Enhancing Investments between India and the European Union

The Case of Bilateral Investments between India and Germany

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Table of Contents

Chapter 1 : Introduction 9

Chapter 2 : Investment Flows into India and Germany: Literature Review and Market Comparison 17

Chapter 3 : Bilateral Investment Flows between India and Germany 26

Chapter 4 : Bilateral Agreements Covering Investment: India and Germany........................ 42

Chapter 5 : Survey of Stakeholders 48

Summary and the Way Forward 60

References.. 65

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Abbreviations

BIPA	Bilateral Investment Promotion Agreement
BIT	Bilateral Investment Treaty
BMW	Bayerische Motoren Werke
BRIC	Brazil, Russia, India and China
BTIA	Broad-based Trade and Investment Agreement
CECA	Comprehensive Economic Co-operation Agreement
CENTAD	Centre for Trade and Development
CEPA	Comprehensive Economic Partnership Agreement
CRISIL	Credit Rating Information Services of India Limited
CUTS	Consumer Unity and Trust Society
DAX	Deutscher Aktien Index (German stock index)
DI	Domestic Investment
DIPP	Department of Promotion and Policy
DTAA	Double Taxation Avoidance Agreement
DTT	Double Taxation Treaty
E&Y	Ernst & Young
EU	European Union
FDI	Foreign Direct Investment
FICCI	Federation of Indian Chamber of Commerce and Industry
FTAs	Free Trade Agreements
GAAR	General Anti-Avoidance Rules
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GER	Gross Enrolment Ratio
GTAI	German Trade & Invest
HITS	Headend-In-The-Sky
IDEAs	International Development Economics Associates
IGC	Inter-Governmental Consultation
IGCC	Indo-German Chambers of Commerce
IMF	International Monetary Fund

IPR	Intellectual Property Rights
IT	Information Technology
ITeS	IT and IT-enabled services
JV	Joint Venture
MEA	Ministry of External Affairs
MFN	Most Favoured Nation
MNC	Multinational Corporation
MoU	Memorandum of Understanding
NMIZs	National Manufacturing Investment Zones
NT	National Treatment
OECD	Organisation for Economic Co-operation and Development
OFDI	Outward Foreign Direct Investment
OLI	Ownership, Location and Internalization
PERI	Political Economy Research Institute
PMR	Product Market Regulation
PPP	Purchasing Power Parity
PSU	Public Sector Undertaking
PTA	Preferential Trade Agreement
RBI	Reserve Bank of India
RCEP	Regional Comprehensive Economic Partnership
RTA	Regional Trade Agreement
S&T	Science and Technology
SIA	Secretariat of Industrial Assistance
SMEs	Small and Medium Enterprises
T&M	Time & Material
TCS	Tata Consultancy Services
TDRs	Transferable Development Rights
TNC	Transnational Corporation
TTIP	Transatlantic Trade and Investment Partnership
UNCTAD	United Nations Conference on Trade and Development
US	United States
WTO	World Trade Organization

List of Tables

Table 1.1: Comparison of GDP and GDP per capita of India and Germany 11
Table 1.2: Key Trade Indicators of India and Germany 12
Table 1.3: Current Account Balance in India and Germany 13
Table 1.4: Labour force in India and Germany (in million)... 13
Table 2.1: Comparison of India and Germany on FDI Indices 21
Table 2.2: Rank of Select Countries in Ease of Doing Business Index, 2013 21
Table 2.3: Ranks of BRIC nations and Germany on Global Competitiveness Index (2013-14) 22
Table 2.4: Ranks of India and Germany on Economic Stability 23
Table 2.5: Ranks of India and Germany on Infrastructure Indicators 23
Table 2.6: Ranks of Select Countries on Logistics Performance Index, 2013 23
Table 2.7: Ranks of India and Germany on Availability of Educated Workforce 24
Table 2.8: Ranks of India and Germany on Labour Market Efficiency................................ 24
Table 2.9: Ranks of India and Germany on IPR Regime... 24
Table 2.10: Ranks of India and Germany on Market Size 24
Table 2.11: Ranks of India and Germany on Good Governance and Transparency 25
Table 3.1: Top 15 Investor Countries in India (April 2000 to September 2013) 27
Table 3.2: Top 15 Sectors for Foreign Equity Inflows to India (January 2000 to September 2013) 28
Table 3.3: Top 15 Investor Countries in Germany (2001 and 2011).................................... 29
Table 3.4: Top 20 Destinations for Indian Investments (July 2007 to Dec 2013)................. 32
Table 3.5: Indian Outward Investments by Sector (July 2007 to December 2013)................ 32
Table 3.6: Top 15 Destinations for German Investments (2001 and 2011) 33
Table 3.7: German FDI Outward Stocks by Sector (2000 and 2010)................................... 34
Table 3.8: Trends in German Investment Inflows into India 35
Table 3.9: FDI Equity Inflows from Germany by Sector (April 2012 to March 2013).......... 36
Table 3.10: Some German companies in India by Sector 38
Table 3.11: Indian Investments in Select EU Member States (in $ million).......................... 39
Table 3.12: Investment by Asian Countries in Germany (2001 and 2011)............................ 39
Table 3.13: Indian Investments in Germany by Sector (July 2007 to June 2013)................. 40
Table 3.14: Presence of Indian Companies in Germany.. 41
Table 4.1: Substantive provisions in BIPAs/BITs of India and Germany 43
Table 4.2: Comparison of Key Provisions in Investment Chapters in Trade Agreements: India and the EU 45
Table 5.1: Sampling Frame 48
Table 5.2: Route of Entry of German Companies in India 49
Table 5.3: FDI Limits in Sectors in India.. 56
Table 6.1: Select measures that can be taken by India and Germany to Facilitate Investment Flows 63

List of Figures

Figure 1.1: Comparison of GDP annual growth rate in India and Germany (in per cent)...... 11
Figure 1.2: Trends in Bilateral Merchandise Trade between India and Germany................. 15
Figure 3.1: Trends in FDI inflows to India 26
Figure 3.2: Trends in FDI inflows into Germany 29
Figure 3.3: Per cent share of Sectors in Inward FDI stock of Germany, 2010 30
Figure 3.4: Trends in FDI Outflows of India and Germany (in US$ billion) 31
Figure 3.5: Locations for German Investments in India (April 2012 to March 2013) 37
Figure 3.6: Locations of Indian Companies in Germany in 2012 40
Figure 4.1: Agreements that cover Investment.. 42
Figure 5.1: Distribution of German Companies in India by Sector....................................... 49
Figure 5.2: Sectoral and Spatial Distribution of German Companies in India....................... 49
Figure 5.3: Sectoral and Spatial Distribution of Indian Companies in Germany................... 52
Figure 5.4: Severity of Barriers for German Companies 54
Figure 5.5: Severity of Barriers for Indian Companies... 57

List of Boxes

Box 5.1: Metro Cash & Carry – India Operations 50
Box 5.2: Shalimar Food GmbH 51

Chapter 1 : Introduction

In recent years, there has been an increase in the number of Regional Trade Agreements (RTAs) and/ or Free Trade Agreements (FTAs). Almost all major member countries of the World Trade Organization (WTO) have notified participation in at least one RTA and some members are signatories of over 20 trade pacts. Between 1948 and 1994, the General Agreement on Tariffs and Trade (GATT) received 124 notifications of RTAs (related to trade in goods), and since 1995 more than 400 additional arrangements covering trade in goods or services have been notified[1]. The WTO allows its member countries to enter into RTAs through which they can trade among themselves using preferential tariffs and opt for easier market access conditions. Over the years, there has been an increase in the amount of global trade through the RTA route.

Studies have examined why countries have diverted their negotiating energies into RTAs or FTAs. The reasons include the slow progress of the WTO talks, snowballing and domino effects as a result of which countries do not want to be left behind and political and strategic reasons. A principal reason for the proliferation of FTAs is the increasing perception that these arrangements promote trade liberalisation among the negotiating partner countries (Urata, 2002). According to Pal (2008), a developing country is motivated to enter into an FTA with a developed country if its competitors can supply goods to the developed country through a preferential trade agreement. If the developing country cannot form an FTA with the developed country, it attempts to create its own market by signing an RTA with other excluded members. This creates a bandwagon effect where no country wants to be left out of major regional groupings. There has also been a surge in investment agreements due to the WTO's failure to agree on direct investment issues[2]; several nations have entered in Bilateral Investment Treaties (BITs) or Bilateral investment Promotion Agreements (BIPAs).

Both the European Union (EU) as a regional bloc among developed countries and India among the developing countries are actively engaged in bilateral and regional agreements. At the same time the EU and India are negotiating a Broad-based Trade and Investment Agreement (BTIA) to broaden bilateral commercial and economic relations with each other. The BTIA is a comprehensive WTO+ agreement that will cover trade in goods, services, investment, trade facilitation measures, government procurement, labour standards and sustainable development, among others. If successfully negotiated, this will be the EU's first trade agreement with a large and growing emerging market. This will also be India's first trade agreement with a large developed nation, which is also one of its largest trading and investment partners. This legally binding agreement would cover almost a fifth of the world population and, therefore, its impact and implications (both positive and negative) would be significant (Singh, 2009).

The BTIA negotiations began in 2007 at the seventh India–EU summit after India and the EU accepted the recommendation of the High-Level Trade Group set up by India and the EU to work on a trade pact. A successful conclusion would increase the competitiveness of both partners in the global arena. The agreement would strengthen the EU's trade ties in Asia as well as the EU's role as a global actor, and revive market confidence in the eurozone. India would gain greater market access to 28 EU Member States (Khandekar & Sengupta, 2012). Since India is a high tariff country, the BTIA is expected to lead to tariff reductions. As a result, companies from EU Member States will have a comparative export advantage vis-à-vis companies from other countries such as China and the

[1] For details, *http://www.wto.org/english/tratop_e/region_e/regfac_e.htm* (last accessed on January 28, 2014).

[2] The Fifth Ministerial Conference of WTO held in Cancun during September 10-14, 2003 failed to arrive at any agreement on several contentious issues including Multilateral Investment Agreements (MIAs).

United States (US). Apart from increasing trade volumes between India and the EU, the BTIA would have several additional advantages: enable technology and knowledge transfer, develop infrastructure, improve the supply chains, link the production networks between India and the EU, create job opportunities, increase competitiveness and enhance skill development. All these will deepen the bilateral ties (Upadhyay, 2012). The BTIA is expected to address some non-tariff barriers, such as differences in product standards. In addition, the BTIA is expected to significantly increase bilateral investment flows. EU companies, which are facing a slowdown and a saturated domestic market, are exploring investment opportunities in growing emerging markets such as India, and Indian companies are exploring investment opportunities in the EU to acquire technology and get the benefits of being treated as an EU company[3] .

The policymakers of the EU and India recognise the trade and investment complementarities between the two economies and the benefits of a bilateral trade agreement. The EU has moved from an aid-oriented strategy to trade-oriented strategy for emerging markets such as India[4]. In 2006, the European Commission suggested that emerging economies like India that have high levels of protectionism coupled with huge market potential are of direct interest to the EU for trade agreement negotiations.

The EU's FTAs generally go beyond the scope of the General Agreement on Trade in Services (GATS) market access negotiations, because the EU ensures regulatory certainty through its FTAs (Horn *et al*., 2010; Marchetti and Roy, 2008). The EU's trade agreements have extensive coverage of issues such as environment standards, labour standards and sustainable development along with government procurement, and ensuring transparency and predictability of regulatory regimes for investment. By contrast, India's existing comprehensive agreements with Japan, Korea, Singapore and Malaysia have not gone much beyond the market access commitments in its Revised Offer[6] submitted to the WTO in August 2005 (Mukherjee, 2008). Thus, the two regions have different approaches in their trade agreements with different levels of expectations and coverage of sectors and issues. Despite these differences, the India-EU BTIA is likely to be mutually beneficial (Ecorys [Netherlands], Consumer Unity and Trust Society [CUTS] and the Centre for Trade and Development [Centad] 2009).

1.1 India and Germany: Strategic and Economic Relationship

Among EU Member States, Germany is the largest economy in terms of purchasing power parity (PPP). It contributes about 20 per cent of the EU's GDP[5] and is also the biggest net contributor in the EU budget. Germany plays a leadership role among EU Member States in the BTIA negotiations with India, which is likely to enhance bilateral investment flows between India and Germany.

In 2011, the two countries celebrated 60 years of bilateral diplomatic relationship, and in May 2011 they set up the first Inter-Governmental Consultation (IGC). India is the first Asian country and one of the few countries with which Germany holds a joint cabinet meeting. This reflects the growing interest of the two countries in each other's market.

India and Germany also have strong economic ties. The two countries have seven Joint Working Groups that cover agriculture, automobiles, infrastructure, energy, coal, tourism and vocational education and focus on enhancing collaboration in each of these sectors. Among EU Member States, Germany is among India's most important partners for trade, investment and technology transfer. Germany is India's seventh largest trading partner in goods, the eighth biggest investor and second

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[3] Foreign companies that invest in the EU are treated at par with EU companies.
[4] European Commission (2006).
[5] European Commission (2012a).

most important partner in technology collaboration. Indian investments in Germany have also increased over time and Indian companies are seeking collaboration with German companies for technology transfer.

At the government level, several measures have been taken to facilitate investment flows. In 1998, Germany signed a Bilateral Investment Promotion Agreement (BIPA) with India that aims to facilitate promotion and protection of investments in the two countries. India also has a Double Taxation Avoidance Agreement (DTAA) with Germany (1996).

Given this background, the objectives of this study are the following:

- To analyse trends and patterns in bilateral investments between India and Germany
- To understand the opportunities and prospects for investment in each other's market
- To identify the barriers to investments
- To determine the expectations of investors and the two governments from the BTIA
- To suggest policy measures and strategies for the BTIA and beyond that facilitate an increase in investments in the two markets

1.2 Macro-economic Overview: India and Germany

Germany and India are at two different stages of development. While one is a developed country, the other is a developing emerging market. In terms of gross domestic product (GDP), the German economy in 2005 was about three times the size of the Indian economy (Table 1.1). Even though Germany has been hit hard by the eurozone crisis, its GDP was about twice the size of India's in 2012. In terms of GDP per capita as well, Germany is about 27 times the size of India.

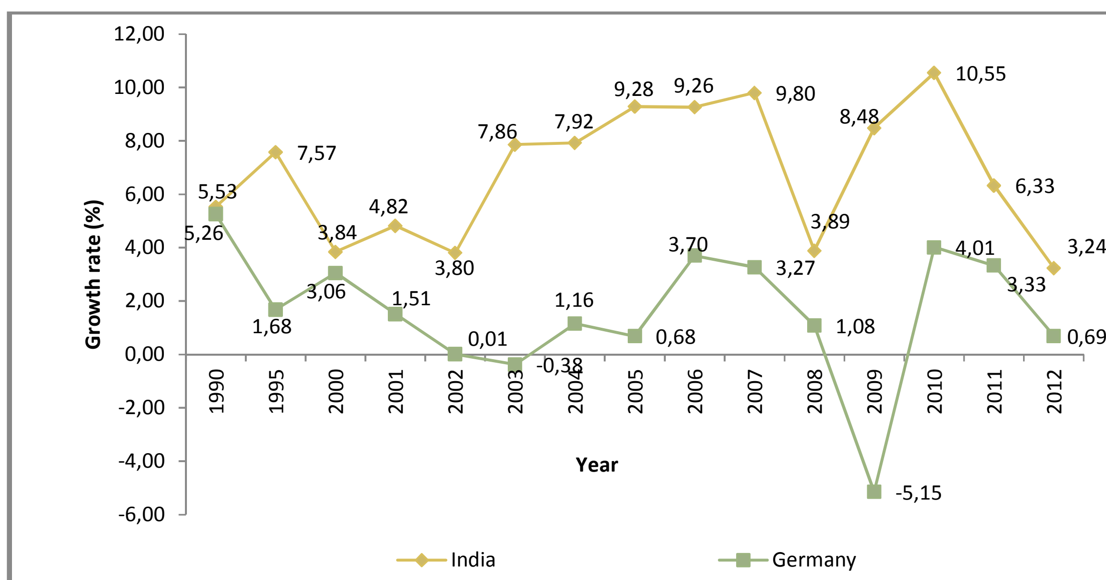
Table 1.1: Comparison of GDP and GDP per capita of India and Germany

Year	GDP (current $ billion)		GDP per capita (current $)	
	India	**Germany**	**India**	**Germany**
1990	327	1714	376	21584
2000	477	1886	457	22946
2005	834	2766	740	33543
2006	949	2903	830	35238
2007	1239	3324	1069	40403
2008	1224	3624	1042	44132
2009	1365	3299	1147	40275
2010	1711	3284	1419	40164
2011	1873	3601	1534	44021
2012	1842	3400	1489	41514

Source: Extracted from World Bank (2013a).

The trend of growth in GDP is depicted in Figure 1.1. Although in terms of GDP Germany is much larger than India, India has been growing at a faster rate.

Figure 1.1: Comparison of GDP annual growth rate in India and Germany (in per cent)



Source: Extracted from World Bank (2013a).

Trade is an important component of the GDP of India and Germany; it contributed about 98 per cent to the GDP in Germany in 2012 and to 55.4 per cent in India (Table 1.2). While Germany has a positive trade balance in its global merchandise trade, India has a negative trade balance with the rest of the world. In trade in services, India has a positive trade balance, whereas Germany has a negative trade balance.

Table 1.2: Key Trade Indicators of India and Germany

Indicator	India				Germany			
	1990	2000	2005	2012	1990	2000	2005	2012
Exports of goods ($ billion)	18.0	42.4	99.6	293.2	421.1	550.4	970.9	1407.1
Imports of goods ($ billion)	23.6	51.5	142.9	489.4	355.7	496.0	777.1	1167.4
Total merchandise trade ($ billion)	41.5	93.9	242.5	782.6	776.8	1046.4	1748.0	2574.5
Services exports ($ billion)	4.6	16.7	52.5	148.1	62.7	83.1	163.8	258.9
Services imports ($ billion)	6.1	19.2	47.3	125.9	84.1	138.1	212.7	286.3
Total services trade ($ billion)	10.7	35.9	99.8	274.0	146.8	221.3	376.5	545.1
Exports of goods and services ($ billion)	22.6	59.1	152.1	441.3	483.8	633.6	1134.7	1666.0
Imports of goods and services ($ billion)	29.7	70.7	190.2	615.2	439.8	634.1	989.7	1453.7
Total trade (goods and services) ($ billion)	52.3	129.8	342.3	1056.6	923.6	1267.7	2124.5	3119.7
Exports of goods	6.9	12.8	19.3	23.8	24.80	33.38	41.32	51.79

Indicator	India				Germany			
	1990	2000	2005	2012	1990	2000	2005	2012
and services (% of GDP)								
Imports of goods and services (% of GDP)	8.3	13.6	22.0	31.5	24.86	33.08	36.10	45.87
Trade (% GDP)	15.2	26.5	41.3	55.4	49.7	66.5	77.4	97.7
Merchandise trade (% of GDP)	12.7	19.8	29.1	42.5	45.3	55.6	63.2	75.7
Trade in services (% of GDP)	3.3	7.6	12.0	14.9	N.A.	N.A.	14.3	16.7

Source: Extracted and compiled from World Bank (2013a) and UNCTAD Statistics on International Trade in services, available at *http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx* (last accessed on January 22, 2014).

Despite the eurozone crisis, Germany maintains a positive current account balance, whereas India has a growing current account deficit, which is a concern for policymakers (Table 1.3).

Table 1.3: Current Account Balance in India and Germany

Year	Current account balance (BoP, current $ billion)		Current account balance (% of GDP)	
2005	India	Germany	India	Germany
2006	-10.28	140.21	-1.23	5.07
2007	-9.30	182.35	-0.98	6.28
2008	-8.08	248.78	-0.65	7.48
2009	-30.97	226.27	-2.53	6.24
2010	-26.19	199.48	-1.92	6.05
2011	-52.27	207.72	-3.06	6.32
2012	-60.04	223.32	-3.21	6.20

Source: Extracted from World Bank (2013a).

