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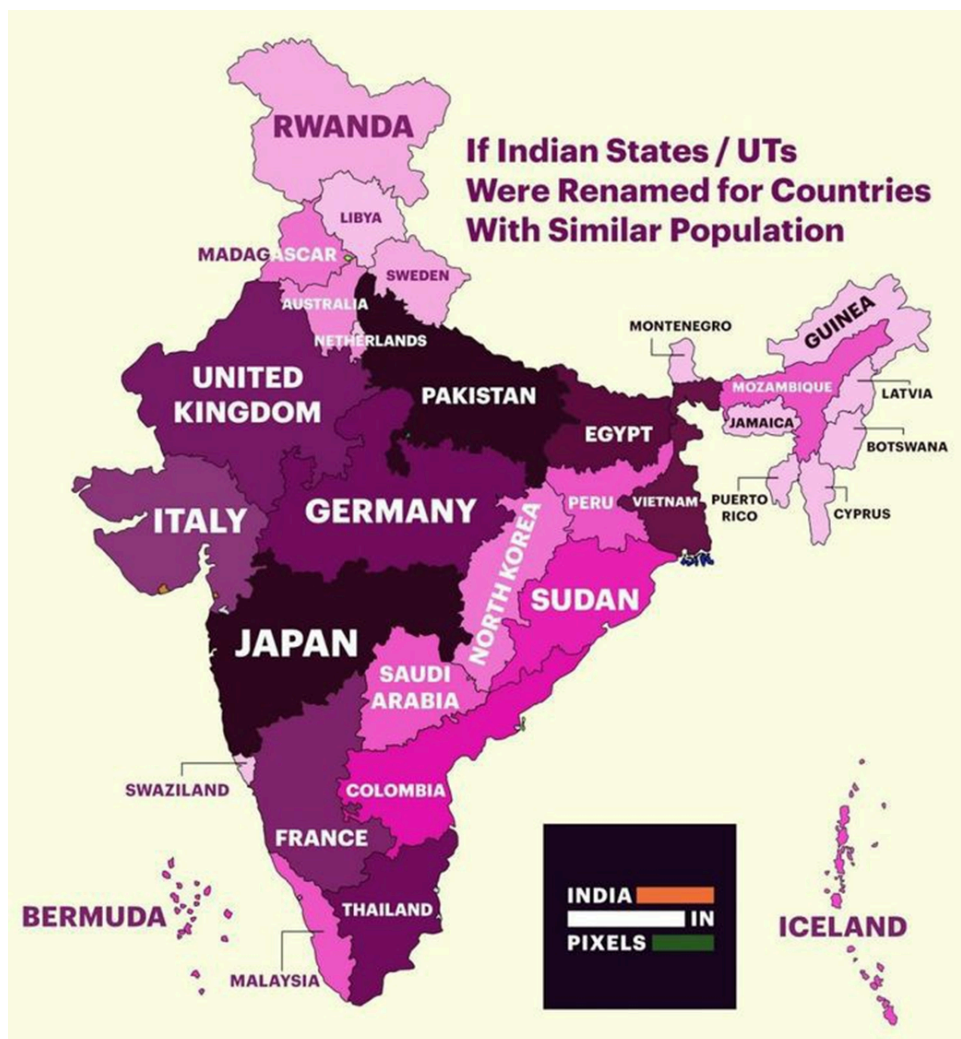
# INDIA, THE NEW CHINA ?

## 1. Extreme India

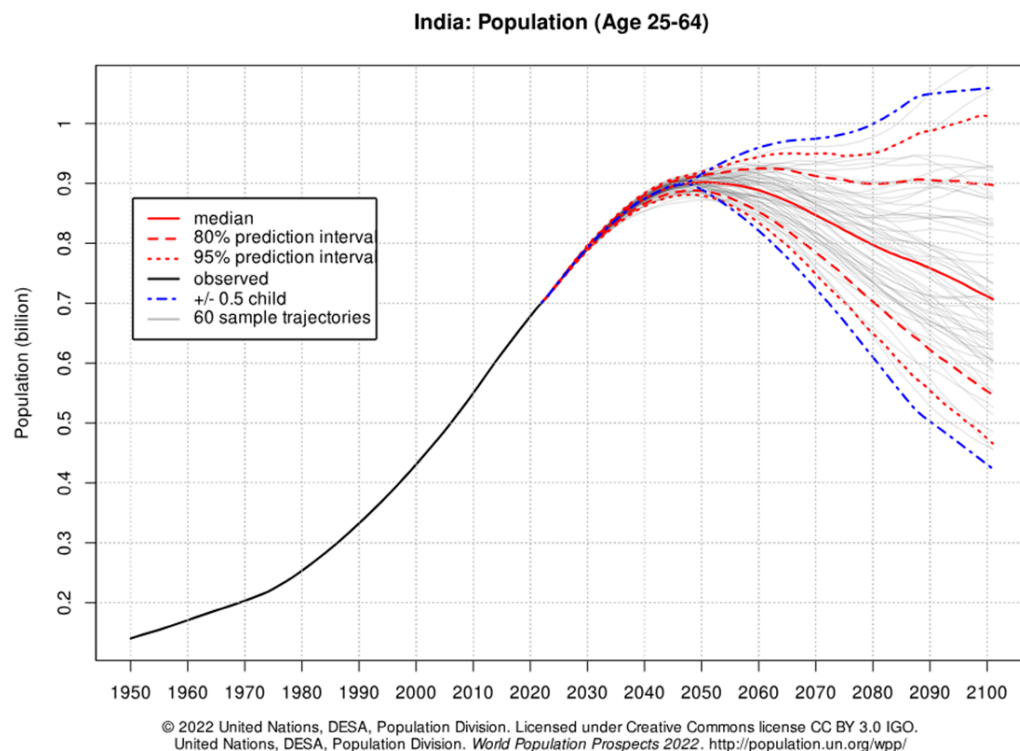
India is a small giant. "But I see it growing into a huge giant in, say, ten years," Jaimini Bhagwati explains to me. Dr Bhagwati is a "Distinguished Fellow" at a Chankyapuri, New Delhi based think-tank called the Centre for Social & Economic Progress (CSEP) and a former Indian ambassador in Brussels. "Roads are being built, as well as ports and airports. The logistics are starting to come. Reforms are being pushed through. And everything will at some point finally come together. When? That is difficult to predict, because it's like a snowball, as it keeps growing and growing and picking up snow from the ground and suddenly you will see this huge ball. And you will ask: where did it come from?"

### India's demographic dividend

In terms of land area and population, India is already a giant. It is 1.2 times the size of the euro zone, 77% of the EU and 1/3 that of the US. However, its population is 3, 4 and 4.1 times larger than these regions, respectively. The total population is expected to peak at 1.7 billion by 2063, compared with 1.4 billion now, and then fall to 1.53 billion by 2100. By 2044, the country will enjoy a demographic dividend: the number of 25-64-year-olds versus 65-year-olds and under 25-year-olds – the support ratio – will fall by 17 per cent over that period. From now until 2050, the working-age population will increase by 0.9 per cent from 706 million to 902 million.



This demographic profile is in sharp contrast to most other industrialised economies and some emerging economies. The US is the proverbial exception, as it will see a further population increase from 175 million to 187 million people by 2050. In Western Europe, the working-age population will fall from 102 million today to 91 million in 2050 (-0.4%/year). In China, the working-age population will fall from 823 to 668 million, or 0.7% per year. Migration from rural China to the cities and a further rise in the labour force participation rate could however, partially offset this. In India, we will see that both elements make India's challenge even greater: providing jobs for everyone.



### India is not the new China

India is often compared to the China of the 1980s. The working-age population had more than doubled by the year 2020. Combined with the opening of its market to foreign companies, China had average annual growth of 10 per cent until 2010. India currently stands at 7%. The IMF expects India to maintain a growth rate of 6 to 7 per cent in the coming years. While for China, growth is expected to decline from 5 per cent in 2023 to 3.4 per cent in 2028. The OECD published growth forecasts for 2040 projects growth of 4.4 per cent for India compared to 1.9 per cent for China.

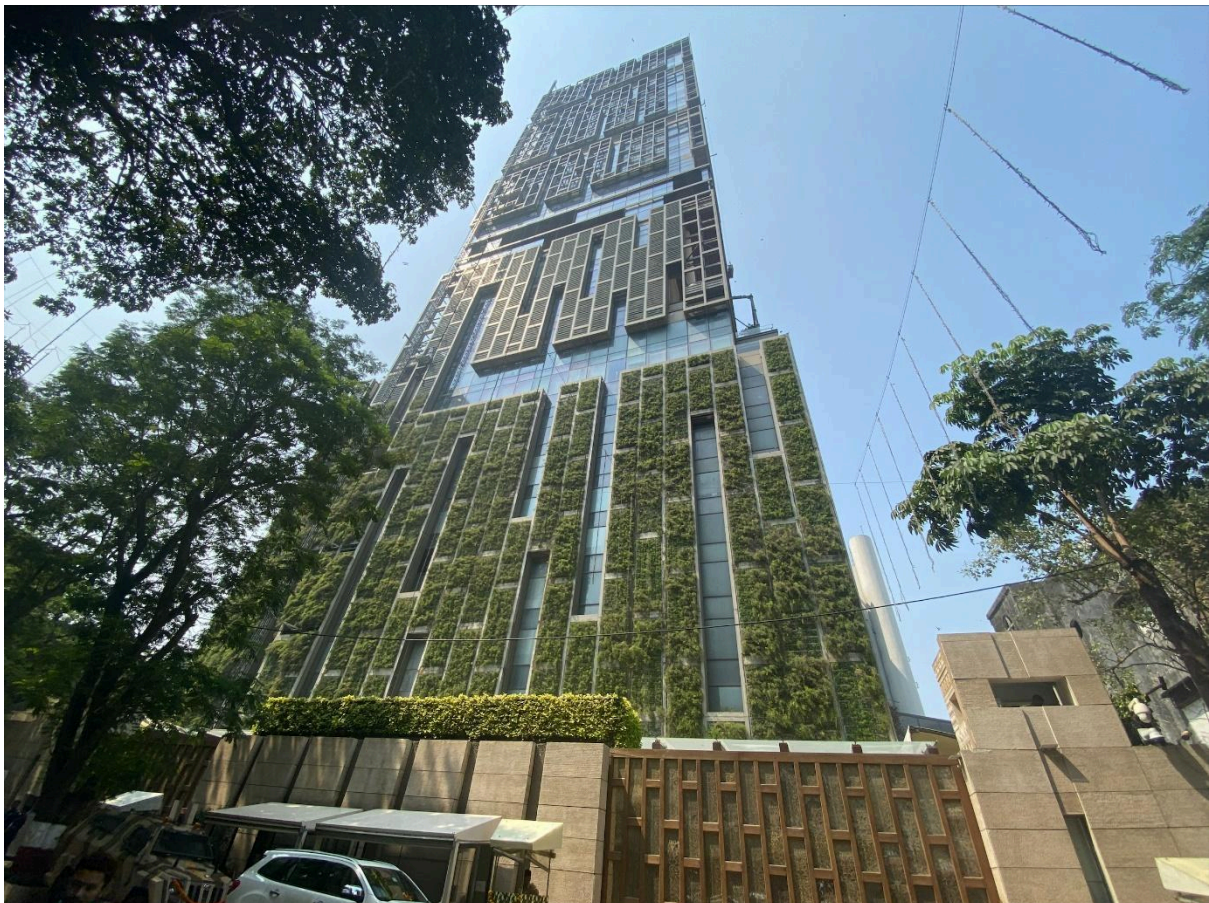
India is not matching the scorching growth rate that China was able to maintain for decades. According to Anantha Nageswaran, Chief Economic Advisor to the Indian government, China achieved these growth rates due to the large amount of debt it accumulated. “Adjusted for this, India has been growing stronger since the mid-90s,” he explains.

