Compass 2020

Germany in international relations
Aims, instruments, prospects

India

Challenges On The Road To Becoming A World Power

Peter Gey, Matthias Jobelius & Renate Tenbusch

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The Compass 2020 project represents the Friedrich-Ebert-Stiftung's contribution to a debate on Germany's aims, role and strategies in international relations. Compass 2020 will organise events and issue publications in the course of 2007, the year in which German foreign policy will be very much in the limelight due to the country's presidency of the EU Council and the G 8. Some 30 articles written for this project will provide an overview of the topics and regions that are most important for German foreign relations. All the articles will be structured in the same way. Firstly, they will provide information about the most significant developments, the toughest challenges and the key players in the respective political fields and regions. The second section will analyse the role played hitherto by German / European foreign policy, the strategies it pursues and the way in which it is perceived. In the next section, plausible alternative scenarios will be mapped out illustrating the potential development of a political field or region over the next 15 years. The closing section will formulate possible points of departure for German and European policy.

Daniel Reichart
Christos Katsioulis
Katrien Klüver

Friedrich-Ebert-Stiftung
Dept. for Development Policy
Hiroshimastraße 17
D – 10785 Berlin

Tel. +49-30-26935-972
Fax +49-30-26935-959
kompass2020@fes.de
www.fes.de/kompass2020

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Abstract

The Indian economy is growing at an average rate of 8 per cent a year. Most Indian and foreign observers are confident that India will sustain this tempo of growth in the near future, and will go on to become one of the world's leading economies and a global political power in 2020. A few voices draw attention to the tremendous economic, political and social challenges facing India that the country must overcome before it can lay claim to being a world power.

In the 1950s, 1960s and 1970s economic growth was stunted by excessive controls and the economy's insulation against foreign trade. India owes its current economic miracle to the reforms launched in 1991 under Manmohan Singh, then Finance Minister and now Prime Minister. The reforms heralded the advent of India's successful participation in the globalisation process. However, decades of investment in heavy industry, neglect of infrastructure and education, rigidity of labour laws and red tape bureaucracy have resulted in structural distortions that are difficult to rectify.

The country is also facing greater demographic and social problems. India's population has increased threefold, from 370 million in 1950 to over 1.1 billion today. As many as 300 million people still live in extreme poverty, more than half the women are illiterate and almost 50 per cent of the children undernourished. By the year 2020, not only will the population grow by an additional 200 to 300 million people, but India will have to deal with the problem of an ageing population because the number of old people needing support will rise as well.

This article visualises India's development up to the year 2020 on the basis of three scenarios. The "hype-disaster" scenario is based on the premise that the Central Government and most State Governments do not implement vital reforms or are too slow to act. For a few years, the economy continues to boom (hype) but then overheats, resulting in a prolonged, deep recession (disaster). In the boom years, the chasm between the lower and upper classes widens leading to violent clashes over distribution. The second scenario is underpinned by the presumption that essential reforms in the business, education and legal sectors are comprehensively and rapidly ("big bang") implemented; the government is firm in its resolve to tackle rural backwardness as well as discrimination against women, tribals and Dalits - and does so successfully. In the big bang scenario, the economy does not experience the spectacular growth of the period between 2004 and 2007 but neither is there a catastrophe - economic growth is balanced and sustainable while political and social conflicts remain within limits. The third scenario, the "interim stage", focuses on the limited powers of coalition governments to take action, as they rely on the support of several parties. It is based on the assumption that future Indian governments will not go in for structural reform but will try to circumvent the problems with case-by-case or partial solutions.

Despite wide-ranging differences in social contexts and cultural values, India, Germany and the European Union share a common interest in an international order based on the principles of democracy and human rights, peace and security - sound foundations on which to expand mutual relations, regardless of the scenario in which India develops by the year 2020. It is unlikely that India will be a world power in 2020 but as a stable regional power with sustained economic growth, it has the opportunity to enhance its significance as a global player. Germany and the EU can offer to initiate dialogue and cooperate on issues such as the environment, economy, rule of law, education and science in an endeavour to support India on this path.

I. Parameters

I.1 India – a world power?

India has nuclear weapons and the third largest military in the world. In terms of geographical area, population and economic power, India far outstrips its South Asian neighbours. And now, given its high economic growth that has touched 8 per cent in each of the last four years, it is also preparing to close in on the world's economic powers. Experts from the media, investment banks and research institutes agree that there is another China in the making, an economic and political powerhouse that will soon overtake Germany and Japan. India will then have fulfilled the economic conditions required of a leading political power that plays a role in moulding international relations.

