



**ASIA-PACIFIC COMMITTEE OF GERMAN BUSINESS (APA)
AND
INDO-GERMAN CHAMBER OF COMMERCE**

**RECOMMENDATIONS
TO FURTHER IMPROVE THE BUSINESS CLIMATE
FOR FOREIGN COMPANIES IN INDIA**

August 2006

Introductory Remarks

The German business community is firmly convinced that the Government of India (GoI) is committed to further reforms in order to build a sound economic base in India thereby offering at the same time relief and support to the poorer sections of the Indian population. The German business community is strongly committed to assist their Indian business partners in their endeavors.

India is among the most important economic partners of Germany within Asia. The impressive growth rate of the Indian production sector as well as the service sectors contributes to India's growing influence in the world market. The German business community especially welcomes the set objectives of the GoI for a countrywide development of the infrastructure and offers its cooperation as an experienced partner in this field.

Outlined below are suggestions on how India could contribute to the further strengthening of Indo-German economic ties.

1. Investment and Trade Regulations

Investment

The Government of India has shown tremendous efforts to even further accelerate the process of economic reform. German companies investing in India are highly welcoming these initiatives. However, this orientation needs to percolate further to the state and local administrative levels. It is well known that a 'one stop shop' concept or 'single window clearance' does not exist in India. Application and approval procedures are often neither transparent nor smooth. The setting-up of a business unit requires approvals that vary greatly from state to state of the Indian Union. Several Government authorities are involved in this procedure. Reforms are needed that reduce the number of approvals at national as well as state level. High-level Indian government officials at the Central or States level are requested to remain accessible to international enterprises to ensure assistance in speeding-up difficult licensing procedures.

Bureaucratic hurdles are detrimental to the efficient allocation of capital across borders. International companies in India are not able to carry out an internal clearing of accounts receivable and payable. The Octroi should be done away with.

Though the Government has clearly stated that the privatisation course would be adhered to in principle, the process which had been set in motion by the previous government, has come to a virtual standstill. The privatisation efforts - especially in the infrastructure sector – should be continued on a high level.

By allowing foreign investors to open mono-brand stores, the GoI has made distribution and trade easier. However, foreign direct investment into the retail sector remains tightly restricted. India should generally open its retail sector to foreign investment and know-how. This step would mark a mile stone on the way to a modern mass distribution system.

Customs and regulations

India is becoming a major player in international trade. Starting at relatively low level, foreign trade – including Indo-German trade – has been growing immensely over the past years. It is an important challenge for the Indian administration to adapt the customs and regulations to the requirements of a modern trading nation. Frequently changing import regulations have proven to be counterproductive. Documents to be prepared are generally extremely elaborate in their complexity. The expenditure of time for application and obtaining of the required documents and permits for import, processing and export in the case of

conversion deals, or job orders is often immense, so that fixed deadlines cannot be adhered to. The import of spare parts, secondhand machinery and equipment, the re-export of imported machinery for repair purposes and the subsequent re-import into India after carried out repairs are too complicated and time-consuming. Additionally, throughput time of items at the customs authorities itself ends up regularly to be very long. Short-term orders are invariably lost to the Indian manufacturer-exporters. Business dealings for which a quick processing is essential, e.g. in the area of biotechnology, are partly infeasible. There is further difficulty in obtaining on time, obligatory certificates to be issued by various departmental authorities in sanctioning/permission of waste disposal, sale of surplus materials, DTA (Domestic Tariff Area) sale permits etc. It is extremely difficult to scrap imported obsolete and non-functioning machinery due to the existing regulations. From the perspective of the German business community in India, respective regulations and procedures should be made reliable, transparent and simple reducing the bureaucracy to a minimum.

Customs Duties

In the 2005 version of this paper it was acknowledged that basic customs duties were reduced from 20% to 15% and the Special Additional Duty was abolished. Counting all other levies, total import duty ultimately was at approximately 35%. This rate was applicable to nearly all manufactured goods of the mechanical engineering industry. In the Budget 2006 the general basic customs duty was further reduced from 15% to 12.5%. However, the Special Additional Duty (4%) and other levies were implemented again. Consequently, compared to 2005, total import duty has risen to nearly 37% (36,82%) on the average. Current import duty rates act as a barrier to the use of modern high-tech and up-to-date machinery in India. The GoI should promote the import of modern technologies by considerably reducing the import duty rates, including the additional duties, across all industrial sectors.

Rather very high custom rates also prevail in the automobile industry, the textile and fashion industry, the steel sector and the chemical fibre industry and might lead to a direct adverse impact on the Indian industry. Due to the considerable import duties substantial deposits are required and, therefore, burden the equity capital of local businesses. High customs duties do also hamper the import of high-end and state-of-the-art products.

