CHAPTER - III

A HOLISTIC VIEW OF TRADE, INVESTMENT AND DEVELOPMENT COOPERATION BETWEEN INDIA AND GERMANY

The history of Indo-German relations is marked more by cultural links than by economic ties. Students of history are aware how Goethe praised the Sanskrit play “Shakuntala”, how Schopenhauer admired the Upanishads, how Max Mueller was called Moksha Moola and Paul Deussen called Devasena by their Indian admirers in loving appreciation of the pioneering studies made by these German indologists.

While such ‘manna’ of mutual admiration may be nourishing enough in the sphere of literature and culture, it is unfortunately not solid enough to form the basis for profitable trade and commerce between our two countries. The base for sound economic relations between India and Germany was laid much later, and got real momentum only after the independence of India.

The first economic links date as far back as to the 16th century when well known German trading companies from Augsburg and Nuremburg built ships in Lisbon and with the help of the Portuguese, developed a new Indo-German trade route around Africa. The first trading post was started in 1505 on the small island of Anjedip close to Goa. Between the 16th and the 18th centuries, a number of German companies were established with the express purpose of trading with Indian and other East Asian countries, and everyone of them was short-lived and had to be wound up. It was only in the 19th century
that German initiative in reviving trade with India proved fruitful.

Trade statistics in terms of rupees or marks over several decades are rendered invalid by the changes in currency values, but it may come as a surprise to many that the balance of trade was almost always in India's favour until India gained independence and launched its ambitious plans for economic development. The imports of iron and tea, machinery, electrical equipments, chemicals etc. necessitated by the development plans led to a continuing deficit in Indo-German trade, which persisted into the next decades.

The first phase began in the fifties, when Jawaharlal Nehru captivated world attention as the leader of the largest democracy in the world. This was the era when the giant public sector projects of the first 5-year plan was conceived and realized.

The sudden spurt in the volume of imports from Germany, triggered by the delivery of plant and machinery for the first stage of the Rourkela steel project, brought in its wake the first surge of Indo-German (former FRG) joint ventures and established Germany as one of the leading technology partners for the industrialization of India. The early tie-ups between Daimler Benz and Telco and the establishment of MICO-Bosch in Bangalore were characteristic of this period, but at the same time a large number of medium-sized German (former FRG) firms ventured out successfully to set up joint ventures in India. The first Indo-German joint venture after India's independence was with the trading house of Protos Engineering, initiated by Mr. Heller, who subsequently became the founder President of the Indo-German Chamber of Commerce. This booming Gruenderzeit of Indo-German economic relations lasted well
into the middle sixties.

From about 1966 foreign exchange shortage and a consequent policy of self-reliance took their toll. Trade stagnated and the increasingly stringent FERA regulations dampened the appetite for industrial collaboration. This "flat phase" of our economic relations gave way to a new resurgence when Mr. Rajiv Gandhi began with liberalization. Though industrial licensing continued to exist, a spirit of youthful dynamism gave a new thrust to the economic relations between our two countries. German industry presented itself with an impressive show at the 'Technogerma'88' exhibition in New Delhi. Indian exporters started to create an impact in the German market and established themselves as the second largest group of exhibitors from Asia at German trade fairs.

The expansionary phase of the 80's, however, lacked solid foundation and almost came to a grinding halt in 1991. Faced with an extreme foreign exchange shortage and a huge internal deficit, the Indian government clamped down heavily on imports and expenditure while simultaneously launching a bold programme of economic reforms.

Few would have thought, in that year of crisis, that this marked the beginning of India's most successful growth phase. Germany, after a slow start, fully participated in the ensuing boom, resulting in the record trade and cooperation figures. Since the year 1991 both trade and industrial cooperation with India have doubled, launching the most intensive phase of Indo-German economic cooperation yet.
Unification and Indo-German Trade Trends:

Germany after its unification, is looking for stable partners and India fits ably into this slot. India not only has a big market and skilled labour force but also minerals. With German technology and management skills, coupled with India’s human resource the two countries could actively participate in reconstruction projects in West Asia and other parts of the world. Moreover, after unification, Germany is emerging as a key power both economically and politically, within Europe.

On the other hand, Germany can also ill-afford to miss the boundless economic opportunities prevailing in India in the wake of India’s liberalization of its economy. Germany is obviously concerned about enlarging its market access in South East Asian region which accounts for over a quarter of the countries total trade. In the past, flow of trade moved towards Eastern Europe. Today, the cosmopolitan spirit of commerce has found a new direction: Germany wants to be part of Asia although East Europe remains its main focus of economic activity.

Germany’s Asia-Pacific content:

Business and government circles in the Federal Republic made their eastern ambitions plan in September 1993, when they adopted the “Asia-Pacific concept” leading to the establishment of the Asia Pacific Committee. The Asia-Pacific committee which involves close interaction of industry, trade, the bilateral chambers of commerce in Asia, and the German government, aimed at overcoming the perceived under-presentation of the German economy
in the region which is now recognized as the main motor of economic growth in the region. The Asia Pacific Conference held in Bangkok drove home German industry’s resolve to establish itself as a major player in Asian markets.

The new era of liberalization has added to India’s appeal considerably. The growth of India’s own trade with its Asian neighbours is now generating fresh enthusiasm among German industry. For German industry, this will not be regarded as dangerous competition but as a potentially profitable synergy, adding a new dimension to its traditionally strong links with India. This has already been happening, with India playing a growing part in the strategic calculations of major German companies repositioning themselves in Asia. India, it is realized, has the double advantage, not found in many other Asian countries, of having a large, rapidly growing home-market, while offering an excellent service, engineering and production base for the larger Asian region. In fact, the only other nation in the same order of magnitude, as it were, is China.

To be sure, China has been a major magnet for western investment, and German investment in particular. China’s flirtation with the market began earlier than India’s economic reforms and it has plainly reaped the benefits. In the long-run however, India has some significant advantages that China will not be easily equal to. Chief among them is the fact that India’s market culture is organic to its society, and that private enterprise has developed hand-in-hand with the Indian state. Further more, India’s robust and well-balanced administrative, legal and democratic political structures are a major plus point
for long-term foreign investment.