The confidence is not without scepticism. Bibek Debroy, Director of the Rajiv Gandhi Institute for Contemporary Studies - a New Delhi think tank with affiliations to the ruling Congress party - put the brakes on India's prospects of becoming a world power when he established in 2002 that an annual growth rate of 6.5 per cent would result in a per capita income of around 1,200 dollars in 2020 (calculated on the basis of constant prices). India would then be where China was in 2002 and still a long way from the 10,000 dollar threshold - the yardstick for a developed country.

Thus, while India would not have the economic strength in 2020 to qualify as a world power, an annual growth rate of 6.5 per cent over a period of almost a decade and a half would have successfully sustained the economic upswing and created the conditions to further improve standards of living. Yet simply to maintain this tempo of growth, India must first cope with immense internal and external challenges.

For one, it must come to terms with the fallout of its socialist-oriented past. For several decades, growth had been hampered by a development strategy based on the Soviet model and an economic system hostile to the market; the resultant structural distortions will not be easily corrected. Second, since the opening up of the economy in the early 1990s, Indian companies and India as a business location are competing with powerful international rivals. India is finally participating in the globalisation process but must now create the necessary institutional and economic conditions to hold its ground in global competition.

The issue here is not only about economic growth and the success enjoyed by Indian companies, but also about overcoming poverty that continues to be widespread. From 370 million in 1950, India's population has grown threefold to over 1.1 billion today. According to the UNDP *Human Development Report*, four-fifths of India's population has to sustain itself on less than two dollars a day. A good one-third has just one dollar a day to make ends meet.

The demographic scenario that emerges by 2020 will add to the social challenges. On the one hand, there will be an additional 200 to 300 million people to be fed and educated. On the other, India will face the problem of an ageing population because there will be a proportionate rise in the number of people who depend on benefits because their age or health prevents them from working.

India must overcome these enormous economic, social and political challenges if it wants to become a world power. The willingness and capacity of politicians in the Central and State Governments to develop promising reforms and to implement them at the political level will be crucial to the process. Two contrasting scenarios and one that visualises a balancing act are conceivable in this context. Each portrays India in 2020 in a different light. The article ends with conclusions that can be drawn from the scenarios for the future of Indo-German relations.

I.2 Socialist model in India

India was not the only country in the erstwhile Third World to adopt the Soviet model of industrialisation after the Second World War. The political leadership in most developing countries believed that a country had to be virtually self-reliant, develop its heavy industry and operate a state-controlled economy to boost economic growth. As in India, the state set up steel plants and automobile factories without a thought for costs and revenue. To add to this, a bloated bureaucracy emerged that controlled prices and loans, granted import licences and investment permissions and used other similar controls to translate political directives into practice. However it must be mentioned that India was more thorough and persistent than the other developing countries.

Shortly after the founding of the republic, the "commanding heights" of the economy (the term used in the former Soviet Union for the iron and steel industry, engineering, the chemical industry and the transport sector) were largely taken over by the state. The nationalisation of banks followed in 1969. In 1953, the state launched the first Five-Year Plan, in which the development targets were weighted in favour of heavy industry and the investments required to achieve these targets.

To control and regulate the private sector, the government gradually introduced the 'licence raj' and ''inspector raj'' systems (*raj* means 'rule' or 'regime'). The former made it mandatory for companies to acquire import licences to be able to import goods. As a result, domestic businesses were thus protected from unwanted foreign competition. Extensive price, loans and investment controls were also introduced to ensure that the state bureaucracy was able to curb private sector development. Under the 'inspector raj' system, the authorities inspected companies and enterprises to ensure adherence to laws, norms and regulations. The inspectors were equipped with extensive powers. An objection on their part could force the temporary or permanent closure of a company as well as involve hefty fines and imprisonment. Both systems fostered bureaucratisation, clientelism and corruption.

Over the years, labour law regulations multiplied and became increasingly contradictory. During an inspection, it was the inspector who decided whether or not a law had been violated. The labour law was applicable to enterprises with 20 or more employees, provided it did not use electricity; an enterprise with electricity was subject to the law if it had just 10 employees. To bypass the 'inspector raj' system, enterprises made sure that the number of employees did not exceed these critical limits.

