



**Indo-Japan Economic Partnership -  
Strategic aims, Challenges, and Future**

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## INTRODUCTION

On October 22, Japanese Prime Minister Shinzo Abe-led incumbent Liberal Democratic Party (LDP) and its allies secured at least two-thirds of the seats in the Japanese Diet (Parliament) following snap elections. If elected the leader of the LDP next year during party elections for a consecutive third term, Abe would secure the legacy of being Japan's longest serving Prime Minister. Abe's win has been characterised by his emphasis regarding rewriting the country's pacifist constitution and Abenomics as well as a more assertive stance with regard to the threat from North Korea. Abe's re election coincides with President Xi Jinping of China securing support from the Chinese Communist Party for a consecutive second five-year-term while emphasizing Beijing's Asian leadership role. In that light, Abe's re-election brings into perspective the question of strategic dynamics in the Asia-Pacific region, especially at a time when Abe seeks to flex his muscles in the region by establishing stronger ties with a fellow nationalist strongman, Indian Prime Minister Narendra Modi.

One of the pivotal hallmarks of the Indian foreign policy under PM Modi has been its Act East initiative, emphasizing the country's outreach toward its Asian neighbours. Corresponding to this policy of New Delhi has been Tokyo's proposition of a Partnership for Quality Infrastructure (PQI) initiative in Asia, thus indicating the two countries' attempt to use regional development as a platform to establish a strong strategic framework. The similarities in both the leaders' approach with regard to foreign policies, especially characterised by using economics and trade as the most important diplomatic tool, points toward the building of a more strengthened alliance between two of the largest economies in Asia over the coming years. One of the most important questions with regard to the strategic alliance between these two countries is the scope of the Chinese factor in a closer relationship between India and Japan. In that light, it is significant to understand the complexities of the relationship between India and Japan in the absence of the Beijing dynamic while also deciphering how the two nations seek to counter hedge Beijing at a time when the latter seeks to establish itself a regional power.

India has been undergoing rapid development in recent years, with consistent GDP growth, a valuable and working demographic, abundant natural resources and loosening government control over its domestic market. Things that remain matters of concern for the country are limited infrastructural investments, absence of capital and still emerging technological prowess. At a time when the country seeks to maximize its growth potential, Tokyo with its economic success story is perceived as an able partner to aid India in realising its optimum, thus keeping a check on emerging Chinese influence in the Asia-Pacific and Indo-Pacific region. Both New Delhi and Tokyo have abstained from participating in President Xi's ambitious Belt and Road initiative, especially as both the countries remain engaged in their respective territorial disputes with China.

Despite the positive aspects of a potential alliance, keeping in mind the sustained challenges existing in India with regard to business investments, it remains to be seen if the Modi government is able to undertake measures that would enable the elimination of these impediments. In turn, it remains to be seen if both Modi and Abe are able to extend the same kind of influence in both Asia and Africa, as has been the case with regard to China across the world and their One Belt, One Road initiative.

## HIGHLIGHTS OF JAPAN-INDIA INVESTMENT

As per Government of India statistics, Japan's share in overall foreign investments in India stands at 7 percent, with Tokyo being the third largest foreign investor for the country.

India and Japan signed 15 MoUs during the 12th annual Indo-Japan annual summit in September 2017.

India is set to send 30,000 youth for on-job training in Japan for 3-5 years as part of skill development programme.

Japan has invested over 25 billion USD between 2000-17 in India and pledged further investments amounting to up to 35 billion USD for the period between 2014-19.

## NEW DELHI - TOKYO RELATIONS - BEYOND COUNTER HEDGING BEIJING IN INDIAN OCEAN REGION?

Japan and India signed 15 Memorandums of understanding (MoU), pledging to increase mutual cooperation between the two countries, during the 12th annual India-Japan Summit that was held at Gandhinagar, Gujarat in September. The MoUs encompassed vowed collaboration in the areas of manufacturing, civil aviation, science & technology, connectivity and skill development between the two countries. The MoUs come amidst historical infrastructural investments by Japan across major sectors of the Indian economy and against the backdrop of the fact that both the countries have consistently enjoyed warm relations with each other traditionally. Both Abe and Modi also launched the Mumbai-Ahmedabad bullet train project during Abe's September visit to India, wherein Japan committed a loan of 10.45 billion Yen (606 crore Rupees) to India for the project. Furthermore, Abe also pledged to set up a training institute in relation to the bullet train project that would develop skilled labor in the country with the knowledge for the operation of High-Speed Railway.