What has been even more remarkable than the overall growth of trade, has been the structural change in the composition of India’s exports on the one hand, and Germany’s continuing role as a supplier of high-tech, even in the face of increasing consumer goods imports today. In the first three decades, i.e., in the 50's, 60's and 70's Indian exports to Germany consisted overwhelmingly of traditional goods, raw materials and semi-finished products. The years since the 80s have seen the emergence of India as an exporter of finished goods or products.

- raw cotton and cotton fabrics gave way to readymade garments, leather and leather garments, and shoes.
- raw chemicals to intermediates.
- while India remains an important exporter of iron ore (mainly to Japan) finished steel items and a growing list of engineering goods have found their way to the German and European markets.
- the arrival of software products as substantial Indian export item shows that India has successfully bridged the technology gap in one of the most dynamic growth sectors of the world economy.

Indo-German trade has seen a steady growth. India’s exports to Germany have growth with an enormous speed, much faster than the supplies to other countries. In DM terms, they made a quantum jump from 1.6 million in 1987 to DM 2.8 million in 1992. I 1991, Indian exporters reached a surplus of DM 377 million in trade with Germany for the first time in history. This
marked a sea-change. Only seven years before this, the German surplus was as much as early DM 2 billion. (See Table 1).

Table 1: Indo-German Trade (in DM million)

The loss of the small former GDR market could already be compensated as a consequence of the strong German import demand-pull after the unification. Even in 1992, when the world economy suffered from a recession, the exports to Germany nominally expanded by 1 percent (in DM), that too, when the post-Ayodhya disturbances in December took their tool of India’s export. More than 80 percent of supplies to Germany consisted of garments, textiles, leather products and gold jewellery. Indian entrepreneurs have made considerable progress. With better quality, workmanship and modern facilities, they have entered the higher market segments.¹

¹ Dr. Dietrich Kebschull, “Steady Growth”, The Hindustan Times, Special Supplement, (New Delhi), 19.2.93.
In the traditional sector, particularly in the production and export of agricultural and marine goods the possibilities for higher value addition had not yet been fully exploited. Items like tea and coffee offered good chances in this context, if they were suitably blended and packed in the country.

The new German Ordinance for packaging materials which came into effect in December 1991, stipulated that packaging materials must be taken back by the seller independently of the public waste disposal system for reuse, and recycling. The Ordinance further stipulated that materials which can cause health and environment hazards must be disposed off in certain ways. The need for such an Ordinance was felt necessary in Germany as the country had to dispose millions of tonnes of waste from packaging materials annually at high costs.

In view of this Ordinance, Indian exporter had to follow new German regulations on packaging materials or else they would lose the German market if they did not comply. As the new regulations had caused considerable costs, the German manufacturers and traders are steadily adopting a system called “Green Dot” to cope with the new task of waste disposal. The Green Dot is given for packaging materials if the seller guarantees to take back the materials. Therefore, unless the packaging material of the Indian products qualifies to get Green Dot symbol, the Indian goods cannot enter the German market.²

The total value of Indo-German trade in 1992 was registered at DM 5,430.4 million, an increase of 7.1 percent over the previous year. However, Indian exports to Germany in the value of DM 2,688.4 million showed a

² German norms may hit Indian Exports” News time (Hyderabad), 19.1.92.
decline of 2.9 percent from 1991 and imports from Germany amounted to DM 2,841 million indicating an increase of 18.7 percent. Hence 1992 showed a trade deficit of DM 156.6 million for India as against a surplus of DM 377.2 million in the previous years.\(^3\)

Indian exports to Germany included food products, beverages, tobacco, tropical fruits, tea, raw materials, cotton textile fabric, web from wool and animal hair and leather products like shoes and garments. Indian imports from Germany included raw materials, refined potassium fertilizer, chemical products and machinery. Exports of two major groups; finished products and semi-finished products had received a tremendous boost.

Semi-finished products eg. cotton textile fabric touched DM 110 million. During the year 1992, the food and beverages sector emerged as a major success in Indian exports to Germany constituting 6.7 percent of the total exports, registering an increase of 13.4 percent over 1991. It was followed by raw materials with its share of 3.3 percent of exports, a rise of 12.8 percent over 1991 and semi-processed products with a 4.1 per cent share in the export basket showing a positive growth of 5.9 percent over the previous year.

1992 showed a decline of imports of raw material from Germany. With its 0.5 percent share of imports, the dip recorded was 12.8 per cent. However, the over-all rise in imports from Germany contributed largely to the trade deficit for India. Further, India's liberalized import policy and relaxation of foreign exchange regulations have been a catalyst for imports from Germany.

After stagnating around DM 5 billion for some time, India's total trade with Germany during a full calendar year crossed DM 6 billion for the first time in 1993. This was an increase of over DM 700 million in a single year, 13 per cent up over 1992. In fact, the track record for Indo-German trade logged many firsts in 1993. A 20 per cent jump took Indian exports to Germany to over DM 3 billion, a landmark in the history of Indo-German trade. Cotton fabrics and garments (25 per cent), leather and leather goods (21 per cent), woolen carpets (11 per cent) and silk fabric and garments (9 per cent) were the four main product groups.\(^4\)

During the same period, the carpet industry faced problems related to child labour. Therefore, RUGMARK was emphasized as a pragmatic and promising approach to reduce child labour in the carpet industry. To avoid a legal ban on carpet imports as proposed in the United States as proposed by Senators Harkins and Brown as well as a collapse of the market because of a consumer boycott, the idea of RUGMARK, a carpet label was introduced. According to the RUGMARK Certification Scheme, the carpet exporters as well as production units commit themselves not to employ children under 14 years in the production of carpets, and to pay their workers at least the official minimum wages. The exporters made available to the RUGMARK Foundation a complete list of looms or sources from which they procure their carpets. These lists are regularly updated. All such looms units must be registered with the Carpet Export Promotion Council.

\(^4\) Ibid.
The exporters of carpets agree to have their looms and premises inspected by professional inspectors of RUGMARK Foundation at any time without prior notice. The compliance with the RUGMARK principles is monitored through inspection of the looms as well as the exporters’ premises by professional inspectors who are employed and supervised by the Foundation. Additionally, non-governmental organizations in the carpet producing areas monitor the commitment of the carpet manufacturers and exporters towards non-employment of child workers.\(^5\)

Till end May 1995, more than 100 companies had sent in their applications. 25 of them had already been registered and more than 36,000 carpets with RUGMARK labels had been shipped to Germany.

