



INDIA AND JAPAN: A NASCENT STRATEGIC BONDING

Policy Brief

May 2015

Pramit Pal Chaudhuri

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Executive Summary

India and Japan have experienced a remarkable transformation in their relations in the past decade on both economic and strategic levels. This paper attempts to explain the reasons for this shift, especially by looking at the motivations on both sides. The relationship developed initially because of a convergence of economic interests. The strategic element became more pronounced as both countries, but more so Japan than India, experienced heightened tensions with China over existing territorial disputes.

But the new trajectory in the relationship has been underpinned by more than mutual concerns regarding an assertive China. Japan's ambitious plans to provide India the sort of modern infrastructure and manufacturing base that India lacks is about ensuring Asia has more strategic ballast against China — as well as providing an economic boost to Japan's economy. India is also seen as playing an important role in legitimising Shinzo Abe's recent attempts to undo Japan's post-war pacifism.

Strategic ties remain nascent, their course partly dependent on the nature of Asian geopolitics in the coming years and the future economic trajectory of both India and Japan. The economic relationship, after a lull during the second Manmohan Singh government, is gathering steam and much is expected from the pro-business Prime Minister Narendra Modi. But Indo-Japanese relations continue to face many hurdles. The most important are the continuing impediments Japan's private sector faces when trying to operate in India. The early strategic signals of Modi's foreign policy are of a willingness to more openly align with Japan and the U.S. on mutual concerns regarding China. However, the difficulties India and Japan have had in reaching a bilateral civil nuclear agreement indicate how hard it will be for two countries, both unused to proactive strategic decision-making, to convert policies into actions.

Introduction

Japan Ups Economic Engagement

Through much of Japan's rapid economic expansion from the 1960s to the present day, India was a country of marginal interest to Tokyo. New Delhi was on the wrong side of the Cold War, prone to carrying out nuclear tests, and a practitioner of unsuccessful socialist economic policies – all of which meant Japanese economic trade and investment with India remained minimal.¹

The first sign of a shift in Japanese interest in India was the visit of Prime Minister Yoshiro Mori in 2000. More tangibly, Tokyo announced in 2003 that India would receive more overseas development assistance than China, though this was largely a reflection of the domestic political difficulties in Japan of continuing to provide aid to China while diplomatic relations worsened.²

What galvanised Tokyo to take a much closer look at India was the conclusion of the Indo-U.S. nuclear deal, negotiated during 2005-2008, in which Washington agreed to end decades of nuclear and related technology sanctions against India. This caught Tokyo by surprise, but was seen as evidence of a much greater U.S. strategic interest in India. This was also in tune with evidence of India's rising economic capacities in high technology sectors.³

Japan, taking its cue from the U.S., became more active in boosting India's economic development. One, it shifted its aid policy to India away from traditional poverty alleviation to infrastructure building. This was helped by its experience with the

Delhi Metro urban transit system. This was Japan's first major experiment in building such infrastructure in India and proved quite successful. Two, from around 2007, Japanese manufacturing firms were encouraged to invest more in India, with a resultant increase in Japanese foreign direct investment (FDI) to the US\$2 billion a year level, a level that continues to this day.

These two areas together have emerged as the cornerstone of the new bilateral economic relationship: large-scale investment in India's industrial infrastructure and manufacturing sectors.⁴ The infrastructure was to be partly financed by Japanese overseas aid. This would pave the way for Japanese private investment, largely in the area of manufacturing, to ride into the country on the back of the infrastructure that was built. As the Japanese ambassador to India noted in 2014, Japan's infrastructure investment helped make East and Southeast Asia major manufacturing hubs, integrated these regions into global supply chains, and "the Japan-India partnership is predicated on following a similar path."⁵

Thus the number of Japanese firms in India has risen from 301 in 2005 to 1,072 in 2013, according to the Japanese Ministry of Foreign Affairs. The annual amount of Japanese FDI flowing into India, less than 30 billion Yen before 2006, jumped to 178 billion Yen in 2007 and peaked at 542 billion Yen in 2008. The global financial crisis and India's economic policy crises saw the figure halve in subsequent years, but the 2013 FDI figure of 223 billion Yen is a "new normal" for Japanese investment.⁶

1 For a summary of the poor state of Indo-Japanese relations during the Cold War, see Arpita Mathur, *India-Japan Relations: Drivers, Trends and Prospects*, RSIS Monograph No. 23, 2012 <http://www.rsis.edu.sg/wp-content/uploads/2000/01/Monograph23.pdf>

2 Conversation with two Japanese Foreign Ministry officials in Tokyo in March 2003. They explained that it was proving domestically difficult to provide China high levels of aid given growing friction with Beijing over a number of issues.

