Indo-Japanese Economic Relations: From 1950 until Today

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Not long after Indian independence in 1947 a diplomatic treaty was signed between India and Japan. Although this was signed in 1952 the political and economic relations between India and Japan were affected by the Cold War. While Japan was firmly in the Western camp, India sought to maintain a neutral position in order to pursue its independent path of economic development and to avoid entanglement in superpower rivalry.

Effects of Colonialism & the Cold War

India had emerged from colonial rule and had to recover from exploitation, although scholars on opposite sides of the spectrum differ about the extent of the negative impact and the drain of wealth from the country (Tirthankar Roy, *How British Rule Changed India's Economy: The Paradox of the Raj*, Palgrave Macmillan, 2019; Utsa Patnaik and Prabhat Patnaik, *Capital and Imperialism: Theory, History and the Present*, Monthly Review Press, 2021). There was an emphasis on rapid industrialization and infrastructure in which the state played an important role. The ideas of socialist planning were dominant but the economy was a mixed economy. Agriculture, trade and small-scale enterprises were in private hands even though the major infrastructure projects were built by the state. The rate of growth of the economy did increase after independence (Pulapre Balakrishnan, *Economic Growth in India: History and Prospect*, Delhi, 2010) but was not very high in the 1950s and 1960s.

The Japanese economy was influenced by capitalist ideology but the state played a very supportive role. The Japanese miracle – the period of rapid growth in the 1950s and 1960s – was based on the developments in prewar Japan, the skill, enterprise and patriotism of the people and harmonious industrial relations in its enterprises and corporations. After the victory of communism in China in 1949 and the Korean War, Japan became a frontline state in the global struggle against communism. It received abundant capital from the United States and access to the markets of the West. Japan was already linked to the economies of Korea and Taiwan and developed its industries in what was described as a flying geese formation in the literature about this period. Japanese corporations produced manufactured goods of high-quality leaving production of products or components requiring less skill in a product cycle to these countries (Bruce Cumings, "The Origins and Development of the Northeast Asian Political Economy: Industrial Sector, Product Cycles and Political Consequences", *International Organization* 38, Winter, 1984.)

As the Japanese economy became a high-wage economy it faced competition from South Korea and Taiwan which had both lower wages and skilled labor. Over time Japan moved to more advanced technologies but its rate of growth slowed down. Contrary to product cycle theory, reverse exports to Japan did not become significant. Technology and components from Japan produced goods in these countries which were exported to America and Europe. Japanese investment also went to these favored regions. Nevertheless, the absolute amounts invested in manufacturing in Asia rose. In fact, Japan's investment in manufacturing in other Asian countries in the years 1986-1989 exceeded the cumulative total for the whole of the 1951-1985 period. In 1990 the flow of investment accelerated, with $10 billion invested in manufacturing in ASEAN and $8 billion in the Asian NICs (Mitchell Bernard and John Ravenhill, "Beyond Product Cycles and Flying Geese: Regionalization, Hierarchy, and the Industrialization of East Asia", *World Politics*, Vol. 47, No. 2, Jan. 1995).

Before World War II, Japan's textile, steel and other industries had made great inroads into India. In fact, the British government introduced a policy of imperial preference in order to restrict Japanese imports into India during the interwar period (*The Impact of Interwar Protection: Evidence from India* by Vellore Arthi, Markus Lampe, Ashwin R Nair, Kevin Hjortshøj O'Rourke, Cambridge, 2020). Historically, India had strong economic ties with Britain – as the colonial power – and the US. India's huge merchandise export surplus with the US was used by Britain to meet its balance of payment difficulties with the US in the 19th century. After World War II, therefore, the direction of Indian as well as Japanese trade and investment was influenced by historical trajectories and ideological preferences shaping economic policies and outlook. India and Japan did not have significant trade with each other despite good diplomatic relations until the 1990s.