In terms of workforce, India has a large workforce that is more than 10 times that of Germany. In 2012, India had a workforce of 484 million compared to 42.5 million workers in Germany (Table 1.4). India's working age population (15-59 years) is expected to reach more than 900 million by 2030[6]. This young and growing workforce is an advantage for both the manufacturing and services sectors; it keeps the cost of production low, making India a favourable location for setting up business and manufacturing units. At the same time, skilled workers from India can contribute to the industry and services sectors in Germany.

Table 1.4: Labour force in India and Germany (in million)

Year	India	Germany
1990	330.7	37.3
2000	337.3	40.3
2005	464.5	41.3
2006	465.5	41.6
2007	466.8	41.9
2008	467.0	41.9

[6] CRISIL (2010).

Year	India	Germany
2009	467.7	42.0
2010	468.1	42.0
2011	476.6	42.5
2012	484.3	42.5

Source: Extracted from World Bank (2013a).

Rising disposable income and a growing upper and middle class in India have led to increased consumption, making India a lucrative market for investors from countries where the domestic market is saturated[7]. For instance, Volkswagen AG, a German automobile company, targets the upper-middle class and rich consumer segment in India and plans to expand its operations in India due to India's growing consumer base.

It is clear that the Indian and German economies complement each other in several ways. Germany is a small and saturated market, while India is a fast-growing developing economy with an unsaturated market. The growing middle class in India provides opportunities for German companies to invest in the market and cater to the Indian population. At the same time, India's large, skilled workforce complements the technological capabilities of German companies. German companies are also competent in providing infrastructure services, and India needs investments in sectors such as construction and logistics. India can become part of the global production network of German companies, thereby enabling them to spread their risk. For India, access to the German market will help Indian companies cater to the wider EU market. Bilateral investment flows can help the Indian economy develop its manufacturing facilities, lead to technological upgrading, diversify the research base, develop the organised services sector and reduce unemployment, while it can help German companies reduce costs, improve their global competitiveness and diversify their production networks. Hence, there are strong synergies between the two nations that will be discussed later in this report.

1.3 Bilateral Merchandise Trade: India and Germany

Table 1.2 shows that the global trade of India and Germany has increased over time. Germany's global trade is much higher than India's. In 2012, Germany ranked 3rd in merchandise as well as in services exports among WTO countries, whereas India ranked 19th in merchandise exports and 7th in services exports[8]. Hence, both countries are major exporters of services in the world, but India is yet to develop as a manufacturing hub.

Since data on bilateral trade in services between India and Germany is not available in the public domain, the bilateral merchandise trade flows have been analysed. Bilateral merchandise trade between India and Germany has increased by about five times in the past decade, from $4.5 billion in 2002-03 to $22 billion in 2012-13 (Figure 1.2). Germany is India's largest trading partner among EU member countries and the 6th largest partner in the world in trade in goods. In 2012-13, Germany accounted for 2.73 per cent of India's total merchandise trade[9]. In contrast, India ranks very low among German's trading partners. In 2012, India ranked 28th among Germany's trading partners (accounting for only 0.7 per cent of total German merchandise trade) and 5th among Asian exporters to Germany.

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[7] Ernst & Young (2012).

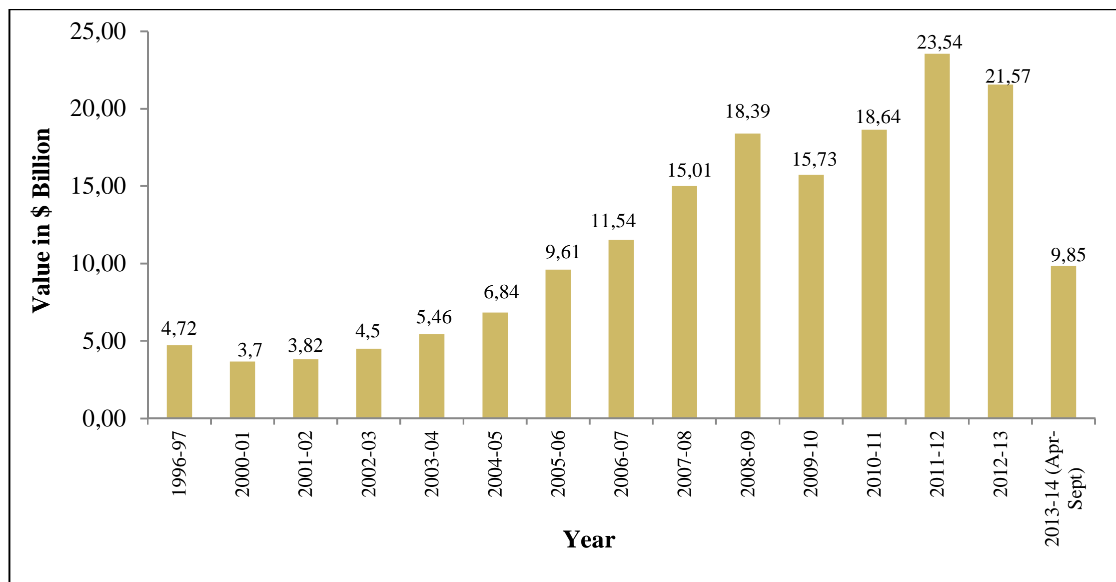
[8] WTO (2013).

[9] Export Import Data Bank, Department of Commerce, Ministry of Commerce and Industry, Government of India, available at *http://commerce.nic.in/eidb/default.asp* (last accessed on January 21, 2014).

Although the volume of trade between the two countries has increased in the past decade, Germany's share in India's total merchandise trade declined from 4 per cent in 2002-03 to 2.7 per cent in 2012-13[10], due to the global slowdown and the euro crisis. Also, countries such as China are competing with Germany in exporting machinery and other products to India.

Exports from India to Germany mainly consist of raw materials and intermediate goods and a few finished products such as cotton and textile products, leather and leather products, chemicals and pharmaceuticals, metal products and automobile components, whereas India's imports from Germany comprise machinery, electro-technical goods, aircraft, metal goods, chemicals, measurement and control systems and synthetic materials.

Figure 1.2: Trends in Bilateral Merchandise Trade between India and Germany



Source: Extracted from Export Import Data Bank, Department of Commerce, Ministry of Commerce and Industry, Government of India, available at *http://commerce.nic.in/eidb/default.asp* (last accessed on January 21, 2014).

1.4 Bilateral Investment Flows: India and Germany

Economic reforms and liberalisation of FDI resulted in an increase in FDI inflows to India. India's global FDI inflows increased from $0.20 billion in 1990s to $31.5 billion in 2011 and $25.5 billion in 2012. Similarly, Germany's global FDI inflows reached $48.5 billion in 2012 from $1 billion in the 1990s. The per cent share in global FDI inflows of both countries also increased over time. Germany's share increased from 0.6 per cent in 1990 to 3 per cent in 2011, compared to India's share from 0.66 per cent to 2.2 per cent in the same years[11].

Bilateral investment flows between India and Germany have increased over time. According to the Department of Promotion and Policy (DIPP), Germany is India's eighth largest source of FDI and, within the EU, Germany is the 4th largest investor in India. Between April 2000 and September 2013,

[10] Extracted from Export Import Data Bank, Department of Commerce, Ministry of Commerce and Industry, Government of India, available at *http://commerce.nic.in/eidb/default.asp* (last accessed on January 21, 2014).
[11] Calculated from UNCTAD Database on 'Foreign Direct Investment', available at *http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx* (last accessed on January 21, 2014).

total cumulative FDI inflows from Germany were valued at $6 billion, which accounted for 2.9 per cent of cumulative FDI inflows into India during this period[12]. The key sectors for investment by German companies in India were services, chemical and other fertilisers, trade, electrical equipment and automobiles. However, developing countries such as India require technology transfer along with FDI inflow and Indian policy favours FDI if it is accompanied by technology transfer. In this, Germany has a distinct advantage. Between August 1991 and December 2009, Germany was the second largest country for technology transfer (after the US), with a share of 13.7 per cent in total technological approvals in India[13]. The top sectors of technology transfer from Germany are industrial machinery, electrical equipment including computer software and electronics, chemicals, mechanical and engineering and transportation. These are also the sectors that can help India develop its manufacturing facilities and improve the quality of service delivery.

Indian investments in Germany have also increased. Between July 2007 and December 2013, Indian investments in Germany were valued at $533.8 million. The official data of Bundesbank shows that India was ranked 37th among foreign investors and 6th among Asian investing countries in 2011. Indian investments in Germany are mainly in the manufacturing sector[14].

To summarise, since Germany is a key investor and an important investment destination for India within the EU, the India-EU BTIA is likely to have a far-reaching impact on bilateral investments between India and Germany. However, studies show that agreements covering investments may or may not lead to an increase in actual investment flows between the contracting parties (Banga, 2003; Berger, *et al.*, 2010). It depends on several factors, including domestic policies and the scope and coverage of the agreements. Both India and Germany are experiencing a series of macroeconomic and policy changes. Germany is experiencing an economic slowdown caused by the eurozone crisis, and is looking for investment opportunities in emerging markets for safer investment options, while India is in the process of initiating several domestic reforms such as the General Anti-Avoidance Rules (GAAR) for taxpayers and streamlining investment procedures that will affect foreign investors. It is also looking to improve its physical infrastructure.

[12] DIPP (2013a).
[13] DIPP (2010).
[14] Compiled from the RBI database on 'Overseas Indian Direct Investment' available at *http://www.rbi.org.in/scripts/Data_Overseas_Investment.aspx* (last accessed on January 21, 2014).

Chapter 2 : Investment Flows into India and Germany: Literature Review and Market Comparison

Investment flows can benefit both developed and developing economies. Given appropriate host-country policies and a basic level of development, FDI triggers technology spillovers, assists human capital formation, contributes to international trade integration, helps to create a competitive business environment and enhances enterprise development (Borenzstein *et al.*, 1998; Hamm and King 2010). In terms of outward investment, overseas investment has provided developing countries better access to global networks and markets, as well as technology and skills, and enables them to share research and development efforts and outcomes. FDI can also be seen as a corporate strategy to promote brand image and to utilise raw materials in the host country (Khan, 2012).

Over the years, both developed and developing countries have liberalised their FDI regimes and pursued investment-friendly policies. This not only encourages domestic and foreign investment but also provides incentives for innovation and improvement of skills and creates a competitive corporate climate. The factors that lure potential investors to developing countries are changes in the policy environment (Amirahmadi and Wu, 1994; Banga, 2003; Chakraborty and Basu, 2002), liberalisation of FDI regulations (Nunnenkamp, 2002), privatisation and globalisation of production (Chakraborty and Basu, 2002), output growth (Chakraborty and Nunnenkamp, 2008), establishment of global supply chains (Reardon et al., 2004), simplified entry barriers and easing of laws and the tax system for foreign investors (Devajit, 2012). For developed countries, a freer business environment leads to outbound investments (Banga, 2003). Trade liberalisation also has a favourable effect on FDI flows; regions with greater involvement in international trade attract larger amounts of FDI (Goldar and Banga, 2007).

There is a significant amount of literature on the motives behind FDI inflows. A foreign firm's primary motive while trying to expand its business is to increase or protect its capital value and one way to achieve this "is by engaging in FDI, either to better exploit their existing competitive advantages or to safeguard, increase or add to these advantages" (UNCTAD, 2006: p. 142). The motives behind FDI flows as identified by Behrman (1972) are:

- *Market seeking:* These investments focus on countries that have large market size and prospective market growth. Participation of countries in free trade agreements and regional trade integration that increase regional demand and potential market size is likely to increase their appeal to investors who aim at penetrating the local markets of host countries (IMF, 2003: p.6)
- *Resource seeking:* Investment decisions are made in order to gain access to natural resources, manpower, technology or organisational resources of the host country (Panayides, 2002). This type of investment was previously rather important and still remains a relevant source of FDI for various developing countries.
- *Efficiency seeking:* The investor focuses on creating new sources of competitiveness for firms through specialisation, low cost of production and strengthening existing ones. This is likely to emerge as the most important type of FDI (Nunnenkamp, 2002).
- *Strategic asset seeking*: This refers to investments that include purchase of existing firms and/or its assets such as intellectual property, business knowledge or technology in the host country to make it more globally competitive. This type of FDI also helps in developing production networks and global value chains.

Competitive pressures might influence a company to invest overseas, but it can still choose to respond to this pressure in a variety of ways, including looking for new customers (market-seeking FDI, perhaps in middle-income developing economies), reducing its costs (efficiency-seeking FDI,

perhaps in lower-income developing countries), accessing key factor inputs (resource-seeking FDI, perhaps in a country with abundant raw materials), or acquiring new technologies to improve productivity (strategic asset-seeking FDI, perhaps in developed economies), or a mix of these (UNCTAD ,2006: p.158). The market-seeking motive is considered to be the dominant reason for FDI inflow (Agarwal *et al.*, 1991; Kudina and Jakubiak, 2008) and has a positive and significant impact on GDP and exports (Wadhwa and Reddy, 2011). With the liberalisation of the services sector, market-seeking FDI has boomed. The bulk of FDI in services, which accounts for a rising share in overall FDI, is market seeking, since most services are not tradable (Nunnenkamp, 2002). This is especially true of flow of FDI into developing countries such as India, which has a large and unsaturated market. Efficiency-seeking FDIs can lead to the establishment of production networks and global value chains; in this, India has had less success than China in attracting such FDI.

Other factors that attract FDI are macroeconomic stability, economic reforms and autonomous liberalisation (Campos and Kinoshita, 2003), trade liberalisation (Mitra, 2012), good governance (Garibaldi *et al.*, 2002), low levels of country risk and high degree of freedom, well-developed infrastructure and public services, tax policies (Chang and Cheng, 1992) and an effective legal system (Perry, 2000). Thus, the overall ease of doing business, i.e., an investor-friendly climate in the host country, will attract foreign investment.

The Eclectic Paradigm attempts to explain why multinational corporations (MNCs) choose FDI rather than serve foreign markets through alternative modes such as licensing, strategic alliances, management contracts and exporting. Also known as the Ownership, Location and Internalization (OLI) framework, this theory was developed by John Dunning in a series of publications (Dunning 1980, 1981, 1988, 1992) based on the Theory of Internalization[15] developed in 1976 by Buckley and Casson (Rugman, 2010). According to the OLI framework, three conditions ascertain the international activities of MNCs, i.e., ownership (O) advantages, location (L) advantages, and internalisation (I) advantages. OECD (2007) explains these three types of advantages: ownership advantages are patents, know-how, and trademarks that offer a profit advantage over local firms; location advantages are low trade, labour or energy costs, and low tax burden that make local production more profitable than exporting; and internalisation advantages make undertaking a business activity directly through FDI more profitable than licensing to other firms in foreign markets the right to use assets that confer ownership advantage.

The potential benefits of FDI inflows include technology spillovers, knowledge transfer (Aitken and Harrison, 1999; Haddad and Harrison, 1993) and improvement in infrastructure. With technological developments, there has been an international division of labour and the creation of global production and distribution networks. The prime contributors to this phenomenon are transnational corporations (TNCs) that are looking at untapped markets to increase their market size and production. With increasing FDI flows there has been increasing participation in global production and distribution (Kaminski and Smarzynska, 2001). Such integration into the production and marketing arrangements of TNCs benefits transition economies.

2.1 FDI Definition and Policy

There are several definitions of FDI. One of the most widely used definitions, given by the International Monetary Fund (IMF), is as follows:

> Foreign direct investment is the category of international investment that reflects the objective of obtaining a lasting interest by a resident entity in one economy in an enterprise

[15] Internalization theory suggested that owing to market imperfections, a firm begins to overcome it by accessing and internalising its activities across national boundaries, thereby becoming a multinational firm.

> resident in another economy. 'Lasting interest' implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the direct investor on the management of the direct investment enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated[16]**.**

Internationally, FDI data is compiled and disseminated by various organisations including the IMF, United Nations Conference on Trade and Development (UNCTAD) and Organisation for Economic Co-operation and Development (OECD). Components of FDI submitted by various countries to these organisations include (a) direct investment income (b) direct investment transactions and (c) direct investment position. Direct investment transactions and positions are sub-classified into equity, reinvested earnings, other capital (inter-company transactions) and financial derivatives.

In India, the Reserve Bank of India (RBI) and the Secretariat of Industrial Assistance (SIA) under the Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industries, monitor and publish FDI data. Until 2001, data on FDI released by the RBI did not include reinvested earnings and other capital and financial derivatives. Since 2001, the database on FDI has been widened to include reinvested earnings and other capital transactions. However, data released by the SIA still does not include other financial derivatives, which are normally included by other countries reporting data to the IMF. Studies have pointed out that this has led to under-reporting of FDI data in India leading to gross under-valuation of actual FDI inflows into the country compared to countries such as China. In addition, data on investment recorded by the DIPP is based on approved investment instead of actual investment. This results in data discrepancies.

In Germany, FDI data is compiled and published annually by the German Federal Bank, viz., Deutsche Bundesbank (Foreign Direct Investment Stock Statistics - Special Statistical Publication 10). It presents stocks of incoming and outgoing FDI, by sector, country and type of FDI. Other dimensions include number of enterprises and employees, annual turnover and balance sheet total. It is published annually in April and contains data on the previous four years[17].

Germany has only a few restrictions on FDI inflows. Except for sensitive sectors such as arms and ammunition, the rest of the economy is open to FDI inflows. For example, companies that are at least 25 per cent owned by foreign holders and want to invest in weaponry sectors need approval from the Federal Ministry of Economics and Technology (Jost, 2012). In comparison, India has more FDI restrictions as some sectors are completely closed for FDI while others have FDI limitations (for details, see Table 5.3).

2.1.1 India as a destination and Germany as a potential investor

Germany is an export-oriented country with strong manufacturing competence, but the country is facing growing labour costs and labour shortage and the domestic market is becoming saturated. Thus, it is in the interests of German companies to expand their global footprint through FDI. In the past a major part of German investment was in neighbouring countries within EU Member States, but East Asian, South Asian and Southeast Asian markets are expected to become destinations for German outward foreign direct investment (OFDI)[18], since they are growing and unsaturated

[16] For details, see *https://www.imf.org/external/np/sta/di/glossary.pdf* (last accessed on February 24, 2014).
[17] *http://www.bundesbank.de/Redaktion/EN/Standardartikel/Statistics/foreign_direct_investment_stock_statistics.html* (last accessed on February 25, 2014).
[18] Indo-German Chamber of Commerce (2010).

economies. Also, countries such as India and China have large domestic markets. German FDI is primarily market-seeking (Deutsche Bundesbank, 2006) and India offers a large consumer market (Ernst & Young 2013). India needs investment in infrastructure not only to meet the demands of its growing population, but also to support its manufacturing and services sectors (Ernst & Young, 2013). Investments and joint ventures in India provide good business opportunities for German medium-sized companies (Deutsche Bundesbank, 2006), and trade and investment flows are interlinked (Agarwal *et al.*, 1991). Since Germany is one of India's top trade partners, there is likely to be significant investment flows and economic activity between India and Germany.

Unlike Germany, India is a large emerging market that is an attractive destination for FDI (Ernst & Young, 2012). After the liberalisation of the Indian economy in the 1990s, the new policy regime placed an emphasis on attracting foreign investment (Rao *et al.*, 1997). Increased flows of FDI have allowed Indian industries to upgrade their technology, provided access to global managerial skills and practices, optimised the utilisation of human and natural resources and allowed them to compete internationally with higher efficiency (Economic Survey, 2003-04)[19]. FDI inflow has also had a positive impact on domestic investment (Prasanna, 2010).

With respect to Indian investments in Germany, Indian firms have a preference for acquisitions to access the technology, physical infrastructure and research and innovation capabilities (Tiwari, 2012). According to Bundesbank, India is a key emerging market investor from Asia[20]. Studies also show that Indian investments have positive spillover effects in Germany such as job creation (Tiwari and Herstatt, 2009).

The literature shows that there are complementarities between India and Germany that will facilitate and enhance India-Germany bilateral investment flows and benefit both nations.

