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India-Japan Investment Relations: Trends & Prospects

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Note: *All $ figures in this paper are in US dollars.*

Foreword

India's success in recent years in attracting foreign investors can be attributed primarily to the strong macro-economic scenario and the progressive liberalisation of the FDI regime. Japan, however, has been slow to take advantage and its share in total FDI coming in to India has not matched the potential. This paper attempts to analyse the reasons for this "chronic hesitation" among Japanese investors with regard to India. As the paper points out, constraints like poor infrastructure, labour laws and administrative red-tape are common to all foreign investors. The deterrent effect of these factors has been compounded by the fact that Japanese companies have been slow to recognise changes in the Indian economy. The paper recommends a speedy conclusion of the Indo-Japan Comprehensive Economic Partnership Agreement as well as the setting up of an information dissemination mechanism to update Japanese investors on investment regulations and developments in the Indian economy regularly.

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(Rajiv Kumar)
Director & Chief Executive

January 28, 2010

Abstract

Though Japan had been one of the top five investors in India for long, its share in India's total FDI inflows has been dwindling since 2000. Other countries have surpassed Japan in terms of their investment and market share in the Indian economy. In this context, this study attempts to analyse the constraints on Japanese investment in India. The study finds that poor infrastructure, taxation system, procedural hassles in customs clearance, and red tapism are important factors deterring Japanese investment in India. Further, many Japanese companies have lost out to stiff competition from South Korean companies, which have been able to understand the price-sensitive nature of the Indian consumer better. It is expected that the completion of the on-going negotiations on the Comprehensive Economic Partnership Agreement (CEPA) will boost Indo-Japanese investment relations. There exist huge opportunities for Japanese investors in sectors such as biotechnology, agriculture, hydrocarbon fuels and information and communication technology.

***Keywords**:* Foreign Direct Investment, Bilateral Trade, Asia

***JEL classification**:* F1, F21

India-Japan Investment Relations: Trends and Prospects

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1.1 Introduction

Japan and India are two leading economies in Asia. According to the latest World Development Indicators, Japan's Gross National Income (GNI) (estimated based on purchasing power parity) for the year 2007 was $4.4 trillion while its GNI (PPP) per capita stood at $34,750. Japanese GDP grew at 2.1 per cent in 2006-07 after registering an average growth rate of 1.7 per cent during the period 2000-07. Comparative figures for India stood at $3.08 trillion, $2,740, 9.1 per cent and 7.8 per cent respectively. The Japanese economy is highly advanced, with the services sector accounting for 68 per cent of the GDP in 2007. The industrial sector, once the engine of Japan's growth, now contributes only 30 per cent to the GDP while the agricultural sector accounts for one per cent. Similarly, the services sector is the largest contributor to India's GDP, accounting for 52 per cent while agriculture and industry contribute 18 per cent and 30 per cent respectively. The two countries, therefore, share a similar structure, especially with regard to their reliance on the services sector.

In recent years, India and Japan have strengthened bilateral ties through new initiatives and programmes ranging from economic and cultural linkages to defence and security. The year 2007 was celebrated as the Year of Friendship between the two countries. Japan gives 30 per cent of its overseas development assistance (ODA) to India and remains committed even in the period of the global economic downturn. For example, Japan has granted almost $4 billion for the Delhi-Mumbai Industrial Corridor (DMIC).

Nevertheless, the economic part of the relationship remains far below potential. Two-way trade between India and Japan ($10,177 million in 2007-08) has risen in the last five years, but the figure still remains way below China-Japan trade ($2,37,193 million) or even trade between India and China ($37,931 million in 2007-08). Similarly, Japan's foreign direct investment in India for April 2007-March 2008 ($815 million) is still low when compared to Japanese investments in smaller Asian countries such as Vietnam ($411 million), not to mention China ($1899 million).

In the context of the global economic downturn, a paper on Indo-Japanese investment relations would be appropriate and relevant to highlight the problems faced by the two countries and to suggest measures to boost trade and investment between them. For instance, several industries in Japan are now in the sunset phase because the current international economic environment has rendered them non-competitive. Exports from the manufacturing sector in Japan have declined in recent years. Such industries could survive if they were relocated and India is a first class option. Consumer durables and food processing industries, for instance, could be relocated to India where skilled labour is available at a reasonable cost. Such industries will not only be

* Fellow, National Council of Applied Economic Research, New Delhi. I thank the anonymous referees for their useful comments in improving the paper. My sincere appreciation is also due to Dr. Geetha Mohan , Ashwani and Monisha Grover at NCAER, New Delhi, for their help in compiling the data.

able to take advantage of India's huge domestic market but could also use India as a base to export to other countries, besides catering to Japan's own domestic market.

For many countries in the region, enhanced trade and investment relations between Japan and India would act a counterbalance to the growing influence of China. 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.

The objectives of this study are to take a critical look at the current state of economic relations between India and Japan and suggest ways to improve trade and investment flows between the two countries. The study

a) provides an overview of the external sector in India and Japan
b) describes the foreign investment regime in India and Japan and analyses FDI inflows from Japan
c) reviews development aid provided by Japan to India
d) examines barriers faced by Japanese entrepreneurs wanting to invest in India and
e) suggests measures necessary to promote investment relations between India and Japan.