Indian Liberalization & Changing Relations

It was in the 1990s that liberalization of the Indian economy became significant though it had started gradually in the 1980s (Rahul Mukherji in *The Oxford Companian to Politics in India*, Delhi, 2010). In spite of liberalization, Japanese companies did not invest in India as much as in China and in Southeast Asian countries. According to the Confederation of Indian Industry, Japanese

investment in India constituted about 6% of total foreign direct investment (FDI) in India between 1991 and 2006. Despite fluctuations, owing to problems faced by a few big companies, Japan has always been among the top 10 countries investing in India since the 1990s. India attracted investment in transport and infrastructure by the late 20th century. Maruti Udyog and the Delhi Metro became symbols of Japanese technology and collaboration with Indian enterprise.

Scholars have noted that more than openness of the economy or size of the domestic market, Japanese direct investment was linked to trade flows. Japanese firms invested in offshore locations where their technology could be used to produce low-cost goods. This promoted competitiveness and trade leading to more investment and greater trade (Arpita Mathur, *India Japan Relations: Drivers, Trends and Prospects*, Rajaratnam School of International Studies, 2012). Japanese companies invested heavily in South Korea, China and Taiwan with which they had substantial trade as well as cultural and historical links. Greater proximity and good infrastructure also made these countries more attractive than India. Between 2000 and June 2023 Japan's investments in India amounted to around $38.74 billion, making Japan the fifth most important FDI investor in India *(Charts 1 & 2)*.

Japan had emerged as the third-largest source of FDI for India by December 2019 compared to its sixth position in December 2010. This increase in investment in India was significant but is considerably lower than Japanese investment in China, Thailand and Indonesia during this period. India's exports to Japan declined during the first decade of the 21st century. Even after the implementation of the Comprehensive Economic Partnership Agreement (CEPA) from August 2011 the decline has continued. As a destination for exports from India the position of Japan declined from fifth in 2000 to 11th in 2010 and 17th in 2019. Merchandise imports into India from Japan fell from sixth position in 2000 to 13th in 2010, increasing to 11th position in 2019.

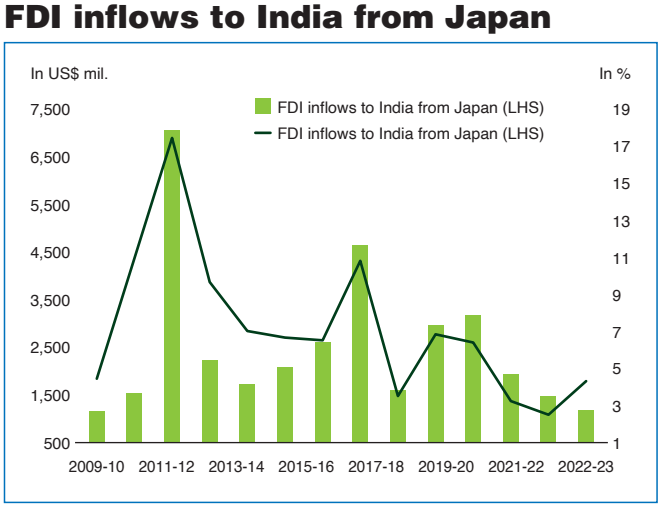
Barriers to Greater Trade & Investment

Trade between Japan and India is limited partly because many products that India can export to Japan have substitutes in ASEAN countries, partly because Indian products are less competitive in terms of price, and partly because Indians have an orientation towards markets in the West. Owing to the recent slowdown in the Chinese economy, trade rivalry between the US and China, geopolitical tensions and the need to spread risks, Japan is investing in countries like Vietnam and Indonesia. As several companies relocate out of China there are expectations that investment in India will grow. Not only big companies but small and medium Japanese enterprises can now overcome their fears and anxieties. Low-cost automobiles can be produced for the world market if the electronic and auto parts hub of Malaysia and Indonesia are linked with facilities in the coastal parts of South India (Srabani Roy Chaudhury, "India-Japan Relations: The Economic Advantage", *Indian Foreign Affairs Journal*, Vol. 10, No. 3, July-September, 2015).