2.2 Market Comparison: India and Germany

This section compares India and Germany on their attractiveness for investors. The three components are market attractiveness of FDI flows, ease of doing business and competitiveness on economic and social factors.

2.2.1 Market Attractiveness for FDI Inflows

Table 2.1 compares India and Germany on three indices in terms of market attractiveness for FDI inflows:

- The *FDI Confidence Index*, by A.T Kearney, assesses the present and future prospects of FDI flows of 25 countries based on the perceptions of CEOs.
- The *Inward FDI Attraction Index* of UNCTAD measures the success of economies in attracting FDI (combining total FDI inflows and inflows relative to GDP). The Index covers 182 countries. The rank of a country is based on the average of a country's percentile ranks in FDI inflows and in FDI inflows as a share of GDP.
- The *Inward FDI Potential Index* of UNCTAD captures four key economic determinants of the attractiveness of an economy for foreign direct investors: the attractiveness of the market (for market-seeking FDI), the availability of low-cost labour and skills (to capture efficiency-seeking FDI), the presence of natural resources (resource-seeking FDI), and the presence of FDI-enabling infrastructure. The Index covers 182 countries.

[19] Ministry of Finance (2003).
[20] Indo-German Chamber of Commerce (2012).

Table 2.1: Comparison of India and Germany on FDI Indices

Country	FDI Confidence Index			Inward FDI Attraction Index			Inward FDI Potential Index		
	2004	**2007**	**2013**	**2004**	**2007**	**2011**	**2005**	**2007**	**2011**
India	3	2	5	92	96	59	84	85	3
Germany	5	10	7	70	63	86	7	5	8

Sources: Compiled from A.T. Kearney (2004, 2007, 2013) and UNCTAD (2012).
Note: A lower number indicates higher performance.

In 2013, India's rank on the FDI confidence index dropped due to the slow growth of the economy and rising inflation and current account deficits. In contrast, Germany's strong rebound from the eurozone crisis and its role as Europe's largest international and industrial economy makes it a better investment destination. On the FDI Inward Potential Index, India has made an impressive leap to rank 3 in 2011 from 84 in 2005, which shows that India has the potential to attract FDI, yet India is not meeting the potential.

2.2.2 *Ease of Doing Business Index*

One important factor determining the inflow of FDI is how easy it is to do business in a particular country. The Ease of Doing Business index by the World Bank ranks 186 economies in terms of their business operating environment and their regulations for foreign investments. Table 2.2 indicates that India and Germany ranked 20th and 132nd, respectively, in 2013, which indicates that it is easier to do business in Germany than in India. The table also shows that India has the lowest rank among BRIC (Brazil, Russia, India and China) countries largely due to its poor infrastructure, need for multiple clearances and quality of governance. The index is based on the perceptions of manufacturers and, therefore, indicates why India has not been able to do well in the manufacturing sector.

Table 2.2: Rank of Select Countries in Ease of Doing Business Index, 2013

Economy	**Ease of Doing Business**	**Starting a Business**	**Dealing with Construction Permits**	**Getting Electricity**	**Registering Property**	**Getting Credit**	**Protecting Investors**	**Paying Taxes**	**Trading Across Borders**	**Enforcing Contracts**	**Resolving Insolvency**
Singapore	1	4	2	5	36	12	2	5	1	12	2
Germany	20	106	14	2	81	23	100	72	13	5	19
China	91	151	181	114	44	70	100	122	68	19	82
Russia	112	101	178	184	46	104	117	64	162	11	53
Brazil	130	121	131	60	109	104	82	156	123	116	143
India	132	173	182	105	94	23	49	152	127	184	116

Source: World Bank (2013b).

2.2.3 *Global Competitiveness Index*

The Global Competitiveness Index of the World Economic Forum ranks economies on various parameters. The latest report (2013-14) compares 148 economies in terms of their economic and social factors that enhance their attractiveness. Table 2.3 compares the ranks of BRIC nations and Germany. Overall, Germany is among the top seven countries in terms of national competitiveness. India is ranked 60th and lies much below other emerging markets such as China but has a better rank than Russia.

Table 2.3: Ranks of BRIC nations and Germany on Global Competitiveness Index (2013-14)

Indicator	Germany	China	Brazil	India	Russia
Overall Rank	**4**	**29**	**56**	**60**	**64**
Basic requirements	**9**	**31**	**79**	**96**	**47**
Institutions	15	47	80	72	121
Infrastructure	3	48	71	85	45
Macroeconomic environment	27	10	75	110	19
Health and primary education	21	40	89	102	71
Efficiency enhancers	8	31	44	42	51
Higher education and training	3	70	72	91	47
Goods market efficiency	21	61	123	85	126
Labour market efficiency	41	34	92	99	72
Financial market development	29	54	50	19	121
Technological readiness	14	85	55	98	59
Market size	5	2	9	3	7
Innovation and sophistication factors	**4**	**34**	**46**	**41**	**99**
Business sophistication	3	45	39	42	107
Innovation	4	32	55	41	78

Source: Extracted from World Economic Forum (2013).

We broke down the individual parameters and examined the components that affect investment flow. While most tables compare scores and ranks of India and Germany, some tables present data for other European markets and emerging markets.

a) *Economic stability: A stable economy is marked by constant output growth and low inflation.* Economic stability over a longer period is important for attracting FDI since FDI implicates a long-term commitment. Despite the global slowdown and eurozone crisis, the overall macroeconomic environment is more stable in Germany than in India. Table 2.4 shows that Germany is ranked the top country with respect to low inflation. However, the ratio of Germany's government debt to GDP (ranked 130) is among the highest as a result of the financial and economic crisis. This could be challenging for the German government, since it may increase the likelihood that investors will demand higher interest rates in order to continue to hold government bonds or to purchase new bond issues (Deutsche Bundesbank[21]). In India, the major macroeconomic issues are the ratio of the government budget balance to GDP (ranked 141) and inflation (ranked 130).

[21] For details, see

http://www.bundesbank.de/Redaktion/EN/Standardartikel/Bundesbank/Views_Insights/background_government_debt_harbours_inflation_risks.html (last accessed on January 24, 2014).

Table 2.4: Ranks of India and Germany on Economic Stability

Indicator	India	Germany
Government budget balance (% GDP)	141	28
Gross National Savings (% GDP)	28	49
Inflation (annual % change)	130	1
General government debt (% GDP)	116	130

Source: Extracted from World Economic Forum (2013).

a) *Infrastructure:* Good infrastructure improves accessibility and reduces transportation costs, hence promoting FDI (Rehman *et al.*, 2011). On the Global Competitiveness Index, Germany is the third best economy after Hong Kong and Singapore in terms of state-of-the-art infrastructure, but it lags behind in quality of electricity supply. India lags far behind in terms of infrastructure.

Table 2.5: Ranks of India and Germany on Infrastructure Indicators

Indicator	India	Germany
Quality of overall infrastructure	*85*	*10*
Quality of roads	84	11
Quality of railroad infrastructure	19	7
Quality of port infrastructure	70	9
Quality of air transport infrastructure	61	8
Quality of electricity supply	111	32

Source: Extracted from World Economic Forum (2013).

Low logistics costs improve global competitiveness and reduce wastage in the supply chain, thereby attracting more FDI. The World Bank's *Logistics Performance Index* shows that in 2013 Germany was ranked first in logistics performance among 215 countries, whereas India is at 47th position (Table 2.6).

Table 2.6: Ranks of Select Countries on Logistics Performance Index, 2013

Indicator	Germany	UK	Netherlands	France	China	Brazil	India	Russia
Overall Rank	**1 (4.11)**	**8 (3.95)**	**4 (4.07)**	**17 (3.84)**	**27 (3.49)**	**41 (3.20)**	**47 (3.12)**	**94 (2.61)**
Customs	3 (4.00)	11 (3.74)	4 (3.98)	32 (3.63)	32 (3.16)	82 (2.37)	52 (2.70)	115 (2.15)
Infrastructure	1 (4.34)	16 (3.95)	2 (4.25)	17 (4.00)	27 (3.54)	37 (3.10)	47 (2.91)	83 (2.38)
International shipments	9 (3.66)	8 (3.66)	11 (3.61)	28 (3.30)	27 (3.31)	65 (2.91)	46 (3.13)	96 (2.72)
Logistics Competence	4 (4.14)	9 (3.92)	3 (4.15)	12 (3.87)	29 (3.49)	34 (3.30)	40 (3.16)	88 (2.51)
Tracking & Tracing	4 (4.18)	7 (4.13)	9 (4.12)	14 (4.01)	30 (3.55)	36 (3.42)	52 (3.14)	97 (2.60)
Timeliness	3 (4.48)	8 (4.37)	6 (4.41)	9 (4.37)	36 (3.91)	20 (4.14)	56 (3.61)	88 (3.25)

Source: World Bank (2013c).
Note: Scores are given in parentheses.

b) *Educated workforce:* In terms of higher education and training, India and Germany rank 91 and 3, respectively. India has a reasonably good position (ranked 40) with respect to quality of education. However, in terms of quantity, it has a low rank (ranked 109) owing to low gross enrolment ratio (GER), inequitable access to higher education and lack of quality research[22].

Table 2.7: Ranks of India and Germany on Availability of Educated Workforce

Indicator	India	Germany
Quantity of education	109	1
Quality of education	40	23
On-the-job training	51	4

Source: Extracted from World Economic Forum (2013).

c) *Labour market efficiency*: India's performance (ranked 99) has been much below that of Germany (rank 41) and BRIC nations (Brazil 92, Russia 72 and China 34). Table 2.8 shows that the labour market in Germany is highly inflexible, but it makes efficient use of its talent. It is the reverse with India.

Table 2.8: Ranks of India and Germany on Labour Market Efficiency

Indicator	India	Germany
Flexibility	51	113
Co-operation in labour-employer relation	61	18
Flexibility of wage determination	50	141
Hiring and firing practices	52	118
Efficient use of talent	127	11
Pay and productivity	58	42
Reliance on professional management	46	19

Source: Extracted from World Economic Forum (2013).

d) *Property rights and Intellectual Property Rights (IPR)*: A strong IPR regime helps induce high-quality FDI (Nunnenkamp and Spatz, 2004). Germany is much ahead of India both in terms of property rights and the IPR regime.

Table 2.9: Ranks of India and Germany on IPR Regime

Indicator	India	Germany
Property rights	58	15
Intellectual property rights	71	14

Source: Extracted from World Economic Forum (2013).

e) *Market Size:* Market size is an important consideration for an MNC to decide where it would invest, India's large market size makes it an attract investment destination.

Table 2.10: Ranks of India and Germany on Market Size

Indicator	India	Germany
Domestic market size	3	5
Foreign market size	4	3

[22] FICCI and E&Y (2012).

Source: Extracted from World Economic Forum (2013).

f) *Good governance and transparency:* Good public governance increases transparency, improves the predictability of laws and regulations and the efficiency of procedures and encourages higher standards of public service. This, in turn, contributes to a better regulatory environment for business and the attractiveness of an investment location (Subasat and Bellos, 2013; UNCTAD, 2004). Table 2.11 indicates that Germany ranks higher than India in terms of transparency and better governance. However, it falls behind India on strength of investor protection, due to restrictions on mode of entry and a less investor-friendly environment.

Table 2.11: Ranks of India and Germany on Good Governance and Transparency

Indicator	India	Germany
Public trust in politicians (2012-13)	115	19
Irregular payments and bribes (2012-13)	110	21
Efficiency of legal framework in settling disputes (2012-13)	62	13
Transparency of government policy making (2012-13)	61	23
Protection of minority shareholders' interests (2012-13)	52	29
Strength of investor protection (2012)	41	84

Source: Extracted from World Economic Forum (2013).

The above tables highlight that even though India is a large market, it ranks poorly in terms of market attractiveness. India's rank in terms of transparency and infrastructure is poor compared to Germany and other European and emerging markets. In terms of labour, even though Germany ranks better in terms of labour efficiency, the Indian work force is more flexible. Overall, even though Germany ranks better than India, the Indian market has huge potential that remains unexplored.

Chapter 3 : Bilateral Investment Flows between India and Germany

India and Germany are at different stages of economic development but they have some commonalities. Both are large markets. While India is one of the fastest growing economies in the world, German, is the EU's largest economy and one of the large economies of the world. India and Germany have a large number of small and medium enterprises that are actively expanding their market presence[23]. Both India and Germany's global FDI inflows and outflows have increased substantially in the past decade. However, there are significant differences. While India is among the attractive destinations, German companies are major investors around the world. India is a capital-scarce country that needs FDI to build productive capacities. Since opening up in 1991, India has become one of the largest recipients of FDI among developing countries. Germany is a large investor abroad and India needs foreign investment. This contrasting economic position of India and Germany creates scope for a mutually beneficial relationship in investment between the two countries. This chapter examines trends and patterns of bilateral investments between India and Germany, along with their global FDI inflows and outflows.

3.1 Global FDI Inflows: India and Germany

Economic reforms in general and liberalisation of FDI in particular have affected the magnitude and pattern of FDI inflows received by India and Germany. Economic reforms and investment-friendly policies have led to an increase in the FDI inflows of India and Germany. However, their FDI flow patterns are dissimilar.

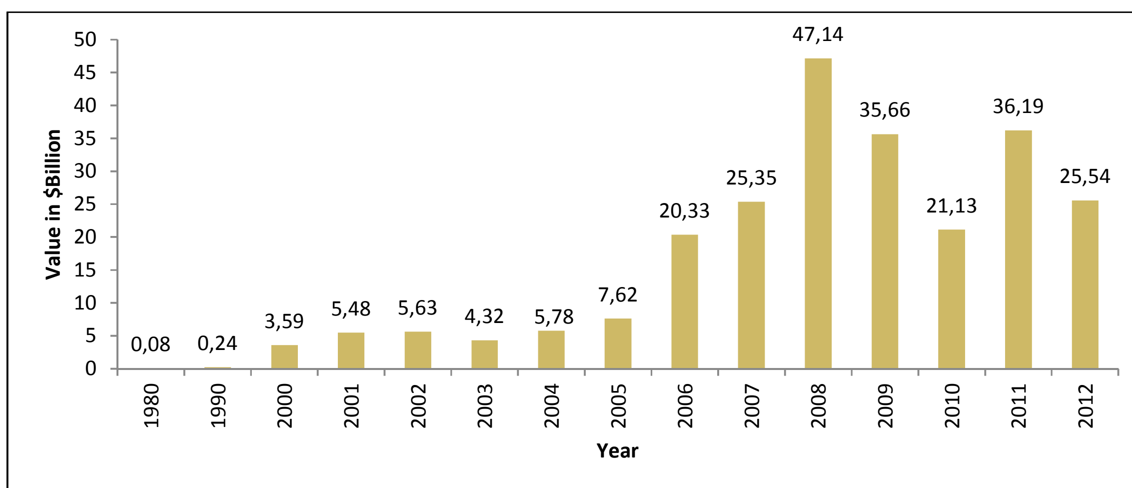
3.1.1 Global FDI inflows: India

Economic reforms and liberalisation of FDI have increased FDI inflows to India. FDI inflows to India were valued at $0.20 billion in the 1990s, which increased to $5.5 billion in 2001, reached a peak of $31.5 billion in 2011 and then declined to $25.5 billion in 2012 (Figure 3.1). The percentage share of India in global FDI inflows increased from 0.66 per cent in 1990 to 2 per cent in 2012[24].

Figure 3.1: Trends in FDI inflows to India

[23] However, the two countries define SMEs in different ways. While India defines an SME based on investment in the plant and machinery, Germany defines them based on the level of employment.

[24] Compiled from UNCTAD Database on 'Foreign Direct Investment' available at *http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx* (last accessed on January 21, 2014).



Source: Compiled from UNCTAD Database on 'Foreign Direct Investment', available at *http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx* (last accessed on January 21, 2014).

Factors such as progressive liberalisation of FDI restrictions, potential market size and the large consumer base have made India an attractive destination for foreign investors. Between April 2000 and September 2013, Mauritius and Singapore accounted for 47.9 per cent of cumulative FDI inflows into India (Table 3.1), primarily because India has signed a Double Taxation Avoidance Agreement (DTAA) with Mauritius and Singapore and the taxes in these countries are much lower than the taxes in India. However, a large part of Indian investment from the US, the EU (including Germany) and other countries is routed through Mauritius and a major part of the investments from Mauritius to India is actually round tripping by Indian firms (Rajan *et al.*, 2008). Germany was the eighth largest investor in India; cumulative FDI inflows from Germany were valued at $6 billion, which accounted for 3 per cent of India's total FDI inflows during that period.

Table 3.1: Top 15 Investor Countries in India (April 2000 to September 2013)

Rank	**Country**	**Cumulative FDI Inflows**		**Per cent share in total cumulative inflows**
		In Rs billion	**In US$** billion	
1	Mauritius	3,566.7	76.5	37.28
2	Singapore	1,043.4	22.0	10.73
3	United Kingdom	924.1	19.4	9.49
4	Japan	722.9	14.9	7.29
5	US	538.6	11.6	5.68
6	Netherlands	487.6	10.0	4.90
7	Cyprus	341.2	7.2	3.51
8	Germany	285.0	6.0	2.94
9	France	177.8	3.7	1.82
10	UAE	123.6	2.6	1.27
11	Switzerland	114.4	2.4	1.19
12	Spain	83.0	1.7	0.83
13	South Korea	61.1	1.3	0.63
14	Italy	56.2	1.2	0.60
15	Hong Kong	56.5	1.2	0.58
Total (Top 15 countries)		**8,582.1**	**181.5**	**88.74**
Total FDI inflows		**9,643.3**	**204.8**	

Source: Extracted from DIPP (2013a) Annex A, pp. 6-8, Table: Statement on Country-wise FDI Equity Inflows from April 2000 to September 2013.

The services sector attracts most of the FDI (Table 3.2). However, the DIPP does not record disaggregated FDI inflows into different services sectors and much of the FDI inflows into services is covered under different sectors such as construction, computer software and hardware and hotel and tourism.

Table 3.2: Top 15 Sectors for Foreign Equity Inflows to India (January 2000 to September 2013)

Rank	**Sector**	**Cumulative FDI Equity Inflows**		Per cent **share in cumulative FDI inflows**
		In Rs. billion	**In $** billion	
1	Services (including financial, banking, insurance, non-financial, business services, R&D, courier and technical and testing analysis, etc.)	1800.8	38.6	18.78
2	Construction (including construction of townships, housing, built-up infra, etc; and infrastructure activities)	1160.7	25.0	12.17
3	Energy (including power, petroleum and gas; coal production and non-conventional energy)	769.3	16.4	7.98
4	Telecommunications	589.4	12.9	6.28
5	Computer software and hardware	544.5	12.0	5.84
6	Drugs & pharmaceuticals	549.6	11.4	5.55
7	Chemicals (other than fertilisers)	427.5	9.3	4.53
8	Automobile Industry	438.8	9.2	4.48
9	Metallurgical industries	362.7	7.8	3.80
10	Hotel & tourism	342.2	6.8	3.31
11	Food processing industries	211.4	3.8	1.85
12	Trading (including retail trade)	203.9	4.3	2.09
13	Information & broadcasting (incl. print media)	174.9	3.6	1.75
14	Transport (including sea transport, road transport, ports and railway-related components)	162.2	3.7	1.80
15	Electrical equipment	151.0	3.3	1.61
Total (Top 15 sectors)		**7888.9**	**168.1**	**81.82**
Total (All sectors)		**9672.5**	**205.5**	

Source: Compiled from SIA (2013) Statement on Sector-wise/Year-wise FDI equity inflows - from January 2000 to September 2013, Table 4.

