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Prospects and Challenges for Expanding India-Japan Economic Relations

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Summary

While India has become the largest recipient of Japanese ODA since 2003-04, both bilateral trade in goods and Japan's FDI into India have almost stagnated during the past decade. With major Indian exports to Japan being dominated by products of mineral oils, gems & jewels, marine products (mainly shrimps) and iron ore, India and Japan have not yet formed such a dynamic international division of labour as can be seen among the East Asian countries. Japan's cumulative FDI into India is so far larger than that of Korea, but as far as electronics appliances are concerned, Japanese companies have been overwhelmed by Korean companies in the Indian market.

India and Japan are highly complementary economies, but their mutual complementarities remained underexploited hitherto. Recently, however, a new tide has been observed in Japan to expand Indo-Japan relations based on mutual complementarities. Japan has abundant capital and is highly advanced in technological skills and product development while India is endowed with a huge market and abundant human resources. Japan is outstanding in terms of manufacturing abilities, whereas India has advantages in IT services and bioinformatics.

Introduction

Thanks to vigorous economic growth in the wake of the economic reforms and the "Look East Policy" introduced after 1991, India has successfully deepened its economic relations with the East Asian countries. We can see a remarkable expansion of India's economic tie-ups with the ASEAN countries, China and Korea since the late 1990s, with only Indo-Japan relations lagging behind. India-China bilateral trade has remarkably expanded to be more than four times larger than India-Japan bilateral trade.

While India has become the largest recipient of Japanese ODA since 2003-04, both bilateral trade in goods and Japan's FDI into India have almost stagnated during the past decade. With major Indian exports to Japan being dominated by products of mineral oils, gems & jewels, marine products (mainly shrimps) and iron ore, India and Japan have not yet formed such a dynamic international division of labour as can be seen among the East Asian countries. Japan's cumulative FDI into India is so far larger than that of Korea, but as far as electronics appliances are concerned, Japanese companies have been overwhelmed by Korean companies in the Indian market.

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India gaining recognition as an important partner in Japanese society

India has been gradually recognized as an important country among every section of the Japanese society. Not only that the Japanese government already stands for the Asian Summit framework comprising of "ASEAN+6" members, but it is no more uncommon that India makes headlines in the newspapers and TV shows. The first Indian boom had occurred in the mid-1990s, but it disappeared after India carried out nuclear tests in 1998. We are now witnessing the second Indian boom quietly spreading through Japanese society, which can be seen in several developments.

First, with India's image as an IT power being established, and Indian people's mathematical ability gaining higher esteem, the elementary books on Indian mathematics have popped up among best-sellers, and the Indian International schools in Tokyo have attracted attention among parents who are enthusiastic about their children's education. Currently, the Japanese people are facing up to the grim fact that the youth are increasingly shying away from science studies and that their mathematical ability is declining because of less stringent educational guidelines across the country.

Second, thanks to a favourable expansion of the Indian economy, Japanese investors have increasingly weighted Indian stocks in their financial portfolios via brokerage firms. Thus, portfolio investment into India has conspicuously increased since 2005, although we currently witness some reverse trends because of the global financial turmoil. Given that domestic interest rates remain pegged at low levels, the Japanese people are increasingly turning to foreign markets for their investment. Actually, Indian stocks are getting no less popular than Chinese stocks.

Third, the long-awaited India-Japan CEPA/EPA was finally signed in February 2011, and came into effect in August. Tariffs will be eliminated on 90 per cent of Indian and 97 per cent of Japanese goods over ten years. Japan is expected to export more auto-parts and steel products to India and import more agricultural and marine products from India. National treatment, on the side of Japan, is accorded for the application of approvals for the release of generic medicines. Some improvement has been made for the movement of people, including Yoga instructors, English teachers and Indian cuisine masters. India-Japan bilateral trade will be more than doubled to $25 billion by 2014 under the CEPA/EPA.