Korean companies have been more proactive than their Japanese counterparts in trade generating as well as domestic demand-oriented investments in India (Mukul G. Asher and Rahul Sen, "India-East Asia Integration: A Win-Win for Asia", *Economic and Political Weekly*, Sept. 3-9, 2005, Vol. 40, No. 36). Samsung, LG and Hyundai

CHART 1

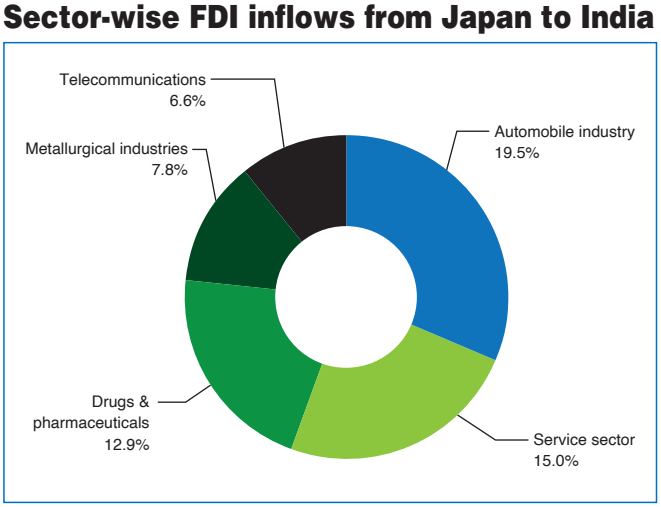
FDI inflows to India from Japan



Note: Values for FY 2022-2023 include data April 2022 to September 2022.
Source: Centre for Monitoring the Indian Economy

CHART 2

Sector-wise FDI inflows from Japan to India



Note: Values for FY 2022-2023 include data April 2022 to September 2022.
Source: Centre for Monitoring the Indian Economy

TABLE 1

Share (%) of India & Japan in the world economy

	India			Japan		
	2000	2010	2019	2000	2010	2019
World GDP	1.4	2.5	3.3	14.5	8.6	5.8
World merchandise export	0.7	1.5	1.7	7.4	5.0	3.7
World merchandise import	0.8	2.3	2.5	5.7	4.5	3.7
World manufacture export	0.7	1.4	1.8	9.6	6.8	4.8
World manufacture import	0.5	1.5	1.7	4.4	3.3	3.1
World services export	1.1	3.0	3.5	4.6	3.4	3.3
World services import	1.3	3.0	3.1	7.8	4.3	3.5
World outward FDI stock	0.02	0.47	0.52	3.76	4.06	5.26
World inward FDI stock	0.2	1.0	1.2	0.7	1.1	0.6

Source: WDO, WTO & UNCTAD data, as compiled by the Delhi Policy Group (Policy Report, Vol. VI, Issue 26, Aug. 9, 2021)

have gained a strong foothold in the Indian market. During FY 2022-2023, bilateral trade between Japan and India amounted to $21.96 billion. Japan's exports constituted 2.31% of India's total imports, and India's exports to Japan represented 1.21% of India's overall exports. While the percentage shares of India in the world economy have grown, those of Japan have fallen *(Table 1)*. Although there is untapped potential in bilateral trade, differing expectations stand in the way. While the Japanese want India to open up maritime insurance, civil aviation, and banking industries, India wants Japan to do likewise in information technology, biotechnology and the medical sectors. The Keiretsu system, language barrier and differences in work culture also hamper growth of both commodity and services exports from India.

Demography & Market Opportunities

India is not only a large emerging market, it also has age on its side. Compared to countries in Europe, Japan and even China, the working age population in India is very large and this is likely to be so for almost another two decades. At present it enjoys what economists call a demographic dividend. By 2050 the median age in India would be 37 years, in Japan 53 years, in Europe 47 and in China about 50 (Alyssa Ayres, "Will India Start Acting Like a Global Power? New Delhi's New Role", *Foreign Affairs*, Vol. 96, No. 6, November-December 2017). It is suggested that countries like Japan, South Korea and Singapore can benefit from India's technical manpower without long-term immigration. Several businesses from the OECD countries have increased their competitiveness by collaborating with or outsourcing a range of knowledge-intensive service activities.