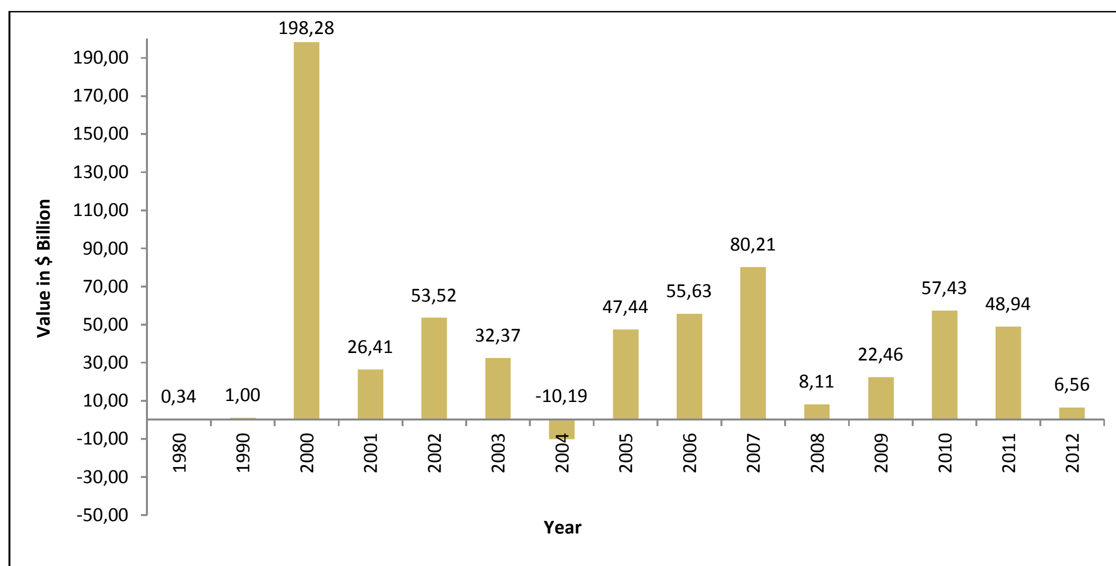
3.1.2 Global FDI Inflows: Germany

Germany is the largest market in the EU and constitutes around 21 per cent of the European GDP[25]. Investors from around the world invest in Germany not only for the domestic market but also to access the wider EU market. Germany's market has numerous advantages such as skilled manpower, quality engineering, state-of-the-art infrastructure and strong trade ties that make it one of the world's leading business locations (KPMG, 2008). In recent years, the devaluation of the euro vis-à-

[25] GTAI (2014).

vis most major currencies has contributed to an increase in direct investment assets[26]. However, FDI inflows into Germany show a fluctuating pattern (Figure 3.2). The per cent share of Germany in global FDI inflows increased from 0.6 per cent in 1990 to 3 per cent in 2011[27].

Figure 3.2: Trends in FDI inflows into Germany



Source: Compiled from UNCTAD Database on 'Foreign Direct Investment', available at *http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx* (last accessed on January 21, 2014).

According to Bundesbank, in 2011 about 76 per cent of all Inward FDI stock into Germany originated from within the EU-27, another 8 per cent came from the rest of Europe, and the remaining 16 per cent came from outside Europe. North America accounted for 10 per cent and Asia 5 per cent of Germany's FDI stocks. However, FDI stocks from Asian countries are increasing. Among Asian countries, Japan, Korea and China have become large sources of FDI stock in Germany in recent years[28] (Table 3.3.)

Table 3.3: Top 15 Investor Countries in Germany (2001 and 2011)

Rank	Country	2001		Rank	Country	2011	
		FDI Inflows (in $ million)	Per cent share in Germany's FDI Inflows			FDI Inflows (in $ million)	Per cent share in Germany's FDI Inflows
1	Netherlands	91.5	21.20	1	Netherlands	259.9	25.14
2	Luxembourg	90.8	21.03	2	Luxembourg	147.5	14.27

[26] Deutsche Bundesbank. 'New results of the foreign direct investment stock statistics'. Press Notice. April 27, 2012. *http://www.bundesbank.de/Redaktion/EN/Pressemitteilungen/BBK/2012/2012_04_27_results_stock_statistics.html?nsc=true&view=render%5BDruckversion%5D* (last accessed on January 24, 2014).

[27] Compiled from UNCTAD Database on 'Foreign Direct Investment', available at *http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx* (last accessed on January 21, 2014).

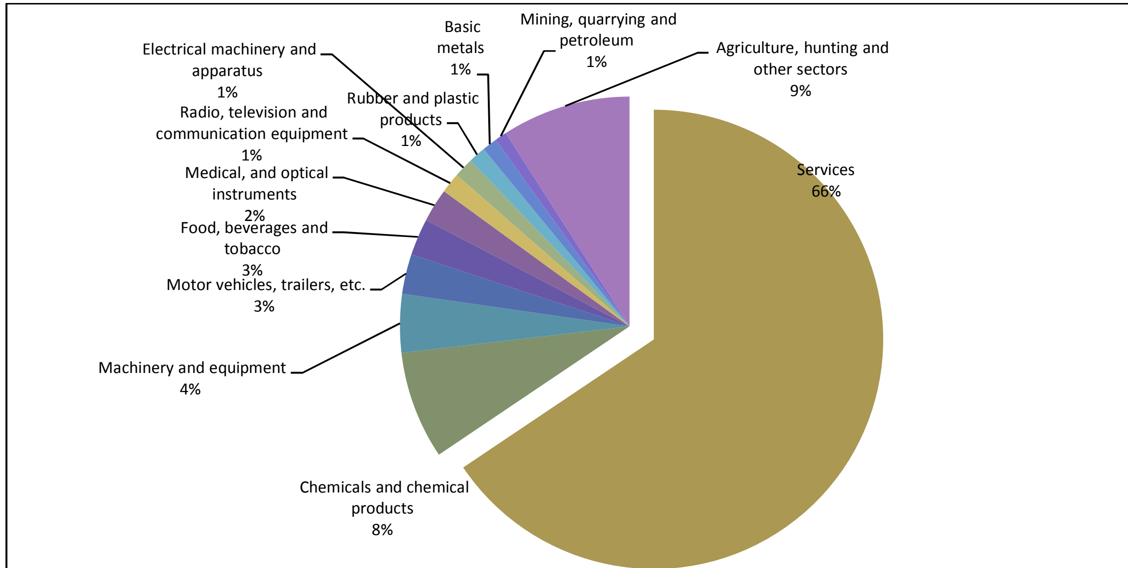
[28] *http://www.gtai.de/GTAI/Content/EN/Invest/_SharedDocs/Downloads/GTAI/Articles/fdi-electroindustrie.pdf;* Jost (2013).

Rank	Country	2001		Rank	Country	2011	
		FDI Inflows (in $ million)	Per cent share in Germany's FDI Inflows			FDI Inflows (in $ million)	Per cent share in Germany's FDI Inflows
3	US	81.6	18.91	3	US	102.9	9.96
4	France	33.9	7.87	4	France	95.8	9.27
5	UK	33.2	7.69	5	UK	87.0	8.41
6	Switzerland	24.3	5.63	6	Switzerland	86.3	8.35
7	Belgium	15.2	3.51	7	Italy	51.7	5.00
8	Japan	8.9	2.06	8	Austria	34.4	3.33
9	Austria	8.3	1.93	9	Japan	22.7	2.19
10	Sweden	8.3	1.92	10	Sweden	21.8	2.11
11	Spain	7.2	1.67	11	Spain	18.3	1.77
12	Finland	6.3	1.47	12	Denmark	16.5	1.59
13	Italy	5.5	1.28	13	Belgium	14.2	1.38
14	Denmark	4.2	0.96	14	Finland	10.8	1.04
15	Ireland	1.6	0.38	15	Korea	6.5	0.63
29	China	0.2	0.04	25	China	1.7	0.17
38	India	0.1	0.02	37	India	0.5	0.05
	Total	**430**			**Total**	**1033.8**	

Source: Compiled from Bundesbank, available at
http://www.bundesbank.de/Navigation/EN/Topics/topics.html
Note: Values have been converted from euros to US$. Exchange rate for 2001 is €1=$ 0.8962 (average) and for 2011 it is €1=$ 1.394 (average). Extracted from historical exchange rates, Oanda currency converter, *http://www.oanda.com/currency/historical-rates/*

FDI inflows into Germany are mainly concentrated in the services sector. In 2010, the services sector accounted for 66 per cent of the country's total FDI stock (Figure 3.3). Within the services sector, real estate, renting and business activities (38.8 per cent), financial and insurance services (23.46 per cent) and transport and communications (12.1 per cent) accounted for the bulk of FDI stocks.

Figure 3.3: Per cent share of Sectors in Inward FDI stock of Germany, 2010



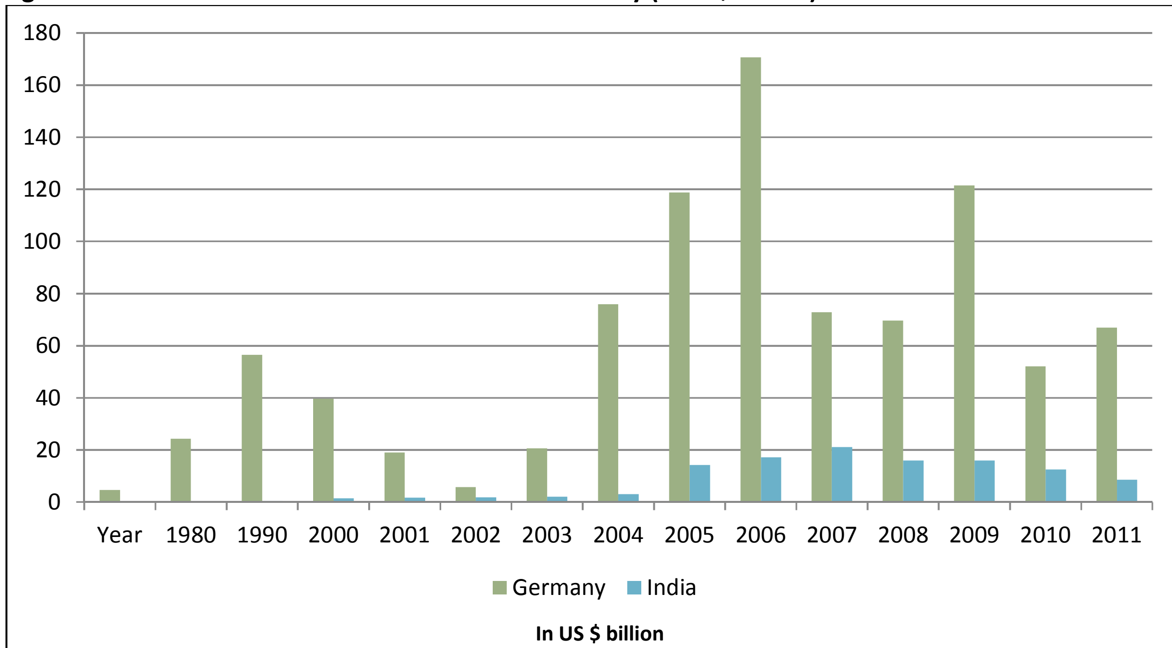
Source: Calculated from Jost (2013) Annex Table 3, p.9.

3.2 Global FDI Outflows: India and Germany

3.2.1 Global FDI Outflows: India

Before the 1990s, Indian investments abroad were very limited and India's share in the world's total FDI outflows was very low compared to several other developing countries. In 1990, India's share in world total FDI outflows was only 0.01 per cent compared to China's share of 0.34 per cent and Brazil's share of 0.26 per cent. Since the 1990s, Indian companies have started investing abroad. India's FDI outflows have increased, from $4 million in the 1980s to $8.58 billion in 2012 (Figure 3.4). In 2010, India's share was 1.11 per cent, which is still lower than China's (5.14 per cent) but more than Brazil's (0.87 per cent) and South Africa's (0.03 per cent).

Figure 3.4: Trends in FDI Outflows of India and Germany (in US$ billion)



Source: Compiled from UNCTAD Database on 'Foreign Direct Investment', available at *http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx* (last accessed on January 21, 2014).

Before 1990, Indian companies preferred to invest in countries where there was little technological competition, but now developed economies have become their preferred destination (UNCTAD, 2007). Data from the RBI for India's outward investment for the period July 2007 to December 2013 show that about 48 per cent of India's total FDI has gone to Singapore and Mauritius, from where a large part is routed to countries such as the US and EU Member States (Table 3.4).

Table 3.4: Top 20 Destinations for Indian Investments (July 2007 to Dec 2013)

Rank	Country	Consolidated FDI Outflows (in $ billion)	Per cent share in Cumulative FDI outflows
1	Singapore	43.38	25.30
2	Mauritius	38.08	22.21
3	Netherlands	25.52	14.89
4	United States	12.90	7.52
5	United Arab Emirates	7.59	4.43
6	UK	6.64	3.87
7	British Virgin Islands	5.69	3.32
8	Cyprus	5.63	3.28
9	Switzerland	2.62	1.53
10	Cayman islands	2.60	1.52
11	Australia	1.99	1.16
12	Hong Kong	1.52	0.89
13	Denmark	1.04	0.61
14	Sri Lanka	0.93	0.54
15	Azerbaijan	0.81	0.47
16	Indonesia	0.77	0.45
17	Canada	0.59	0.34
18	Luxembourg	0.54	0.31
19	Belgium	0.54	0.31
20	Germany	0.53	0.31
	Total	**171.44**	**93.26**

Source: Calculated from 'Data on Overseas Investments', RBI,
http://www.rbi.org.in/scripts/Data_Overseas_Investment.aspx (last accessed on January 21, 2014).

In the past, the majority of India's outward FDI was in the manufacturing sector, but in recent years the share of the services sector has increased. Data from the RBI for India's outward FDI for the period July 2007 to December 2013 show that Indian companies have outward FDI worth $171 billion. Of this, about $95 billion has been in different services sectors, $61 billion has been invested in manufacturing and the balance in agriculture and allied activities (Table 3.5). Today, several Indian IT firms like Tata Consultancy Services, Infosys Limited, Wipro Limited and Mahindra Satyam have acquired global contracts and established offices in developed countries such as the US, the UK and Australia.

Table 3.5: Indian Outward Investments by Sector (July 2007 to December 2013)

Sector	Consolidated FDI Outflows (in $ million)	Per cent share in Consolidated FDI outflows

Services	*95130*	*55.49*
Transport, storage and communication services	33858	19.75
Financial, insurance, real estate and business services	30451	17.76
Wholesale, retail trade, restaurants and hotels	16655	9.71
Construction	9712	5.67
Community, social and personal services	4454	2.60
Manufacturing	*61475*	*35.86*
Agriculture and mining	*11465*	*6.69*
Electricity, gas and water	*1616*	*0.94*
Miscellaneous	*1750*	*1.02*
Total	**171437**	**100.00**

Source: Calculated from 'Data on Overseas Investments', RBI, *http://www.rbi.org.in/scripts/Data_Overseas_Investment.aspx* (last accessed on January 21, 2014).

3.2.2 Global FDI Outflows: Germany

In search of new markets and to support export growth, market-seeking German companies started expanding abroad early in the 1960s and 1970s and this trend continues (Hirdina and Jost, 2010). According to UNCTAD's World Investment Report (2013), Germany ranked sixth among the top investor economies in 2012. It contributed 4.81 per cent in global FDI outflows. Among EU Member States, Germany is the second largest investor in the world (after the UK). It contributed 21 per cent in the EU-27's global FDI outflows in 2012.

The majority of German outward investments is to other EU Member States (67 per cent in 2011)[29]. Among non-EU countries, the US, China and Russia were large recipients of German outward investments in 2011 (Table 3.6). German investment in China has increased significantly in the past few years, due to China's low-cost manufacturing advantage, cheap labour, huge market potential, favourable FDI policies in several sectors and accession to the WTO[30]. In 2011, German direct investments in China were valued at $34.4 million compared to $10.9 million in India.

Table 3.6: Top 15 Destinations for German Investments (2001 and 2011)

		2001				**2011**	
Rank	**Country**	**FDI Inflows (in $ million)**	Per cent **share in Germany's FDI Outflows**	**Rank**	**Country**	**FDI Inflows (in $ million)**	Per cent **share in Germany's FDI Outflows**
1	US	182.5	32.42	1	Netherlands	259.9	17.66
2	Netherlands	61.0	10.84	2	US	147.5	16.29
3	UK	60.5	10.75	3	UK	102.9	9.32
4	France	34.0	6.04	4	Luxembourg	95.8	7.57
5	Luxembourg	24.8	4.41	5	Belgium	87.0	4.47
6	Belgium	20.1	3.56	6	France	86.3	4.19
7	Austria	18.5	3.28	7	Austria	51.7	3.46

[29] Extracted from Bundesbank website.
[30] *http://www.auswaertiges-amt.de/EN/Aussenpolitik/Laender/Laenderinfos/01-Nodes/China_node.html*; and *http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000196028.PDF* (last accessed on January 21, 2014).

Rank	Country	2001 FDI Inflows (in $ million)	2001 Per cent share in Germany's FDI Outflows	Rank	Country	2011 FDI Inflows (in $ million)	2011 Per cent share in Germany's FDI Outflows
8	Switzerland	16.0	2.83	8	China	34.4	3.20
9	Italy	15.8	2.81	9	Italy	22.7	3.12
10	Spain	11.8	2.10	10	Switzerland	21.8	2.82
11	Sweden	8.3	1.47	11	Spain	18.3	2.60
12	Poland	7.7	1.36	12	Malta	16.5	1.80
13	Hungary	7.4	1.32	13	Poland	14.2	1.76
14	Ireland	7.1	1.26	14	Russia	10.8	1.65
15	Brazil	6.7	1.20				
18	China	6.2	1.10	15	Sweden	6.5	1.57
33	India	1.4	0.25	24	India	10.9	0.71
	Total	**875.9**			Total	**1418.5**	

Source: Compiled from Bundesbank, available at *http://www.bundesbank.de/Navigation/EN/Topics/topics.html*
Note: Values have been converted from euros to US$. Exchange rate for 2001 is €1=$ 0.8962 (average) and for 2011 it is €1=$ 1.394 (average). Extracted from historical exchange rates, Oanda currency converter, *http://www.oanda.com/currency/historical-rates/*

In terms of sectors, about 70 per cent of Germany's FDI outward stocks were in the services sector in 2010 (Table 3.7). Within the services sector, financial and insurance services accounted for around 50 per cent, followed by real estate, renting and business services (19 per cent) and trade, repair of motor vehicles, motorcycles and personal and household goods (18.2 per cent). German investments have largely been market-seeking as opposed to efficiency-seeking FDI, as it has largely been in the financial and infrastructure services.

Table 3.7: German FDI Outward Stocks by Sector (2000 and 2010)

Sector	2000 Value (in $ billion)	2000 Per cent share in Total FDI Outward stock	2010 Value (in $ billion)	2010 Per cent share in Total FDI Outward stock
Primary	**4.8**	**0.90**	**20.6**	**1.45**
Mining, quarrying and petroleum	4.2	0.79	18.9	1.33
Agriculture, hunting, forestry, and fishing	0.6	0.11	1.7	0.12
Secondary	**165.4**	**30.75**	**400.5**	**28.05**
Chemicals and chemical products	49.0	9.11	113.5	7.95
Motor vehicles, trailers and semi-trailers	38.8	7.21	100.1	7.01
Machinery and equipment	15.1	2.81	36.4	2.55
Medical, precision and optical instruments	6.5	1.21	32.8	2.30
Electrical machinery and apparatus	16.4	3.05	25.0	1.75
Other non-metallic mineral products	7.2	1.34	21.9	1.53
Basic metals	2.3	0.43	14.2	0.99
Rubber and plastic products	5.4	1.00	12.4	0.87

Sector	2000		2010	
	Value (in $ billion)	Per cent **share in Total FDI Outward stock**	**Value (in $ billion)**	Per cent **share in Total FDI Outward stock**
Fabricated metal products, except machinery and equipment	4.5	0.84	11.0	0.77
Food, beverages and tobacco	3.7	0.69	8.6	0.60
Radio, television and communication equipment	5.7	1.06	7.6	0.53
Services	**367.6**	**68.35**	**1,006.5**	**70.50**
Finance and insurance	215.8	40.13	493.8	34.59
Real estate, renting and business activities	69.2	12.87	191.6	13.42
Trade, repair of motor vehicles, motorcycles and personal and household goods	65.3	12.14	183.3	12.84
Electricity, gas and water supply	3.9	0.73	66.3	4.64
Transport and communication	7.3	1.36	52.7	3.69
All Sectors/Industries	**537.8**	**100.00**	**1,427.6**	**100.00**

Source: Compiled from Jost (2012) Annex Table 3, p.8.

