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India's Economic and Diplomatic Strategy and its Prospects: Challenges for Realization of Make-in-India Program

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＜Summary＞

1. The Indian People's Party (Bharatiya Janata Party: BJP), the ruling party led by Prime Minister Narendra Modi achieved a land-sliding victory in the 17th general election for the Lower House (Lok Sabha) held from April to May 2019, with the second Modi administration launched at the end of May. Although the support base of the Modi administration was strengthened in the Lower House, the ruling coalition has not gained the majority in the Upper House (Rajya Sabha), with a divided condition of the parliament continuing. The next target of the government for a smoother parliament management is how to attain majority in the Upper House.
2. Holding a slogan of "Make in India", a program to promote manufacturing industry, and "Digital India", the Modi administration has worked to develop infrastructure, promote deregulation and legal and tax system reforms. The introduction of Goods and Services Tax (GST), enactment of Insolvency and Bankruptcy Code and putting the administrative procedures online as part of "Digital India" which the Modi administration implemented during its first term have been evaluated to have surely contributed to the improvement of business climate.
3. In the second term, amid concerns about the deceleration of growth, continued effort to foster manufacturing industry and create employment remains an important challenge for

the government, not only to prop up the economy in the near term but also to ensure a sustained growth in the longer run. To fully implement “Make in India” program, in addition to the government’s promotion of infrastructure development and reform of legal system, more of the private sector should be encouraged to participate in the global supply chains. For Japan, it is important that it will make efforts to construct mutually beneficial relationship not only by strengthening cooperation in the areas of infrastructure development and human and technical assistance but also through business cooperation in the third country markets.

1. Political development

(1) Next target after the overwhelming victory in the Lower House election: Resolution of divided parliament by acquiring majority in the Upper House

In the 17th lower house general elections (for 545 seats) [1] held in seven phases from April to May 2019, the ruling party BJP led by Prime Minister Narendra Modi independently won 303 seats, far exceeding the simple majority of the seats, ensuring Prime Minister Modi’s second term (Figure 1).

Despite the strengthened support base in the lower house, however, the BJP holds only 81 seats in the upper house (total 245 seats) [2], and even with the seats of the National Democratic Alliance, a ruling party coalition, which totals 105 seats, it lacks a majority in the upper house (Figure2), causing a divided parliament. How to earn the majority in the upper house will be the next focus in the coming days. As most of the members of the upper house of the Union are elected from the members of State legislative assemblies, the situation of the state assemblies will have the key. The BJP not only holds the reign in many states, but also there are moves of transfer to the BJP from other parties against the background of the BJP’s superiority in the central government. Therefore, it is seen highly likely that the divided parliament will be resolved as the NDA will gain the majority in the upper house possibly by around 2022 at the latest.

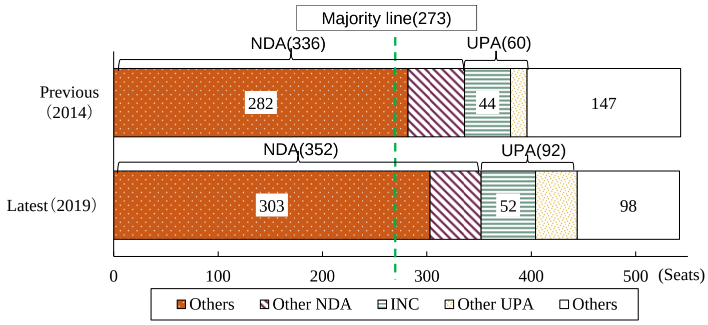
The BJP was forced into a hard fight in the elections for the Legislative Assembly and by-elections held in October in some of the states like Haryana and Maharashtra, however. The factors contributed to the overwhelming victory of the BJP in the lower house of the Union included, in addition to the charisma of Prime Minister Modi, the strong leadership that the administration showed when it took a tough stand in dealing with heightening tension between Pakistan. However, such a temporary factor that boosted the BJP seems to be wearing off, and the

[1] Out of 545seats for the lower house, 543 seats are elected from single-seat constituencies and the remaining 2 seats are nominated by the president for the term of 5 years respectively.

[2] Out of 245 seats for the upper house, 233 seats are indirectly elected by the members of state assembly, with the remaining 12 nominated by the president. Their term is for 6 years, and one third of the members are subject to reelection every two years.

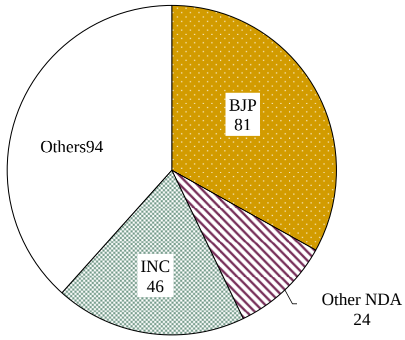
attention is moving to a phase where the BJP policies will be put to the test.

Figure 1: Result of 2019 General Election of Lower house (Lower house/Lok Saba)



(Notes) 1. NDA (National Democratic Alliance) is a ruling coallision with dominance of BJP (Bharatiya Janata Party).
2. UPA (United Progressive Alliance) is an opposition coallision with dominance of INC (Indian National Congress).
3. "Others" include the third parties and non-affiliated parties.
4. 543 seats excluding 2 presidential nominations out of total 545 seats of the lower house.
(Source) Election Commission of India and various news reports

Figure 2: Seats structure of Indian Upper house (Upper house/Rajya Sabha)



(Notes) 1. As of November 15 2019.
2. NDA(National Democratic Alliance) is a ruling coallision centering on BJP (Bharatiya Janata Party).INC(Indian National Congress) is the largest opposition party.
3. "Others" include non-affiliated parties, indipendent, and presidential appointments.
(Source) Website of the upper house of India

(2) Fairly Good Start of the Second Modi Administration with an expanded support Base

On May 31, 2019, the second Modi administration was launched. Among the main members of the cabinet, Mr. Amit Shah, a close aide of Mr. Modi since his days of governor of Gujarat State and president of the BJP, joined the cabinet as Minister of Home Affairs for the first time, emerging as a de-fact No. 2 status (Table 1). Mr. Rajnath Singh, former Minister of Home Affairs, assumed the office of Minister of Defense, former Defense Minister Nirmala Sitharaman took office as Minister of Finance, and the post of Minister of External Affairs was taken by Mr. Subrahmanyam Jaishankar who used to be former Deputy Minister of External Affairs and served as ambassador to the US and China. It is also noteworthy that Mr. Piyush Goyal who has served as Minister of Railways in the first administration, has also assumed the office of Minister of Commerce and Industry in the second term.

Helped by the expansion of ruling party's power in the parliament and weakening of the opposition parties, the second Modi administration has had generally a good start, enacting important bills in succession. In the budget deliberation the parliament held from June 17 to August 7[3], 28 out of 38 newly submitted bills were passed and enacted. It is an astounding pace that already overwhelms the 24 bills that were enacted during one year of fiscal year 2014[4] when the first Modi administration was inaugurated. Although they are not so conspicuous as the enactment of the main budget for fiscal year 2019, and revision[5] of a law that deprives the state

[3] The parliament for budget deliberation was extended from the initial date of July 26.
[4] A fiscal year starts in April and ends in March next year.
[5] The revision proposed to delete Article 370 that authorized autonomy to Jammu and Kashmir State since India's independence, and to divide the State into two union territories of "Jammu and Kashmir (J&K)" and "Ladakh" which

of Jammu and Kashmir of the right of special autonomy, the government has enacted one after another the bills that contribute to the improvement of business environment and rejuvenation of the economy, including revision of Insolvency and Bankruptcy Code that speeds up the bankruptcy procedures and enactment of Wage Act that brings together four bills relating to wage payment and revision of Aadhaar and Other Laws that relate to the use of biometric identification data by banks and telecom companies.

Table 1: Members of the Second Modi Cabinet

Position	Name	Age	Main careers
Prime Minister	Narendra Modi	68	Former Chief Minister of Gujarat State
【Cabinet Ministers】			
Minister of Home Affairs	Amit Shah	54	President of the BJP
Minister of Defence	Raj Nath Singh	67	Former Minister of Home Affairs, ex Chief Minister of Uttar Pradesh
Minister of External Affairs	Subrahmanyam Jaishankar	64	Former Foreign Secretary, ex Ambassador to China and the US
Minister of Finance, Minister of Corporate Affairs	Nirmala Sitharaman	59	Former Defence Minister, Minister of Commerce and Industry
Minister of Road Transport and Highways Minister of Micro, Small and Medium Enterprises	Nitin Gadkari	62	Former Minister of Road, Shipping and Ganges River, ex President of the BJP
Minister of Railways, Minister of Commerce and Industry	Piyush Goyal	55	Former Minster of Railways
Minister of Law and Justice, Minister of Communications, Minister of Electronics and Information Technology	Ravi Shankar Prasad	64	Former Minister of Law and Justice, Communications, Electronics and Information Technology
Minister of Women Child Development Minister of Textiles	Smriti Zubin Irani	43	Former Minister of Textiles, ex actress
Minister of Environment, Forest and Climate Change, Minister of Information and Broadcasting, Minster of Heavy Industries and Public Enterprises	Prakash Javadekar	68	Official Spokesman of the BJP
Minister of Petroleum and Natural Gas, Minister of Steel	Dharmendra Pradhan	50	Former Minister of Human Resource Development

(Note) Total number of ministers is 58 including Prime Minister Modi.
(Source) President Secretariat of India and others

2. Economic Strategy of the Modi Administration

The Modi administration has been promoting what can be called Modinomics, an economic policy package that will encourage investment from in and out of India to help the economic growth, under the slogan of "Make in India", a manufacturing promotion policy, and "Digital India". Specifically the program aims to improve business climate through infrastructure development, deregulation, and reform of laws and taxation system. In its first term, as part of reforms of the governing system, the administration strengthened the power of the prime minister's office while cutting the number of ministers, and established the National Institution for Transforming India (NITI)-Aayog[6] (Hindi for Policy Commission) as a government-affiliated think tank that makes policy recommendations and plays a role of coordinator between the central

is located in the eastern part of J&K.

