



INDIA & JAPAN

PARTNERS IN CHANGE AT HOME & ABROAD

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Prime Minister Narendra Modi visits Japan in November 2016 to meet his counterpart, Shinzo Abe, and further what has emerged as one of India's most important strategic relationships. The visit is expected to see announcements deepening cooperation in the areas of transport, defence, technology and nuclear power. The stability in the relationship, however, results from a remarkable convergence of interests not only when it comes to geopolitics but how each country can support fundamental changes in the other's domestic aspirations.

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Summary

IN 2000 INDIA AND JAPAN DECLARED a mutual Global Partnership for the 21st Century. The statement initially reflected Japan's greater interest in India's liberalized economy. A defence and foreign policy component was grafted on following the strengthening of strategic relations between India and the United States a few years later.

Under Japanese Prime Minister Shinzo Abe and two Indian leaders, Narendra Modi and Manmohan Singh, the partnership has become much more about fundamental and transformational change. Japan seeks to transform the growth trajectory of India's economy and thus New Delhi's ability to play a greater role in Asia. India, on the other hand, seeks to facilitate and legitimize Japan's shift away from its postwar pacifism towards a more normal diplomatic and military posture.

Japan's strategy to change the nature of India's economy is symbolized in the 1500 kilometre long Delhi-Mumbai Industrial Corridor designed to provide the foundation for the export-oriented competitive manufacturing base lacking in India. But there are numerous other areas where Japan is working to move India's economic growth to a higher level including urban development, nuclear power, transport infrastructure and generally ramping up Japanese corporate investment in India.

India, on the other hand, has expanded the arena of military cooperation with Japan in areas like naval exercises. New Delhi is negotiating to buy military equipment from Tokyo to help the latter in its first attempts at arms exports. As both countries face a mutual problem in an increasingly assertive Chinese foreign policy, the two countries have issued statements showing an increasing convergence in their strategic visions of Asia. This, in turn, has spawned nascent cooperation in aid and infrastructure development in third countries in the Indian Ocean, Southeast Asia and potentially Africa which is partly driven by a desire to minimize Chinese influence in these areas.

Converting this evolving grand strategy into concrete reality continues to be a major challenge. Japanese direct investment to India has risen to \$ 2 billion every year, but many Japanese firms find the Indian market a difficult place to make a profit. The industrial corridors and larger infrastructure plans have been coming up slowly. But Modi and Abe have shown remarkable tenacity in overcoming successive problems in the bilateral relations, the most recent being a civil nuclear cooperation agreement.



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INDIAN PRIME MINISTER NARENDRA MODI and his Japanese counterpart, Shinzo Abe, are often described as having a strong personal relationship. Commentators speak of their Twitter “bromance”. Indian and Japanese diplomats talk of their sharing a “perfect chemistry.”

Underlying this close bond, however, is the strong and increasing overlap of interests that both Asian leaders see in each other’s national priorities. Much is made of how both are conservative nationalist politicians, how they share concerns regarding an assertive China. But they are also conscious of what the other can contribute to their domestic agendas. It is one reason Prime Minister Abe calls the Indo-Japanese bond the “the most important bilateral relationship”. India’s contribution is not just about the Asian balance of power, it is how India can help legitimize and support his ambitious plans for reform on the home front.

The Modi government sees a clear convergence in Japan’s overseas investment strategy and its own plans to revive India’s manufacturing sector. It also understands that, as a first step, this requires the sort of large-scale infrastructure development in India that Abe has been personally advocating since 2007.

As a newly-elected prime minister, Modi deliberately made Tokyo his first major bilateral overseas visit. Part of this was drawn from his experiences with Japanese investment as chief minister of Gujarat. Part of this was a recognition that for many of his pet domestic programmes, like Make in India, Japan was an obvious and interested partner.

Also drawing from his Gujarat experience, Modi at the centre has from the start sought to create a degree of comfort for Japanese bureaucrats and businessmen with India. Hence, for example, his unique administrative partnership, Japan Plus, under which Japanese officials have been inducted into Indian ministries.