This discussion shows that India's FDI inflows and outflows have grown significantly in the past decade. In Germany, outbound investments considerably surpassed inbound investments between 2000 and 2010. While India is among the top 15 host economies for foreign investments, Germany is ranked sixth among the top investor economies in the world. Germany, being a developed country, is a looking for new markets to make investments, whereas India, as an emerging economy with enormous potential, is actively easing its investment regulations, encouraging foreign investors and opening new sectors to welcome FDI. Therefore, India and Germany have huge potential to deepen their economic ties by enhancing their investment relation. Here, one needs to look into the bilateral investment flows to understand how the two economies have tapped each other's markets and how they can increase their bilateral investments.

3.3 Bilateral FDI flows between India and India

3.3.1 *German Investments in India*

Investment flows from Germany into India have increased over time. According to DIPP statistics, German FDI inflows were valued at $123 million in 2000-01 and increased to $1,622 in 2011-12 (Table 3.8).

Table 3.8: Trends in German Investment Inflows into India

Year	From Germany (in $ million)	From All Countries (in $ million)	Per cent share in India's total FDI inflows
2000-01	123.34	2,907.52	4.24
2001-02	113.48	4221.89	2.69
2002-03	143.91	3133.85	4.59
2003-04	81.17	2634.21	3.08
2004-05	145.35	3758.94	3.87

Year	From Germany (in $ million)	From All Countries (in $ million)	Per cent share in India's total FDI inflows
2005-06	302.85	5545.94	5.46
2006-07	119.95	15,726.19	0.76
2007-08	513.61	24,580.85	2.09
2008-09	629.22	27,330.82	2.30
2009-10	626.14	25,834.41	2.42
2010-11	199.74	19,426.90	1.03
2011-12	1621.95	36,504.00	4.44
2012-13	860.00	22,423.00	3.84
2013-14 (April-Sept)	538.00	11,376.00	4.73
Cumulative (April 2000 to September 2013)	**6,018.00**	**204,780.00**	**2.94**

Source: Extracted from DIPP, Government of India, FDI Statistics, various years.
Note: Data is given for the financial year starting in April and ending in March.

Although German investments in India have declined in recent years due to the global economic recession and the Euro crisis, it is still large compared to other EU member countries such as France, Spain and Italy (Table 3.1). Among EU Member States, Germany is ranked 4th after the UK, the Netherlands and Cyprus (Table 3.1). Overall, German investments since the year 2000 amounted to nearly $6 billion, accounting for a share of 2.9 per cent of total investments in India. Between April 2000 and September 2013, Germany was ranked 8th among foreign investors in India. According to Bundesbank, between 2000 and 2011 German companies invested $56.3 billion in India. In 2011, India was ranked 24th among Germany's destinations for outward investments (Table 3.6).

German investments in India are mainly concentrated in the automobile and chemical industry and the services sector (Table 3.9).

Table 3.9: FDI Equity Inflows from Germany by Sector (April 2012 to March 2013)

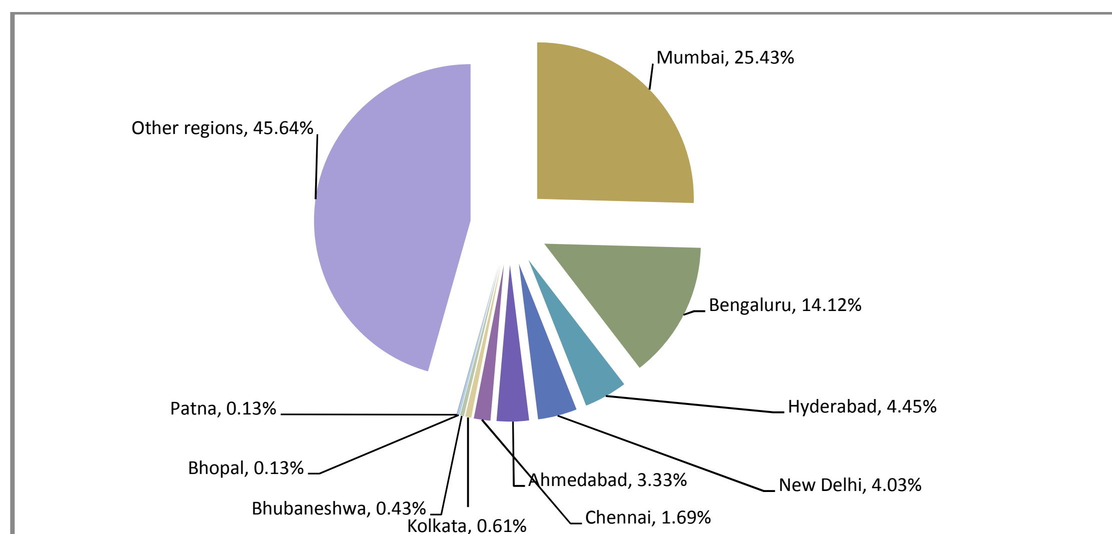
Sector	Amount of FDI inflow (in $ million)	Share in FDI inflows
Industry	**569.4**	**66.3**
Automobile industry	284.6	33.1
Chemicals (other than fertilisers)	108.8	12.7
Scientific instruments	62.1	7.2
Glass	46.4	5.4
Industrial machinery	44.2	5.1
Electrical equipment	6.1	0.7
Medical and surgical appliances	5.6	0.7
Agricultural machinery	3.8	0.4
Electronics	3.0	0.4
Metallurgical industries	2.5	0.3
Prime Movers (other than electrical generators)	2.3	0.3
Services	**269**	**31.3**
Services (including financial, banking, insurance, non-financial/ business, outsourcing, R&D, courier, tech.	115.8	13.5

Sector	Amount of FDI inflow (in $ million)	Share in FDI inflows
testing and analysis & others)		
Trading	64.8	7.5
Energy (including power, petroleum and natural gas, and railway-related components)	39.1	4.5
Agriculture services	25.7	3.0
Construction development (including townships, housing, built-up infrastructure, etc.)	10.1	1.2
Consultancy services	7.6	0.9
Computer software & hardware	5.9	0.7
Others	**21.2**	**2.4**
Total	**859.6**	**100**

Source: Extracted from Indo-German Chamber of Commerce (2013), Table 9, p. 115.

Among the cities/locations in India, Mumbai attracted the highest amount of German investments amounting to $218.53 million (25.43 per cent), followed by Bengaluru, Hyderabad, New Delhi and Ahmedabad in 2012-13. More than half the total German investments went to these five cities during this period.

Figure 3.5: Locations for German Investments in India (April 2012 to March 2013)



Source: Extracted from Indo-German Chamber of Commerce (2013), Table 10, p.117.

Foreign Investors can invest in India through two routes: (a) automatic route[31] and (b) approval route[32]. During 2012-13, of the $859.62 million German investment in India, around $440.23 million (51.2 per cent) came through the automatic route, compared to 21.7 per cent through this route in 2011-12 and 75.3 per cent in 2010-11[33]. The Indian government has initiated policy reforms to attract investments through the automatic route. Barring a few sectors such as tea plantations,

[31] Under the automatic route, no permission is required from the Government of India or the RBI.

[32] Under the approval route, approval is required from the Foreign Investment Promotion Board (FIPB) under the Ministry of Finance, Government of India.

[33] Indo-German Chamber of Commerce (2013).

mining and mineral separation of titanium, defence, broadcasting and retail, FDI is allowed through the automatic route in most sectors[34].

Today, several major German companies have a presence in India (Table 3.10). German automobile giants such as Bayerische Motoren Werke AG (BMW) and Volkswagen Group have their manufacturing facilities or assembly plants in India. Several German small and medium enterprises (SMEs) are also showing greater interest in the Indian market. A German Centre has been established in Gurgaon by two German banks, viz., Bavarian Landesbank and Landesbank Baden Württemberg, to facilitate the activities of German SMEs in India.

Table 3.10: Some German companies in India by Sector

Company	Sector
Bayerische Motoren Werke AG (BMW), Daimler AG and Volkswagen Group	Automobile
Deutsche Bank	Banking
Oiltanking GmbH, Hypo Real Estate International AG	Construction
Beko Technologies GmbH, Bayer GmbH, Siemens AG	IT and IT-related services (ITeS)
Enercon GmbH, Juwi International GmbH	Energy generation
BMW Holding AG, Volkswagen Financial Services AG	Finance
DHL International GmbH	Logistics
Allianz AG, Munich Re Group	Insurance
Gerresheimer Regensburg GmbH, Beiersdorf AG (Nivea), OSRAM Licht AG	Manufacturing
Metro AG	Trading

Source: Compiled by the authors.

German companies prefer to establish a wholly-owned subsidiary in India. This may be due to the fact that a foreign parent company may transfer its technological know-how only to its wholly-owned company rather than to a joint venture (JV) to avoid leakage of technology to the foreign partner (Desai *et al*., 2004; Javorcik and Saggi, 2004).

3.3.2 Indian Investments in Germany

Economic growth and liberalisation of the outward foreign direct investment regime led to the global presence of Indian companies in different regions of the world. The primary drivers of Indian investment in foreign markets are market potential and access to the latest technology. The EU is becoming a critical market for Indian companies for a range of industries, and Germany in particular is one of the most lucrative sources of potential business (KPMG, 2008) due to better technology, high-quality infrastructure and reliable institutional set-up (Indo-German Chamber of Commerce, 2010).

According to RBI data, in 2008 Indian investments in Germany were valued at $81.5 million and in 2013 it increased to $131 million. Between July 2007 and December 2013, the consolidated investments by India in Germany were valued at $533.8 million. Among EU Member States, the Netherlands and the UK are preferred destinations for Indian investments and have received much higher investment flows than Germany (Table 3.11).

[34] For details see the DIPP Consolidated FDI Policy effective from April 17, 2014, available at http://dipp.nic.in/English/Policies/FDI_Circular_2014.pdf (last accessed on April 22, 2014)

Table 3.11: Indian Investments in Select EU Member States (in $ million)

EU Member States	2007 (July - Dec)	2008	2009	2010	2011	2012	2013	2007-2013
Netherlands	1179	993.8	1594.9	7937.4	2649	3963.1	7207.6	25524.7
UK	159.3	849.4	361.1	691.1	1675	1254.2	1647	6637.1
Cyprus	710	643.4	2527	444.8	647.3	333	321.1	5626.6
Denmark	314.2	283.9	81.1	150.1	92.9	117.1	1.5	1041
Luxembourg	4.6	1.7	1.5	7.4	90.5	395.4	38.6	539.7
Belgium	4.6	68.3	99.4	41.7	44.4	82.6	198.5	539.5
Germany	**29.3**	**81.5**	**49.1**	**62.3**	**76.7**	**104.1**	**130.8**	**533.8**
Spain	2.6	75.5	138.8	23.1	44.6	51.4	85.9	421.9
France	52.9	137.5	12.5	33.4	23.4	12.5	45.9	318.2
Italy	20.9	55	77.4	36.6	17.5	24.2	34.4	265.9
Czech Republic	20.7	17.5	18.8	7.1	82.2	19	1.1	166.4
Total EU (27)	**2530.801**	**3144.62**	**5032.848**	**9446.429**	**5583.961**	**6443.984**	**6443.984**	**41553.3**

Source: Calculated from 'Data on Overseas Investments', RBI, *http://www.rbi.org.in/scripts/Data_Overseas_Investment.aspx* (last accessed on January 21, 2014).

According to official data from Bundesbank, India was ranked 37th in 2011 compared to China at the 25th rank among investors in Germany. Among Asian countries, India is the 6th investor country in Germany (Table 3.12). In 2011 Indian investments contributed to only 0.05 per cent of the total FDI inflows into Germany.

Table 3.12: Investment by Asian Countries in Germany (2001 and 2011)

Country	**2001**			**2011**		
	FDI Inflows (in $ million)	**Per cent share in Asia's total FDI outflows to Germany**	**Per cent share in Germany's total Inflows**	**FDI Inflows (in $ million)**	**Per cent share in Asia's total FDI outflows to Germany**	**Per cent share in Germany's total Inflows**
Japan	8899	88.32	2.06	22691	66.56	2.19
Korea	677	6.72	0.16	6530	19.15	0.63
China	159	1.57	0.04	1721	5.05	0.17
Singapore	82	0.81	0.02	1355	3.98	0.13
Malaysia	29	0.28	0.01	817	2.40	0.08
India	67	0.67	0.02	494	1.45	0.05
Hong Kong	56	0.56	0.01	367	1.08	0.04
Taiwan	108	1.07	0.02	112	0.33	0.01
Asia Total	**10077**	**100**	**2.34**	**34087**	**100**	**3.30**

Source: Compiled from Bundesbank, available at *http://www.bundesbank.de/Navigation/EN/Topics/topics.html*

Note: Values have been converted from euros to US$. Exchange rate for 2001 is €1=$ 0.8962 (average) and for 2011 it is €1=$ 1.394 (average). Extracted from historical exchange rates, Oanda currency converter, *http://www.oanda.com/currency/historical-rates/*

The majority of Indian investment is in the manufacturing sector. According to RBI data, between July 2007 and June 2013, 66.5 per cent of Indian investments were in the manufacturing sector and 30 per cent in services (Table 3.13). A study by Tiwari and Herstatt (2009) on Indian subsidiaries operating in Germany found that a large number of Indian companies are investing in sectors such as IT and ITeS, pharmaceuticals and automotive.

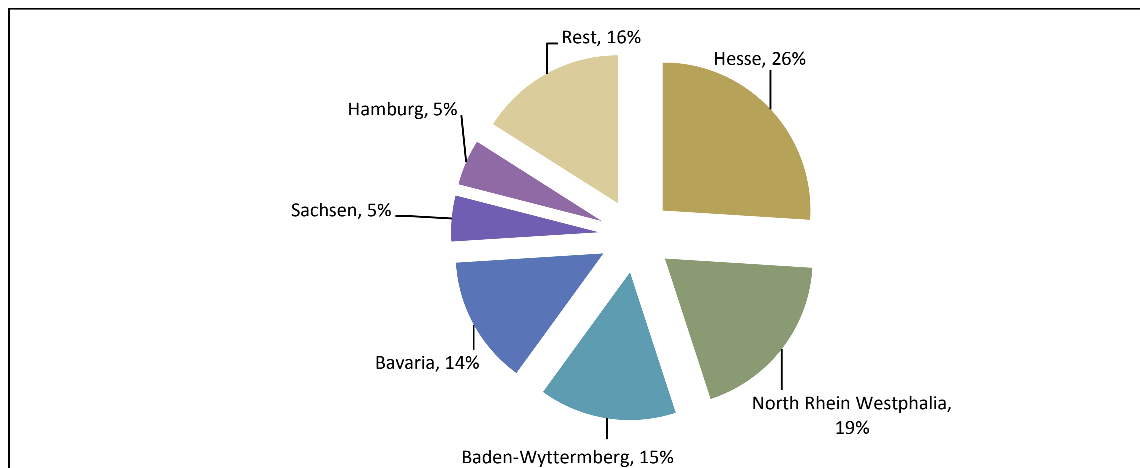
Table 3.13: Indian Investments in Germany by Sector (July 2007 to June 2013)

Sector	**Consolidated Indian FDI Outflows to Germany (in $ million)**	Per cent **share in Consolidated Indian FDI outflows**
Manufacturing	334.1	66.50
Services	153.5	30.55
Financial, insurance, real estate and business services	129.0	25.67
Wholesale, retail trade, restaurants and hotels	18.1	3.60
Community, social and personal services	4.2	0.84
Transport, storage and communication services	2.2	0.44
Electricity, gas and water	14.8	2.95
Total	**502.4**	**100.00**

Source: Calculated from 'Data on Overseas Investments', RBI, *http://www.rbi.org.in/scripts/Data_Overseas_Investment.aspx* (last accessed on January 21, 2014).

Hesse, home to the national bourse (DAX) and the international airport at Frankfurt, is a preferred location for Indian companies (especially IT companies). Other locations are North-Rhein Westphalia and Baden (Figure 3.6).

Figure 3.6: Locations of Indian Companies in Germany in 2012



Source: Extracted from Indo-German Chamber of Commerce (2012), p. 124,

In Germany, Indian companies invest through two routes: (a) acquisition of firms and (b) by establishing their own subsidiaries. As of September 2012, 143 Indian companies are present in Germany (Table 3.14). Several Indian companies including Suzlon Energy, HCL Technologies, Bharat

Forge Limited, Tata Consultancy Services (TCS), Tech Mahindra and Ranbaxy have subsidiaries in Germany.

Table 3.14: Presence of Indian Companies in Germany

indicators	**December 2008**	**August 2012**	**July 2013**
No. of Indian companies in Germany	123	143	149
No. of subsidiaries of Indian companies in Germany	167	204	218
Full-time employees of Indian companies in Germany	20,000	22,500	26,000

Source: Extracted from Indo-German Chamber of Commerce (2010), Table 1, p.123; Indo-German Chamber of Commerce (2013), Table 2, p. 121.

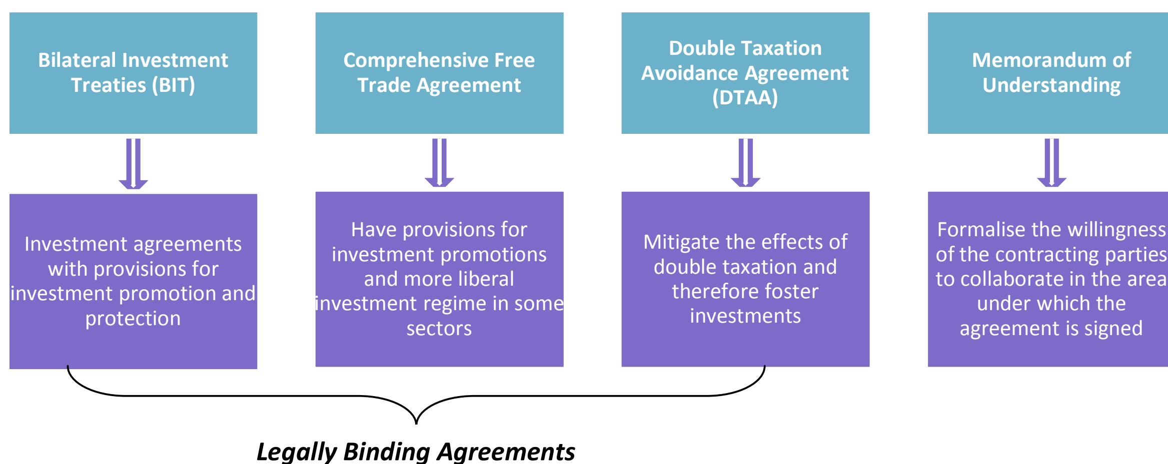
Indian companies have started acquiring companies in Germany and, according to KPMG (2013), Germany is the third-largest among developed countries for investment through acquisition by Indian companies after the US and the UK. Between 2005 and 2012, of the 658 acquisitions, Indian companies made 43 acquisitions in Germany compared to 25 by China (KPMG, 2013). The major acquisitions are Suzlon Energy's acquisition of REpower Systems (now known as Senvion SE), Dr. Reddy Laboratory's acquisition of Betapharm GmbH, the acquisition of Trevira GmbH by Reliance Industries Limited and Jeco Holding AG by Mahindra and Mahindra Limited.

In short, this chapter shows that bilateral investment flows between India and Germany are increasing and the complementarities between the two countries will facilitate such investment flows.

Chapter 4 : Bilateral Agreements Covering Investment: India and Germany

Investment flows can be facilitated by robust inter-government agreements since such agreements offer operational certainty, investment protection and other benefits to investors from the contracting party, putting them in an advantageous position vis-à-vis the rest of the world. These agreements come in different forms: a pure investment agreement, called a bilateral investment treaty (BIT), a bilateral investment promotion agreement (BIPA)[35], or a double taxation avoidance agreement (DTAA). They can also be part of a comprehensive free trade agreement that covers goods, services and investment among others such as a comprehensive economic co-operation agreement (CECA), a comprehensive economic partnership agreement (CEPA) or a Memorandum of Understanding (MoU) between the government and other institutions (Figure 4.1).