At times, the classification of similar items under different custom tariff heads is proving a problem in the determination of the valid custom tariff rates, and especially so when the imported material is used as a basis material for further processing in India. Particularly the German textile and fashion industry find fault the intransparent structure of making it hardly possible to calculate the final duty in advance. Too much is left to the discretionary power of the respective customs officer.

The GoI is requested to examine whether the duty rates could be simplified and reduced further. Import duties should not only be reduced for the export orientated industries but in general. The Special Additional Duty should not be charged on the import of trading items like cars and spare parts on which sales tax has to be paid.

Service Tax

The scope of the Service Tax has been recently expanded to include a number of additional services, which were previously not falling under the purview of the directive. There is great confusion on the German side as to when and why service tax is applicable to foreign companies. The Finance Act 2006, for instance, amended the provision of Finance Act 1994 to include in the definition of taxable services, fare charged to first and business class passengers in respect of international journeys from any customs Airport in India. This levy has very serious and wide ranging effects and implications on airline industry and has resulted in many questions on the implementation. To avoid set-backs to mobility and international business, the GoI is kindly requested to evade contradictions to international norms and to end the considerable legal uncertainty caused by the imposition of service tax.

Press Note No. 1 / Press Note No. 18

Reinvestment of foreign enterprises is complicated by bureaucratic procedures laid down in this Press Note. Especially the required 'No Objection Certificate' may lead to delays, to high compensation claims or may even frustrate the whole investment. Additionally, from an investor's point of view, it seems to be rather unreasonable that the Press Note is relevant to minor shareholdings defining a participation of 3 percent already as a "joint venture". According to the experience of the German business community the revision of Press Note 18 of 1998, which is Press Note 1 of 2005, does not give a positive answer to the problems. A proper revision of the Press Note 1 or its withdrawal would be welcomed.

Non Tariff Barriers

Regarding transport cylinders for compressed gases, it now appears that, in order to get the DOE approval, these cylinders must be produced in India, only. The GoI is requested to avoid the implementation of this regulation because it would constitute a clear violation of WTO rules.

Indian standards and regulations in the construction sector are often not in line with international standards; e.g. in the area of fire protection and escape routes.

Due to its long-standing experience with internationally recognized standards, the German industry would be prepared to support the Gol to prepare adequate standards in this field.

Fairs

India makes special efforts to support international fairs in key industries. Foreign exhibitors are, however, at a considerable disadvantage vis-a-vis their Indian competitors: they have to pay a substantially higher price for the same service. The German business community urgently requests the Gol to intercede and mitigate these discriminating practices.

Intellectual Property Rights

With the altered Patents Bill the Gol has made a decisive step towards becoming a sought-after location for research and development based activities. The German business community would appreciate the fulfilment of all WTO obligations under the TRIPs agreement. To reach this goal, the Patents Bill and its implementation regulation need to be further developed. The German business community also welcomes that the Gol is making efforts to establish an effective data protection system covering registration and admission procedures of new medicinal drugs for entry into India. A system based on the recommendations made by a Government commission in June 2006 would, however, not result in a sufficient data protection.

2. Sector specific regulations and barriers

Infrastructure / Mega Project Clause

In the international tender process, foreign bidders are at a disadvantage vis-à-vis domestic manufacturers due to the Mega Project Clause. In the case of Hydro Power Projects of a capacity exceeding 500 MW, an additional 15% will be loaded on to the import content supply price (cif) of the bidders for evaluation purposes. This clause should be withdrawn forthwith for fair play's sake.

The German business community also requests more transparent tender placing procedures.

Metal Industry

India is following an offensive global procurement policy in the case of concentrates and scrap. Government-backed preferential incentives make it possible for Indian entrepreneurs to offer considerable higher prices for concentrates and scrap material in the global market, than it is possible for her non-protected and non-subsidized European competitors. During the previous years, subsidies in India have led to economically unsound investments in copper plants.

Earlier investigations by the EU Commission indicated a distortion of competition. Subsequent negotiations, and at a later date, an officially ordered statistical monitoring review of copper scrap exports to India have not secured any change. The German industry is concerned about persisting differences in customs duties between raw materials and refined metal, in particular for copper concentrates as compared to copper scrap and refined copper. These duty differentials should be completely withdrawn.

In particular the German business community requests

- the binding of India's customs tariff schedule for non-ferrous metals at much reduced rates and escalation factor within each metal sector,
- the elimination of disguised subsidies in the form of exemption authorisations in respect of environmental obligations, tax drawback systems on exports operated by the "new" operations, etc.