Abe has long believed India and Japan shared a common strategic interest over the threat posed by China and a weakening American commitment to the Asia-Pacific. He is often credited with popularising the phrase “Indo-Pacific” to reflect this convergence. In his 2007 book *Towards a Beautiful Country: My Vision For Japan*, Abe went as far as to write that it would “not be a surprise if in another decade, Japan-India relations overtake Japan-US and Japan-China ties.”

Abe has an overriding desire to dilute Japan’s postwar pacifist policies and make it, to use his phrase, a “normal nation” in its enunciation of policy and exercise of power in the region. He has wanted India to support and legitimize actions like the Japanese resumption of arms exports and adoption of offensive military capabilities. Having Asia’s most established democracy and embrace a Japan shedding its postwar inhibitions would be politically and diplomatically useful to Abe. His aides admit India’s lack of any World War II historical baggage regarding Imperial Japan is also useful.

Abe’s view was influenced by his own grandfather’s experience with India in the 1950s. As Abe described it, his grandfather, 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” in a US that had not fully shed its wartime hostility. [Shinzo Abe’s speech before the Indian Parliament, “*Two Democracies Meet at Sea: For a Better and Safer Asia*,” 20 September, 2011]



A Distant Past

INDIA WAS LARGELY IRRELEVANT TO JAPAN'S postwar interests, especially during the rapid growth of Japan's economy from the 1960s onwards. There was no shortage of reasons for this political distance between the two countries. India was seen as a supporter of the Soviet Union during the Cold War, Japan was firmly wedded to the US Cold War alliance system. New Delhi's early adherence to socialist economics meant it was a small market and hostile to foreign investment and trade. India's two bouts of nuclear testing also soured opinion with the only country to have suffered from nuclear bombing. [On the poor state of Indo-Japanese relations in the Cold War see Arpita Mathur, "*India-Japan Relations: Drivers, Trends and Prospects*," RSIS Monograph No. 23, 2012]

India's adoption of more market-friendly economic policies in 1991 piqued Japanese interest. Prime Minister Yoshiro Mori's state visit to India in 2000 was a direct consequence. In one of the first tangible signs of Japan's growing problems with China's more nationalistic foreign policy, in 2003 Tokyo announced India would replace China as the primary recipient of Japanese foreign aid.

What led the Japanese government to see India in a radically different light was the negotiation of the Indo-US civil nuclear cooperation agreement between 2005-2008 in which Washington agreed to end decades of nuclear and technology sanctions against India as part of a longer process to develop a stronger strategic relationship between the two countries. Tokyo accepted this was a sign the US was going to take a much greater, long-term interest in India than before. [See the introduction in Pramit Pal Chaudhuri, "*India and Japan: A Nascent Strategic Bonding*," RSIS Policy Brief, May 2015]

Additionally, from 1998 onwards, automobile component makers in Indian began winning Deming prizes, a prize given by the Union of Japanese Scientists and Engineers to the world's best corporate practitioners of total quality management. This was seen as evidence Indian industry was entering the realm of high-precision manufacturing at an unusually early stage in its economic development and provided a potential environment that Japanese manufacturers could work within.



Economics

JAPAN SAW BOTH ITS ECONOMIC AND STRATEGIC interests converging in helping create an economically more powerful India. This manifested itself in a number of ways.

One, Tokyo's aid policy towards India was redirected from poverty alleviation to the more strategic area of infrastructure building. The construction of the Delhi Metro urban transit system was effectively an experiment by Japan to see if such mega-projects were feasible in India. The Metro's expansion continues to receive Japanese funding to this day, but its success paved the way for increasingly ambitious infrastructure plans like industrial corridors and, most recently, high-speed train lines.

Two, from about 2006 Japanese firms were encouraged to invest more in India. The surge in Japanese foreign direct investment that has followed has pushed such investment to its present average of \$ 2 billion a year.

These represent the foundation of a new bilateral economic relationship with the goal of allowing the eventual erection of a superstructure of Japanese factories and supply chains based in India. Japanese overseas aid is used to build infrastructure which in turn encourages Japanese private investment, largely in the area of manufacturing, to set up shop in India.