6 NITI(the National Institution for Transforming India)-Aayog was organized as a successor of the Planning Commission which had played an important role in economic policy making through setting five-year programs for the last 65 years. Prime Minister Modi currently takes the chair of NITI-Aayog.

government and state governments. The NITI-Aayog has a function to coordinate the process in implementation phase by administering its progress of the states on a weekly basis, and it is believed it has had a certain degree of influence on the acceleration of reforms.

Although Make-in-India program has not produced any visible outcome of an increase of the share of manufacturing in GDP, government efforts like introduction of Goods and Services Tax and enactment of Insolvency and Bankruptcy Code, and online processing of administrative procedures as part of Digital India are evaluated to have surely contributed to the improvement of business environment. Such evaluation on the progress of reform is reflected in the rising ranking in World Bank's Ease of Doing Business Index in which India ranked 63rd in 2019, rising from 142nd in 2014.

More recently, however, slowdown of the growth rate has been a concern and it is an urgent task to prop up the economy. In the medium- and long-term perspective, the government is also required to further promote improvement of infrastructure and reforms of various regulation systems to help foster manufacturing industries and create employment.

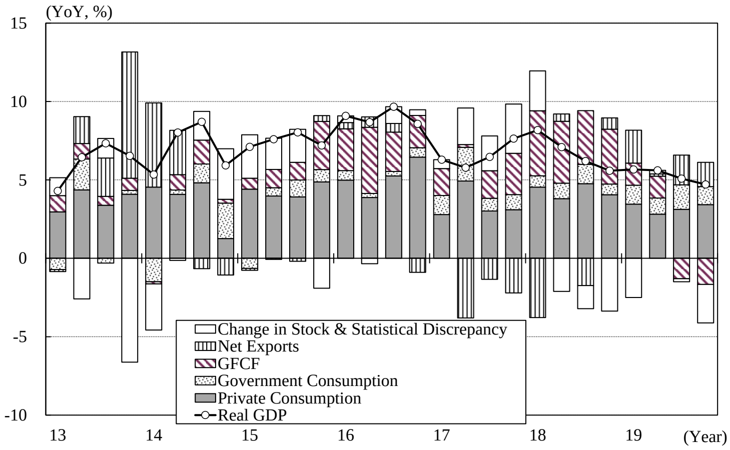
(1) Immediate needs to prop up the economy

i) Economic situation

Growth is slowing down in India. In the October-December period of 2019, real output rose 4.7% year on year, which was the lowest growth in the past 6 years or so (Figure 3). Amid the continuing stagnant growth of income and employment, tight liquidity and high interest rate reflecting bad loan problems of commercial banks and credit crunch of non-banks have put restraints on private consumption and private investment. The damage on rural areas and SMEs of the demonetisation of certain high denomination bank notes [7] in November 2016 and the introduction of GST in July 2017 is considered to still remain, and a decrease of income in the agricultural sector due to poor harvest caused by bad weather is also pointed out as a factor of the stagnant economy. The sluggish sale of automobiles may have been affected by the introduction of emission controls slated for April 2020.

[7] On the night of November 8, the government announced to nullify the 500 rupee and 1,000 rupee notes (effective November 9) and to introduce new 500 rupee and 2,000 rupee notes. People were allowed to convert the old notes to other notes including new notes or deposit them in banks by December 31, 2016.

Figure 3: Real GDP Growth Rate



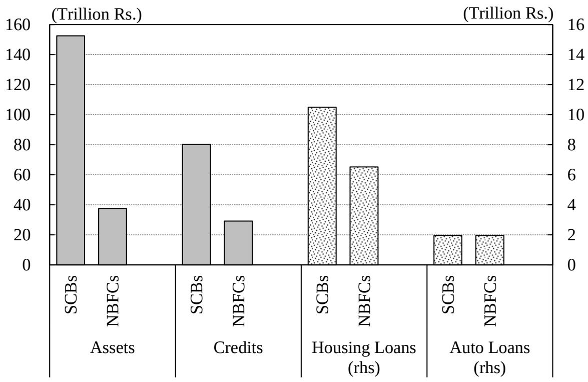
(Source) National Statistical Office, Ministry of Statistics & Programme Implementation, GOI

ii) Financial sector puts downward pressure on the economy

Lowering financial intermediation function due to credit contraction in the non-banking finance companies (NBFCs) sector is pointed out as a factor of sluggish domestic demand. In recent years, NBFCs had increased their share of lending in India against a backdrop of stagnant lending of commercial banks suffering from non-performing asset problems. They stepped up their presence especially in retail finance like auto loans and housing loans although the gross assets of NBFCs including housing finance companies remain one quarter of those of commercial banks, with their lending outstanding about one third (Figure 4). On the other hand, not a few NBFCs increased their dependency on commercial papers (CP) as a means of fund raising, in addition to the historical corporate bonds and bank lending. This practice of short-term funding and long-term operation has raised a miss match problem in their assets and liabilities, increasing a risk of liquidity crisis.

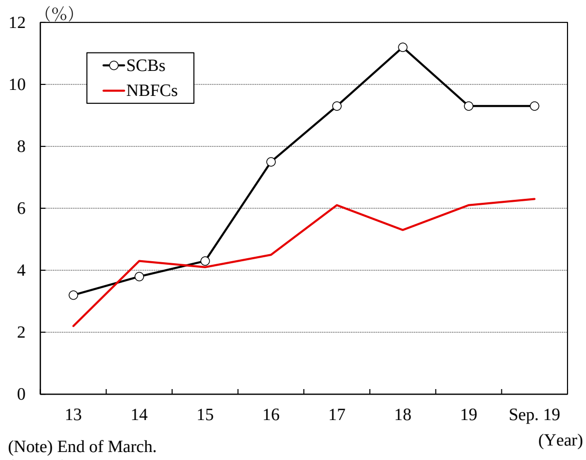
Triggered by the default on payment of a major NBFC "Infrastructure Leasing & Financial Services Ltd (IL＆FS) that took place in September 2018, concerns grew over the payment capacity of NBFCs and made asset management companies including mutual funds, which had been NBFCs' main source of that capital, accelerate selling of CPs and short-term issues, causing liquidity crisis and deterioration of financing to some NBFCs. The shake-up of NBFCs continued and in June 2019 Dewan Housing Finance Corporation Ltd (DHFL), a major housing finance company fell into default. Although the non-performing assets (NPA) ratio of NBFCs stayed at 6.3% as of the end of September 2019, fairly below 9.3% of scheduled commercial banks (SCBs), it needs continued attention as the ratio is on a rising trend (Figure 5). As for the NPA ratio of SCBs, Public Sector Banks (PSBs) recorded 12.7%, much higher than 3.9% for private sector banks (PVBs) and 2.9% for foreign banks(FBs), showing that the bad assets were heavily concentrated in PSBs. PSBs, following the policy of the government, had increased their loans to infrastructure development and airlines/communications based on an optimistic outlook and loan appraisal standard, but these loans became uncollectable as the projects were delayed by, in addition to the economic slowdown, slow permission procedures and influence of regulations. In response to these developments, the Reserve Bank of India (RBI, central bank) strengthened the examination of commercial banks since FY2015, and directed them to increase loan-loss reserves and accelerate the bankruptcy procedures for major non-performing companies.

Figure 4: Major Indicators of SCBs and NBFCs



(Note) Non-banking finance companies (NBFC) includes housing finance companies. Figures of assets of scheduled commercial banks (SCBs) and those of NBFCs are as of March 2018. Other figures are as of September 2018.
(Source) RBI

Figure 5: NPAs of SCBs and NBFCs



(Note) End of March.
(Source)RBI

iii) Government and central bank intensify efforts to prop up the economy

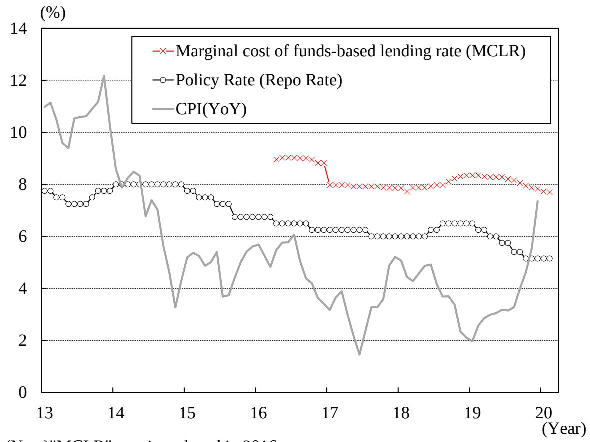
In response to the economic slowdown, the government announced one after another in 2019 measures to stimulate the economy, including support for purchase of cars and low-priced houses, corporate tax cut, and infrastructure projects. Meanwhile, the RBI implemented policy rate cuts five times starting February to October 2019 with a total cut of 135bps (Figure 6). However, the bank left the rate unchanged in December, showing a stance that it will focus on recovering financial intermediary function while assessing the effects of the past monetary easing amid the increasing upward pressure on prices centering on foods. Actually, according to the developments of the Marginal Cost of funds-based Lending Rate (MCLR), a fall of market rates from February to end November remained at only about 50bps, suggesting the delay of passing through of monetary easing effect.

As for the recovery of financial intermediary function, in addition to the Insolvency and Bankruptcy Code 2016 which was implemented in December 2016, a new framework[8] for accelerating the disposition of problem assets that the RBI announced in June 2019 helped to push the rapid disposals of bad-assets of NBFCs that faced debt defaults. The government also came to support the financial sector by announcing a policy to inject public funds to PSBs and

[8] RBI(2019a)

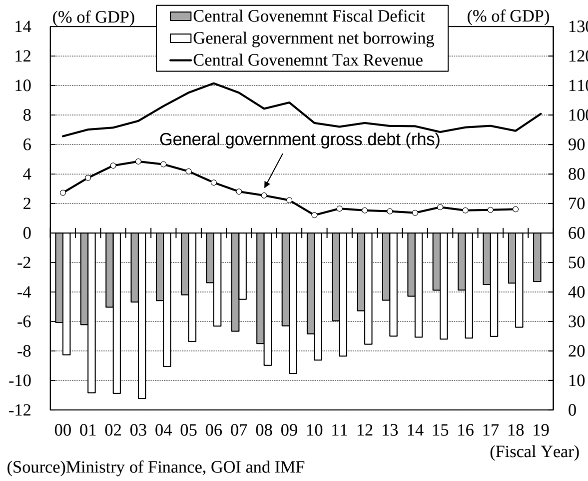
integration programs of PSBs. As noted above, the non-performing asset problems of SCBs are mostly concentrated in the PSBs and inappropriate governance, lack of market principles, government intervention into credit policies and appointment of important posts of the PSBs had long been pointed out as problems of the PSBs. The government of India is required to tackle these problems in their efforts to restore sound management of the PSBs.