At DM 679 million in 1993, leather exports were the largest items of export to Germany in 1994. The range included processed leather, footwear, garments, accessories, sports goods etc. In 1993, exports closed with a 27 per cent increase and the 1994 account opened at over 42 percent in the first quarter. Cotton fabrics and garments were DM 790 million of the total exports to Germany in 1993 and silk and silk products accounted for another DM 301 million. Their 1993 growth of 16 per cent (cotton) and 3 per cent (silk) had accelerated to 28 per cent and 7 per cent during 1994.

Making a strong case for the trend in Indian exports to Germany towards more technical rather than traditional goods; the auto ancillaries industry nearly doubled its exports to Germany in 1993. An 84 percent increase had taken exports to DM 72 million and in 1994 business with Germany was still

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\(^5\) Dr. Dietrich Kebschull, “RUGMARK for more exports and less exploration” German News, German Embassy (New Delhi), July-August 1995.
expanding. As per a report from one of Germany’s leading car manufacturers, Indian auto components were figuring prominently in the German auto industry’s global sourcing. Transmissions, axles and other crucial components made in India are going into the production of a new range of heavy vehicles.

India’s total imports from Germany during 1993 were to the tune of DM 3.005 billion. In 1994, imports from Germany declined by 14 per cent against the backdrop of delayed investment decisions, doubts among entrepreneurs regarding future developments in a market characterized by growing competition, a high foreign exchange rate and comparatively high custom duties. At nearly DM 7 billion, Indo-German trade was only 10 per cent higher in 1994. Exports of DM 3.49 billion yielded a marginal surplus over imports from Germany, valued at DM 3.34 billion.

In a situation where a booming Indian industry was looking for swift and efficient solutions to its growing needs of machinery and equipment, German suppliers were rising to the occasion. The 11 per cent increase in imports from Germany at the end of 1994 had accelerated to a 50 percent rise by March 1995. Statistics reflect intensified cooperation in the areas of industrial machinery, in particular, machinery for the textile and leather goods industries, power generation and telecommunication while iron and steel goods imports dipped in 1994.

In fact, India’s import account with Germany, one of the world’s leading suppliers of high-tech echoes the home industry’s committed pursuit of “technology for the competitive edge.” With a share of 44 percent machinery is

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the largest import sector, chemicals and pharmaceuticals have 16 per cent, electronics and precision instruments account for another 13 per cent. 14 per cent of India’s imports from Germany were iron and steel goods; vehicles make up 4 percent. India’s total imports from Germany during 1994 were to the tune of DM 3.341 billion and crossed DM 4.574 DM billion by March 1995.

At the helm of growth in early 1994, exports had to relinquish this stewardship by the year end, set back by conditions at home that adversely effected India’s business worldwide. The downtrend in exports to Germany had continued into 1995 with carpets, leather goods, fabrics, coffee and tea – all exports winners on the German market declining sharply. Garments however continued to do well with Indian designers drawing an exclusive clientele worldwide. The total Indo-German trade during 1995 crossed over 8 billion. Indian imports from Germany were to the tune of DM 4.6 billion and exports to Germany were to the tune of DM 3.6 billion. The total volume of India’s trade with Germany stood at DM 8.175 million.

Whereas the traditional sector for Indian exports for Germany had low and even negative growth in 1995, its technical exports to the country continued to make progress. Auto ancillaries maintained a 20 per cent increase and crossed DM 100 million in 1995, while the electronic sector achieved a 31 per cent increase (DM 61 million). Pharmaceutical exports also gained ground and were up by 45 percent of DM 53 million. 7

This positive growth, however, was weighed down by the traditional sector which at that time still made up the bulk of exports to Germany. Cotton

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garments and fabrics (DM 840 million) were down by 4 per cent, leather and leather goods (DM 745 million), silk fabric and garments (DM 340 million) and gem and jewellery (DM 121 million) slid down by 5 percent each. Carpets, rugs, garments of wool at DM 280 million looked down by 15 per cent.

Coffee exports plummeted with a recovery of world supplies (-68 per cent) while tea gained 8 per cent to DM 72 million. Meanwhile, imports from Germany increased in a specific sector. India’s machinery imports from Germany, the world’s leading manufacturer for quality engineering, zoomed 53 per cent to cross DM 2 billion in 1995.

That German companies wish to foray into the Indian market, sounds common enough but there was a difference in 1995. A delegation of eleven German software companies (a 100 member delegation) from the Federal State of Baden-Wuerttemberg had arrived in India in 1995 to explore the Indian scene in software and gauge the possibilities of tie-ups with Indian organizations. This is, in fact, the first time a German hi-tech delegation came to India, which wanted to source from India, and which was not planning to sell. The importance that these German companies attached to their employing Indian skills in software, shows the impact that India is making on the West in the software sector.

Indo-German trade achieved a total value of DM 8.6 billion during 1996, a modest increase of 6 per cent over the previous year. Unravelling quarterly data for 1996 shows an increasing pace for exports and a slowdown of imports, swinging the trade balance in India’s favour. The 1996 deficit was down 36 per
Exports to Germany gained a healthy 10 per cent in 1996, closing within a hairs breadth of the 4 billion mark at DM 3.96 billion. Among the markers ticking off growth, technical goods and chemicals, and pharmaceuticals were prominent. Rising rapidly, India's technical goods exports to Germany were moving into the ranks of the major items. This has, in fact, opened up a promising flank for more balanced and broad based exports to Germany. While cotton textiles and garments (DM 908 million) and leather and leather goods (DM 724 million) had the largest volume of exports, their growth pales in comparison with India's ancillaries exports for the transport industry. This sector has unspooled a series of sharp increases (1994 and 1995: + 20%, 1996: + 188%) to achieve the third position among India's leading exports to Germany. In an export volume of DM 303 million for ancillaries exports, the auto sector was strongly represented, with aviation making a significant breakthrough in 1996. Also on the growth trajectory were chemicals and pharmaceuticals exports which gained the sixth position (up 22%) and electro technology (up 18% to DM 71 million). Major items like silk fabrics and garments, carpets and gem and jewellery were in the minus column. The agricultural sector recorded some gains with tea (DM 85 million), tropical fruits (DM 82 million) and coffee (DM 71 million), faring well.