As the then Japanese ambassador to India, Takeshi Yagi, noted in 2014, Japan's infrastructure investment helped make East and Southeast Asia major manufacturing hubs, integrated these regions into global supply chains, and that "the Japan-India partnership is predicated on following a similar path." [Takeshi Yagi, "A Power With Responsibility," Indian Express, 16 January, 2014]

The number of Japanese firms registered in India has risen from 301 in 2005 to 1229 in 2015, according to the Japanese Ministry of Foreign Affairs. The annual amount of incoming Japanese FDI 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 the crisis in India's economic policy-making saw the figure halve in subsequent years, but the 2013 FDI figure of 223 billion yen amounts to a "new normal" for Japanese investment into India.

Japan Inc has developed a greater incentive to look to India as China has come to be associated with heightened global risk, rising labour costs and slowing growth in the Middle Kingdom. A Hitachi executive was quoted as saying, “Japan in the past, Thailand now, India the future.” [Victoria Tuke, “*Expanding Strategic Horizons: Japan’s Foreign Policy Towards India*,” tokyofoundation.org, 25 March, 2013]



Strategic Debate

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.

The best example of this was the continuity of support for the massive 1480 kilometre-long Delhi-Mumbai Industrial Corridor (DMIC) project. Though first proposed by Shinzo Abe in 2007, it was adopted by successive Japanese governments on both sides of the political spectrum. The left of centre DPJ became a strong proponent because of Japanese calculations that 40 per cent of the project’s initial \$ 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 expectation it would provide jobs back home.

New Delhi was cognizant it needed a larger manufacturing base and that the first step towards getting one was to build the sort of world-class infrastructure that the DMIC represented. Japan’s proposal easily found support from Prime Minister Manmohan Singh, an economist and Japanophile who had visited the country over a dozen times. He used the term “transformational” to describe only two bilateral relations of India: the US and Japan. In other words, only these two countries were seen as being capable of changing India’s economic capacities in a fundamental and structural level.

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 to invest. He was unable, for example, to stitch together the consensus among state governments needed to allow the DMIC to be set up or stop changes to the land acquisition rules that massively increased the corridor's cost. 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 investment into India.

Japanese firms did set up localized clusters of manufacturing in a few states, most notably Delhi/Haryana, Maharashtra and Tamil Nadu. But the sort of export-oriented infrastructure that a much larger Japanese investment transfer needed – and of the variety that the industrial corridors represented — was stuck in political and regulatory uncertainty.

The DPJ, however, was less enthused about a strategic relationship with India as many of its members wished to preserve a good relationship with China. The idea of an Indo-Japanese strategic relationship is closely related to two Japanese prime ministers, both members of the LDP: Taro Aso, prime minister from 2008 to 2009, and Abe, who has been prime minister since 2012. Aso had a more limited view, but successfully ramped up naval exercises and diplomatic cooperation between India and Japan.

New Delhi was also initially cautious about the benefits of a deeper military or strategic relationship with Japan. The Singh government was internally divided, in part because his Congress Party's left wing saw strategic ties with Japan as moving closer to the US.

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. The concept of the "Indo-Pacific" as a strategic construct was treated with skepticism, at one point being openly questioned by the last Indian national security advisor, Shiv Shankar Menon.

Japan also seemed to be failing on a crucial litmus test that India applied to any country that sought a strategic relationship: civil nuclear cooperation. Following the Indo-US nuclear deal, India broadly argued that if a government was unwilling to end the past nuclear and dual use technology sanctions that had been imposed on India, then there would be severe limits on strategic ties with that country.

There was an additional problem that Japanese dominance in civil nuclear supply chains meant that other countries like France or South Korea could not sell reactors to India without a bilateral Indo-Japanese agreement in place.

After a delay of several years that led Indian officials by 2013 to talk of abandoning the agreement and the Japan relationship altogether, the two sides announced the conclusion of civil nuclear negotiations in December 2015. The formal agreement is expected to be announced during Modi's upcoming November visit to Japan, clearing the way for Abe to put it up for vote before the Japanese Diet.

