# EXECUTIVE SUMMARY

In the last decade, significant structural reforms helped India become one of the world's fastest growing emerging economies, boosting living standards and reducing poverty. Economic liberalisation and rising incomes also stimulated rapid trade growth with Australia and significantly increased Australia's foreign direct investment in India. India is a big, diverse economy with a current growth outlook that overshadows most Asian markets. While the pace of growth in the medium to longer term will depend largely on the speed and extent of ongoing reform, at a time when almost all other Asian economies are anticipating contraction or slow growth, the Indian market cannot be ignored. India has already risen from its position as Australia's twenty fifth largest export market a decade ago, to twelfth largest as we entered the new century. Several fast growing sectors and states provide increasing opportunities for Australian traders and investors to build on that success.

## MACROECONOMY AND REFORMS

An early 1990s balance of payments crisis prompted the Indian Government to undertake significant reforms; these opened the economy more to international trade and investment, abolished industrial licensing, floated the exchange rate and increased domestic and foreign private participation in financial markets. Over the 1990s, these reforms considerably boosted productivity, economic growth and living standards, reducing poverty and increasing the number of high income consumers.

Since the mid 1990s, a dual economy has been developing in India. Highest growth has been concentrated in the 'new economy' services sectors like information technology, telecommunications and finance. Productivity improvement and output growth in many 'old economy' sectors such as agriculture, infrastructure, mining and to some extent manufacturing has not been as strong. A slower pace of reform in the second half of the 1990s has meant that some key reforms required to boost growth further in these sectors have yet to take place. Despite a slowing in average annual real GDP growth from over 7 per cent in the mid 1990s to between 5 and 6 per cent in recent years, a group of four more outward oriented states in the south and west of the country, Gujarat, Karnataka, Maharashtra and Tamil Nadu, are growing more strongly than the rest of India due to a concentration of new services sector industries in those states. Looking forward, these 'new economy' sectors and high performing states should continue to grow at above average levels.

The report considers three potential future growth scenarios. Comprehensive fiscal, labour market, trade, foreign investment, privatisation and government administration reforms could see India return to previous real GDP growth peaks of 7 to 8 per cent per year or exceed them. However, rapid reform is unlikely due to sectional interests' resistance to reform; in India's large decentralised democracy, achieving consensus is difficult. The most likely scenario is continued incremental reform, as experienced in the past few years. Together with reforms achieved to date, this could sustain growth averaging 5 to 6 per cent in the short to medium term. This is in line with Consensus Economics' real GDP growth forecasts, which rate India and China as the two highest growth major Asian economies.

However, a third less probable scenario is possible if significant fiscal and infrastructure shortfalls become more serious and reforms stall; this could see medium term growth dip to 3 to 4 per cent or lower. The current disruption to Parliament's passage of the Government's needed reform legislation increases the risk of this third scenario; however, the most likely scenario remains continued incremental reform over the medium term.

## TRADE

In the 1990s, trade reform was India's most substantial and successful area of economic reform. The Government removed quantitative restrictions on imports, lowered average import tariffs significantly, floated the exchange rate and reduced controls on exports. In response, exports and imports expanded more quickly and the Indian economy is now far more integrated into the international trading system than previously. Opening the economy contributed to gains in productivity and competitiveness and Indian exports now constitute a much higher share of world trade.

Despite these important reforms, restrictions on trade remain. Tariffs are still high by regional standards and have recently increased again in weighted average terms. Also, controls continue on a variety of imports, some export restrictions remain in place and business finds customs procedures challenging to navigate. Hence, successful exporting and importing often requires considerable time, effort and investment. Nevertheless, the previously protected nature of many markets means Australian exporters' opportunities should increase as import barriers decline. The launching of a new WTO round at Doha in November 2001 augurs well for further reductions in import barriers and an expansion of trading opportunities in the Indian market.

## FOREIGN INVESTMENT

Since the early 1990s, India has significantly reduced its controls on foreign investment; FDI surged from low levels as a result. Large parts of the economy are now open to some level of foreign participation, although many sectors still permit less than 100 per cent foreign ownership. Initially, FDI flows responded to the opening of a large new market which had been protected for several decades, often motivated by a desire to avoid India's high tariff walls. However, over the past five years or so, fast growing 'new economy' services sectors, particularly the information technology, IT, industry and several high performing states are attracting increasing foreign investor interest. Most IT firms supply export markets. The challenging business environment and policy restrictions currently constrain sustained inflows into agriculture and to a lesser extent infrastructure, manufacturing and mining. Due to recent liberalisation, mining, infrastructure areas like ports and niche manufacturing, particularly of high value added products, offer good potential investment opportunities. Australian businesses could benefit from investigating investment opportunities in these sectors and fast growing regions.

## THE BUSINESS ENVIRONMENT

Many Australian and other foreign companies successfully trade and invest in India. Growing incomes expanding the middle class, gradual liberalisation of the economy, generally low labour costs and the widespread use of English are some major attractors. Despite reforms over the last decade, companies doing business in India face considerable challenges; however, for those who do succeed, returns can be high. Infrastructure, which is in short supply and expensive by regional standards, is a major problem for business. Red tape and transparency issues are significant, intellectual property protection is limited and the court system is pressured by a large backlog of cases. However, a good local partner can assist business in dealings with government and other regulatory bodies, along with facilitating market access. Thorough due diligence is needed before selecting business partners, agents and associates. While India remains a challenging place in which to do business, profitable opportunities exist for experienced and informed traders and investors.