The Duty Free Import Authorization Scheme which allows duty-free imports of inputs which are used in the manufacture of export products is a one-sided subsidy for Indian manufacturing which enables India to have preferential access to raw materials on the world market. This creates trade distortions in the metals raw material markets and should be withdrawn.

Textile and Fashion Industry

The German business community asks the GoI to tackle the following issues:

- Authorities take extraordinarily ample samples of import textiles to test whether they are free from azo dye. This is very costly because the samples are to be destroyed after the test.
- Import items are requested to have an extremely elaborate labeling in English and Hindi – for textiles on every single meter.

Transport and Logistics

Aviation - Due to the development of the domestic aviation sector in recent years doing business in India has become more convenient. While the situation is improving still quite a lot needs to be done. Flight timings are, for instance, restricted on defense reasons at important airports like Pune. The German business community asks for the lifting of such limitations.

Indian Postal Legislation - The GoI has published a Draft Postal Reform Bill which, if enacted in its present form, would restrict the operations of the express industry in favour of an increased monopoly for the Post Office. The German business community would like to encourage the GoI to liberalise instead of monopolize the express industry on behalf of an efficient and low priced service.

Banking

An efficient, competitive and internationally integrated financial sector can be seen as the backbone of any modern economy. In India, setting-up fully-owned subsidiaries and the opening of branch offices of foreign banks is already generally permitted. However, the required implementation of the wholly-owned subsidiary option by the Reserve Bank of India (RBI) is still pending. As regards branches of foreign banks, India should seek to provide enough licences for new branches for both newcomers and banks already established in India which intend to expand their branch network. Branch authorisation should not depend on regional or social policy criteria as foreign banks are usually less equipped than domestic institutions to follow such conditions.

The percentage of foreign share holding in domestic banks is limited to 74% (49% for portfolio investment). Individual promoters/ shareholders may hold only 10% in voting rights and are restricted to hold only 10% of the equity of Indian banks. For all established domestic and foreign banks with on-going operations in India, this limit has even been reduced to 5% only. Well-known international banks should be eligible to hold up to 100% with corresponding voting rights.

The conversion of branch offices of foreign banks to fully-owned subsidiaries (or vice versa), and their merger with acquired domestic banks, or similar transactions, should be treated on a legally and fiscally neutral basis and should not be obstructed.

As regards cross-border business like export finance to India, the growing presence of Indian banks abroad exacerbate the effect of the discriminatory withholding tax on interest payments to non-Indian banks. These are taxed at 10% under the current German-Indian Double Tax Treaty, while interest payments on export credits from European branches of Indian banks are completely exempt from withholding tax. This privilege for overseas branches of Indian banks should be lifted in order to create a level playing field.

A very laudable aspect is the withdrawal of any limitation in the repatriation of profits by foreign banks. Meanwhile, the equity capital requirements are deemed to be applicable to domestic and foreign banks alike. However, taxation rates unfortunately still remain higher for branch offices of foreign banks.

The policy of a step-by-step introduction of derivative financing instruments into the securities markets by the RBI is appreciated. In this connection, Indian banks and enterprises may profit from the market and product knowledge of foreign banks. However, the regulations governing the securities markets are still quite restrictive. FDI and portfolio investment in Indian enterprises of certain sectors is restricted by law or may also be restricted by a resolution passed by the management / shareholders of the respective enterprise. Individual foreign portfolio investors may not hold more than 10% of the equity capital. The legal requirements for setting-up of business for foreign stock brokers, investment portfolio managers and investment funds continue to be extremely restrictive.

RBI approvals for foreign currency payments should be accelerated to enhance settlement of overseas payments. German business would also appreciate it if the Gol made the Indian currency fully convertible in the near future.

Insurance

Since 2001 foreign insurance companies are permitted to offer personal insurance as well as general insurance in collaboration with an Indian partner, with a maximum ceiling of 26% for the foreign partner. The German business community is hopeful that the market for insurance services will be further liberalized. A suitable guideline for liberalization is given by the "Model Schedule for future Insurance Commitments by WTO Members" of the Financial Leaders Working Group. In order to overcome the constantly aggravating liquidity problem of Indian private sector insurers the present investment restrictions for foreigners should be reduced gradually. The German business community requests the Gol

to at least consider an investment ceiling for foreign insurance providers at 49% and in due course, allow majority share holding as well.