Figure 6: Inflation and Policy Rates



(Note)"MCLR" was introduced in 2016.
(Source)RBI

Figure 7: Fiscal Balance and Public Debt



(Source)Ministry of Finance, GOI and IMF

(2) Also need to pay attention to fiscal discipline

i) Concerns over growing fiscal burdens

The fiscal balance of India has been chronically in red. Factors of the deficits include narrow taxation base and stiffened expenditure due to interest payments, subsidies and defense costs which account for more than half of outlays. Accordingly, the share of capital expenditures like infrastructures continues to hover at around 10% of total expenditures and the crowding out of private investment through higher interest rates has been a long-standing problem in India. The share of the central government revenues against GDP has remained below 10% despite the high economic growth in 2015 to 2016 and introduction of GST in July 2017 (Figure 7).

Further, associated with the enhanced economic stimulation measures, concerns over growing fiscal burdens are increasing amid the prospect for downside tax revenues reflecting the slowdown of economic growth. Based on the Fiscal Responsibility and Budget Management Act, the government has made efforts to reform taxation system so as to contain the fiscal deficit of central government under 3% of nominal GDP, but the target year has been often postponed. In the budget for FY2019 (draft) the government expects the deficit at 3.3% of GDP, a bit lower than 3.4% in FY2018 (actual), and seeks a further decline to 3% in FY2020. However, the possibility cannot be ruled out that the budget deficit would expand to the upper half of 3% in the FY2019 due to a fall of tax revenues associated with corporate tax cut (R1.5 trillion, 0.7% of GDP).

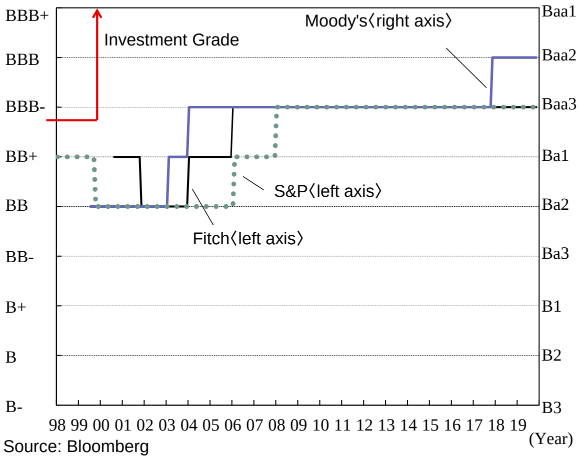
ii) Worsening environment surrounding the economy and finance putting India's rating outlook negative

Entering in the 2000s, major ratings agencies gradually upgraded India's sovereign rating to "Investment Grade (BBB-/Baa3)" (Figure 8). In addition, Moody's International further upgraded it to Baa2 in November 2017, positively evaluating the medium-term growth prospect and improved fiscal position reflecting the reform efforts of the Modi administration. The agency pointed out as specific reform efforts the introduction of the GST, disposal of non-performing assets of banks, demonetisation of certain high denomination bank notes, and reduction of informal economy through introduction of national identification (Aadhaar).

These agencies cite the worsening of growth prospect and fiscal position and stalled reform efforts as factors leading to a possible downgrade in the future. Against this backdrop, Moody's changed the outlook on the Government of India's ratings to negative from stable on November 7 2019 reflecting worsening environment surrounding the economy and public finance of India. Even if Moody's actually downgraded the rating of India, its impact would be limited as it means only Moody's joining the other ratings agencies on the level of rating for India. The fundamentals of India show an improvement like narrowing budget deficits and accumulation of foreign exchange reserves as compared to around 2013 when selling pressures intensified on emerging currencies triggered by the expectation on a tapering of the US quantitative easing. Therefore, the possibility for another downgrade (to a speculative grade) seems to be small (Table 2).

The Modi administration revealed in late November measures like acceleration of privatization of state-owned enterprises (SOEs) to maintain fiscal discipline. Nonetheless, the revenues from selling the stocks of SOEs remain at R200 billion so far although the fiscal bill set a target of R1.05 trillion. It is indispensable for the government not only to implement steadily the stated plan but also to maintain the reform efforts so as to enhance growth prospects and reduce fiscal burdens in the medium and long run.

Figure 8: India's Sovereign Ratings



Source: Bloomberg

Table 2: Fundamentals and Currency Performance in Major Emerging Economies

	Current Account (% of GDP)		Fiscal Balance of General Government (% of GDP)		Public Debt (% of GDP)		Foreign Reserve (% of ARA)	
	2013	2018	2013	2018	2013	2018	2013	2018
India	▲ 1.7	▲ 2.1	▲ 7.0	▲ 6.4	67.4	68.1	143.6	147.3
Indonesia	▲ 3.2	▲ 3.0	▲ 2.2	▲ 1.8	24.8	30.1	123.3	80.0
Philippines	4.2	▲ 2.6	0.2	▲ 1.6	45.7	38.9	243.2	192.6
Thailand	▲ 2.1	6.4	0.5	▲ 0.3	42.2	42.1	209.3	212.8
Mexico	▲ 2.5	▲ 1.8	▲ 3.7	▲ 2.2	45.9	53.6	122.6	118.3
Brazil	▲ 3.2	▲ 0.8	▲ 3.0	▲ 7.2	60.2	87.9	159.4	169.1
Russia	1.5	6.8	▲ 1.2	2.9	13.1	14.6	151.0	300.9
South Africa	▲ 5.8	▲ 3.5	▲ 4.3	▲ 4.4	44.1	56.7	81.8	70.3
Turkey	▲ 6.7	▲ 3.5	▲ 1.5	▲ 3.1	31.4	30.2	101.6	75.6
Argentina	▲ 2.1	▲ 5.3	▲ 3.3	▲ 5.2	43.5	86.1	n.a.	95.2

(Note) 1. Shadowed portion indicates an improvement from 2013.
2. Appropriate level of reserves to hold is culcurated by the Assessment of Reserve Adequacy (ARA) Metric below and figures within the 100-150 % range of the metric is considered to be appropriate.
ARA metric (Float Exchange Rate) = 5% × Exports + 5% × Broad Money + 30% × Short-term Debt + 15% × Other Liabilities

(Source) IMF

(3) Fostering manufacturing and creating jobs in the medium and long run are the highest priorities

In the medium and long run, it remains the highest priorities for the government to foster manufacturing and create employment by promoting the Modinomics which contains infrastructure development and reform of legal system.

The Modi administration set it a target at the time of presenting budget for FY 2019[9] at the beginning of July 2019 to increase the economic scale of India from the current $2.7 trillion to $5 trillion in the coming few years, while positioning as important policy measures for the next decade those measures for infrastructure improvement and digitalization and Make-in-India program that the government has promoted since its first term (Table 3). The main policy measures taken so far and challenges for the future are described below.

Table 3: Ten points of the Vision for the Decade

1	Building physical and social infrastructure
2	Digital India reaching every sector of the economy
3	Pollution free India with green Mother Earth and Blue Skies
4	Make in India with particular emphasis on MSMEs, Start-ups, defence manufacturing, automobiles, electronics, fabs and batteries, and medical devices
5	Water, water management, clean rivers
6	Blue Economy
7	Space programmes, Gaganyan, Chandrayan and Satellite programmes
8	Self-sufficiency and export of food-grains, pulses, oilseeds, fruits and vegetables
9	Healthy society – Ayushman Bharat, well-nourished women & children. Safety of citizens
10	Team India with Jan Bhagidari. Minimum Government Maximum Governance

(Source) Ministry of Finance, GOI

[9] The second Modi administration presented on July 5 formal union budget for FY 2019 (April 2019-March 2020) in a way to modify the interim budget it presented in February.

i) "Make in India"

"Make in India", a program to promote manufacturing in India which the first Modi administration revealed in September 2014, aims at making India a globally attractive hub for manufacturing by encouraging investment for domestic and foreign companies, raising the share of manufacturing to 25% in GDP by 2022, strengthening its international competitiveness and creating 100 million new jobs in manufacturing. Giving high priority not only to such manufacturing sectors as automobiles and automobile components, chemicals, and electric machines but also to a wide range of business lines that include IT and BPM (business process management), tourism, media and entertainment (Table 4), it promotes deregulations and simplification of investment approval procedures. Yet, the share of manufacturing industry still remains at mid-teen % of GDP, and unemployment rate has been standing high, with people's deep dissatisfaction continuing[10].

Regarding restrictions on foreign capital contribution ratio, a 100％ foreign investment is allowed in all industries with some exceptions due to gradual deregulations made until now. However, with consideration toward micro- and small-sized retailers, the government maintains its cautious stance toward retailers of multi-brand products[11].

Also there are some moves, in the name of promoting domestic production, of an increase of tariff rates on some of imports or introduction of non-tariff measures like an increase of products subject to Bureau of Indian Standards (BIS) certification. For instance, the Phased Manufacturing Program (PMP), a program to promote indigenous manufacturing for cellular mobile handsets, plans to raise tariffs on cellular products and parts gradually from the current 1% to 15%-20%. Despite of some criticisms of such raises of tariffs, actually there has been seen an increasing number of local productions by foreign affiliated companies[12], and the number of imported cellular mobile handsets has been decreasing after peaking in FY2014 (Figure 9). Looking ahead, the government aims at further promotion of domestic production by gradual raise of tariffs on various parts used to make cellular phone handsets.