Imports from Germany continued to focus on refurbishing infrastructure and updating production capabilities of Indian industry. However, there was a slowdown of expansion plans and a restraint on new projects, due to high

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interest rates and political uncertainty. With that total imports from Germany showed a sluggish growth of 2.4 per cent and were valued at DM 4.7 million in 1996.

Availing of Germany’s leading-edge technology in engineering, India imported DM 2.4 billion worth of machinery in various categories in 1996. Machinery imports made up 52.2 per cent of total Indian imports from Germany with textile machinery as the largest group, followed by machine tools. Imports for the transport sector included automobiles, bicycles, aviation and shipping. Imports increased firmly (up 12%) with automobiles as the dominating sector. Electronics imports expanded marginally by 2 per cent.

Key import sector recorded sharp falls in 1996:
- chemical imports with fertilizers making up a significant volume.
- iron and steel goods.
- in the machinery sector, a sharp fall was evident for textile machinery, machinery for the leather goods’ industry and paper and printing industries.

However, as Germany’s technological prowess gained more and more in demand, the finished goods category of imports into India grew to 80 per cent in 1996.

Rapidly expanding exports had also helped reduce the trade deficit substantially. In fact, India even achieved a surplus during 1993 and 1994, despite rising imports from Germany. But with a 37 per cent jump in imports in 1995, the deficit reappeared at DM 970 million and again at DM 728 million in
1996 as imports edged higher by 2.4 per cent.

During 1997, trade between India and Germany remained more or less static, but there was strong growth for chemical exports to Germany. There was a marginal change of – 0.6 per cent in the Indo-German trade volume of 1997. The total for two-way trade stagnated at the previous year’s figure of DM 8.6 billion.

Brisk import trade which had provided the motor of growth in the early nineties slowed down. On the flip side, stronger exports tipped the trade balance once more in India’s favour. The deficit in India’s trade with Germany was down by more than half at just DM 304 million.

Exports to Germany gained 4.4 per cent in 1997, crossing the 4 billion mark for the first time at DM 4.2 billion. Major traditionals clocked modest growth rates, while chemicals and pharmaceuticals surged ahead, providing a useful prop for export growth. India’s chemical exports to Germany jumped 58 per cent, adding as much as DM 150 million to last year’s total. This means an export volume of DM 409 million in 1997, it also means that chemicals and pharmaceuticals were then in the front ranks of India’s exports to Germany, providing 10 per cent of the total export volume.

Cotton fabrics and garments were leading as the largest export item with DM 885 million (21% of total exports). Leather, including footwear and leather garments was second, up 4 per cent over previous year at DM 753 million. Chemicals gained the third position, and was followed by carpets of wool and silk fabrics and garments.

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Auto ancillaries which had been hitting fresh high each successive year did not fare well in 1997. Faced with a difficult climate at home, the industry's exports to Germany plummeted 37 per cent to DM 193 million.

India's exports in the category of electro technology gained 17 per cent to reach a total of DM 83 million. Also on the growth trajectory among traditional items of exports were gem and jewellery (up 17 per cent), and coffee (up 59 per cent). Tea exports declined 6 per cent, whereas tropical fruits steadied at DM 95 million.

Total imports from Germany dipped 5 per cent in 1997 to DM 4.5 billion. Machinery, the mainstay of Germany's import trade with India had only 40 per cent of the total import volume (1996: 52%); 1997 imports closed at DM 1.8 billion. All major categories were off on highs with the exception of printing and food processing machinery which saw a healthy increase of over 25 per cent. Textile machinery continued to be the largest item followed by machine tools.

Gaining in on a larger share with over 20 percent growth in 1997 were:
- electro technology: DM 687 million, up 24 per cent over 1996.
- chemicals and pharmaceuticals: DM 651 million, (up 24 per cent)
- imports for the transport sector which included automobiles, bicycles, aviation and shipping DM 263 million (up 20 per cent). Automobiles was the dominating sector.

Iron and steel goods were in the minus column with a fall of 6 per cent.

While the trade balance tipped in India's favour yielding a surplus of
DM 356 million, bilateral trade between India and Germany experienced a further slowdown of 6 per cent in 1998. The volume of Indo-German trade decreased by DM 506 billion (-6 percent) to reach a figure of DM 8.1 billion. The main reason for this decline was on account of the sharp drop in imports (-13.1 per cent).10

Indian exports to Germany, which registered a 2 per cent growth during the year 1998 was mainly on account of the increase in technical goods supply to Germany. Exports of most traditional goods remained either static or declined, while certain technical goods showed an impressive swing in valuations. Electro-technical goods exports to Germany jumped 51% to DM 125 million. Chemicals goods increased 17 per cent to DM 480 million, where growth was concentrated in the areas of primary and semi-finished chemicals. Pharmaceuticals improved marginally to DM 93 million. While iron and steel achieved a nearly 40 per cent increase to DM 75 million. Silk fabrics and garments were up 22 per cent to DM 305 million. Gem and jewellery exports increased by 7 per cent to DM 134 million. Total Indian exports to Germany increased by 2 per cent to DM 4.2 billion.

Lower orders from the Indian industry resulted in a 13 per cent decline in imports from Germany. Curbed by recessionary trends and cautioned by an uncertain political climate, Indian industry’s high-tech requirements were markedly reduced, which reflected in the import account with Germany. In fact, imports in all categories were down. Total Indian imports dropped 13 per cent to DM 3.8 billion.

10 Indo-German Chamber of Commerce, Annual Report 1999: Economic Cooperation, (Bombay, IGCC, 1999), p.11
With 40 percent, machinery retained its dominant position in the Indian import basket. After the introduction of reforms in 1991, imports of machinery grew substantially and in 1996, machinery accounted for more than 50 per cent of total Indian imports from Germany. The first decline came in 1997 and the negative trend continued in 1998, however, with a reduced tempo. On account of the increase in the cost for German machinery due to the strong DM in 1996, the Indian industry turned to other markets for buying machinery. Sluggishness of the Indian economy is another reason for the setback in imports of German machinery. Textile machinery still retained its leading position among machinery imports followed by prime movers and machine tools.