New horizons for further Japanese FDI into India

Faced with stagnant markets in the advanced countries and the aggravating investment environment in China where wages are rising and industrial policy is becoming more restrictive and unpredictable for foreign companies, India has become more attractive in the eyes of Japanese business circles. Until recently, Japanese companies had a negative image about India's investment environment, which constituted a sense of "psychological distance" from India. However, the success of Korean companies in gaining a large share of the Indian consumer electronics market indicates that what Japanese companies tended to identify as areas of concern, i.e. adverse investment environment, are not necessarily critical factors that deterred Korean or Singaporean companies.

Convinced, at long last, that India offers a huge domestic market and will grow to be a leading economic power, Japanese companies have begun to increasingly commit themselves to India. The number of Japanese companies in India has increased from 267 in January 2006 to 438 in January 2008 and from 550 in October 2008 to 725 in October 2010. Their investment value has more than doubled to 189 billion yen in 2007-08 and totalled 809 billion yen in 2008-09, outstripping Japanese FDI into China. Although Japanese FDI into India declined steeply to 89.3 billion yen in 2009-10, it soon recovered to 168.2 billion yen in 2010-11. The new developments in Japanese FDI into India can be summarized as follows:

First, more and more Japanese companies have entered into a wider range of manufacturing sector, keeping in mind the importance of making inroads into a huge market. Thus, not only automobile assemblers and auto suppliers, but also other companies in various fields, including steel makers, pharmaceutical companies, and construction machinery producers have begun to make their presence felt in India. As for the automobile sector, all major Japanese assemblers have positioned India as the strongpoint for small car production in their global strategy. Nissan and Toyota have newly released remarkably low-priced cars geared for emerging countries. A firm presence of Japanese automobile assemblers strongly induces other companies engaged in steel and logistics to come to India. As for the electronics appliances sector where Japanese companies have lagged far behind Korean companies, Panasonic and Sony have determined to make a strenuous effort to catch up with LG and Samsung with a firm commitment from the top management. In the construction machinery sector, Hitachi and Komatsu will reinforce their production in India.

Second, both the Japanese government and private companies are now more willing to commit themselves to infrastructure development in India. Poor conditions in infrastructure used to constitute the most formidable barrier keeping the Japanese companies away from investing in India. However, given that India is going to invest as much as $500 billion in infrastructure development during the Twelfth Five Year Plan, the Japanese companies have come to realize that it will surely provide major business opportunities for them. Some Japanese companies are keen to be suppliers of mechanical equipment, notably generation turbines or rolling stock in Ultra Mega Power Projects or Dedicated Freight Corridor. Delhi-Mumbai Industrial Corridor and Dedicated Freight Corridor between Mumbai and Delhi will be among the priority areas of Japanese government-sponsored investment into India. However, when it comes to those areas where management aspects are quite important, Japanese companies are more likely to tie up with Singaporean or Australian companies, as they are not experienced in these areas.

Third, Japanese financial institutes, including commercial banks, insurance and security companies, have also come to aggressively approach the Indian market. This has never occurred before. Up until now, the Indian subsidiaries of Japanese commercial banks used to furnish funds only to Japanese companies operating in India. However, given that infrastructure development projects require huge capital and Indian companies are active in fund-raising in the global capital markets, Japanese financial institutes have come to recognize the Indian market as an important target, becoming now serious about furnishing funds to Indian companies.

IT Offshoring

Japan is globally ranked the second largest IT market with an estimated turnover of $100 billion. Japan is renowned as one of the most competitive nations in manufacturing industries or hardware production. Today, however, hardware and software are merging, and the importance of software in the manufacturing industry has increased especially in leading-edge sectors so that Japan's strength in hardware manufacturing will inevitably decay without software development capabilities. Japan now faces an acute shortage of the IT engineers to meet these demands. As of 2007, Japan had a total of 907,990 IT engineers and was short of 501,000 IT engineers including 360,000 professionals. Generally speaking, Japanese companies are inclined towards in-house procurement and are rather cautious about overseas IT offshoring. But when they offshore, they prefer to turn to China despite the fact that there is much advantage in utilizing Indian IT capabilities. India enjoys good esteem in high quality control/management capability, wide range of IT skills covering from open to mainframe environment and rich global experiences, and its intellectual property regulations are more reliable compared with China.

