

APA Discussion Paper

India: Forever a Future Market?

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Introduction

At the EU-India Summit in May 2021, the President of the European Commission, Ursula von der Leyen, declared that “the European Union stands by India as friends and partners”, stressing “that the European Union and India are the world's largest democracies”. Then and now, challenges like growing geopolitical tensions, Russia’s war of aggression against Ukraine, global warming and the Covid pandemic as well as strained supply chains have increased the urgency for Europe and India alike to assert their strategic autonomy by diversifying partnerships. Europe’s interest continues to grow in gaining a reliable ally in India that, in addition to geostrategic goals, also shares and defends common values such as multilateralism and respect for international law, democracy and human rights. New Delhi’s position on these issues in international affairs is being closely observed more than ever.

Germany and India can build on a long, stable and amicable relationship, particularly since the 1990s when India instituted large scale economic reforms and took steps to liberalize its economy. Germany is India’s biggest trading partner in the EU, and its sixth largest trading partner worldwide. A cornerstone of the bilateral exchange are vast networks of personal friendships, built through encounters based on openness to each other’s worldviews.

In the past, Europe and Germany failed to put enough time and effort into their relationships with Indo- and Asia-Pacific countries and despite longstanding high-level engagement between the EU and Germany with India, the respective relations remain well below their potential. Yet, changes are on the horizon. While Prime Minister Modi has shown a renewed interest in Europe, exemplified by the EU-India Summit in May 2021, the recent Indo-German intergovernmental consultations, and the restart of the trade and investment negotiations, the EU has also realized that it needs to diversify its relations.

The 2020 policy “Guidelines for the Indo-Pacific” of the German Government have rightfully been read as a call for the expansion of interests in the region. When Portugal made the relationship with India a cornerstone of its Council Presidency in 2021, culminating in the EU-India Summit in May last year and in the announcement of renewed negotiations for investment protection and free trade agreements, it became clear that India’s potential as an ally and a market had inspired European foreign policy makers once more. This was also reflected in the “EU strategy for cooperation in the Indo-Pacific”, which mentions India as a partner in the fields of regulatory cooperation, human rights, trade and investment, green transition, digitalization, data protection, connectivity, security, and healthcare.

While some hailed this development as the overdue realization that India needs to be taken more seriously, others pointed to protectionist and democratic setbacks in India that could limit the country’s openness for stronger partnership and its growth potential.

To get closer to a mutually rewarding relationship it is time for an honest appraisal of the current barriers to economic engagement and to provide suggestions for framework conditions to improve the potential for closer cooperation in a challenging geopolitical context. This paper presents a contemporary perspective based on interviews with practitioners and stakeholders from various fields and sectors, including business, politics and think tanks. The analysis combines desk research, semi-structured interviews, and input from various sectors of German business.

1. Manifold potential of economic cooperation with India

The Asia-Pacific Committee of German Business (APA) appreciates India's growing strategic importance and ambition as a geoeconomic and geopolitical player. The potential size of India's market is huge, the country has an educated and skilled workforce, and it combines the advantage of English as the language of business with low labor costs, business-friendly policies in certain states, as well as a liberal political system with a vibrant civil society.

We are convinced that India's standing in the world, its economic development and its role as a partner for Germany and Europe will benefit further from a clear commitment to economic reforms, curbing down bureaucracy, improving education and training, modernizing public service, investing in infrastructure, strengthening civil rights and continuing the fight against corruption and bribery.

After all, the strategic importance of a country as big, diverse and dynamic as India is obvious. Even though this seems self-evident, it is important to point out again why it is necessary to engage actively with India from a German perspective and what India might gain from more openness and closer economic cooperation.

Growth of the economy, FDI and people: In the last decade, the Indian economy grew at an average of 6.4 percent – if the COVID-19 induced slump of 2020 is disregarded (figure 1). India is home to a large and vibrant tech sector as the country boasts various centers of IT industries and promising startups, driven by a pronounced entrepreneurial spirit, thus offering great potential for cooperation and mutual learning in the field of digitalization.

The opening up of the economy has also led to a consistent increase in FDI inflows (figure 2). India's growth alongside its demographic trend facilitated an expansion of the workforce and its middle class, leading to a growing demand for goods and services – although the pre-pandemic size of the middle-class in India, with approximately 100 million people – or about 7 percent of the country's total population – is still very low. Given the quantity of well-educated people, the Indian labor market cannot absorb all of them, whereas Germany suffers from a shortage of skilled workers. Both countries can thus benefit from efforts to facilitate migration.