Apart from the MoUs and the high-speed railway network project, one of the most significant commitments from Tokyo has been its involvement in the project to improve connectivity in India's Northeast region. A loan of approximately 38.66 billion Yen (2, 242 crore INR) from Japan has been planned to enhance the roads and bridges across the eight states in India's northeast that is seen as a strategic gateway for the country's link to the South and Southeast Asian region. Tokyo will participate in the construction of two national highways NH-40 and NH -54 bypassing Mizoram and Meghalaya, respectively, that will enhance connectivity of the region via Myanmar. According to available data, between 2000-17, Tokyo has invested over 25 billion USD across various sectors and infrastructure projects in India. Going ahead, the country has pledged further investments of approximately 35 billion USD for the period of 2014-19 in a bid to contribute to India's manufacturing and infrastructure sectors.

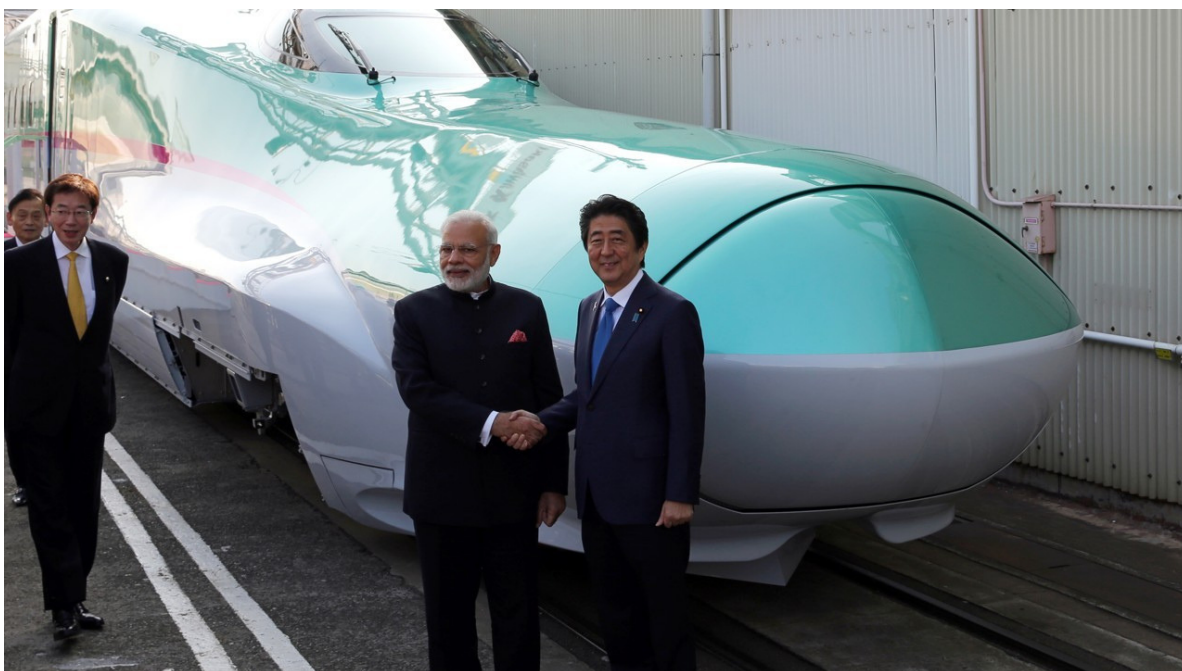


**PM Modi and Abe at Gandhinagar, Gujarat during a roadshow at the 12th annual Indo-Japan summit**

Japan is the third largest investor in India while India has consistently been ranked as the most attractive investment destination in a survey of Japanese manufacturing companies that was conducted by the Japan Bank for International Cooperation (JBIC). India's northeast region has not been one of the most accessible regions for investors and Tokyo's entrenched infrastructural investments to enhance connectivity in the region as well as in the remote Andaman & Nicobar islands only emphasizes the trust between the two strategic partners with regard to development and shared foreign policy goals.

A priority foreign policy goal for both the countries over the past years has been to hedge against the global and regional emergence of China as a significant economic and strategic partner for all the nations in the region. In light of expanding Chinese influence and president Xi's assertive foreign policy goals to ensure Beijing's place at all international negotiation tables, New Delhi and Tokyo have recognized the need to build a strategic partnership as a counterweight. However, one of the most significant questions against that backdrop is the scope of Beijing being the deciding factor in the Tokyo-New Delhi strategic partnership. Beijing's Belt and Road Initiative has been a cause for concern for India due to infrastructural projects envisioned in its backyard and the weight of China's support for India's arch-nemesis and neighbor, Pakistan. While Pakistan and China and the China-Pakistan Economic Corridor (CPEC) may be part of the strategic calculus of the Indo-Japan strategic partnership, the relationship has to look beyond just being a counter-strategy, the onus of which is likely to fall on the willingness of the incumbent leadership of the two countries at this time.