The study is based primarily on secondary data. It has used documents and reports with government and private sources to collect information on Indo-Japanese investment relations. Data sources used include the Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry, Government of India, which collects and maintains data on FDI inflows into India, and one of its wings, the Secretariat of Industrial Assistance (SIA), Reserve Bank of India (RBI) reports and bulletins, World Investment Reports and the Global Competitive Index.

1.2 India-Japan Trade in Goods

Bilateral Trade

In 2007-08, Japan ranked third amongst India's trading partners. Bilateral trade between Japan and India has been rising steadily since 2003. From $4.37 billion in 2003-04, it rose to $6.5 billion in 2005-06, $7.45 billion in 2006-07 and to $10.17 billion in 2007-08. The growth rate during this five-year period was 35.56 per cent. The Confederation of Indian Industry (CII) estimates that the trade volume could touch $15 billion by 2010 if issues like trade facilitation and non-tariff barriers were addressed.

Exports

Exports from India to Japan touched $3.85 billion in 2007-08, an increase of 34.73 per cent over the $2.86 billion registered in 2006-07. In the first quarter of the Indian fiscal year 2008, India exported goods worth $786.10 million. India's exports to Japan consist largely of raw materials, minerals such as raw iron ore, agricultural products, marine products, pearls, semi-precious stones and imitation jewellery. In 2007-08, Japan imported $1276.24 million worth of minerals from India, an increase of 185.88

per cent from 2006-07. This was followed by $451 million worth of natural pearls, semi-precious stones and imitation jewellery. Other items exported to Japan include agricultural products, handicrafts, cotton, carpets, leather garments and goods, fresh fruits/juices and dried fruits, spices and herbs. Japan is also the largest importer of Indian shrimps.

In an attempt to boost exports of organic products to Japan, the Agricultural and Processed Food Products Export Development Authority (APEDA) has suggested that the Japanese government accord equal status to Indian certification agencies. The step will go a long way in reducing the cost of these products in the Japanese market. At present, the prices of products exported to Japan are significantly higher than those exported to other countries. This is because the cost of certification by Japanese agencies is much higher than that charged by Indian agencies. Once Indian agencies get equivalence of standards and certification with their Japanese counterparts, the former, accredited by APEDA, can certify organic products. Organic products that are exported by India include basmati rice, honey, spices, tea, garments and some dry fruits.

Imports

According to data provided by the Indian commerce ministry, India's imports from Japan were worth $6.32 billion in 2007–08, up by 37.70 per cent from the 2006-07 level of $4.59 billion. For the period April to June 2008, imports from Japan were worth $2.196 billion. India's imports from Japan have been increasing because of the rising import volumes of commodities like heavy machinery, iron and steel, mineral fuels and mineral oils, surgical equipment, organic chemicals, plastic, rubber etc. India imported $2.17 billion worth of heavy machinery from Japan in 2007-08. This was followed by $814 million worth of electrical machinery and equipment.

The figure below presents India's trade with Japan from 2000-2007.

Figure 1: India's Trade with Japan: 2000-2007 ($ billion)

Source: CMIE, India Trades

1.3 Overview of Japan's FDI

At the end of 2007, Japan's overseas investments stood at $543 billion[1], up from $450 billion at the end of 2006 and $387 billion at the end of 2005. Japan's outward FDI stock at the end of 2007 accounted for 3.5 per cent of the world's outward FDI stock and 4.2 per cent of the outward stock of developed countries. The inward FDI stock values were $100.3 billion at the end of 2005, $97.3 billion at the end of 2004 and $89.8 billion at the end of 2003. In 2007, the inward FDI stock of Japan stood at $132 billion.

FDI outflows from Japan have risen consistently, especially during 2005-2007. In 2005, FDI outflows stood at $457 billion; it increased to $502 billion in 2006 and further to $736 billion in 2007. Hence, Japan ranked high on the outward FDI performance index with a rank of 44 in 2007. In terms of the inward performance index, however, it ranked a low 135.

In 2006 and 2007, there was a surge in FDI flows into Japan, reflecting a revival of interest in the Japanese economy. Investment inflows into Japan rose from $2.8 billion in 2005 to $6.5 billion in 2006 and further to $22.5 billion in 2007. However, the story is vastly different in 2008 and 2009 because of the global economic crisis and Japan's descent once again into a major recession. Table 1 below shows global trends in FDI inflows including inflows into Japan. For more detailed information on FDI stock by region, see Annexure 1 (Table 1).

Table 1: Global Trends in FDI Inflows: 1999-2007 ($ billion)

Region/ Economy	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
World	1086.8	1388.0	817.6	678.8	557.9	742.1	958.7	**1411.0**	**1833.3**
Developed Economies	828.4	1108.0	571.5	489.9	358.5	418.9	611.3	**940.9**	**1247.6**
Developing Economies	231.9	252.5	219.7	157.6	175.1	283.0	316.4	**413.0**	**499.8**
Asia	112.6	146.1	111.9	94.4	110.1	170.0	210.0	**272.9**	**319.3**
China	40.3	40.7	46.9	52.7	53.5	60.6	72.4	**72.7**	**83.5**
India	2.2	2.3	3.4	3.5	4.6	5.8	7.6	**19.7**	**23.0**
Japan	**12.7**	**8.3**	**6.2**	**9.2**	**6.3**	**7.8**	**2.8**	**6.5**	**22.5**

Source: World Investment Report, Various Issues

[1] Source: World Investment Report 2008

1.4 Japanese Investment in India

With growing economic strength, India has adapted its foreign policy to increase its global influence. Consequently, Indo-Japanese relations have undergone a paradigm shift and there is now an ongoing effort to build a strategic and global partnership between the two countries.