As for the destination of Japan's IT offshoring, currently 80 per cent of Japanese companies offshore to China and only 25 per cent to India. For India, Japan accounts for only less than 2 per cent of its total software and IT services exports. The main reasons for this state of affairs include language barriers and cultural misunderstanding, scarcity of Indian residents in Japan, scarcity in globalized human resources on the side of Japan, and different software development style ("integral approach" rather than "modularization") including ambiguity in requirement specifications among Japanese companies. However, recently some new trends can be observed in Japanese IT offshoring to India. It is true that leading Indian IT companies are still struggling to penetrate the Japanese IT market, although quite recently they have begun to show their intention of increasing their share in the Japanese IT market through mergers and acquisitions. More importantly, some Japanese IT companies, including NTT Data and Rakuten, are becoming more serious about tapping Indian IT capability by setting up their own IT captive centres in India. As for Japanese subsidiaries of IBM and Accenture, they are already fully utilizing Indian IT resources through offshoring to their Indian subsidiaries. It will be strategically more important for Japanese companies to focus on India as an IT offshore location, especially if they want to go global.

Human Exchanges

The promotion of human exchange is vital for the improvement of mutual understanding and thereby further consolidating and expanding India-Japan relations. Admittedly, the level of people-to-people exchange between India and Japan is still far from satisfactory, which is exemplified by stagnated student exchanges. The number of Chinese students studying in Japan amounts to almost 70,000, while Indian students amount to less than 500 and are in fact outnumbered by Bangladeshi and Sri Lankan students. It should be remembered that there are as many as three million Indian Americans, most of whom are professionals, playing an indispensable role in deepening and cementing the relationship between India and USA. Improving the scholarship and Japanese language training schemes for Indian students, increasing the number of lectures given in English at Japanese universities, and providing attractive career paths for Indian graduates to apply for enlarged employment opportunities in Japanese companies are urgently needed for attracting more Indian students to Japan.

Currently, Japanese companies are desperately in need of young people qualified for promoting business in emerging economies. Some Japanese MNCs, including JFE, IHI and Toshiba, which fully recognized the necessity of globalized personnel to brush up their English communications skills and enhance multi-culture understanding, have started to send a certain number of their employees to India for training. Now is a good time, when entering a new phase of India-Japan relations, for us to consolidate our relations especially through accelerated people-to-people exchanges.

Prospects and Challenges

The Japanese economy has been strained in the aftermath of the massive earthquake and tsunami, accompanied by radiation leak at the Fukushima nuclear power plant. We cannot ignore the after effects of the Great East Japan Earthquake on India-Japan economic relations. First, the number of Indian IT engineers working in Japan has been reduced from 15,000 to 7,000, since many Indian IT engineers have not yet returned to Japan. Second, some Japanese manufactures were obliged to reduce their production in India, as Japanese domestic supply chains were abruptly damaged. Third, negotiations on an India-Japan Nuclear Agreement are now temporarily suspended. It is to be noted that Japanese technologies are indispensable in nuclear power plants, with Japan Steel Works playing a dominant role in the world in producing reactor pressure vessels. At this moment, the prospect of nuclear cooperation cannot be clearly envisaged.

Currently, Japanese companies are at a crossroads. Faced with stagnant markets at home, many are under pressure to go global and are paying much attention to rising emerging economies. Further, since domestic supply chains have been damaged by the earthquake and given the record appreciation of the yen, Japanese companies are under even greater pressure to reallocate their production facilities to emerging economies. All these factors provide a good opportunity for further accelerating Japanese FDI into India.

The following two tasks should be addressed for further expanding India-Japan economic relations. First, the Delhi-Mumbai Industrial Corridor should be started along the right line, which will be the touchstone for future India-Japan collaboration. Second, human exchanges should be promoted by all means for cementing and expanding bilateral relations.