[10] A public opinion survey implemented in May 2018 (with some 840 thousands respondents) found employment generation, demonetization (abolishment of high-denomination bills), Kashmir policy, and supports to farmers (tackling agrarian crisis) as the biggest failures the first Modi administration made.
（https://timesofindia.indiatimes.com/india/mega-times-group-poll-71-9-of-indians-say-they-will-vote-for-narendra-modi-as-pm-again-in-2019/articleshow/64324490.cms）。

[11] The areas with a ceiling include insurance and pensions (49％), banking (74％) and retailers of multi-brand products (51％). Forbidden industries include real estates, nuclear energy, gambling, and tobaccos. Judgement on entry of multi-brand retailers is left to the discretion of each state, and there are seen very few cases where entry is actually permitted although about one third of states institutionally permit the entry.

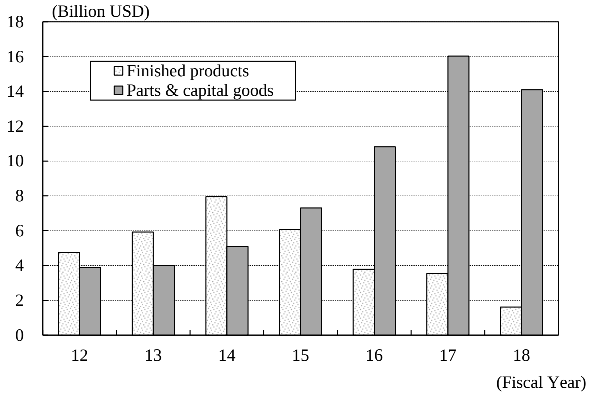
[12] Following Wistron (iPhone 6、7), a major EMS in Taiwan, Honghai (iPhone XR, XS, etc) started its production of iPhones in 2019 (surplus products were exported to Europe).

Table 4: 25 Fields in "Make in India"

Automotiles	Mining
Auto Component	Oil and gas
Aviation	Pharmaceuticals
Biotech	Ports and Shipping
Chemistry	Railways
Construction	Tourism and hospitality
Defence Manufacturing	Roads and highways
Electrical machnery	Space
Electronic systems	Textile and garments
Food processing	Thermal power
IT and BPM	Media and entertainment
Leather	Wellness
Renewable Energy	

(Source) GOI

Figure 9: India's Trade of Mobile Phones



(Note) 1. "Finished products" includes Feature Mobiles and smartphones.
2."Parts & capital goods" includes base stations, digital micro-wave communication device, printed circuit board, LCD module for smartphones.
(Source) Ministry of Commerce, GOI

ii) "Digital India"

Under the "Digital India" program the Modi administration formulated in August 2014, digitalization is in progress in India in a top-down manner (Table 5). To simplify administrative procedures, all applications to central government and ministries were unified to e-biz portal site (e-Government), through which online applications for an industrial license or memorandum of business entrepreneur became available for 24 hours. More construction permissions and trade processing can be conducted online, contributing to speed-up of business deployment and improvement of transparency.

Further, in addition to utilization of national ID numbers (Aadhaar)[13], wider use of banking accounts and mobile phones are important factors to realize the efficiency of administrative procedures and financial inclusion. Although registration on Aadhaar is voluntary, as it gives an advantage when receiving various social security benefits, the number of registered citizens reached approximately 1.2 billion as of the end of June 2019, covering about 90% of the whole population of 1.35 billion. It is the largest ID platform in the world now. The "Jan Dhan Yojana (People Money Scheme)" the Modi administration launched in August 2014 enabled everyone to open account linked with Aadhaar, which made it possible for citizens to conduct financial transactions like withdrawal or deposit of cash, transfer of money, check of balance, by Aadhaar number and biometric identification through fingerprints by using micro ATM terminals equipped in the agencies of a bank even in rural areas with no bank branches and ATMs. As a result, bank accounts became much popular, the account holding ratio of the nation aged 15 or older rose from

[13] "Aadhaar" (means "foundation" in Hindu and is translated into English as Unique Identification Number) is a 12 digits identification number which uses biometric identification. It registers basic private information (name, birthdate, sex, address) as well as biometric information (face photo, fingerprints of 10 fingers, iris of both eyes) (free of charge). The Unique Identification Authority of India (UIDAI), established in February 2009, started registration from September 2010.

53% in 2014 to 80% in 2018, a level competing with those in higher middle-income countries (Figure 10).

Aadhaar, by directly paying to the beneficiaries of various benefits, has contributed not only to its main objective of streamlining social security and other administrative services to prevent illegal receipts by double charges or under fictitious names of social security benefits and the like. It also has contributed to the progress of financial inclusion. Furthermore, communication companies, financial institutions, and electronic settlement agencies have started one after another to provide settlement services that use smartphone applications. Together with the increased number of shops where such services are available and the demonetisation[14], a cashless society has been developing in India where the ratio of cash transactions used to be high in general commercial transactions.

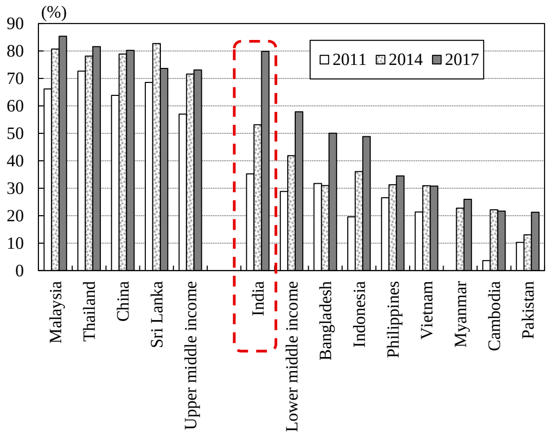
On the other hand, there also remain challenges for the utilization of Aadhaar, such as how to protect privacy, and measures to deal with information leak. The Supreme Court declared in August 2017 that the right of privacy corresponds to the basic human rights defined in the Constitution and in September 2018 delivered a verdict that forbade private companies to use Aadhaar as a means of personal identification from the standpoint of privacy protection. This made the use of Aadhaar hard for private companies. However, the revised "Aadhaar and Other Laws" that was enacted in July 2019 left the use of Aadhaar to an individual initiative, paving the way for banks and communication companies to use Aadhaar as a means of personal identification with the consent of the individual. Thus, it is considered that uncertainties surrounding the expansion of services utilizing Aadhaar have receded.

Table 5: Vision Areas of Digital India

1) Digital Infrastructure as a Utility to Every Citizen	
	Availability of high speed internet as a core utility for delivery of services to citizens
	Cradle to grave digital identity that is unique, lifelong, online and authenticable to every citizen
	Mobile phone & bank account enabling citizen participation in digital & financial space
	Safe and secure cyber-space
2)Governance & Services on Demand	
	Seamlessly integrated services across departments or jurisdictions
	Availability of services in real time from online & mobile platforms
	All citizen entitlements to be portable and available on the cloud
	Making financial transactions electronic & cashless
3)Digital Empowerment of Citizens	
	Universal digital literacy
	Universally accessible digital resources
	Availability of digital resources / services in Indian languages
	Citizens not required to physically submit Govt. documents / certificates

(Source) Ministry of Electronics & Information Technology, GOI

Figure 10: Account ownership ratio in Asia



(Note) Percentage share of population ages 15+ with bank account.
(Source)World Bank

[14] Although the evaluations vary on the effect of original purpose to eradicate illicit funds, many think that the measure created a momentum for promoting cashless systems.

iii) Goods and Services Tax

The introduction of Goods and Service Tax (GST)in July 2017 has been evaluated as the biggest achievement of the first Modi administration and the most important tax reform in the history of India. In India, in addition to the goods tax and services tax controlled by the central government, different tax systems had been taken by state, such as value added tax and central sales tax that were controlled by the state governments or border tax that was levied to the transactions crossing the states. Those tax rates differed according to the kind of transactions and states. Tax cost and transaction cost associated with these complicated tax systems had been long pointed out as one of the largest barriers to the business in India, while an introduction of GST had been contemplated for more than 10 years. The introduction needed an amendment of the Constitution with more than two thirds of votes in favor in both houses together with the ratification of more than half of the state assemblies. However, Prime Minister Modi, despite the divided parliament, managed to enact it. His ability to achieve that has been highly evaluated.

With the introduction of GST, taxation system was unified into uniform indirect tax applied throughout the country (Figure 11)[15]. In more concrete terms, India has two tier system of Central GST (CGST) as national tax and State / Union Territory GST as regional tax with Integrated GST (IGST) levied on the cross-state transactions and imports[16]. The benefit of GST may include simplification of procedures and reduction /streamlining of distribution costs, but some point out that the burdens on the procedure have increased as the number of tax filing increased. In addition, some technical problems, like the limited capacity of data that the online tax payment system (GST network) can handle, are pointed out, and improvement in such questions is expected in future.

Figure 11: Summary of indirect tax regime in India

【pre-GST regime】

	Items
Central Gov.	・Central Excise Duty ・Additional Duties of Excise ・CVD & SAD ・Service Tax ・Additional Duty and Cess etc.
State Gov.	・State VAT ・Central Sales Tax ・Entertainment & Amusement Tax ・Luxury Tax ・Entry Tax ・Additional Duty・Special Additional Duty etc.

【post-GST regime】

Items
＜Sale within the State＞ ・Central GST(CGST) ・State GST(SGST) / Union Territory GST(UTGST)
＜Sale to another State＞ ・Integrated GST(IGST）

(Source) GOI

15 Tax rates are divided into five phases (0% exemption), 5%, 12%, 18%, 28%.

16 Institutionally, IGST is imposed on the cross-state transactions and imports, but practically it can be offset with other GSTs.

iv) Insolvency and Bankruptcy Code

The “Insolvency and Bankruptcy Code, 2016” enforced in December 2016 can also be called one of the reforms that greatly contributed to the improvement of business environment. Conventionally, there was no general law that comprehensively dealt with personal and corporate bankruptcy or exemption of their liability and plural legislations had been implemented. For instance, restructuring procedures of manufacturing industry were handled by the “Sick Industrial Companies Act, 1985 (SICA)”, debt collection procedures for creditors including banks and other financial institutions by "Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (SARFAESI Act)” and “Recovery of Debts Due to Banks and Financial Institutions Act 1993”, private consolidation procedures of debts by syndicated banks followed the guideline by the RBI, and company liquidation procedures were handled by the Company Act. This mixed existence of plural regulations not only complicated the application of procedures but also hindered a quick processing of debtor-led insolvency and bankruptcy procedures[17], widely spreading the recognition of the difficulty of exit as a risk for investment in India.