According to a survey conducted by the Japan Bank for International Co-operation (JBIC) in 2008[2], India has become the most favoured investment destination for long-term Japanese investments. In the portion of the survey dealing with promising countries (including quantifications of countries viewed as promising for business expansion), China maintained the top position, but the number of companies viewing China as promising is declining. On the other hand, more companies are viewing India, Russia, Brazil, and other emerging countries as promising. The number of companies that view India as promising has increased to a level on par with China. The "growth potential of the local market" was listed as the top reason for India being a promising destination, a response revealing the hopes placed on the future growth of the Indian market. Listed third is the presence of "qualified human resources", for which India got relatively higher marks than other countries. The biggest issue for India remains its "underdeveloped infrastructure". Infrastructural improvements are believed to be making progress, but the demands of companies seeking to make forays into India also appear to be on the rise.

India's robust economic growth in recent years has not gone unnoticed in Japan. Japan is now the sixth-largest FDI investor in to India. Cumulative FDI inflows from Japan touched $2,324 million during 2000-08. This includes investments in acquisition of existing shares, RBI's NRI schemes, stocks swapped and advance pending issue of shares etc.

Though Japan has remained one of the top ten investors into India since the 1990's, its contribution to India's FDI inflow was only 4.29 per cent of total FDI inflows between 1991 and 2007. Investment volumes have also fluctuated. FDI inflows from Japan increased during 2000-2002 but declined thereafter until 2006, only to rise again in 2007.

Table 2: FDI inflows in India from Japan ($ Billion)

Year	FDI Inflows from Japan	Total FDI Inflows into India	Share of Japan in total FDI inflows
2002-03	0.41	3.13	13.15
2003-04	0.08	2.63	2.96
2004-05	0.13	3.75	3.36
2005-06	0.21	5.55	3.75
2006-07	0.09	15.73	0.54
2007-08	0.82	24.58	3.32
2008-09	0.23	21.15	1.07

Source: DIPP, FDI fact sheet, various issues

[2] Report on Japanese Manufacturer's Overseas Business Operations, FY November 2008 (the 20th) Survey on FDI by JBIC

The decline in Japan's share in total FDI inflows into India can be attributed to several factors including the failure of Japanese companies to understand the Indian consumer. The constraints faced by Japanese investors in India are explained later in the paper.

An analysis of sector-wise inflows from Japan shows that the automobile sector received the maximum FDI during 2000-07, accounting for nearly 41 per cent of the total FDI inflows. Other sectors included electrical equipment, trading, services sector and telecommunications. These five sectors together account for nearly 72 per cent of the total FDI inflows from Japan. (See Table 3 below for details.)

Table 3: Share of top sectors attracting FDI inflows from Japan

(From January 2000 to November 2007)

Ranks	Sector	Amount of FDI inflows		% of FDI inflows from Japan
		In Rupees	*In $*	
1	Automobile Industry	36203.8	792.7	40.58
2	Electrical Equipment	16378.0	385.0	18.36
3	Trading	6086.9	145.7	6.82
4	Services Sector	2672.8	59.1	3.00
5	Telecommunications	2440.8	54.8	2.74
Total of the above		63782.3	1437.3	71.5

Note: (I) Amount includes the inflows received through FIPB/SIA route, acquisition of existing shares and RBI's automatic route only.
(II) RBI does not provide country and sector specific data on FDI inflows for the period before January 1, 2001.
Source: DIPP, Japan Cell (www.dipp.nic.in).

As far as technology transfer is concerned, 863 technical collaborations, accounting for 10.93 per cent of the total collaborations approved from August 1991 to November 2007, have been from Japan. The largest number of technical collaborations has been in the transportation industry, followed by the electrical equipment (including computer software and electronics) and chemicals (other than fertilisers). (See Table 4 below)

Table 4: Sector-wise Technology Transfer Approvals

(From August 1991 to November 2007)

Ranks	Sector	No. of technical collaborations approved	%age of technical collaboration approved
1	Transportation Industry	247	28.69
2	Electrical Equipment (including computer software & electronics)	198	23.00
3	Chemicals (other than fertilisers)	77	8.94
4	Misc. Mechanical Engg. Industry	53	6.16
5	Industrial Machinery	48	5.57

Source: Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, GOI

In a bid to encourage further investment in India, Japan has set up a business support centre in Mumbai. This business centre is expected to facilitate technical transfer agreements between Japanese and Indian companies.

Further, Japanese companies have shown a keen interest in investing in joint ventures with Indian companies. The top FDI inflows received from Japan through Indian companies from January 2000 to November 2007 include M/s. Maruti Udyog, Escorts, Yamaha Motor Ltd., Yamaha Motor India Pvt. Ltd., Sanyo BPL Pvt. Ltd., Yamaha Motors Escorts Ltd., Welspun Products, Telco Constructions Equipment Co., Birla NGK Insulator Pvt. Ltd., Toyota Kirloskar Motors Ltd. etc. (See table 5 below for FDI inflows received from Japan through Indian companies.)