Providing structural solutions and incentives for local and foreign companies to satisfy and capitalize on these demands from customers and the workforce is one of the opportunities for India, which can be supported by Germany if the Indian Government prepares the ground. Yet, as a consumer market for German products, India will remain less attractive than more established markets for the time being.



Fig 1, Source: World Bank

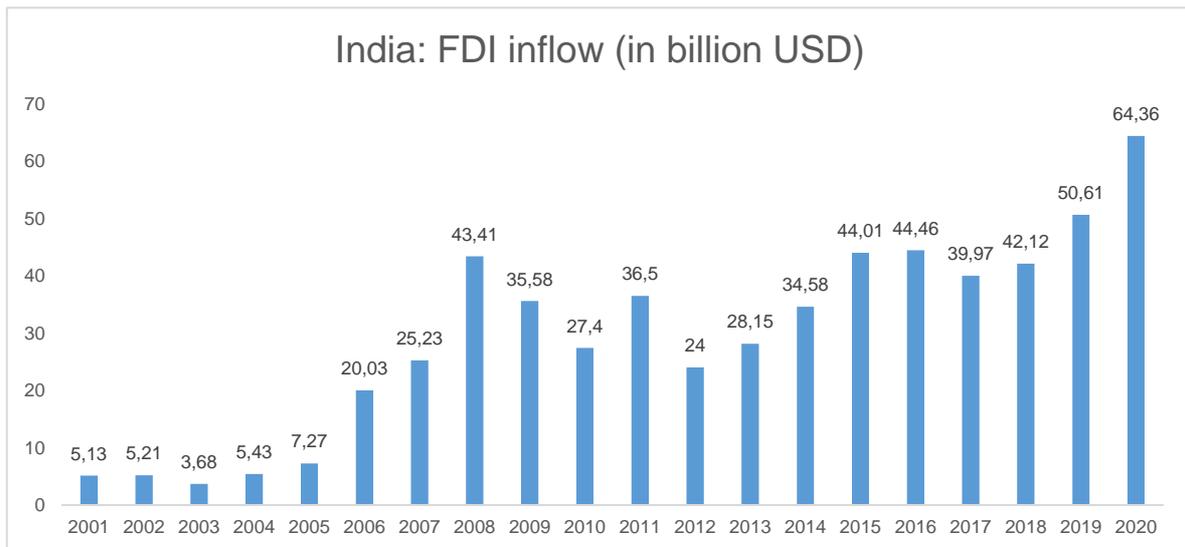


Fig. 2, Source: World Bank

Strategic interests: India has decided not to join the Regional Comprehensive Economic Partnership (RCEP), turning instead to Japan, Australia, the UK, the EU and the United States in search for trade and investment partnerships. The desire to decrease dependencies and to manage risks is a common ground on which Germany and India can meet. India is marketing itself actively to businesses seeking to diversify their interests in the region, albeit sometimes overestimating the flexibility of companies that have continuously invested in other economies.

India could benefit both geopolitically and economically from moving more systematically towards more liberal, market-oriented economic policies. As history has shown, democracies are not at a disadvantage regarding efficiency if they focus on providing suitable framework conditions for market forces to thrive in. To the contrary, they tend to unleash creative forces and a competitive spirit in the service of progress.

India's democratic set-up and the diversity of the country have the potential to enable a competition for the best solutions between administrative units within a business-friendly framework set by the central government. Leveraging the benefits of market efficiencies, liberal freedoms, a level playing field and international trade integration could therefore boost growth in India and strengthen its economic and soft power.

Sustainability challenges: The sustainable transformation of the economy poses major challenges for India. In terms of global carbon emissions, the country ranks third in the world, with a share of seven percent. Additional investments in coal energy would foreseeably lead to a strong increase in emissions. By international comparison, India's relative share would increase even more in view of falling emissions elsewhere. It is therefore in the global interest to find ways for India to meet its rising energy demand, enable economic growth and at the same time achieve climate targets.

The strong growth of solar and wind energy in India, supported by the Indian Government, and the country's emergence as a world leader in battery storage, are indications of how great the opportunities are – also in terms of future economic growth and the emergence of new industries, such as green hydrogen. It is of vital importance, and in Germany's own interest,

to cooperate with India in the areas of green energy, transport and production in search of alternatives to fossil fuels.