## THE AUSTRALIA-INDIA BUSINESS RELATIONSHIP

India accounts for only 1.6 per cent of Australia's merchandise exports, but in the decade to 2000, Australian exports to India increased by 12 per cent per year and India moved from Australia's twenty fifth to twelfth largest export destination. Resource exports, especially coal and metal products, dominate Australia's exports. Continued liberalisation of the Indian economy will increase opportunities for exports of Australian commodities and some niche, often advanced technology, manufactures. Service exports like tourism and education also are growing strongly.

While Australian direct investment in India increased substantially during the 1990s, at about A$1 billion, its Indian investment stock is still well under 1 per cent of Australia's total overseas direct investment. Faster growing service sectors, including IT, media and finance, mining and niche manufacturing are the main areas attracting recent Australian investor interest.

## 'NEW ECONOMY' OPPORTUNITIES

In future, these fast growing 'new economy' sectors, including information technology, IT, finance, telecommunications, health, education, environmental services, biotechnology and media and entertainment increasingly should offer attractive direct investment opportunities. In particular, the Indian IT sector is flourishing due to its strong comparative advantage in relatively low cost skilled IT engineers and supportive government policy. Significant opportunities exist for Australian firms to enhance competitiveness through direct investment in and outsourcing to the Indian IT sector.

The financial sector is increasingly open to foreign investment and growing strongly. Although the sector remains constrained by a strong public presence, overstaffing and high non performing asset levels, the Government is working to address these issues. Nevertheless, intending investors need to be well prepared and may find the best opportunities lie in partnering with recent private Indian entrants to these sectors.

The telecommunications sector also is growing strongly. In the past, frequent policy changes made this a challenging sector to enter; however, recent reforms promise better opportunities for private companies to compete with public incumbents and foreign investor interest in this sector is increasing again. Health, education, biotechnology, environmental services and media and entertainment also are sectors where recent gradual liberalisations and stronger market growth should allow Australian firms with strong capabilities in these sectors to invest profitably; several Australian educational institutions and other companies already participate successfully in these sectors.

## 'OLD ECONOMY' OPPORTUNITIES

Among the 'old economy' sectors, manufacturing, mining, infrastructure and agriculture, mining currently is the most prospective for Australian firms. Recently, several progressive states have issued more mining prospecting leases, significantly increasing Australian miners' interest in this sector. Fiscal regimes for mining also are approaching international standards, while oil and gas could offer medium term opportunities.

While sectors like manufacturing, infrastructure and agriculture are slowly opening to foreign direct investment, foreign ownership caps, infrastructure shortages and government regulation of private sector activity in these sectors has kept foreign investment to modest levels. Nevertheless, several Australian firms are succeeding in the manufacturing sector, usually by bringing high technology processes, skills and products to India. Furthermore, good opportunities exist in private ports and aid funded road projects; at present, these are the most prospective infrastructure sectors for investors and goods and service exporters. In most other 'old economy' sectors, significant opportunities remain contingent on further policy liberalisation and an improving business environment.

## THE STATES

Culturally, linguistically and economically, India has always been a highly diverse country. Economic divergence widened in the 1990s, when four southern and western states, Gujarat, Karnataka, Maharashtra and Tamil Nadu, achieved significantly stronger real GDP and per capita income growth than other major Indian states. These high performing states excelled because economic reforms most benefited industry and services in which they specialise; they also are more outward oriented and, in most cases, have better infrastructure endowments. A strong historical focus on education and business and some state policy reforms also assisted their performance. Australian businesses could benefit from this regional divergence by focusing their efforts on those states that are performing better, have better business environments and higher and faster growing incomes; these may offer investors and traders more opportunities.

## IMPLICATIONS

India's reforms are creating relevant trade and investment opportunities for Australian firms in a range of fast growing 'new economy' sectors and high performing states; as well, higher incomes and trade liberalisation are boosting Australian commodity, niche manufactures and services exports to India. Further comprehensive reforms would consolidate growth and expand these opportunities further.

In the short to medium term, Australian businesses operating in India can expect incremental reforms to continue; in the short term, more comprehensive reform is unlikely given political constraints faced by the central coalition government. Major changes to the business environment also are unlikely in the short to medium term, though some states gradually are reducing red tape and increasing labour market flexibility. Infrastructure shortages are likely to remain acute for some time.

Three key messages to emerge from case studies of Australian firms doing business in India are:

- the crucial nature of business partner choices
- the need for patience and perseverance in dealing with the bureaucracy
- the good sales growth prospects for firms which succeed on these first two issues and have a well priced or unique commodity, service or product to sell.

India and Australia increasingly recognise they share many common trade and political objectives. Shared trade reform issues include trade in information technology, e-commerce issues, and services negotiations in the WTO. As a large agricultural producer embarking on a process of economic reform and opening, India shares many concerns in common with the Cairns Group of agricultural exporting nations, which Australia heads. Liaison between Australia and India already is well established, and prospects for further development in this relationship are promising. Sharing common democratic ideals and Commonwealth membership, India and Australia also are leading members of the Indian Ocean Rim Association for Regional Cooperation.

As India's reforms deepen, its growth potential is huge. Already Australian businesses are developing many trade and investment opportunities in India and prospects for bilateral commercial relations are bright.