

*V.R.F. Series*

**No.482**

*May 2013*

**India-Japan Politico-Economic Engagement: Between the  
Entrepreneurial Interests and Strategic Objectives**

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## **Acknowledgements**

This monograph is the product of my research as a Visiting Research Fellow (VRF) at the Institute of Developing Economies, IDE-JETRO. During the span of three months of the research project, I greatly benefited from the support of a number of people, to whom I would like to express my deepest gratitude. I am thankful to IDE President Takaishi Shiraishi and a number of anonymous members of selection committee who found merit in my research proposal and selected me for the fellowship. I am thankful to Dr. Rajaram Panda and Professor Takenori Horimoto for giving me recommendation for the fellowship. Takao Tsuneishi and Chisato Ishii, through a series of emails provided me guidance even prior to my visit to Japan and arranged accommodation and other hospitalities for me. They remained with me like an angels whenever I faced any problem including during my brief illness. I am indebted to my counterpart and guide Dr. Norio Kondo, who provided useful inputs for my research and introduced me to a number of scholars from whom I benefited a lot. The library staffs had been very humble in listening to my queries and provided all assistance I required.

During my stay at the IDE my work was greatly improved with inputs I received from Professor Hori Sato, Prof. Takenori Horimoto, Professor Makoto Kojima and Professor Masanori Kondo. I consulted a number of people for some of the data back in India. I am thankful to Ambassador Arjun Asrani who agreed for an interview despite his busy schedule and provided useful insights on India-Japan relations. Many thanks also to Shin Oya of Japan Bank for International Cooperation and Nayoshi Noguchi, Director

General of JETRO's New Delhi office for providing literature and inputs for my research.

I am also thankful to my friends Dr. Jalis Nasiri, Dr. Nimesh Chandra and B. Vinoth Raj who assisted me in this research. Special thanks to my wife Neelu and daughter Taiyyaba Fatima for accompanying me in Japan. I did not feel loneliness in Japan and because of them I discovered many new places in Chiba and Tokyo, which I did not visit during my previous stays in Japan.

Back to IDE again, I owe thanks to many senior colleagues Etsuyo Arai, Hitoshio Ota, Mayumi Murayama, Hajime Sato, Tsujita san, Hossam san and other fellows with whom I had fruitful lunch on meetings. Thanks also to all my contemporary VRFs at the IDE, including Professor Ramasawamy, Scarlett, Somchai San and Changcam san. Thanks to various mentors at the IDE including Yamgata san, IDE executive Vice President Hiratsuka san, Noburo Yoshida san, Tetsusaburo Hayashi san.

Many thanks also to IDSA Director General Dr. Arvind Gupta and Deputy Director General Rumel Dahiya for allowing me to undertake this fellowship which helped me enhance my understanding on economic aspects of India-Japan relations.

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## ***Abstract***

*Trade and economic ties between Japan and India- the number two and number three economies in Asia has not been as strong as was expected. Statistics suggest that Japan's two way trade with India is only one percent. The scholars have argued that this is mainly because of the minimal political interactions between the two countries during the Cold War period. It is argued that during the Cold War India tilted towards Soviet Union and adopted a socialist economy with which Japan- a member of free world- was not comfortable with. New Delhi took bold decision to engage with Japan both politically and economically following the end of Cold War which coincided with India's economic liberalization. Japan welcomed the new initiatives taken by New Delhi but was not satisfied with the pace of its reform. Therefore, there was no quantum jump in India-Japan economic relations. New Delhi, however, took consistent efforts to attract Japanese investment and took various initiatives including signing of a Comprehensive Economic Partnership Agreement, which promises gradual elimination of tariffs and offers "national treatment" to each other's investors. The monograph against this context looks at various aspects of India-Japan economic engagement from the perspectives of political economy. Since the research was conducted at the commemoration of 60 years of India-Japan diplomatic relations, it has tried to capture the political and economic interactions between the two countries during these years. It discusses various drivers of India-Japan economic relations and speculates on the future. Since there is a debate in the academia and the media that the India-Japan economic engagement has some strategic intent in it, the researcher has tried to capture the debate. There is a greater concern among the Japanese investors that India's*

*infrastructure does not meet their expectations and standards, the researchers have tried to look into those aspects as well. Since the research has been conducted for a policy institute, the researcher has tried to dispel some of the perceptions that Japanese investors continue to have about India. It has been argued, with some facts and figures, that the Japanese investors should look to the fact that India in the near future will no more be a country with 'poor infrastructure' but will emerge as a well integrated country both internally and externally. It will show no sign of "ageing society" as China-Japan's biggest market- has started showing and demand of appliances and goods will remain high here, a point the Japanese investors should not ignore.*

## **1. Introduction**

Sixty years of India Japan diplomatic relation has witnessed various intermittent phases during which interactions between the two countries have been negligible. This has affected a normal political and economic relation between the two Asian countries. India and Japan in the post war have started their relations on a positive note when India signed a peace treaty with Japan and waived “the right to reparation.” It provided Japan- the war ravaged country, raw materials including iron ore, coal and cotton bales, and other key resources to start off industries. As has been discussed below, various scholars have acknowledged this gesture by India and termed this era as a golden period of India Japan relations. However, emergence of the Cold War compelled them into two different camps and relations between the two countries could not develop as expected. At the end of the Cold War, which coincided with India’s economic liberalization, Japan was identified by the government of India as “an important source of both investment and technology.” Therefore, it can be said that the decision to forge relations with Japan was a political decision. During the Prime Ministership of Manmohan Singh, economy was identified as “bedrock” of India Japan relations. However, soon the relationship was transformed into a strategic partnership in which economic cooperation was an essential element.

Today various factors including Comprehensive Economic Partnership Agreement (CEPA), maritime security cooperation, India’s interest in Japan’s nuclear technology and Japan’s help in improving India’s infrastructure can be termed as drivers of India-Japan relations. One of the less stated aspects of India-Japan relation is driven by



strategic objective: minimizing economic dependence on China. Some of the drivers, mentioned above, have both the strategic and economic aspects in it and these have been elaborated in separate sections. Since the study has been undertaken at the conclusion of 60 years of India-Japan relations, it also maps the developments that have taken place at the political and economic fronts between the two countries during these years. As the research has been conducted for a policy research institution, it also outlines challenges faced by the two countries especially at the economic front and offers policy suggestions to overcome these challenges.

## **2. India-Japan economic relations in retrospect**

India and Japan have completed 60<sup>th</sup> years of their diplomatic ties in 2012. However, this relationship has witnessed some intermittent phases during which the interactions between the two Asian democracies had been minimal. However, one binding factor between them all through the years has been economic and trade relations, even though it was marginal. Certainly, it was economy and trade upon which India and Japan's relations have evolved over the years. In 1894 when India was still under British Empire, Japan signed a trade convention which gave fillip to the cotton trade. The trade convention also paved the way for the opening of the regular ocean transport between India and Japan.<sup>1</sup> By the mid 1910s, India became third leading partner for Japan after the United Kingdom and the United States. In terms of Japanese exports, India by 1920s became the fifth largest market after China, the United States, Hong Kong and the United Kingdom.<sup>2</sup> With no regular bank facilities for transactions, both the countries were using barter system in lieu of the present system of their trade settlements. Toshio Yamanouchi, one of the Japanese businessmen, notes that in exchange of first shipment of "10,000 tons of iron ore" from a mine in Goa, Japan sent "a small carton of Japanese pearls."<sup>3</sup> Apart from the iron ore, other raw materials included supply of raw jute and raw cotton to Japan.<sup>4</sup> It was because of the interdependent nature of Indian and Japanese economies that developed during pre-war years, India wanted to see an economically resurgent Japan following the World War II. A senior Japanese observer notes that

India's position clearly contrasted with that of the UK and Australia, which showed extreme caution against Japan's post-war recovery as a revival of competitive economic power....Independent India, on the contrary, envisaged the Japanese economic recovery not in a competitive

but in a more complementary perspective.<sup>5</sup>

Since India, before the wars, was a supplier of capital goods as well as raw materials to Japan, it welcomed recovery of Japanese economy for its own economic development. Prime Minister Nehru while meeting a Japanese trade mission remarked that “the economies of both the countries should be **complementary**”. He assured them that India would assist as much as possible in sending “raw materials to Japan”.<sup>6</sup> (emphasis added)

Despite good beginning, both the countries could not take their relations to an upper trajectory. Many Indian scholars as well as bureaucrats believe that it was because of the perception in Japan that India has tilted towards the Soviet Union and has adopted a socialist economy.<sup>7</sup> Japanese businessmen were not comfortable with socialist system as they favoured US-led free world. They viewed Indian economic policies as “un-realistic and non-pragmatic.”<sup>8</sup> Yasukuni Enoki, Japan’s former ambassador to India pointed that during the Cold War there was a “psychological fence separating Japan from India.”<sup>9</sup> Similarly Sakutarō Tanino, yet another Japanese ambassador to New Delhi noted that India’s special relationship with the USSR and Japan’s security engagement with the US “eventually resulted in the cooling off of the great enthusiasm of the 50s.”<sup>10</sup> A retired Indian bureaucrat, however, believes that India was equally responsible for ignoring Japan. He notes:

If India was guilty of dismissing Japan as a camp follower of the US, the Japanese in turn, perceived India as a chaotic, dysfunctional, desperately poor country and not as a potential partner.<sup>11</sup>

Despite the low economic exchange between India and Japan during the Cold War period, India remained a resource supplier for Japan. Yoichi Funabashi, a veteran Japanese journalist who later rose to the position of Editor in Chief of the *Asahi Shimbun*, acknowledges that when Japan “still found itself surrounded by hostile nations, India offered it an olive branch, giving Japan coal and steel when others would not and reaching out the hands of friendship.”<sup>12</sup>

Yet another Japanese businessman writes that newly independent India “extended maximum cooperation” to Japan. As a result, “the Japanese steel industry could make a start in the direction of reconstruction and expansion.”<sup>13</sup> However, he divides India-Japan relations into a “bright” and a “dark” periods. According to him the dividing lines between the two periods was “end of Nehru era.” By 1956 India has started to nationalize mines and restricted export of iron ores and minerals for the needs of domestic industries. A similar strategy was adopted by other resource suppliers such as Australia. Toshio Yamanouchi was so upset with the Indian nationalization process that he went on to suggest that the tourism and trade are the two sectors from which the “government should keep itself away and leave them to the private sector.”<sup>14</sup>

Despite the nationalization of mines, India continued export iron ores to Japan. Yamonouchi acknowledges that till late 1950s “India accounted for approximately 31 to 32 per cent of total iron ore by Japan.”<sup>15</sup> In 1960s Australia replaced India as number one iron ore supplier to Japan when it opened iron ore exports. However, till 1980s, iron ore remained the biggest item of India-Japan trade composition. In 1980 diamond became number one item in both the countries trade.<sup>16</sup> Recent statistics suggest that presently Japan imports only 3% of iron ores of its total steel production from India.