The Japanese desire for terms, especially regarding on future nuclear testing, that went beyond what the US had asked of India had been a major barrier. It was overcome largely through a gentleman's agreement to avoid specific clauses on contentious issues, allowing the other side to revert to its own internal procedures in case of a major disagreement. This was an example of New Delhi and Tokyo recognizing a strategic imperative and overriding deeply-entrenched policy differences on a sensitive issue because it was assumed that their relationship would only strengthen over time. This is a pattern that is now being replicated in other bilateral spheres such as defence.

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What Needs To Be Done

Driven partly by geopolitical equations but also by the belief of the two leaders, Narendra Modi and Shinzo Abe, that the relationship has important domestic benefits, the India-Japan engagement is an ever-expanding frontier. When Prime Minister Modi visits Japan this November his policy priorities should include:

- Finding innovative means to accelerate the Indian freight and industrial corridors being constructed with Japanese assistance and finance. Such administrative solutions will provide a template for the high-speed train project.
- Addressing the taxation, arbitration and other regulatory problems that act as major barriers to Japanese private sector investment in India.
- Announce an agreement to buy US-2 seaplanes from Japan, keeping in mind this is about helping Tokyo become a “normal” military nation.
- A plan from Japanese government on how it will operationalize the dormant immigration agreement.
- Announce means by which India and Japan can work together in third countries, at both government and private sector levels.

Infrastucture | The DMIC is only the best-known of the Japanese financed and designed mega-infrastructure projects that are beginning to transform the Indian economic landscape. All the contracts and 90 per cent of the land for the Dedicated Freight Corridor, whose western arm parallels the DMIC, have been awarded and acquired. A Chennai-Bengaluru industrial corridor is being mapped out and a 1000-km East Coast Economic Corridor is planned for India’s eastern coast. Further in the future are the Ahmedabad-Mumbai high-speed train project for which Japan has sanctioned a long-term \$ 14 billion loan.

These projects are so large that they overshadow the numerous city metro stations and smart cities that are also being funded and designed by Japan in various parts of India.

But these mega-projects are coming up too slowly. New Delhi needs to find means to overcome the various regulatory and legal brakes that are slowing down construction. The Dedicated Freight Corridor, for example, has been bogged down by over 2000 court cases and 9500 arbitration disputes largely over the issue of land acquisition. Setting up special tribunals to handle such cases or working directly with a state like Haryana, where much of this litigation is concentrated, would go a long way to expedite construction of the corridors. [Mahendra Singh and Sidhartha, *“Freight Corridor Land Cost Increases 75%,”* Times of India, 3 November, 2016]

The Indian government must also push progress on the “soft infrastructure” that is needed to make such corridors work optimally. Electronic tagging of containers has already begun along the DMIC. The Modi government’s decision to pass the Goods and Service Tax (GST), a major economic reform that would merge the patchwork of central and local taxes that hinder intra-state business in India, will also be important to the success of such corridors.

All of this would provide an administrative precedent for ironing out some of the similar problems that will inevitably bedevil the even more ambitious high-speed train project.

Another source of contention is that there is growing unhappiness in Japan that though many of these projects are financed by Tokyo, the actual construction contracts are often going to firms from other countries. Japanese firms often offer technical standards that are beyond India’s tender requirements but mean their products and services are too expensive. The result is that these contracts are being awarded to Chinese and South Korean firms despite Japanese financing. This has been partly addressed by some of the Japanese firms forming joint ventures with Indian companies. But Indian officials are urging their Japanese counterparts to take a more “strategic” view of this problem. As long as the infrastructure comes up and irrespective of who actually builds it, runs their argument, the end result will be an Indian market that will over time be larger and more advanced and, thus, a perfect future partner for Japan Inc.

Investment | While the number of Japanese firms registering in India has increased dramatically and accumulated Japanese direct investment is now about seven per cent of India's total, **most of the Japanese firms in India are struggling to find a firm financial footing.** A minority of them turn a profit. An official of the Japanese Ministry of Economy, Trade and Industry estimated in 2013 that only 40% of Japanese firms in India were turning a profit, compared to 70% in Southeast Asia. [Roudra Bhattacharya, "Fixing FDI Issues is Positive, But It's Not the Only Problem in India," Financial Express, 2 December, 2013] Many investors were battered during the policy chaos of the second Singh government.