At the same time, APA also welcomes further efforts to implement the United Nations Sustainable Development Goals in India. We fully support the fight against hunger and poverty, the improvement of the quality of life in rural and urban areas and the efforts to improve education and training. German industry can also make valuable contributions here: with technology and know-how – but also through education and training in companies or via cooperation with educational and research institutions. We want to build and expand on these joint efforts and develop them further.

- **Eyes to the future:** A closer alliance with Europe would entail a clear commitment in India to this relationship and a shift in foreign policy towards the shared implementation of universal standards and values now and in future. Meanwhile, Europe needs to respect Indian perspectives rooted in historical experiences of exploitation.
- **Realizing complementary economic and strategic interests:** India is seeking sustainable investments and economic as well as political cooperation with its partners. Germany is looking to diversify its investments and strengthen its political relations in the region as well as to improve the dynamism of its digital sector. APA calls on both sides to put these complementary interests into action while contributing its own share, for example by facilitating exchange with platforms such as the joint APA-CII Indo-German Digital Experts Group. Crucially, a strong Indian commitment for WTO-reform is needed, to strengthen the multilateral rules-based trading system.
- **Improving mutual understanding:** APA believes that, with a policy that allows for more competition and openness – for example by easing trade and investment conditions – India could increase considerably its engagement with liberal market economies like Germany, and consequently achieve sustainable economic growth. Meanwhile, Germany and the EU must realize that – while values remain important – the strategic potential of a partnership with India can only be realized if a certain degree of pragmatism is applied.

2. Spotlight: Economic liberalisation in India

The election of Prime Minister Narendra Modi in 2014 had provided new reasons for optimism about India's economy. However, in 2016, India's unilateral decision to cancel existing bilateral investment protection agreements sent shockwaves through its network of partnerships. On the tariff barrier front, India continues to levy high tariffs on goods from Europe in several sectors. As per WTO's latest Trade Policy Review, the average tariffs in India rose from 13% in FY15 to 14.3% in FY21. It is expensive to import finished products or components into India, in some areas effectively cutting off the country from global value chains.

On the non-tariff barrier front, international standards are sometimes not recognized in India, and situations are not uncommon in which the Indian Government introduces its own standards at short notice, making it impossible for manufacturers to respond in time.

Additionally, the historical lack of land reform in India has made the acquisition of land for production facilities difficult and expensive, as ownership is not always clear, and incidents occur in which plots have come into the possession of German companies only after lengthy waiting times and legal struggles. From a board room perspective, this lack of predictability makes decisions to invest in India very complex.

The recent announcement of the “Atmanirbhar Bharat” (Self-reliant India) campaign focusing on boosting domestic production and reducing reliance on imports has raised concerns among German businesses, as did the Production Linked Incentive (PLI) scheme which incentivizes domestic production in selected industries.

On the one hand, the PLI may offer benefits to companies that want to invest locally in certain sectors or that can demonstrate an export share as a result of their involvement, while the fact that India wants to attract more technology into the country or expand existing capacities is a widespread concern in other markets as well and therefore not specific to India. On the other hand, the PLI seems to go hand in hand with high tariff barriers in certain sectors, leaving local investments and production in a challenging environment as the only option for foreign companies to access the Indian market, while at the same time increasing costs for local producers to acquire necessary imported components.

Similarly disconcerting are planned policies to enforce the localization, expropriation and mandatory sharing of non-personal data in India, restricting cross-border data flows and the usage of sensitive and non-personal data. From increased costs of compliance, to the undermining of intellectual property rights to hampering innovation, the government’s proposed Data Protection Bill seems out-of-step with global standards on data protection and competition, while at the same time giving a wide range of exemptions to government agencies for handling and processing data.

A lot could be gained from changing course and aligning India’s data policy with that of the EU. At the EU-India Summit in 2021, cooperation in the field of digitalization was strengthened with an agreement to deepen engagement on emerging technologies. More importantly, against the backdrop of the EU’s promotion of a convergence between data protection regimes worldwide to ensure safe and free data flows with the eventual aim of adequacy talks, India should start to orient itself towards established global standards if it seeks to strengthen its digital partnerships.

While the legitimate intent to boost domestic production is acknowledged by German firms, and the Indian Government promises that these measures are in no way aimed at reducing trade or cutting down foreign investment, it is yet unclear what the long-term impact of “Atmanirbhar Bharat” would be. For example, where would an FTA with the EU feature in this drive towards self-reliance? And how will India induce German companies to invest locally if they must fear being cut off from the global free flow of fabricated components due to prohibitive customs duties?

