridor Development Corporation Limited, the corporate entity responsible for implementing the project (the Indian government owns 49% through DIPP and the rest is owned by state-run institutions).

Moreover, in 2015, Japan won the tender for India's first high-speed rail project, between Ahmedabad and Mumbai. The project, scheduled to be completed by 2022, is essentially being financed by Japan. Tokyo pledged a loan of USD 12 billion dollars (out of a total cost of USD 15 billion) at very favorable terms (1% interest rate, with a 15-year lock-in period, repayable in 50-60 years). India's choice of the Shinkansen can be seen as one of the most successful outcomes of the Abe government's infrastructure export policy.[17] As for the Chennai-Bengaluru Industrial Corridor (CBIC), it is still in its early stages. It was launched in December 2011, with a view to developing a belt stretching 560 km across Tamil Nadu, Andhra Pradesh and Karnataka.

Industrial townships: attracting Japanese SMEs

A large majority of the Japanese companies based in India are big firms. In contrast to what happened in Northeast and Southeast Asia, big Japanese firms in India have not come with their network of Japanese ancillaries; rather, they have worked with Indian suppliers and subcontractors. While this strategy has helped big Japanese firms to cut their production costs, it has resulted in very few Japanese SMEs being able to enter the Indian market. Indeed, without the support of a large "mother" company, most

16. Interestingly, when the project was officially launched, in 2007, Shinzo Abe was Prime Minister, albeit for a short stint.
17. H. Yoshimatsu, *op. cit.* [7].

SMEs deem the Indian market too challenging for their limited resources and choose to stay away from it.

The difficulty for Japanese SMEs in entering the Indian market has been identified as a missed opportunity. Both the Indian and Japanese governments have made it a priority to encourage mid-sized companies to start a business in India. To this end, in April 2015, they decided to develop "Japan Industrial Townships" (JITs) in India, through the joint efforts of METI and JETRO on the Japanese side, and DIPP and its "Japan Plus" team on the Indian, along with the interested Indian state governments.[18] The township projects have raised much interest among the state governments, which have competed with one another to attract them.[19]

Twelve candidate sites for JITs have been shortlisted and mutually approved by the Indian and Japanese governments. Most are located around the regions of the two industrial corridors developed with Japan's support, the Delhi Mumbai and Chennai Bengaluru corridors. While their level of advancement varies widely – some, such as Neemrana in Rajasthan, are well established while other are just a concept – they all stick to a particular model whereby they will provide investing firms with high-level infrastructure, special tax incentives and plug-and-play rental factories. Moreover, as they are meant to facilitate investment from Japan to India, they are exclusively dedicated to Japanese companies.

Traditionally, Japan's industrial parks overseas have been created and run by the private sector.[20] In India however, Japanese and Indian public agencies have had a leading role, as only three out of 12 park projects have been private-led. This can be explained by the necessity to work closely with the Indian state governments, in order to secure the land tenure and defend the firms' interests in case of friction with local authorities or communities.[21] What is even more unusual is that JETRO has initiated four industrial parks (Neemrana and Ghilot in Rajasthan, Supa in Maharashtra and Mandal in Gujarat).[22] In these instances, state governments have provided industrial land while JETRO has marketed the park project to Japanese business. JETRO has also committed to form Japanese industrial

18. *Action Agenda for the India-Japan Investment and Trade Promotion and Indo-Pacific Economic Integration* by H. E. Nirmala Sitharaman, the Minister of State (Independent Charge) for Ministry of Commerce & Industry, India and H. E. Yoichi Miyazawa, the Minister of Economy, Trade and Industry, Japan, 30th April, 2015, New Delhi, India, available: www.meti.go.jp.

19. G. Yamada, "Japan-Backed 'Townships' to Aid India's Industrial Makeover", *Nikkei Asian Review*, 16 July 2015, available at: https://asia.nikkei.com.

20. See examples in Cambodia and Myanmar provided by Françoise Nicolas, 2018, *op. cit.*

21. M. Ito, "Industrial Parks for Japanese Companies Taking Shape in India", *Nikkei Asian Review*, 19 August 2015.

22. Interview at JETRO, Tokyo, February 2018.

clusters and to maintain its support even after the parks have started their operations.[23]

Another five industrial township projects are Indian state governments' initiatives: Sri City in Andhra Pradesh (near the border with Tamil Nadu), Tumkur in Karnataka, Jhajjar in Haryana and Greater Noida in Uttar Pradesh. The fifth project, Pithampur in Madhya Pradesh, was later added to the list. The remaining three projects, all located in Tamil Nadu, are being developed by private companies with solid experience in the business of park development, such as Japanese trading houses Sumitomo (with Indian developer Mahindra World City) and Sojitz (with Motherson Group, a major player in India's autoparts business). The third park, OneHub Chennai, is to be developed by Japan's Mizuho Bank and engineering company JGC, along with Singaporean business complex developer Ascendas.[24]

As can be seen from the above examples, state actors are playing an important role in launching initiatives, building industrial corridors and industrial townships designed to further attract and facilitate Japanese public and private investments in India, and support the sustainable growth of Japanese companies' commitments in the country.

23. N. Tomofumi, *Japanese Companies in India: Expectations, Achievements and Challenges*, JETRO, 20 December 2016.
24. G. Yamada, *op. cit.* [19].