3 On the importance of the Indo-US nuclear deal, several conversations with Japanese diplomats between 2009 and 2013. One said, "We realized then we had a lot of catching up to do." On Japanese recognition of India's nascent technology capabilities, see: "Indian Engineers Backbone of IT Industry," Press Trust of India, 7 November, 2009, http://articles.economictimes.indiatimes.com/2009-11-07/news/27658051_1_engineers-indians-japanese-industry, http://pages.stern.nyu.edu/~asheopur/Indian_autoSep_2006.pdf; Vinay Kamath, "Land of the Rising Yen," *Business Line*, 15 April, 2013 <http://www.thehindubusinessline.com/industry-and-economy/land-of-the-rising-yen/article4619446.ece>

4 Some Japanese officials argue the greater interest in India began to take shape in 2002. But most Indian and Japanese officials see 2007 as the time when interest began to manifest itself as actual policy.

5 Ambassador Takeshi Yagi, "A Power with Responsibility," *Indian Express*, 16 January, 2014.

6 See "Recent Japan-India Relations," Japanese Ministry of Foreign Affairs handout, January 2014. http://www.mea.gov.in/Portal/ForeignRelation/Japan_-_July_2014_.pdf

There was a consensus between the two main Japanese parties, the Liberal Democratic Party (LDP) and the Democratic Party of Japan (DPJ), on the new economic engagement with India. A major incentive which both shared was the sense that larger infrastructure investment in India would help boost demand for Japanese firms. The best example of this is the massive 1,480 kilometre-long Delhi-Mumbai Industrial Corridor (DMIC) project.⁷ Though first proposed by the nationalist Shinzo Abe in 2007, it was adopted by successive Japanese governments on both sides of the political spectrum. The left-of-centre DPJ, for example, became a strong proponent because of Japanese calculations that 40 per cent of the project's initial US\$90 billion-worth of contracts would go to Japanese firms. Japan's labour unions, a key source of DPJ support, became votaries of the deal in the expectation that it would provide jobs in Japan.⁸ Tokyo proposed a number of similar corridors and large-scale infrastructure projects.

Japan developed a greater incentive to push such projects as its relations with China worsened. This made its manufacturing firms with large production bases in China, already concerned at rising labour costs and slowing growth in the Middle Kingdom, interested in alternative countries.⁹ A Hitachi executive was quoted as saying, "Japan is the past, Thailand now, India the future."¹⁰

India's Economic Interest

India was receptive to the economic agenda of Japan. New Delhi was cognisant that it needed a larger manufacturing base and that the first step towards getting one was to build the sort of infrastructure that India lacked. Thus Japan's proposal easily found support from Prime Minister Manmohan Singh, an economist and ardent Japanophile, who had visited Japan over 20 times during his life. His aides noted that he used the



Indian Prime Minister, Shri Narendra Modi (left) along with Japanese Prime Minister Shinzo Abe (centre front), feeding fishes at State Guest House, in Kyoto, Japan on 30 August 2014. Photo courtesy: Website of the Indian Prime Minister's Office (PMO) <http://pmindia.gov.in/en/image-gallery/page/22/>