Imports from Germany were down in major categories. Machinery imports were down by DM 215 million to DM 1.6 billion. Chemicals and pharmaceuticals were down by DM 44 million to DM 607 million. With a minus of 33.5 percent and a total of DM 200 million, imports in the transport sector which include automobiles, bicycles, aviation, shipping, the drop in imports was particularly sharp. There was a reduction in imports of electronic goods of DM 516 million. Iron and steel was also in the minus column with imports declining almost 19 per cent to DM 214 million.

Indo-German trade declined 4 per cent in 1999. The total for two-way trade was down to DM 7.76 billion. Imports from Germany which have been on the decline since the highs of the early nineties, dropped 7 per cent. Exports
too dipped 2 per cent. However, the trade surplus in India’s favour improved to DM 534 million.\textsuperscript{11}

Exports to Germany crossed DM 4 billion despite the 2 per cent decline in 1999. Major traditionals were down except silks (up 7 per cent) and gem and jewellery (up 13 per cent). After some years of double-digit growth, chemical exports fell by 8 per cent. But pharmaceutical exports continued to rise: up 18 per cent, exceeding DM 100 million for the first time. India’s total exports of chemicals and pharmaceuticals to Germany were DM 427 million or 10 per cent of export. A 16 per cent increase in the export of auto ancillaries was achieved in 1999. India’s exports in electronics crossed DM 100 million in 1998 and reached DM 141 million in 1999. Cotton fabrics and garments continued to be the largest export item with a value of DM 815 million (20% of total exports). Leather, including footwear and leather garments was second down 8 per cent over 1998 at DM 427 million. Chemicals were in the third place, followed by silk fabrics and garments and carpets of wool.

Indian imports from Germany which had focused on machinery and high-tech goods dipped further by 7 per cent in 1999 to DM 3.61 billion. The depressed business climate and lack of investment activities by Indian companies did not promote the import of capital goods as it did in the early 90s.

Machinery supplies from Germany dropped 21 per cent and were in 1999 only 34 per cent of the total import volume (1998: 43%). 1999 imports closed at DM 1.2 billion. All major categories were down with the exception of

food processing machinery where imports increased over 130 per cent to DM 22 million. Textile machinery continued to be the largest item followed by machine tools.

Gaining in on larger shares in 1999 were electronics, i.e., DM 548 million, up 6 per cent over the previous year; chemicals and pharmaceuticals up by 11 per cent or DM 672 million. Imports for the transport sector which include automobiles, bicycles, aviation and shipping declined 22 per cent to DM 157 million. Iron and steel goods declined 43 per cent of DM 121 million.

After three years of decline, Indo-German trade was on the uptrend again in the year 2000. The total trade volume was 8.83 billion. Exports to Germany rose 14.5 per cent to cross DM 4.7 billion. Pharmaceutical and chemical exports showed a strong growth of 24 per cent and were the third largest export item. Cotton fabrics and garments were up by 10 per cent or DM 892 million.

Imports from Germany were worth over DM 4 billion and mainly comprised machinery, chemicals, electro technology, iron and steel and vehicles and ancillaries. An over 50 per cent growth in imports was recorded in the auto sector.12

What has no doubt contributed substantially to India’s success story on the export front is the constant flow of technology through industrial collaborations. German industry, right from the beginning, was always more than a supplier of goods to India, periods of high export were always accompanied by large flows of investment and technology. Rourkela,

Germany’s first and biggest aid project became the cradle of Indo-German industrial collaboration. The development aid for projects between Indian and Germany is transferred on a Ministry to Ministry basis with no involvement from a third party. Additionally, there is no binding for Indians to purchase any machinery or tools for the projects from the aid as it is provided by Germany directly. In other words, financial assistance is normally accompanied with technical assistance.13 And even since 1991 – the post liberalization era, the new spurt of German exports to India has led to an equally impressive boost in new investment and technical cooperation projects. The interaction is threefold:

a) A high demand for German products in India always meant additional opportunities for producing “German goods in India”.

b) At the same time every new joint venture in India has meant additional demand for machines, equipment and other inputs from Germany.

c) Finally up-to-date technology and marketing know-how has opened up new export opportunities in Germany and Europe.

Since 1991, when the economic reforms were introduced, success of the reforms is considered with reference to not only the number of joint ventures sanctioned by the Government, but also with reference to the volume of foreign investment proposed in them. While Germany is prominent in the number of sanctions, it is less so in regard to the volume of investments. One reason for the lower volume of investment is that majority of German collaborators bringing in their new technologies into India are small and medium-sized

13 Interview with Ms. Paramita, KfW, New Delhi, 7.6 2004
companies. A second reason is that the German collaborations are mainly in respect of technical products, and not for consumer goods.

At the end of 1991, German foreign investment in India was to the tune of Rs.418 million in 1991; Rs.863 million in 1992; Rs.1759 million in 1993; Rs.5694 million in 1994; Rs.13395 million in 1995; Rs.15379 million in 1996; Rs.21558 million in 1997; Rs.8538 million in 1999; Rs.11430 million in 1999 and Rs.5938 million in the year 2000 respectively. (See Table-2).

Table 2: German Investment India (in Rs. million)

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In the initial stages of the economic liberalization, it was claimed that the Government of India approved of almost all foreign investment proposals
and that hardly any applications had been rejected. Of late, however, proposals are being subjected to closer scrutiny with regard to the following criteria:

- whether the technology offered is of importance to India.

- the project has export potential.

- the project is capable of creating a substantial number of jobs.

- there also seems to be a growing reservation against allowing very high foreign shareholding, i.e., more than 74 per cent in proposed ventures, eg., the rejection of a chewing gum manufacturing firm’s proposal to raise equity from 85 to 100 percent, an airlines’ joint venture and also a joint venture for retail trading in consumer goods.\(^{14}\)

Apart from these instances, India’s foreign collaboration policy continues to be liberal.

It may be observed that Indo-German investments and collaborations during the pre-unification years had its own pattern of gradual increase. Beginning with such high-profile collaboration of Rourkela Steel Works in 50’s, the Indo-German investment and collaborations gained momentum only in the 60’s with 68 collaboration agreements in 1968. Subsequent years did not find any major momentum until the beginning of 80’s when a record number of agreements totaling 183 was concluded in 1986.