The main reason, in my view, why India has not had such growth rates in the past, nor will it in the future, is that it is a democracy. An autocracy with no public say would be the ideal place to build infrastructure faster than today and to implement the necessary reforms. In India, the fragmentation of political parties and the great diversity of the population make any reforms politically sensitive. As a result, change in India is always slower than planned. “And, although the central government under Modi enjoys a strong parliamentary majority, a constant election cycle due to staggered timelines of

state elections makes it politically sensitive to unpopular reform measures”, says Shumita Deveshwar, Chief Economist India for research provider GlobalData TS Lombard. “That is why the government had to withdraw farm reforms. Furthermore political competition at the state level keeps it from implementing steps that would need to be executed by local governments. The stalled labour reforms are here a case in point.”

### A country of extremes

The diversity of its population makes India a land of contrasts. “Whatever you hear about India is true. And the opposite of that is also true. So that is where you are”, says Mukesh Malhotra, CEO of Solvay India when I tell him I’m a bit confused about India. The 27-storey 'house' of billionaire Mukesh Ambani – the first apartment to cost more than one billion dollars and the largest single-family home in the world – is located in the middle of Mumbai city where an estimated 62 per cent of the population lives in squalid slum conditions. India is one of the most unequal countries in the world, with the top 1% holding 22 per cent of the national income, compared to 13% for the poorest half of the population. “India is a land of big extremes,” acknowledges Tata’s Chief Economist Roopa Purushothaman, “and this goes for a lot of things. Take for example ageing. On average we have a young population, and in some parts of North and East India, you still have relatively high fertility rates. But in South India we’re ageing even faster than France! So people there have other needs.”



The average income of the 28 states and 8 union territories (which are directly under the federal government) also varies widely. India’s average income per capita in 2021-2022 was USD 1,955. However, four states had incomes more than twice as high and two states were less than half. These states have different priorities that can be addressed by the locally elected state administration.

“India is not just one country. It is too big for that and there are too many differences in culture, language, and so on,” says Amitabh Dubey, political analyst at research provider GlobalData TSLombard. “It is good that state power is strong so that the state government can do things that are important for their own region. There is a central government, but 90% is decided by the state government.”

### **Highly diverse and yet one nation**

Is India more like the United States than the European Union? “In Europe, you have Belgians, French, German people,” explains Raman Madhok, Economic Diplomacy Advisor of the Consul General of Belgium. “You all belong to Europe, but the way you behave is different, your food habits, how you interact. So you see that as well in India, where the people that you have met in New Delhi are different to those in Mumbai. But the big difference is that they still feel Indian, whereas your loyalty is to your country. You don't have that glue which is there in India.”

On the other hand, in terms of diversity of culture, languages and habits, it is much closer to Europe, and by quite a lot. “You know, over the last 20 years, we've added almost 30% more states. So Delhi has become a state, we have bifurcated bigger states to make them more manageable. And because of the differences in culture, habits, wealth and so on in the different states of India.” An Indian banknote illustrates this diversity perfectly. There are now 15 languages on Indian bank notes. The value of a bank note is written in a total of 17 languages from the 22 official languages. These include Hindi, English, Konkani, Kashmiri, Oriya, Nepali, Marathi, Urdu, Sanskriti, Tamil, Assamese, Bengali, Gujarati, Kannada, Malayalam, and Punjabi.

Hindi is the most widely spoken language and is the first / second language of 44% of the population. However, it should be noted that many other official languages serve as the primary language in different states and regions of the country. English is spoken by an estimated 194 million people, or 14% of the population, according to a study from 2012 (although another source puts the figure at 30% without citing a source). The number of English-speaking Indians has probably increased since 2012, but even at 194 million, India is now second only to the US in terms of the actual number of English speakers in the country. English is widely spoken in India's major cities, such as Bangalore, Mumbai, Chennai and others and is one of India's main advantages over, say, China in attracting businesses. English is, however, much less widely spoken in the more rural and northern areas, where Hindi and various local dialects are more common.

## 2. Indian Politics and Democracy ... according to Modi

*India will not become the new China. In a democracy, everything moves at a slower pace. Prime Minister Modi's BJP has a majority in the all-important Lower House and in 17 of the 28 self-governing States. The battle for voters in 2024 is, as always, a mix of religion, caste and freebies. For the financial markets, stability would be the best outcome.*

### The Hindu nationalistic BJP party of Modi

The political framework in India, with its federal structure and 28 states and 8 Union territories, is complex. It is a Union of States; this means that the states did not come together to appoint a central administration, but that the centre created the states. There is a clear division of powers between the central government and the state administrations. The central government is responsible for defence, foreign affairs, railways, banking and some other matters. The States' have authority over, among others, police, healthcare, agriculture and local government.

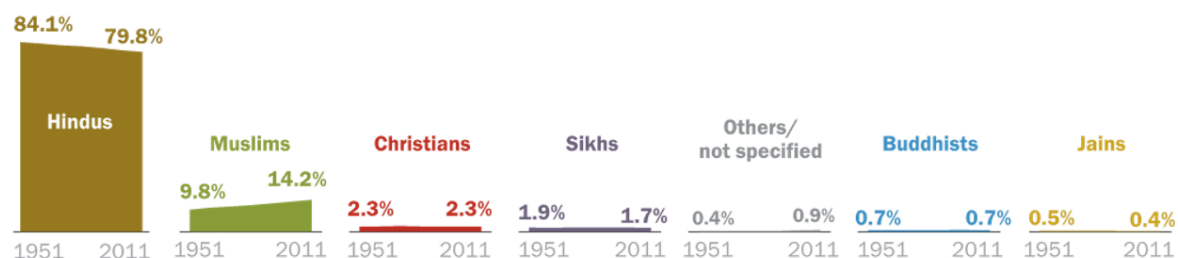
The National Democratic Alliance (NDA) currently leads the central administration, with Prime Minister Narendra Modi's Bharatiya Janata Party (BJP) as the main party. The BJP is a Hindu nationalist party, while the main opposition Indian National Congress – often referred to simply as Congress – is known to be a secular political party. The BJP began to gain popularity after 1992, when Hindus claimed the site on which the Babri Masjid mosque stood in Ayodhya. This sparked violent riots between Muslims and Hindus that left 17 people dead in the city and more than 2,000 elsewhere in India. In January 2024, Modi opened the Ram Mandir temple for Hindus on the same site, a promise made by the BJP in 1992. Religion plays a major role in politics. Almost eighty per cent of the Indian population is Hindu. Just under 15 per cent are Muslim.

Thomas Easton ([thomaseaston@substack.com](mailto:thomaseaston@substack.com)) of the online newsletter India Business and Finance notes: "The Indian Administrative Services officer in charge of tourism told me there are currently only two hotels in Ayodhya (along with all the unofficial guest houses). Within the very near future, there will be another 115 and more are on the way." He concludes: "Beyond everything else (and there is a lot of everything in this case), it does demonstrate that when India wants to get things done, it can."

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### Hindus still large majority in India, while the share of Muslims has gradually grown

*% of Indians who are ...*



Source: Census of India, 1951-2011.  
"Religious Composition of India"

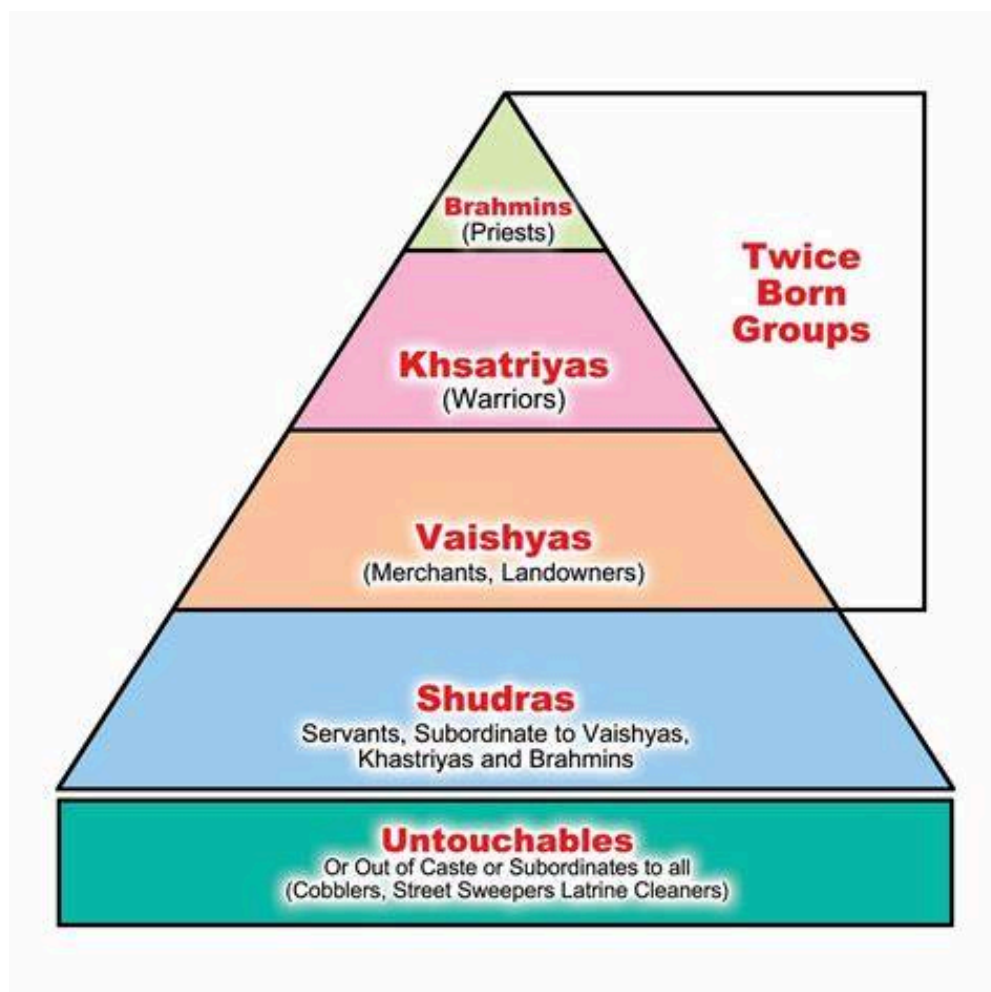
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## The forbidden but pervasive caste system

Alongside religion, the caste system adds another layer of complexity to India's political and social landscape. Communities and birth groups are grouped into castes (jatis). These jatis usually include groups of one, but sometimes several social classes, or varnas. There were four varnas: (1) brahmins, the priestly and learned class; (2) kshatriyas, the warriors and rulers and also the large landowners; (3) vaishyas, the farmers and traders; and (4) shudras, the citizens and labourers. The fifth were the dalits or untouchables, an outcast group that had to do the hardest and dirtiest work.

Caste-based discrimination is officially outlawed, but it is still alive and well in many places. It defines your status, your job and often your opportunities for advancement. Putting someone from a lower caste in charge of someone from a higher caste can cause problems. Dalit girls are still segregated in schools.



Caste is also implicitly enshrined in Indian law. To eliminate caste inequality, every school and university should be required to reserve 40 per cent of seats for lower-class students. The same applies to government jobs, but these are shrinking as a result of gradual privatisation. "Progress has been made in recent years," says human rights activist Manjula Pradeep in an interview with the Belgian newspaper De Standaard. Pradeep has addressed the United Nations and the European Parliament on forced labour, sexual violence against women and discrimination against the dalit. "The younger generations are more vocal about their rights. That's because women have become more empowered."



## A fight for 'mind space'

Women from the lowest castes suffer the most. "But the culture has not changed. An example: while waiting for the train a fortnight ago, a strange man started a conversation with me. The first thing he asked me was: what is your caste? [...] Sooner or later that question comes up. The best proof of this is that even today there are very few mixed marriages between castes."

"Economic growth has meant that many in the lower castes have become prosperous," says Amitabh Dubey, political analyst at GlobalData TS Lombard. "Political parties are formed around these castes, and in some states, a caste with a large number of people and political influence can win elections and thus attract financial resources." The lower castes with the most supporters thus gain political power and money for better education, for better housing, something that the higher castes have long had. "The high castes, in contrast, unite on the basis of religion, Hinduism. Some of the lower castes say: I'm a Hindu too, I don't want to be clubbed with Muslims politically, so I'm happy to join the upper castes. And so it becomes a battle for the voters' 'mind space'." Election campaigns are therefore run by some parties on the basis of economic achievement, whilst others take a nationalist line that includes religion.