Figure 4.1: Agreements that cover Investment



Source: Compiled by the authors.

This chapter examines the different agreements of India and Germany covering investments to understand the level of integration between the two markets and examine the scope and coverage of their individual agreements to derive their negotiating strategies in investments.

4.1 Bilateral Investment Treaties

UNCTAD defines BITs as 'international agreements signed between two countries for the reciprocal encouragement, promotion and protection of investments in each other's territories'. Recent years have witnessed a sharp increase in the number of international agreements covering policies on FDI protection (Franck, 2007; Malik, 2006; Nziramasanga *et al.*, 2011). At the end of 2012, a total of 2,857 BITs had been concluded (UNCTAD, 2013).

By establishing the terms and conditions for private investment, BITs guarantee a 'level playing field' and certain standards of treatment that can be enforced via binding investor-to-state dispute settlement outside the domestic juridical system (Neumayer and Spess, 2005). Generally, BITs address four issues (Wong, 2006):

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[35] Bilateral Investment Treaty (BIT) is a widely accepted term for investment treaties. However, it is termed differently by countries. For instance, India prefers to name it Bilateral Investment Promotion and Protection Agreement (BIPA), Canada prefers to name it Foreign Investment Protection and Promotion Agreement (FIPA) and Germany calls it BIT.

1. Conditions for the admission of foreign investors to the host State
2. Standards of treatment of foreign investors
3. Protection against expropriation
4. Methods for resolving investment disputes

Germany concluded 127 investment treaties as of June 2013[36] and India has signed BIPAs with 83 countries of which 72 BIPAs are in force[37]. The BIPA between India and Germany was signed on July 10, 1995 and came into force in July 1998. In India, the Ministry of Finance is responsible for signing BIPAs, whereas in Germany BITs are signed by the Federal Foreign Office[38]. Architecturally, a BIT provides the scope, definition and coverage of the agreement and highlights the provisions in terms of admission and establishment, national treatment, most favoured nation treatment, expropriation and dispute settlement, among others. In certain cases, the extent of commitments under investment treaties may vary. For instance, BITs involving the US and Canada have a pre-establishment clause that allows potential investors to enter the domestic market of the host state with minimal or no regulations. Indian and German agreements largely do not have a pre-establishment clause. The architectural design of Indian and German bilateral investment treaties is given in Table 4.1.

Table 4.1: Substantive provisions in BIPAs/BITs of India and Germany

Provisions	**German Model (2008)**	**Indian Model (1991)**	**India-Germany BIPA (1998)**
Definition/coverage of Investment - Open List	Yes	Yes	Yes
Umbrella Clause	Yes	Yes	Yes
Post-Admission			
Most Favoured Nation (MFN)	Yes	Yes	Yes
National Treatment (NT)	Yes	Yes	Yes
Investment Protection			
Standards of treatment	Yes	Yes*	Yes
Transfers	Yes	Yes	Yes
Expropriation			
Direct	Yes	Yes	Yes
Indirect	Yes	Yes	Yes
Key personnel	Yes	Yes	Yes
Exceptions			
Economic Integration Agreements	Yes	No	Yes
General exceptions	Yes	No	Yes
Security interests	No	No	Yes
Taxation	Yes	No	Yes

Note: Compiled from OECD (2006), Table 6.2, p. 147; Indian Model Text of BIPA, available at Department of Economic Affairs, Ministry of Finance, Government of India,

[36] For details, see UNCTAD, *http://unctad.org/Sections/dite_pcbb/docs/bits_germany.pdf* (last accessed on January 10, 2014.)
[37] For details, see Ministry of Finance, Government of India, *http://finmin.nic.in/bipa/bipa_index.asp?pageid=1* (last accessed on January 10, 2014.)
[38] *http://www.auswaertiges-amt.de/EN/AAmt/Uebersicht_Navi.html* (last accessed on January 2, 2014).

http://finmin.nic.in/the_ministry/dept_eco_affairs/icsection/Indian%20Model%20Text%20BIPA.asp (last accessed on March 31, 2014).

In terms of architectural design, the Indian and German agreements are similar. Both have an Umbrella Clause that creates an international law obligation by requiring a state to observe commitments it may have entered into with investors of the other contracting state. Apart from talking about favourable investment conditions and treatment, the Umbrella Clause in the India-Germany BIPA has a provision where neither party can place any constraints on the international movement of goods or persons directly connected with an investment being transported subject to bilateral or international agreements. In that sense, the Umbrella Clause has broad coverage.

As regards admission and establishment of investments, international law does not bind any nation to admit foreign investment. FDI is in the territorial jurisdiction of each country and can be liberalised autonomously, unless bound under a trade agreement such as the India-EU BTIA. Each government determines whether to admit a foreign investor and it can also decide the terms and conditions for admission and establishment.

Although the provisions of both National Treatment (NT) and Most Favoured Nation (MFN) are included in the Germany-India BIPA, it makes an exception for investors of third States on account of its membership of, or association with, a customs or economic union, a common market or a free trade area. This implies that in the case of Germany, it can accord more favourable treatment to EU Member States. Interestingly, the Germany-Singapore Investment Treaty signed in 1973 does not make this exception. The India-Germany BIPA also accords fair and equitable treatment and full protection and security to investments and investors and has provisions on direct and indirect expropriation.

It is also important to note that the status of the India and Germany BIPA is likely to change after the India-EU BTIA is signed. In 2009, the EU signed the Lisbon Treaty, which states that the EU will negotiate new trade agreements and individual member countries (including Germany) will not be able to negotiate future trade agreement on their own with their respective trading partners. However, the trade agreements from before 2009, which member countries have, will be valid until the EU negotiates a trade agreement with the respective partner country[39]. This is also true of investment agreements. In fact, individual EU member countries' BIPAs or BITs with other countries such as India prior to 2009 will be valid as long as the EU does not have a trade agreement with those countries. After 2009, if the European Commission negotiates new BITs with third countries including India, it will overrule the existing bilateral investment protection agreements that India has with select EU Member States. Moreover investment is a key component of the India-EU BTIA. Thus, the India-EU BTIA or any investment agreement that India signs with the EU can overrule the bilateral agreement between India and Germany. While this takes away the advantage that Germany has today vis-à-vis other EU members who do not have bilateral investment protection agreements with India, the new agreement has to be more robust that the existing bilateral agreement between India and Germany.

In a nutshell, the India-Germany BIPA as it stands today encompasses all provisions for protection of investors and investments in each other's markets. This legally binding document highlights the obligations of each contracting party towards investors and investments from the other contracting party. However, while the agreement highlights general obligations, it does not make any specific liberalisation commitment. In this regard, it will be useful to study the investment provisions under the free trade agreements of India and Germany.

[39] For details, see European Commission (2012b).

4.2 Provisions for Investment under Bilateral Trade Agreements: India and Germany

Besides BITs, comprehensive free trade agreements also have provisions on investment promotion and protection. These agreements play a significant role in increasing FDI flows by legally binding the host country to provide assurance to investors as well as taking commitments in specific sectors that often go beyond the autonomous regime of the contracting parties (this is also known as forward-looking commitments to liberalise FDI).

In most cases, if countries have a bilateral investment treaty with a trading partner, the provisions of existing BIT get included in the horizontal investment chapter of the comprehensive trade agreement. However, they may also include clauses that go beyond the standard BIT template as well as the WTO commitments of the countries. A study by Horn *et al.* (2009) indicates that the Preferential Trade Agreements (PTA) signed by the EC or the US go beyond the coverage of regulatory issues, by including provisions in areas that are not currently covered by the WTO agreements at all, such as investment protection, competition policy, labour standards and protection of the environment.

Most comprehensive agreements can have dual coverage of investments, especially for the services sectors; while there is a separate 'Investment' Chapter, investments in services sectors are covered through Mode 3 (commercial presence) in the Trade in Services Chapter. However, there is also a provision built in the trade agreement about which chapter prevails. Such dual coverage has been seen in India's trade agreements with countries such as Korea and Singapore.

The on-going India-EU BTIA is a comprehensive trade agreement covering trade in goods, sanitary & phyto-sanitary measures and technical barriers to trade, trade in services, investment, intellectual property rights, competition policy, customs and trade facilitation, dispute settlement mechanism, government procurement and sustainable development issues, among others[40]. If signed, this agreement will supersede the bilateral investment agreements that India has with individual EU Member States and will be the most comprehensive agreement.

Table 4.2 compares key provisions of the investment chapter in India's four comprehensive trade agreements with Japan, Korea, Malaysia and Singapore and the EU's agreement with Mexico, Chile and Korea.

Table 4.2: Comparison of Key Provisions in Investment Chapters in Trade Agreements: India and the EU

	Pre-establishment	**Post-establishment**	**Provision on Environment**	**Labour Protection**	**Restriction on performance requirements**	**Non-conforming measures***	**Transparency requirement**	**Taxation clause**	**Financial services**
EU-Mexico FTA (2000)	×	√	√	√	√	√	√	√	√
EU-Chile	×	√	√	√	√	√	√	√	√

[40] India-EU BTIA negotiations are in their final leg: Anand Sharma Government Invites Poland companies to invest in the infrastructure sector. Press Information Bureau, GOI. July 11, 2011.
http://pib.nic.in/newsite/erelease.aspx?relid=73130

	Pre-establishment	Post-establishment	Provision on Environment	Labour Protection	Restriction on performance requirements	Non-conforming measures*	Transparency requirement	Taxation clause	Financial services
FTA (2002)									
EU-Korea FTA (2011)	√	√	√	√	√	×	√	√	√
India-Singapore CECA (2005)	×	√	×	×	√	×	√	×	×
India-Korea CEPA (2005)	√	×	√	×	√	√	√	×	×
India-Japan CEPA (2011)	×	√	√	×	√	×	×	×	×
India-Malaysia CECA (2011)	√	×	×	×	×	×	√	×	×

Source: Compiled from trade agreements of India and EU; Tan (2012).
Note: Symbol '√' refers to 'FTA has a related provision' and '×'refers to 'FTA has no provision'.
*Non-conforming measures refer to any law, regulation, procedure, requirement or practice that violates certain articles of the investment agreement. For example, a law prohibiting an investor of another member country to own a factory does not conform to the article on national treatment.

The agreement shows that India and the EU do not have a standard approach while designing their agreements; however, the EU's agreement has more provisions, particularly with respect to labour and taxation provisions.

4.3 Double Taxation Avoidance Agreement between India and Germany

Double Taxation Avoidance Agreements (DTAA)[41] are legally binding bilateral agreements covering taxes on income imposed on behalf of each Contracting State. When a taxpayer is resident in one country but has a source of income in another country, it may give rise to double taxation if the income is repatriated. This is primarily governed by two rules:

- Source of Income: When income is earned in the source country, the jurisdiction of that country applies tax on the income originated irrespective of whether the income accrues to a resident or a non-resident;
- Residence of Income: This mandates that power to tax should rest with the country in which the taxpayer resides.

[41] For details, see *http://law.incometaxindia.gov.in/DIT/intDtaa.aspx* (last accessed on January 6, 2014).

If both rules apply simultaneously to a business entity and it were to suffer tax at both ends, the cost of operating on an international scale would become prohibitive and deter the process of globalisation. To avoid that problem, the DTAA becomes important. The DTAA is, in effect, a bilateral agreement between two countries that aims at mitigating the incidence of double taxation, thereby promoting and fostering economic trade and investment between two countries. DTAAs can be comprehensive agreements covering all sectors and entities or limited agreements covering only certain sectors. India has DTAAs with 85 countries including Germany. The DTAA between India and Germany is a comprehensive one, signed on June 19, 1995 and came into force on October 26, 1996 with respect to taxes on income and capital[42].

4.4 Bilateral Co-operation and Collaboration between India and Germany

India and Germany have had a strategic partnership since 2000 and has been further strengthened with the first Intergovernmental Consultations (IGC) held in New Delhi in May 2011. The two countries have several institutionalised arrangements to discuss bilateral and global issues of interest, etc. The two countries signed Science and Technology (S&T) Agreements in 1971 and 1974. As present there are more than 150 joint S&T research projects and 70 direct partnerships between Indian and German universities.

Indo-German co-operation in trade and technology is one of the most dynamic facets of the bilateral partnership. There is a Joint Commission on Industrial and Economic Co-operation led by the Finance Minister on the Indian side, and the Economics Minister on the German side. In addition, there are seven Joint Working Groups in agriculture, the automobile sector, infrastructure, energy, coal, tourism and vocational education. Forums such as the Indo-German Energy Forum focus on specific issues such as renewable energy, energy-efficient technologies, the power sector, and alternative fuels.

There are several MoUs between India and Germany. These are inter-government or between industry bodies or between industry and government. There are also MOUs between companies from both countries. Examples of inter-government MoUs include the agreement between Ministry of Human Resource (India) and Federal Minister of Education and Research (Germany) to facilitate student exchange programmes. Inter-industry MoUs include an agreement between Infosys Ltd (India) and Bertelsmann Stiftung (Germany) to support vocational education and training in India. MoUs between the government and industry include an agreement between DB Systel (Germany) and Centre for Railway Information Systems (India) in the field of information systems related to railways. The Solar Energy Centre, Ministry of New and Renewable Energy, Government of India and Fraunhofer Institute for Solar Energy Systems (Germany) have an MoU to promote co-operation in solar energy. Industry associations have also been involved in strengthening relations between India and Germany. For example, the Federation of Indian Chamber of Commerce and Industry has various MoUs with German companies. These MoUs facilitate collaboration and joint work but they do not have legal standing.

This chapter highlighted that India and Germany are engaged in inter-government discussions to promote and protect investments at several levels with a strong commitment by the two governments. Though there are some differences in the design of their individual agreements, their scope and coverage are largely similar.

[42] The full text of the agreement is available at *http://law.incometaxindia.gov.in/DIT/File_opener.aspx?fn=http://law.incometaxindia.gov.in/Directtaxlaws/cbdt/dta/A1_Germany.htm* (last accessed on January 6, 2014).

Chapter 5 : Survey of Stakeholders

The previous chapters, based on secondary information highlight the trends and patterns in investments in India and Germany. The data reflects the present volume, areas of investment and the comparative position of India and Germany in each other's global investments. To better understand future prospects and barriers to enhancing bilateral investments in the two markets, a primary survey was conducted in India and Germany. It included stakeholder's consultation, in-depth one-on-one interviews and an online survey. This was conducted in four phases. In the first phase, a preliminary survey was conducted through a webinar in which both Indian and German companies participated. In the second phase, a stakeholder's consultation was conducted in Chennai (Tamil Nadu) to gather the views of German companies in India and Indian companies that have a presence in Germany. In addition, in-depth interviews were held in Delhi, Mumbai, Chennai and Bengaluru with German and Indian companies that have a presence in each other's market. In the third phase, in-depth interviews were conducted in Frankfurt and Köln in Germany with companies, government bodies and associations to identify prospects and problems in each other's market. Field visits were made to factory sites to understand the size and operations of Indian companies in Germany. In parallel, as a fourth phase, an online questionnaire was circulated to members of the Indo-German Chamber of Commerce (IGCC), which included separate questionnaires for Indian and German companies. The primary survey was based on a semi-structured questionnaire, with some open-ended questions to get more information. Care was taken to cover companies across different sectors. The sampling frame is given in Table 5.1.

Table 5.1: Sampling Frame

Profile of Respondents	Number of Respondents
Indian Companies	132
German Companies	187
Indian Associations	2
German Associations	2
Academics and sectoral experts	4
Central ministries	2
Embassies	2
Total Number	**331**

Companies were asked about their mode of entry in India, their economic activity and their preferred location in the Indian market. The companies were then asked about their perceptions on the two markets—their reasons for establishing operations and their views on the operating environment. To better understand the problems, companies were asked about the barriers they faced and the ease of doing business in India and Germany. Finally, questions were asked about future prospects and the potential for investing in India and Germany. The following sections present the survey findings.

5.1 Sample Distribution

5.1.1 German Companies in India

Foreign companies can enter India through two routes—the automatic route, which does not require approval from the government, and the government route, which requires prior approval from the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, Ministry of

Finance. . The majority of German companies (80.7 per cent) have entered India through the automatic route (Table 5.2). Of these, around 96.3 per cent have established a wholly-owned subsidiary in India while the remainder have set up a joint venture with an Indian partner. Some German companies pointed out that they wanted full control over their operations and technology transfer; therefore, they prefer the wholly-owned subsidiary route rather than a joint venture with an Indian company.

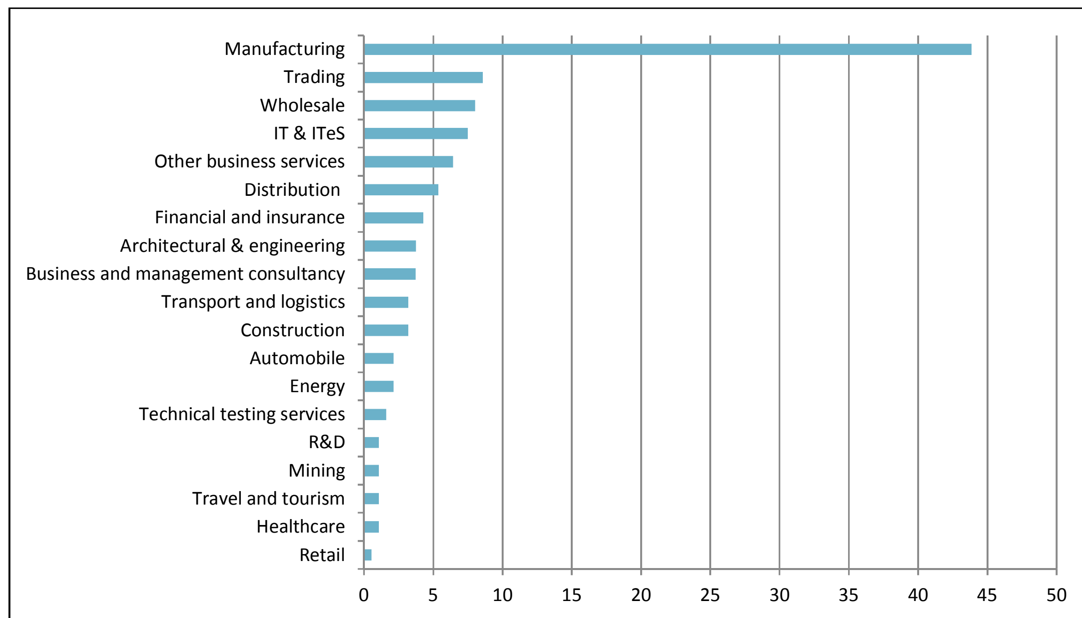
Table 5.2: Route of Entry of German Companies in India

Mode of Operation	Number of Companies	Per cent Share
Automatic route	151	80.7
SIA/FIPB or government route	11	5.9
Mergers and acquisition	25	13.4
Total number	**187**	**100.0**

Source: Primary survey.

Unlike China, where Germans have largely invested in the manufacturing sector, in India German companies have mainly invested in the services sector. Of the 187 companies, 97 have invested in the services sector (51.87 per cent) and 82 in manufacturing (43.85 per cent). Within the services sector, information technology (IT) and IT-enabled services has the majority of German companies (Figure 5.1).