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- 7 The Delhi Mumbai Industrial Corridor has several websites dedicated to it, some of them representing different stages of its administrative evolution. <http://www.dmicdc.com/>, <http://www.dmic.co.in/>, <http://delhimumbaiindustrialcorridor.com/>
- 8 Private email from Japanese foreign ministry official, October 2010.
- 9 "Japan and China: What's the Best Way Forward?", Knowledge@Wharton, 17 October, 2014 <http://knowledge.wharton.upenn.edu/article/the-japan-china-conflicts-impact-on-business/>, Bruce Einhorn, "Battered in China, Japan Inc Looks to Southeast Asia," *Bloomberg Businessweek*, 7 February, 2013, <http://www.businessweek.com/articles/2013-02-07/battered-in-china-japan-inc-dot-looks-to-southeast-asia>
- 10 Victoria Tuke, "Expanding Strategic Horizons: Japan's Foreign Policy towards India," [tokyofoundation.org](http://www.tokyofoundation.org), 25 March, 2013 <http://www.tokyofoundation.org/en/articles/2013/expanding-strategic-horizons>

term “transformational” to describe only two bilateral relations of India: the U.S. and Japan. In this he meant these two countries were capable of changing India’s economic capacities in a fundamental and structural level.¹¹

However, the Singh government, paralysed by a variety of internal political ills in its second term, proved largely unable to provide the sort of business environment that Japanese firms needed for investment. More damagingly, it was unable to stitch together with India’s state governments the sort of agreements that were needed to build such large projects as the DMIC, which runs through five states. After the passage of a 2012 Indian budget bill that imposed arbitrary retroactive taxes against multinational firms, many Japanese firms shelved plans to ramp up their investments in India.

Nonetheless, Japanese firms were able to set up localised clusters of manufacturing in a few states, most notably Delhi/Haryana, Maharashtra and Tamil Nadu.¹² But the creation of an export-oriented infrastructure of the sort that much larger Japanese investment required was hampered by various political and regulatory issues.

However, having a nation as wealthy as Japan interested in its well-being helped India in other ways. In 2014, India suffered an exchange rate crisis over the Rupee. Tokyo proposed a currency swap arrangement that would give India access to Japan’s enormous foreign exchange reserves. The idea was to end the speculative bids against the Rupee, which it succeeded in doing once the swap was announced.¹³

The Strategic Element

The addition of a strategic element to this relationship is closely related to two Japanese prime ministers,

both members of the LDP: Taro Aso (2008-2009) and Shinzo Abe (2012-present). Aso had a more limited view, but successfully ramped up naval exercises and diplomatic cooperation between India and Japan. Abe had long been a proponent of the idea that India and Japan shared a common strategic interest over the potential threat posed by China and a weakening U.S. commitment to the Asia Pacific. He is often credited with inventing the term “Indo-Pacific” to reflect this convergence. In his 2007 book, *Towards a Beautiful Country: My Vision for Japan*, Abe wrote it would “not be a surprise if in another decade, Japan-India relations overtake Japan-U.S. and Japan-China ties.”¹⁴

India was initially cautious about the benefits of a deeper military or strategic relationship with Japan. First, it was argued in New Delhi that this would worsen India’s already frayed relations with China in return for minimal benefit, given Japan’s geographical distance from India.¹⁵ Second, the concept of the “Indo-Pacific” as a strategic construct was treated with scepticism, at one point being openly questioned by the last Indian national security advisor.¹⁶

Third, following the Indo-U.S. nuclear deal, New Delhi had made similar civil nuclear cooperation agreements the litmus test of the strategic interest of other countries. Broadly, India argued that if a government was unwilling to end the nuclear and dual-use technology sanctions that had been imposed on India because of its past nuclear tests, then military and other strategic ties with that country would be limited. The strength of anti-nuclear sentiment in Japan, however, has made this a difficult demand for Tokyo to fulfil.¹⁷ India has refused to concede any more limits on its nuclear activity than it has conceded to the U.S., providing little political cover to Japan for signing such an agreement.¹⁸

11 Private conversations with aides of Prime Minister Manmohan Singh between 2010 and 2012.

12 “Japanese Business Establishments in India,” Embassy of Japan in India website, January 2015, http://www.in.emb-japan.go.jp/PDF/20150105_j_cos_list.pdf

13 Pramit Pal Chaudhuri, “How Japan Saved the Rupee,” Foreign Hand blog, [hindustantimes.com](http://hindustantimes.com/foreign-hand/2014/01/31/how-japan-save-the-rupee/), January 2014, <http://blogs.hindustantimes.com/foreign-hand/2014/01/31/how-japan-save-the-rupee/>