A number of major Japanese investments in India have turned sour and left the Japanese investors with billion-dollar plus liabilities. The most notable one was pharmaceutical major Dai-Ichi Sankyo's purchase of Indian generics maker Ranbaxy. Another crisis in the making is Japanese telecom firm DoCoMo's failed joint venture with Tata Tele-Services. Even now, India's opaque taxation policies and shifting regulatory parameters cause much heartburn among Japanese managers.

The success story that Japanese executives point to is Suzuki. The Japanese small car and motorcycle maker's South Asian subsidiary is the largest and most successful automobile company in India. In terms of market capitalization and car production numbers of the Indian subsidiary, Maruti Suzuki, are larger than those of its Japanese parent.

Japanese companies presently hold over a trillion dollars in reserves. That only a fraction of this is being invested in India is an indication of how difficult India continues to be seen in Japan as an investment destination.

Tokyo has set up a number of funds and schemes to mitigate risk for Japanese investments in India, but ultimately New Delhi needs to take the lead in determining and addressing Japanese corporate concerns about India. A simple example is the Modi government's unwillingness to clarify the status of foreign investment in e-commerce in relation to other restrictions on foreign investment in multi-brand retail. Japanese e-commerce firms like Rakuten have held back from investing because of the uncertainties in India's policies.

Energy et al | There are many other economic areas where India and Japan have barely begun to scratch the surface. While earlier joint statements between the two governments have many lines about working together on reforming global gas pricing structures, clean coal technology and other climate change related areas there is little evidence that anything has happened on these fronts at the actual policy level. Climate change is a particular interest of Modi and Japan is among the world leaders in the technologies that India needs to meet its ambitious green energy targets.

So far, the focus of bilateral energy discussions has been largely about the issue of nuclear power and persuading Japan to loosen its extremely tight hold on the export of nuclear parts and technology. While this is of importance, there is a need to expand the debate to cover other elements of the energy sector.

Modi's 2016 visit to Japan will also see the two governments address how Tokyo can help New Delhi in some of the other social programmes announced by Modi, notably Skill India, Digital India and Clean India. Increasing vocational education, building a modern telecommunications system and solving public health and hygiene issues were policy problems that Japan solved decades ago but its experiences and present capacities still have relevance to India.

While much of the relationship is skewed towards determining what Japan can do for India, **One area where New Delhi should press Tokyo for greater action is immigration.** Though the two governments signed an immigration pact designed to allow the greater flow of nurses and other skilled workers from India to Japan, very little movement has happened on the ground. Japan has among the lowest unemployment rates in the developed world and among the world's oldest populations so its dilly dallying on guest worker visas is an area India needs to lobby more pro actively against. Even temporary migration could help strengthen both political and economic bonds between the two countries immensely.

Strategic Relationship | As mentioned, the Singh government and the pre-Abe governments both had strong schools of thought that were wary of bringing India and Japan closer together strategically for fear this would antagonize China. Both schools were partly motivated by the uncertainty of US commitment to the security of Asia-Pacific during the first administration of Barack Obama.

Modi and Abe have moved some distance away from this hedging strategy to a more full-blooded acceptance that India and Japan have a clear strategic convergence. **A key external driver for a more public acceptance of an Indo-Japanese strategic bond has been a common concern about the direction China's external policy is going.**

The Joint Statement on India and Japan Vision 2025: Special Strategic and Global Partnership issued in December 2015 outlined this belief. It came close to naming China as a threat to regional stability by noting “developments in the South China Sea” and calling “upon all States to avoid unilateral action that could lead to tensions in the region.”