The rather high current minimum capital requirements for foreign insurance companies of Rs. 1 billion constitute another barrier to entry into the Indian market. In this context, the recommendations of the Insurance Regulatory and Development Authority (IRDA) to reduce the minimum capital requirements to Rs. 50 crores for standalone health insurance companies should be implemented as soon as possible.

The German business community strongly recommends regulating the health insurance sector separately by specific laws. This measure would enable the building of the foundation for the development of a modern and efficient health-care system.

Further liberation in the insurance sector will consequently require a sustainable liberalisation process of the reinsurance sector. This would entail specifically the scrapping of the legally sanctioned monopolistic position of the state-owned reinsurer and would necessitate the introduction of a specific legal framework. Currently, foreign reinsurance companies are only allowed to operate in India as a joint venture partner of an Indian reinsurance provider (26% ceiling, 49% ceiling in discussion). Taking the international experience of liberalisation and the large capital need of reinsurance providers into account, the German business community is convinced that issuing branch license (100% ownership) to international reinsurers would be the best solution for all parties. Permission may only be given to selected international reinsurance companies with good track record and business experience in India, for opening of branches in India and for building up cooperation with local Indian business partners.

Private life insurers could play a pivotal role in giving a head start to the implementation of pension reforms in India. As the GoI has already formed the Pension Fund Regulatory and Development Authority, the next step would be the speedy opening of the sector. The sector should be opened with the FDI norms same as insurance.

India's economic development would greatly benefit from a broad opening of the insurance and reinsurance sector to international competition. At the same time, the role of strong supervision and regulatory authorities would grow as a safeguard against adverse market effects. The Indian authorities are requested to support transparent regulations and apply clear criteria in the licensing procedure for national as well as international insurance and reinsurance providers.

3. General obstacles to business in India

Complex State Regulations

Although the Central Government is moving ahead with reducing the complexity in regulatory framework, there is no clarity in many Acts like entry tax, Value Added Tax etc. The State Government tends to take their own view which is often dominated by the revenue criteria. More transparency and harmonization of trade and investment rules across the Indian States would be very much welcomed by all companies doing business in India.

The Motor Vehicle Registration Tax is different in various states and there is a tendency to increase these taxes abruptly. A uniform regulatory framework would strengthen the development of the Indian industry and particularly of the automobile sector.

Labour Market

Generally very rigid laws govern the Indian labour market. The Industrial Disputes Act, 1947, for example, contains several archaic and retrograde provisions, which affect the management's right to manage and affect productivity:

- Item 10 of the Fourth Schedule to the Industrial Disputes Act, 1947, read with Section 9A thereof, expressly prohibits any rationalization, standardization or improvement of plant or technique which allegedly is "likely" to lead to retrenchment, unless a settlement is reached with the union of the concerned workmen or an Industrial Tribunal has adjudicated the justification for the proposed change and made an award permitting the employer to implement the proposed change. Such adjudication would take between three and five years (on a conservative estimate), consequently an employer would proverbially "miss the bus".
- Similarly, item 11 of the Fourth Schedule prohibits any increase or reduction (other than casual) in the number of persons employed or to be employed in any occupation unless a settlement is reached with the union of the concerned workmen or an Industrial Tribunal has adjudicated the justification for the proposed change and permitted the employer to implement the proposed change.

If the reduction of persons as a consequence of a voluntary retirement scheme or even by natural wastage (i.e. death, superannuation or resignation) has the effect of increasing the workload of the remaining workmen or has the effect of rendering the job content of such remaining workmen more onerous, then such reduction could be challenged as

violative of Section 9A read with the said item 11.

In the context of technological changes and the induction of new technology or new plant or capital goods, the necessity for re-training workmen or changing their job content and/or their duties and responsibilities, becomes imperative. Item 11 of the Fourth Schedule becomes a barrier in a highly competitive market.

- In cases of transfer of the ownership or management of an undertaking, the workmen of the transferor undertaking generally refuse to accept the transfer of their services. In such cases, the workmen of the transferor generally raise an industrial dispute alleging that what is transferred is not an “undertaking” or challenging the legality and bonafides of the transfer of the undertaking, thereby coercing the transferor to offer a voluntary retirement scheme at a cost significantly higher than retrenchment compensation.

Enterprises should be given the possibility to exercise more flexibility in personnel management policies. In India it is virtually impossible, to execute necessary entrepreneurial and economically normal management decisions such as restructuring, mergers and acquisitions, or the relocation of production units. A liberalization of the Indian labour legislation is certainly of utmost importance.