Despite the argument that the countries' relationship should be independent of expanding Chinese influence in the region, it is significant to understand the strategic rationale for the countries' outreach toward each other and the collaborative cooperation with other countries. Given the countries' historical and cultural ties as well as mutual interests, while providing an alternative for Beijing, both India and Japan also have the capability to anchor maritime and economic security for the Indo-Pacific region. The following section will take a look at the strategic rationale for the budding partnership between the two countries, especially under two visionary yet idealistic leaders.



**Image of Japanese PM Shinzo Abe and Indian PM Narendra Modi with the Japanese bullet train**

## BROTHERS-IN-ARMS - STRATEGIC RATIONALE FOR MUTUALLY BENEFICIAL INDO-JAPAN RELATIONS

President Xi Jinping envisioned the One Belt, One Road Initiative encompassing over 150 countries across the world in a bid to make a more economically interdependent world and secure trade routes that would enable Beijing to build connectivity with countries across Asia, Africa, and Europe. In November 2016, Prime Minister Narendra Modi and Prime Minister Shinzo Abe in a joint declaration announced the launch of the Asia Africa Growth Corridor (AAGC), pledging regional connectivity and both India and Japan's commitment to ensuring regional infrastructural development against the backdrop of the countries' historical ties in both Asia and Africa. Japan's expertise and influence in ensuring quality infrastructure and managing railroad networks would give the region an alternative to deal with a power other than China for their economic development. In turn, these projects are likely to be sources of broader local employment for the countries, thus positively enhancing the local population's perception about these countries.

The AAGC has been envisaged on the four fundamentals of Development and Cooperation Projects, Quality Infrastructure and Institutional Connectivity, Enhancing Capacities and Skills and People-to-People partnerships. The advantage that the AAGC enjoys over the rationale behind BRI include both India and Japan's historical ties to both nations in Asia and Africa, the lack of any form of trust deficit, and also the similarities and simulation of projects in countries such as India that would enable a relatively more feasible success story regarding project implementation in the region. The similarities in the form of availability of abundant natural resources, the exploitable working demographic that would be available, the cultural connectivity and capabilities with regard to dealing with natural disasters would facilitate a more favorable perception regarding the envisaged initiative across the region.

Furthermore, at a time when sustainable development is the need of the day and the established success with regard to Japanese innovation in these sectors, countries in Asia and Africa are likely to benefit from the proposed economic corridor by India and Japan. Keeping all this in mind, the AAGC was likely intended to favorably utilize the perception of India and Japan as non-threatening regional powers that seek to ensure development against China's extending influence over Asia and Africa, especially due to its not-so-cordial relations with many of its Asian neighbors. With that, strategic infrastructure investments by India and Japan under the aegis of the AAGC is likely to impede the expanded success of the BRI by China, while ensuring the parallel emergence of India and Japan as Asian regional powers coinciding with China's attempt to emerge as a global power.

While the AAGC appears to be a workable alternative to China’s BRI, the implementation of the projects is also likely to encounter a unique set of challenges. While the proposed corridor would ensure economic security, strategic security would remain a matter of concern for the participant countries. Furthermore, both the countries’ domestic challenges as they deal with democratic institutionalism internally is likely to be a cause for bureaucratic hurdles even as a single-party system in China aids is the swift implementation of its foreign policy objectives. Both countries historical affinity toward protectionism is likely to further impede any extensive objectives abroad. Despite these factors challenging the envisioned AAGC, given the corridor’s indiscernible objective of being an alternative for China’s BRI, both India and Japan’s leadership are likely to seek the successful realization of the economic objectives under the AAGC vision document.

Compounding the challenges that both countries are likely to encounter collaboratively for the implementation of the AAGC vision is the domestic challenges that Japanese investments in India has historically encountered and the incumbent Indian government’s attempt to minimize them. While the joint foreign policy objective is likely to go a long way in establishing the strategic alliance envisioned by both PM Modi and PM Abe, it is imperative for Tokyo to be able to completely be successful in all its strategic vision with regard to New Delhi in the near future.