Growth and diversification of Japanese ODI in India, despite problems

The political voluntarism of Prime Ministers Modi and Abe seems to have given the right signals in view of the surge in Japanese ODI in India, between 2014 and 2017. Over the years, Japanese ODI in India has increased (albeit at an irregular pace) and diversified from a sectoral and geographical point of view. At the same time, the Indian business environment remains a tough one for Japanese investors and the "Make in India" policy has introduced new constraints.

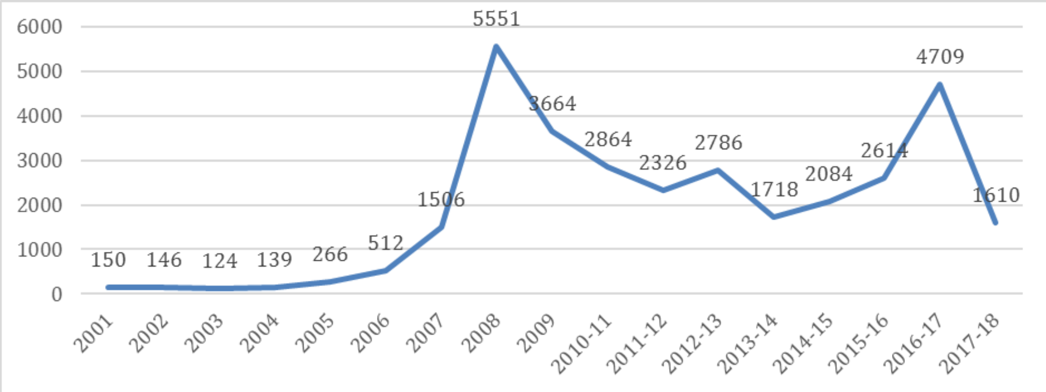
Japan as a major investor in India

Japan's cumulated ODI accounted for nearly USD 27 billion between January 2000 and December 2017, amounting to 7.3% of India's total FDI inflows during that period.[25] Japan ranked as the third largest investor after Mauritius and Singapore. It could even be regarded as the largest investor in India as a single country source, since Mauritius and Singapore's top positions result from the fact that they channel FDI from third countries (incidentally, how much India-bound Japanese ODI goes through Mauritius and Singapore remains unclear).[26]

On a year-on-year basis, Japanese ODI flows have followed an irregular path. After reaching a peak of USD 5.6 billion in 2008 (because of the acquisition by Daiichi Sankyo of Ranbaxy Laboratories in 2008), they went on a downward trend for the next five years (with the exception of 2012-13). They began to grow again from 2014-15 to 2016-17, when they reached USD 4.7 billion (almost 11% of total FDI inflows that year), but dipped sharply to USD 1.6 billion in 2017-18.

25. *Quarterly Fact Sheet*, DIPP, February 2008, available at: http://dipp.nic.in.
26. D. Roy Chaudhury, "Japan's Investments in India Getting Diverse", *The Economic Times*, 27 May 2017.

Evolution of Japanese ODI in India (million USD), 2001-2018



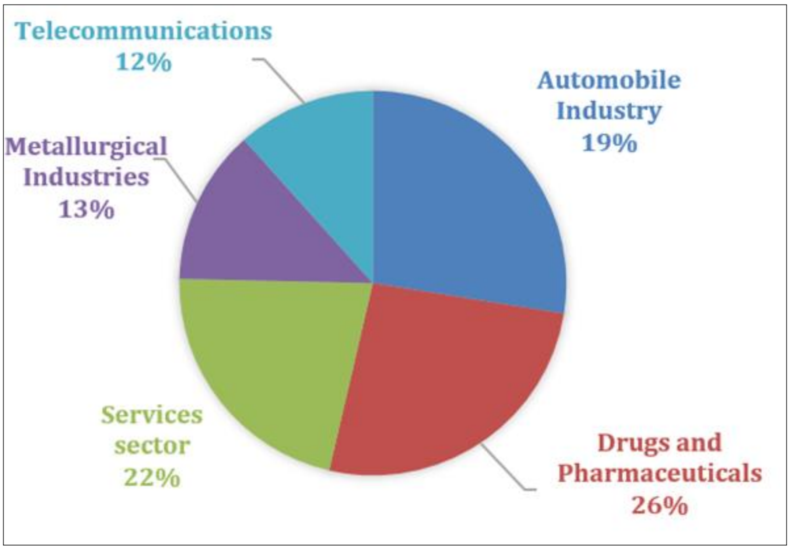
Author compilation, source: DIPP.

Traditionally, the automotive sector has attracted a major part of Japanese ODI in India since the 1980s. Big Japanese firms have settled in India's three main automotive clusters: in Haryana and Uttar Pradesh (Suzuki, Honda, Yamaha), in the western states of Karnataka (Toyota) and Gujarat (Honda, Suzuki) and, finally, in Tamil Nadu (Nissan, Isuzu and Yamaha). These firms have successfully adapted to the local market and designed specific products for emerging countries (low-cost cars, minivans). Their success has encouraged Japanese companies in steel production and logistics to invest in India.