German business is also worried to become collateral damage of protectionist policies by the Indian Government that appear to be directed at China. This sentiment was exacerbated by border skirmishes between India and China, and the announcement of new non-tariff barriers put in place soon thereafter, apparently for combating Chinese imports and investments into

India. One example is the automotive sector, where India's stricter quality controls and tighter regulations directed at reducing Chinese imports and boosting domestic production have affected the German automotive sector. A free trade agreement could certainly mitigate those effects, which makes its successful conclusion all the more decisive for closer cooperation between Germany and the EU with India.

In order to make India attractive as destination for regional diversification efforts of businesses, a conversation at higher levels of government is necessary. The country still features less prominently in business considerations about alternative investment destinations in the Asia-Pacific region than smaller countries in Southeast Asia. Reasons given include greater predictability in those countries, stability, better infrastructure and less complex bureaucratic and legal hurdles.

- **More economic openness to foster cooperation:** Mixed signals from India regarding its economic policy are a serious hindrance to closer cooperation. More consistency and a commitment to open markets in the government's messaging to domestic audiences on the one hand and international partners on the other, would help to increase predictability and make investment decisions easier.
- **Supporting German companies in their support of local development:** Trade and investment policies should complement each other, rather than being treated separately. Likewise, it would be desirable if the government were to speed up efforts across all levels – from central to local – to attract businesses by improving infrastructure, decreasing red tape and creating trade and investment opportunities.
- **Increasing interoperability and exchange by streamlining standards:** Internationally agreed-upon standards should be adopted in India across the board, from digitalization to the environment. For example, policies that force companies to localize data, redundant certifications in India for already certified products, or violations of intellectual property rights standards would constitute serious barriers for German companies.

3. Spotlight: The prospect of free trade negotiations

The announcement of restarting trade negotiations between India and the EU during the EU-India-Summit in May 2021 is seen as a welcome step by German stakeholders. Across the board, they feel that a trade agreement would be a huge leap in the right direction for improving the bilateral relationship. Some industry sectors are putting high hopes on an agreement and even regard it as a precondition for a deeper engagement with India, whereas others would welcome successful negotiations while pointing out that even without an agreement some positive developments were already observed in the past.

A case in point is the mechanical engineering industry with an annual share of 25 to 30 percent in the total goods traffic. The sector's duty burden on imports to India has been steadily decreasing since the first decade of the century and currently lies at 5 to 7.5 percent basic duty for most product groups. The sector's exports to India increased by almost 30 percent in 2021, whereas imports from India to Germany grew by almost 40 percent compared with the

previous year, thereby overcompensating for the losses of 2020 due to the pandemic. Moreover, the Goods and Services Tax reform in India has resulted in products such as precision tools being priced more favorably for local customers. For the mechanical engineering sector, the largest bilateral sector, India has improved conditions over time. Moreover, both sides have been working for some time on a uniform approach to standardization. However, with regard to a possible free trade agreement of the EU with India, a complete elimination of the respective tariff barriers and the abolition of additional duties and levies should be the goal.

Other sectors whose India engagement suffers from continued high tariff burdens, are still waiting for barriers to be lowered. The German automotive sector in India, for example, is currently at a disadvantage compared to its Asian competitors due to tariffs on imported components from the European Union. With the FTA between India and ASEAN, where Japanese and Korean manufacturers have a strong base, some components can be exported “duty-free” into India. In contrast, the fiscal burden on fully assembled vehicles from Europe ranges from 66 to a whopping 110 percent, where the highest tariffs apply to vehicles priced above \$40,000, including freight and insurance costs. Here, significant gains can be made from trade and investment agreements between the EU and India.

But when asked about how likely it deems a success of the negotiations with India, the German business community is more inclined towards pessimism. This cautious appraisal is based primarily on the conflicting expectations both negotiation partners seem to have. While the EU prefers a comprehensive trade agreement that would likely include the service sector, this might be perceived as an attack on the many subsistence traders in India’s tertiary sector. They fear that the possible admission of Carrefour and other European trading giants might lead to their extinction and thus to additional social problems. More importantly, comprehensiveness also involves high standards regarding social and environmental sustainability, while India seems to prefer an agreement with an eye on “low-hanging fruits”. Whereas the EU wants to ensure that an increase in trade would not impact negatively on workers and the environment, India points to its own unique conditions, for example by referring to its vast informal sector that can hardly be managed according to European expectations. India’s insistence on the historical responsibility of industrialized countries regarding climate change does not make it easier to negotiate high environmental standards within the scope of an agreement. However, the current discourse in Europe with its focus on sustainability – in which economy, ecology, and society are seen as interlinked – needs to be understood by India as a core aspect of Europe’s strategic positioning.

