

FDI and Inequality: A Comparative Study of India and Japan

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Abstract: *The paper explores the relationship between foreign direct investment (FDI) and income inequality, using India and Japan as case studies. Despite similar levels of FDI, these countries exhibit different levels of inequality. The paper argues that factors beyond economic development, such as education systems, FDI distribution, and government policies, play crucial roles in shaping this relationship. The paper demonstrates that the relationship between FDI and income inequality is complex and influenced by factors beyond economic development. Understanding these factors is essential for policymakers seeking to harness the benefits of FDI while mitigating its potential negative impacts on inequality.*

Keywords: Income Inequality, FDI, India, Japan

1. Introduction

The world is heading towards becoming more interconnected through the greater levels of foreign direct investment (FDI) flowing across countries. (Global FDI Flows | Economic and Political Weekly, 2024). In fact, more than 1 trillion USD worth of FDI was exchanged in the last year. (UNCTAD, 2024). The additional fundings procured by various countries have led to a greater number of jobs, consumer choice, and skilled labour force. However, paradoxically, it hasn't led to greater equality.

This is potentially a grave concern for states and IGO's, due to income inequality having the ability to threaten the stability of a state. (International Monetary Fund, 2022). The great amounts of FDI inflow into developing countries, such as India, Brazil, Mexico, etc, has undoubtedly spurred rapid economic growth, but there is a growing inequality in these states. (Sadhu, 2024). This suggests that FDI and income inequality may be correlated, but it involves a variety of factors such as the state's level of economic and social development, for example.

Literature currently points towards different findings. According to Ravinthirkumaran (2018), APEC countries, which is a trade forum consisting of 21 member nations, experienced reductions in income inequality by 8% per percent increase in FDI. The study finds that an inflow of FDI, increased economic growth and human capital, which caused reductions in inequality. However, this was only feasible due to good healthcare, education and governance. Other countries, which aren't a part of APEC and are considered to be developing, experience greater levels of inequality as FDI increases, according to Nguyen. (Nguyen, 2023). There are a number of reasons for this consensus, with various countries conforming to the identified. However, there has been a lack of study which compares two case studies, which could help better the understanding of why this difference for one exists, and the role of some key factors. Furthermore, most papers have followed a quantitative analysis of data sets, while this paper will be more qualitative in nature.

In order to investigate the complex relationship between income inequality and FDI, this paper will be conducting a comparative analysis of two countries. For this paper, India and Japan will be used as primary case studies. This is due to both states possessing similar levels of FDI (~ 48731.335 USD million), but having different Gini coefficients (India: 40.2, Japan: 32.9). Even though both countries contribute roughly similar amounts to the Asian GDP, their paths to reach this point diverged significantly. In addition, both countries share a strong trade relationship with the US. Also, technology occupies a central place in the economic visions of India and Japan, with both countries being progressive towards technological development through policies implemented by their respective governments. Through a comparative case study, this paper would compare and contrast three of the most crucial factors of income inequality's relationship with FDI: education, the flow of FDI within both states, and each government and labour force's approach. Analysing these factors could further establish a more concrete understanding of both FDI and inequality's relation.

The paper will first introduce both economies and how they have come to be. Then, the substantial arguments which establish the differences in education systems between Japan and India have resulted in varying levels of skill and employability among their labour forces, contributing to greater income inequality in India. Next, FDI in India is heavily concentrated in a few developed states, leading to geographical income inequality, while Japan's FDI distribution is more balanced due to proactive government policies and incentives. Finally, Both countries employ strategies to attract FDI and manage income inequality, but Japan's collaborative approach with trade unions and progressive taxation has been more effective in promoting wage equality. These arguments show the relation of FDI with income inequality.

2. Setting the scene: India and Japan's Journey

In this section, I will elucidate the case study choice, through elaborating on the selected countries' recent economic

history, in order to track how they developed. Ultimately then establishing where they stand in current times.

As of 2024, India's GDP is the 5th largest in the world, and has had consistent economic growth, an average of 6-7% per annum over the last decade. (Nanjundaiya, 2024). India owes a large amount to trade liberalisation of the 1990's to the current levels of FDI it receives.