Bulk of its raw material for steel industries comes from Australia (62%) and Brazil (28%).<sup>17</sup> India, however, once again has identified that steel should be the pillar of India-Japan economic cooperation. India has signed an agreement with Japan to export 2.1 million tonnes (mt) of Iron ore to Japan over three years.<sup>18</sup>

The sad part of India Japan economic relations during the Cold War period was that it remained a “resource driven” relationship. The Japanese companies and investors did not show much interest in India. Sakutarō Tanino notes that the only “strong pillar” which sustained economic relationship between the two countries during this period was Japan’s Official Development Assistance (ODA). Highlighting the significance of Japanese ODA to Indian economic development, Arjun Asrani, a former Indian ambassador to Japan notes that “the most outstanding” ODA contribution to India was the Bombay High Deep Sea Drilling Project which “greatly reduced India’s dependence on expensive imported oil.”<sup>19</sup> He enumerates other projects such as Vishakhapatnam Outer Harbour Project in Andhra Pradesh and Cochin Shipyard in Kerala which played an important role in India’s infrastructure development. He also lauds Japan’s role in “making India self-sufficient in food grains production” by several fertilizer projects through the ODA.<sup>20</sup>

The main reason for the absence of Japanese companies in the Indian market could have been the fact that India during the Cold War period adopted a restrictive foreign private investment policy. As per Indian law a foreign company could have equity holdings of only up to 40 per cent. However, Japanese companies were not totally absent from the Indian market altogether. Srabani Roy Choudhury points that few Japanese companies had circumvented the Licence Raj system. For example Honda was

operating with its Indian Partner Hero and was doing business in India. By the 1980s, some relaxation was made in the foreign investment policy, and this resulted in the setting up of Maruti, a central government joint venture with Suzuki Motors of Japan, in 1982. A crop of Japanese companies followed, who gained entry through technical collaborations or by getting exemptions. Sanyo and JVC used the technical collaboration route.<sup>21</sup>

In 1991, India initiated a policy of economic reform and “Japan was identified as one of the most important source of both investment and technology by the government of India.”<sup>22</sup> Japanese side also view “economic liberalization” as “return to the inspiring phase” of Indo-Japan relations.<sup>23</sup> From Indian point of view, the decision to engage Japan was a political decision. J.N. Dixit, the then Foreign Secretary of India describes that “the Foreign Minister Dr. Manmohan Singh established contacts with his Japanese counterparts, thereby laying the foundation for increasing the content of Indo-Japanese relations.”<sup>24</sup> This was the phase during which other industrially advanced countries were also showing interest in Indian economic reforms. But Japan was “the most responsive”<sup>25</sup> to the economic transformations being undertaken by India. However, Japan was not satisfied with the pace of India’s economic transformation. Sakutarō Tanino blamed “red tapism” of Indian bureaucracy in delaying reforms. He noted that many of the Indian officials “still seem to be prisoner of the erstwhile controlled economy and this often leads to bureaucratic high-handedness and questionable practices distorting the system.”<sup>26</sup> J.N. Dixit also pointed that Japan was not happy with the pace of Indian economic reforms. He noted:

Japan remains impatient with regard to the speed and extent of our

economic liberalization. Consequently, there has been no quantum jump in Indo-Japanese economic relations. In fact, expansion and growth pattern have been cautious and gradual.”<sup>27</sup>

J.N. Dixit, despite these concerns, noted that it is the economy which will drive the relationship between the two countries. He rightly prophesied:

Japan’s interest in India is primarily economic. In other spheres, India does not form a primary focus of attention yet. This is the backdrop against which Indo-Japanese relations will evolve in the foreseeable future.<sup>28</sup>

## **2.1 India-Japan economic engagement: The current phase**

In the post Cold War Period, political and economic interaction between the two countries increased many folds and proved a cornerstone in the diplomatic relations. The diplomatic relations between the two touched the lowest ebb after Japan’s reactions following 1998 Pokhran test. A number of scholars in India believe that the economic stake of Japan in Indian market had become so strong in post liberalization that Japanese had to set aside the economic sanctions and Prime Minister Mori envisaged a “global partnership” in which economic relations was an essential component.<sup>29</sup>

As mentioned above, J.N. Dixit had noted that Finance Minister Manmohan Singh was instrumental in forging economic ties with Japan. When Dr. Singh became Prime Minister, he took some bold initiatives to strengthen the economic ties further. He announced that the economic ties should be the “bedrock”<sup>30</sup> of Indo-Japan relationship.

During his leadership both the countries institutionalized annual Prime Minister level talks and since 2005 Prime Ministers of both the countries have been holding summit level talks alternating between Tokyo and New Delhi. Both the Prime Ministers have signed a series of Memorandum of Understandings (MOUs) during their meetings and have issued statements in which economy and trade relations has been a prime focus. A joint statement signed by Japanese Prime Minister Koizumi and his Indian counterpart Manmohan Singh noted that “a strong prosperous and dynamic India is in the interest of Japan and vice versa.”<sup>31</sup> However, Prime Minister Singh acknowledged that economic ties between the two countries remain “well below the potential.”<sup>32</sup> As a result of strategic talks, both the Prime Ministers agreed in 2005 to set up a joint study group to study areas in which both the countries could engage in bilateral trade. The group in 2006 came up with a set of proposals. It concluded that “there is a huge untapped potential to further develop and diversify the economic engagement between India and Japan.”<sup>33</sup> For a “comprehensive expansion of bilateral economic and commercial relations”, the group suggested negotiation on a Comprehensive Economic Partnership Agreement (CEPA) covering “trade in goods, trade in services, investment inflows” and ways to enhance their trade. Prime Minister Singh considered the CEPA with Japan so important that he visited Tokyo (by pre-poning his scheduled visit) in October 2010 to announce that negotiations between the two had been completed. Indian Prime Minister termed the conclusion of CEPA as a “historic agreement”<sup>34</sup> The reason why he termed the conclusion of CEPA as a historic one was his personal wish to forge a “complementary relationship” between India and Japan. In his view “India’s buoyant economy, young population and large market combine well with Japan’s technological prowess, manufacturing skills and financial sources to create a win-win situation for



both the countries.”<sup>35</sup> He added that both the countries must synergise their “**complementary strengths**” to impart momentum to Asian as well as global economic growth and prosperity.<sup>36</sup> (emphasis added)

Prime Minister Manmohan Singh’s view on achieving complementary relationship with Japan is coincidentally similar with that of Prime Minister Nehru’s vision. There is only one difference. Nehru wanted to maximize economic benefits by providing raw materials to the Japanese industry and wanted to see a re-emergence of an industrial Japan. Prime Minister Singh wants to take the relationship beyond a resource provider and wants to maximize benefit from Japan’s technological prowess, manufacturing skills and financial sources. Indian objective to CEPA was made clear by a punch line sentence by the then Indian Foreign Secretary who termed the agreement as “an alliance between Japanese technology and capital and a young Indian labour force.”<sup>37</sup> The CEPA, however, is not limited to achieving economic objectives. It also has some strategic intent in it. A joint declaration by India and Japan notes that “the India-Japan CEPA will elevate the strategic and Global Partnership between India and Japan to a new level.”<sup>38</sup> Various scholars have argued, perhaps because of this single sentence, that the CEPA is aimed at challenging China’s economic pre-eminence in Asia. Their arguments have been analysed in a separate section in this monograph.

Apart from the CEPA both the countries took series of measures to take their economic relations to a new height. In 2011, India and Japan upgraded their currency swap arrangement from the previous US \$ 3 billion to \$ 15. The swap agreement will help both countries in managing short term liquidity problems.<sup>39</sup> As per the agreement, Japan will accept rupee and give dollars to India for up to 7.5 billion. Similarly India will take

yen and send dollars for the corresponding amount to Japan if speculators seek to thrash down respective currencies.<sup>40</sup>

India on its part is doing its best at the political and economic level to keep Japanese economy unharmed. China restricted exports of rare-earth materials-key component for manufacturing high-tech products- following a spat between Chinese fishing trawler and Japanese coast guards in September 2010. This move by China was construed in Japan as a strategic move by Beijing to squeeze Japan economically. Against this backdrop India offered cooperation in rare-earth. The shortage of rare-earth minerals, used in manufacturing of high-tech products had some negative impact on production and export of electronic goods. After a one and half year discussion at the political level on the possibility of exporting rare-earth minerals, both the countries agreed in May 2012 to jointly extract rare earth minerals in India. Japan's Toyota Toshu Corp. and Indian Rare Earths Limited are collaborating in rare-earth extraction project. The project will provide 4000 tons of rare earth to Japan annually accounting for about 14 per cent of Japan's annual demand of the strategic elements.<sup>41</sup> This move was seen in Indian strategic circles as a strategy to break China's monopoly in rare earth materials.<sup>42</sup>

As a result of consistent political and economic interactions between the two governments, Japanese investors are also showing interest in the Indian market. A survey by the Japan Bank of International Cooperation (JBIC) conducted in 2010 suggests that 74.9 percent of the 605 Japanese manufacturers selected India as their investment destination over the next 10 years, compared with 71.7 percent that chose China. A previous survey conducted by JBIC in 2009 found that China was first and India second.<sup>43</sup> Here territorial disputes with China over Senkaku is acting as a factor as

more and more Japanese investors want to reduce their dependence on China and wants to diversify investment risk. They are looking at India and Vietnam. However, China remains the top favourite for short term investment for Japanese entrepreneurs. The 2012 JBIC Survey suggests that though China remains number one country among the most favourite destination for the Japanese companies, India has narrowed the gap. The percentage gap among the respondent companies between China and India was only 2.8 per cent. (see table 1)

**Table 1. Recounted Ranking of Promising Countries/Regions for Japanese Business Operations**

Ranking			Country/Region	No. of respondent companies (Total: 288)			Percentage Share	
Added this time	←	July survey Recounted		Added this time	July survey Recounted	Increase or decrease	Added this time	July survey Recounted
1	—	1	China	172	184	▲ 12	59.7%	63.9%
2	—	2	India	164	163	1	56.9%	56.6%
3	—	3	Indonesia	130	118	12	45.1%	41.0%
4	↑	5	Thailand	102	97	5	35.4%	33.7%
4	—	4	Vietnam	102	99	3	35.4%	34.4%
6	—	6	Brazil	63	62	1	21.9%	21.5%
7	—	7	Mexico	48	41	7	16.7%	14.2%
8	—	8	Russia	35	35	0	12.2%	12.2%
9	—	9	Myanmar	34	33	1	11.8%	11.5%
10	—	10	USA	30	26	4	10.4%	9.0%
11	—	11	Malaysia	27	23	4	9.4%	8.0%
12	↑	14	Korea	13	9	4	4.5%	3.1%
13	↓	12	Turkey	11	11	0	3.8%	3.8%
14	↑	17	Philippines	10	7	3	3.5%	2.4%
14	↓	12	Taiwan	10	11	▲ 1	3.5%	3.8%
16	↓	14	Cambodia	9	9	0	3.1%	3.1%
17	↓	14	Singapore	8	9	▲ 1	2.8%	3.1%
18	—	18	Australia	7	6	1	2.4%	2.1%
19	↓	18	Bangladesh	5	6	▲ 1	1.7%	2.1%
20	—	20	Germany	3	4	▲ 1	1.0%	1.4%

Source: JABIC Survey 2012 <sup>44</sup>

### **3. India-Japan economic relations: A case study of CEPA**

India and Japan formally signed the CEPA in Tokyo on February 16, 2011 which came into effect from August 1, 2011. CEPA covers not only trade in goods but important areas of trade in services, movement of natural persons, investment, intellectual property rights, custom procedure and other trade related issues.<sup>45</sup> The CEPA will gradually lead to a reduction of 10 percent of the tariff India had been imposing on over 9,000 imported Japanese industrial products. The official CEPA document has laid down rules for elimination of custom duties in Article 19<sup>46</sup>.