14 Adrien Frossard, “Is the Return of Shinzo Abe Good News for India?” Institute for Defence and Studies and Analyses Issue Brief, 8 January 2013 http://www.idsa.in/issuebrief/IsTheReturnofShinzoAbeGoodNewsforIndia_AdrienFrossard_080113

15 Victoria Tuke, “India and Japan Must Get Closer,” *Business Line*, 25 March, 2014, <http://www.thehindubusinessline.com/opinion/india-japan-must-get-closer/article4547665.ece?homepage=true>

16 National Security Advisor Shivshankar Menon, at a book launch on 6 March, 2013, questioned the idea of the “Indo-Pacific.” <http://orfonline.org/cms/sites/orfonline/modules/report/ReportDetail.html?cmaid=49060&mmacmaid=49061>

17 On the extent of anti-nuclear sentiment in the Japanese system see Rajiv Nayan, “India-Japan Strategic Partnership,” Institute for Defence Studies and Analyses Issue Brief, 11 June, 2013 http://www.idsa.in/idsacomment/IndiaJapanStrategicPartnership_rnayan_110613

18 Private conversations with Indian diplomats involved in the negotiations from 2010 to 2014.

Shinzo Abe's return to power has fast-tracked Japanese strategic initiatives with India. India played a major role in Abe's broad vision of diluting Japan's post-war pacifist policies and making it a "normal nation" in its exercise of power in the regional arena. At the heart of this was a desire for India to support and thus legitimise actions like the Japanese resumption of arms exports and independent action in military activities. This was influenced by Abe's grandfather's experience with India in the 1950s. As Abe described it, the then Prime Minister Nobusuke Kishi visited a welcoming New Delhi before he went to Washington because "as a pragmatic politician he knew that India would give him some political capital" since the U.S. had not fully shed its wartime hostility.¹⁹ Abe and his government are fully cognisant that India is much easier to deal with, in part because there is no World War II legacy or historical baggage.

Singh was supportive of this, partly because of the larger economic relationship with Japan, but also

because of his own concerns about the rise of China. Abe became the first Japanese prime minister to be invited as the chief guest on India's Republic Day. India and Japan also began negotiating the possibility of India buying Japanese-made weapons. Abe sought similar understandings with other Asian nations, but India was prominent in his plans because of its democratic standing and its potential to counter-balance China.²⁰

One of the areas where the strategic-cum-economic interests of India and Japan coincide is improving the trade and transport connectivity between India and Southeast Asia. This would be about building east-west linkages for both land and sea usage, which would provide an alternative to the north-south infrastructure projects of China. Such Japanese funded projects include the India-Myanmar-Thailand trilateral highway and the South Asian Sub-regional Economic Cooperation (SASEC) Sub-Regional Trade Facilitation Programme.



Indian Prime Minister, Dr Manmohan Singh and the Japanese Prime Minister Mr Shinzo Abe, greeting each other after signing an agreement on Indo-Japan Strategic partnership, in Tokyo on 15 December 2006. Photo courtesy: Website of the Ministry of Information and Broadcasting, India, <http://pib.nic.in/photo/2006/Dec/12006121611628.jpg>

¹⁹ See Shinzo Abe's speech before the Indian Parliament, "Two Democracies Meet at Sea: For a Better and Safer Asia, 20 September, 2011, <http://en.jinf.jp/wp-content/uploads/2011/09/HP-E%E3%82%A4%E3%83%B3%E3%83%89%E6%BC%94%E8%AA%AC%E4%B C%9A%E5%A0%B4%E9%85%8D%E5%B8%83%E7%94%A8916.pdf>

²⁰ For an early analysis of China's role in bringing India and Japan closer, see Victoria Tuke's Warwick University thesis, "Japan's Relations with India: A Neoclassical Realist Analysis of Japan's Foreign Policy Behaviour and Regional Integration," <http://www.abstract.xlibx.com/a-political/11717-1-japans-relations-with-india-neoclassical-realist-analysis-ja.php>