## Indian democracy

India remains the world's largest democracy, but its score on the Economist Intelligence Unit's (EIU) Democracy Index has fallen from a peak of 7.92 in 2014 to 7.04 today. This puts it in 46th place out of 167 countries, on par with Poland and between South Africa (45) and Suriname (48). The EIU speaks of a 'flawed democracy'. "Indian institutions are highly developed and entrenched," the institute writes. However, "a weakening of political culture due to shadowy political funding systems in favour of the ruling party, the increasing trend of fomenting tensions between different communities and jurisprudence steering decisions in favour of the ruling party" weigh on the political culture score. Freedom of the press in India is legally protected. However, in 2023 India's ranking in terms of press freedom according to the Reporters Without Borders' Press Freedom Index, slipped from 150 in 2022 to 161 in 2023, out of 180 countries.

Of the 323 out of a total 543 seats in the powerful Lower House – which is run on the British model, of which India was a colony until 1947 – 290 are held by the BJP. The BJP also has a majority in 17 states. The NDA is seen as more right-wing and pro-business than the Indian National Development Inclusive Alliance (I.N.D.I.A), a 29 party coalition led by the Indian National Congress. "But the economic policy pursued by both is heading in the same direction," says Shumita Deveshwar, chief India economist at TS Lombard. Both parties have socialist views, but the BJP's interpretation focuses more on a Hindu-centric nationalist discourse, while the Congress advocates a broader, more inclusive view of the Indian nation. "The BJP is trying to capitalise on Modi's high popularity at the federal level in the state elections today and make it a 'Modi-Congress' election rather than a BJP versus Congress election," says political analyst Amitabh Dubey of GlobalData TS Lombard.

Modi's power means that the BJP-ruled states are more in line with the central government. They get votes thanks to Modi, so they have to listen more. But there are also many states that are governed by other coalitions. "And often then there are negotiations between states and the central administration about what they will and will not introduce, depending on whether it's in the interest of the state or not." In 2018, for example, the central government introduced a national health insurance scheme for roughly 50 per cent of the poorest Indians: the Ayushman Bharat Prime Minister's People's Health Scheme. Some states refused to join because they had already launched their own health programmes. Others did so, but included an extra layer, adding their own "branding".

## Standing on the shoulders of giants

Is Modi a good leader? “He has flair. He’s charismatic,” says Deveshwar. “There are people who will tell you that, if you love India, you have to love Modi.” Modi is seen by most as a competent manager. But some would rather see him return as leader than others. “If I’m the CEO, I want people like Modi,” says Dr. Bhagwati. “You say to him: ‘OK, get this done. You have six months.’ And it’s done. But he is too much head and too little heart.” Modi has implemented many reforms since taking office. “But if you remember Newton, when he was praised in Cambridge by his fellow scientists, they said: ‘You have been so advanced in your thinking’. Newton said, ‘I could look further ahead because I have stood on the shoulders of giants.’ So I would argue that Modi has also stood on the shoulders of the giants of the past.”

The main benefit of Modi’s high popularity is that it brings political stability. “It’s the first time in almost 10 years that we have had a stable government and policies,” says Muhammad<sup>1</sup>, an Indian contact who prefers to remain anonymous. The Indian National Congress ruled with an absolute majority from 1952 to 1976. Since 2014, the BJP has governed federally, and in a majority of states, with an absolute majority. “And I believe there is a good chance that the BJP will remain in power with a majority in the next five years. This reminds me of the 1930s in the US, when Franklin D. Roosevelt<sup>2</sup> was elected president three times in a row.”

## Stability good for financial markets

Things have often been different in the past, he tells me. “In 1996, the BJP, the winning party with 161 out of 543 seats in the Lower House, formed a coalition to reach a majority. The dispute over who got which portfolio led to its collapse after only 13 days.” Several smaller parties then formed a coalition with the support of Congress, only to stumble 18 months later.

In 1998, the BJP won 182 of the 543 seats. The National Democratic Alliance was formed with some regional parties, but the government still fell after just 13 months. “The rapid succession of elections blew a hole in the budget: elections with their freebies are expensive in India. It took years to recover from it.” Demonstrating economic performance is important in elections. But the key lies in the hands of the rural population, which tends to be less affected by this growth. In the fight for their votes, freebies are widely used, ranging from cash, health insurance, a blanket and food to colour televisions, laptops, bicycles and gold: immediate and tangible benefits in exchange for a vote.

Financial markets would certainly be happy with another five years of a Modi coalition. In the case of a non-Modi coalition, it would depend on the coalition formed. “If there is an alliance of opposition parties, the impact on financial markets will be negative in the short term,” says Dubey. “The last time a BJP coalition was replaced by an opposition alliance – in 2004 – the market dropped by 20 per cent in four days, although it recovered after that.”

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<sup>1</sup> Muhammad is a fictional name.

<sup>2</sup> Roosevelt is considered one of the most influential and impactful presidents of all time. He redefined the role of government in the US, and his support for government social programmes was crucial in redefining liberalism for future generations. His New Deal programme focused on the '3 Rs': 'relief' for the unemployed and poor, 'recovery' of the economy, and 'reform' of the financial system to prevent a repeat of the Depression.

### 3. Demographic dividend doesn't rhyme with substandard education

*India will enjoy a demographic dividend until 2044, as it has a relatively growing number of 25-64-year-olds in comparison to over 65 and under 25-year-olds. It can however only reap this dividend by creating 200 to 300 million jobs. In recent decades, most of the jobs created have been in the service sector. A relatively small, well-paid elite has driven its economic growth. But the education level of the majority of Indians is not high enough to enter this service sector. India needs to attract industry to create well-paid factory jobs. But before that, it needs to raise the quality of its substandard primary education. India has been the standard-bearer for the developing world in recent decades with its high growth rates despite skipping the industrialisation phase. To maintain these high growth rates, it needs to take a step back and embrace that industrialisation after all.*

#### Consumption

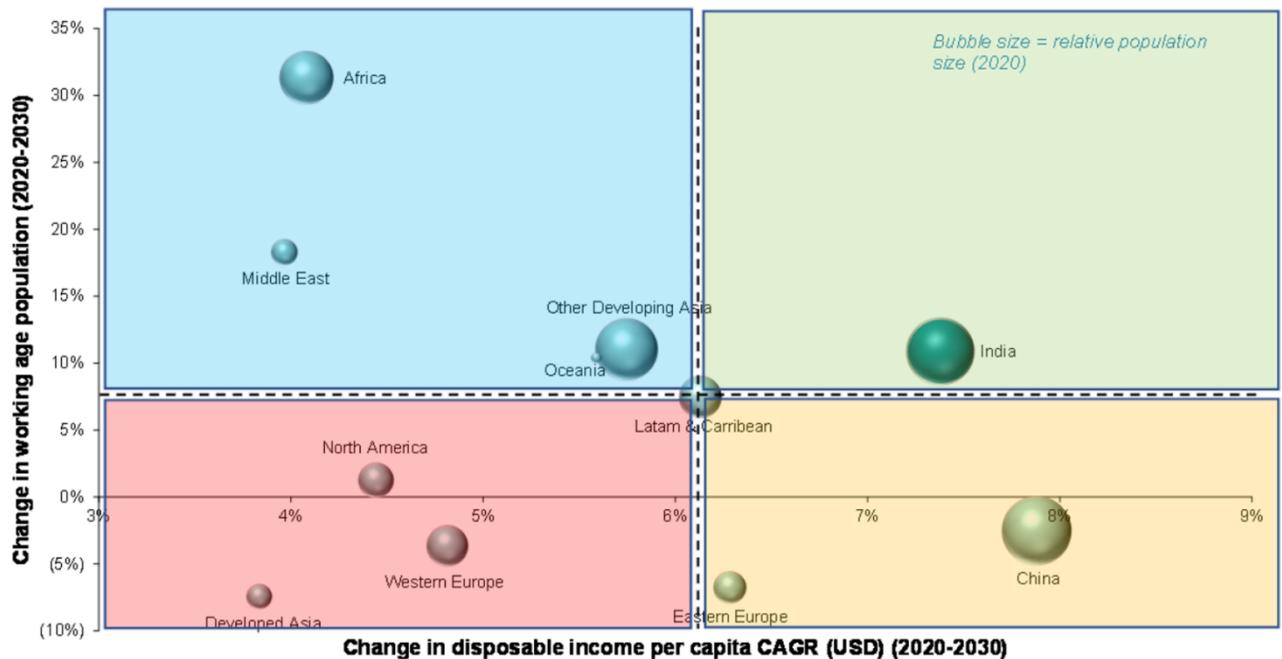
Jobs, jobs, jobs. This is what India needs in order to capitalise on its demographic dividend. Millions of people can then join the middle class and drive up domestic consumption. "Already today, consumption is the engine of economic growth," Shumita Deveshwar of the research firm GlobalData TS Lombard confirms to me as we do our bit to boost consumption in a restaurant. Wine is not off the hook. Taxes on imported alcohol are sky-high, making wine very expensive. Tip: If you want to drink something without tearing a whole in your pocket, order a cocktail.

"I live in a suburb of Delhi called Gurgaon, where there are a lot of international companies." Gurgaon is a planned city – a so-called SMART city – equipped with all the public infrastructure and institutions. The aim is to ensure that India's urbanisation runs smoothly and that the major cities are not completely overwhelmed by uncontrolled migration. "One flat after another is being built here. And you really can't imagine how many huge alcohol shops there are here. The demand for alcohol is enormous, despite these high taxes. And you can see this explosive demand popping up in all retail products. This increasing demand for consumer goods is driving economic growth."

Stijn Rijckbosch, CFO of L'Oréal in India, is also optimistic. "The affluent consumer starts with an income of \$20 a day. We're not seeing this everywhere in India as yet, but for the wealthier middle class, it's not far off. In addition, women are gradually becoming more important in society. They're taking on more important positions, even though there's still a long way to go. The combination of both clearly works to the advantage of L'Oréal's beauty products."

**Figure 6: India offers both working age population growth and disposable income growth**

Working age population change (2020-2030) vs. Per capita disposable income growth CAGR (current USD) (2020-2030)



Source: UN Population data, Euromonitor, BNP Paribas Exane estimates. Note: bubble size denotes relative population size in 2020; dotted line = straight average; working age population = ages 15-65.