The document has classified goods traded between the two countries in separate schedules and has divided them in total seven categories and have marked them as A, B5, B7, B10, B 15, Pa/Pb and X. Custom duties on goods identified as A has been eliminated from the date of entry into force of the CEPA, while custom duties on goods identified as B5, B7, B10, B15, will be eliminated in six years, eight years, 11 years and 16 years respectively. The custom duties on goods identified as Pa and Pb shall be reduced in accordance with the terms and conditions set out in respective Notes indicated in Scheduled of India. However, there would be no duty elimination on goods indicated as X<sup>47</sup>. Some of the goods on which both countries will remove tariff in phases have been indicated in Table 2.

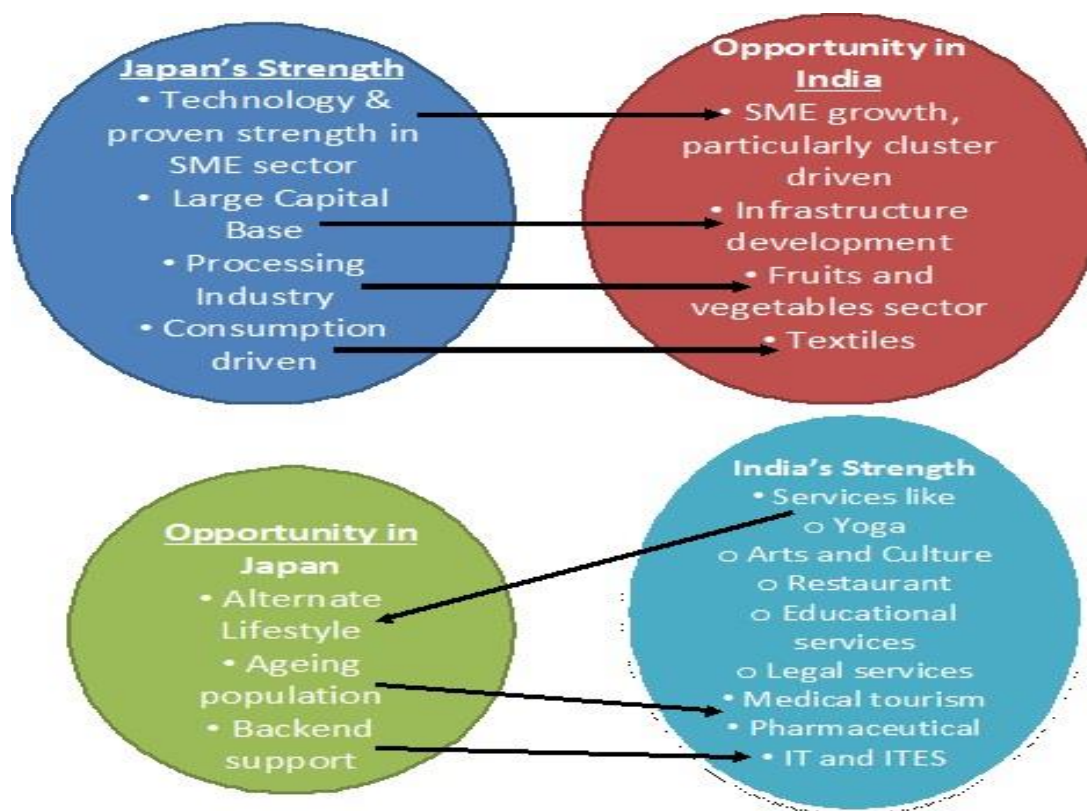
**Table 2. Selected list of goods on which tariff would be eliminated gradually**

Period over which tariff has to be reduced	Goods Description	
	Schedule of India	Schedule of Japan
Immediate	<ul style="list-style-type: none"> <li>• Most textile products including yarn and fabric</li> <li>• Computer printers, PCs and other automatic data processing machines</li> <li>• Cell phones and other types of phones, networking equipment and SIM cards</li> <li>• Capacitors, diodes, specified measuring instruments</li> </ul>	<ul style="list-style-type: none"> <li>• Specified petroleum products</li> <li>• Ores, slag and ash</li> <li>• Inorganic chemicals and specified organic chemicals</li> <li>• Machines – mechanical and electrical and parts thereof</li> <li>• Most textile and textile products</li> </ul>
Seven years	<ul style="list-style-type: none"> <li>• Lubricating oil</li> </ul>	<ul style="list-style-type: none"> <li>• Specific types of fish and fish meat</li> </ul>
Ten years and above	<ul style="list-style-type: none"> <li>• Specified petroleum products</li> <li>• Most metals and articles thereof</li> <li>• CDs, DVDs, watches, musical instruments</li> <li>• Arms and ammunition</li> <li>• Certain types of furniture</li> </ul>	<ul style="list-style-type: none"> <li>• Specified iron and steel products</li> <li>• Certain fruits like oranges, apples, grapes</li> </ul>

Source: CEPA pages 105 to 961/CII Study on India-Japan relations

The beauty of CEPA is that some 17.4 % of the tariff lines have been offered for immediate reduction of tariff to Zero percent by India while Japan side has put 87 percent of its tariff lines under immediate reduction to zero.<sup>48</sup> Since CEPA is not only limited to goods but it also covers trades in services and investments, the scholars have identified few areas in which both countries can benefit from each other. (Please refer to figure 1 depicting opportunities CEPA offers to Japan and India)

**Figure 1. Opportunities for Japan and India under the CEPA**



Source: Pinaki Dasgupta, “India and East Asia: Towards a regional economic integration”, *Keizai Koho Centre*, Tokyo.

To attract Japanese investment in India, the CEPA has given Japanese investor a kind of “national treatment.” One of the provisions in CEPA states:

Each Party shall accord to investors of the other Party and to their investments treatment no less favourable than that it accords like circumstances to its own investors and to their investments with respect to investment activities in its Area.<sup>49</sup>

Both the countries have granted Most Favorite Nation treatment under the CEPA. It

seems it is a calibrated move by the two governments to give this status given the fact that Japanese investors had largely been confined to East Asian countries. Ranja Sengupta argues that “countries usually impose performance requirements on foreign investment such as limits on ownership, board membership, and on exports; compulsory local content etc. But under CEPA these restrictions are no longer permissible.”<sup>50</sup> The CEPA also provides investor, investment protection and also allows foreign investor to sue the government if their rights and profit are infringed upon.<sup>51</sup>

India had been demanding from a long from Japan to allow its Basmati Rice to Japan but during the negotiations, New Delhi agreed to put rice sector under the “exclusion” list. However, a similar FTA signed with Malaysia, India has successfully bargained for allowing rice imports into Malaysia. It seems India considered the sensitivities of Japanese farmers who have also been opposing Japan’s participation in Trans Pacific Partnership as they are wary that TPP will allow inflow of cheaper rice from the TPP member countries.

India was expecting that Japan will allow entry to its nurses and caregivers to Japan with a long term work permit. New Delhi was demanding treatment to its caregivers at par with Indonesia and Philippines, with whom Japan has also signed Economic Partnership Agreements. However, Japan has asked India to wait as it is facing some problems as the nurses from these countries have not been able to pass the necessary language tests after two years of their probations. However, some media sections in Japan have urged their government to make “concessions” to India on this point. The *Yomiuri Shimbun* in its editorial demanded that “to deepen economic partnership between this country and India, Japan should make concessions.”<sup>52</sup>

Despite the CEPA easing the duties on the goods, Indian export will continue to face some non-tariff barriers such as standards and technical barriers. The Indian producers will have to match with standards set by Japanese importers.<sup>53</sup> Gethanjali Nataraj, points that “Japan’s Sanitary and Phytosanitary Measures (SPS) standards are major barriers of Indian exports of poultry, meat, tuna, shrimp, marine products and fruits”. She suggests that both the countries should share and facilitate “the underlying technology” to help improve Indian products sanitary standards.<sup>54</sup>

India Japan CEPA has generated wider interest in Indian media and academic circles. B.S Raghavan, a columnist of *Business Line*, argues that “there is a great responsibility cast on both India and Japan to make a success of it so that it becomes a path setter for CEPAs with other developed countries.”<sup>55</sup> He cites a simulated computer study to suggest that India’s GDP can grow by as much as 3.45 percent if New Delhi signs similar agreements with ASEAN countries and its dialogue partners.<sup>56</sup> C. P Ravindaran, however, believes that the gains from India-Japan CEPA “will come eventually through competition with more efficient producers on the one hand and in demanding markets, on the other.” He adds that the CEPA through its free trade provisions, hold such possibilities for India.<sup>57</sup> Ambassador Arjun Asrani, who was part of 50 member India-Japan study group which recommended negotiation on CEPA between the two countries, however, believes that the inclusion of a large number of goods in the negative list would remain an impediment in the wider trade flows between the two countries.<sup>58</sup>

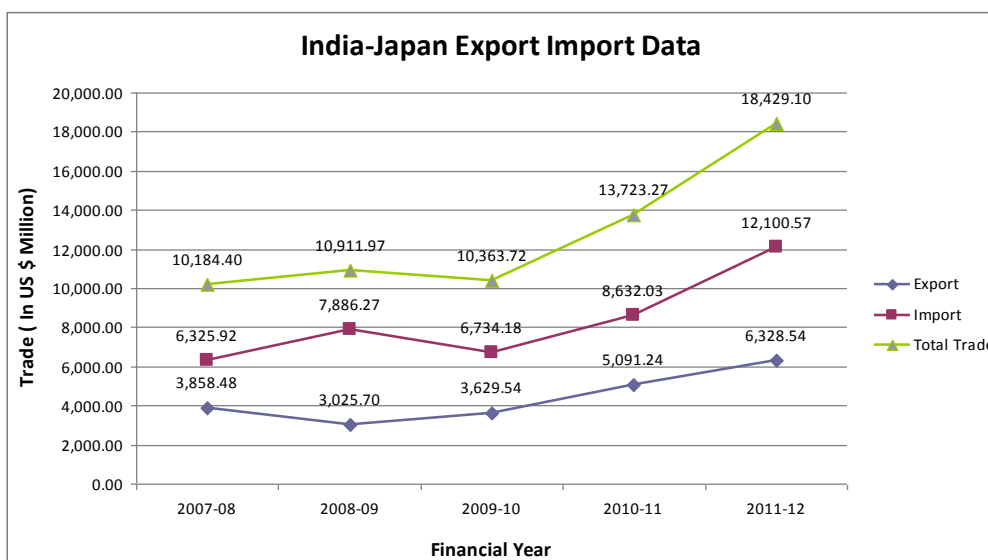
The CEPA has certainly boosted bilateral trade. In 2010-11 fiscal, trade between the two countries stood around \$ 13.4 billion. However, in fiscal 2011-12, within months of



CEPA coming into effect it touched \$ 18.3 billion. (See graph 1 below) It is likely to grow further. There will be a strong demand in India for social infrastructure such as railway lines and metro rail networks. Japanese investment has been high in these sectors and patterns indicate that the Japanese investors are working with a growth strategy in these fields.