The Indo-German collaboration, joint venture and investment agreements had a new phase and escalating tread since the unification. Broadly,

this greater collaboration and joint ventures could be attributed to the transformed environment both in India and in Germany. The Indian economic liberalization and reforms provided greater opportunity and conducive environment and attractive economic returns for German investors. On the German side, the unification too transformed and integrated the East German economy with West German economy and the principles of normal market economy started taking shape in prioritizing overseas investments for better economic returns. Thus, soon after unification there is a greater number of Indo-German collaborations, joint ventures and investments. In statistical terms as shown in Table 3 in the year 1991, there were as many as 157 Indo-German collaborations and joint ventures. This figures although was less than the figure of pre-unification year of 1986, was precursor of greater collaborations that were to follow in the succeeding years. Indeed, the 1992 statistics reiterate this aspect when the figure 198 collaborations and joint ventures are taken into account. This figures is not only more than the record figure that was achieved in 1986, the content of collaborations and joint ventures too are significant. In 1993, the figure 174 collaborations and joint ventures was a little lower than the previous year. In 1994, the number increased to 217 collaborations and joint ventures. In 1994, the number increased to 217 collaborations and joint ventures. Since 1993, the figure of collaborations and joint ventures increased every successive year reaching the record joint collaboration and joint venture totaling 252 in 1995.
Another feature of the Indo-German collaboration and joint venture had been during the period under review is financial investment. Each financial assistance came either as part of the technical collaboration or modernization of the existing collaborations. What may be significant in observing would be that the financial investment agreements also increased simultaneously in relation to the increasing Indo-German technical collaborations. Based on the figures in Table 3, it may be observed that in 1991 there were 35 financial agreements and this increased every successive year and thereby reaching a total of 129 financial agreements in 1995. What is significant is that financial agreements in 1995 was more than technical assistance. This meant that the Indo-German collaborations in the field of financial agreement was not tied only to the Indo-German technical collaborations.

15 Collaborations sanctioned by the Indian Government.
Industrial co-operation between India and Germany progressed further in 1996 with 269 new Indo-German tie-ups approved by the Government of India. German firms increased their financial commitment in partnerships with Indian firms with 23 per cent more joint ventures. In fact, joint ventures exceeded licence agreements for the second year in succession, a development directly attributed to the Government's policy of economic liberalization introduced in 1991. At 159, joint ventures were 59 per cent of the total number of new Indo-German tie-ups in 1996.

Though sanctioned German investments jumped 40 per cent, Indo-German collaborations were less by 6 per cent in 1997, but at 254, the number is substantial. In fact, more German firms have been opting for financial participation in collaboration agreements with Indian partners. This has been an on-going trend, telescoping the change brought about by liberalization. In 1997, it translates into a 63 per cent joint venture content.

193 Indo-German collaborations were sanctioned by the Government of India in 1998 out of which 108 had financial participation. This indicates a decline of 24 percent in technical and 32 percent in financial collaborations in the year 1998. This is also the fourth year in succession that there were more financial than technical collaborations.

The decline in the total number of foreign collaborations as well as of Indo-German collaborations sanctioned is attributed to the recessionary conditions prevailing in the Indian economy and the slowing down of the liberalization process after the initial euphoria.

The number of Indo-German collaborations sanctioned in 1999 by the
Government of India was 208, out of which 139 had financial participation as well. This is the fifth year in succession for Indo-German collaborations to have more financial collaboration. It implies that in 1999, 67 per cent of the new approvals were for joint ventures.

Joint ventures continue to outnumber mere licence agreements in the new millennium. 131 out of 201 agreements in 2000 has financial participation.

The regionwise split-up of the Indo-German collaborations sanctioned each successive year shows that Mumbai-Pune has the largest number of collaborations followed by Delhi-Faridabad area and Calcutta (see Table 4). As for the figures in Table 4, it shows that the same region continue to attract more collaborations.

**Table 4: Region wise Indo-German Collaborations (Joint Ventures in brackets)**

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<tr>
<td>Total There of:</td>
<td>157(35)</td>
<td>198(81)</td>
<td>174(76)</td>
<td>217(96)</td>
<td>252(68)</td>
<td>269(159)</td>
<td>254(159)</td>
<td>193(108)</td>
<td>208(139)</td>
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<tr>
<td>Bombay-Pune</td>
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<td>67(28)</td>
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<td>13(10)</td>
<td>13(10)</td>
<td>18(140)</td>
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<td>18(4)</td>
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<tr>
<td>Maharashtra (excl. Bombay/Pune)</td>
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</table>

While the industrywise splitup of Indo-German collaborations shows that industrial machinery has been leading each successive year followed by
chemicals and pharmaceuticals (Table 5). As per the data in Table 5, it is interesting to note that Germany has in the recent past started showing interest in consumer goods as well.

Table 5: Industrywise Indo-German Collaborations (Joint Ventures in brackets)

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<td>157(35)</td>
<td>198(81)</td>
<td>174(76)</td>
<td>217(96)</td>
<td>252(68)</td>
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<td>254(159)</td>
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<td>Machine Tools</td>
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<td>13(9)</td>
<td>11(5)</td>
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<td>6(4)</td>
<td>2(2)</td>
<td>11(11)</td>
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</table>
However, though the number of collaborations sanctioned increase every year, there is a wide discrepancy between the number of sanctioned collaborations and those in operation mainly because of the following reasons: Technical collaborations are sanctioned only for a limited period of 8 to 10 years at a time. Many agreements of earlier years have expired in the meantime. Also, it is pertinent to recall that not all Government sanctions lead to effective agreements. Some of the sanctions simply lapse without implementation of any agreement, either because the parties cannot concur on the precise terms and conditions, or because the changed economic circumstances, render it unprofitable to implement the projects. About a quarter of all the sanctions are thus infructuous, and another 10 per cent of the sanctions represent merely extension of existing agreements.\(^\text{16}\)

**Present Policies and Procedures**

The economic liberalization in progress since 1991 continued during the years and culminated in the enforcement of the Foreign Exchange Management Act, 1999 (FEMA) with effect from June 1, 2000, replacing the earlier Foreign Exchange Regulation Act, 1973 (FERA).