The most tangible evidence of mutual concern is the strengthening of defence relations between the two countries. Japan participated and was then permanently inducted into the Indo-US Malabar naval exercises in 2015. And the 2016 Malabar exercises were held offshore Japan. The two governments are reportedly close to finalizing a deal for India to buy US-2 military seaplanes from Japan, an act that would formally end Japan's 1967 ban on arms exports. Again, for Abe, India's role is more about legitimizing actions designed to undermine his country's postwar pacificism than it is about the monetary value of the purchase itself.

However, the defence relationship needs to be explored in greater depth by India and Japan. As China becomes increasingly unruly in its dealing with the rest of Asia, it is less and less impressed with other countries holding military exercises or issuing joint statements and only concerned in the face of tangible, power-based challenges. This may require India and Japan to look at taking the military relationship a step further to include, for example, a dialogue about offensive weapon systems like the Japanese fifth generation fighter and conventional submarines. India should also consider taking up Japan's offer to let Indian warships to dock at Japanese facilities in Djibouti in the same way New Delhi think about granting Japanese access, as Tokyo has asked, to Indian naval facilities in the Andaman Islands.

Connectivity and third Countries | China's announcement of the One Belt, One Road programme of continent-wide infrastructure development has become a strategic concern for both New Delhi and Tokyo. Among other things, the

north-south alignment of much of the proposed rail, road and port infrastructure would lead to a natural domination of trade and movement in Asia by China.

As India's Foreign Secretary S Jaishankar noted in a speech in the 2015 Raisina Dialogue, "Connectivity itself has emerged as a theatre of present day geopolitics. When diplomats get agitated about lines on the map today, they are more likely to be discussing proposed road connections, rail lines, oil pipelines or maritime routes than contesting national boundaries. Who draws these lines; who agrees with them; what are the financial institutions to convert them into reality; what would be the modes of managing and implementing them once built – all these questions carry geopolitical significance."

Indian officials speak of the need to build an alternative east-west connectivity between south and southeast Asia in particular and an Indian Ocean littoral infrastructure more generally. The Indo-Japan Vision 2025 recognizes this need by agreeing to "develop and strengthen reliable, sustainable and resilient infrastructure that augments connectivity within India and between India and other countries in the region."

At present, both India and Japan have announced a number of overlapping infrastructure programmes and plans for regional trade and investment understandings, mostly around the Bay of Bengal region as well as in the larger Indian Ocean area. New Delhi has begun attempts to deepen and widen BIMSTEC, an older Bay of Bengal trade agreement. Abe had announced a BiG-B – the Bay of Bengal Industrial Growth Belt. Both countries are developing ports and road corridors in Myanmar and have extensive aid programmes in that country as well as Bangladesh.

Beijing has recognized that this is partly about curbing its influence in the region, especially after Dhaka handed over the development of Sonadia port from China to Japan. Beijing has responded as well. Chinese leader Xi Jinping offered to invest or loan \$ 24 billion to Bangladesh when he visited in October this year, a figure that on paper overshadows the \$ 2 billion in grants provided by India and a \$ 6 billion set of deals signed earlier by Abe.

Bangladesh, however, is an example of the sort of soft power rivalry with China that both India and Japan are facing. **While India and Japan consult with each other on their activities in the Bay of Bengal and other regions, a much greater degree of**

strategic cooperation is needed between the two countries. And it must include not merely the Bay of Bengal area but also virgin geopolitical territories for both governments like littoral Africa and potentially even the Persian Gulf region. At the government-to-government level, there is an obvious match between Japan's deep pockets and technical skills and India's diplomatic and military influence. But a successful programme of Indo-Japanese development cooperation in third countries would also require a greater degree of joint private sector activity.

India and Japan presently both have powerful leaders in the form of Modi and Abe who have the political capital to invest in long-term strategic calculations. What also unites them is a strong desire to change the character of their countries at home. There are common strategic concerns as well but even these are increasingly running independent of the US, in many way the original progenitor of the new Indo-Japanese bilateral relationship of today. Senior Indian officials have noted how the arrival of Maruti Suzuki and the construction of the Delhi Metro helped changed mindsets in both India and Japan and how, potentially, the arrival of high-speed trains in the future may carry out a similar change. What both sides do agree is that this relationship needs to keep broadening in every way or "else its momentum will slow down".





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