Standards

The Bureau of Indian Standards (BIS) rules are extremely complex, time-consuming and costly as well, as the registration with the BIS will be valid over limited time only, and has to be renewed after its lapse. Simplification of the procedures to give more transparency to these rules would be very welcome. It is also requested that the BIS authority consult with the ministries and/or commodity boards concerned in order to avoid bottlenecks for the Indian manufacturing, exporting and trading communities. It would be beneficial for Indo-German business relations if the BIS list of items would further be pruned.

Being a founding member of the International Organization of Standardization (ISO), as well as an active member of the International Electrotechnical Commission (IEC) and ITU, the BIS should be in line with the WTO – TBT – recommendations and adhere to and take over as much of these international standards as possible. This would also facilitate Indian export to the European Union, where the mostly identical European Standards (EN) give the necessary presumption of conformity with the relevant European Directives.

The test for the homologation of vehicles, engines and components in India are very similar or equal to those required by the United Nations Economic Commission for Europe (UN ECE). Currently, for the homologation, the vehicles,

engines and many automobile components that have already passed ECE tests need to be tested again in India. The recognition of ECE approvals in India could avoid expensive double testing and would, consequently, support the development of the Indian automotive industry and market.

The recent discussion on compulsory ISI marking on tyres has to be regarded as counterproductive. The GoI should accept testing / marking by outside agencies (e.g. E-mark) and relieve OEMs from procedural hassles.

The German business community urges the GoI to conform their weighing standards and measures to the OIML Standards (International Organisation of Legal Metrology), and further to allow automatic approval for production and sales in India through OIML standard certification by the Weights & Measures local offices and/or by specialized companies.

Throughout the world basically all countries accept and allow the import and shipment within the country of compressed gases in transport cylinders which are approved for these gases according to international standards (e.g. German TÜV or US DOT). Only in India special transport cylinders are needed. These cylinders must comply with the regulations of the "Department of Explosives" in Nagpur (DOE) and require a higher test pressure than all other international standards, and thus making them more expensive. From the technical point of view the need for such a cylinder test pressure is not given. The above outlined mandatory cylinder approval creates an entrance barrier for European companies to the Indian market. The German business community therefore requests the approval of international standards in this field.

Power

As in the past years, India is still adversely affected by a chronic shortfall in power supply. Enterprises are therefore, quite often forced to set up captive power generation capacity in order to counteract power failures or fluctuations of the grid net. The Electricity Act 2003 is of great significance as it permits larger users of electricity a free choice of the supplier and allows captive power generating units to feed power into the national grid. The respective legislature with regard to the improvement of the infrastructure has still to attain validity in most of the Indian States. Top priority should be given to the development of power generation and to the new laws which will assure greater independence to State Electricity Boards.

The GoI plans to increase the present capacity, promotes energy saving programmes as well as specific investments to bring about a reduction of transmission losses incurred in the national grid. There is a very urgent need for an expansion of the distribution net. The measures by the GoI foresee, inter alia,

the introduction of legislation pertaining to power theft and the installation of electric meters on a countrywide scale. In this context, good chances for the engagement of the German electrical and electronic Industries are clearly visualized. The German business community expresses their support for an accelerated introduction of the proposed legislation, and recommends its rapid extension to new power projects.

Under section 80-IA of the Income Tax Act, a company is entitled for 100% deduction for an amount equivalent to the profit derived from any infrastructure business for 10 consecutive assessment years. The term infrastructure facility includes ports. The Central Board of direct Taxes (CBDT) has clarified that structures at ports for storage, loading and unloading would fall under the definition of port for the purpose of section 80-IA. In line with the objective to improve infrastructure facilities in the energy sector, the Gol may also consider to include the terminalling facility for storage of oil and gas as an infrastructure facility under the provisions of section 80-IA of the Income Tax Act. As a result, more private investment would be attracted to the benefit of the economic development of India.

Chemical Industry

Certain chemical products still remain on the list for manufacture reserved to the Small Scale Industry. Due to this fact, the market is artificially divided into small-scale and large-scale enterprises. Chemical enterprises are unable to develop a comprehensive product portfolio, resulting in confronting the buyer with higher prices. The Gol is urged to go ahead with the total de-reservation of products. As a result, India could most likely benefit from large-scale investment and production, ensuring high quality products with proper environmental protection measures.

Supply Chain Management

There is an immense loss of food in India due to inadequate storage capacities and insufficient transport logistics. The German business community is offering its know how to assist in the development of comprehensive food value chains, along with the required basic infrastructure and financing. The Agricultural Produce Marketing Acts relating to the storage, purchase and sale of fruit, vegetable and other fresh food has proven to be an obstacle for the efficient marketing of these agricultural goods by private trading companies and should therefore be abolished in all states in India.