Japan has also invested in India's pharmaceutical, service and telecommunication sectors, and, over the past few years, Japanese ODI has diversified and entered the sectors of consumer goods (Muji in 2016, and Uniqlo, scheduled in 2019), food-processing (Kagome in 2013 and Ise Foods, in 2018), e-commerce (Rakuten, 2014) and insurance companies, as well as renewables (Orix, 2017, Softbank Group, 2018). In recent years, Japanese banks have also raised their operations in India, as domestic negative interest rates are pushing them to invest in emerging markets.[27]

27. A. Joshi, "India Inc Eyes Long Samurai Loans from Yield-Hungry Japan Banks", *Bloomberg*, 1st March 2018; A. Iyer, "Why Indian Companies Are Saying Domo Arigato to Japanese Banks", *Livemint*, 4 May 2016.

Sectors that attracted maximum FDI equity inflows from Japan, 2000-2016



Source: DIPP (21.12.2016), http://dipp.nic.in.

In its 2017 survey on Japanese companies operating in India, JETRO shows that the prospect of making profits in India has been steadily growing since 2012. With 61% of firms expecting profits, India's profitability rate is now converging with those of China (70%) and Vietnam (65%).[28] As a result, 69% of firms established in India are planning to expand in the coming years. The main incentives are expected sales increase in the local market (89%) and the high growth potential of the market (64%). The current trend toward diversification is shown by a more positive outlook expressed by the wholesale or retail sector (78%), rather than by the more traditional motorcycle/automotive branch (59%).

A good illustration of this trend is the case of Mitsui, one of Japan's largest conglomerates. Over the last five years, Mitsui has turned to the consumer market. Since 2018, India has been the priority market for Mitsui, with more investments pouring into the automotive and housing sectors as well as the food and retail sectors. In this process, finding local partners has been a key success factor, and the Japanese firm intends to expand its network of Indian partners in the coming years.[29]

28. *2017 JETRO Survey on Business Conditions of Japanese Companies in Asia and Oceania*, 21 December 2017.

29. Interview with the authors, Tokyo, January 2018.

India is thus a popular destination for Japanese ODI. From 2014 to 2016, it has been the number one destination with regard to "promising countries/regions for overseas business over the medium term", according to a JBIC annual survey.[30] Market-scale (36%) and growth potential (85%) are cited as major incentives for Japanese companies to invest in India. India and China's scores in mid-term performance are actually close (approximately 40% of Japanese firms bet on them). However, a 20% gap separates India (63.5%) and China (43.3%) when considering the most promising countries over the long term (next 10 years or so). India has been the top-ranking country over the last eight years.[31] One can expect, then, that Japanese firms' interest in India will persist for a long time, especially as wages in China are continuing to grow and as India's market potential is still untapped.

Growing competition among Indian states to attract Japanese investment

In India, Japan has met two specific, inter-related challenges: the federal structure of India's governance and its heterogeneous economic conditions from one place to the other. This has led Japan to try to find the best practices at the state level and to work with the state governments that offer the best business environment.[32] Not surprisingly, then, Japanese companies concentrate in India's high-growth areas. In combination, Delhi Territory and Haryana host the largest number of them (with respectively 162 and 369 registered companies out of a total of 1,369 as of October 2017).[33] In Haryana, Gurgaon stands as the capital of Japanese industry in India, as it offers comparatively better facilities for the daily life of Japanese expatriates' families. Moreover, the city is located at a reasonable distance from Neemrana township, where many Japanese firms are based, as well as other Japanese factories in Haryana and Uttar Pradesh, while being close to New Delhi and its international airport, which has three daily flights to Japan. Japanese companies are also well established in the western state of Maharashtra (220), as well as in the dynamic southern states of Karnataka and Tamil Nadu (respectively 215 and 197).

30. In 2017, though, China replaced India, which fell to second rank. Survey report on overseas business operations by Japanese manufacturing companies – results of the *JBIC FY2017 survey*, JBIC, November 2017.

31. *Ibid.*

32. Interview, JETRO-IDE, Chiba, January 2018.

33. JETRO, "Japanese Companies Growing in India", in: JETRO, "JETRO's Activities in India-Japan Economic Relation", January 2018, p. 7.

Recently, however, the two states of Andhra Pradesh and Gujarat have attracted much interest.[34] While they do not yet host a large number of Japanese firms – in late 2017, there were 33 of them in Gujarat and 16 in Andhra Pradesh (43 if Telangana is added) – the activism of their government has raised the interest of Japanese investors. JETRO describes the attractiveness of these two states as "convergence between good business environment and political will".[35]

In Andhra Pradesh, Chief Minister Chandrababu Naidu has been anxious to attract Japanese investments ever since he returned to power in 2014. His wooing of Japan has been driven by the need to boost his state's economy following the separation of Telangana and the loss of Hyderabad as its capital city (due to the attraction of Hyderabad, Telangana hosted 27 Japanese firms, as against 16 for the new state of Andhra Pradesh in 2017). To this end, Chandrababu Naidu has maintained close interactions with METI and signed a series of MoUs to promote projects in the industrial and logistics sectors as well as in urban and human resources development.[36] Japan's most visible contribution in Andhra Pradesh is its decision to invest in the development of the new capital city of Amaravati. With its Visakhapatnam Port, Andhra Pradesh is also important in terms of connectivity to Southeast Asia.