Furthermore, business stakeholders still remember vividly how the previous trade negotiations had stalled in 2013. They wonder if the changes that have occurred in India since then are sufficiently substantial and warrant a more optimistic outlook. One of the obstacles is the exclusion list of the Indian side, in which those manufacturer groups are listed that would like to see certain products permanently exempted from tariff dismantling.

While the trade and investment negotiations must be pursued with full force and engagement, for the time being, a pragmatic solution to existing barriers seems most promising. Since India will not deviate from its general protective tariff policy in the foreseeable future, one way of easing it – particularly with regard to the Indian Government’s repeatedly stated wishes for investments in the high-tech sector – would be project-related tariff suspensions for required capital goods, both for direct investments and for infrastructure projects.

- **Considering the bigger picture:** Both negotiation parties should conduct the talks with a clear understanding of the opportunities involved. India needs to prepare itself to jump over the hurdles posed by sustainability chapters for the sake of strengthening alliances, while the EU must be prepared to offer India more flexible transition periods or a gradual entry into force of individual modules.
- **Waking up from the FTA fatigue:** Free trade is the backbone of successful economies and leads to immense prosperity gains. The EU and India must explain to domestic audiences that the FTA is part of diversification efforts that reduce overreliance on established trade partners and reduce dependencies.

4. Spotlight: Democratic values and rule of law

German companies in India observe with some concern emerging illiberal and nationalist tendencies like the erosion of democratic values and institutions, deterioration of free speech and repression of (religious) minorities.

Business representatives point out that, within their production facilities in India, Muslims enjoy the same opportunities as anyone else and social responsibility obligations can easily be maintained. There is no concern yet that there could be spill-over effects from wider socio-political setbacks into their business operations.

However, German business does factor India's political development into their investment decisions with regard to the general weakening of the rule of law and of market economy principles in general, such as reemerging protectionism or doubts over the independence of the Reserve Bank of India (RBI).

Moreover, foreign business demands regarding environmental and social sustainability are equally increasing as they become interlinked with economic success, but are hardly met in India. In light of the EU's directive on corporate sustainability due diligence and Germany's supply chain law, discussions with India have only just begun on how the Indian Government can facilitate compliance by German companies, ensuring that there are no violations of fundamental rights and burdens on the environment in local production facilities.

Companies would therefore welcome stronger support by the Indian Government for the prevention and investigation of fundamental rights violations and instances of child labor or suspected cases. In this context, the adoption of the National Business and Human Rights Action Plan would be desirable.

- **Values are hard criteria for investment decisions:** Reinforcing democratic values, rules and institutions, making human rights and the rule of law a strong feature of the Indian system, would be an important contribution to giving India an advantage in competition with other countries in the region with poorer political track records, particularly from the point of view of German companies wishing to diversify their investments.

Conclusion

The strategic importance, the economic potential and dynamism of India is undeniable, as is the need to attempt fostering closer ties. The expectation of German industry is a realization in India that international alliances require a strong will and active steps towards a harmonization of agreed-upon values and standards. By implementing the necessary reforms that make any economy fit for the race in cooperation with its partners, India will not be poised to forever be a future market and has all the potential to feature prominently in diversification efforts of German companies.

However, the determination to be an attractive alternative in the region entails the support for international collaboration based on universally agreed standards, open markets, an attractive investment framework, adherence to fundamental rights and continued bold steps towards sustainable economic development.

These are tasks for all liberal democracies and the economies that support them. But those tasks will be all the easier to solve if common ground is sought and harmonized approaches are developed. Therefore, existing differences need to be addressed in an open manner. At the same time, a focus on what is already working could point to a way forward. It should not be forgotten that many best practice examples exist. The goal is to provide framework conditions for an even stronger Indo-German relationship.

Imprint

Asia-Pacific Committee of German Business (APA)

c/o BDI

Breite Str. 29

10178 Berlin

Germany

www.asien-pazifik-ausschuss.de

Contact

[+49 3020281522](tel:+493020281522)

s.uenaldi@apa.bdi.eu