Table 5: FDI inflows received from Japan through Indian Companies

(From January 2000 to November 2007)

Nos.	Name of the Indian company	Name of Foreign Collaborator	Sector	Amount of FDI inflows (Amt. in Millions)	
				Rupees	*$*
1	Maruti Udyog Ltd.	Suzuki Motor Co. Ltd.	Transportation Industry (Passenger Cars)	10000	208.3
2	Escorts Yamaha Motor Ltd.	Yamaha	Transportation Industry	4000	88.9
3	Maruti Udyog Ltd.	Suzuki Motor Co. Ltd.	Transportation Industry (Passenger Cars)	3990	83.1
4	Yamaha Motor India Pvt. Ltd.	Yamaha	Automobile Industry	3000	65.2
5	Sanyo BPL Pvt. Ltd	Sanyo Electric Co. Ltd.	Telecommunications	2269	51.0
6	Yamaha Motor Escorts Ltd.	-	Transportation Industry	2152	47.8
7	Telco Constructions Equipment Co.	Hitachi Constructions Machinery Co. Ltd.	Mfg./Sale Construction Equipment's/Earth Moving Machinery	2043	44.7
8	Birla NGK Insulators Pvt. Ltd.	NGK Insulators Ltd.	Ceramics	1193	25.9
9	Welspun Productions Pvt. Ltd.	Dunearn Investment Mauritius P. Ltd.	Textiles (including dyed, printed)	1183	27.2
10	Escorts Yamaha Motor Ltd	Yamaha	Misc. Industries	1172	27.3

Source: www.dipp.nic.in

Another aspect of growing India-Japan investment relations is the increasing number of projects in India where the Japanese are involved, especially in the automobile sector. Recent FDI projects involving Japan include:

- Honda, the Japanese auto major, has announced its foray into the compact car segment in India and is going to invest $205.25 million in its Rajasthan plant.
- Maruti Suzuki India Ltd (MSIL) will invest $1.8 billion for research and development (R&D) at a new facility in Haryana.
- Toyota, another Japanese car major, is going to spend $680 million on a planned second car factory in India where it will begin producing its new compact car and the Corolla sedan, from 2010.
- Japan's second-largest lender, Mizuho Financial Group, has tied up with one of India's top banks, the State Bank of India. The tie-up will include co-operation in various areas including syndicated lending and infrastructure finance.
- The $63 billion Toshiba Corporation has entered into a joint venture with the JSW group to manufacture turbines for large power plants.

1.5 India-Japan CEPA Negotiations: Issues

In January 2007, India and Japan launched negotiations on a Comprehensive Economic Partnership Agreement (CEPA). The process was initiated in April 2005 when a joint study group was set up to explore the possibility of a bilateral agreement. The study group concluded its work in 2006 with a recommendation to start negotiations. Being a comprehensive agreement, the Indo-Japan CEPA will cover trade in goods as well as services and chart out the modalities (or protocols) for investment facilitation between the two countries.

Under a framework agreement concluded by the two countries, both India and Japan are expected to commit to a zero-duty customs regime on substantially all imports from each other though currently, a large number of Indian exports made to Japan face stiff entry barriers. So far, the issues regarding Japan's unwillingness to lower tariffs on certain products of export interest to India, technical barriers to trade (TBT) and Japan's stringent sanitary and phytosanitary (SPS) measures (which act as non-tariff barriers to trade) have remained unresolved.

In services, the major hurdle lies in the area of mutual recognition agreements (MRA). An MRA will ensure that both parties accept foreign professionals with degrees and diplomas offered in their home country. Computer-related and IT services, accounting, auditing, and book-keeping services, architectural services, engineering services, medical services, advertising services, and services for telecommunication and audio-visual communication are of particular interest to India in this context. If an MRA is finalised, it could further negotiations for trade in services substantially. Japan's 15 per cent withholding tax (share of payment withheld by the paying party on account of taxes levied by Japanese authorities) is another major disincentive for Indian professionals.

1.6 Overseas Development Assistance (ODA)

An important aspect of Indo-Japanese economic relations is the official development assistance (ODA) provided by Japan. Japan has been India's largest bilateral donor since 1957. In 1958, Japan started providing ODA to India in the form of yen loans. This was Japan's first case of yen loans since the beginning of its ODA policy in

1952. Since then, most ODA (95 per cent of the total) has been in the form of yen loans.

The focus areas of Japan's ODA to India have been

a) infrastructure sectors including power and transportation
b) agricultural and rural development
c) environmental protection through afforestation and improvement in the quality of water and
d) health and medical care

Japan reviews the performance of ODA recipient countries periodically. In fact, the recent policies of Japan's ODA to India are largely based on the recognition of India as an emerging economic power in the region and in the world economy. The objectives of extending ODA to India include:

1. strengthening India's commitment to the international economy and help in its growth as a constructive partner in the Asian region
2. promoting closer bilateral relations to strengthen Japan's security environment by maintaining stability in South Asia where India is a dominant regional player and
3. contributing to India's poverty reduction strategies for achieving the Millennium Development Goals (*MDGs*)

Japan's yen loan assistance to India is received through the Japan Bank for International Co-operation (*JBIC*) while grant aid and technical co-operation is received through the Japan International Co-operation Agency (JICA). For five consecutive years since the financial year 2003, India has been the top recipient of Japanese soft loan assistance. The rising yen loan commitment year after year at a time when Japan's overall loan budget has come under severe fiscal strain reflects the growing partnership between the two countries. During the year 2006-07, India received ODA loans for 11 projects worth ¥184.9 billion from Japan, i.e. 18.9 per cent above what was agreed to in 2005-06. In 2007, Japanese ODA loans to India touched a record of ¥225,130 million (approximately $2,085 million) for the first time. The ODA soft loan package of ¥99,019 million under the first track of FY 2008 follows this trend.