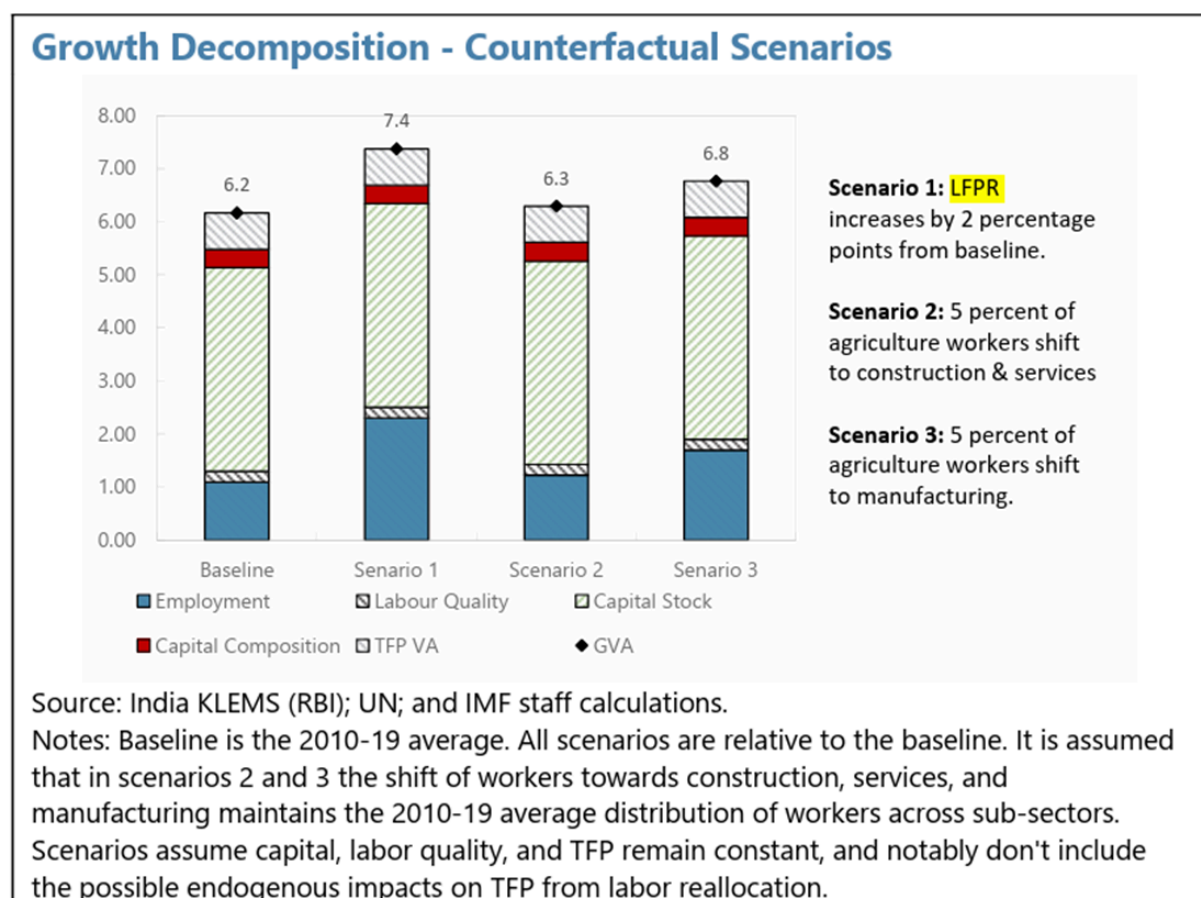
## Hundreds of millions of jobs

According to the IMF, India will need to create between 145 and 330 million jobs for its growing population by 2050. Some figures (hold on, dear reader): in 2022, India's working-age population – 15 years and above as per the IMF definition – was just over 1 billion people. Of this group, 50% were working, with an employment rate of 53% and an unemployment rate of 5.7%. The upper part of the estimated range of 145-330 million jobs includes 84 million jobs that would exist if the employment rate had remained at 61%, as it was in 2005. 61% is also the average employment rate of other emerging economies within the G20. In addition to these 330 million jobs to be created because of the increase of the working population and the higher labour force participation rate, extra jobs in the service/industrial/construction sectors are required for workers today that want to move out of agriculture. Currently, 42% of the population is employed in agriculture (versus 22% in China and 2% in the US).

There is a huge bonus to this shift. Agriculture's share of total employment is high, but its share of total value added - the total value added of all sectors equals GDP – was only 15% in 2019 compared to 40% in 1980. The share of the services sector in value added has risen from one third to more than half. In terms of employment, the services sector accounts for a third of all jobs. The remaining quarter is split between industry and construction. The challenge is clear: guide (many) more blue-collar workers from the particularly unproductive agricultural sector to the more than four times more productive service and industrial sectors. By comparison, between 1990 and 2022, China's productivity grew by 14 times, while India's grew by 4 times. The main reason for this spectacular increase in China was the migration from rural to urban areas. The rest was the result of large capital investments that led to massive productivity gains in the industry. India also lacks such investments. However, the growing service sector has been responsible for productivity growth.

## Shrinking share of agriculture

In the IMF's baseline scenario, growth will increase by 6.2% in the coming years, which is also the average for the period between 2010-2019. Capital investments and the like account for 2/3<sup>rd</sup>s of this growth, the inflow of new workers for 1 percentage point, while the rest comes from better workers and increased efficiency. In a first alternative scenario, this growth rises to 7.4% simply by raising the participation rate by 2 percentage points. In a second scenario, the employment rate remains constant but India manages to shift 5% of agricultural workers into industry. The expected growth rate then moves towards 6.8%. If the shift is from agriculture to services and construction – scenario three, and following the pattern of past decades – then growth will remain at 6.3%. Conclusion: the combination of rising labour force participation and a shift towards industry will win India the jackpot.



Other analyses also point to huge growth potential. Bloomberg Economics forecasts a gradual rise in economic growth towards a peak of 8.5% in early 2030, driven by corporate tax cuts, incentives for manufacturers and privatisation of state-owned assets. Closing the gender participation gap alone will add an additional 30% to India's GDP by 2050.

## Women's empowerment

The employment rate for men is 76.7%. For women, it is 28.6%. Sixty per cent of them work in subsistence agriculture, especially in rural areas. In China, one of the best-performing countries in the Asia-Pacific region, the average female employment rate is 61%. India is a very traditional society.

Women go to work, but when children are born, the woman takes care of the children and stops working.

A feeling of insecurity keeps women from working in industry. At Bekaert India in Pune, only 50 of the 1,350 employees are women, says top manager @SrikanthChakravarthy in an interview with De Standaard<sup>3</sup>, and this despite the fact that Bekaert drops female employees off at their homes in a van after work. What's more, they receive all sorts of benefits, such as free sanitary towels and a few hours of rest if they are in severe pain during their periods. "But it's still difficult to convince girls and women to join us in the factory," admits Chakravarthy.

To attract women to industry, there is a gradual move to create "women-only" factories. "Foxconn has such factories in Taiwan, China and Vietnam," says Sameer Narang, Head of Economic Research at ICICI bank. "It also wants to set up such a factory in India too." But the hurdles facing industrial companies are far from over. "In these other countries, employees work 12-hour shifts. In India, the law restricts workdays to 8 hours. In some states such as Uttar Pradesh and Karnataka, they wanted to change this or the companies won't come. But after protests, the proposal was temporarily withdrawn." Labour and other laws need to be adjusted. We will discuss these in another contribution.

### Top Indian CEOs

India is often seen as a standard-bearer for developing countries because of its high growth rates despite skipping the industrialisation phase. In recent decades, this growth has mainly been driven by the service market. "That's the result of our education system," explains Professor Parth Shah, Director of the Indian School of Public Policy. "In China, South Korea, Taiwan, Vietnam and so on, governments invested mainly in lower and secondary education. So everyone receives at least a solid primary education up to grammar school. Maybe they did not pursue higher education, and perhaps those countries did not even have good universities or colleges. But that was the norm in most parts of the world."

What did India do? Exactly the opposite. "We invested even more in higher education from the 1950s to the 1990s. It wasn't until after the 1990s that we started investing more in primary and secondary education. That's why today, with the Indian Institutes of Technology, we have a network of top engineering and technology institutions (IITs) as well as world-class management schools (IIMs). And because India is so big, we have smart people, even if they have not always gone to good schools. What IITs and IIMs have done is simply select the 1,000 smartest people out of the millions of students taking the entrance exam. And that has had two consequences for India. First of all, it has produced people who run global companies." Well-known examples of Indian CEOs include Sundar Pichai (Alphabet), Satya Nadella (Microsoft), Shantanu Narayen (Adobe), Punit Renjet (Deloitte) and Vasana Narasimhan (Novartis). There is even a British Prime Minister of Indian origin.

### Weak primary education

But the great masses – and this is the second less positive point – have had very little education. "Because of that huge gap, we have evolved directly from agriculture to services," Professor Shah continues. "The small group of a few million people who entered the top universities did not go to work in factories. They chose the call centres and back offices that were at the heart of India's rapid

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<sup>3</sup> Nico Tanghe, "Is alles binnenkort 'Made in India'?" ["Will everything soon be 'Made in India'?"], *De Standaard*, 28 October 2023

growth in the nineties. Those who went abroad did well, but so too did those who stayed in India. But going to work in a factory? Nobody did that." This is also why China, and more recently Vietnam, have been more attractive to international industrial companies. And why India has so far missed the globalisation train in industry.

But that will change, according to the professor. "Ninety per cent of farmers' children no longer want to work in agriculture." A developing industry needs to create jobs for them, as well as for the growing workforce in the coming years. But the quality of education is insufficient to employ graduates in industry. Almost everyone goes to school, but they don't learn much. That said, the overall literacy rate for 15-24-year-olds has risen from 55% in the 1980s to 90% today, putting it on a par with Indonesia and Nepal. But according to a survey by NGO Pratham in 2021, barely 43% of fifth-grade students (10-11 years old) in rural areas can read at second-grade level (7-8 years old). In 2005, this figure was 53%. Public education in rural areas, where 2/3<sup>rd</sup>s of the population live, is also much poorer than in cities.

The main reason for the – recent – sharp fall was the Covid lockdown, during which schools remained closed for two years. This exacerbated an already weak system. According to The Economist, poor governance and pedagogy remain the main causes. Spending on education has risen sharply over the past decade, but at just under 3% of GDP, it lags far behind the other BRICS countries China (4.3%), Russia (3.6%), Brazil (4.7%) and South Africa (6.9%). "Ten years ago, only one third of state schools had washbasins to wash their hands and barely half had electricity; today, around 90% have both. Since 2014, India has opened nearly 400 universities. Enrolment in higher education has increased by a fifth." Free food attracts the poorest and keeps them off the streets. Great strides have also been made in terms of infrastructure and framework.

### **Reforms needed in education**

Progress has been made, but that doesn't mean that children are learning more in these new classrooms. "Teachers often don't come to class. And those who do, use a rigid syllabus that is unsuitable for many of the children (most of whom are among the first generation in their families to actually go to school, and can therefore expect little help from their parents)."

Instead of throwing more money down the drain, India needs to implement reforms in three areas, according to The Economist:

1. Children need to be schooled at the right level. Pupils should not be admitted to a higher grade without mastering the subject, for example through "learning camps".
2. The system needs to be made more meritocratic and accountable. Teachers should be recruited on the basis of their talents, not their connections. "Since 2011, when the government introduced a test for prospective teachers, 99% of candidates have failed it every year."
3. Policymakers need to do more to support good private providers of education, for instance through vouchers and public-private partnerships. Because of failing public schools – where a quarter (!) of teachers play truant every day – almost half of families send their children to private schools, especially in rural areas.

## Mismatch between skills acquired (or not) and skills required

Today, there is a huge mismatch between the skills acquired and those required in different occupations, ranging from managers to factory workers. As a result, foreign companies are hesitant to come to India. But it also means that many top engineers from these prestigious IITs can't find satisfactory jobs within India. "For mechanical engineers, the labour market in India remains difficult," says Suman, a 33-year-old PhD student at the Faculty of Electrical Engineering at IIT Mumbai<sup>4</sup>. "The top ten per cent always find a good job. But the rest – the engineers who do not really excel in terms of marks – have to go to Germany or other Western countries if they want to work in an industrial company."

Raman Madhok, economic diplomacy advisor for the Belgian Consul General in Mumbai – and former student of IIT – confirms this. "I am in close contact with a university for managers and engineers. We have around 4,000 students. Japanese companies with a shortage of staff visit our school. In their third or fourth year of study, they select a few of them. These are then given a three-month training in Japanese language and etiquette so that by the time they graduate, they can be employed by Japanese companies on a three-year contract. After three years, they come back."

The same is now happening with Norwegian and Swedish companies. Is this a problem for India? "If they stay over there, then we've got a brain drain," Madhok admits. "But in many of these countries, they don't want to grant permanent residency to these foreign workers. Then they have to come back, but they'll come back as well-trained engineers and possibly even well-trained entrepreneurs." Engineering colleges in India are known for their in-depth theoretical knowledge but complete lack of practical experience. So it becomes an opportunity, and not necessarily a brain drain."

## Private schools

Over the past quarter of a century, the private sector has invested heavily in education. Demand has been particularly strong in rural areas. "Admittedly, these private schools are not top notch either, but they are better than the public schools," says Professor Shah. "You pay a fee. So you can demand some accountability from the private school. The teacher shows up every day, teaches in class and gives the children some homework. The homework may not make much sense. But having the child sit down in the evening and do their homework teaches them discipline. And that's what you need in factories. That mentality has been missing until now. These future workers can now sit in a factory and do their jobs for eight hours. Most can read and follow instructions, which is important when operating machines."