Ever since CEPA came into effect, trade between the countries has grown a bit faster compared with the traditional growth. But concerns about growing trade imbalance in Japan's favour have also started surfacing. Indian media reports suggest that India-Japan merchandise trade grew 38% from August 2011 to March 2012. Japanese exports to India grew by 40.96% while India's export to Japan managed to grow only 18.39 %. A year before CEPA Indian exports to Japan had grown by 43% and imports had grown by only 28%. Concern in Indian business circles that CEPA has increased the trade balance in Japan's favour has started surfacing.<sup>59</sup> ( see graph 2 )

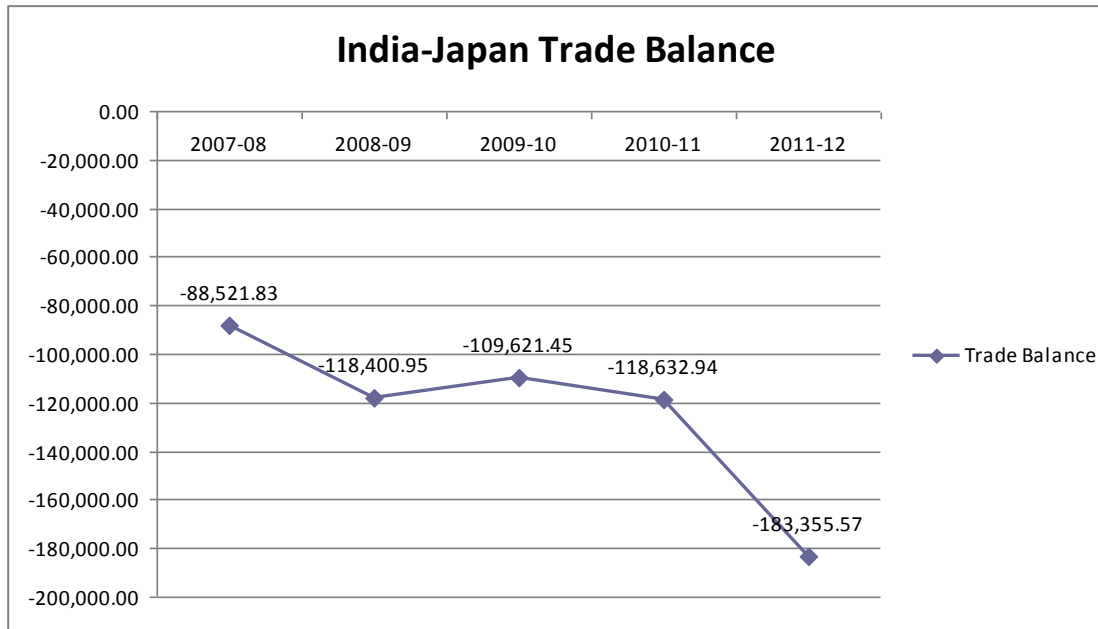
**Graph 1.**



Source: Ministry of Commerce and Industry, Government of India

(Trade figures for financial year 2011-12 shows bilateral trade during first three quarters from April 2012 to December 2012)

**Graph 2.**



Source: Ministry of Commerce and Industry, Government of India

Some concerns of growing trade imbalance also came to the fore at the political level. Indian media quoted Commerce, Industry and Textile Minister conveying his Japanese counterpart that India's generic medicines' share in Japanese markets is less than 1% of the total Japanese market and urged to remove "non-tariff barriers" on the Indian drug companies. He also requested Japan to start negotiations on nursing and healthcare.<sup>60</sup>

Despite consistent efforts by both the governments, bilateral trade which was projected to touch \$20 billion by 2010, missed the target<sup>61</sup>. Trade between India and China touched around \$ 75 billion despite no FTAs with the neighbour and no visible political backing to improve trade relations. By signing the CEPA with Japan, India wants to attract more Foreign Direct Investment (FDI) in India and increase its trade volume

from its current level. The statements by the Indian leadership suggest that they want to see “Japan become the largest FDI investor in India, in addition to being the largest development partner of India.” One of the Indian External Affairs Ministers noted that “Japanese investment is still insignificant compared to its total FDI, and very low compared to levels of China, and even in South East Asian countries.”<sup>62</sup> But since China is registering high growth, for the Japanese investor it will remain a favourite destination for the next two to three years. So how to wean Japan away from China is a biggest puzzle for the Indian leadership and economic community.

There is another expectation from India in terms of trade relations. India wants to achieve complementarities when it comes to trade. But finding such complementarities with Japan is difficult since Japan is an ageing society and consumerism remains low in Japan. India on the other hand has a growing economy and a society with a large consumer base. So in this scenario, it would be difficult to find complementarities and a trade balance which remains in Japan’s favour is likely to grow further. Thus, it will be a challenge for both economies to achieve a balance in trade. But surely, a trade conflict between India and Japan is not likely to emerge as was seen between the US and Japan during the late 80s because India is offering trade relaxation to Japan with an objective that goes beyond the economic dividend.

### **3.1 India-Japan CEPA: The strategic aspects**

There is a general perception among the academician and the media that the unstated

purpose of India-Japan economic engagement is to achieve some strategic objective. Yazuru Takano, New Delhi based correspondent of *Asahi Shimbun* notes in an opinion column that CEPA will bring “huge economic benefit to Japan” but it is unlikely to “offer new benefits to India”<sup>63</sup>. His argument that the trade pact is not going to bring huge benefits to Indian is based on the fact that Japan’s tariffs on imports of industrial products were already low. He adds that during the negotiations, India made no major demand concerning agricultural products such as rice. Then why India offered a bigger market to Japan? To substantiate his arguments, Takano quotes Rahul Khullar, the then Secretary in Indian Commerce ministry as saying that the CEPA is aimed at sending a “signal of bilateral cooperation to the world.” Takano has ably interpreted that “Khullar’s message would become clearer if “the world” here is replaced by “China””.

A section of Indian scholars also believe that the CEPA between India and Japan would act as a “counterbalance” to China. Geethanjali Nataraj for example argues that “for many countries in the region, enhanced trade and investment relations between Japan and India would act [as] a counterbalance to the growing influence of China.”<sup>64</sup> She adds that “stronger economic ties with Japan would also help India establish its presence in East Asia and get market access for its exports through Japan’s bilateral agreements with other countries in the region.”<sup>65</sup> Harsh V. Pant elaborating on India’s economic engagement with East Asia and ASEAN countries points that India’s FTAs “allows India to challenge China’s growing penetration of East Asia and prevents India’s growing marginalisation in the most economically dynamic region in the world.”

<sup>66</sup> Interestingly he also notes that “smaller states in the region are now looking at India to act as a balancer in view of China’s growing powers...”<sup>67</sup> Pravakar Sahoo, a former

Visiting Research Fellow at the Institute for Developing Economies also believes that CEPA is a “strategic move given the overdependence of Japan on China for trade in goods.”<sup>68</sup> Arjun Asrani, former Indian ambassador to Japan who was part of India-Japan study group that recommended CEPA negotiations, says that CEPA is not only aimed at challenging China’s economic clout in Indian market but it is also a joint effort by India and Japan to thwart China’s economic pre-eminence in entire East Asian market.<sup>69</sup> A somewhat similar observation has also been made by the Japanese experts who closely view India-Japan economic ties. For example, Masanori Kondo, who had been a part of 50 member India-Japan study group which recommended negotiation on a CEPA, believes that India made concessions to Japan during the negotiations “partly in the hope of counterbalancing China’s increasing clout by firming its relations with Japan.”<sup>70</sup> He explained to this researcher that a high tariff imposed by India on imported machinery has been impacting on profitability of Japanese manufacturers in Indian market. With tariffs removed, profitability and global competitiveness will increase challenging monopoly of cheaper Chinese goods in Indian market. He added, however, that the Japanese SMEs are still hesitant to go to Indian market because of inadequate infrastructure.<sup>71</sup>

India has signed similar agreements with South Korea, Singapore and Malaysia but has showed no indication that it will sign a similar agreement with China. This also gives doubts to the minds of academicians and media that India is going for a certain kind of economic hedging with China. When Indian Prime Minister Manmohan Singh was to visit Tokyo to announce the conclusion of land mark trade agreement with Japan in October 2010, the Japanese media was curious whether India will sign a similar

agreement with China. When the Japanese media posed a pointed question to Prime Minister Singh asking him “do you see a need for an EPA with China”, Indian Prime Minister was categorical in his answer. He said that “as regards the economic cooperation agreement, we have not reached to that stage” adding that “there is an imbalance in our trade.”<sup>72</sup>

Some Japanese media has also viewed the CEPA as a tool to reduce Japan’s “economic dependence on China”. The *Japan Times* for example has stated in an editorial that “the Japan-India CEPA will not only help Japanese firms catch up with Korean firms but also help Japan reduce its economic dependence on China.”<sup>73</sup> The daily reiterated this point in yet another editorial. It stated that “Japan can counter China” by deepening ties with India and “can reduce the excessive economic reliance on China.”<sup>74</sup> In a similar tone, *The Yomiuri Daily*, Japan’s largest selling daily, observed in its editorial that “enhancement of Japan’s economic partnership with India will alleviate the nation’s economic dependence on China.”<sup>75</sup>

The arguments above suggest that there is a wider perception among the academicians and media that the agreement is not merely “entrepreneurial” in nature. It has a broader objective. Let me refer to Takano again. He argues that behind the economic partnership agreement was “New Delhi’s strategic thinking based on a broad diplomatic perspective.” He advises Tokyo to “asses the value of its trade pact with India from a broader strategic perspective.”