The enactment of the “Insolvency and Bankruptcy Act, 2016” unified these plural legislations and enabled the creditor-led insolvency processing with a time limit (in principle within 180 days from the bankruptcy petition, with one time extension available for 90 days), which is expected to help handle the bankruptcy procedures for companies more quickly and smoothly. It is in turn expected to promote an increase of investment. The Act has been amended to remove uncertainties around some interpretations, and this is also expected to contribute to a rapid implementation of bankruptcy processing.

v) Infrastructure development

Infrastructure development has seen a steady progress despite a delay in some fields due to problems in land acquisition and funding, and concerns for impact on environment. In the first term, the Modi administration expanded a budget for infrastructure investment to Rs 5.9 trillion in FY2018, three times as much as Rs 1.8 trillion in FY2014. In its second term, the administration is planning to allot Rs 100 trillion for infrastructure investment in the next five years.

Specifically, the improvement in the supply of electricity is highly evaluated as an example of success from international institutions like the World Bank and other experts[18]. In the field of electricity, supply did not catch up with an increase of electricity demand associated with population growth and economic growth, and coupled with the loss in power transmission and

[17] According to the ranking in the “Doing Business, 2019” of the World Bank, the length required for bankruptcy proceedings in India was 4.3 years on average, much longer than in other Asian countries (Indonesia, 1.1 years, Thailand 1.5 years, China 1.7 years).
[18] For examples of high evaluation, see IEA (2018) and The Business Line (2018), others.

distribution and the problem of the accumulated deficits of power transmission and distribution companies[19], chronic electricity shortage had been a social problem in India, for which the past administrations had devoted much efforts to reform. At the time of general elections in 2014 the Modi administration publicly committed for achieving an access to electricity for 24 hours a day and 7 days a week by 2019. In order to promote the 24x7 power project, the administration established an organization DDUGJY which plays the role of expanding the electric power grid and in November 2015 introduced a scheme UDAY to sell the securitized debts of the power distribution companies.

Actually, the electric power supply and demand gap (electricity deficit rate) in India improved from 4.2% in FY2013 to 0.6% in FY2018 on the national base (Figure 12). By region, short supply has been dissolving, not only in Gujarat in the west where Prime Minister Modi successfully dissolved the power shortage through a power reform in the days he served as Chief Minister of the state, but also in the south and the east (Figure 13). As is seen above, the electricity deficit rate is steadily declining, although there remains a room for improvement in the north where demand grows rapidly and in the northern east where the development of power source is underdeveloped. Furthermore, it has been made possible to allot the funds made available through UDAY to investment in power system, and the rate of Aggregate Technical and Commercial Loss (AT&C loss) also has been on a declining trend.

In addition, the construction of a high-speed railway[20] connecting Mumbai and Ahmedabad about 505km, to be open in 2023) and a freight exclusive railway[21] between Delhi and Mumbai (app. 1,500km, to be fully opened in 2025) under the Delhi-Mumbai Industrial Corridor Project (DMIC) has been promoted with the cooperation of the Japanese government and the government of India involving both public and private sectors.

Development of urban transportation (subways) is also well under way. Especially, the operating distance of 373km of the subway in the Delhi metropolitan area already exceeds Tokyo (304km of combined distance of Toei Subway and Tokyo Metro) and has come to compete with 374km of New York. Currently, subways operate in 7 main cities including the Delhi metropolitan area, and more construction has been pushed forward in 8 cities for the opening of business.

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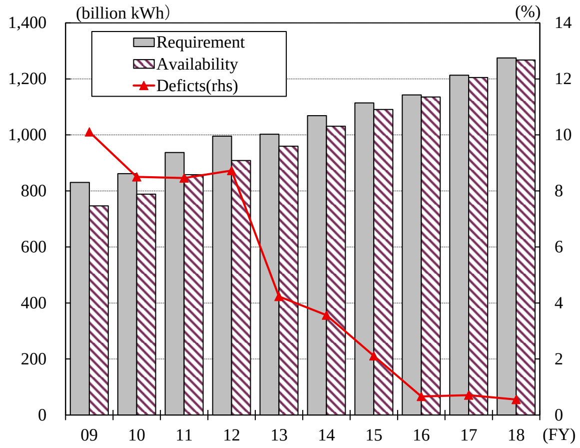
[19] As the electricity charge for agricultural use has been kept politically low, distribution companies can recover only about 80% of the cost, and accumulated deficits and debts have pressed their management.

[20] Of the total operation cost of R980 billion (app. ¥1.6 trillion) of the high-speed railway between Mumbai-Ahmedabad, about 80% of construction cost excluding the acquisition cost of land is financed by the yen loan provided by Japan. Meanwhile, in response to the election for Maharashtra State Assembly held in October, a new state government led by the local political party Shiv Sena was launched. The new Chief Minister Uddhav Thackeray, leader of the party, had been expressing an objection to the project that passes his state, and there is a concern about its influence on the project.

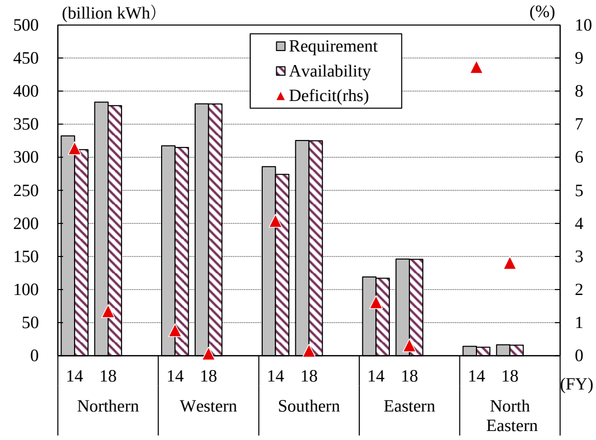
[21] Delhi-Mumbai Industrial Corridor project is a Japan-India joint project to construct a freight exclusive railway between Delhi and Mumbai, two biggest cities in India, extending to about 1,500km with the provision of yen loan of ¥450 billion. It includes the development of infrastructures in their periphery like industrial complexes, power plants, roads and ports, and other commercial facilities mainly operated with private investment.

Figure 12: Power Supply Position (All India)



(Source)Central Electricity Authority

Figure 13: Power Supply Position by Region



(Source)Central Electricity Authority

vi) Amendment of Land Acquisition Law

The realization of a smooth land expropriation is essential for the infrastructure development and promotion of investment by private enterprises. "The Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act**,** 2013 **(**Land Acquisition Act**,** 2013) was enacted in 2013 under the previous administration and came into force in January 2014 (Table 6). The Act clarified the land acquisition process such as agreement duty of the land owners or the compensation for the land owners on the occasion of the land acquisition. Specifically, in the case of a private project, it required the agreement of 80% of land owners and in the case of a public-private partnership (PPP) project, the agreement of 70%. In addition, in the rural areas, it obligated the payment of compensation money in four times as much as the market price, and double of the market price in the urban areas, together with equivalent amount of consolation money, respectively. Since in the past the consent of virtually 100% of land owners was necessary on an individual negotiation in the case of private development project, it can be said that the hurdle of land acquisition has become not necessarily too high. However, in addition to the remaining deep-rooted criticisms that the law is too advantageous to land owners with generous compensation, for which oppositions of land owners are also likely to happen easily, there are not a few cases where the project is delayed as it takes more time to acquire land owing to the newly added procedures like Social Influence Assessment (SIA) and Environment Influence Assessment (EIA),

Against this backdrop, the Modi administration once tried to revise the law while issuing Presidential Order[22] at the end of 2014 which simplified the land acquisition procedures on some

[22] Presidential Order refers to issuance of new laws or amended laws by President at the request of Prime Minister at emergency or during the prorogation of the parliament. Its validity is temporary and expires when the law fails to be enacted within 6 weeks after the convening of the next parliament. The Presidential Order of December 31, 2014

important fields, but he met a strong opposition from the opposition parties and was forced to drop the amendment. Differing from the time of launch of the first Modi administration in 2014, no initiatives for the amendment of the law were incorporated in the BJP campaign platform in 2019, and it seems that the realization of the amendment is not in sight at present.

Table 6: Summary of Land Acquisition Laws in India

<table>
<tr><th colspan="2" rowspan="2"></th><th rowspan="2">New Land Acquisition Law (2013)</th><th colspan="2">Old Land Acquisition Law (1894)</th></tr>
<tr><th>provisions</th><th>Note</th></tr>
<tr><td rowspan="3">Consent of land owners</td><td>Government Development</td><td>not required</td><td rowspan="3">not required</td><td rowspan="3">development for private purpose required concent of 100 % of owners on an individual negotiation</td></tr>
<tr><td>PPP</td><td>70%</td></tr>
<tr><td>Private Development</td><td>80%</td></tr>
<tr><td rowspan="4">Compen sation</td><td>to</td><td>affected families</td><td>owners only</td><td></td></tr>
<tr><td>amounts</td><td>Rural Area: 4 time of market price
Urban area：two times of market price</td><td>market price equivalent</td><td rowspan="3">as a transaction practice, market price (registered price) is set drastically lower than the actual transaction price</td></tr>
<tr><td>consoleum</td><td>same amount of compensation</td><td>30% of market price</td></tr>
<tr><td>others</td><td>・40% of profit of transfer
・alternative housing and support for reconstructing lives</td><td>-</td></tr>
<tr><td colspan="2">Procedures</td><td>・Social Influence Assessment (SIA)and Environment Influence Assessment (EIA)
・obligation to define urgency</td><td>usually chances given for opposition petition and hearings</td><td>formal one (just for reference to the government after the petition to an official in charge)</td></tr>
</table>

（Source）Various reports

vii) Amendment of Labor Act

About the labor law, in addition to more than 40 laws that the central government established, there existed the laws and ordinances that each state government established. Moreover, permission of the state government was required to the establishments employing more than 100 workers when they close the business or cut jobs. This has been pointed out as a factor that discourages companies from increasing their employment. The Modi Administration aims to integrate and simplify these complicated labor related legislations into four laws of “wage”, "labor security and hygiene", “labor-management relationship” and “social security” and to relax the requirements for the application of the labor dispute law (Table 7).