Gujarat has taken center-stage in Japan-India relations for economic as well as political reasons. On the economic side, it has pushed a pro-business agenda, which has successfully attracted a number of Japanese companies. For instance, Suzuki Motor Corp established its first wholly-owned plant in India, in the city of Hansalpur, near Ahmedabad, in 2014. The construction of the Ahmedabad-Mumbai high-speed rail project has also been an additional incentive for Japanese investors to choose this state.

Political considerations have also weighed in favor of Gujarat. Prime Minister Modi has seemed to remain attached to his home state and has given it special prominence in his interactions with world leaders. In 2014, he hosted President Xi Jinping in Gujarat and oversaw the conclusion of a Chinese project to build an industrial park for Chinese companies in the state. Similarly, the 2017 India-Japan Summit meeting between Modi and Abe took place in Gujarat and, on this occasion, 15 Japanese companies signed MoUs for investments in the state, while the Gujarat government

34. Interview with JETRO official; JETRO, "JETRO Supports Investment Promotion by States", in: JETRO, "JETRO's Activities in India-Japan Economic Relation", January 2018, p. 6.
35. *Ibid.*
36. "Joint statement between the ministry of economy, trade and industry of Japan and the government of Andhra Pradesh, India for development of new capital city and industrial cooperation", July 12, 2017, available at: http://apedb.gov.in.

announced the creation of a new Japanese industrial park, near Sanand. Interestingly, Prime Minister Abe did not even stop in New Delhi during his trip, which is a fairly unusual instance of a head of government skipping the national capital for a bilateral visit.

Remaining obstacles and constraints

While Japanese companies are very interested in the Indian market, it takes a long time (five to 10 years) for them to implement an investment project. Administrative hurdles and local business conditions are still putting brakes on Japanese projects. Moreover, most Japanese companies are struggling in India, as compared with Southeast Asia and China. For many of them, despite good prospects for profitability, India stands as one of the toughest markets in Asia.[37]

An unstable and opaque regulatory environment

In JETRO's study on Japanese companies in India, complaints about the country's "complex tax system and procedure" have regularly topped the list of perceived difficulties, along with "inadequate infrastructure".[38] The Modi government's decision to enforce a national uniform Goods & Services Tax (GST) in July 2017 raised expectations that operating in India would eventually become easier. However, the transition from the old system to the unified GST proved chaotic and added a level of confusion for business. The example of the GST illustrates a more general concern of Japanese companies, which is the opacity of administrative procedures and the lack of precision with which Indian policies are implemented. Indeed, the need to have a stable and transparent regulatory environment has been a regular request of Japanese businesses operating in India. Land acquisition has also been a major challenge, especially with respect to the two mega-corridors of DMIC and CBIC. These projects have actually been delayed. Land-acquisition difficulties are also affecting the development of the high-speed railways between Delhi and Ahmedabad.[39]

37. Interview, JETRO-IDE, Chiba, January 2018.

38. India Japan Business Leaders Forum (IJBLF), *Industry Issues highlighted at the Forum meeting held on 14 September, 2017 at Gandhinagar, Gujarat, Annexure, 14 September 2017*, available at: www.keidanren.or.jp.

39. N. Dasgupta, R. Jadhav and Y. Obayashi, "India Set to Miss Key Target for Japan-Backed Bullet Train Project", *Reuters*, 12 June 2018.

The rise of peer competitors

According to the 2017 JETRO survey, new issues such as wage increases have also arisen (cited by 72% of respondents), but do not yet discourage the prospect of hiring local employees (66%). Another challenge is to find adequate local partners (40%). Moreover, India is the Asian country in which Japanese companies are now feeling the toughest pressure from competitors (64%). Competition comes from local and other East Asian companies. South Korean cars, home appliances and electronic goods, for instance, have been well established in India since the 1990s, and a very competitive pricing policy for them has been successfully maintained. The Chinese have also become increasingly competitive. Their smartphone manufacturers have already won over the Indian market. In the high-speed railways sector, Japan has kept a watchful eye on the Chinese, especially as India has also expressed its interest in their technology and know-how.

The constraints of Modi's "Make in India" policy

With its local content requirement, the "Make in India" policy of Prime Minister Modi has raised additional constraints. Japan has highlighted its commitment to Modi's flagship policy though the establishment of the "Japan-India Make in India Special Finance Facility", which provides USD 12.9 billion in loans and insurance guarantees by JBIC and Nippon Export and Investment Insurance (NEXI) and is supporting the development of industrial townships; the creation of Japan-India Institutes for Manufacturing, which are to train 30,000 Indians to Japanese-style manufacturing skills and practices over the next 10 years, and an initiative to train 300,000 Indian students in Japan, especially in the IT sector.[40]

In other cases, however, Japanese interests are difficult to align with those of India. In the case of the Delhi-Ahmedabad High-Speed Railway, Japan came under pressure to set up factories in India, as the Modi government, with the 2019 general election in mind, was anxious to deliver on its "Make in India" and technology transfers promises. The Japanese side, however, stuck to its line that it could not set up factories locally unless more lines were undertaken.[41] Thus, while the coaches will be made in Japan, only some parts of the infrastructure or signals system will be built in India, with only small technology transfers involved. As of January 2018, the media reported that 70% of the core components of the high-

40. "India to Send 300,000 Youth to Japan for On-Job Training", *Business Standard*, 11 October 2017.
41. Interview with a JETRO official, January 2018.