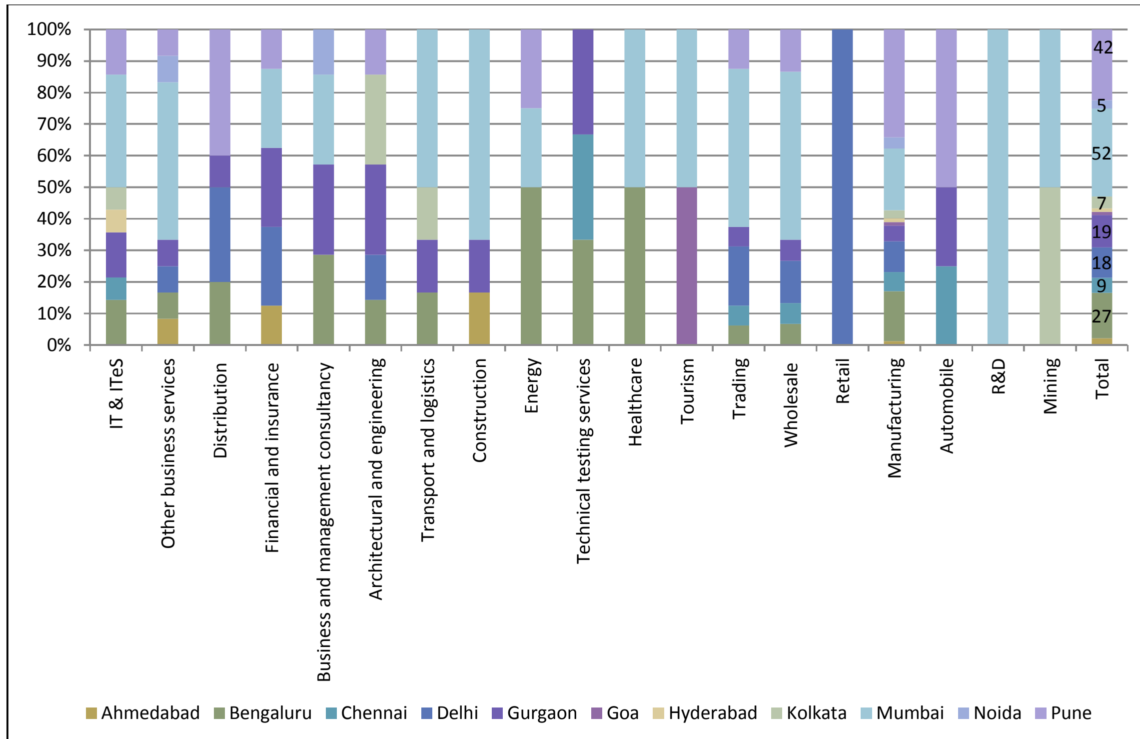
Figure 5.1: Distribution of German Companies in India by Sector



Source: Primary survey.

Mumbai is the preferred location for German companies, with 52 per cent having offices in Mumbai followed by Pune (42 per cent) and Bengaluru (27 per cent). In terms of sectors, the majority of the manufacturing companies are in Pune, transport and logistics companies and construction companies are in Mumbai, tourism is in Goa and mining is in Kolkata (Figure 5.2).

Figure 5.2: Sectoral and Spatial Distribution of German Companies in India



Source: Primary survey.

German companies in India are aware of the growth prospects and are investing in developing end-to-end infrastructure in the Indian market. Companies are also working with smaller enterprises to foster overall growth of the Indian economy. The case of a German company in distribution services is given in Box 5.1.

Box 5.1: Metro Cash & Carry – India Operations

The first Metro Cash & Carry centre in India opened in Bengaluru in 2003 and at present there are 15 wholesale centres, including two each in Bengaluru, Hyderabad and Mumbai, and one each in Jaipur, Ludhiana, Jalandhar, Amritsar, Delhi, Kolkata, Vijayawada, Indore and Zirakpur. Metro Cash & Carry started its presence in bigger cities and then opened smaller stores in Tier 2 and Tier 3 cities. The stores stock only a few categories of products. Metro Cash & Carry sources 95 per cent of its products locally. In India it has joined hands with various government agencies; it has an agreement with the Punjab Agro Industries Corporation and has set up agriculture sourcing platforms—'farmers' collection centres'—in Karnataka, Andhra Pradesh, Punjab, Maharashtra and West Bengal. Metro has its own distribution channel and logistics solution in India. Due to its B2B operating model, Metro is doing well even in states such as West Bengal where the state government is opposed to FDI in retail. In West Bengal, small retailers are the largest buyers from Metro Cash & Carry stores. According to an estimate, in 2012 Metro generated revenue of €355 million ($492 million) from India, which is around one per cent of the company's global revenue.

Source: http://www.metro.co.in/public/home; http://www.smartinvestor.in/market/Compnews-206578-Compnewsdet-Metro_Cash_amp_Carry_revamps_India_strategy.htm

Overall, the survey findings were in consensus with the secondary information. The survey reiterated that German companies have an investment interest in the services sector in India and largely opt for the automatic route to avoid regulatory problems.

5.1.2 *Indian Companies in Germany*

Germany does not have multiple entry routes. Foreign companies that are willing to invest in Germany come under the 'Foreign Trade and Payments Act' and the 'Regulation Implementing the Foreign Trade and Payments Act'. For companies that are at least 25 per cent owned by foreign holders, approval has to be sought from the Federal Ministry of Economics and Technology. To invest, a foreign business has to register the company or purchase shares in the existing company. The majority of Indian companies (72 per cent) have established a wholly-owned subsidiary in Germany, 21.2 per cent merged or acquired German companies to establish their operations in the region and the remainder are present through joint ventures. Wholly-owned subsidiaries in Germany receive the same benefits as any other EU company. The experience of an Indian company established in Germany as a wholly owned subsidiary is given in Box 5.2.

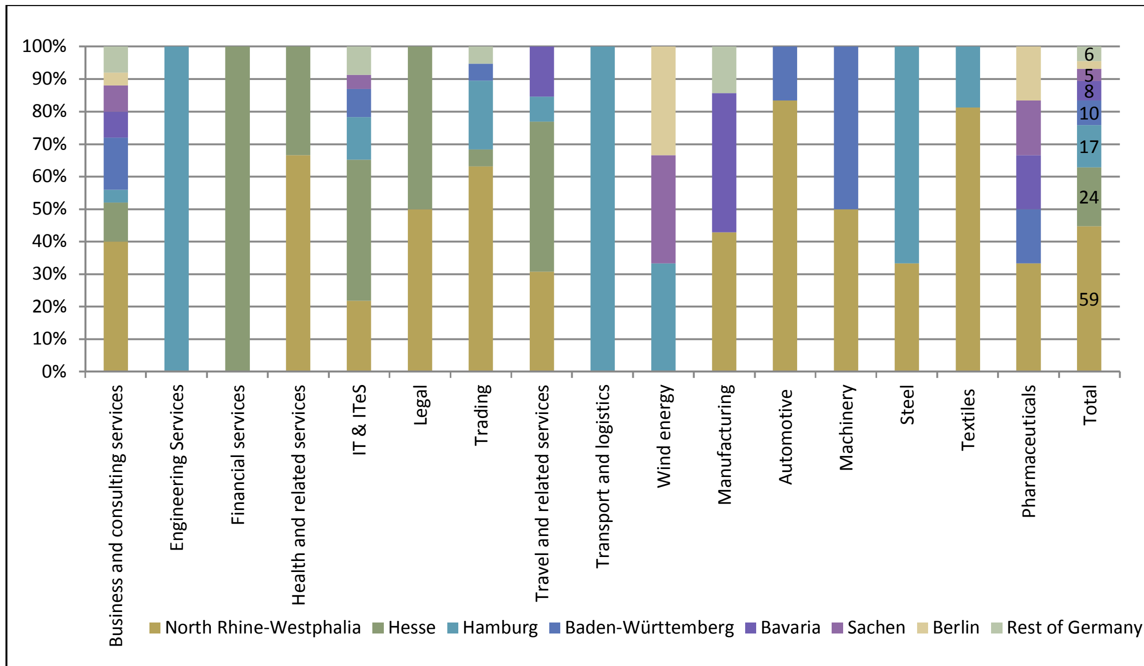
Box 5.2: Shalimar Food GmbH

The company is a wholly-owned subsidiary of an Indian company called Shalimar Food Private Limited that was established more than 30 years ago. The company is owned by an Indian who has been living in Germany for more than three decades and has German citizenship. In Germany it has a state-of-the-art manufacturing and packaging facility in Köln and the product range includes more than 1,000 different products for Italian, Indian, Mexican and Chinese cuisine. While the top-level management of the company constitutes Indians with German citizenship and knowledge of the language, it also employs Germans. It largely sources its products from Italy, including some traditional Indian products, as the products are better quality and import procedures are simpler. Germany has a mix of cultural ethnicities and, therefore, there is a huge market and growth potential in the imported and packaged food segment. It is happy with its operations in Germany and the operating environment and regulatory structure. The company forecast the future growth rate to be at least 25 per cent and, keeping in view the growth prospects, the company has acquired another space to set up a branch.

Source: Primary survey

The sector-wise spatial distribution of Indian companies in Germany is given in Figure 5.3. Most Indian companies are located in the western region of North Rhein-Westphalia (59 per cent), while Hesse and Hamburg also have high concentrations of Indian companies. Real estate prices have a bearing on the choice of location for a company; there are variations in real estate costs across different cities, with Frankfurt and Munich being the most expensive locations.

Figure 5.3: Sectoral and Spatial Distribution of Indian Companies in Germany



Source: Primary survey.

North Rhein-Westphalia is the preferred location for healthcare services, the automobile sector, trading and textiles because of its proximity to the Netherlands. Hesse has a large number of financial service providers and IT companies, while transport and logistics companies and engineering service providers are concentrated in Hamburg.

5.2 Overall Perceptions of Respondents

The survey participants were asked for their views on issues that affect trade and investments between India and Germany. These include the present agreements, tax and investment regime in each other's markets and future prospects. Open-ended questions were asked and, therefore, the responses were descriptive.

5.2.1 Perceptions of German Companies

Most German companies consider India an attractive investment destination due to the large and growing market. In addition, technology penetration is low in India and, therefore, there is huge untapped potential for companies to invest in the country. Within the country, several factors are considered when selecting the investment location. These include infrastructure connectivity, cost of establishment, consumer preference, market size, knowledge of English and manpower availability. Companies pointed out that it is market size and potential that attracts investment into India and not the incentives offered by the Indian government. Some of the incentives given by India, especially those linked to exports, can be actionable under the Subsidies and Countervailing Agreement of the WTO and, therefore, German companies do not consider them attractive. When asked about the Indian Special Economic Zone (SEZ) policy, most companies said that they do not have any operations in SEZs since the regulations change frequently. Moreover, there is no support from the Department of Commerce in infrastructure development and there is a negative feeling in India through the media about SEZs. The lack of co-ordination between the centre, the state and the Development Commissioner's office has made it difficult for units to locate in SEZs. Moreover,

several SEZs do not have basic facilities such as waste disposal facilities. In general, German companies found the National Manufacturing Policy to be more focused than the SEZ policy. They said that the government has identified 12 national manufacturing zones and similarly there should have been a limit on the number of SEZs. However, it may be difficult to acquire land for the zones, especially contiguous land. German companies also said that India should have a vision to develop manufacturing and production networks and economic corridors. Foreign companies are willing to invest in India if they are given the right investment environment.

Companies considered the states of Gujarat, Maharashtra, Tamil Nadu and Goa as investor-friendly. They pointed out that the state policies should be growth-driven and aim to generate employment. Most companies report stable revenue growth in India with India's market share to be around 5-10 per cent of their global market. Companies expressed satisfaction with the fact that even during the global slowdown their revenue from the Indian market did not decline significantly.

In India, German companies are engaged in government contracts, which they receive either through competitive bidding or through their partners. They said that it would increase transparency in government procurement if India became part of the WTO's Plurilateral Government Procurement Agreement. Companies engaged in infrastructure projects would like government procurement to be part of the India-EU BTIA.

In terms of employment, German companies said that they do not face any problems. Most German companies employ locals and not German staff, as it would increase their costs. At the outset companies face minor hurdles due to differences in work culture, but after being trained, the employees' performance is satisfactory. It was also pointed out that Indian staff is enthusiastic and eager to learn.

German companies highlighted macro-economic and political instability in the Indian market. In the past few years India has faced a slight slowdown in growth rates and experienced high inflation. This has affected demand and the business of German companies in India. Political instability leads to policy uncertainty, which affects existing businesses as well as the will of other companies interested in the Indian market. For instance, in the case of FDI in multi-brand retail, states have been given the right to reject or allow multi-brand retailers. This has led to uncertainty, as companies are unsure if with a change in government the policy can be changed for each state.

While companies are aware of the bilateral investment promotion agreement (BIPA) and the double taxation avoidance agreement (DTAA) between India and Germany and also use these two, the level of knowledge about the India-EU BTIA is still very low. Companies were hardly aware of the benefits that the agreement might bring and they said that there is limited engagement of industry in the negotiation process. As a result, the companies did not have major suggestions on the agreement or were not very aware of its likely outcomes.

5.2.2 Perception of Indian Companies

The majority of Indian companies said that Germany is a large market in Europe, which is well protected by law and the incidence of corruption and bribes is much lower than in India. The country has well-developed infrastructure and a strong R&D base. Some respondents pointed out that they have been operating in Germany for a long time because of which they have established their operations and supply chain not only in the country but also across Europe. Within Germany, companies decide their location based on cost, assistance from the government and connectivity with other locations. Indian companies in Germany are less globalised than Germany companies in India. Unlike German companies that prefer to engage in competitive bidding for projects, Indian

companies largely work with close associates and acquire information about projects through word-of-mouth or through trusted contacts. Their market share is largely concentrated in Germany with around 20-50 per cent share in the total revenue; the rest of the business comes from other countries in Europe. Interestingly, most Indian companies pointed out that they did not suffer from the global slowdown as they are in the business of specialised products such as Indian food products or in providing IT services or in a specific technology.

The companies pointed out that there is a local employment condition in Germany and in any case, companies have to hire Germans for legal and technical support. It was also pointed out the Germans are employed for managerial positions which helps to get business. Companies were satisfied with the available skills; however, they mentioned that labour laws in Germany are very strong and cumbersome and sometimes it poses a problem for them. Labour unions are more active than in India and they regulate the salaries and grading of employees. Worker's Councils regulate work timings.

Indian companies are more aware of the BIPA and DTAA, but they hardly understood the concept and function of the India-EU BTIA. Most companies pointed out that businesses should be given adequate knowledge about the BTIA and this would enable them to understand its costs and benefits.

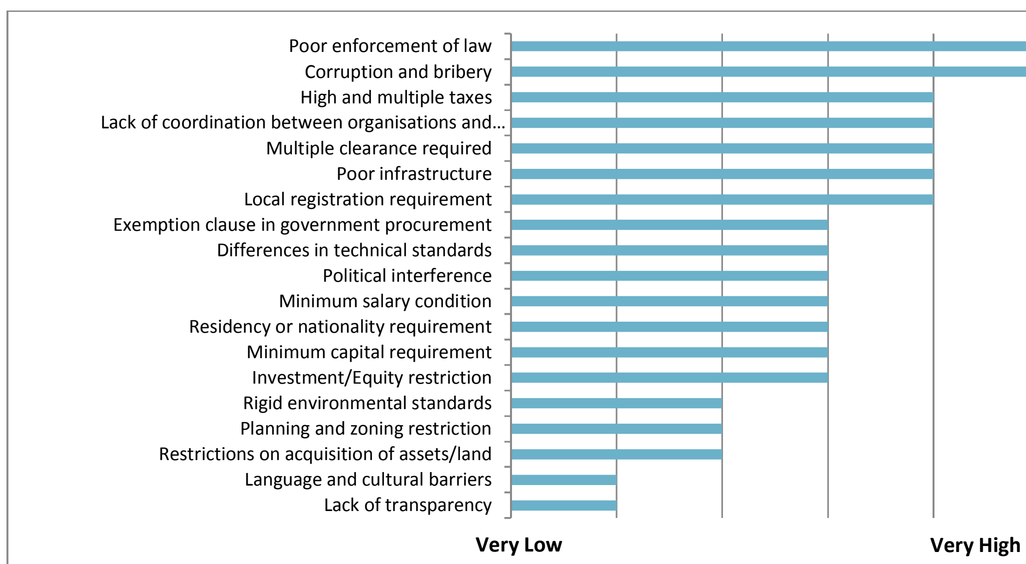
5.3 Perceptions about Barriers

To understand perceptions about barriers, we created a severity index. Participants were given a list of potential barriers and asked to rank their impact on the business as 'very high', 'high', 'normal', 'low' and 'very low'. Based on the responses, the frequency of the rank for each barrier was calculated and the rank receiving the highest frequency (mode) was assigned to the barrier. The barriers were then ranked.

Participants also elaborated on some barriers, which are included below.

5.3.1 *Barriers faced by German Companies in India*

Figure 5.4: Severity of Barriers for German Companies



Source: Primary survey

The participants elaborated on some of these barriers.

- *Corruption and bribery.* While most companies face this barrier in India, in Germany bribery is an offence under the law, since Germany follows the anti-bribery convention. If a German company makes informal payments, it faces a legal trial in Germany.

- *Poor law enforcement.* Although India has laws in place, their enforcement is weak, which leads to operational uncertainty. Some participants said that the application of law is subject to interpretation by individual government officials and therefore, they often face new issues. Most German companies fear that the courts cannot do much to resolve an issue and there are delays. In general, survey participants expressed low faith in the Indian legal system.

- *Issues related to taxation.* Even though basic tax rates are higher in Germany than in India, the overall tax burden is greater in India due to the multiplicity of taxes. In India the highest income tax rate is 33 per cent compared to 45 per cent in Germany[43], but the corporate tax rate is 29.5 per cent in Germany and 33.9 per cent in India [44]. Moreover, companies have to pay several state taxes and duties if they want to establish a pan-India presence. Companies have to pay corporate tax, capital gains tax, dividend tax, etc., which leads to a high tax burden. It was also pointed out that tax policy decisions are taken without industry consultation and certain exemptions such as the Minimum Alternative Tax (MAT) exemption, are withdrawn without a discussion with the stakeholders. In addition, the transfer price policy of India is narrowly defined, which undermines genuine foreign transactions. For instance, transfer pricing of intra-group financial arrangements such as loans and guarantees has led to major controversies. Some of these financial arrangements do not come under the purview of transfer pricing in other countries. In addition, taxes are imposed spontaneously in India, such as the retrospective tax policy, which adds to operational uncertainty. Companies also pointed out that they face difficulties in realising refund of duties from India.

- *Profit repatriation.* While salaries earned in India can be transferred to the home country, dividends earned by the foreign owner can only be transferred when closing operations and after paying taxes on them. As per the India-Germany Double Taxation Avoidance Agreement, dividends may be taxed in both countries, with some exceptions. As a result, some participants pointed out that they reinvest the dividends, but it is not their preferred option.

- *Infrastructure Bottlenecks.* Manufacturing facilities in India are poor and located in remote places with poor road and port connectivity. This is true even of SEZs and industrial clusters. Even if companies locate in states with major ports, the roads connecting the ports are not well developed, leading to losses and pilferage during transportation. Storage and warehousing facilities in India are inadequate and most companies have to invest in these facilities. German companies such as Deutsche Post (DHL Express) have used this as an opportunity to invest in logistics services; however, they are unable to operate in verticals such as the processed food supply chain due to lack of supporting infrastructure in India.

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[43] Extracted from Table: Individual income tax rates between 2006 and 2013, *http://www.kpmg.com/Global/en/services/Tax/tax-tools-and-resources/Pages/individual-income-tax-rates-table.aspx* (last accessed on February 2, 2014).

[44] Extracted from Table: Global corporate tax rates between 2006 and 2013, *http://www.kpmg.com/Global/en/services/Tax/tax-tools-and-resources/Pages/corporate-tax-rates-table.aspx* (last accessed on February 2, 2014).

On getting market information, participants said that there are very few reliable sources. There is no website that provides consolidated information. Companies also find it difficult to identify a reliable Indian partner that has a huge investment capacity and similar business interest. Some companies mentioned that a decade ago it was easier to work with Indians; however, Indian entrepreneurs have become arrogant, which makes it difficult to work with them

Second, even though India has progressively liberalised its FDI regime, it is still restrictive and several conditions are imposed on foreign companies. According to an index of 53 countries prepared by the OECD, India has the fourth most restrictive FDI regime after China, Saudi Arabia and Indonesia[45].