Among them, based on the Wage Act enacted in August 2019, it was decided that the minimum wages which had been prescribed by each state should be prescribed by the central government. Although it may require some revision of employment agreement, it is expected that the new law will make it easier for companies to keep legal compliance in the long run. In addition, the Modi

abolished the obligation of agreement of land owners and exempted the Social Influence Assessment in the fields of national security and defense, infrastructure projects in rural areas, housing for low incomes, industrial corridor, social infrastructure projects by PPP among the provisions of Land Acquisition Act, 2013. The order expired in August 2015.

Administration submitted in late November "the labor-management relations bill" to the winter session of Parliament (from November 18 to December 13). It is likely that the requirement of permission of the state government in the case of the closure and a personnel cut will be kept unchanged to factories with more than 100 workers.

Table 7: Major points in Amendments of Indian Labour Laws

	Bills	Old Law (No.s of laws)	Points of amendments	Progress
①	The Code on Wages Bill, 2019	4	・Unified the definition of "wage" ・Provision of minimum wage unified by the central government (formerly varied by state	Enacted
②	The Code on Occupational Safety, Health and Working Conditions 2019	13	・Unified range of application (to establishments employing at least 10 workers) ・Decision by central/state governments of an appropriate working hours ・Provisions for leaves and overtime works ・Establishement of welfare facilities, etc.	Submitted to the lower house in July 2019. Under deliberation by an independent comittee since October (within 3 months)
③	The Industrial Relations Code Bill, 2019	3	・Permit direct employment of fixed term workers in all industries (formerly employment through contractors. Provide fixed-term workers social security and benefits package equal to regular workers. ・No change in the provision for number of workers of less than 100 in the factories which can dismiss workers or close factories without permission of the state government ・establishment of funds for reskilling workers, etc	Introduced in the Lower House in November 2019
④	The Draft Labour Code on Social Security 2018	8	(Reportedly the deliberations seem to include the followings) ・Coverage by insurance and pension of unorganized workers (including those of start-ups) ・Company pension, privatization of employees national insurance ・Maternity benefits, etc.	Drafted in 2018. Currently under third revision.

(Source) Information by the Government of India and various news reports

Incidentally, there are moves on the level of state governments to aim at revising labor related laws independently. States like Haryana, Gujarat, Maharashtra, and Andhara Pradesh permit companies with less than 300 employees to dismiss their employees without approval of the state government. On the other hand, Andhara Pradesh state government promulgated a new state law in August 2019, in which it obliged the companies to employ locally more than 75% of employment in factories or of PPP projects in the state. It is concerned that the obligation will increase the cost to the companies coming into the state, and it should be noted that all the amendments are not always made in the desirable direction for incoming companies.

3. Diplomatic strategies of the Modi administration

(1) Overview

The foreign policy of India has been characterized by its principle of nonalignment or omnidirectional diplomacy taken from a viewpoint of securing strategic autonomy without depending on any specific country. However, since the end of the 1990s, India has built "strategic partnership" (SP) relations with countries and regions with strategic importance in such areas as politics, economy, security and energy resources. Based on this strategy, and in an effort to pursue the realization of “Make in India” program, the Modi administration adopted “Act East” policy, in a way to build on the “Look East” policy, trying to strengthening the relations with Asian countries. At the same time, the administration launched “Link West” policy, aiming to strengthen its relations with countries in Africa and the Middle East. Another characteristic of the foreign policy of the Modi administration is the re-strengthening of its relations with neighboring South Asian countries. As the destinations of his first foreign trip just after the inauguration, Prime Minister Modi chose Bhutan and Nepal in his first term, and Maldives and Sri Lank in his second term, with the number of the visits to the area in the first term already exceeding the number of visits in two terms of the previous administration.

Regarding the trade policy, based on the perception that the Free Trade Agreements (FTAs) India had concluded in the past did not contribute to the promotion of exports, the country had remained cautious on the conclusion of a new FTA. Actually, the Modi administration did not conclude any FTA during its first term (Table 8).

Table 8: Current status of India’s FTA conclusion

	Partner country / region
1981	Argentina
2001	Sri Lanka
2003	Afghanistan
2004	Thailand (only Early Harvest)
2005	Singapore
2006	Bhutan
	Bangladesh
	SAFTA
2007	Chile
2009	Nepal
2010	Korea
2011	Malaysia
	ASEAN
	Japan
	MERCOSUR

	Partner country / region
under negotiation	RCEP, GCC, SACU, EU, EFTA, China, Australia, New Zealand, Indonesia, Pakistan, Russia, Peru, Canada, Serbia-Montenegro, US

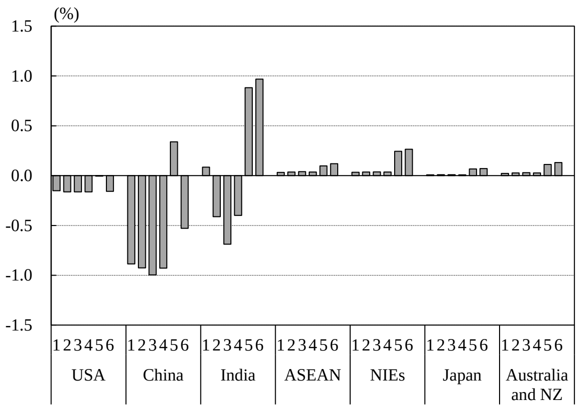
(Source) Various reports

However, in the second term, a recognition gradually spread that it could have positive impact on realization of the “Make in India” program for India to participate in the production networks in East Asia, and a proactive approach came to be seen in participation in the East Asia Regional Comprehensive Economic Partnership (RCEP) on the ground that it would secure its economic interests on the whole. The High-Level Advisory Group (HLAG) on Trade, established by the Ministry of Commerce and Industry, highlighted in its research report[23], the importance of Global Value Chains (GVCs) which brings investments and technology besides the other benefits of

[23] HLAG (2019).

domestic manufacturing and services and argued that India should be looking for opportunities of locating itself on GVCs. It also provided an analysis that in the presence of the USChina trade war, maximization of its economic benefits can be expected by joining an RCEP-like free trade agreement (Figure 14). In addition, the Confederation of Indian Industry (CII) also showed its expectation for the participation in value chains (VCs) of the East Asia through the RCEP[24].

Figure 14: Economic Impacts of the Trade disputes between US-China Trade War on Major Economies



(Note)Change in GDP from base case. Simulation based on the GTAP Model at NCAER. Detail in each Simulation 1- 6 descrived in the table on the right.
(Source)High Level Advisory Group (HLAG)

Simulation 1	USA and China increase tariffs against each other up to 20% on mining and manufacturing sectors. Tariffs already above 20% remain stable at their existing rates.
Simulation 2	USA and China raise tariffs against each other up to 20% on mining and manufacturing sectors, as well as against India. Tariffs already above 20% remain stable at their existing rates. India does not react.
Simulation 3	USA and China raise tariffs against each other up to 20% on mining and manufacturing sectors, as well as against India. India responds by increasing its import tariffs on mining and manufacturing up to 20% against USA and China. Tariffs already above 20% are remain at their existing rates.
Simulation 4	USA and China raise tariffs against each other up to 20% on mining and manufacturing sectors, as well as against India. India responds by lowering its above 20% import tariffs on mining and manufacturing down to 20% against USA and China. Tariffs already below above 20% remain at their existing rates.
Simulation 5	India, China, Japan, ASEAN- NIEs and ANZ eliminate bilateral tariffs on non-agricultural products – hypothetically mimics RCEP-like free trade bloc. USA and China have not yet gone to tariff war outlined in Simulation 1.
Simulation 6	India, China, Japan, ASEAN- NIEs and ANZ eliminate bilateral tariffs on non-agricultural products – hypothetically mimics RCEP-like free trade bloc. USA and China have gone to tariff war outlined in Simulation 1.

(Source) High Level Advisory Group (HLAG)

(2)With the US: Strengthening Strategic relations despite intensifying conflicts on trade

India has given the US utmost importance as it brings to it important interests on many fronts including politics, economy, military and diplomacy. The United States also had taken foreign strategy that focused on relations with India, particularly after the 2000s, in view of its strategic importance associated with war on terrorism and a power balance between China, as well as its high potential as a future market. The two countries built a Strategic Partnership relationship in 2004 and, in 2005, signed a "Defense Framework Agreement" in a manner that made an exception of India which was a non-member of Nuclear Nonproliferation Treaty (NPT), and in 2008 concluded the “U.S.-India Civil Nuclear Cooperation Initiative”.

Relations between the two countries have been getting much stronger since the start of the Modi administration in 2014. More recently, the Free and Open Indo-Pacific Strategy (FOIP)has taken a central status as a significant concept in the relationship of the two countries. The FOIP Strategy aims at connecting a rapidly growing Asia with Africa with a high potential by free and open Pacific Ocean and Indian Ocean, by which to pursue prosperity in the whole area. Following

[24] CII (2019b)

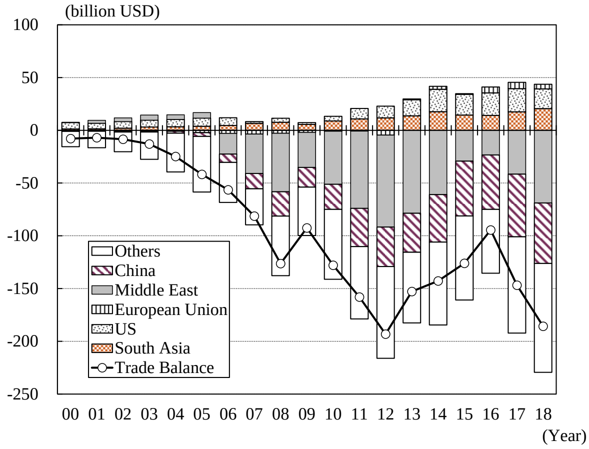
Japan, the US State Secretary Tillerson referred to it in October 2017 and President Trump in November and the concept was clearly mentioned in the National Security Strategy announced in December. The FOIP which the U.S. Government advocates positions as major pillars freedom of navigation and overflight in addition to the rule of law and peaceful solution of disputes, suggesting that the US attaches more importance to the security aspect of the relations. In 2018, four cabinet ministers of foreign affairs and national defense of the two countries gathered to have a "two-plus-two" dialogue, the first one for India.