The loan package covers four large-scale projects in the areas of transportation, environment and finance. These concessional loans will be made available through the Japan International Co-operation Agency (JICA) at interest rates ranging from 0.3 per cent to 1.2 per cent per annum with a repayment period of between 15 and 30 years, including the grace period. The Chennai Metro Project and the Micro, Small and Medium Enterprises Energy Saving Project deserve special mention[3].

To promote economic growth, Japan proposes to assist infrastructure development that contributes to private investment-oriented economic development. In particular, Japan attaches priority to the power and transport sectors. As part of its efforts to help reduce poverty in the country, the country strategy and programme (CSP) proposes to

[3] Source: Embassy of Japan in India, Press Releases from the Embassy, Japan-India Relations Press Release No. 9

focus its attention on enabling the poor and socially vulnerable to participate in market economic activities. It also intends to provide assistance for the health and sanitation sector, local development, development of tourism that contributes to employment and disaster prevention. Japan is also offering ODA to tackle the increasingly serious problem of environmental pollution in India. To address environmental concerns, Japan's ODA will be directed towards providing assistance to improve water supply and sewage systems, afforestation programmes, renewable energy and energy saving projects, urban environment improvement projects and environmental conservation of rivers and lakes.

One of the important goals of Japan's ODA to India is to build mutual understanding between the two countries. To achieve this, a substantial increase in people-to-people contact is required, particularly in areas involving technology. Japan will, therefore, collaborate with the private sector in the areas of human resource development, youth invitation programmes, the Japan Overseas Co-operation Volunteers (*JOCV*) programme, and the India-Japan intellectual exchange programme.

1.7 Japan's Infrastructure and other Support to India

A large part of Japan's assistance to India has been for infrastructural development, (particularly power and transportation). Projects in the power sector include the "Bangalore Distribution Upgradation Project" and the "Transmission System Modernisation and Strengthening Project in Hyderabad Metropolitan Area". In the railroad sector, the project funded is the "Delhi Mass Rapid Transport System Project Phase 2". In the port sector, aid will be given to expand the cargo handling facilities of the "Vishakhapatnam Port Expansion Project".

One of the most significant projects that have received funds under the ODA is the Delhi-Mumbai Industrial Corridor (DMIC). Japan has assured technical and monetary support for the project, which will require an estimated investment of $50 billion. Japan agreed to partner the corridor project during Indian Prime Minister Manmohan Singh's visit to Tokyo in December 2006. The DMIC would be built along the lines of the successfully operating Tokyo-Osaka belt in Japan. The 1,483 kilometre long industrial corridor would be located beside the proposed Delhi-Mumbai Freight Corridor. The corridor will cover six states - Uttar Pradesh, Delhi-NCR, Haryana, Rajasthan, Gujarat and Maharashtra. It will link a number of cities with a population of more than 10 lakh including Faridabad, Surat, Delhi, Greater Mumbai, Meerut, Jaipur, Ahmedabad, Surat, Vadodara, Pune and Nashik. The government may identify around 20 industrial hubs along the proposed Delhi-Mumbai industrial corridor, covering approximately 12,500 hectares. The industrial corridor will have a 4,000 MW power plant, three ports and six airports, apart from connectivity with existing seaports. Besides giving a grant, Japan will also invest in the project. Work on the Delhi-Mumbai Industrial Corridor began in January 2008 and is expected to be completed in seven years. It will take an initial investment of $2 billion from both governments. The remaining part of the total cost of $50 billion will be met through foreign investment and private sector partners.

Environment and pro-poor programmes

Four projects to improve sanitation and the quality of water have been approved. These include two water supply projects, viz. the “Kerala Water Supply Project Phase 2” and the “Agra Water Supply Project”. The other two are in the sewerage sector, viz. the “Amritsar Sewerage Project” and the “Orissa Integrated Sanitation Improvement Project”. Further, the pro-poor rural development projects to be funded include the “Andhra Pradesh Irrigation and Livelihood Improvement Project”, the “Tripura Forest Environmental Improvement and Poverty Alleviation Project” and the “Gujarat Forestry Development Project Phase 2”.

The Government of Japan also provides assistance to NGOs based in India under its Grassroots Funding Programme for environment improvement projects. The Japanese embassy co-ordinates the programme. The Japanese government also provides technical assistance under the Green Aid Plan (*GAP*). This plan supports efforts of self-help groups dealing with energy conservation issues. The specific areas of co-operation include prevention of water pollution, air pollution, treatment of wastes and recycling, and alternative sources of energy.

1.8 FDI regime in Japan

The FDI regulatory regime in Japan is mainly governed by the Foreign Exchange and Foreign Trade Law, supplemented by relevant cabinet and ministerial ordinances. Inward FDI needs to be reported to the Japanese finance minister and the minister in charge of the industry involved within 15 days of executing a foreign investment in Japan. Inward FDI needs prior notification in the case of FDI in industries recognised in the OECD Code of Liberalisation of Capital Movements. These include agriculture, forestry and fisheries, petroleum, leather and leather products, and air and maritime transport. Some other sectors also require prior notification on the grounds of public order and national security. There are various other laws that stipulate specific restrictions on inward FDI in certain sectors, such as real estate, fisheries, financial services, telecommunications, and transport. The Japanese government in recent years has not rejected any notified inward FDI project in recent years. The provisions of bilateral investment treaties (BIT) also regulate the investment policy. Japan has eleven such treaties but does not have one with India yet.