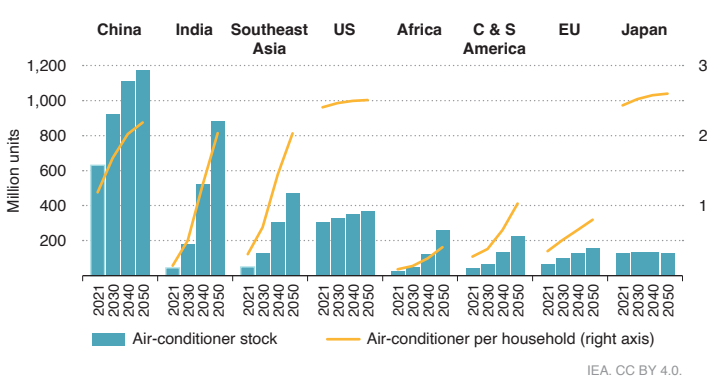
It is estimated that almost 90% of the increase in the air-conditioner stock to 2050 will come from developing countries. Average rates of air-conditioner ownership in India are expected to increase from 11% today to 85% in 2050; in Africa from 7% today to 20% by 2050 *(Chart 3)*. So there is great scope for Japanese firms to try and tap this market independently or in collaboration with Indian companies. Japan and India have declared that they want to achieve carbon neutrality by 2050 and 2070, respectively. The US has offered tax credits to incentivize energy storage, nuclear power, clean energy vehicles, hydrogen and carbon capture, utilization and storage (CCUS). Other dispatchable low-emission technologies include fossil fuels with CCUS, and co-firing with ammonia in coal plants and hydrogen in gas-fired power plants. Indo-Japanese collaboration can make some of these technologies commercially viable. At present the Japanese can help in decarbonizing the steel and cement industries of India.

Geopolitics & Indo-Japanese Relations

It is estimated that by 2030, the Indo–Pacific will account for 21 of the top 25 sea and air trade routes with two-thirds of global oil shipments and one-third of the world's bulk cargo movements. Further, by 2050, half of the world's top 20 economies will be in the

CHART 3

Household air-conditioner ownership in selected regions in the STEPS, 2021-2050



Almost 90% of the growth of household air conditioners to 2050 is in emerging market and developing economies, adding 2.4 billion units as incomes and temperatures rise.

Note: C & S America = Central and South America.
Source: World Energy Outlook, 2022 from page 269 (published by the International Energy Agency, 2022)

Indo–Pacific (Bharti Chhibber, "India–Japan Relations", *World Affairs: The Journal of International Issues*, Vol. 22, No. 3, July-September, 2018). As the Japanese economy is dependent on oil imports from West Asia and agricultural products from Southeast Asia and East Africa, the government is keen to prevent the disruption of trade in the Indo-Pacific. India's version of the Indo-Pacific Oceans' Initiative (IPOI) announced by Prime Minister Narendra Modi in 2019 acknowledges the growing space for cooperation between late Japanese Prime Minister Shinzo Abe's Free and Open Indo-Pacific and IPOI (Urbi Das, "Evolution of Indo-Japan Economic Ties", *Indian Foreign Affairs Journal*, July–September 2021, Vol. 16, No. 3).

It is estimated that China's ambitious Belt and Road project could entail spending nearly $1.2–$1.3 trillion. By promoting infrastructure development China has become a dominant force in the countries in which it has invested. It involves more than 60 countries constituting 55% of the world's GDP, 70% of the world's population, and 75% of its energy resources. Scholars have pointed out that the economic security nexus is important in understanding the contemporary period of transition because of the fourth industrial revolution.

According to a 2012 McKinsey Global Institute report, by 2025 the Asian continent is expected to become once more the economic center of gravity after nearly two centuries. Some 380 million Indians, 350 million Chinese, and 210 million other Asians are expected to join the global middle class. But China's ambitions and assertiveness are troubling several of its neighbors. As China builds smart cities, smart ports, and satellite-networked communications, using 5G as a baseline for other technologies like artificial intelligence, data analytics, and the Internet of Things, it is in a position to shape the international order to its advantage. These developments have serious security implications as well.