"And so I think factories and entrepreneurs will gradually come here," Professor Shah continues. "Before, they didn't, because even if they had the money to invest in a factory, they couldn't find good employees. Now they can. There are people coming straight out of school now who can be trained. And that is exactly what Indian companies are doing. They're investing a lot of money in training." But in order to attract these international companies effectively, Modi has to tackle a few other important projects.

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<sup>4</sup> Nico Tanghe, 'Boomt de economie? Dat voelen wij niet: alleen de rijken worden rijker' ['Is the economy booming? We're not feeling it: only the rich are getting richer'], *De Standaard*, 4 November 2023



#### 4. Slowly reforming towards a more efficient economy

*Human capital is the foundation of economic growth in developing countries. If India wants to increase the share of industry in its economy, it urgently needs to improve the quality of its primary education. "But I emphasise the crucial importance of institutional quality for long-term economic success or failure," said Professor Michael G. Jacobides in an interview with PWC<sup>5</sup> in 2017. According to Jacobides, institutional development will also determine whether India can match China's success. "The old-fashioned bureaucracy that has slowed down the growth rate in the past needs to be shaken off."*

#### Reforms boosted growth

India has been working on this since the early 1990s, but it's been an arduous process. In 1991, the IMF rescued India from bankruptcy. The country was in trouble because its foreign debt had tripled to more than 30 per cent of GDP. The rising oil bill due to the Gulf War in 1990–1991 – India is more than 80 per cent dependent on oil imports – had pushed up the current account deficit. The rating agency Moody had downgraded its credit rating. This, combined with dwindling foreign reserves at India's central bank, caused foreign investors to flee. The IMF threw India a lifeline on the condition that it implement reforms.

Narasimha Rao took over as Prime Minister and, despite massive protests, did what was expected of him. The New York Times wrote: "Mr Rao, who was sworn in as prime minister last week, gave a clear signal to both the nation and the IMF that 'there are no soft options'. It should open the door for foreign investment, reduce stifling red tape and streamline industrial policy." The path of gradual economic liberalisation was successfully followed in the following decades. Growth accelerated from an average of 5.5% in the 1980s to 6.4% since the start of the reforms in the 1990s and 7% in the following two decades, including the last few years.

#### Free Jan Dhan accounts

In Modi's first term of office, from 2014-2019, reforms - whether prepared by his predecessors or not - shifted up a gear. In 2014, the NDA coalition led by the BJP, introduced a free bank account: the Jan Dhan Yojana. "Nearly 500 million accounts were opened at different banks," says Sameer Narang, Chief Economist of ICICI Bank. "These bank accounts were linked to the unique Aadhaar ID numbers, which allowed government benefits to be paid directly to the beneficiaries."

In 1985, former prime minister Rajiv Gandhi noted that barely 15 paise of every rupee spent on social welfare reached the needy. This was a problem that has been effectively addressed by the Aadhaar-linked bank accounts and Direct Benefits Transfers (DBT), electronic transfers of payments. The unique identification number – Aadhaar – is a biometric ID card introduced in 2009 to eliminate duplicates and fake identity papers. Together with the 1.1 billion mobile phones, 820 million people using the Internet, the in 2016 rolled out Unified Payments Interface (UPI) and the many related digital services offered by the government, these are the key pillars of Digital India. We will go into this in more detail later in our series.

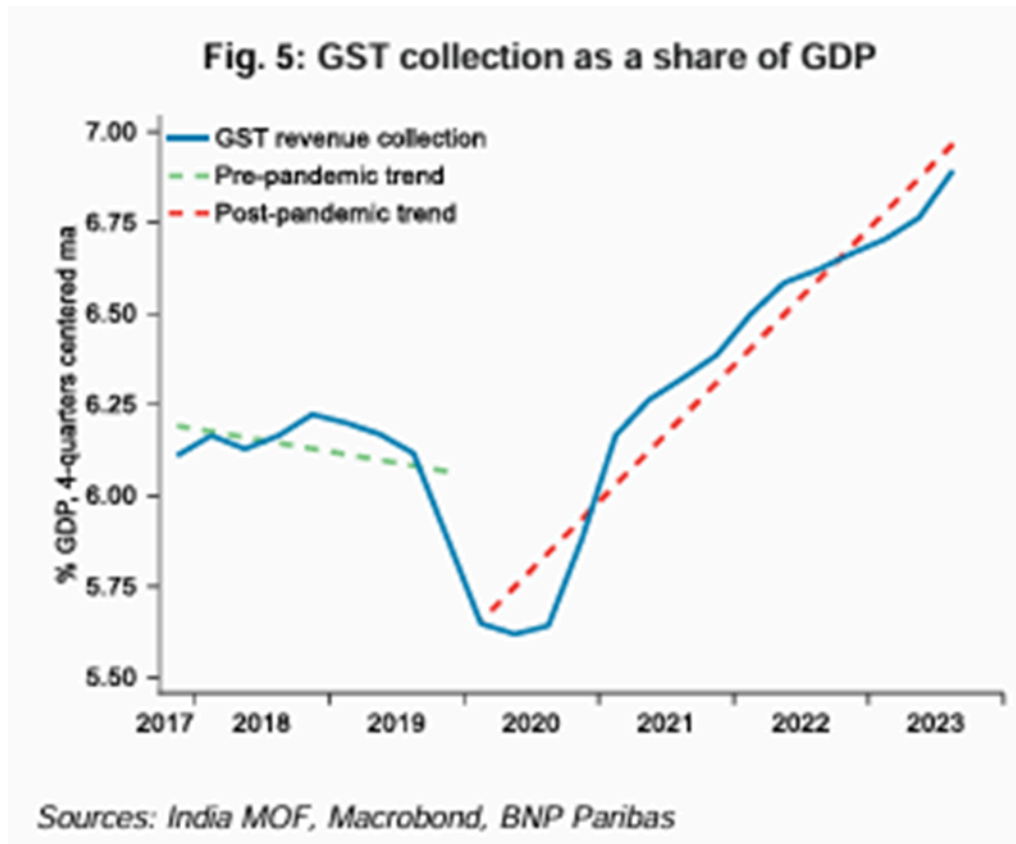
#### Unified Goods and Services Tax

The most significant change for businesses has been the introduction of the 'Goods and Services Tax' (GST), a value-added tax. It replaced eight central and nine state taxes. "In the past, during boom times, the number of trucks increased and with it the number of delays," Narang says. "This was due to poor infrastructure, but also because you had to pay different taxes in each big city. GST has solved

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<sup>5</sup> The Long View, PWC, 2017 February

this problem. In addition, GST collection was automated during Covid, which made the whole system even more efficient."



This also means that fewer vegetables and other food products go bad these days, although according to Daljit Singh, representative of the Port of Antwerp-Bruges in India, this problem has not yet been completely resolved. "There's still not enough storage space in the distribution. Vegetables and other perishable products no longer have to wait at the borders of the states. Still, they must be stored and kept cool at the final or intermediate station. That's why the government is investing so much in infrastructure to connect the nodes and provide temporary storage space facilities."

### Shock to smaller businesses

As well as increasing efficiency, GST is also increasingly formalising businesses. "The whole chain becomes visible the moment you sell to a person or a large company in the formal economy," explains Sameer Narang. "And that person won't want to buy from you if you don't report taxes, because then he won't get a tax break on that." This leads to a positive waterfall system for the government, as the more businesses that are removed from the black economy, the better it is for tax revenues.

"But GST has hurt micro, small and medium-sized enterprises," says GlobalDataTS Lombard's policy analyst Amitabh Dubey. "Due to the mandatory formalisation, the cost of doing business has increased and has made some businesses unprofitable. Secondly, this GST again adds red tape. It is too much and too complex for the typical small family business run by the middle-aged man and his wife. You need to hire an accountant to pay your taxes because you need to upload forms online. And there are penalties if you don't do it correctly. That all costs a lot of money." Professor Parth Shah of the Indian School of Public Policy nods in agreement. "Although we don't have the real data,

we hear a lot of anecdotes about SMEs going bankrupt because they didn't know how, or didn't have the manpower, to implement this GST."

### Tax reductions and recapitalisations

In addition to the introduction of the GST, the corporate tax rate was reduced from 30% to 22% in September 2019. A lower corporate income tax rate of 15% was introduced for new manufacturing companies. The public banking sector was recapitalised from 2016 on and over the following years, and non-performing loans were restructured. This has helped to get credit flowing again. For now, however, private investment remains weak.

"The biggest obstacle for Indian companies is likely to remain the high cost of capital, and this is being driven up by high government debt," writes Thomas Easton in his weekly 'Indian Business and Finance' newsletter. Last year, the Indian central bank raised its short-term interest rate from 4 to 6.5%. As a result, average lending rates rose by 183 basis points between April and December 2023.

### India rates



MACROBOND

### Bankruptcy law needs to address moral hazard

Another sticking point for entrepreneurial Indians is the new corporate bankruptcy law introduced in recent years. "What used to happen was that when there were repayment problems, the various parties would come together, the bank would take a haircut, and everything would just go on," Narang says. "This creates 'moral hazard' because the owner has an incentive to take out more and more loans because he knows that the underlying asset remains his, even in case of a so-called restructuring. The owners have lost virtually nothing."

For the government and the Indian central bank – headed by economist Rajan Raghuram from 2013 September to 2016 September – this was no longer feasible. "They introduced bankruptcy proceedings with the underlying condition that the assets had to change hands. Management also had to change because it had proved it was incapable of managing the assets properly. Only then would a restructuring process be possible." This has been a very important change, but the result is that "entrepreneurs today are much less daring than before. They know that if they fail, they'll have to bear the brunt in the future." This is one of the reasons why private investments have been put on hold.

So Modi has been trying to push reforms during his nearly 10 years of rule. But the really 'big bang' changes have not yet happened and won't be easy to implement, as evidenced by the repeal of the agricultural laws. Reform of land ownership laws is also needed if India is to attract big companies. The same goes for labour reforms. "They have so far failed to push through these reforms," acknowledges GlobalDataTS Lombard's Shumita Deveshwar. "The government is afraid to implement major reforms because it's very sensitive to the political consequences."

## 5. Indian reforms: waiting for the "big bang"

India has undertaken major reforms in recent years and decades. Should the government be able to execute reforms to land ownership, agricultural and labour laws in the coming years, they will bring greater leaps forward.

In the "Ease of Doing Business" ranking of the World Bank, India had risen from 116th to 63rd out of 190 countries. India is just behind countries such as Mexico, Bulgaria and Chile, but ahead of Oman, Uzbekistan, Colombia and Vietnam. Still it remains difficult to start a business (ranked 136) or register buildings and land (ranked 154). What's more, what the people I talk to in India call the three 'big bangs' have yet to happen.

### Big bang

They're referring to reforms in land ownership, labour and agriculture laws. Closely linked to this is infrastructure development. "It's important to look at the direction India is heading," says Shumita Deveshwar, Chief Economist India at GlobalDataTS Lombard. "And it's getting there. India's complex structure makes us slow to evolve. We're very different from China in the way our society operates. And yes, you can say that this government is able to execute policies a little more effectively than the previous administration. But we're still a federal system, with all the challenges that brings."

Each state has its own elections and political governance. Much depends on the political initiatives launched by the central government in Delhi. But many of these measures still have to be implemented at the state level. Another political reality is that the National Democratic Alliance (NDA) – of which Modi's BJP is by far the largest partner – has a large majority in the Lower House, where the laws are proposed and submitted, but not in the Upper House – yet - where they are passed. However, following recent elections for the Upper House the NDA is now short only 4 seats.

### Archaic labour laws

Let's start with the necessary labour reforms. "If India wants to attract the tech industry and replace Asian competitors, or at least become an alternative to them, it will have to update its labour laws," says Anirudh Suri, author of the book *The Great Tech Game* in the Financial Times<sup>6</sup>. For example, the still in force "Factories Act" of 1948 aims to ensure the health, safety and comfort of people working in companies with ten or more employees. Its contents are fascinating. In some states, the frequency with which latrines must be washed and the size of the bucket required to fight fires is precisely defined: at least once in every seven days, and nine litres, respectively. As for spittoons, they must be made of galvanised iron with conical funnels and placed at a height of 3 feet.