The authorities in Japan believe that FDI brings benefits to Japan by, for example, creating new management resources, such as personnel, capital, and sales networks and bringing in new technologies, creating employment opportunities and increasing benefits to consumers by providing a wider choice and better quality of goods and services through increased competition.

The Japan Investment Council (JIC), a ministerial-level council established in July 1994, was until recently the central body for promoting FDI in Japan. On March 9, 2006, the JIC announced its goal of doubling the share of FDI in GDP by 2010[4]; and, to this end, it launched a programme for the acceleration of foreign direct investment in June 2006. The programme focused on three key issues: attracting FDI not only to the Tokyo metropolitan area but also throughout Japan, improving the investment

[4] Thus, a target for inward FDI of around 5 per cent of GDP

environment further to sustain Japan's competitive edge; and actively promoting and providing information regarding Japan's efforts to attract FDI. However, the JIC was abolished on 28 December 2007, and the Expert Committee on FDI Promotion was established in the Cabinet Office in January 2008.[5] The Committee's "Five Recommendations towards the Drastic Expansion of Foreign Direct Investment in Japan", submitted on May 20, 2008 to the Council on Economic and Fiscal Policy, covered improvements to facilitate mergers and acquisitions (M&A), comprehensive studies on FDI regulations, establishment of priority strategies by sector, reduction of business costs, improvement of transparency and regional revitalisation through FDI.

The Japanese government supports activities conducted by selected regional governments, including planning of strategies to attract FDI, executing public relations campaigns, inviting potential investors, and helping the start-up process of selected companies through its 'Project to Promote Foreign Direct Investment in Selected Areas'. In FY2004, four regions were selected for such support measures; by FY2007, the support measures had been extended to 17 regions. In FY2008, the government started a project to help potential investors attend regional exhibitions, with a view to creating further business opportunities in Japan.

Japan's bilateral economic partnership agreements (involving free-trade agreements) with Singapore, Mexico, Malaysia, Chile, Thailand, Indonesia, Brunei, ASEAN, and the Philippines include provisions on investment, articles on national treatment and prohibition of performance requirements.[6] These articles are applied to investors and investments as defined in the agreements, with exceptions specified in annexures.

The existing mechanism for investment co-operation between Japan and India is based on the Japan-India Investment Dialogue, Japan-India Policy Dialogue and Business-to-Business Dialogue. With a view to enhance these linkages, the India-Japan Study Group Report in 2006 stated:

"As a result of these detailed deliberations and studies, the Joint Study Group has concluded that there is a huge untapped potential to further develop and diversify the economic engagement between India and Japan. With the objective of bringing about a comprehensive expansion of bilateral economic and commercial relations, the Joint Study Group is making a series of recommendations, covering trade in goods, trade in services, investment flows, role of Japanese ODA in promoting economic partnership, and other areas of economic cooperation. The Group is also recommending that India and Japan launch inter-governmental negotiations to develop an Economic Partnership Agreement or Comprehensive Economic Partnership Agreement, within a reasonable period of time."

Indeed Japan is already implementing the Programme for the Promotion of Foreign Direct Investment in Japan, including the establishment of a one-stop consolidated

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[5] The authorities maintain that the abolition of JIC does not affect Japan's policy on FDI promotion, including the goal of doubling FDI by 2010. The Programme for the Acceleration of Foreign Direct Investment in Japan remains valid. When deemed necessary, a cabinet meeting or other ministerial meetings will be held to discuss further policies on FDI.

[6] Performance requirements are stipulations, imposed on investors, requiring them to meet certain specified goals with respect to their operations in the host country. They are and have been used by developed and developing countries together with other policy instruments, such as trade policy, screening mechanisms and incentives, to enhance various development objectives.

business consultation service point (Invest Japan) and intends to support further investment from India to Japan. As a result, an increasing number of Indian companies are now exploring opportunities to invest in Japan. Around 70 Indian IT companies have already established their offices in Japan. The IT market in Japan is the second largest with a value of $100 billion in 2006-07. Japan provides the ideal investment platform for Indian companies to get access to other new Asian markets. There is tremendous investment potential in Japan particularly for companies engaged in the pharma, bio-technology, IT and IT-enabled services sectors.

The Japan External Trade Organisation (*JETRO*) helps foreign business firms to invest in Japan, besides assisting Japanese companies in their overseas operations. For example, Tata Auto Comp Systems, part of India's largest conglomerate, the Tata group, is an auto parts maker with 16 global partners, 20 manufacturing sites and five engineering centres worldwide. The company established an office in September 2007 in Yokohama, with the aim of dispatching engineers to Japanese auto parts manufacturers and gathering orders for systems development at the parent company in India. To support Tata’s entry, the JETRO IBSC provided free temporary office space (at the IBSC in Yokohama), consultation on company establishment procedures and help in finding suitable offices.