speed rail would be made in Japan, which was presented as "a setback to Make in India".[42] It also transpired that the Japanese had reservations about the difference in work culture and the lack of experience of Indian companies and engineers in high-speed transportation. However, to mollify India, Japan has provided training to the future operator of the Shinkansen system, with JICA funding the construction of the Training Institute for High-Speed Rail.[43]

India, a difficult environment for Japanese expatriates

Beyond the exotic clichés, India suffers from an image deficit in Japan. Its business environment is deemed complicated, opaque and unstable, while daily life is seen as difficult in the light of Japanese standards. As a result, Japanese employees are often reluctant to work in India. In a recent speech, former Foreign Secretary Subrahmanyan Jaishankar acknowledged the special difficulties that Japanese expatriates have in India: "While making it easier to do business will itself make an impact, in the case of Japan it is also important to focus on issues like language, work culture, training and quality of life for expatriates".[44] Indeed, Japanese expatriates in India generally leave the country after three years, while South Koreans can stay for ten to twenty years, thus ensuring better continuity and the building-up of their firm's market share over the long term.

42. N. Dasgupta, R. Jain and Y. Obayashi, "Exclusive: Japan in Driver's Seat for Indian Bullet Train Deals", *Reuters*, 18 January 2018.

43. "Signing of Japanese ODA Loan Agreements with India: Supporting Human Resource Training, Manufacturing and Nation-Building to Open the Way to a New Era", 15 September 2017, available at: www.jica.go.jp.

44. "Speech by Foreign Secretary at the India-Japan Colloquium in New Delhi", 8 September 2017, available at: http://mea.gov.in.

Promoting regional and transregional connectivity: a core strategic cooperation

The agenda of Japan and India regarding the promotion of infrastructure building to enhance connectivity both within India (see part one) and within the greater Indo-Pacific region has been converging. It supports the strategic goal to help India to reintegrate East Asia while counterbalancing China's growing influence in the region, through three pillars: growing synergies between Indian and Japanese grand visions for the region; promoting Japanese investment in strategically sensitive Indian states, and efforts to promote joint investments in third countries, especially in Africa.

The political setting: building synergies between Act East and Free and Open Indo-Pacific Strategy

In their "Vision 2025" joint statement, dated 12 December 2015, India and Japan lay out their strategic goal to "realise a peaceful, open, equitable, stable and rules-based order in the Indo-Pacific region and beyond", emphasizing "the principles of sovereignty and territorial integrity; peaceful settlement of disputes; democracy, human rights and the rule of law; open global trade regime; and freedom of navigation and overflight."[45] In this common vision, shared prosperity and respect of liberal norms are the two pillars for stability in the region, in an implicit criticism of Chinese economic expansion under its Belt and Road Initiative (BRI). Launched in 2013, BRI is a framework that offers funding for infrastructure development under very flexible political conditions (high loan amounts with no requirement for state guarantee of repayment), but also opaque processes and few guarantees regarding social, environmental and economic sustainability.

Indeed, Japan and India have shared concerns over BRI. The former sees it as China's grand strategy to take center-stage in world affairs and

45. "Japan and India Vision 2025 Special Strategic and Global Partnership: Working Together for Peace and Prosperity of the Indo-Pacific Region and the World", 12 December 2015, available at: www.mofa.go.jp.

impose its interests on others, while India strongly opposes BRI on sovereignty and security grounds. More precisely, India strongly denounces the China-Pakistan Economic Corridor, as it includes some parts of Kashmir over which it has territorial claims. It also equates China's large investment in port infrastructure in the Indian Ocean to a new containment policy. Therefore, India and Japan have found converging interest in developing a common infrastructure agenda for the region, with a view to balancing and countering China's BRI.

Japan's ambition became even clearer after Prime Minister Abe unveiled his Free and Open Indo-Pacific Strategy (FOIP) at the August 2016 Japan-Africa Summit in Nairobi. In this strategy, Japan clearly states its ambition to promote connectivity in the Indo-Pacific region as well as maritime security cooperation, while defending liberal values. The FOIP strategy is thus an attempt to propose an alternative to China's BRI projects and to offer other infrastructure funding options to the countries of the region, so as to help them avoid getting locked into a face-to-face encounter with Beijing. The FOIP also proposes an alternative geopolitical narrative to the New Silk Roads, gives more visibility to the already numerous Japanese activities in the area, and attracts the attention and cooperation of other countries. Indeed, the United States endorsed this concept in November 2017, while India approved the new Japanese strategy as early as November 2016 and agreed to seek deeper cooperation and synergy with its own Act East policy, which aims to enhance its profile in the Indo-Pacific region.

Since Japan can't compete with China in funding infrastructure financing, it rather highlights the quality of its offers, their transparency and compliance with social and environmental standards. In this regard, it unveiled the Partnership for Quality Infrastructure in May 2015, with USD 110 billion to be allocated over five years, in collaboration with the Asian Development Bank (ADB), to financing infrastructure in South and Southeast Asia. The amount of money allocated to the program was reportedly set so as to surpass the initial Asian Infrastructure Investment Bank (AIIB) allocation of USD 100 billion. The principle is to facilitate higher-risk investments by relaxing the process for acquiring loans and grants, and allow greater flexibility as regards conditions such as the beneficiary state guaranteeing its ability to repay the loan. The focus on the "quality" part of the infrastructure offer also helps Tokyo to justify its tied loans and the use of Japanese technology and construction in implementing the ODA program. While India in principle does not accept tied aid, it has a special arrangement with Japan to use such assistance for big projects (Dedicated Freight Corridor, Shinkansen).[46]

Under this common agenda, cooperation between India and Japan has started developing in several directions: first, the Japanese are funding infrastructure in India's Northeast, and are exploring potential funding opportunities in the Andaman and Nicobar Islands; they have also coopted India in their so-called Asia Africa Growth Corridor to promote joint investment in Africa.