"The government pushed through labour reforms about three years ago," explains Deveshwar. Four new Labour Codes were approved by Parliament in 2019–2020 to replace 29 existing laws. "The aim is to simplify labour laws and facilitate recruitment and redundancies, while protecting employee rights. The Codes have been approved by the central government, but the implementation has to be done across India. This is not yet complete."

### Large companies are more productive

The most progressive states have taken some initiative, with nine of them allowing certain industrial companies with fewer than 300 employees to make redundancies without government permission. It used to be 100, which put a firm brake on the size of the companies. The definition of "small business" has also changed. "In the past, you had a classification ranging from micro to medium to

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<sup>6</sup> John Reed, Backlash over labour reforms tests India's manufacturing ambitions, FT, 4 July 2023

large companies," explains Roopa Purushothaman, chief economist at Tata Group. "As soon as you were above 5 crore (1 crore = 10 million) rupee, you were a big company and all laws applied. With just one stroke of a pen, the current central government has now changed that 5 crore to 250 crore, or 2.5 billion rupees. This has also raised the limits for micro, small and medium enterprises. As a result, the number of medium-sized companies has increased by 75% in one year. It motivates companies to grow and hire more people. And it pulls many companies out of the informal economy. But that still represents a large minority."



Estimates of the share of employees working in non-agricultural enterprises without legal personality owned by small households – micro SMEs or MSMEs, including many small self-employed – range from 60 to 71.4 per cent in 2020-2021. They account for almost 30 per cent of GDP. The average productivity of Indian firms is less than 1/5 of the top 10 per cent of firms in industrialised countries, the IMF calculates in its country report. But productive Indian businesses do exist. "These strong

Indian firms tend to be large [...] and more foreign-owned," the IMF writes. "[...] The success of these companies first underscores the importance of removing obstacles that prevent companies from growing and of encouraging foreign investment."

### **Shift and night work**

Two of the most business-friendly southern states, Karnataka and Tamil Nadu, amended their laws in 2023 to allow 12-hour shifts. A major foreign investor such as Apple and its subcontractor Foxconn insisted on this. Karnataka, where the Taiwanese manufacturer plans to set up a large factory, also changed its legislation to make it easier for women to work nights (which is common in the technology industry elsewhere in Asia).

Neighbouring Tamil Nadu, where Foxconn already manufactures iPhones for Apple today, has adopted similar rules. But resistance from the trade unions and the opposition parties has prompted Tamil Nadu's chief minister, the head of state, to put the plans on hold. In Karnataka, the opposition Congress party recently won the elections. It had promised in its manifesto to withdraw the legislative amendment.

### **Complex land laws discourage entrepreneurship**

Agricultural and agrarian reforms have also stalled. "Land acquisition remains one of the major hurdles for infrastructure developments in India," says Deveshwar. "When Modi came to power, he wanted to make it easier for companies to acquire land to expand."

Four main problems regarding land ownership stand in the way of entrepreneurship, access to credit and thus higher growth in India's interior. The first is the poor quality of the land registry, which leads to uncertainty about land rights and discourages investment. Second, there is the difficulty, often even the impossibility, of leasing or renting out certain land, which means that land cannot be merged. Third, there are the complex administrative procedures – always two separate processes – for the sale of land. This, alongside corruption in local governments, leads to endless delays. India is ranked 166<sup>th</sup> out of 190 countries in the World Bank's goods registration index for a reason.

### **Huge property disputes**

Finally, there is the huge number of property disputes. This is undoubtedly the result of the three previous points. According to a study by the Indian think tank DAKSH, two-thirds of all civil lawsuits relate to land and property. The vast majority of litigants have an annual income of less than Rupee 3 lakh (300,000 Rupees, or EUR 3351). Property rights are very sensitive. On average, 60 per cent of the average Indian's wealth is tied up in real estate and land ownership.

"Modi wanted to push through parliamentary reforms in 2015, but encountered strong resistance," says Deveshwar. In his first speech in parliament as leader of the opposition, Rahul Gandhi said in response to Modi's proposals: "Your government is one of great gentlemen, a 'suit-boot' government" by which he meant that it is a government for businesses. "And that nickname really stuck," says Deveshwar.



### **Agricultural reforms**

Finally, Modi tried to amend agricultural legislation. This would allow companies to conclude contracts directly with farmers. The Minimum Support Price (MSP) that the government pays for many crops would be abolished, as would government-mandated middlemen.

The problem with the MSP is that some farmers – the best-connected ones – can sell their entire crop at this minimum price, while other farmers have limited access to it (because the government cannot store it all). They have to sell much of it to authorised middlemen. But these middlemen have a monopoly because farmers aren't allowed to sell to anyone else. So the authorised middlemen can easily drive down the price they pay to farmers, only to charge a much higher price to processors and retailers later. Some recent reports have shown that the price of onions sold in Mumbai is up to 20 times higher than what farmers in Nashik get for them.

### **Mass farmer protests**

The current system results in a rising government deficit (the government buys at a high MSP but sells low due to food subsidies), higher inflation (due to the high MSP and the monopoly of the mandated middlemen) and only a small proportion of farmers benefit from the system. In a liberalised market, the farmer can choose to sell directly to the processor or the retailer. He can get a higher price by bypassing the cartel and reduce the costs by selling anywhere. Who is not happy? The farmers who always receive the MSP for their entire harvest, and the authorised middlemen.

"Following parliament's approval of the 'Farm Bills', there were farmers' protests for more than a year since August 2020, especially in Punjab and Haryana, two small but wealthy states with large food production surpluses", says Deveshwar. To strengthen their demands [and make them audible in New Delhi], they occupied Delhi's borders. Consequently, one year later, these agricultural reforms were also withdrawn."

### **What's to be done now?**

"If it were up to the government, it would make significant reforms in many markets," says Antara Haldar, Professor of Law and Economics at the University of Cambridge. "I think they really want to do this, but there's a lot of political resistance at the grassroots level." Deveshwar agrees. "The



government is afraid to make deep reforms because of the political consequences. That's why Modi ended up withdrawing some of the most politically controversial reforms."

To attract more foreign investment and take full advantage of its demographic dividend, the next government will need to press ahead with reforms and, above all, speed up their implementation. With the federal election coming up, the central government isn't going to ruffle any feathers. But once the elections are over, Modi will try again and – hopefully – succeed. (This is not attributed to anyone. I don't think I said this because I don't believe that Modi will try again and again. If he faces resistance, he seems to back off) If not, then doing business in India will remain a venture reserved for only the bravest and most patient.

## 6. India rolls out the red carpet to industrial companies

*“India offers you maximum growth: in scale, ambition and in results. Come to India and be part of our growth story.” This is the message on Prime Minister Narendra Modi’s video to visitors at the Indian pavilion of Expo 2020 Dubai. India is inviting companies to invest in the country. They are benefiting from a pick-up in consumption as the middle class grows. Huge infrastructure projects are also cutting logistics costs. Manufacturing subsidies are the icing on the cake.*

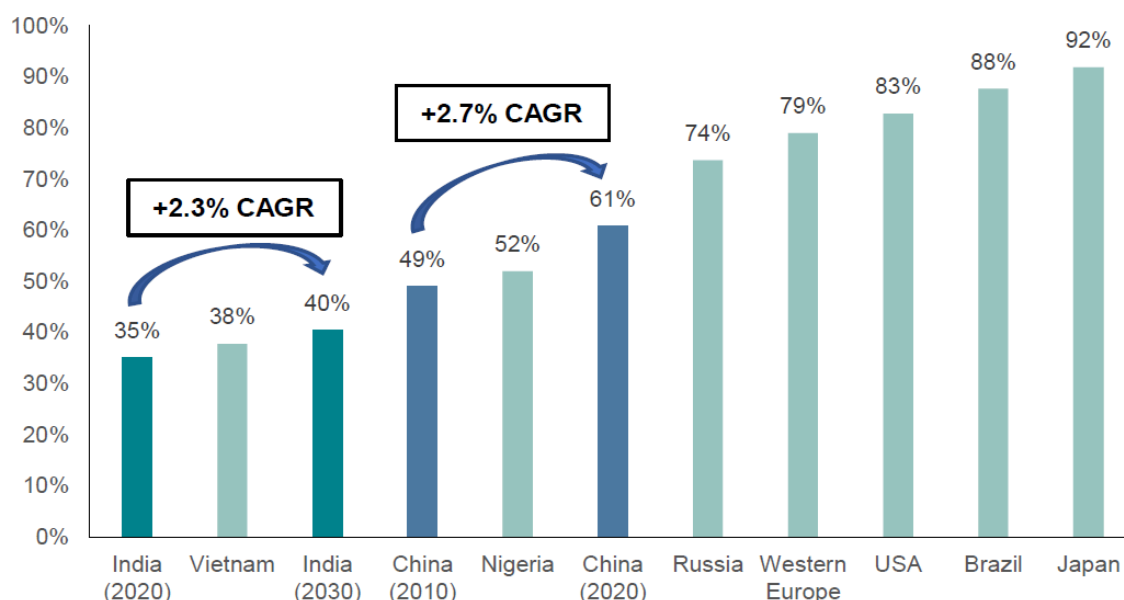
### Consumption sweet spot

“While it was made very clear that we should not underestimate the difficulties of the logistical and bureaucratic complexity of the Indian market – both exacerbated by the federal state structure – we believe that India offers an opportunity that European consumer goods companies should not ignore.” Our colleagues at BNP Paribas Exane<sup>7</sup> are clearly convinced of India’s huge potential after their study tour in May 2023.

India’s unique demographic profile, rapidly growing middle class and urbanisation and digitalisation trends put it in the consumer goods sweet spot, where China was 10 years ago. “India’s urban population will grow at an average annual rate of +2.3% in the coming years, increasing the urbanisation rate from 33% in 2020 to 40% in 2030 (compared to 61% in China today and 79% in Western Europe). Per capita consumption rises with disposable income. In 2019, the average disposable income per person was USD 1,800, slightly lower than China’s average of USD 2,600 in 2010.” The latter has exploded to USD 6,500 today, along with consumption. The amount Americans spend on consumer goods is 5.5x higher than in China and 30x higher than in India. Growing household consumption will remain the growth engine of the Indian economy for years, if not decades, to come.

**Figure 14: There is huge scope for urbanisation in India**

Urban population (% of total) in 2020



Source: Euromonitor, BNP Paribas Exane estimates

<sup>7</sup> India’s decade: key learnings from our field trip, BNP Paribas Exane, 31 May 2023

Aadhaar, a unique 12-digit identity number based on biometrics and showing demographic data, and its associated free financial account, which can be obtained voluntarily by all residents who have an Aadhaar card, has made credit and hire purchase a reality for more and more Indians today. “This is how America grew in the 1950s,” says Dr Bhagwati, a ‘distinguished fellow’ at the think-tank Centre for Social & Economic Progress (CSEP) and former ambassador to Brussels and elsewhere. “You don’t pay the full price of a product that you buy, but just a fraction of it. And the rest you pay later. This is completely new here, especially for people in rural areas. And slowly the number of people for whom this is possible is growing from 50 million, to 100, 200, 400 million. If consumer finance alone becomes accessible to the rapidly rising number of people migrating to the cities, you are going to see a boom in household consumption.”

### **Emerging middle class & e-commerce**

In 2004, 14% of India’s population belonged to the middle class. Today, it is 31%, or 450 million people. This will drive India’s economy for decades to come. “L’Oréal is focussing to the upper middle class of let’s say 200 to 300 million people,” Stijn Rijckbosch, CFO of L’Oréal India, explains to me. “We don’t sell cola, or water. Our products are slightly more expensive. The number of more affluent people will also increase, our target group is set to double in the next 5 to 10 years.” According to colleagues at BNP Paribas Exane, this affluent class will increase by 14 percentage points (!) to a quarter of India’s population by 2030. But there is another specific factor that will fuel L’Oréal’s growth. “Women are playing an increasingly important role in Indian society. This will encourage them to buy more beauty products.”