1.9 Constraints on Japanese Investment in India and Indian Investment in Japan

As mentioned earlier, several countries have overtaken Japan in terms of their investment in the Indian market. According to a recent report submitted to the Department of Industry Policy and Promotion, the Japan Chamber of Commerce and Industry in India characterises the Indian business environment as “tough”. The document titled *“Suggestions for Government of India by JCCII”* contains detailed suggestions related to the following issues:

- land acquisition and utilisation
- tax system
- infrastructure
- logistics distribution
- relaxation of FDI regulations
- visa application procedure
- inefficiency and lack of administrative transparency
- social security agreement
- intellectual property rights
- specific issues related to the financial sector and steel
- others including standardisation of bid requirements as per international standards

JCII contends that these issues need to be settled to generate greater interest among Japanese investors.

Japanese investors describe the tax system in India as too complicated and difficult to understand. India’s land acquisition and utilisation procedures are also cited as a major obstacle to Japanese investment in India because they are both complicated and non-transparent. The failure to fulfil contractual obligations such as those relating to power and water supply, drainage etc. in the case of industrial parks is another major issue. Japanese companies have also asked for simplification and speeding up of procedures for various permissions related to construction. In fact, language itself is a major barrier and restricts easy interaction between business representatives of the two countries. There is lack of awareness and information about each other's market.

What is noteworthy is that these factors have not constrained investment from other countries like South Korea. A comparison of Japanese and South Korean companies in India shows that Korean companies have dominated the Indian market for the last few years. Korean firms like Daewoo, Hyundai, LG, Samsung and Goldstar entered the Indian market aggressively after the mid-nineties. Japanese firms like Toshiba, Sanyo and Sharp lost out to the competition posed by Korean products. The only exception was Sony. Korean products appear to have fared well in the price-sensitive Indian market[7]. One reason is that Korean companies have localised the production of components and parts and used local labour. Hyundai's success in undertaking large investments with high domestic content demonstrates that there is scope for FDI inflow in hi-tech industries, subject to scale economies (Nagaraj, 2003).

India has been unable to attract the attention of Japanese multinational enterprises and benefit from the trade-FDI nexus as other countries have. According to Goldar and Ishigami (1999), the extent of trade flows between Japan and the host country has been found to be a more significant factor influencing FDI inflows from Japan than the size of the local market and degree of openness. The much greater level of trade union activity in India relative to East Asian economies also influenced the investment decisions of Japanese multinational enterprises. According to Kumar (2002), a high valuation of geographical proximity and cultural affinity by Japan's MNEs and the availability of quality infrastructure in the host countries helps explain the concentration of export-oriented investment by Japanese MNEs in the East Asian economies and their relative neglect of India. Overall, Japanese firms are deterred from investing heavily in India due to differences in business practices, environment and culture.[8]

Even the Indian corporate sector acknowledges the chronic hesitation among Japanese corporations to do business in India. Mandal[9], one of India's largest law firms has been quoted as saying that Japanese businesses have been slow in recognising the changes that have taken place in India's economic regime.

After years of subdued ties following India's nuclear tests in 1998, two large deals last year appear to have set the stage for a renewed wave of Japanese investment in India. Japanese pharmaceutical major Daiichi Sankyo bought a 34.8 per cent controlling stake in India's largest pharmaceutical firm, Ranbaxy Laboratories. The deal, announced in June 2009, valued Ranbaxy at $8.5 billion. A few months later, Japanese telecom giant NTT DoCoMo bought a 26 per cent stake in Tata Teleservices Ltd. (TTSL). However, Japanese business would do better if they established 100 per

[7] Japan-India Comprehensive Economic Cooperation Report (2004), National Council of Applied Economic Research, India
[8] Federation of Indian Chambers of Commerce and Industry
[9] Fox Mandal Little, India's topmost law firm on Japanese Investors

cent subsidiaries that tap the local market for their work force, including managerial requirements than setting up joint ventures with local Indian partners.[10]

1.10 Government Initiatives

Both Japan and India have taken several steps to promote Japanese investment in India and vice-versa. India has become an attractive investment destination with simplification of investment procedures through a single window clearance. Trade policy has been liberalised to facilitate investment in the country. There are laws in place to protect intellectual property rights; financial sector reforms have helped reduce the anomalies that existed in the capital market and the liberalisation of foreign exchange regulations etc. have helped promote FDI in the country. Further, the Secretariat of Industrial Assistance provides information to investors.

The Indian government has established the Foreign Investment Implementation Authority (FIIA) to facilitate implementation of FDI projects by helping investors get the required clearances. The Indian government has also set up a dedicated "Japan Cell" in the Department of Industrial Policy and Promotion to promote and facilitate Japanese investment in India.

The Japanese government and associated agencies have been equally proactive in promoting Japanese investments in and attracting investment from India. The Japan External Trade Research Organisation (JETRO) regularly organises and dispatches overseas investment missions to all parts of the world to promote investment in countries with high potential. Necessary data and information are collected from the 74 JETRO offices located all over the world. Japan has also entered into bilateral investment treaties (BITs) with several countries in order to promote Japanese investors and investments abroad. Apart from a conducive investment environment provided by the host country, the home country, i.e. Japan, also promotes investment in other countries by providing adequate support to its investors. For instance, Japan provides insurance cover to its investors when they are forced to discontinue their activities because of war, terrorism, natural disasters or suspension of remittances to Japan.

1.11 Future Prospects

Japan's FDI has been concentrated largely in two major sectors: automotive industry (60 per cent of the total) and petrochemicals (20 per cent) during 2000-2007. However, new areas of investment are emerging such as other manufacturing industries, pharmaceuticals, food processing, IT software and textiles. It is also noteworthy that many Japanese SMEs (small and medium scale enterprises) are demonstrating a keen interest in the Indian market.