- In India, FDI restrictions vary across sectors (Table 5.3). In several sectors where full foreign presence is allowed, it is subject to minimum capital requirements and other restrictions. For example, in construction and related engineering services, there is a minimum capital requirement of $10 million for wholly-owned subsidiaries and $5 million for joint ventures with Indian partners; and a minimum lock-in period of three years (from the completion of minimum capitalisation before original investment) for repatriation of the amount. Unlike services, most of the manufacturing sector is open to foreign investment but there are investment restrictions in the agriculture sector. FDI is prohibited in sectors like railways, manufacture of cigars, cheroots, cigarillos and cigarettes, of tobacco, etc. , Nidhi companies and atomic energy, among others.

Table 5.3: FDI Limits in Sectors in India

FDI Limit	Sectors	Route
74%	Broadcasting carriage services including teleports, direct-to-home, multiple system cable networks, mobile TV and headend-in-the-sky (HITS) Air transport services (non-scheduled air transport service) Ground handling services Banking private sector	Up to 49 percent through automatic route; beyond 49 percent through government route
	Satellites – establishment and operation	Government route
51%	Multi-brand retail trade	Government route
49%	Cable networks (local cable operators) Petroleum refining by public sector undertakings (PSUs) Air transport services- domestic scheduled passenger airline	Automatic route
	Private security agencies	Government route
26%	Insurance	Automatic route
	Defence industry Broadcasting services (terrestrial broadcasting FM radio and uplinking of news and current affairs TV channels) Print media (publishing of newspapers and periodicals dealing with news and current affairs and publication of Indian editions of foreign magazines dealing with news and current affairs) Banking services – public sector	Government route

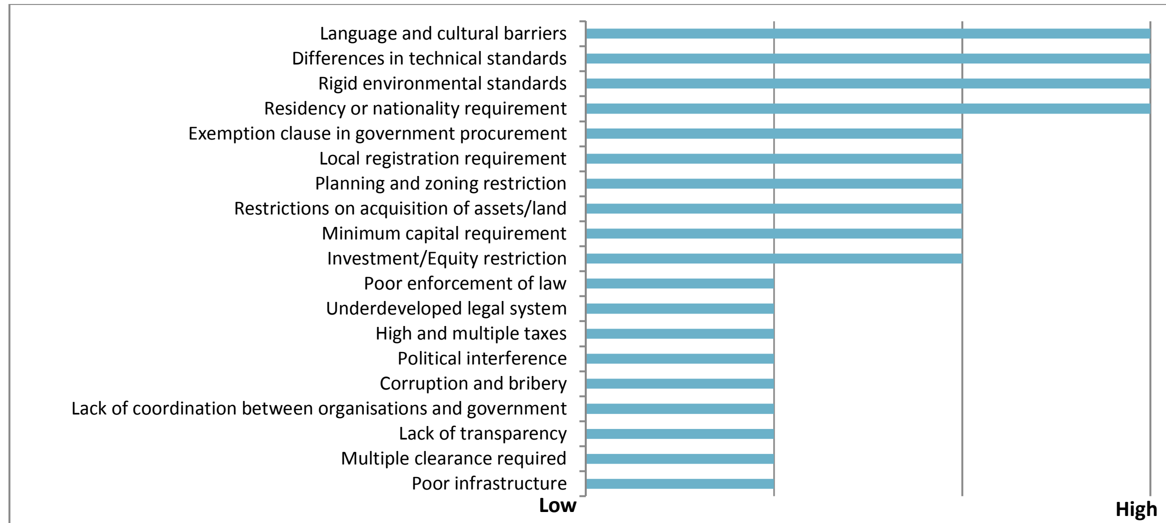
Source: Compiled from DIPP (2013b, 2014).

5.3.2 Barriers faced by Indian Companies in Germany

[45] For details see http://www.oecd.org/investment/fdiindex.htm (last accessed on April 27, 2014)

Very few Indian companies gave extreme ranks to the parameters with respect to Germany. Therefore, the ranks were calculated based on 'high', 'normal' and 'low' impact.

Figure 5.5: Severity of Barriers for Indian Companies



Source: Primary survey.

Factors that have the highest impact are language and cultural barriers, differences in technical standards, rigid environmental standards and the nationality requirement. Barriers that are common in the Indian market such as poor infrastructure, FDI restrictions and corruption hardly exist in the German market.

The participants elaborated on some of these barriers.

- *Language and culture*. Knowledge of German is a precondition and one has to undergo language training. There are also differences in the work culture between India and Germany. Labour regulations strongly favour the workforce. The labour union regulates the salaries and grading of employees, while the worker council determines work timings.

- *Meeting standards*. Germany has strong health and safety regulations and the standards are much higher than in India. As a result, Indian companies have to make very high investments to meet German standards.

- *Market saturation.* In some sectors the German market is getting saturated and, therefore, there is limited scope for Indian companies to operate and expand. For instance, in the financial services sector, Germany is the most banked country in the world. It is expensive to set up retail banks in Germany and Indian banks face strong competition from German banks.

- *Local employment*. Most Indian companies have to employ at least 25 per cent German staff, which is not easy to get in terms of skills particularly for software and consultancy services, because most of the good quality workforce is locked up in German companies. Indian companies have to work very hard on employee branding and human resource practices to ensure good quality workforce. The laws related to employing foreign workers are getting tightened and it is likely that in future it

would be difficult to employ people on a time and material basis (T&M)[46]. This is a German concept and most information technology service suppliers are employed on this basis. In addition, it is difficult to get an independent professional unless s/he has been appointed to give services for specialised products such as new software.

- *Legal system*. Indians consider the stringent legal system in Germany a barrier, as there is no way around the law. This is particularly true for small and medium enterprises.

5.3.3 Sector-specific Barriers

The in-depth interviews found useful insights in sectors of interest to Indian and German companies.

- *Information Technology:* Data protection laws in Germany are more stringent than Indian laws and, as a result, companies cannot host any data in India. Indian companies in Germany have to make huge investments in data centres in Germany and the staff has to undergo special training to understand data-specific regulations.

- *Banking:* Unlike other countries where the capital of the parent company is treated as the capital of the branch, this is not the case in Germany. In Germany, each branch has to bring in capital and the total capital from India for that bank is subject to a ceiling of € 150 million. In addition, each bank can give a loan of up to 25 per cent of their total capital base. While the EU has strict banking regulations, Germany is more stringent. It follows Basel III norms that are more rigid than the norms in India.

- *Legal Services:* German legal companies need to establish a presence in India to provide information on German laws and regulations and also facilitate business development in both markets. However, foreign lawyers and law firms are not allowed to practise in India.

5.4 Prospects and Expectations

The survey found that both India and Germany are potential investment destinations, although the reasons for making investments are different. Since markets are growing and countries are moving towards a regime with unrestricted movement of goods and services, it is likely that opportunities will grow and companies will expand their presence in each other's market.

German companies pointed out that the technology adoption rate has grown in India and Indian companies and the workforce have become accustomed to using new technologies. This has enlarged the scope for investment by German companies in India. Several companies said that they have plans to set up an R&D base in India as the country has a huge advantage in terms of skilled manpower. German companies that invested in R&D in China are keen to shift base from there due to their poor Intellectual Property Rights (IPR) regime and, therefore, by strengthening the regulatory structure, India can become the new R&D base for German companies.

Indian companies pointed out that if German companies invest in technology, India could become a high-quality, low-cost manufacturing destination for German companies. Consequently, Indian companies can upgrade the existing small-scale businesses with new technology.

[46] Time-and-materials (T&M) contracts may be used to acquire supplies or services. These contracts provide for the payment of labour costs based on fixed hourly billing rates that are specified in the contract. These hourly billing rates include wages, indirect costs, general and administrative expenses and profit. For details, see: http://www.fta.dot.gov/13057_6240.html (last accessed on April 29, 2014)

Both India and Germany have a large number of SMEs and there is scope for enhancing SME collaboration. At present, only a few German SMEs have targeted the Indian market.

While the companies were not well aware of the India-EU BTIA, they suggested that the DTAA and BIPA should be revised from time to time to incorporate the changing requirements of corporates in India and Germany. For instance, since the FDI limit in India has been extended in several sectors and foreign companies are buying a greater stake in existing companies, the government should include taxes on dividend under the DTAA. Those who understood the modalities of BTIA pointed out that trade in services should get similar treatment as trade in goods and the negotiators should aim at achieving a free trade scenario in both goods and services. The government of India should explore the possibility of scheduling commitments under the negative list for the services sector rather than following the GATS-type positive list approach. While the EU benefits from free trade in goods, greater benefits would accrue to India under trade in services if the two countries sign the BTIA.

Most companies were also in favour of removing restrictions on movement of people under the BTIA since it would facilitate business development. Several companies pointed out that the BTIA might help reduce paper work and streamline procedures. The negotiations should go beyond the normal negotiating points and aim at having simplified procedures for EU companies in India and vice versa.

India is a high tariff country. Since India has given different tariff concessions to different trading partners, on the one hand, FTA utilisation is low and tariff lines are complex and on the other hand, there are cases of tariff hopping and inverted duties. India should examine its tariff structure and simplify tariffs. Unilateral tariff reduction will enhance India's bargaining power in trade negotiations. Sometimes, domestic non-competitive industries are protected by high tariffs. They should be helped to improve their technology and skills rather than protected through high tariffs. Respondents said that India should re-examine its incentive schemes. Incentives should be targeted at high-value manufacturing, better technology, environment-friendly and clean energy processes and SMEs. Incentives should be designed so that they are not actionable under the WTO.

The survey participants identified certain sectors for collaboration between India and Germany. India and Germany can have institutional collaboration for product development, language training and cultural exchange. The two countries can collaborate in sectors such as biomedicine, pharmaceuticals and engineering. Moreover, they can foster knowledge sharing and create awareness about each other's market. In addition, there is a need to generate greater awareness about the India-EU BTIA by engaging businesses in the negotiations from time to time and by publishing timely and transparent information about the progress of negotiations for the agreement to be encompassing.

Summary and the Way Forward

The discussions in this paper show that India and Germany have a close diplomatic and economic relationship and trade and investment flows between the two countries have increased over time. The two countries are trying to strengthen their relationship further through bilateral inter-governmental dialogues and agreements (such as the BIPA) and through a comprehensive trade agreement known as the India-EU BTIA. As a member of the EU, Germany has a keen interest in the successful conclusion of the BTIA. Once signed, the BTIA will be the EU's first comprehensive trade agreement with a large emerging market. If barriers to trade and investment are removed or even reduced under the BTIA, it is likely to benefit both German and Indian companies in each other's market. German companies can have better access to the large and unsaturated Indian market; they can diversify their risks and establish production networks in Asia. At present, a large proportion of the German investment in Asia is in countries such as China but there is scope for German companies to invest in India, especially in manufacturing, given that the Indian government has come up with several policies that favour manufacturing, including the establishment of economic corridors, the National Manufacturing Policy and the SEZ policy. India needs investment in infrastructure and investment by German companies in sectors such as green energy, construction and logistics will be beneficial for India.

India's outward investment in Germany has shown an increase and Indian companies are investing in Germany to acquire technology and access the wider EU market. A comprehensive trade agreement with the EU would not only give Indian companies preferential access to the EU market, but also help to reduce some of the investment barriers. Companies from the two countries can leverage their mutual strengths and collaborate in third-country markets. Despite these benefits the progress of the India-EU BTIA negotiations is slow, Indian and German companies face several barriers in each other's market and reforms in both countries have slowed down, partly due to the global slowdown and other macro-economic and political instabilities.

Against this background, this report examined the trends and patterns of bilateral investment flows and identified the barriers to investment. Based on a primary survey, the study found that Indian and German companies have strong trade and investment complementarities. Germany is one of the largest investors in India and India's investment interest in Germany is also rising. Germany is a key investor and supplier of technology products in the world and in India. Over time, the technology adoption rate in India has increased and Indians companies are acquiring foreign companies for technology transfer. This has led to an increase in Indian investment in Germany. In addition, recently several German companies have started pulling out their investments from China due to the weak regulatory regime and low property rights protection. This places India in an advantageous position and opens a new outlet for German companies interested in emerging markets and, therefore, there is both scope and potential for enhancing bilateral investments between the two markets.

At the institutional level, India and Germany have undertaken several steps to promote bilateral investments. However, bilateral investment flows are still below potential due to the barriers faced by Indian and German companies in each other's market. On this, German companies referred to the multilayered bureaucracy that results in multiple regulations, corruption and bribes, poor regulatory and legal enforcement, infrastructure bottlenecks, issues related to taxation and profit repatriation. Indian companies considered market saturation, language and cultural differences, difference in standards (which are often higher than the EU standards), local employment requirements and rigid labour laws as some of the key barriers. The nature of the barriers shows that there is a need for unilateral domestic reforms in India and both countries should work together to address some of these barriers.

- ***What India Should Do***

  This study highlights that India needs foreign investment in infrastructure and manufacturing, but the investment inflow into these sectors is below the country's potential since there are several barriers to investment. The barriers faced by German companies in India are also faced by other foreign investors and, therefore, if these barriers are addressed India is likely to receive the desired foreign investment. First, the Indian government should streamline the approval process and reduce delays in approval. Here, India can learn from how Germany has streamlined the administrative processes through the use of technology. The use of technology and on-line clearances will reduce the scope for bribe and corruption, which is a major barrier faced by German companies in India.

  Second, India should progressively reduce the FDI barriers in sectors such as retail and insurance. It is important to note that in sectors such as retail, FDI restriction is not an entry barrier since a foreign retailer can operate in India through other routes, such as wholesale cash & carry and franchising. However, it limits their ability to select the best route of entry, while the Indian government is losing much-desired FDI. Unless foreign companies are allowed to establish end-to-end supply chains or production networks, they will not be keen to invest in India.

  Third, India should strengthen its IPR regime, and outdated regulations that affect international businesses should be replaced by new regulations to facilitate investment. For example, the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013 is pending in Parliament. Unless there is a clear policy on land acquisition, business will not be keen to invest.

  Fourth, although taxes are high in India, German companies have not raised them as an issue since taxes are also high in Germany. However, they have raised concerns about the changes in the tax policy, which are often sudden and are not supported by stakeholders' consultation (as has been the case in the withdrawal of the Minimum Alternative Tax –MAT exemption) and they have concerns related to transfer pricing. The delay in implementation of the single goods and services tax (GST) is preventing companies from establishing a pan-India supply chain. GST should be implemented at the earliest. Once the GST is implemented, India can learn from the German experiences of setting up seamless logistics networks where clearances can be made online at inter-state check posts.

  Fifth, the government should work with businesses in a public-private partnership model to develop the supporting infrastructure. This model can be operationalised if the government helps businesses to access basic infrastructure such as land and electricity.

  Sixth, reduction of tariffs under a preferential trade agreement is often trade-distorting and hinders the establishment of production networks. Sometimes tariffs are lower for final products and higher for raw materials and intermediate goods. India should unilaterally lower tariffs, which will help to establish production networks.

  Seventh, this study shows that several subsidies given by the Indian government can be actionable under the WTO. The Indian government should review the subsidy and incentive schemes and link subsidies to high-value manufacturing, better technology, green energy, SME promotion, etc. This will enable India to attract more foreign investment.

- ***What India and Germany Should Do***

India and Germany should realise that there is scope for enhancing mutually beneficial collaboration and investments. At present, a large part of the investment by German companies is in China. The labour costs in China are rising and the concentration of investment in one country leads to business risks. German companies have to spread their investments and production networks and the German government policy should support that. The UK is trying to work with the Indian government to encourage investment by UK companies in the Bangalore-Mumbai Industrial Corridor and the Japanese government is working closely with the Indian government to develop the Delhi-Mumbai Industrial Corridor. The German government should also explore opportunities for joint development of industrial clusters, SEZs and National Manufacturing Investment Zones (NMIZs) in states such as Tamil Nadu and Maharashtra where there is a presence of German companies. For example, joint development of automobile and auto-component clusters and the development of infrastructure around the clusters in cities such as Pune can benefit both Indian and German companies.

Second, both India and Germany have a quasi-federal governance structure. Hence, collaboration should not only be at the federal level but also at the state and provincial level. The exchange of information and sharing of market knowledge will help reduce several barriers including barriers related to language and culture.

Third, standards-setting bodies from India and Germany should collaborate and share information. In the long run, the two countries can work together for mutual recognition of standards.

Fourth, India and Germany have entered into several MoUs, but these are not legally binding. A legally binding and strong investment agreement is likely to facilitate investment flows, as it will offer a predictable investment environment. The two governments should focus on MSMEs and SMEs partnership by indentifying areas for such partnership. They can also develop industrial clusters in each other's market to facilitate investment. For example, there can be a German cluster in Pune and an Indian cluster in Köln.

Fifth, there is a need to enhance academic and research collaboration between institutions of the two countries in product development and R&D in sectors such as automobile and auto-components, pharmaceuticals, engineering goods and biomedicine. The Indian government is keen on local procurement of electronics hardware, and investment by German companies in this segment in India will benefit them.

Sixth, the governments of India and Germany should push for successful completion of the India-EU BTIA, since this agreement will facilitate trade in goods, services and investment by removing barriers to trade and through trade facilitation measures. In both countries, there is an urgent need to raise awareness among businesses about the benefits of the India-EU BTIA by engaging businesses in the negotiations and sharing information with them in a transparent and timely manner.

Some measures that India and Germany can take that may facilitate investment flows are listed in Table 6.1.

Table 6.1: Select measures that can be taken by India and Germany to Facilitate Investment Flows

Action	**Enacted by**	**Risk**	**Advantage**
Better organise and disseminate information on web portals.	Both India and Germany through their respective embassies and trade promotion bodies	Differences in individual interpretation of the law	Better flow of information and improved market knowledge of investors
Policy reforms to ensure better operating environment	Indian government	Political instability, coalition government after the 2014 general election	Reforms will help India attract investment. It will provide German companies with regulatory certainty.
Academic collaboration, research and cultural exchanges	Both India and Germany	No risks	Can lead to technology-related investment in both market and, enhance market knowledge. Improve understanding of each other's organisational structure, work culture, etc.
Strengthening bilateral agreements such as BIPA and DTAA	Both India and Germany	The existing bilateral agreements will cease to exist after the India-EU BTIA is signed	This will ensure operational certainty for investments and help in profit repatriation.
Mutual recognition of standards and qualification	Both India and Germany	The standards of the two countries are widely different and there is lack of information. India has no common accreditation process. Standards in Germany are higher than EU standards	This will ensure sale of products in each other's market and enhance investment flows.
Speed up the India-EU BTIA negotiations	India, Germany and the European Commission	There has been no progress in the India-EU BTIA negotiations. India has now focused on the Regional Comprehensive Economic Partnership (RCEP) negotiations, while the EU is focusing on the Transatlantic	The India-EU BTIA is the most comprehensive agreement, which will remove barriers to trade and investment and ensure regulatory certainty.

Action	Enacted by	Risk	Advantage
		Trade and Investment Partnership (TTIP) negotiations with the US.	

Source: Findings of the survey and report.

- ***Business-to-Business Collaboration***

Business- to-business collaboration between Indian and German companies is taking place either among individual companies or through business associations such as the Indo-German Chamber of Commerce or between business and government. However, the extent of such collaboration is weak. The database of companies kept by the business councils is outdated. Moreover, any company/ individual can become a member of the Indo-Germany Chamber of Commerce on payment of a specific fee. Joint Chambers should have a list of investors who have investments or are willing to invest in each other's market along with their sector of investment interest. This will help companies identify business partners. They should conduct regular survey-based market research and publish the findings. This will enhance market knowledge among investors from the two countries. It is also important for industry associations and trade bodies to engage in trade negotiations and provide inputs to their respective governments.

Overall, the study found that there is significant scope for enhancing bilateral investment flows between India and Germany, which will benefit companies from both countries. If the reforms suggested above are implemented, they will not only enhance bilateral investment flows but also enhance the global competiveness of Indian companies, improve India's ranking in Ease of Doing Business and other indicators, and increase investment inflows in the manufacturing and infrastructure sectors, which Indian needs. Enhanced investment and collaboration between India and Germany will enable companies from the two countries to leverage their mutual strengths and enhance their presence in third-country markets.

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