Japanese investments in the Indian Northeast: a test case

Japan's commitment to infrastructure development in India's Northeast could be a test case for the materialization of the geopolitical convergence of views between the two countries.[47] Indeed, with its 1,600 km border with Myanmar, the Northeast stands as a natural gateway to Southeast Asia, but India's efforts to bring growth to this remote region have been unsuccessful to a large extent. As part of its Act East policy, the Modi government has renewed its focus on the Northeast development and asked Japan to support its efforts, including for the construction of 1,200 kilometers of roads.

JICA, which has for long been involved in environmental and energy projects in India's Northeast, is now moving on developing greater connectivity within the region as well as with its neighborhood. It is assisting in renovating the road network in Mizoram, improving a 350 km section that is part of the larger Kaladan Multi-Modal Transit Transport Project developed by India to connect the Northeast to Myanmar. In Meghalaya, it is working on an 80 km Shillong to Dawki road section, on the Indo-Bangladesh border. While JICA has pledged about USD 900 million to the Northeast road projects in the two years 2017 and 2018,[48] further engagement in infrastructure development in this region remains uncertain.

In deciding whether to further engage in India's Northeast or not, Japan is faced with a dilemma between its political/strategic vision and the economic and security reality of the region. From a strategic point of view,

46. P. Jain, *op. cit.* [1], p. 29.

47. M. Chansoria, "Japanese Investments Are Instrumental to India's Act East policy", *Asia Pacific Bulletin*, No. 385, 21 June 2017.

48. "JICA Continues to Invest in Improving Transitability by Extending ODA Loan of Approximately INR 2,500 Crore for the North East Road Connectivity Project", 2 April 2018, available at: www.jica.go.jp.

Japan's involvement in the Northeast could help India contain China's influence. Indeed, as part of its larger BRI campaign, China has put pressure on India to institutionalize the BCIM (Bangladesh-China-India-Myanmar) informal dialogue, so as to expedite the creation of an economic corridor connecting Kunming to Kolkata through Mandalay, Dhaka and the Northeast. However, because it is uncomfortable with China's influence, India has preferred to develop its own connectivity project with Myanmar and Bangladesh and to reach out to Japan.

However, the local security situation does not look promising for further Japanese engagement. JICA has conducted a security assessment on the possible expansion of its projects under the Northeast Road Network Connectivity Improvement project, and has identified three types of security threats: the various local insurgencies that trouble the region, the risks of infiltration of jihadist militants from Bangladesh (especially as border control is deemed too lax) and possible pressure from China.[49] More precisely, Chinese claims on Aruchanal Pradesh (which it refers to as Southern Tibet) make it very sensitive to invest there. Japan, therefore, is nowhere near willing to invest in this state.

Even from an economic point of view, the picture is quite mixed. On the one hand, according to JETRO, Japan can see the big picture over the long term: a connection from New Delhi to Kolkata and the Northeast up to Myanmar and Thailand, a country where Japan has a very good industrial base. On the other hand, New Delhi and Tokyo do not entirely see eye to eye on the Northeast development strategy. Indeed, some Japanese experts have suggested that the best development strategy for the Northeast would be to promote logistical infrastructure and transform the city of Guhawati into a logistical hub to handle the inflows of Chinese and Southeast Asian products, which are in high demand in the region (and are currently sold on the black market). However, the Modi government rejected this option, because it does not want to open its border to cheap Chinese products and is committed to its objective of transforming India – including a remote city such as Guhawati – into a manufacturing center, in keeping with its national campaign of "Make in India".

Despite these caveats, according to various practitioners and experts in Tokyo, the final decision is likely to be highly political. In other words, the will to show Japan's strong commitment and to help India contain China in the Northeast may weigh in the balance, even though the security condition is not optimal, and the expected economic benefit quite unclear. Indeed, there is strong political will to develop symbolic cooperation there,

49. Interview, JICA, Tokyo, January 2018.

as the region has been described by a Japanese official as "the cornerstone of the Abe-Modi strategy to balance China".[50] Some signals have already been given in this respect. The ambassador of Japan to India, Kenji Hiramatsu, has strongly supported his country's involvement in the Northeast, as illustrated by his four visits to the region since the beginning of his mandate in late 2015. And an India-Japan Act East Forum, gathering state actors from the two countries, was established in December 2017 to explore opportunities for Japan's involvement in infrastructure development in the Northeast. This forum further highlights the highly political dimension of Japanese cooperation in Northeast India.

Japanese investment in Andaman and Nicobar: much ado about nothing?