## KEY ELEMENTS OF THE PROPOSED AAGC



Enhancing capacity and skills

Quality infrastructure and institutional connectivity



Development and cooperation projects

People-to-people partnerships





## DOMESTIC CHALLENGES FOR JAPANESE INVESTMENTS IN INDIA - CAN THEY BE OVERCOME?

On October 31, World Bank data indicated that India had climbed 30 positions to rank 100 among 190 countries across the world in the Ease of Doing Business in the country based on a number of tax reforms, as well as reforms in licensing, investor protection and bankruptcy resolution. In spite of the positive outlook indicated by the data provided by the World Bank, India as an investment destination remains a matter of concern for many foreign investors. With an FDI inflow of about 4.7 billion USD by the end of 2016-17 from Japan, including 4,590 Japanese business establishments operating in India, Japan boasts of being the third largest source of FDI inflow into the country. However, despite the concentration of Japanese investments, challenges abound for the country's establishments in dealing with the regulatory framework of India. This has been despite the fact that the country has a number of MoUs in place in various industrial sectors that have vowed to ease the restrictions on business operations in the country. Indian automobile sector boasted of one of the initial collaborations with the Japanese, with Suzuki motors initiating a collaboration to cater to the larger consumer market available in India. Currently, many start-up Small and Medium enterprises have received a steady infusion of capital from Japanese sources such as Softbank that have facilitated the escalation of the FDI inflow in the country from Japan. That being said, Japanese investments like any have been at the receiving end of various bureaucratic hurdles that have been a characteristic of the Indian investment market. It is necessary to hierarchically identify the various impediments that have undermined the further expansion of Japanese economic interest in India.

One of the most common yet rampant challenges for economic expansion in India, like in any other developing country has been bureaucratic corruption across all government sectors. The necessity to deal across all ranks of the bureaucracy and government to ensure the success of an investment makes the process extremely tedious for investors, thus in a way likely discouraging further investment in the country. Secondly, the complex and exhausting licensing regulatory as well as tax system likely acts as a factor that makes investors wary of infusing more capital in securing them than the actual investment. One of the most important challenges that have been sought to be addressed has been the availability of a skilled workforce in the country, despite the presence of significant manpower. Given the extremely advanced technological prowess that is characteristic of Japanese investments, the lack of the technical know-how to deal with the innovations and make their optimum use also acts as an impediment for Japanese investors being circumspect of completely expanding themselves in the country. Furthermore, the perception of mechanized investments undercutting manual employment has made the Indian population wary of extensive outreach from these corporations, thus causing an unfavorable perception among the locals regarding these investors.

Taking into account these challenges for Japanese investments in India, it is necessary to understand the incumbent government’s conscious effort to eliminate these challenges. The largely favorable perception of the incumbent government’s and especially PM Modi’s development agenda is likely to go a long way in assuaging both investors as well as the local population’s doubts regarding the broader agenda regarding the investments. While the investment impediments regarding regulatory framework, licensing system, and bureaucratic hurdles can be addressed at the level of the government, challenges at the level of the population are aspects are not likely to be immediately addressed. Nevertheless, the last few years have indicated the positive investment climate that has been characteristic of the Indian economy, with multiplying FDI inflow. In that case, given that Japan is characterized by an abundance of available capital with an aging and declining population and dwindling labor force and contracting domestic market, India can come to its rescue as a market with investment potential for Japanese goods with an expanding middle class and a burgeoning consumer society. Furthermore, with Japanese managerial expertise and technical assistance, India can ensure a successful manufacturing society with a skilled and quality labor force, thus making a collaborative success story.



Major Japanese brands with investments in India

## CONCLUSION

While China remains a major part of the strategic calculus that invokes the foreign policy objectives of both India and Japan, the aforementioned cooperation points toward the strategic relationship being one that goes beyond just being a counterweight for China's rise in the region. In that light, the two countries through continued cooperation and collaboration can help establish an alliance that can anchor Asian relations and prevent the emergence of a hegemonic power in the form of China. Furthermore, the positive perception regarding both India and Japan in the region can aid in them acting as the accessible regional powers, especially in the face of a US-China conflict.

With that in mind, both Abe and Modi, with their convergent ideologies and interests, are likely to seek to establish a strategic relationship independent of any external strategic calculus in the near term. While the fact remains that the economic challenges with regard to Japanese investments in India are likely to impede or slow the accelerated phase of growth for India, the incumbent Indian government's consistent focus on economic development may go a long way in assuaging Tokyo's concerns. Put together, the Indo-Japanese cooperation, if sustained, is likely to pave the way for a successful alliance system that may be completely characterized by economic development.

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