The recent statistics, however, suggests that China remains top trading partners for both India and Japan and the CEPA has not helped lessen their dependence on China. India-

China trade hovers around 75 billion US dollars and in few years it is expected to surpass \$ 100 billion mark. This suggests that economics work on a different formula and not necessarily could be contained by strategic calculations. However, the development such as the US-led Transpacific Partnership (TPP) has kept the hope alive. The TPP is seen as a counter arrangement to APEC or ASEAN which is mainly Sino-centric. TPP sets high value standards for the participating nations and it is said that China would not be able to meet the standard set by the TPP. Howard Schneider, also see it from a strategic prism. He argues that TPP if successful “will present China’s new leaders with a potentially large, US-influenced trading bloc emerging on their home turf.” He opines that TPP is “couched in terms of increasing US jobs and exports” but the larger aim is to force China to “speed up the opening of its economy and curbing some of the country’s economic clout.”<sup>76</sup> A Japanese lobby had been pushing the government to join TPP negotiation for “countering China.” The Japan Institute of National Fundamentals (JINF), a Tokyo based think tank, has urged the Japanese government through series of opinion pieces to join the TPP. In one of the opinion article the JINF states that TPP is US’s “counter-China strategy” and urges Japan to “ride on the high tide of the counter-China strategy” by joining the TPP negotiations.<sup>77</sup> Japan, finally has agreed to participate in TPP negotiation despite persistent opposition from farming lobbies in Japan.

It is yet to be seen whether India and Japan succeed in countering China’s economic clout in Asia, is not sure. But one thing is sure that both can ease the economic overdependence on China in their markets by offering preferential treatment to goods from countries other than China.

#### **4. India-Japan Nuclear cooperation: Between economic gains and ideal principles**

India attaches great importance to forging a civil nuclear cooperation with Japan. However, there is a basic disagreement on the approaches of the two countries. Japan, looks the nuclear cooperation purely from strategic angle, while India sees it from an economic perspective and considers Japan's approval of a nuclear deal important for going ahead with installation of nuclear power plants. This is primarily because Japanese companies enjoy a monopoly over certain key components including "reactor vessels" required for nuclear reactors<sup>78</sup>. India has signed agreements with General Electric, Areva SA and Westinghouse- in which Japanese companies have major stakes- to set up nuclear power plants. If Japan does not sign an agreement with India, these companies cannot proceed with their installation plans. To sustain its economic growth India needs 3128 Trillion Watt hours of electricity annually.<sup>79</sup> India considers nuclear energy as one of the important components for its energy mix. At present, share of nuclear energy in India's "energy mix" is roughly 2%. Coal and oil remains major contributor in India's energy mix. 42% of India's total energy comes from coal and 24% from oil. As a result, carbon emission also remains high. To cut the carbon emission and to achieve self-sufficiency in energy, India wants to set up another 20 nuclear reactors in near future with a target of producing 20,000 Megawatt nuclear energy by 2020. Therefore, India looks at Japan for nuclear energy cooperation from an economic perspective.

There had been some headway, however, in this regard. The then Foreign Minister Katsuya Okada while in his New Delhi visit has agreed to launch a negotiation on nuclear agreement. Okada stated that "the decision to launch the negotiation for the



nuclear cooperation agreement was probably one of the toughest decisions that I had to make as Foreign Minister.”<sup>80</sup> Japan took almost five years to move from commitment to negotiation stage. It had made a commitment to India to enhance civil nuclear energy cooperation “through constructive approaches under appropriate IAEA safeguards” in a Joint statement signed by Prime Minister Manmohan Singh and then Japanese Prime Minister Shinzo Abe in 2006<sup>81</sup>. Japan’s slow but steady approach in this regard suggests that Japan is finding it difficult to generate a consensus at home and convince its anti-nuclear lobby which is against extending nuclear cooperation to non-NPT signatory countries including India.

On the other hand, there has been sustained pressure on Tokyo from certain policy circles to go for the deal. The Japan Forum for International Relations, a leading think tank, was the first to underscore the need for nuclear cooperation with India. In a 2007 policy recommendation it suggested that the government should forge an agreement with India, arguing that

“...because of the need to reduce global warming, India will presumably want to depend much more heavily on nuclear power in the future. Japan’s technology and expertise in generating and ensuring the safety of nuclear power is among the best in the world, so it is in an excellent position to cooperate with India in these areas.”<sup>82</sup>

To allay Tokyo’s nuclear proliferation concerns, the think tank argued:

“...even though India developed nuclear weaponry..., it has always called for global nuclear disarmament, it has strongly maintained policies promoting nuclear non-proliferation and it has not abandoned those policies even after it had acquired a nuclear force. For these reasons we

call upon the Japanese government to cooperate with India on this issue...”<sup>83</sup>

The Japanese government under the supervision of Ministry of Economy, Trade and Industry (METI) has set up International Nuclear Energy Development of Japan Co. (JINED) with an aim to form a centralized platform to increase Japan’s competitiveness in winning contracts for nuclear power projects overseas. The newly formed enterprise is eyeing the nuclear energy potentials of UAE, Jordan, Saudi Arabia and India. Indian nuclear energy market alone offers \$ 150 billion. So the Japanese government will continuously face a pressure from a business group to conclude the deal.

The challenges to the deal, however, come from the anti-nuclear lobbies and the Japanese media which has openly expressed concerns about the deal. Japanese leading dailies which help construct and opinion on certain issues has been consistently asking the Japanese government to proceed cautiously over the issue of nuclear cooperation with India. *The Japan Times*, *The Asahi Shimbun* and the *Mainichi Daily* have not approved the idea of a nuclear deal with India. When the Naoto Kan administration started negotiation with India , the *Japan Times* in one of its editorial opined that “Japan, which has advocated for a nuclear weapons-free world ... has started talks with India on a pact to allow India to import civilian nuclear technology and equipment from Japan.”<sup>84</sup> The daily suggested that “before agreeing to civilian nuclear cooperation...Japan should impose strict conditions on India so that Japan’s nuclear technology does not proliferate to other countries and thus the NPT regime is not undermined.”<sup>85</sup> Similarly, the *Asahi Shimbun* argued:

“we must not forget that lax export controls are responsible for nuclear proliferation to India, Pakistan and North Korea. Exporting nuclear power plants is big business, and it can also help curb global warming. But is it right to develop this business at the price of damaging the NPT?”<sup>86</sup>.

The *Mainichi* editorialised that “Japan should stop working with India on atomic energy if it conducts nuke test.”<sup>87</sup> All these media organizations have expressed similar opinion in their latter editorials also.

The support to the deal comes, however, from the *Yomiuri Daily* which has been advocating for not abandoning the Japanese nuclear industry. The daily writes in its editorial post Noda visit that “we think it appropriate that the two leaders also agreed to make more efforts toward an agreement on peaceful nuclear energy cooperation between the two countries.”<sup>88</sup> The daily, however, attaches a rider, “if India clarifies that it would not use Japan’s nuclear technology to develop nuclear weapons, the progress of bilateral negotiations would improve.”<sup>89</sup>

As regards Japanese government’s official position on civilian nuclear cooperation with India, Tokyo has been treading very cautiously. To assuage Japanese nuclear allergic public, majority of whom remain unaware of India’s “unilateral moratorium on nuclear testing”, Japan has been asking to include a clause in the pact that “Tokyo would halt nuclear energy cooperation if New Delhi conducts a nuclear test.” They continued with this demand in three rounds of negotiations. However, post Fukushima, Japan has been urging upon India more emphatically to join the CTBT. A joint statement signed during Noda’s visit to New Delhi notes in this regard that “Prime Minister Noda stressed the importance of bringing into force the CTBT at an early date.”

Japan is in a bargaining position with India, since it enjoys monopoly over certain key components required for nuclear reactors. A Japanese media report states that “Japan Steel Works Limited produces nearly 80 percent of global supplies of forged nuclear reactor parts.”<sup>90</sup> Since General Electrics and Areva SA also depend on Japanese components, they cannot start new nuclear power generation projects they have bagged contract for setting up nuclear reactors in India. So Japan has “considerable leverage” on Indian civil nuclear program. However, a group of Japanese, especially from the nuclear industry, worry that more suppliers would surface in the future and there will be “global supply chain without Japanese makers”<sup>91</sup> which would put Japanese nuclear power industry in a disadvantageous position. So they do not want to prolong the negotiation with India further and seize the opportunity as soon as possible.

A close look on Japanese thinking on nuclear cooperation with India suggests that Japan faces a dilemma. It is not able to decide which one to choose between the economic gains and ideal principle of not selling nuclear technology to a non-NPT member. Fukushima incident has also acted as an impediment to the deal. Post Fukushima crisis, a new anti-nuclear trend has emerged in Japan. A section of Japanese people now oppose using the nuclear reactor as a tool for the trade. However, the Abe administration has renewed its commitment to use nuclear energy cooperation as a growth strategy for Japan. It seems the Indo- Japan nuclear energy cooperation will come back on agenda again.

Expectations remain high in India about Japan giving a green signal for the deal. Whenever a key Japanese minister visits New Delhi, Indian media puts headlines suggesting that the deal is around the corner.<sup>92</sup> This issue is also becoming political

issue in India as lots of questions have been raised in Indian parliament by the elected parliamentarians about the fate of nuclear cooperation with Japan. It may be mentioned here that questions in Indian parliament are tabled when the issue is considered as an issue of national interest. As of February 2013, total seven questions about the nuclear cooperation have been tabled in both the houses of the Indian parliament. Since 2006, ever since the issue of nuclear cooperation first emerged in a joint statement between the two, total 14 questions have been tabled in the Indian parliament about different aspects of India-Japan cooperation. out of 14, seven queries were about nuclear cooperation.<sup>93</sup>

In Japan also, a section of bureaucrats believe that a key to strengthening economic ties with India will be an early conclusion to bilateral nuclear energy cooperation deal. The *Asahi Shimbun* quoted an unnamed high ranking Foreign Ministry official as saying that the absence of cooperation in nuclear sector will become a “bone stuck in the throat” of Japan India ties.<sup>94</sup>

The conclusion of an Indo-Japan civilian nuclear accord would depend on how both the countries reconcile on an agreed position. Japanese side demands a clause in the proposed accord that Japan will suspend cooperation on nuclear power generation issue if India conducts further nuclear tests. The Indian side, however, urges Japan to consider that it has a moratorium on nuclear testing and is committed not to undertake an explosive testing.