The Andaman and Nicobar Islands (ANI) are a strategically important archipelago that provide the Indian Navy access to the Malacca straits. With their status as Union Territory, they are directly controlled by the central government, which has for long kept them closed to any foreign investment. Japan expressed interest in helping to develop infrastructure there, such as ports and bridges, and in response, in early 2016, India proposed a project to build a 15-megawatt diesel power plant on South Andaman Island.[51] Japan is thus the first country allowed to invest in the ANI, albeit in a small-scale project.

Concomitantly, India and Japan referred to the joint building of "smart islands" in their declarations in 2016 and 2017. This project is still at the planning stage and lacks details (consultation on technologies, infrastructure and development strategies) about precise locations. The ANI are cited by experts as a possible setting, as India wants to turn them into a maritime hub.[52] The Indian government has already launched a couple of projects to better connect ANI, such as the submarine optic-fiber cable running between Chennai and Port Blair. In addition, to expand the base of Port Blair, development of civilian infrastructure is needed (in terms of access to water, electricity, housing and schools), and Japan could help with funding this.[53]

50. Interview, JICA, Tokyo, January 2018.

51. E. Barry, "India Collaborates with Japan on Andamans Project", *The Hindu*, 3 March 2016; E. Barry. "As India Collaborates with Japan on Islands, It Looks to Check China", *The New York Times*, 11 March 2016.

52. D. Baruah, "Growing Strategic Engagement Between Tokyo and Delhi", *Economic Times*, 31 May 2017.

53. D. Baruah, "Andaman and Nicobar as India's Smart Islands", *Economic Times*, 18 October 2017.

However, in addition to the fact that India's projects for ANI still lack specifics,[54] Japan has so far proved halfhearted in its approach. The Japanese Ministry of Defense does not have a direct interest in the islands, METI shows no enthusiasm, as the projects will likely have low or no profitability, and MOFA, while considering the counterbalancing strategy vis-à-vis China, would rather not make too provocative a move.[55] All this may explain why there was no mention of ANI in the joint declaration of September 2017. Indeed, even Japan's modest power plant project is making little progress.[56]

The Asia-Africa Growth Corridor (AAGC): when business interests meet geopolitics

At their November 2016 summit, Abe and Modi underscored the importance of promoting Indo-Japanese cooperation in Africa, "with the objective to synergize their efforts and explore specific joint projects". Subsequently, a report was commissioned from Indian and Japanese economic research centers (India Research and Information System for Developing Countries (RIS) and Japan's Institute of Developing Economies – IDE-JETRO) to develop this vision.[57] The report was officially presented by Modi during a session on Japan-India cooperation at the African Development Bank meeting in Ahmedabad in May 2017. The Asia-Africa Growth Corridor (AAGC) has since been portrayed as a way to promote joint projects in key priority areas – development, quality infrastructure, institutional connectivity, training and capacity-building, people-to-people cooperation – by playing on the complementarity between India and Japan.[58]

Interestingly, the AAGC concept partly results from a bottom-up process and the realization that many Japanese automakers based in India export to Africa.[59] In another sector, Hitachi Construction Machinery Co. has started selling its machines in Africa, following a successful joint venture with Tata Group. A 2017 JETRO survey shows that Japanese companies operating in India have a significant interest in the African

54. Some experts say that the "smart island" concept is a political bargaining chip *vis-à-vis* China.

55. Interview with a Japanese expert on geopolitics, Tokyo, January 2018.

56. V. Mai Chotani, "India-Japan Ties: Getting a Boost under Modi and Abe", *ORF Issue Brief*, No. 205, November 2017, p. 7.

57. "Asia Africa Growth Corridor: Partnership for Sustainable and Innovative Development", *African Development Bank Meeting*, Ahmedabad, India, 22-26 May 2017, available at: www.eria.org.

58. T. Basu, "Thinking Africa: India, Japan and the Asia-Africa Growth Corridor", *The Diplomat*, 3 June 2017.

59. "It's Africa next for Toyota-Suzuki tie-up", *Nikkei Shimbun*, 26 May 2018.

market, which they see as the most important future destination in the coming years.[60] For many of them, India is a good springboard to enter the African market, as it is geographically closer to Africa, enjoys strong historic and cultural ties with the continent thanks to its companies and diaspora, and shares a similarity in market characteristics and product needs.

That said, this interest is not new; it was identified back in 2013 by a JETRO survey, titled "'Look West' with the strategic partnership between India & Japan".[61] In this document, JETRO provided examples of Japanese companies already investing in African and Middle-East markets from India.[62] The Look West strategy may have served as a basis to revive the idea, with a "repackaging" in the form of the AAGC initiative. In its official documents, JETRO therefore states that its focus is now "to nurture the motivation of Japanese companies for 'collaboration with India for their business in Africa'".[63] Indeed, both countries could benefit from this collaboration: in keeping with Prime Minister Modi's objective, India would enhance its exports of manufactured goods, while Japanese companies based in India could take advantage of the Indian business networks in Africa to enter African markets and then enjoy large economies of scale in expanding their business on the continent.[64] In 2017 alone, JETRO hosted three Africa business seminars in India, arranged a Japanese business delegation to Ethiopia and networking with Indian business there, and coordinated a business-matching event for Japan-India cooperation in Africa.