Analysis

Investment Activity

While large-scale Japanese manufacturing and infrastructure-building is the cornerstone of Tokyo's policy towards India, Japanese firms have struggled in India. They faced a particularly bad period during the second half of the Manmohan Singh government and await evidence of Modi's plans to improve the business environment in India. A minority of Japanese firms in India make profits. An official of the Ministry of Economy, Trade and Industry estimated that only 40 per cent of Japanese firms in India were turning a profit, compared to 70 per cent in Southeast Asia.²¹ A number of major Japanese investments in India have turned sour, most notably pharmaceutical major Dai-ichi Sankyo's purchase of Indian generics maker Ranbaxy and Japanese telecom firm DoCoMo's joint venture with Tata Telecom. The success story that all Japanese executives cite, however, is that of Suzuki,

whose Indian subsidiary is the largest and most successful automobile company in India.

The Modi government sees a clear convergence in Japan's strategic investment approach and its own plans to revive India's manufacturing sector. The new Indian prime minister deliberately made Tokyo his first major bilateral overseas visit. He has also set up a unique administrative structure, Japan Plus, to help facilitate Japanese investment in India. This structure includes inducting Japanese officials into positions inside the Indian ministries.

Nonetheless, whether Japan is able to increase its investment in India to the scale that Tokyo and New Delhi would like will ultimately depend on a strong Indian economic recovery and a fulfilment of long-standing plans by India to make itself a less hostile environment for foreign firms in manufacturing and infrastructure-building.²²



The Emperor of Japan, His Majesty Akihito (left) with the Indian Prime Minister, Shri Narendra Modi (right), in Tokyo, Japan on 2 September 2014. Photo courtesy: Website of the Indian Prime Minister's Office (PMO) <http://pmindia.gov.in/en/image-gallery/page/21/>

21 Roudra Bhattacharya, "Fixing FDI Issues is Positive, but It's Not the Only Problem in India," *Financial Express*, 2 December 2013, <http://archive.financialexpress.com/news/fixing-fdi-issues-is-positive-but-it-s-not-the-only-problem-in-india/1201969>

22 Amiti Sen, "Japan writes to India on Problems Faced by Its Companies Here," *Business Line*, 25 June, 2014, <http://www.thehindubusinessline.com/economy/policy/japan-writes-to-india-on-problems-faced-by-its-companies-here/article6148654.ece>; and Vinod Mahanta and Sachin Dave, "Spike in valuation and past experiences affect Japanese fund flows," *Economic Times*, 26 December, 2014, http://articles.economicstimes.indiatimes.com/2014-12-26/news/57420701_1_japanese-companies-indian-companies-daiichi-sankyo.

Strategic Relationship

The strategic relationship consists of several skeins that have yet to be knitted into a single cloth. Both India and Japan will come closer together in a slow and measured manner because both governments have been hedging over the uncertainty of the future of Asia's geopolitical landscape. Thus India under Modi is seeking a stable economic and political relationship with China even while wooing Japan. Meanwhile, Abe is working toward a recasting of relations with countries all across Asia, including Vietnam and Australia, and not merely India. Both governments are keeping an eye on U.S. behaviour as well, given continuing uncertainty over the nature of Washington's commitment to the Western Pacific. But both India and Japan have schools that question the trade-off between a closer embrace with each other and a strong Chinese backlash.²³

Under the Singh regime, India took a rhetorically harder position on various issues regarding China, most notably the South China Sea, in its statements with Japan and the United States.²⁴ However, it declined to take up Japanese offers to the Indian navy to use Japanese base facilities in Djibouti, on the African littoral of the Indian Ocean. It also blew hot and cold over plans to join multilateral naval exercises that included Japan and other countries, presumably with Chinese sensitivities in mind. Moreover, Tokyo has dithered for so long on a civil nuclear agreement that it has ended up frustrating Indian officials, who privately talk of abandoning the idea.²⁵

The two countries have begun exploring cooperation in other international policy arenas. For example, India is urging Japan to help it develop a more cohesive global gas pricing structure.²⁶ The two countries are also seeking bilateral solutions to climate change. While the Modi government maintains a traditional wariness regarding multilateral commitments, the Indian leader is welcoming of bilateral measures to reduce domestic carbon emissions. The Indo-Japanese joint statement of 2014 was studded with references to clean coal technology and renewable energy cooperation.