Prior to the 90's, the Indian economy was highly planned, with some form of government intervention present in each sector, be it in industries such as agriculture, infrastructure, etc. This shows that the Indian government followed a dirigiste approach, instead of the aimed mixed economy. (Patnaik & Chandrasekhar, 2010). This economic doctrine resulted in corruption, red-tapism, and low levels of economic growth. (Devi, 2015). In 1991, India's worsening Balance of Payments (BOP) deficit required the assistance of a bail-out package from the IMF. This was the result of a poorly managed foreign reserve in addition to great political instability at the time. (Prep, 2023). When Narasimha Rao came to power, he entrusted the then finance minister Manmohan Singh to usher the country towards greater economic certainty. Manmohan Singh, introduced expansionary policies, one of the most noteworthy being a reduction in restrictions for foreign direct investment, allowing for greater levels of economic globalisation. (Desk, 2024). Thus began India's growth, with the BOP deficit being decreased, and sustained levels of economic growth. (Varghese, 2018).

Post trade liberalisation, the Indian governments have primarily been neoliberal in nature, with expansionary economic policies being instituted through annual budgets, barring years with black swan events. However, in the 1980's, more than 50 MNC's, such as Coca-Cola and IBM, exited the country, but now, India hosts upwards of 20 thousand MNCs operations. (Panchal, 2014; MATHER HISHAM, 2023). In addition, the country has received over 70.9 USD Billion in the last financial year. (Economics Times, 2024). Contrary to its dire position in the 1990's, India's most recent measure of BOP was only 1% of its GDP in value. (Lele, 2024). India holds its strengths in agriculture, manufacturing, and its booming IT sector. (Page, 2023).

While the Indian economy may seem to prosper, certain facets still have not developed to this day. In the most recent measurement of income inequality, India is found to be having a greater inequality than it had under British rule. (Rajvanshi, 2024). This is found to be due to an economic and political nexus instituted by the Bharatiya Janata Party (BJP), through its reforms that has led to a centralisation of power. (Kumar Bharti et al., 2024). Furthermore, social exclusion on the basis of casteism, an ancient hindu hierarchical system has led to certain communities not having equal access to jobs. (Balakrishnan, 2024). This has led to greater lapses in education, with more than 1.2 million kids estimated to be out of school. (Correspondent, 2023).

While India's economic boom began in the 90's, Japan's economy had its significant turning point occurring after World War II.

Following the war, Japan's economy lay in tatters. However, the nation embarked on an ambitious reconstruction effort. The government, in cooperation with private businesses, implemented a policy of export-oriented industrialization (EOI), similar too India's trade-liberalisation move. This strategy focused on producing goods for international markets, leveraging Japan's skilled workforce and technological advancements. This led to surges in population in national hubs for production, leading to greater levels of consumption in the Japanese economy. Furthermore, other industries, such as agriculture, also benefited from greater surges in demand brought on by industrialisation and urbanisation. This is similar to how the Indian economy began developing, wherein it was a predominantly agrarian economy. The Korean War (1950-1953) provided a critical boost, as American demand for Japanese goods surged. By the 1970s, Japan had become a major global exporter, particularly in sectors like steel, shipbuilding, and automobiles. (Britannica, 2019).

The 1980s saw a shift towards a more knowledge-based economy. Japan invested heavily in research and development, leading to breakthroughs in consumer electronics, semiconductors, and robotics. A similar period was witnessed in India, about a decade later, post trade-liberalisation. This period also witnessed the rise of powerful Japanese multinational corporations that dominated global markets. It led to Japan's trade balance being one of the best globally, inevitably creating friction with its western counterparts. (Britannica, 2019). Despite its success, the Japanese economy has faced challenges in recent decades.

A declining birth rate is posing serious threats to the country's economy and has prompted its government to come up with policy measures. It is to be noted however, that while Japan has a similar level of FDI as compared to India, it has a significantly better Gini coefficient. This would indicate a greater level of equality in the island nation, and is largely attributed to the significant differences in its education system. (Brown, 2021). Furthermore, good governance over the years in Japan, has led the state to become one of the most equal globally. (Eda, 2021).

3. What role is each state's education playing?

One of the main causes of income inequality globally is the level and quality of education a population of a state is exposed to. (Income Inequality and the Earnings Gap between Educated and Non-Educated Workers, 2021).