In recent times, Japan has been eclipsed by South Korea in terms of establishing its presence in the Indian market. South Korean consumer brands have moved aggressively into India. Their brands have very high recognition value among Indian consumers. On the trade front, India's trade with both China and South Korea is booming and grew around 40 per cent with both countries in 2007-08. China's trade

[10] Fox Mandal Little, India's topmost law firm on Japanese Investors

with India is nearly three times as much as India's trade with Japan while Korea's trade is almost at the same level.

Unless Japanese investors become more proactive, they are likely to miss out on the opportunities offered in India's rapidly growing economy An economically resurgent India offers a variety of investment opportunities, both in traditional and new sectors, in labour-intensive and knowledge-based industries. Japan and India could collaborate in the bio-technology, nano technology, information technology, automobile, aerospace, textiles, leather, marine product and other industries. India's fast expanding economy will create a large demand for energy. There are many opportunities for collaboration between Indian and Japanese companies in the area of energy efficient and environment friendly technologies.

1.12 Conclusion

The conclusion of the India-Japan Comprehensive Economic Partnership Agreement (CEPA) needs to be expedited to tap the huge potential that exists for further development, since both bilateral trade and investment are below potential considering the economic size of the two countries. Trade and investment values are also low in comparison to other major economies. Trade and investment flows from Japan to India are only 3 per cent of the volume of trade and investment from Japan to China.

As highlighted in the 2008 survey conducted by JBIC, the flow of investment in recent years from Japan is still not satisfactory despite India's potential as an investment destination. There exists tremendous investment opportunities in areas like infrastructure, manufacturing and services. Japan's technology and investment in the infrastructure sector can help bridge the supply gap in India's infrastructure sector. Besides, Japan's IT hardware can complement India's strength in software while, India's edge in pharmaceutical, biotechnology, and auto components industry can complement Japanese proficiency in heavy engineering, automobiles, machinery and chemical industry. India can also benefit from the export of agricultural products since Japan is a huge importer of food. Japanese investment and technology could also play an important role in promoting SME clusters in the country.

Realising the importance of promoting FDI in the country, the Indian government is introducing reform and liberalisation measures. At present, more than 200 of the Fortune 500 companies from the US, the UK, Germany, France, Japan, Netherlands, South Korea, Switzerland, Canada and Sweden are present in India. India provides a favourable investment climate to these companies, which include freedom of entry and exit, investment location, choice of technology, import and export etc.

What India needs to do is disseminate information on investment opportunities, identify new areas of collaboration and co-operation, ease procedural hassles and remove delays to boost Japanese investment in India.

1.13 Policy Suggestions

This brief analysis of Indo-Japanese trade and investment links has shown that investment has been the focus of increasing economic co-operation between the two countries. Japanese investment in India has undoubtedly risen, but its share is small when compared to the potential that exists. The challenge is not only to exploit this potential but also to make investment more broad-based with a marked bias towards high technology, manufactured goods. The recommendations of the study are as follows:

- Provide information required by Japanese investors: Creating bilingual information products on FDI policies, outlook, investment climate and opportunities and disseminating the information both through the print and electronic media will go a long way in helping Japanese investors take decisions on setting up plant in India. Information can also be disseminated via conferences and exhibitions on India's investor friendly policies.

- Enhance and upgrade dialogue architecture including strengthening high-level exchanges, launching of a high-level strategic dialogue and fuller utilisation of existing dialogue mechanisms. Expediting the process of concluding the India-Japan comprehensive economic partnership agreement needs to be the focus of a high-level strategic dialogue between the two countries.

- Set up a committee in the Department of Industrial Policy and Promotion under the Japan cell to carefully address the grievances of Japanese investors and ensure that they get proper consideration at the cabinet level. The grievance committee would not only facilitate implementation of rules and help investors but will also act as a vigil for different departments and ensure that bureaucratic red tape does not result in avoidable delay in decision-making. It could also implement some of the measures suggested by Japanese investors such as providing information and contacts and networking with central and state departments and industry associations.

- Consider the conclusion of an investment agreement: This would help address a wide variety of issues including national treatment, transparency, promotion, facilitation, investment protection and dispute settlement.[11]

- Improve civil aviation links between the two countries: The holding of bilateral civil aviation talks and implementing agreed measures expeditiously would help expand air links commensurate with the requirements of growing economic relations and enhanced tourist flows. The Indian side has invited Japanese participation in the development of airports in India through public private partnerships and under the ODA.

Indo-Japanese relations have undergone a paradigm shift in recent times. Though Japan is the sixth largest investor in India, there is hope that the proportion of investment will significantly increase. Successful Indo-Japanese ventures such as Suzuki-Maruti, Hero Honda, and Toyota Kirloskar are few and need to be emulated. India will need to create an investor friendly environment by introducing further economic reforms and changing policies to address the grievances expressed by Japanese investors to increase investments.

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[11] Source : Report by India-Japan Joint Study Group, 2006, www.commerce.nic.in

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Annexure 1

Table 1: FDI stock by region (1990, 2000, 2004-2007), in $ million

	1990	**2000**	**2004**	**2005**	**2006**	**2007**
World	1785267	6148211	9732233	10671889	12474261	15602339
Developed Economies	1640405	5265116	8610146	9271932	10710199	13042178
Japan	201441	278442	370544	386581	449567	542614

Source: World Investment Report, various issues

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