And then there is the digital step forward (which we will come back to later). The benefits of e-commerce in rapidly expanding distribution to smaller cities were summed up nicely by Jean-Paul Agon, the former CEO of L’Oréal, at a conference in 2019: “What’s great for us is that e-commerce helps us extend our reach far beyond traditional distribution. As a beauty products company, for years it was difficult for us to go very deep into distribution in countries like India, China, Indonesia and so on. With e-commerce, that problem is off the table and we can reach any consumer in any part of the country.” This is true for mass market sellers such as Amazon, Flipkart, Myntra - in fact so many brands also now have a direct e-commerce platform, and the use of mobile telephony with social media influence is also prompting millions to buy online.

### **Government takes ownership of infrastructure investment**

India is gearing up to attract and welcome foreign companies. Reforms are being made, and hopefully the pace will pick up after Modi’s likely re-election. Until recently, poor infrastructure has been a major stumbling block for foreign companies in this vast country. The Economist Intelligence Unit (EIU) expects the greatest progress in this area over the next few years. India would then move up from 62nd out of 82 countries in the EIU’s ‘business environment’ ranking (2019-2023) to 51st in the 2024-2028 period.

“We were surprised by the rapid pace of development since our last visit in 2018,” our colleagues wrote in their report. “New roads, metro lines and a large shopping mall in Mumbai are examples. You can just feel the growth.” Prime Minister Modi has increased infrastructure spending from RS 1,000 billion in the 2015 fiscal year to an estimated RS 8,000 billion in the last fiscal year. “In the past, the government was counting on the private sector to make these investments,” Shumita Deveshwar of GlobalDataTSLombard tells me. “But that didn’t work out. Until a few years ago, the banks were groaning under the weight of non-performing loans and had become very risk averse, especially to providing long-term loans for infrastructure projects. Eventually, the government realised that it had to invest money itself. Building infrastructure is seen as one of the core functions of government anyway.”

Note that India is not China. “The real estate explosion and over-investment in construction in China was state-funded,” notes Raman Madhok, economic diplomacy advisor to the Belgian consul general in Mumbai. “In India, basic infrastructure is paid for by the government and the states to attract private investors. Otherwise, they would not come. But now that the infrastructure is starting to come in, private investment is following. These investors are much more cautious than the Chinese government, which reduces the risk of over-investment.”

### Accelerated road works during Covid

For the current fiscal year, the government plans to spend nearly 20% of the national budget on capital investment. This is the highest percentage in at least a decade. Construction of roads and highways (Bharatmala), ports (Sagamala), regional airports to open up hitherto inaccessible places (Udaan) and dedicated freight corridors are expected now to be completed by 2027-2028, gradually improving connectivity.



“That bridge for the above-ground metro line that you see from this office, they weren’t working on that last year,” Muhammad<sup>8</sup>, a key contact who wishes to remain anonymous, tells me. “Construction is moving at lightning speed. During Covid, the day labourers just kept on working. Because if they don’t work, they don’t have an income. It was a clever move by the government to let this happen. Because there was nobody on the streets, everything went much faster.” In the pandemic year 2020-21, a record 13,298 kilometres were added, or 36.4 kilometres per day. In FY22 and 23, the pace slowed to 29 kilometres per day. For the current fiscal year 2024, the government has set an ambitious target of 45 kilometres per day. “However, the official target is more likely to be closer to

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<sup>8</sup> Muhammad is a fictitious name.

35 kilometres due to delays in obtaining permits and land purchases,” writes the financial newspaper *Mint*. Some things do not change slowly in India.

### Smart cities

Infrastructure development is not limited to roads. Total annual investment in rail infrastructure has quadrupled since 2015. The operational metro network currently stands at just under 900 kilometres spread across 20 cities, but another 1,100 kilometres of new lines are in the pipeline. These will also be built in new cities.

Today, 67 per cent of the population lives in rural areas versus 85 per cent in the 1960s. “People want to migrate en masse to the cities,” Muhammad explains to me. “But if they all do it, and go to the five main cities, these will collapse. They cannot cope with such a mass.” The current populations of Mumbai, Delhi, Bangalore, Calcutta and Chennai are 12.7 million, 10.9 million, 5.1 million, 4.6 million and 4.3 million, respectively, according to the World Population Review.

“So what did the government do in 2015? It funded a hundred smart cities.” Smaller cities received government support for all services and infrastructure, such as water supply, public transport, affordable housing for the poor and so on. In this way, the migration flow could be well distributed across all those cities. “All the facilities are there for citizens, but also for businesses. Next time you come to India, instead of Mumbai and Delhi, go to some of these tier 2 or tier 3 cities. You will find that in terms of infrastructure and economic development, they are perfectly competitive with the big cities.”

### Plug and play

The growth and importance of these cities got a serious boost from covid. “Skilled people could suddenly work from home,” says Madhok. “Six months of covid gave companies at least a 10-year step forward in terms of working environment, and they adapted very quickly to this new reality. With the option of working from home, tier 2 and tier 3 cities grew rapidly. New buildings were erected including new shopping malls, which in turn created more jobs and income. When you see all this happening, you have to be very risk-averse not to want to be here as a consumer company.”

Pune, with a population of 6.2 million, is one such city in the midst of change. There are construction projects everywhere, half-finished skyscrapers and an overland metro line under construction, as journalist Nico Tanghe of *De Standaard*<sup>9</sup> describes in his travelogue. It used to take 7 hours to drive the 165 kilometres – a short hop in Indian terms – to Mumbai. A new toll road has cut the journey to 3.5 hours. And a third motorway, currently under construction, is expected to cut travel time by a further half. The Bekaert steel company has set up a state-of-the-art plant in one of the large ‘five-star’ industrial estates on the outskirts of Pune that the Indian government has established especially for it. “All the facilities are available here,” says a local senior executive Srikanth Chakravarthy. “For an industrial company that wants to start here, it is just ‘plug and play’.”

### Widening tax base

These industrial companies are also being lured with a sharp reduction in taxes in 2019. “Incidentally, this was the second year in a row that taxes paid by individuals exceeded those of companies,” notes Thomas Easton in his online weekly *India Business and Finance*. “My guess is that this is a more deliberate strategy on the part of the government to reduce the cost of doing business in order to stimulate growth.”

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<sup>9</sup> Nico Tanghe, Will everything soon be 'Made in India', *De Standaard*, 28 October 2023

Widening the tax base would mean a massive increase in taxes – and therefore resources – for the government. In 2014, 35 million people paid income tax, while the size of the non-agricultural workforce was over 200 million. “As a result of implemented reforms, that number has now increased to 78 million,” says Roopa Purushothaman, Chief Economist at the Tata Group. “That is still far from the entire labour force, but with the digitalisation that the government is implementing, this number will continue to rise.”

## **Make in India**

In 2014, the ‘Make in India’ programme was launched. Growth in the industrial sector was to be boosted to 12-14 per cent a year, creating 100 million additional jobs by 2022. By then – but recently pushed back to 2025 – the sector would account for a quarter of GDP. However, the sector’s growth remained stuck at around 7 per cent a year in the period 2014/2015-2019/2020, in line with economic growth. As a result, the industrial share has remained stable.

Nevertheless, Mukesh Malhotra, CEO of Solvay India, continues to believe. “I am convinced that investment in Indian industry will increase significantly in the coming years. India has no other choice.” The scepticism among foreign companies is normal, he says. “In the past, India has always made more noise than it has actually delivered. So these bold statements from India are taken with a pinch of salt, especially if you’ve had a bad experience. But India needs technology, and the red carpet is being rolled out to multinational companies that have it. I get calls from at least two states every month asking me to meet them to discuss new investments.”

## **Redesigns for the Indian market**

Poul Jensen, Managing Director of the European Business and Technology Centre, also sees the need for technology. “Technology at the lowest price, adapted to the Indian environment. What does that mean? That you have to work with Indians, that you do your R&D here, and ideally in collaboration with universities. The consulting firm Accenture already employs 300,000 people in India. Phillips does a lot of research here. Because of the strong mathematical skills of Indians, it is mainly about big data analysis, but increasingly also about redesigning products for the Indian market.”

This redesign to Indian dimensions is often necessary. “You know, I had a Toyota and a Mercedes,” says Dr Bhagwati. “The difference in air conditioning between these two cars is night and day. Why is that? Japanese people come here and want to get to know the people and the environment first. They like golf. They play in Delhi and then drive to, say, Chennai. But in the meantime, they have played golf for several days in 47 degrees Celsius or more. And then they come back to Japan and say to their boss: ‘Nice golf, but I barely got to the 10th hole. In Japan, I do 36, without any problems. But with the heat over there ...’ This experience then leads to the installation of much more powerful air conditioners specifically for the Indian market. You can forget about that with the Germans.”

## **Cricket versus basketball**

A variation on this story is Puma versus Nike. “Nike is not a brand in India,” says Harsha Raghavan, managing partner of venture capital firm Convergent Finance. “Nike has a global market strategy that they don’t deviate from. Their brand ambassadors are Michael Jordan and Tiger Woods. But who plays basketball in India? Or golf? Nike has invested almost USD 2 billion in recent years. This compares to an annual turnover of USD 5 million. A complete failure.”

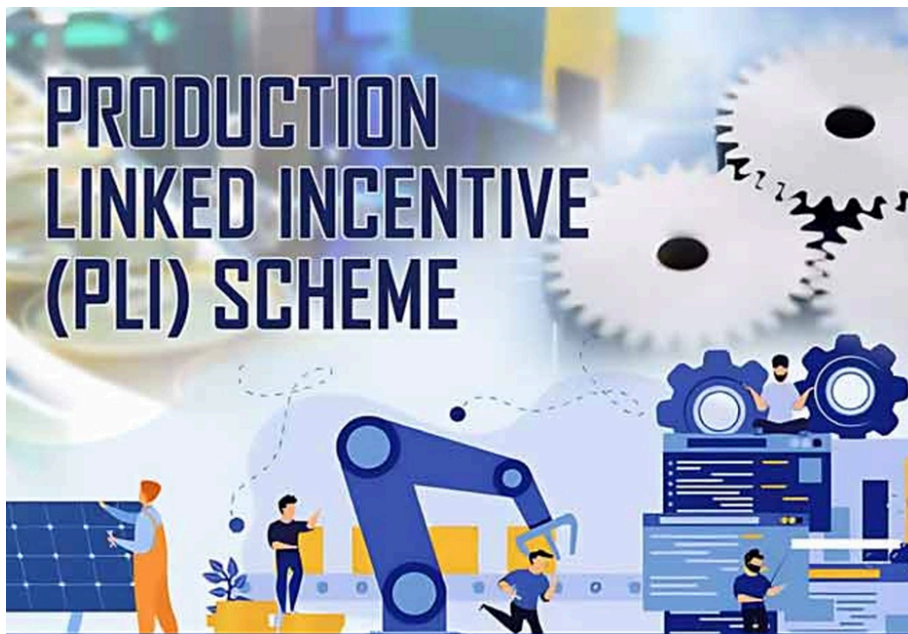
Their competitor Puma is doing a lot better. “They have invested about USD 30 million over the past 20 years, no more. Today their turnover is in the billions.” When recruiting an Indian marketing team, Puma made it clear that they had no global sponsorship deal and that the team would have to make do with a “small” budget. “They told the marketing team to do with it what they thought they

should,” continues Raghavan. “And they did. They hired cricketers, icons of India’s national sport. They understood what India is all about and managed to do something appropriate with a lot less money. India is not part of the global market. It is a market in its own right!”

### **Production Linked Investment scheme**

If you are successful in India, you will succeed in other countries too, says Jensen. “Co-developing customised products with the Indians has not hurt General Electric, for example. They developed a low-cost mobile defibrillator that they could then export to other countries.”

More recently, foreign companies’ enthusiasm for India seems to be growing, even as China becomes more politically difficult. One of the mainstays of the ‘Make in India’ programme is the Production Linked Investment (PLI) scheme that gives companies grants to set up manufacturing hubs in India. “This is what has made ‘Make in India’ a reality,” says Mukesh. “Before that, it was just a slogan.” Initially, 14 sectors – mostly high-tech – were chosen in which India wanted to become a global producer. The goal is to replace imports with exports. Market participants see the PLI scheme as a signal that the government wants to work with the private sector. The cost is limited, according to the IMF, but the projected job creation is also very meagre at 6 million – 2 to 4 per cent of the total number of jobs needed.