**From FERA to FEMA:** FERA, enacted in 1973 in the context of recurrent foreign exchange scarcity, sought to control and restrict foreign exchange transactions. The transactions allowed under it were permitted by separate notifications and circulars. Procedures for many transactions relating to trade and investments were liberalized in recent years through successive

\(^{16}\) Interview: Mr. P.P. Kapoor, *Economic Division*, German Embassy (New Delhi).
notifications, and the numerous changes called for a consolidated law on the subject. Accordingly, what was earlier provided by the notifications has became part of the new law FEMA. Current account convertibility, for example, is now the law itself, rather than a concession made by notifications under FERA.

The Reserve Bank of India, by its A.D. (M.A. Series) Circular No. 11 of May 16, 2000 has advised all the banks to take note of its Notifications dated May 3, 2000 under the new law, and to ensure that all foreign exchange transactions taking place with effect from 01 June 2000 are governed by the new rules. Pending issues of further instructions, the banks were to be guided by the existing provisions of the Exchange Control Manual in all other matters.

While capital account transactions (transactions in property and investments and lending and borrowing money) will need Reserve Bank permission as before, other transactions on current account (payments relating to foreign trade, foreign travel and education, interest on loans, etc.) can now be made without any need for such permission. The upper limits applicable to some current account transactions had been substantially enhanced, and these transactions would need Reserve Bank permission only if they exceed the prescribed ceilings e.g. the earlier limit of US$ 1,000/- for sending a gift abroad has been raised to US $ 5000/-, no permission is needed for availing of foreign exchange up to US$ 25,000/- per business trip irrespective of the period of stay etc.

CCFI Approval for large Projects: Joint ventures with foreign equity of more than Rs. 6 billion, going beyond the scope of the FIPB, are decided by
the Cabinet Committee on Foreign Investment. The applications for approval have to be submitted to the SIA, (Secretariat for Industrial Approvals) as in other cases..

**SSI Units:** A SSI (Small Scale Industry) unit is one with investment worth not more than Rs.10 million in plant and machinery. By way of promoting such small units, 810 products are at present reserved exclusively for manufacture in the SSI sector. The upper limit for foreign shareholding in a joint venture to produce a reserved item is 24%, when the production is meant mainly for the domestic market. If the proportion of such shareholding is more, the SSI unit loses its SSI status and the right to produce a reserved item, unless the output is meant for export abroad.

**EPZ/EOU Units:** Foreign equity up to 100% is allowed in joint ventures set up in any of the Export Processing Zones (EPZ Units) or as 100% Export Oriented Units (EOUs) anywhere else in the country.

**STP / EHTP Schemes:** The Software Technology Park (STP) and Electronics Hardware Technology Park (EHTP) are two schemes operated by the Department of Electronics (DoE) for promoting the export potential of electronic components and software. They are similar to the above EPZ / EOU schemes and foreign equity up to 100% is allowed in joint ventures set up under these schemes.

**Branch Offices:** Foreign companies are allowed to open branch offices in India for specified activities like research, export and import, and promotion of technical and financial collaborations with overseas companies.

**Automatic Route of the RBI:** Both for 100% subsidiary companies and
joint ventures, being in the automatic route means there is no need for prior approval from the RBI either for receipt of funds from or for issue of shares to their foreign collaborators. This applies to foreign investments in EPZ/EOU/STP/EHTP units also.

The subsidiary / joint venture company is free to issue shares (both equity and preference shares) to its foreign collaborators, if its approval is coming within the scope of the RBI’s automatic route, or if the proposal has received SIA / FIPB approval and conditions stipulated in the SIA/FIPB approval letter are duly complied with.

Within 30 days of receipt of the above funds, the subsidiary / joint venture company has to inform the concerned regional office of the RBI of the fact of the receipt, and within 30 days of issue of shares to the foreign collaborators file the prescribed documents with that office.

While the inflow of foreign investments has been facilitated in this manner, payment of any remuneration to the foreign collaborators for transfer of their know-how to their Indian subsidiary / joint venture company requires prior approval of the concerned Regional Office of the RBI, to be obtained by submission of the details of proposed payments in the prescribed form FT (RBI).

The automatic route for investing in India is not open to 13 sectors that is banking, non-banking financial companies, civil aviation, petroleum, housing and real estate development etc. For 7 sectors, the percentage of foreign investment in the automatic route can only be up to the cap /ceiling applicable to each category. For example, the cap is 49% in telecom services, 49% in
public sector units in coal and lignite mining, 74% in drugs and pharmaceuticals, 51% in hotels and tourism, and so on.

Moreover, the automatic route is not open to investment proposals, which requires an industrial licence (alcohol, cigarettes, explosives etc) which plan to produce items reserved for small scale sector (garments, leather shoes, domestic utensils, etc.) which are located within 25 kms, of specified metropolitan centres, and where the foreign collaborators have or had another collaboration in India.

Having regard to the many exclusions from the automatic route, and the fact that the SIA can grant simultaneously approval for foreign investment as well as for payment of lump sum fees / royalties for transfer of know-how in all cases submitted to it, within a month of the application being submitted, many parties may prefer to approach the SIA directly, instead of considering recourse to the automatic route at the risk of being advised at a later date that they need SIA approval.

**Employment of Foreign Nationals:** Indian firms are now free to engage foreign nationals on short-term assignments without prior approval of the RBI. The earlier ceilings on the daily rates and on the total payments in a year have been removed. Commercial banks can now allow foreign nationals not permanently resident in India but in regular employment with Indian firms on payment of a monthly salary to make recurring remittances for family maintenance etc. up to 75% of net salary after deduction of income-tax and contribution to provident fund etc.

**Capital Markets:** Foreign institutional investors like pension funds,
mutual funds, investment trusts and asset management companies are allowed to operate in the capital markets to buy and sell shares of Indian companies.

**Immovable Property:** Subsidiaries and joint ventures of foreign companies, since they are incorporated in India, they are deemed to be "resident" in India and are free to buy immovable property like any other Indian companies.

A liaison office of a foreign company cannot own immovable property in India, and it can only take on lease immovable property not exceeding five years to conduct its activities. But branch offices of foreign companies are allowed to buy immovable property necessary or incidental to their activities, they have to only inform the RBI of the purchase within 90 days of the acquisition, in the form IPI prescribed for the purpose.