## **5. India-Japan Infrastructure cooperation**

One of the key areas of India-Japan economic cooperation is infrastructure development projects including the rail, roads and transportation sectors. India plans to invest US \$ 1 trillion on infrastructure during its 12<sup>th</sup> five year plan, during 2012 to 2017.<sup>95</sup> Japan is helping India through ODA loans and Japan Bank for International Cooperation (JBIC) to finance some of these projects. But one of the projects that has become a landmark of India-Japan cooperation in development project is Delhi Mumbai Industrial Corridor (DMIC). This dedicated freight corridor is based on Tokyo-Osaka expressway model along which several industrial zones would be set up. This 1483 kilometers long mega project will start from Delhi National Capital Region and will link to Mumbai port in Maharashtra crossing through six Indian states viz. Uttar Pradesh, Haryana, Rajasthan, Madhya Pradesh, Gujarat and Maharashtra.<sup>96</sup>

Map 1. Delhi Mumbai Industrial Corridor



Source: DMIC website

This mega project was institutionalized at the political level. A Memorandum of Understanding was signed in December 2006 between Vice Minister, Ministry of Economy, Trade and Industry (METI) of Government of Japan and Secretary, Department of Industrial Policy & Promotion (DIPP), India. A Final Project Concept was presented to both the Prime Ministers during Prime Minister Shinzo Abe's visit to India in August 2007.<sup>97</sup>

India has floated Delhi Mumbai Industrial Corridor and Development Cooperation (DMIDC)- a public enterprise to complete this project. The company has identified a band of 150 km (Influence region) on both sides of the Freight corridor to be developed as the Delhi-Mumbai Industrial Corridor. The vision for DMIC is to create strong economic base in this band with globally competitive environment and state-of-the-art infrastructure to activate local commerce, enhance foreign investments, real-estate investments and attain sustainable development. In addition to the influence region, DMIC would also include development of requisite feeder rail and road connectivity to hinterland and markets and select ports along the western coast. Yet another aim of the project is to ensure faster movement of goods. At present the goods that arrive at Mumbai port from abroad takes some 40 days to reach to a market in Delhi. The completion of the project will lessen the timing and certain good can be delivered within 13 to 14 hours after its arrival on Mumbai port.<sup>98</sup>

It has been planned to construct new eco- friendly cities along both the sides of the DMIC, with world class infrastructure including the airports. It will incorporate 11 investment regions and 13 industrial areas. If materialised, it will give new look to India's landscape.

The cost on the project has been estimated at USD 90 billion part of which would be covered by Japanese funding and loans. India is clearing political obstacles to provide 26% equity stake to Japan in DMIDC. Indian government had moved a cabinet note for the participation of the Japanese government in DMIC.<sup>99</sup> Japan has already established a "Japanese Zone" in Neemrana, Rajasthan where Japanese companies have started setting up their industries.



This project has generated huge interest in India including New Delhi's strategic circles. Rajaram Panda, a senior Indian observer on Indo-Japan relations, notes that "this huge project will dramatically transform the character of India-Japan economic relations in few years."<sup>100</sup> Professor K V Kesavan, a distinguished fellow at the Observer Research Foundation believes that the dedicated projects being built with the help of Japan are expected to "bring greater flow of Japanese investment and technology" as well as "change the industrial climate of several states in India."<sup>101</sup>

Similarly, Japan's bullet train technology is also fascinating Indians. India has announced that it will start bullet trains on seven routes including between Ahmedabad and Mumbai. Japanese companies have already started promoting the Japanese Shinkansen technology and there are reports that first such bullet train will run between Mumbai and Ahmedabad. The project is predicted to cost some 1 trillion yen and would be undertaken by East Japan Railway Company and Kawasaki Heavy Industries Limited.<sup>102</sup> If completed, the Shinkansen line would shorten the 500-kilometer trip between Mumbai to Ahmedabad to two hours from the current 10 hours.

## 6. Maritime Security Cooperation: Strategic and economic aspects

The maritime security cooperation between India and Japan is driven by two factors: the strategic factor and the economic factor. It will not be an exaggeration to say that Indo-Japan maritime cooperation is driven more by economic concerns than the security concerns. In fact, the hijacking incident of Alondra Rainbow- a Japanese freight ship which was rescued by Indian coastguards in 1999 triggered this cooperation.<sup>103</sup> (See map)

**Map 2. Alondra Rainbow incident**



Source: OPRF, Japan.

It was an act that threatened Japan's economic security since Japan's 98% of inbound and outbound trade takes place through the sea. For the first time the then Japanese Vice Transport Minister Toshihiro Nikai in a letter to Indian Defense Minister underscored

the need of combating piracy and sought India's cooperation.<sup>104</sup> Prabhakaran Paleri, a former Director General of Indian Coast Guard, also believes that the Alondra Rainbow hijacking "opened a new chapter in Indo-Japan relations" and both the countries collaborating "to eliminate the bane of piracy."<sup>105</sup>

In 2000, a year after Alondra Rainbows hijack, the then Indian Defence Minister George Fernandes visited Tokyo. He announced that both the countries will held annual high level defence consultation and noted that "...the Japanese coastguard ships and Indian vessels will conduct joint training in tackling piracy. The issue, though, is not piracy alone."<sup>106</sup> While referring to the unresolved territorial disputes in the South China Sea region, he further stated, "a strong India, economically and militarily well endowed, will be a very solid agent to see that the sea lanes are not disturbed and that conflict situations are contained."<sup>107</sup> The statement by Fernandes clearly suggests that India was not looking maritime cooperation by an "economic security" prism only. He saw the issue from a strategic angle as well. Interestingly, the then Japanese Foreign Minister Yoriko Kawaguchi during India visit in 2003 stated that maintenance of maritime traffic between Indian Oceana and the Straits of Malacca are among the "security and defense issues which deserves our increased attention."<sup>108</sup>

Similarly the then Japan's Defense Agency Chief, Shigeru Ishiba who later became Defense Minister, referring the need of a stronger maritime cooperation in the region observed:

"The Most important thing for this region is to have a good collaboration between Australia, the US, India and Japan. These four countries should have a candid exchange of views and then try to make a contribution to formulate

rules for international society.”<sup>109</sup>

These statements suggested that Japan wanted to extend existing maritime cooperation-, which it started with India to ensure the safety of Sea-lane of Communication (SLOC)-beyond the present commitments.

Against this background, India, Japan, the US and Singapore participated in a joint naval exercise in Bay of Bengal in 2007. Though the participating countries claimed that the exercise was aimed at responding a regional disaster, it was construed in strategic circles that this is aimed at containing China<sup>110</sup> which by that time had started naval expansion in the Indian Ocean. Gradually, this maritime cooperation from multilateral exercise has been transformed into a bilateral naval exercise. In June 2012 navies of both the countries held bilateral naval exercise in Japanese waters. A veteran strategic thinker in India saw this exercise as “expanding engagement” between the two navies. He opined:

“the expanding engagement with the Japanese navy, one of the strongest in world, should give boost to India’s maritime diplomacy in Asia. If New Delhi’s interests in Pacific are growing, Tokyo’s naval profile in the Indian Ocean has begun to expand.”<sup>111</sup>

The maritime cooperation between India and Japan reached to a new height as they held first maritime dialogue in January 2013. In the dialogue they discussed issues of “maritime security including non-traditional threats, cooperation in shipping, marine science and technology, marine biodiversity and cooperation at various multi-lateral forums.”<sup>112</sup>

Institutionalization of the dialogue between New Delhi and Tokyo would mean that they will meet alternately in the two capitals and discuss issues pertaining to maritime interest.

In future also, maritime security would remain one of the driving factors of India-Japan relation as China's "first island" and "second island chain" strategy have generated wariness in Japan's strategic community. It must be mentioned here that in 1982 Chinese strategic planners under the leadership of Liu Huaqing, then Vice Chairman of the Central Military Commission had envisioned a "three stage scenario"<sup>113</sup> for its maritime expansion planning. For their first stage scenario from 2000 to 2010 they had identified naval expansion through "first Island Chain." The Senkaku Islands in East China Sea and various contested islands in South China Sea fall within the "first island chain". For the second stage scenario from 2010 to 2020, the Chinese maritime planners have identified its naval expansion along "Second Island Chain" that links to Japan's Ogasawara Island, Guam and Indonesia. In the third and final stage from 2020 to 2040, China envisages to put an end to US domination over Pacific and Indian Ocean through its naval expansion.

The recent naval expansion and repeated intrusion in Japanese waters off Senkaku has been interpreted in Japan as a Chinese plan to control the "first island chain". They are also increasingly worried about China's "second island chain" strategy that seeks to control the waters around Ogasawara Island -- 600 km south of Tokyo -- in the next 10 years.<sup>114</sup> (See map 3)

**Map 3. China's naval expansion: First and Second Island Chains**



In case China aggressively pushes its maritime strategy, there are strong possibilities that it will impact on free flow of Japanese in bound and out band goods. In the foreseeable scenario, Japan wants to ensure freedom of navigation and looks for partners. India, being one of the regional players, is one of the hopes for Japan. Yuriko Kioke Japan's former Defense Minister, in an opinion piece has opined that "... fear of provoking China should not stop Asia's leaders from seeking a regional security consensus, such as the proposed code of conduct for disputes in the South China Sea."<sup>115</sup> She adds that "America alone cannot construct a viable security structure for the region. From India to Japan, every Asian country must play its part."<sup>116</sup> In the backdrop of increasing conflicts in the Pacific involving China, India has ensured that it will stand by Japan to ensure freedom of navigation. India's Foreign Minister Salman Khurshid while visiting Tokyo in March 2013 stated:

Countries like India and Japan must cooperate in ensuring the security of global commons including freedom of navigation on the high seas that is critical to both our countries which imports large amounts of oil and gas.<sup>117</sup>

Though India-Japan maritime cooperation initially was aimed at safeguarding economic interest, gradually it has transformed into security cooperation. However, securing economic interest of both the countries' remains one of the essential elements of the bilateral maritime cooperation.

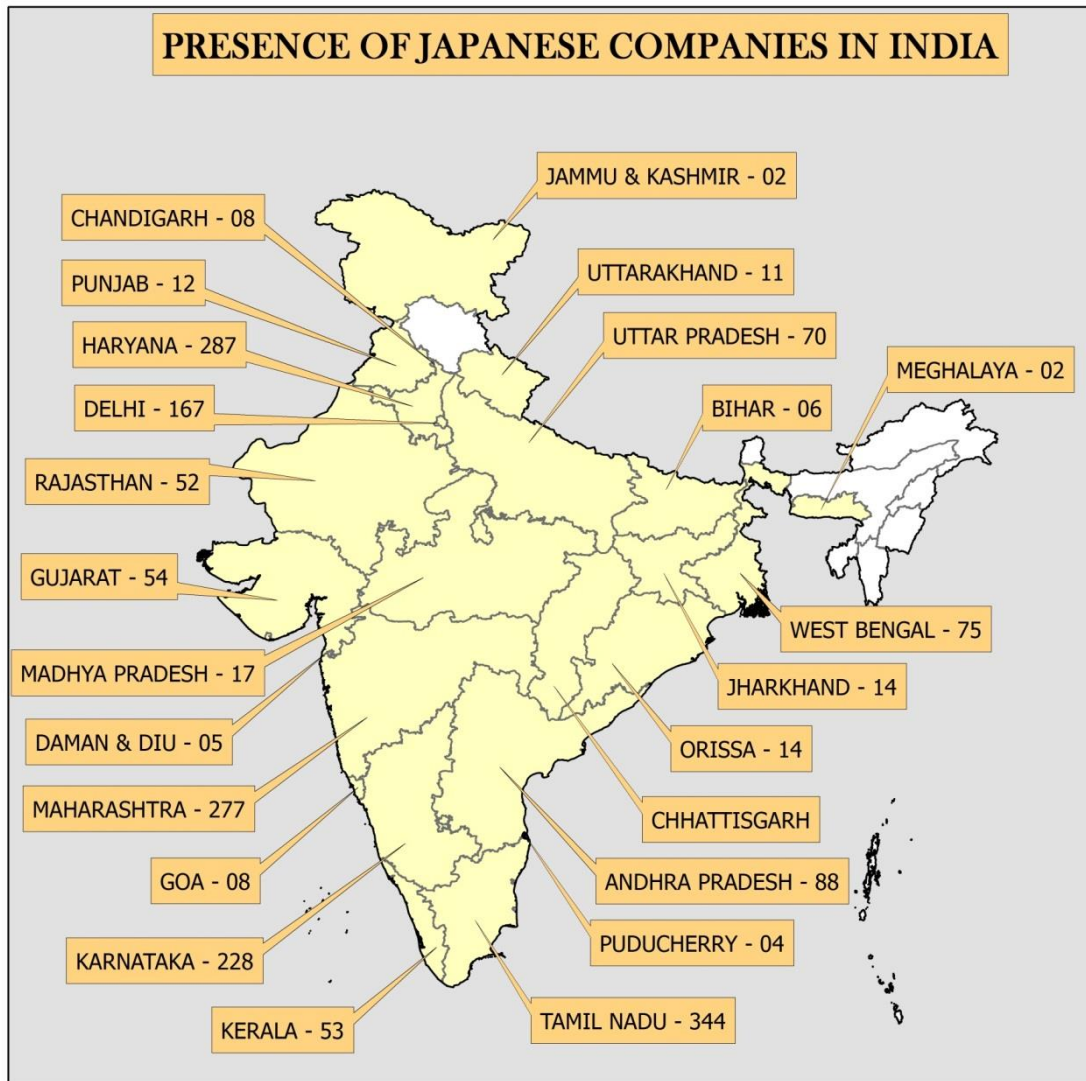
## **7. India-Japan economic relations: The Challenges and Prospects**