On the other hand, conflicts over trade issues have been intensifying in recent years between the two countries. Conflicts over high tariff rates and protection of intellectual property rights in India had continued in the past, and in the annual reports based on the Section 301 (identification of infringement of intellectual property rights and sanction) of the Omnibus Foreign Trade and Competitiveness Act, India had been designated on the "priority monitoring list" in the past 25 years for the reason that India's intellectual property regime was deemed with concern. However, in recent India, there has been an increasing number of moves that raise tariffs and non-tariff barriers to protect and foster domestic industries or to reduce trade deficits, which constitutes a factor that prompts further the complaints of the US administration. Also frustrating the US is India's launch in June 2019 of retaliatory tariffs on some of its imports from the US as a countermeasure to the imposition of additional tariffs on steel and aluminum products by the Trump administration in March 2018 based on the section 232 of the Trade Expansion Act of 1962. It also fueled the conflicts of the two countries that in early June the US Trade Representative Office terminated India's status as a beneficiary of the Generalized System of Preferences (GSP).

Since then, the two countries have continued negotiations to conclude partial trade agreement. The agreement seems to include the content that India lowers tariff rates on some of the items imported from the US and in exchange the US restore the GSP status for India. However, there is a strong opposition to the restoration of the designation among the US business groups which had been demanding its termination for a long time. On the Indian side, too, there seems to exist a substantial resistance to the lowering of tariffs on electric appliances and the like that the US demands, in the context of promotion of "Make in India" and control of trade deficits. However India keeps a trade surplus with the US (Figure 15), and according to a survey of the NITI-Aayog[25], the US ranks the top as a potential export market for India, thus the incentives for India to seek a trade agreement with the US still remain (Figure 16).

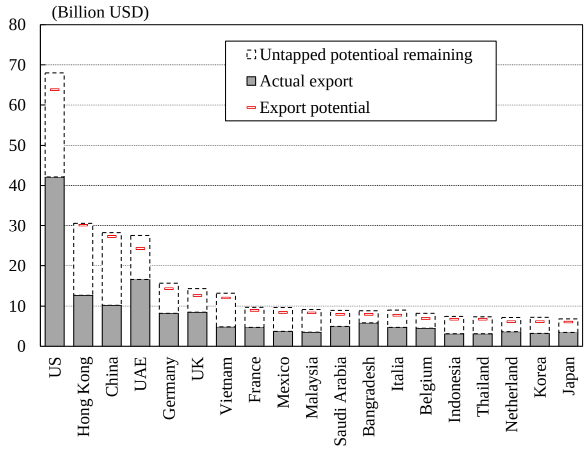
[25] NITI-Aayog (2018)

Figure 15: India's Trade Balance



(Source)IMF

Figure 16: India's potential export markets (Top19)



(Source) International Trade Center (ITC)

(3) With China: Balanced diplomacy with focus on practical gain while strengthening caution

Conflicts over the border dispute have been continuing for many years between India and China. Especially India is strengthening its vigilance against China, as China, in addition to its intensified ties with Pakistan, has been expanding in recent years its influence over South Asia region through its "Belt and Road Initiative".

On the other hand, economic relations between the two countries through trade and investment are intensifying and with the objective to secure investment fund to promote infrastructure development and secure common interests in the multilateral talks, India engages in a balanced diplomacy focusing on practical gains as a whole. India, while maintaining its opposing position to the Belt and Road Initiative, joined the China-led Asian Infrastructure Investment Bank (AIIB) as a founding member, with the largest commitment next to China. Incidentally, India is the biggest beneficiary of the AIIB with the amounts ($2.8 billion as of end-September 2019) of investment in India approved by the AIIB accounting for about 30% of the total. In the fora of multilateral talks, India joins China in taking an opposing stance to regulations relating to global warming and reduction of agricultural subsidies, from a standpoint of placing a priority to economic development.

The Chinese share among the exports of India stood at the third (5.1%) in 2018, following the United States (16.0%) and UAE (9.0%). On the import side, China was the largest (14.5%) trade partner. Imports from China have been growing while India's exports to China remain stagnant, making China the single largest country with which India has trade deficits (Figures 15 and 18). By commodity, imports of electrical equipment and parts like telephone sets accounted for about 30% of the total imports from China. Therefore, the Modi Administration aims at the restraint of the trade deficits by raising the tariff rate on some items including the electronic equipment while trying to increase domestic production ratio.

It is not only in the area of imports that the presence of China has increased. The investment from China is also increasing in the rapidly growing start-up companies. More than 70 Indian start-ups including 12 unicorn companies (start-ups with valuation of more than $1 billion) have received investment from Chinese big tech companies and venture capitals like Alibaba, Tencent, and Shunwei Capital (Xiaomi), and caution is growing in some quarters in India to the data hegemony by China (Table 9)[26].

Table 9: Major Unicorns in India

Indian Company	Brand Name	Major Service	Chinese Investor	Estimated Investment (Million USD)
Innovative Rtail Concepts Pvt.Ltd.	Big Basket	EC	Alibaba Group, TR Capital	250
Think an Learn Pvt.Ltd.	Byju	Online Education app.	Tencent	50
Hike Ltd.	Hike	Chat app.	Tencent Holdings	150
ANI Technologies Pvt.Ltd.	Ola	Taxi app.	Tencent, Steadview Capital, Sailing Capital and China, Eternal Yeild International Ltd, China-Eurasian Economic Cooperation Fund	500
Oravel Stays Pvt, Ltd.	Oyo	Hotel, Housing	Didi Chuxing, China Lodging Group	100
Paytm E-Commerce Pvt, Ltd.	Paytm Mall	EC	Alibaba Group	150
One97 Communications	Paytm.com	Digital payment	Alibaba Group (Alipay Singapore Holding Pte,Ltd.), SAIF Partners	400
Jasper Infotech Pvt,Ltd.	Snapdeal	EC	Alibaba Group	n.a.
Zomato Media Pvt,Ltd.	Zomato	Restaurant search App., Food delivery	Alibaba Group (Alipay Singapore Holding Pte,Ltd. & Ant Financial Services Group), Shunwei Capital	200

(Source)Gateway House

(4) With Japan: Challenge is how to deepen economic relations despite their high cooperation in ODA and security

In the 2000s, Japan tried to strengthen close ties with India starting with the Official Development Assistance (ODA) and cooperation in security area taking into account India’s geopolitical importance and as a check against China. Specifically, following the US, Japan decided in 2001 to lift the economic sanctions against India[27], and restarted its Yen loans in 2003. Since then, India has been the biggest beneficiary of the Japanese yen loans. After the inauguration of the Modi administration in 2014, the relations of the two countries were upgraded to "Special Strategic Global Partnership" and the shuttle diplomacy continues in which top leaders of the two countries meet in each country every year. In his keynote address at the Tokyo International Conference on African Development (TICAD) held in August 2016, Prime Minister

[26] Gateway House (2019)
[27] In response to the nuclear tests India conducted in 1998, Japan imposed economic sanctions including freeze of new provision of ODA.

Abe mentioned the "Free and Open Indo-Pacific (FOIP) " strategy while in January 2018 he positioned in his policy statement the promotion of the FOIP strategy as the top priority of Japanese diplomacy. In the summit meeting held in October in the same year, the two tops agreed on the cooperation in the digital field where they can mutually complement and in the summit meeting in June 2019, they also expressed their hope to develop cooperation in the fields such as a Fund of Funds, digital affairs, cooperation in third countries and so on. In the security and defense fields, they had held regular meetings (2+2) since 2010, and at the end of November 2019, they had the first meeting of Foreign Ministers and Defense Ministers (2+2). Japan is the second country next to the US with which India holds a 2+2 ministerial level meeting, and India is the seventh to Japan.

Meanwhile, the pace of deepening of their economic relations is slow. The direct investment from Japan to India amounted to $3.2 billion in 2018, exceeding that to Vietnam and standing in parallel with Indonesia. However, it remained at one-third of China and around a half of Thailand and it is expected it will further expand in the future (Figure 17). On the other hand, the statistics on the Indian side show that Japan is the fifth largest investor in India[28], following Singapore, Mauritius, the Netherlands, and the United States. However, part of investments from the largest three countries may include those made by the Japanese affiliated companies, and it can be seen that actual Japanese investments have amounted to a substantial level as a single country. By type of business, although Japanese investment into India has mainly been in manufacturing led by automobiles and in more recent years by services sector like retails and restaurants are on an increase, diversification of manufacturing and more penetration by small- and medium-sized enterprises remain as a big challenge for the Japanese investment in India.

On trade relations, the Japanese share in India's exports remained low at 1.5% (ranking 19th by country) of the total, and 2.5% (14th) of imports. By commodity, India exported to Japan mainly processed goods of primary products like petroleum products (naphtha) in 2018, followed by chemicals, marine products, jewelries, textiles, while India imported from Japan mainly industrial products like general machines and electronic equipment, and steel, with India's trade deficits with Japan on an increasing trend (Figure 18).