Foreign nationals are now allowed to buy immovable property in India, once they are "resident" in India. They are deemed to be resident, if they come to India for taking up employment in India or for carrying on a business or vocation, or intend to settle down or live in India for an indefinite period, after they have resided for more than 182 days in India in the preceding financial year. If they come to India for employment, they are free to repatriate the sale proceeds on retirement from employment, without any need for approval of the RBI, subject to the amount remitted for calendar year being not more than Rs.2 million and on production of documentary evidence in support of acquisition of the assets and a tax clearance / no objection certificate from income-tax authorities for the remittance. In other cases, they will need prior approval of the RBI for repatriation of the sale proceeds.
The Exchange Earners’ Foreign Currency (EEFC) account Holders and Resident’s Foreign Exchange (RFC) and account holders are permitted to freely use the funds held in EEFC/RFC accounts for the payments of all current account transactions permissible under the provisions.

**Foreign Collaborations:** Under the new law FEMA, the procedure for foreign collaboration remains the same as before. But for liaison offices and branch offices, the procedure has changed a little, in the sense a common Form FNC 1 has been prescribed for both. Given below is a summary of the present policies and procedures relating to foreign collaboration.17

a) **Import of Designs and Drawings:** Importers of designs and drawings are free to remit the actual cost of the designs and drawings without any upper limit. The banks are also allowed to open letters of credit for import of designs and drawings, subject to production of evidence of import by the parties concerned within three months from the date of remittance.

b) **License Agreements:** The RBI gives automatic clearance of license agreements in which lump sum fees payable are up to US$ 2 million and royalty upto 5% for domestic sales and 8% for exports, subject to total payments being up to 8% of sales over a 10-years period from the date of agreement or 7 years from commencement of production, whichever is earlier. License agreements going beyond the jurisdiction of the RBI have to be submitted to the Secretariat for Industrial Assistance for approval.

c) **100% Subsidiaries:** A 100% subsidiary can be set up in many industries even under the automatic routes of the RBI. Either because it is not quite

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clear whether a proposed project falls within the scope of the automatic route, or because the partners prefer to do so, any proposal for a 100% subsidiary can be submitted to the Secretariat for Industrial Assistance, which gets it approved by the Foreign Investment Promotion Board (FIPB) and conveys its decision to the applicants. According to the guidelines issued in January 1997 and amended from time to time, the FIPB may allow a 100% subsidiary to be set up in the following circumstances:

i) where only “holding” operation is involved and all subsequent / downstream investments to be carried out would require prior approval of the government.

ii) where proprietary technology is sought to be projected or where sophisticated technology is proposed to be brought in

iii) where at least 50% of production is to be exported.

iv) proposals for consultancy

v) proposals for model towns / industrial parks or estates.

vi) where the foreign investors are unable initially to identity an Indian joint venture partner (subject to the condition that at least 26% of the equity will be Indianised within a period of three to five years).

vii) where the Indian partner in an existing joint venture is unable to raise resources for expansion / technological upgradation.

viii) where a trading company plans exports, bulk imports with export / expanded warehouse sales, cash and carry wholesale trading, or other import of goods or services provided at least 75% is for
procurement and sale of goods and services among companies of
the same group.

d) **Joint Ventures:** Instead of 100% subsidiary, a foreign company may choose to set up a joint venture company in cooperation with an Indian partner. The relations between the two partners will be regulated by a financial collaboration agreement, specifying the shareholding pattern and rights and duties of the two parties promoting the joint venture company.

Following in the tradition of the previous years, more liberalization measures have been announced in the Exim Policy of the years in the millennium. To analyse it briefly, the EXIM policy announced in 2001 has completed the process of removal of Quantitative Restrictions on Balance of Payment grounds by dismantling restrictions on the remaining 715 items. Out of these items, 342 are textile products, 147 are agricultural products including alcoholic beverages and 226 are other manufactured products including automobiles. The policy has, however, put in place necessary mechanism, to provide a level playing field to domestic players vis-à-vis imports. These mechanism include shifting of imports of certain products under the state trading category, making imports subject to various existing domestic regulations on health and hygiene and environment, and need for bio security and sanitary and phytosanitary permit for imports of primary products of plant and animal origin. The policy has also established a monitoring mechanism to monitor imports of 300 sensitive items on a regular basis. The change from FERA to FEMA has only not reduced the legal formalities for traders but has
also provided the requisite boost.

But, the question still remains...where do we go from here? The challenges are clearly outlined.

While the growth of Indo-German business over the past four-and-a-half decades has been quite spectacular, it still lags behind the most success stories of German economic cooperation in Asia. Why should German investment in India rank, midfield and not second or first? Why does India only figure as No. 10 in the ranking of German exports to Asian countries? The answers lie partially in Germany and partially in India, but the underlying problems will have to be addressed. German business’s changing its perception of India as an “island” and is beginning to see it as a strategic part of Asia, the premier growth region of the world.

Germany itself is at present struggling hard to adapt itself to the structural changes in the world economy. The international division of labour is getting more intensive and complex as time goes on. Remorseless price-competition demands the mobilization of all productivity resources. Technological changes proceeds at an even more rapid pace demanding rapid adjustments, not all of them painless.

After 45 years of solid growth, both India and Germany stand on the threshold of a new era holding out tremendous promise but not without pitfalls.

Despite revival of world trade, exports of developing countries like India continue to be threatened by the emerging protectionist sentiments in some sectors in the guise of technical standards, environmental and social concerns. Non trade barriers like anti-dumping duties, countervailing duties, safeguard
measures and sanitary and phytosanitary measures have affected market access for exports from the developing countries. Indian products which have been affected by such barriers in the recent past include exports of floriculture products, textiles, pharmaceuticals, marine products and basmati rice to the European Union, and mushroom and steel exports to the USA. Market access is also affected by the tariff differential in imports by the developed countries, with average tariff on developing countries imports being higher than on imports from the developed countries.

Amongst the domestic factors that continue to hamper our export growth are infrastructure constraints, high transaction cost, SSI reservations, inflexibilities in labour laws, quality problems, quantitative ceilings on agricultural exports and constraints in attracting FDI in the export sector, remain problematic. Of particular importance is the existence of small scale industry reservations and lack of flexibility in labour laws. A significant number of products that India has a comparative advantage in are reserved for small scale industries. It is, therefore, difficult for Indian exporters of such items (e.g., toys, clothing, shoes, transistor radios, leather goods and the like) to upgrade their quality and to attain economies of scale.