The evidence is that this two-sided hedging may be much reduced under the Modi government. New Delhi has announced plans for military exercises that include the U.S., Japan and possibly Australia. The likelihood of a Japanese arms sale to India and further defence cooperation are much stronger today.

The recent Indo-U.S. "strategic vision" document on the Asia Pacific and the Indian Ocean, with its implicit criticism of China, indicates that the trajectory of Modi's Asian strategy converges sharply with Abe's.²⁷ The Indian prime minister does not seem to see much point in hiding India's stance on regional issues or using the kind of coded language traditionally favoured by Indian diplomacy. This less ambiguous policy should help Abe to push for policies which herald a strategic partnership in the making.

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- 23 On Japanese concerns that a military relationship with India might be counterproductive, see Hans Kundlani, "Asia's Security Dilemma," European Council for Foreign Relations commentary, 30 July 2014, http://www.ecfr.eu/article/commentary_asias_security_dilemma292
- 24 See the joint statements issued by India during Modi's summits with Abe and Barack Obama. "Tokyo Declaration for India-Japan Special Strategic and Global Relationship," Indian Ministry of External Affairs, 1 September, 2014 <http://www.mea.gov.in/bilateral-documents.htm?dtl/23965/Tokyo+Declaration+for+India++Japan+Special+Strategic+and+Global+Partnership>; and "US-India Joint Statement," White House Office of the Press Secretary, 30 September 2014, <http://www.whitehouse.gov/the-press-office/2014/09/30/us-india-joint-statement>.
- 25 A Japanese official is quoted as admitting that a civil nuclear agreement with India would create an "unbreakable alliance" in Tuke, "Expanding Strategic Horizons."
- 26 "Tokyo Declaration for India-Japan Special Strategic and Global Relationship," Indian Ministry of External Affairs, 1 September, 2014 <http://www.mea.gov.in/bilateral-documents.htm?dtl/23965/Tokyo+Declaration+for+India++Japan+Special+Strategic+and+Global+Partnership>
- 27 "US-India Joint Strategic Vision for the Asia-Pacific and Indian Ocean Region," Indian Ministry of External Affairs, 25 January 2015, http://pmindia.gov.in/en/news_updates/us-india-joint-strategic-vision-for-the-asia-pacific-and-indian-ocean-region/

About the Author

Pramit Pal Chaudhuri is the Foreign Affairs Editor of the *Hindustan Times*. He completed his second two-year term on the National Security Advisory Board this January. As a member of the Aspen Strategy Group of India, he is a delegate for track two strategic dialogues including those with the United States, China, Israel, Turkey and the U.S.-India-Japan trilateral. He is also a senior associate of the consultancy Rhodium Group, New York, an adviser to the U.S.-based Bower Group Asia, and a member of the Council of Emerging Markets, Washington D.C. He also serves as an advisor to Mitsubishi Corporation India. He has been a media fellow at the Fletcher School of Law and Diplomacy; fellow at the Henry Stimson Centre, Washington D.C.; a Hubert Humphrey Fellow at the University of Maryland-College Park; a South Asian fellow at Cornell University; and a Schwarz Fellow with the Asia Society New York. Mr Pal Chaudhuri graduated in history from Cornell University in 1985. He has lived in or travelled through more than 50 countries.

About the S. Rajaratnam School of International Studies

The **S. Rajaratnam School of International Studies (RSIS)** is a professional graduate school of international affairs at the Nanyang Technological University, Singapore. RSIS' mission is to develop a community of scholars and policy analysts at the forefront of security studies and international affairs. Its core functions are research, graduate education and networking. It produces cutting-edge research on Asia Pacific Security, Multilateralism and Regionalism, Conflict Studies, Non-Traditional Security, International Political Economy, and Country and Region Studies. RSIS' activities are aimed at assisting policymakers to develop comprehensive approaches to strategic thinking on issues related to security and stability in the Asia Pacific.

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