Despite all efforts, Japan's two-way trade with Asia's number three economy accounts for only one per cent. This is the biggest challenge as well as impediments in bilateral economic relations. On the contrary, Japan's trade with China- Asia's number one economy accounts for some 20% of Japan's total trade. Why this is so? The answer could be found in the number of Japanese companies working in China. There are some 14, 400 Japanese firms that are operating in China whereas in India the number remains some 926 (see Map 4 below). Also, presence of Japanese companies remains largely concentrated in few selected states. However, there is one positive trend in Japanese investment in India. The number of Japanese companies has grown from 550 in 2008 to 926 by 2012.

Various factors can be attributed to the Japanese companies' slow pace of flow towards India. An observer has argued that "poor infrastructure, corruption, and a dense Indian bureaucracy as well as the political instability and social unrest prevalent until the end of the 1990s presented many risks to Japanese firms."<sup>118</sup> Japan Chamber of Commerce and Industry in India (JCCII) has also identified infrastructure as one of the "bottlenecks"<sup>119</sup> in enhancing manufacturing and industrial capacity in India. In its suggestion to government of India, the JCCI has suggested "early completion of Bengaluru-Chennai expressway project", "introduction of the efficient operating controlling system for Railways" and introduction of comprehensive port logistic management system."



**Map 4. Presence of Japanese Companies in India**



Source: Embassy of Japan, New Delhi.

Other hurdles in flow of Japanese companies and its associate identified by JCCII were VISA procedures. It demanded that Japanese professional dispatched by Japanese companies should be eligible for business visa. Similarly it requested issuance of Stay permit by FRRO as same as the period of validity of Employment Visa. These are not

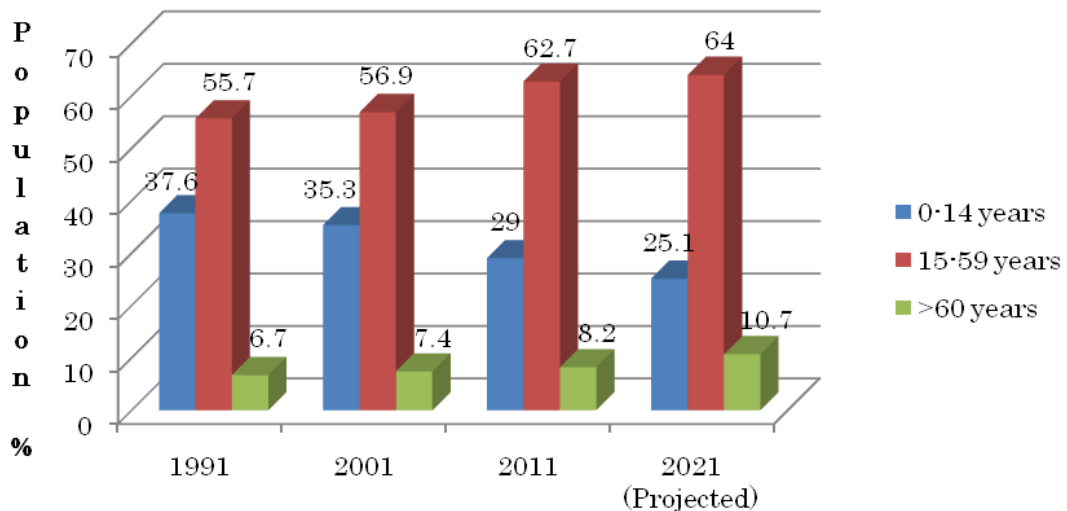
the major hurdles and it could be addressed gradually by the government agencies. However, the major demand by the JCCII is regarding the tax system. Most importantly introduction of Goods and Services Tax and abolition of the surcharge, education cess and Central Sales Tax remains their major concerns. It also demands exemption of Special Additional Tax for the Completely Built Unit automobile for sale. These demands have not only been raised by the industry bodies but also by the Japanese leadership. Prime Minister Shinzo Abe conveyed similar concern to Indian Finance Minister who visited Tokyo in April 2013. The Japanese media quoted Japanese Foreign Ministry as saying that Abe suggested the visiting Indian minister “to pursue financial sector regulatory reform and improve its tax system in order to increase Japanese investment there.”<sup>120</sup>

Some of these demands certainly have some merits. However, the Japanese company should not make it a pre-requisite in moving towards India. Rather they should look at bigger size of the Indian market, profitability and a long term demand in the country. The Japanese companies should have a bigger strategy to tap Indian market which has 1.3 billion consumers. The Indian market is likely to outstrip China as Chinese society will become an ageing society in the next 20 years and will lose the current purchasing power parity. It should be noted that as per the 2009 estimate the percentage of aging people (65 and above) in 1.35 billion Chinese population is around 8.1% while this is only 5.2% in 1.18 billion Indian population. India has median age of 25 while China has median age of 34, which means China would become an ageing society faster than India. It would lose appetite for automobile and home appliance product, the Japanese are known for.

Indian census data shows that by 2021 percentage of ageing population (60 and above) will be merely 10.7 % while those ranging from 15 to 59 years will constitute 64 per cent. So India will be a relatively young society as compare to other rising powers and consumerism will remain high there for a longer period.

**Graph 3.**

### Age Distribution of Population in India Over Decades

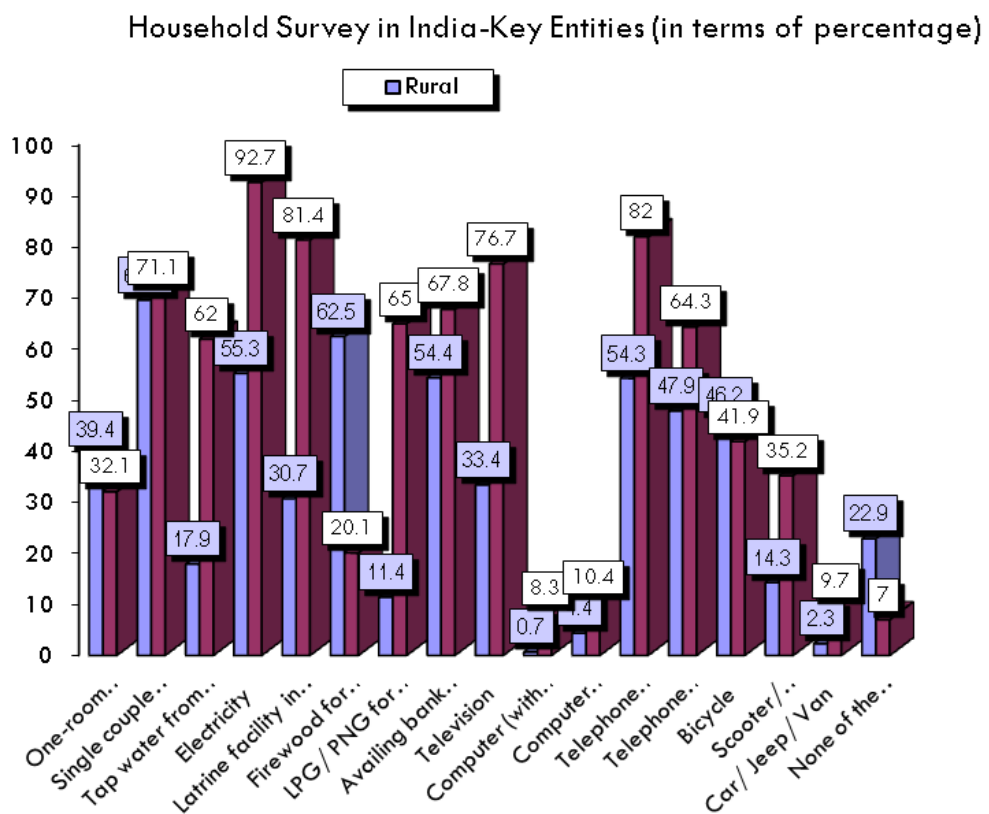


Source: Census of India 2011.

A house hold survey conducted by Census of India suggests that consumption of key entities such as computer, cars, mobile and internet facilities, both in urban and rural India still remains low. However, the demand is growing in these sectors. Some of the facilities including house, gas and electricity connection are still unsaturated and this can be tapped by investors and manufacturers (see graph 4 below)<sup>121</sup>. It remains to be

seen whether the Japanese companies who feel that the Japanese market in these fields have saturated at home sets their eye on Indian market in near future or not.

**Graph 4.**



Source: House, Household Amenities and Assets Survey, Census, 2011

A study by METI also suggest that the consumer market in India will surge from 660 billion US dollars to 3.06 trillion dollars by 2020.

One of the key concerns as mentioned above for Japanese investors is India's poor

infrastructure that constrains them to set up their base in India. The infrastructure development is certainly an issue in India at present. However, India is taking efforts not only to enhance infrastructure within the country but it is also taking efforts to re-integrate with its neighbouring countries by laying new rail and road networks and increasing the aviation links to promote people to people and trade relations with its neighbours. With Pakistan, India has established various Communication services as a result of growing political engagement. There was only one rail link between India and Pakistan known as Samjhauta Express plying weekly between Delhi (India) to Lahore (Pakistan). In the recent past India has revived the Munabao Khokrapar rail link that connects Rajasthan (India) and Sindh (Pakistan). Both the countries have also opened up few trade routes across the Line of Control in Kashmir. They have also revived the aviation links which was suspended after 1998 Kargil conflict.