In order to cope with the changing geopolitical scenario, India and Japan are trying to promote a maritime order based on international law and to safeguard the regional SLOCs as a "public good". The India-Japan Indo-Pacific Vision 2015 aims to strengthen bilateral maritime cooperation in the Indo-Pacific. By negotiating the Regional Comprehensive Economic Partnership (RCEP) India and Japan are trying to achieve a mutually beneficial economic partnership agreement among the ASEAN member states, and ASEAN's FTA partners. To protect their vital interests India and Japan are cooperating with the US and Australia as part of the strategic "Quadrilateral Security Dialogue".

Japanese companies can assist India in expanding 5G services as they are developing a software rather than hardware-based network model – known as the Open Radio Access Network (ORAN) – to replicate signal-processing functions. This reduces the size of base stations and permits greater density and dispersion of stations (Robert Manning, *Emerging Technologies: New Challenges to Global Stability*, Atlantic Council, 2020).

Mega Projects, Cutting-Edge Technology & Semiconductors

Official Development Assistance (ODA) loans from Japan in power, transportation infrastructure, connectivity projects, and human development have been significant. The Mumbai-Ahmedabad High Speed Rail Network, popularly known as the bullet train, is a high-profile project. The western Dedicated Freight Corridor, the Delhi-Mumbai Industrial Corridor and the Chennai-Bengaluru Industrial Corridor are the mega projects that have been supported by Japanese ODA. Japan's ODA loans to India in FY 2022 amounted to 567.49 billion yen, according to the Ministry of Foreign Affairs (Dec. 15, 2023). The Northeast is the strategic space where Japan's Free and Open Indo-Pacific Strategy and India's Act East policy converge. Northeast infrastructure projects will enable connecting India to Southeast Asia through the Trilateral Highway between India, Myanmar, and Thailand.

In July 2023, India and Japan signed a memorandum of cooperation to collaborate in the fields of semiconductor design, research, and manufacturing. Both state and private industry will try to strengthen the chip supply chain which has been affected because of the ongoing de-coupling of US and Chinese economies. It is estimated that China has imported $300 billion worth of semiconductors and semiconductor manufacturing tools and the export curbs have forced them to manufacture these products within the country. The Indian Semiconductor Mission (ISM) has been set up to promote investment in this sector as it is important from both an economic and security point of view.

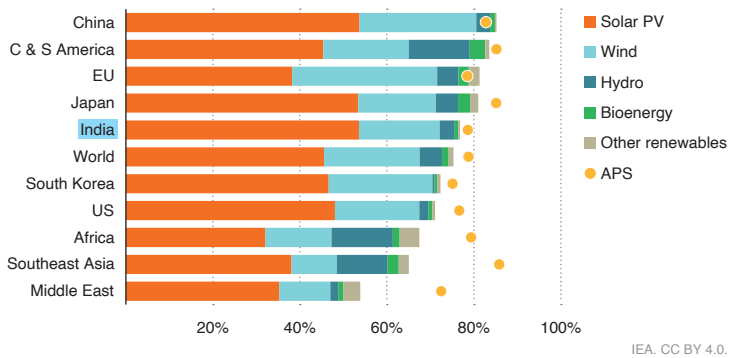
A key player in Indo-Japanese collaboration is the Rapidus Corporation, a semiconductor manufacturer formed in August 2022 with the backing of prominent Japanese companies, such as Denso, Kioxia, MUFG Bank, NEC, NTT, SoftBank, Sony, and Toyota. While Rapidus can focus on advanced nodes of semiconductor fabrication, India can develop legacy nodes. While US companies excel in manufacturing and packaging, Japanese companies are leaders in peripheral industries that produce the necessary chemicals and gases for semiconductor chip manufacturing. Tata Motors has partnered with Japanese chip manufacturer Renesas Electronics to design and develop semiconductors which could be crucial for the electric cars Jaguar Land Rover plans to produce. The Indian semiconductor market is expected to grow to $55 billion by 2026.