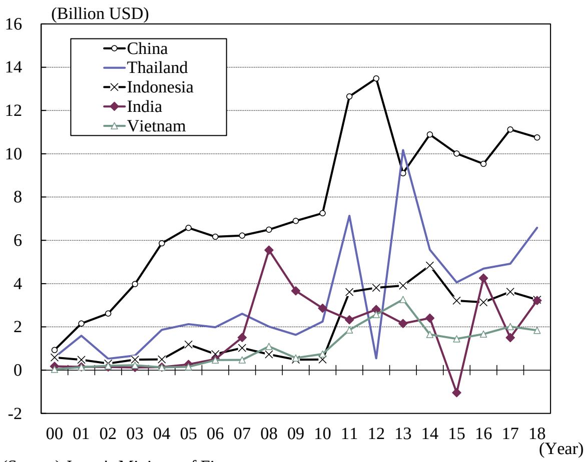
In the background of this limited expansion of their trade relations, there is a fact, it is pointed out, that India has been following a domestic oriented growth model and therefore most of the Japanese affiliated companies in India tend to focus on acquiring local domestic demands. Therefore, increase of exports to the third countries can be a promising field where the Japanese affiliated companies can contribute to the expansion of export of India. Companies penetrated in India have increased their cost competitiveness through increased local content ratio and other

[28] In the past, India was exempted from capital gains tax on a certain condition by the taxation treaties with Singapore and Mauritius. However, the Modi administration revised the treaty with Mauritius in May 2016 and in December 2016 with Singapore and normal tax rates came to be applied afterward.

efforts to cope with intense competition with the local companies and there have been some moves in recent years to explore the possibility of exports to ASEAN countries and the Middle East from Indian bases.

In addition, an expansion of cooperation between Japanese and Indian companies in the third nation markets will also contribute positively to both economies. In a report[29] on the trilateral partnership of the Indian companies and third nation companies in Africa that the Confederation of Indian industry (CII) announced in March, 2019, Japan, US, Germany, France and UAE were named as a candidate of the partner. As the reasons why Japan can become a candidate, the report pointed out such facts that the Japanese companies have not fully explored the African market yet, that they have political boosts through such frameworks as the TICAD and the FOIP strategy, and that synergy effects can be expected from their human resources and technological aspects. The Japanese companies can expect expansion of their business opportunity through cooperation and partnership with Indian companies and connections which have networks in the Middle East and the African region while utilizing the operating resources of their Indian bases.

Figure 17: Japan's FDI flow to Major Asian Countries



(Source) Japan's Ministry of Finance

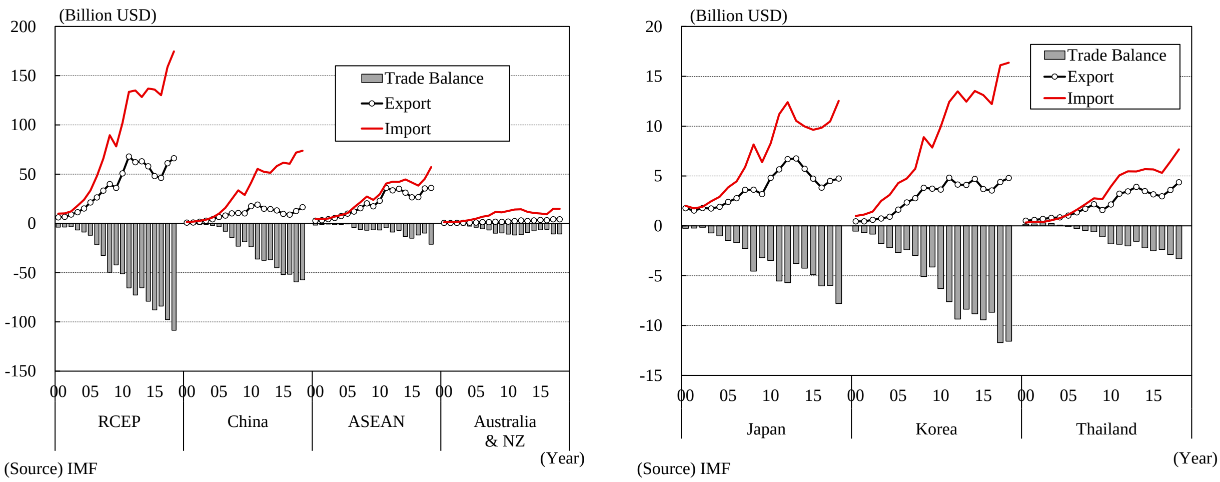
(5) With East Asian region: Future course of the RCEP

Amid the growing concerns over the rise of China in the 2000s, recognition increased that Indian participation in the framework of regional cooperation in the East Asia was necessary and in 2005, the East Asia summit meeting was launched by 16 countries consisting of "ASEAN+3 (Japan, China and South Korea) " and Australia, New Zealand and India. At the East Asia summit meeting held in 2011, setup of a taskforce for the East Asia Regional Comprehensive Economic Partnership (RCEP) was agreed in response to the joint proposal made by Japan and China, and in the following year, 2012, it was declared to start the negotiation, which actually started in 2013.

[29] CII (2019)

The third RCEP summit meeting held in November, 2019 " specified in its joint statement[30] that “15 RCEP Participating Countries (except India) have concluded text-based negotiations for all 20 chapters and essentially all their market access issues” and they “tasked legal scrubbing by them to commence for signing in 2020”. This confirmed that 15 countries except India have reached a broad agreement on their negotiations and signing of the agreement in 2020 came into sight. On the other hand, it referred to India by saying that “India has significant outstanding issues, which remain unresolved”, and that “India’s final decision will depend on a satisfactory resolution of these issues”. Although the statement left the possibility of India’s return to the negotiations, the government of India clearly said that it “conveyed its decision not to join the agreement of the RCEP”[31] reflecting both assessment of the current global situation as well as of the fairness and balance of the agreement, making the conclusion of the agreement by 16 participating countries quite uncertain.

Figure 18: Trade between India and RCEP member Countries



In the background of India’s non-participation in the agreement there lies a concern over the expansion of trade deficits with China above all. Other than China, the trade balance went into deficit in 2005 with Thailand after India started to lower the tariff rates on some items from Thailand in 2004 in advance of others, and deficits have been also increasing with the ASEAN, Japan, and Korea with which India has concluded FTAs (Figure 18).

In addition, although the concise contents of the negotiation have not been revealed, various reports suggest that India had taken a hard-line attitude on some of its matters of concerns and requests. As for trade on goods, it is believed that the India’s recent decision was influenced by the dissatisfaction on the insufficient reflection of their demands for (i) base year for tariff

30 Ministry of Foreign Affairs, Japan (2019)
31 Ministry of External Affairs, Government of India (2019)

reduction or removal, (ii) liberalization on a lower level or at a slower pace, (iii) introduction of safeguard measures, (iv) strict rules of origin, etc. Regarding the base year, effectively implying that member countries should slash import duties on products from the level that existed in the certain year, it seems that India is demanding for the adoption of base year of 2019, instead base of 2014 that the RCEP currently uses, aiming to make the pace of liberalization milder by using the latest tariff rates as the base, given that import duties on many products have gone up in recent years. As for liberalization ratio (ii) and introduction of safeguard measures (iii), they are believed to be the measures to prepare for a rapid increase of imports from China.

In the individual fields, focus of discontents is likely to be on the improvement of the non-tariff barriers in the pharmaceutical products market of China and regulations on the movement of professionals. The Chinese pharmaceutical market has been deregulated gradually in recent years, yet, foreign pharmaceutical products manufacturers find it very hard to enter since it takes a long time before they can obtain import permission from the Chinese authorities, and they are required to guarantee quality assurance that is severer than the domestic manufacturers when they deliver generic medicines to hospitals. As a consequence, India has recorded deficits with China even in the trade of pharmaceutical products for which India has a competitive advantage[32].

Furthermore, it is highly likely that the decision of withdrawal was influenced by the opposition campaigns waged in various places just prior to the Third RCEP summit meeting by such groups as an economic group The Swadeshi Jagran Manch, an affiliated with the social group Rashtriya Swayamsevak Sangh (RSS) which advocates the principle of Hindu supremacy and is a support base of the government ruling party BJP and farmers' organization All India Kisan Sangharsh Coordination Committee (AIKSCC). It is supposed that politically the Modi administration could not ignore those domestic oppositions as the solution of divided parliament by gaining majority in the upper house.

The government of India underscores its policy to assign the highest priority to domestic economic interests in the days to come and protect farmers, micro-, small- and medium-sized enterprises and domestic manufacturers. Although it seems currently very difficult for India to return to the RCEP, it is expected that the government will continue negotiations with the countries concerned while domestically explaining and addressing the merits of RCEP carefully and in detail, given the positive contribution that the participation in the production networks in Asia will bring to the realization of "Make in India".

The RCEP-related countries including Japan will be required, first of all, to aim at reaching agreement by 16 countries. If the RCEP is realized by 16 countries, it will make an economic zone which occupies about half of the world population and about 30% of the world GDP.

[32] India imports from China $2.5 billion worth of active pharmaceutical ingredients while India's exports of pharmaceutical products to China remain at $0.23 billion, one tenth of imports.

However, if India should pull out, it could greatly lower the significance of RCEP not only from a standpoint of an economic strategy but also from a geopolitical point of view. For India, it will be the key how to relax the negative influence on the trade side. For others, options may include securing of flexibility on the safeguard introduction and the liberalization rate, deregulation on the movement of people and services, and cooperation in fostering industry and small-and medium sized business that India has urged.

4. Future prospects and challenges

The Modi administration won an overwhelming victory in the general elections for the Union Lower House held in April-May 2019, consolidating its political foundation. However, the administration will have to be cautious in taking policies unpopular to the people until the divided parliament is dissolved by winning a majority in the Upper House. Even in such a circumstance, it still remains an important agenda for the government, in addition to take immediate economic stimulus measures, to foster manufacturing industry and create employment aiming at a sustainable growth. Towards realization of “Make in India”, participation in the global production networks will be effective from the viewpoint of reinforcing industrial competitiveness as well as promoting investment from in and out of the country through accelerated infrastructure development and legal system reforms.

On the Japanese side, it can be said that Japan should continue, and reinforce, cooperation with India in the areas of infrastructure development and human and technical support which will contribute to the achievement of “Make in India”, and deepen trusting relationship by constructing mutually beneficial relations through cooperation in IT and digital technology, as well as business cooperation in the third country markets.

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