Japan and India's education systems differ greatly. The former has a more modernised structure of education, that includes vocational schooling and other options for its students. (Japan National Tourism Organization, n.d.). Whereas India has a more traditional set up with emphasis on examinations taking place in 10th grade and 12th grade. (Education in India: A Detailed Analysis, n.d.).

While the differences in both states' education systems haven't led to any immediate impact to both states' FDI (~ 48731.335 USD Millions), this has impacted the employability of labour, due to which there remain differences in levels of income inequality between both

states. The difference in skill sets between India and Japan, could be attributed to the differences in access to education in each state.

Japan has found success, with an average overall enrollment rate of over 90% since the early 2000's. (Ellington, 2005). This success could be associated with the desire to better the nation carried by the vast majority of the Japanese. (Why Is Japan Successful in Education?, n.d.). India, on the other hand, has struggled to match the level of success. It has an enrollment rate of just over 75% recorded in 2023. (Trading Economics, n.d.).

The Indian population that doesn't enrol, usually are in rural areas, wherein India lacks common education infrastructure; qualified teachers; and most importantly a holistic nature present in developed countries. (Miller & Jordan, 2022), (Out-of-School Children in the Context of School Education in India (2023) | Education for All in India, 2023). These include eastern states that contain fewer Tier 1 cities, such as Bihar, Jharkhand, and Odisha, which possess a high level of unemployed workers. (Srivastava et al., 2024).

This has led to geographical income inequality in India, where there are clusters of poorer population in the aforementioned eastern states and beyond. Whereas urbanised parts of the country are more wealthy, prominently in the western parts of Maharashtra, Gujarat, Delhi-NCR, etc. (Bhattacharya, 2018). These urbanised areas possess greater infrastructure, higher enrollment rates, and literacy rates. (State Wise Literacy Rate in India 2023, 2023). In addition, the vast majority of FDI is received by the western parts of India. (Santander, 2019).

But being literate in India may simply not be enough to create greater equality. In fact, studies have found that Indians who attain professional qualifications are paradoxically among those who experience the highest proportions of unemployment, due to a disconnect between theory and practice. (Schneider & Pilz, 2024). This is against the norm in most developed countries otherwise, wherein skilled labour are better able to secure employment. This may be possibly due to the large surplus of labour, coupled with a limited number of jobs in the private sector. (Chakravarty, 2024).

While these problems are being worked on by the government through various governmental schemes, the impacts would only come to light in the long run. (Overview, 2018). However, with the current education systems in place in India, the youth are suffering. Educated Indian youth account for nearly 70% of the unemployed labour force. In addition, wages of workers, skilled and unskilled, have remained at low levels according to the ILO. (ILO, 2024).

Another vulnerable group, apart from the Indian youth, are Indian women. Men far outnumber the amount of women working, wherein there are 361 million working men compared to 39 million women. (Al Jazeera, 2023). Furthermore, Indian men are comparatively more literate as compared to Indian women. (Kapoor, 2019). In Japan, however, there is a lower gap between the participation of each gender in the labour force with there being 71.4% participation rate for men and 54.8% participation rate.

(Statista, 2023). This could be attributed to Japan's economy being more developed, having different cultural values than India, and having greater demand for labour. But even though both countries are receiving similar levels of FDI, what has been its impact on job creation?

The vast majority of FDI into India goes towards private sectors that require a higher volume of skilled workers. For instance, the service sector received the majority of FDI (16%), and it includes banking, insurance, R&D, etc. These are all businesses that have demand for skilled labour, and if educated youth in India aren't being employed by them, there is bound to be a large disparity in incomes. (Invest India, 2024).

This may also be due to different objectives possessed by Indian labour. Government jobs are highly competitive and sought after in India, with the attractive wage and non-wage benefits available. (Pandit, 2023). With there being a finite number of jobs, graduates are often underemployed, in pursuit of these lucrative jobs. (Jeffrey, 2010). With underemployment, a problem that has been long combated, India faces greater inefficiency and income inequality. (González & Menendez, 2000).

Therefore, it can be asserted that Japan's education system is more developed than India, and has instilled different levels of skill in labour. The different levels of development has impacted the employability of labour in both states. Which has left more graduates in India out of jobs, and, thereby, causing greater inequality amongst the Indian population than that in Japan. There is also a huge surplus of labour in India with a scarcity of jobs, as compared to Japan, which has led to greater unemployment in India than in Japan. In addition, the differing approaches to the job market, such as Indian labour prioritisation of greater job security, has also led to underemployment. This indicates the disparity between Indian and Japanese education systems.