However, AAGC also results from a top-down process, as it is inspired by Japan and India's geopolitical vision of countering China's BRI by improving interconnectedness between Asia and Africa (as explained above). In other words, both the Japanese and Indian states may increase their support to Japanese and Indian firms that wish to jointly invest in Africa so as to achieve their geopolitical vision of a synergy between the Act East policy and the Free and Open Indo-Pacific Strategy. However, despite ambitious statements and an abundance of media reports, AAGC is still a

60. JETRO, "JETRO's Activities in India-Japan Economic Relation", January 2018, p. 8 (personal communication).

61. "'Look West' with the Strategic Partnership Between India and Japan", JETRO, September 2013, available at: www.jetro.go.jp.

62. Toyota exporting a strategic vehicle model for India (Etios) to South Africa; Suzuki and Nissan supplying vehicles and auto parts to Middle East and Africa, Daiichi-Sankyo taking control of Ranbaxy, and selling medicines in Africa.

63. JETRO, "JETRO's Activities in India-Japan Economic Relation", January 2018, p. 9 (personal communication).

64. The Bank of Tokyo-Mitsubishi UFJ (MUFG), *Global Business Division, Japanese Investments in India –Prospects & Challenges*, 31 October 2017.

vague vision, at a very early stage of development. A Research Support Unit is set up in the Research and Information System for Developing Countries (RIS) institute in New Delhi, with a study group based on a network of Japanese and East Asian experts to review the existing collaborations between Asia and Africa, study the needs, make recommendations for concrete cooperation and eventually flesh out the vision. The results should be presented to the governments by 2019.[65]

65. "Asia Africa Growth Corridor: Partnership for Sustainable and Innovative Development", *op. cit.* p. 16.

Conclusion

The political voluntarism displayed by Prime Ministers Abe and Modi has paid off to some extent. On the Indian side, a number of dedicated measures to grant preferential treatment and encourage Japanese public and private investment have been implemented. In return, Tokyo has put a political priority on developing ties with India, and succeeded in mobilizing a large number of Japanese state actors to implement the policy. Moreover, Japanese ODI in India has increased and diversified as companies see the potential of a promising market over the long term, even if India's complex business environment is still difficult to handle for the risk-averse Japanese.

The high level of governmental commitment reflects the complementarity between India's dire need for infrastructure and development and Japan's focus on infrastructure exports and diversification of overseas markets, as well as a convergence between the two strategies to promote regional connectivity while balancing China's growing clout in the Indo-Pacific area. If the bilateral rapprochement has been accelerated under Abe and Modi, one has to underline that previous governments, both in Japan and in India, consistently supported the building up a strategic partnership. Therefore, for the time being, Japan's ODA and ODI disbursement to India should be set on a sustainable upward trend.

A weak point that should be worked on, however, is the trade relations, which remain below potential. India-Japan trade has continuously contracted since 2012-13. From a peak of USD 18.6 billion that year, it dropped to USD 13.4 billion in 2016-17.[66] While these figures may be below the reality, as many products (such as auto-components) transit through third countries,[67] there is no denying the fact that India-Japan trade is the weakest dimension in their overall partnership. By comparison, in 2016, India's trade with China stood at USD 70.8 billion and Japan's trade with China was more than USD 350 billion. This means that China is still a central trade partner for the two countries. They are currently renegotiating their CEPA in order to boost India's exports to Japan.

66. *India-Japan Economic Relations*, available at: www.indembassy-tokyo.gov.in.
67. JETRO-IDE, interview, February 2018.

More strategically, despite the rhetoric on shared values and interests, Japan and India differ on regional economic norms. Japan's priority is to promote ambitious regional trade deals with a view to setting stricter rules in terms of social and environment norms, in part to constrain China and push it to reform its system. This has been the ambition behind the Trans-Pacific Partnership (TPP) and is why Tokyo has taken the lead to keep the deal alive after the US withdrawal. India is not part of the TPP, and is nowhere near joining. Indeed, the deal would require ambitious commitments, in particular with regard to intellectual property rights and the compliance of Indian pharmaceutical companies, which New Delhi cannot fulfill. Also, while both India and Japan are committed to the Regional Comprehensive Economic Partnership (RCEP), New Delhi is still reluctant to support the dismantling of import tariffs.

Differences also exist regarding Chinese economic initiatives. Since 2017, Japan has softened its stance on China's BRI, which may cause concern in India. Tokyo now sees BRI as an "irresistible" project at the heart of Chinese strategy. It is also interested in seizing the potential economic opportunities of BRI for Japanese companies. In May 2018, China and Japan signed a MOU on cooperation in third countries and announced a joint project in the East Economic Corridor in Thailand (while Japan and India are looking to jointly develop infrastructure in South Asia, such as the Trincomalee port in Sri Lanka).[68] That said, India is one of the main investors in the Chinese-led Asian Infrastructure Investment Bank (AIIB), while Japan is not part of it.

To conclude, if economic cooperation is indeed strategic for Indo-Japanese rapprochement, and seems to be set on good tracks, political leaders in New Delhi and Tokyo need to maintain a high level of commitment to further develop it. The two countries will also have to strike the right balance between their expanding cooperation and their respective relations with China. Finally, lest they become a source of growing misunderstanding, Japan and India should consider the divergence in terms of trade norms and practices, and work to reduce it.

68. T. Singh Maini, "Improving Japan-India Infrastructure Cooperation in South Asia", *The Diplomat*, 26 June 2018.

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