India is also re-opening various trade routes with Bangladesh. It has resumed rail network with Bangladesh in 2008 which was suspended after the 1965 war between India and Pakistan. Apart from re-opening rail route between Kolkata and Dhaka, India is planning to build a 15-km railway track linking Agartala (India) with Bangladesh's southeastern city of Akhaurah. Akhaurah is an important railway junction connecting the Chittagong port, resource-rich Sylhet and Dhaka.<sup>122</sup> Both the countries are also negotiating on transit facilities on a reciprocal basis. India would provide transit access to Bangladesh to reach out Bhutan and Nepal, while Bangladesh will provide access to India to its Northeastern regions.

To deepen the economic linkages further with Nepal, India is trying to improve infrastructure on the Indo-Nepal borders. As part of this process, India is extending rail

connectivity to Nepal at six points. The Indian railway has proposed to build six rail links with Nepal. The proposed lines will run from Nepalgunj road in Uttar Pradesh to Nepalgunj (12 km), Nautuna to Bhairahawa (15 km), Jayanagar to Bardibas (70 km), Jogbani to Biratnagar (17 km) and New Jalpaigudi to Kakarvitta (46 km). There is only one existing rail link (Jayanagar-Janakpur) between India and Nepal. The proposed new railway link will help both the countries in improving their socio-economic conditions. It will give a boost to the economy of Nepal as various food items, including salt, milk and fertilizers could be easily transported to Nepal through the rail routes from India.<sup>123</sup>

How to connect to Afghanistan through a trade route was a major challenge for Indian policy makers. The only physical boundary which connects India with Afghanistan lies under Pakistan Occupied Kashmir. Therefore, India does not have a direct access to Afghanistan. To overcome this situation, India has undertaken 160 mile long road project linking Nimroz to Iran's Chabahar port. The road will provide the landlocked country an access to the Arabian Sea in the Indian Ocean. If this project completes successfully, India can get access to Afghanistan through sea ports and trade between the two can prosper.

(Please see the map below for India's envisioned rail and port connectivity with its neighbours.)

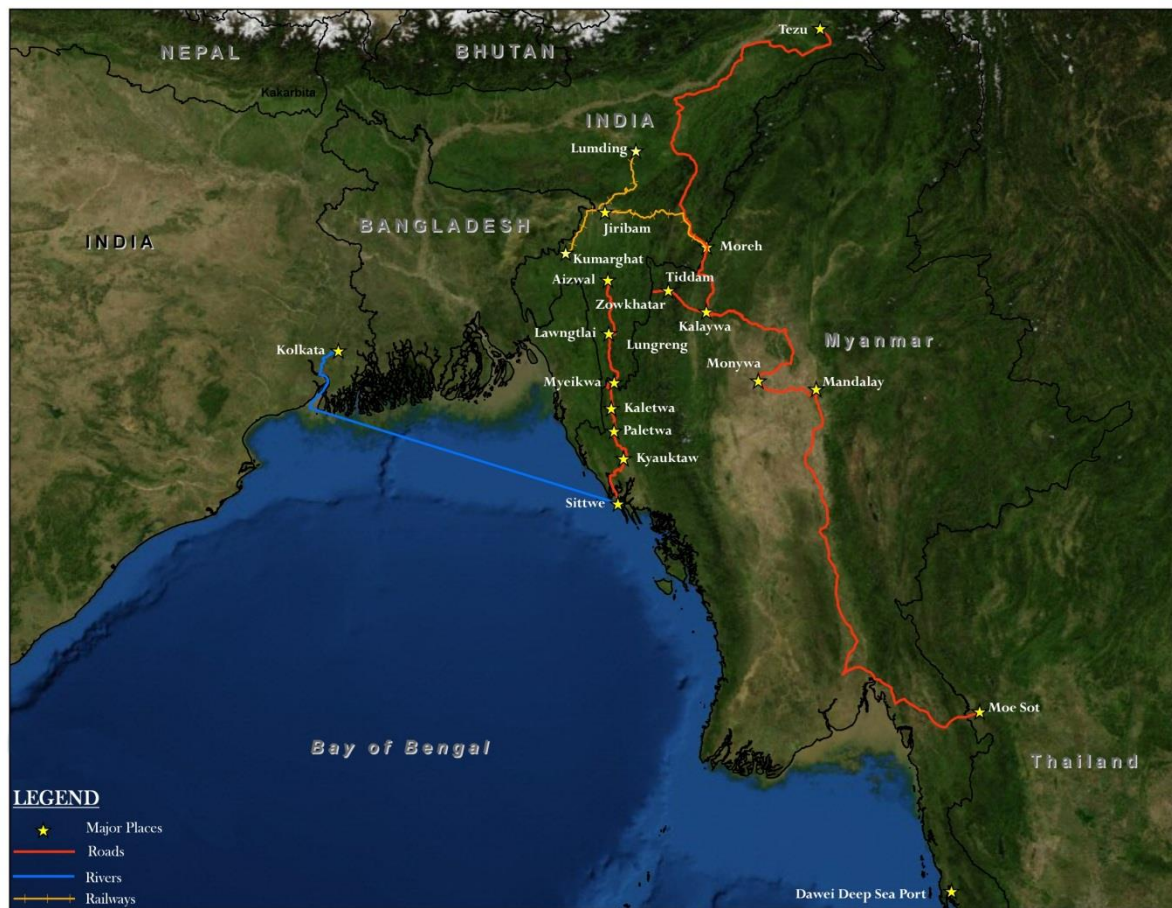
**Map 5. India's reintegration with neighbours through rail and ports**



India is also trying to connect with South East Asia, through Myanmar-Japan's last "economic frontier" and India's only Southeast Asian neighbor with which it shares a land boundary. One of the ambitious project is a trilateral highway connecting Moreh in India's north east via Myanmar to Mae Sot in Thailand expected to be completed by 2016<sup>124</sup>. India has already granted a US \$ 500 million loan to Myanmar, part of which will be used to finance the construction of 3200 kilometer highway. ( See Map 6 below) Other financiers are Asian Development bank and World Bank.<sup>125</sup>The trilateral highway

project will allow freight and container trucks to move across the borders from India to Myanmar via Chiang Rai. To many critiques it seems a pipedream to achieve this project to establish connectivity with Southeast Asia, but successful conclusion of 8000 kilometer India-ASEAN car rally in December 2012<sup>126</sup> gives hope that India can really establish land connectivity with the region.

**Map 6. Indian plan to connect with ASEAN**



Source: IDSA GIS Map.



If the planned highway is completed, it will connect India to the East-West economic corridor which stretches up to Vietnam via Thailand, Laos and Cambodia. Indian strategic thinkers believe that the East-West Corridor is a counter to China's South-West corridor linking country's borders with Laos and Cambodia.<sup>127</sup> Whatever, may be the objectives, completion of this freight corridor will help establish a supply chain between Indian companies and Japanese companies working in East Asia, especially in Thailand and Myanmar.

India's another plan is to connect Myanmar through ports which will help establish a supply chain with other ports in East Asia. India and Myanmar are also working on Kaladan Multimodal Transport Project. The other objective of the Kaladan project is to connect India's land locked north east with mainland through Sittwe project.

As mentioned previously, Japan is already helping six states of India to develop as a global manufacturing and trading hub. Once the Delhi Mumbai Industrial Corridor (DMIC) completes and Japanese companies set up their industrial bases alongside the DMIC, it will give outlet to Japanese companies to reach out to West Asian countries through the ports. On the other hand the rail and road networks India is laying to connect itself with its periphery more closely, will also provide new avenues to the Japanese companies to transport their goods to all the land locked countries. Thirdly, India's efforts to develop road and port connectivity with Southeast Asia through Myanmar and Thailand will help Japanese companies extend their supply chain to Indian states.

## **8. Summary and Policy suggestion**

The analysis above suggests that India-Japan economic relations have transformed from a “resources driven” trade ties to a strategic partnership. Comprehensive Economic Partnership Agreement signed in 2011 has given a new dimension to the relationship. It has pushed trade flows between the two countries and thus bilateral trade between the two countries have seen a 38% jump as compared to 2010 statistics. However, some concerns of growing trade imbalance in Japan’s favour have come to the fore. India has demanded to ease the non-Tariff Barriers including the early conclusion of an agreement on nurses and care givers, which was part of CEPA negotiation, but remained inconclusive as Japan demanded more time. These concerns are not likely to hamper the normal economic relations as the objective of CEPA is wider than achieving a trade balance. The analysis above suggests that for India at least, one of the objectives is to ease its economic over-dependence on China, whose presence in India is growing. As various scholars have argued, India has signed various Preferential Trade Agreements with South East Asian countries to allow a level playing field in Indian market and thus wants to minimize dependence on China. Therefore, the trade imbalance will not become a major irritant, as is being witnessed in India-China economic relations. However, conclusion of nursing and caregiver agreements, an inconclusive part of CEPA, will help ease some of these concerns. Japan should give India a similar treatment at par with Indonesia and Philippines, with whom it has signed similar EPAs.

India has helped Japan diversify the need of rare-earth elements; following China restricted export of these metals and thus tried to stifle production of various electronic items. An estimate suggests that India alone can offer 14 per cent of Japan’s rare earth

needs. Seen from this perspective, India has become a shock absorber for Japan. India on the other hand, wishes to conclude a civilian nuclear energy pact, in line with US-India nuclear agreement. India considers nuclear energy key for electricity production to sustain its economic growth. However, both the countries are still to reach on a meeting point to forge the deal. Japan demands inclusion of a clause in the accord stipulating that the nuclear cooperation with India will be terminated if it further tests nuclear weapon. However, India argues that it will not go for further explosive testing and urges Japan to accept its moratorium on nuclear testing. It is hoped that both the countries will reach to a meeting ground so that Japanese companies grab the opportunity to invest in India's 150 billion nuclear energy market.

Another expectation from India is to attract investments from Japan. Keeping this in mind the CEPA has given Japanese investor "national treatment" in the trade pact. But the flow of Japanese manufacturers to India remains slow. Statistics suggest that as of 2012 only 926 companies have set up their bases in India, while in China there numbers have crossed 8000. There are various factors that checks Japanese companies' influx into India. As discussed above 'poor infrastructure' in India remains one of the major problems for Japanese companies. However, Japanese investors should not ignore the fact that, India is improving its internal infrastructure, with the help of government of Japan. It's western (Delhi Mumbai Industrial Corridor) and eastern corridor is an example. Secondly, owing to its strategic concerns, propelled by China which is integrating with various Asian countries through port and rail networks, it is re-connecting with South Asian and East Asian neighbours by laying, rails and roads as well as developing ports. This can prove a boon for the investors who plan to make

India a trade hub for West Asian and Southeast Asian countries. Japan should also take advantage out of it by making India a trade hub for its exports. Thirdly, Japan should not ignore the fact that there is a huge demand of electronic goods and household utilities in India and this will surge in near future. Instead of waiting for India's infrastructure to improve, Japanese investors should grab the opportunity and they should not be the late comers in Indian market.

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