4. The geographical trend in FDI fuelling inequality

Even though Japan and India possess similar levels of FDI, as previously mentioned, both states are in different stages of development. (International Monetary Fund, 2023).

A trademark of development is how the concentration of economic activity in certain parts of the country differs to others, wherein parts of later developed countries, such as India, are found to have a less equal distribution of economic activity geographically as compared to earlier developed countries, like Japan. (Henderson et al., 2017).

Similarly in terms of FDI, certain parts of India have received a greater proportion. Specifically, the western states of Gujarat and Maharashtra and the southern state Karnataka account as the destination for 67% of total FDI inflow into India. (India Briefing, 2024). The aforementioned states are a host to Tier 1 (T-1) cities, which are major economic hubs, whereas the states with lesser levels of FDI have no T-1 cities. This would lead to greater economic development in those areas as compared to the eastern states, which receive lesser levels of FDI. (Loungani & Razin, 2001). Furthermore,

Indian states receiving the largest share of FDI have amongst the highest incomes per capita compared to others. (Tambe, 2023). Thus indicating that the concentration of FDI has possible tie-ins with the income per capita on a state level, with it exacerbating inequality.

However, the Indian central government has been vocal in its support and somewhat biased towards developing the western state of Gujarat. This was, after all, from where Prime Minister Narendra Modi came to power. (Lobo, 2019). In addition, the state has established the Vibrant Gujarat Global Summit, which aims to attract foreign investors to establish industry. This was initiated by the current PM, and is till date seen as a benchmark to match for other states. (Vibrant Gujarat, 2024). This while benefiting the host state has had drawbacks for others, like Maharashtra, with the event deterring the government from hosting similar investment events to keep the spotlight on Gujarat. (TOI, 2024).

This indicates that there is some bias towards Gujarat in particular, and this may harm the contestability of other states when attracting investment and business for their own labour. (Joshi, 2024)

While it is difficult to recognise geographical concentrations of FDI in Japan, most parts of the island nation are fully developed, with its government putting special attention towards under-developed and secluded islands. (Kuwahara, 2012). (Bayoumi & Lipworth, 2017). Furthermore, Japan's Gini coefficient indicates its income distribution is more equal than India.

FDI is most notably known to be a catalyst for job creation. (Padia, 2019). This has been notable in both India and Japan. For example, in the Indian economy, it has positively impacted the banking and finance industry, which is the highest recipient of FDI in the country. (Malla Reddy, 2016). Specifically, profit and income increased with FDI according to Reddy (2016). However, while job creation has been prevalent in the sector, government policy making and growing derived demand for labour are most likely to have caused this surge even with it receiving the highest amounts of FDI. (Mishra & Palit, 2020). However, where are these jobs being created? As discussed earlier, these would be in places which have better infrastructure and are economic hubs of India: T-1 cities. This therefore indicates that while jobs are being created, they aren't as accessible to the poorer factions of society. In addition, owing to the low internal mobility of labour in India, the rural population won't have access to these opportunities, and this will increase the prevalent income inequality. (Kone et al., 2018).

In conclusion, this part establishes an unequal distribution of FDI in India, with a large proportion of FDI being split across three key states: Gujarat, Maharashtra, and Karnataka. It was also found that there has been a slightly greater political backing received by Gujarat in the recent past. It can also be asserted that the majority of job creation as a result of FDI has been found to be in the banking and finance industry in India. As mentioned earlier, most of these jobs have come to be created in states that receive higher proportions of FDI. It is to be noted that trends of FDI concentration in Japan were difficult to establish, due to a lack of literature at the time of

writing. This thereby shows how due to a lack of even spread of FDI across India, there has been a creation of geographical inequality.

5. The government and labour force's actions

FDI is a lucrative commodity for countries around the globe as it fosters economic development. (Mallampally & Sauvart, 1999). So how have India and Japan tried to encourage FDI?