Emerging Areas of Cooperation

In recent bilateral talks, India and Japan have focused on enhancing cooperation in the steel sector and addressing

CHART 4

Share of renewables in total power capacity additions by region in the STEPS, 2022-2050



Renewables account for the majority capacity additions in all regions, with massive growth for solar PV and wind in all markets, followed by hydro in many markets/regions as indicated in the table.

Note: C & S = Central and South America.
Source: World Energy Outlook 2022 published by the International Energy Agency in 2022. From page 294. (STEPS – Stated Policies Scenario. This means trajectory implied by today's policy settings. APS means Announced Pledges Scenario.)

TABLE 2

GDP average growth assumptions by region

	Composed average annual growth rate			
	2010-2011	2021-2030	2030-2050	2021-2050
North America	1.9%	2.0%	2.0%	2.0%
US	2.0%	2.0%	2.0%	2.0%
Central and South America	0.9%	2.4%	2.4%	2.4%
Brazil	0.7%	1.8%	2.5%	2.3%
Europe	1.6%	2.0%	1.4%	1.6%
EU	1.2%	1.9%	1.2%	1.4%
Africa	2.7%	4.1%	4.2%	4.1%
South Africa	1.1%	1.6%	2.8%	2.4%
Middle East	2.0%	3.2%	3.2%	3.2%
Eurasia	2.1%	0.1%	1.4%	1.0%
Russia	1.7%	-1.1%	0.7%	0.1%
Asia Pacific	4.9%	4.7%	3.1%	3.6%
China	6.8%	4.7%	2.8%	3.4%
India	5.5%	7.2%	4.4%	5.2%
Japan	0.5%	0.9%	0.6%	0.7%
Southern Asia	4.1%	5.0%	3.3%	3.8%
World	**2.9%**	**3.3%**	**2.6%**	**2.8%**

Note: Calculated based on GDP expressed in year 2021 US dollars in purchasing power parity terms.
Source: World Energy Outlook 2022 published by the International Energy Agency in 2022, from page108

decarbonization challenges. India and Japan are exploring new areas, such as electromagnetic spectrum, space, high energy lasers, cryptography, sensors and optic cables. Greater defense cooperation in robotics, lithium-ion batteries, Unmanned Aerial Vehicles (UAVs), and anti-drone systems is possible. At the first India-Japan Defense Industry Dialogue, building warships and submarines, and participating in the Advanced Medium Fighter (AMCA) project and in producing parts for these were discussed. After signing a civil nuclear agreement, Japan has agreed to supply materials and technologies to build India's nuclear power program to reduce dependence on coal and oil.

The possibilities for cooperation are increasing as a result of India's infrastructural push, greater incentives through the creation of Special Economic Zones and the production-linked incentive scheme for industries. Sectors covered under the scheme include solar photovoltaic modules ($3.18 billion), semiconductor manufacturing ($10 billion), and the auto industry ($3.43 billion). Although China is the world leader in manufacturing electric vehicles, India has set ambitious targets for itself. The NITI Aayog aims to achieve EV sales penetration of 70% for commercial cars, 30% for private cars, 40% for buses, and 80% for two- and three-wheelers by 2030. Japanese firms can collaborate with the government and Indian companies to build charging stations and rechargeable batteries for the hybrid and EV segment.

In March 2022, India and Japan instituted a Clean Energy Partnership (CEP) by incorporating EVs, EV charging infrastructure, solar sector development, biofuels, green hydrogen, and battery storages. Owing to the size and climatic diversity of India it is possible to develop solar, wind and tidal energy, although the emphasis is on the development of solar power *(Chart 4)*. India has the potential to become a net exporter of green hydrogen in the future. According to a NASSCOM report, advanced tech start-ups including AI, blockchain, and the Internet of Things grew cumulatively 40% during 2014-2021 with enterprise software and technology companies in health and education comprising over 40% of total start-ups.

It is estimated that India will grow at 5.2% per annum between 2021 and 2050 – faster than any other country *(Table 2)*. This provides ample scope for greater trade, investment and collaboration between India and Japan. JS

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