### **Creating jobs**

This is also the main criticism of Amitabh Dubey, political analyst at research firm GlobalDataTSLombard. “The selected sectors like chemicals, phones, computers, EVs, batteries and so on are very capital intensive. So you are putting all your money into specialised sectors that create very few jobs. That is wrong. What India needs is garments, textiles, leather, furniture and so on, the simple labour-intensive industries for people with basic education. We have to create jobs. And every scarce rupee that you spend on attracting business should have that goal in mind.”

In the last financial year, which runs until March 2023, just under 50 per cent of the 12 million jobs created were in IT, finance and banking, according to a roundup by the Bank of Baroda. “The rise in broad industrial employment does not – yet – demonstrate China-like characteristics,” notes Thomas Easton. Dubey cites the example of Micron, which is building a factory to test chips in Gujarat. “India

is paying 70 per cent of this project: 70 per cent! I think Micron will make a nice return on its investment," he notes delicately.

Growth countries are more likely to have a mix of capital and labour as the engines of their economies; in India, growth has recently been mainly capital-driven. The economy is growing like a cabbage, but employment growth is lagging behind. But the latter remains necessary to reap the demographic dividend. Otherwise, inequality will only rise in tandem with growth.



## 7. The obstacle course for business investments

*"India is facing its hockey stick moment," argue entrepreneurs. By this they mean that after a long period of slow growth, an industrial boom is coming<sup>10</sup>. Last year saw announcements from big international names such as Amazon, Apple and Ikea. But despite the huge opportunities, the decision to invest in India is not an easy one for companies.*

Taiwan's Foxconn plans to build 3 new factories in southern India, representing a total investment of \$1.2 billion. It already has 3 campuses and 36 factories in India, according to an internal presentation seen by the FT. However, its chairman has said that building a chip ecosystem in India is only for the "very brave". In July 2023, Foxconn pulled out of a deal with India's Vedanta to build a \$19.5 billion chip factory. The reason: the project "was not moving fast enough". The joint venture also failed to secure government subsidies under the "Production Linked Investment" scheme, which is often the deciding factor for any new investment project.

### Difficult production transfer at Apple

Apple, Foxconn's main customer, announced that it would increase its production in India fivefold to \$40 billion. However, the company has recently complained about India's difficult logistics and infrastructure. In February 2023, the Financial Times reported that only one in two components produced at a casing factory owned by India's Tata Group was of sufficient quality to be used in Apple iPhones.

"But this fault doesn't just lie with the Tata Group," confides a contact who follows the case closely and wishes to remain anonymous. "Apple has completely outsourced the production of its smartphone to China since the iPhone 8. For the production of subsequent versions, Apple handed over the specification of all the extras to the Chinese. They had to see how to produce and integrate everything. So that knowledge is in Chinese hands. And now that they have to transfer that knowledge to India, suddenly there is no one there to explain it, and certainly not in English." The Chinese make it difficult to transfer production, so technology 'transfer' is a process of trial and error. Nevertheless, it is reported that India's iPhone output is expected to be around 12% of global output in FY24, up from a planned 9%.

### Complex labour laws

Excessive business regulations also make life difficult. The government is working on simplification but progress is slow. "I think a lot of companies are waiting to invest until after the elections," says Mukesh Malhotra, CEO of Solvay India. "They want assurances that Modi will be re-elected with a majority. Then the key reforms are more likely to be implemented and everything will be easier for business."

Today, labour laws still vary widely from state to state. In the state of Maharashtra, where most industrial companies are located, it is very difficult to fire workers, which hurt many entrepreneurs during covid. In other states, it is easier. "You don't come to India," says Chief Economist Roopa Purushothaman of Tata Group. "You come to a state. It is the policies of the state that could make it difficult or easy for you as a company. At times, some states have been run closer to communist, lines while other, market forces have dominated more. The regulation of land ownership, employment and much more is largely in the hands of states." A good illustration of the power of the states is the

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<sup>10</sup> Nico Tanghe, Will everything soon be 'made in India'? De Standaard, 28 October 2023

fact that the labour laws passed by the centre were not implemented by the states, even those run by Modi's BJP.

### Scarce workforce

Besides labour laws, there is the problem of finding suitable workers, a consequence of poor basic education. Skilled workers, in turn, are difficult to retain. "For years, I struggled to keep my good IT workers," says Mantavajja Gajjar, boss and co-founder of Odoo India. Odoo, the first Walloon start-up to reach the billion-dollar threshold in Belgium, employs 450 IT professionals in India. "After a few successful projects, they were soon bought out by large Indian companies or set up their own companies," he says. High salaries are now needed to attract people. And attractive working hours, from 10 am to 7 pm. Unlike in China, among others, the balance between work and leisure time is very important to young people in India<sup>11</sup>.

"India has the absolute top-notch talents and a huge number of low-skilled workers. But it's in between, the medium-skilled people, that we have a problem," says CEO Malhotra. "In factories, you have three levels. The middle level is a problem. These people have to go through an in-company training programme. They can read, write, do maths and so on. But they don't know how to use the machines. This training is organised within the industry associations." The government's Skill India programme is being adapted accordingly. "There is a skills gap, but it can be bridged," he says.

### Chaotic India

India is chaotic, and you have to be able to deal with that, says Poul V. Jensen, Managing Director of the European Business and Technology Centre. "Nothing happens in a straight line here. You have your plan in the morning, but by the end of the day, chances are that you may have had to change your whole schedule. My employer came here a few years ago with a full schedule for Monday. On the Sunday they arrived, it was decided that Monday would be a public holiday. You never know what will happen in India."

The same goes for government decisions. Sudden policy changes discourage investors. On 3 August 2023, a ban on the import of laptops, tablets and personal computers without a government licence was imposed with immediate effect. A day later, the licensing requirement was delayed by three months to 1 November 2023. This gave companies time to adapt their operations to the new rules. This was necessary because while the government encourages domestic production of these products, India imports more than 80% of its laptops and 63% of its tablets. An effective import ban would therefore have been disastrous ... a fact they realised a day later.

### Price sensitivity

The typical Indian is very price sensitive. "They want value for money," says Jaimini Bhagwati, "Distinguished Fellow" at the Centre for Social & Economic Progress. "That's why Maruti Suzuki [the alliance between Japan's Suzuki and India's Maruti] succeeded and General Motors failed in India, apart from the fact that GM was just not well run from the US at the time." The Maruti Suzuki is small and made in India. But Maruti Suzuki also succeeded because "not only did they come out with a cheap car, but at that price average Indians began to consider replacing their two-wheelers."

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<sup>11</sup> Nico Tanghe, India is more than ever the back office of the world: 'The future is ours' The Standard, 2 November 2023



India is the world's largest producer – and market – for scooters. Its growing middle class is upgrading to a - safer - and highly fuel-efficient four-wheeler at little extra cost. And the fact that this four-wheeler is backed up by good after-sales service is just the icing on the cake. "I will only buy something if I am sure there will be good after-sales service," explains Dr Bhagwati. "That was the problem with Ford: they had good models, like the Fiesta, but they had a very limited after-sales service." Maruti Suzuki dealerships can be found from the biggest cities to the smallest rural villages. Today, more than one in two Indian car buyers chooses a Maruti Suzuki.

### Intellectual property rights and price caps

Raman Madhok, Diplomatic Advisor on Economics to the Consul General of Belgium, sees two other specific issues that are difficult for foreign companies in India. "First, there is the issue of intellectual property rights. The laws have improved, but some multinationals still don't trust them. Also, companies want to protect their manufacturing processes. Why hasn't Tesla set up a production facility here yet? Because there is a lot of pressure from the government for companies to build a whole local supply chain instead of importing components. Some companies are not ready for that yet." But India adjusts when needed. By cutting import duties on electric vehicles, India is trying to make Tesla reconsider and the latest reports are that it is looking to set up factories in India now.

A second challenge is pricing. "You have to sell at a - low - price here, a price at which the government is not inclined to intervene. Take paracetamol, for example. My American colleague buys it on his trips to India because it is so cheap. A strip of 10 tablets costs less than half a euro. Why is that? Because of DPCO, which stands for Drugs Price Control Order."

### One and a half billion consumers with individual tastes

Should this deter companies from coming to India? Madhok: "India's advantage is the numbers: one and a half billion people. Then small margins become big profits. But you have to be willing to adapt your products to the Indian market. Look at companies like Unilever, Cadbury, Kraft: they have adapted their products to Indian tastes and local products. Nestlé's Maggi noodles, one of the most popular snacks in India, have Indian spices added to them."

Sales of Maggi noodles were virtually non-existent in the first few years after the company entered the Indian market in 1983. Nestlé studied the market and saw a need for an easy, quick to prepare and relatively healthy snack: the quick 'evening snack', for when children and students came home hungry and did not want to wait long for food. The '2-minute noodles' slogan caught on and catapulted Maggi noodles to cult status. A vast distribution network ensured that noodles were available everywhere, even in the most deprived areas.

The example also shows what India is all about. "You don't invest in India for the short term. If you are not prepared to invest for several years before you start making profits, then you are out of place." Poul V. Jensen agrees with Madhok. "You have to have deep pockets to make it in India: there is the cultural adjustment, convincing the Indians, the huge capacity that needs to be set up and so on. When a global top-5 management consulting firm set up here, it factored seven years of losses into its business plan."

### **ESG awareness low**

"You should also know that there is still a lot of work to be done on the 'Environmental, Social and Governance' (ESG) framework. The whole production system may be perfectly set up, but far from all Indian companies are awake to ESG today," Jensen continued. "And that has to change." In 2024, the new Corporate Sustainability Reporting Directive will come into force in the European Union. Between 2024 and 2028, 50,000 companies will have to provide as much detail as possible about their supply chain emissions. This will increase the pressure on suppliers to meet more stringent requirements. There will be increasing trade restrictions between the European Union and emerging markets as a result of new rules to combat deforestation (Deforestation-free Regulation<sup>12</sup>). And from 2026, the first carbon border tax will be introduced, which emerging markets have called "unilateral" and "discriminatory".

On the other hand, these climate 'sticks' are also leading emerging economies to revise their climate ambitions upwards. Indonesia and India, for example, have made progress in their plans to launch their own carbon markets. Emerging countries, including India, are well aware of the huge potential for those who adapt.

### **India grows at night**

"India grows at night while the government sleeps." This popular saying by author Gurcharan Das illustrates the country's excessive bureaucracy. Acquiring land for business expansion and infrastructure projects, for example, is a long and slow process. "The legal system is independent," says Shumita Deveshwar of GlobalDataTSLombard, "and there is a level playing field for foreign and domestic companies. But it can take years to resolve disputes."

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<sup>12</sup> Deforestation-free legislation aims to ensure that commodities such as palm oil, soy, beef, coffee, cocoa, rubber, timber and related products imported into the EU do not contribute to deforestation. Monitoring is done through strict traceability requirements and fines of up to 4% of annual EU agricultural revenues for offenders.



*India grows at night, while  
the government sleeps*

"That's why it's crucial for foreign companies to work with local partners who know how things work. And how to do it faster." Dr Bhagwati agrees. "These partners often contribute nothing in capital and have little technical expertise. But they do know all the legal hurdles and how to get approvals faster. They know the local government people and the local way of doing things. And yes, sometimes money has to be passed under the table to make things go a little faster. As a foreign company, it is best to take into account that you will have to pay this or that tax, and such and such a payment."

Of course, the government is trying to reduce this corruption. "But even then you need local help, just as you would if you were a Belgian company in Greece. You would want a Greek guide. In India, you have different languages, different eating habits, different religious practices, that vary from state to state." Raman Madhok adds: "The way people behave is different and some things are very sensitive here. You have to know them to be successful. For example, foreigners believe that everyone can be trusted, but Indians do not. Remember, we were colonised before, and we don't forget that easily." Madhok concludes, "The global statistics are very clear: 7 out of 10 mergers and acquisitions fail largely because of people issues. And this is doubly true in India. You cannot run India from abroad."