Japan offers a range of tax incentives: in particular sectors, strengthening small businesses, and even wage and productivity improvements. (Santander, n.d.). Furthermore, they have simplified procedures for foreign firms to set up businesses, in a way to promote more foreign entries. (EU-Japan Centre for Industrial Cooperation, 2018). The island nation has also set up National Strategic Special Zones in the cities of Tokyo, Osaka, Hokkaido, and Fukuoka, where in foreign entities setting up businesses will be able to avail local tax exemptions and subsidies. (Kubota, 2024).

The Indian government too has been active in its economy with an emphasis on promoting entrepreneurship. The government has used a variety of expansionary economic policies such as deregulating FDI inflows, which now no longer will be requiring government approval, starting initiatives that promote start-ups, helping firms export through remitting taxes and duties on exports. (Business Friendly Reforms: India's Path to Prosperity, 2024).

With there being more than adequate measures being taken to ensure FDI for domestic businesses by both governments, how has income inequality been addressed?

Japan has a progressive taxation system, which simply charges a higher proportion of tax for higher income bands. The tax revenue is then used to support the retired population, which is approximately one third of Japan's entire population. (Hisanaga, 2022). (ILC - Japan, 2022). While the government has implemented other policies, such as minimum wage legislation and welfare programs, the role of trade unions working collectively with the government is noteworthy. For instance, during the 1990's Japan introduced age milestones, wherein once a worker reaches a certain age, they would receive a fixed increase in their wages. (Box, 2017).

In addition to this, Japanese trade unions have a great amount of involvement in the wage-determination of its members, due to their bargaining power. With which, they are able to seek equitable wage raises for its members, ensuring that a manageable level of inflation is sustained, but also reducing the level of income inequality.

For example, this past year, during the annual spring offensive, which is a period of time where wages are negotiated for, the Japan union was able to achieve a 33 year high wage increase. (Kajimoto, 2024). This not only increased real wages, but created greater equality in the process of doing so.

In recent studies India is deemed to be more unequal than it was more than 70 years ago. (Sharma, 2024). This is a result of a regressive tax system when viewed with the lens of net

wealth. (Bharti et al., 2024). However, in the recent union budget, the central government has provided financial aid to underdeveloped eastern states such as Andhra Pradesh and Bihar, to invest in capital and better infrastructure. (Mukul, 2024). This would help the aforementioned states create jobs and other opportunities for its unemployed labour.

Apart from the central government, the Indian labour unions have been instrumental in securing important labour rights, such as minimum wages, paid leave, and safe working conditions. (NCIB, n.d.). For instance, unions in the organised sectors like banking and railways have successfully negotiated for better salaries and benefits for their members. (Nishith Desai Associates, 2019). However, most trade unions work independently in India, with there being little to no government involvement in their actions, contrasting the situation in Japan. (Ministry of Statistics and Programme Implementation, n.d.). This, along with more contracted labour in formal sectors, and labour law reforms reduces their effectiveness, and ability to create safer working conditions and create greater wage equality. (Bandyopadhyay, 2023).

6. Conclusion

This paper first looked at the history of both economies in order to understand how they were formed and in brief how they reached their current levels of FDI.

Next, the education system and process of both states was analysed to establish its relationship with income inequality. It was found that in Indian states with lower literacy rates, there was lower income, which was caused by a lack of infrastructure.

This was further explored in the subsequent argument, wherein trends of Indian inflow of FDI was analysed. It showed how employment increased in the top 3 destinations of FDI, whereas fewer were created in poorer states. This displayed a potential for these jobs to be available to highly skilled and experienced labour which wouldn't be available to the rural population, thereby stagnating income inequality.

Lastly, government measures to foster FDI and tackle income inequality were discussed. Both countries utilised similar policy measures to invite FDI, however, India was deemed to be more unequal due to certain tax systems implemented by the Government of India, which allowed the rich to get richer. Furthermore, the power of trade unions was also discussed, which found that Japanese trade unions possess greater bargaining due to them working with the government. In addition, due to the changing nature of contracted labour and labour law reforms in India, trade unions have been made less effective.

The paper could've been enhanced through the procurement of greater primary data, and more testimonies of rural and urban populations in order to gain a greater understanding on how income inequality persists in different regions of India and Japan.

This paper has effectively established that the relation between FDI and income inequality is impacted by more than just the level of development present in its destination.

Rather, it is influenced by a variety of factors as discussed in the paper.

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