Besides the state-run heavy industry, agriculture was the focus of India's economic planning. It prioritised enhancing agricultural production to avert the threat of famine and idealised village life in an attempt to curb rural-urban migration. As in other sectors of the economy, here too extensive production, price and credit controls as well as numerous promotion schemes were put into practice. The Green Revolution, followed by the White Revolution, ensured India's self-sufficiency in agricultural production until the mid-1960s; the country has since been spared further famines. Yet state-prescribed cultivation of high-yield crops and the extensive use of pesticides and fertilisers led to monoculture cultivation, over-fertilisation of the soil, environmental pollution and excessive water consumption. Indian agriculture was characterised by subsidised, state-controlled small and micro enterprises with low productivity.

Between 1950 and 1980, the socialist model applied in India produced disappointing results. Indian industry focused on capital-intensive products (machines to produce machines), was inefficient, did not innovate, exported little and created next to no jobs. Over a period of 30 years, India's gross domestic product (GDP) grew by an average of 3.7 per cent per year. At the same time, as the population virtually doubled from 372 million to 689 million, the per capita annual average growth rate was a mere 1.5 per cent. It came to be known as the 'Hindu Rate of Growth'.

I.3 Era of reforms

India's leadership adhered to the Soviet-style development strategy and believed in a state-controlled and regulated private sector without paying heed to the negative developments in the Soviet Union and in other communist countries. In the 1950s, tentative discussions were already under way in these countries about the functional problems of centralised economic systems and the enormous sacrifices to be made when an economy is too oriented towards heavy industry. The criticism became increasingly severe, paving the path for the far-reaching attempts at reform which were reflected in the Prague Spring in 1968, the dissolution of the people's communes in China in 1978 and the general strike called by the Polish trade union, Solidarity, which in 1980 demanded not only free elections but also privatisation of state-owned enterprises.

In the 1980s, the Indian Government still displayed a reluctance to turn its back on its long-standing policy of curbing and regulating the private sector. While the government was liberalising exports and creating export incentives, reducing price controls and providing private companies with loans and hard currency, it was also tightening labour laws. A 1976 regulation stipulated that companies with a workforce of over 300 required government permission to dismiss an employee. In 1982, the cut-off mark was 100 employees.

It was only in the early 1990s that there was an evident radical change in course. The immediate cause for this change was not the fall of the Berlin Wall, or the dissolution of the Soviet Union and the nascent transformation process under way in Central and Eastern Europe, but the threat of bankruptcy facing the Indian state in 1991. To obtain international standby credit, the government was compelled not only to mortgage its gold reserves but also give an undertaking to the International Monetary Fund (IMF) that it would initiate economic reforms in the country.

The half-hearted "pro business" reforms of the 1980s were followed by what were known as the "pro market" reforms. The licence raj system was abolished. The government allowed foreign direct investment (FDI), opened up numerous state monopolies to the private sector - for instance, telecommunications and air transport - and liberalised the banking and financial systems. The reforms fell short of being far-reaching, as the 'inspector raj' system and the labour law remained untouched, but India finally opened up to an already globalised world.

Success was not long in coming. Between 1980 and 2000, macroeconomic growth in India averaged 6 per cent. This compared well with countries in Latin America and Africa but was lower than in China or South Korea and dismal in relation to its spiralling population growth. In this time span, it grew by a further 358 million people, crossing the billion mark in 2000.

At the turn of the millennium, the growth rate surged, touching the 8 per cent mark for the first time in the financial year 2003-04 and the tempo was maintained in the following years. Given the high economic growth, the media in India increasingly spread euphoria and the government was prompted to raise the growth target for 2012 from

9 per cent to 10 per cent. Yet critical voices were sporadically heard and the limits and obstacles to sustained high growth were becoming apparent.

I.4 Infrastructure and education

An economy that grows at an average rate of 8 per cent a year will be in five years 1.5 times its size. India would like to achieve this rate of growth in the coming years too. The additional transactions this would imply would put an enormous strain on the infrastructure, which already falls far short of meeting even the minimum requirements of producers and consumers, particularly with regard to electricity and water, transport and traffic.

For many years, the government had to spend an additional 3.5 per cent to 4 per cent of the GDP to ensure that infrastructure kept pace with demand. This would be about twice what India currently spends on transport, electricity, water, storage, irrigation, harbours and airports. Should the government fail to provide the resources required for infrastructural development, the economy would over-heat. In the worst case, the economic upsurge would stall. The government is therefore making a more concerted effort to promote private-public partnerships, an example being the extremely successful partnership between the Delhi Government and private companies to build the Delhi Metro. In contrast, in the energy sector, and particularly with regard to water, private sector involvement is either an extremely delicate political issue or too risky a business for investors.

While India's lack of infrastructure in general is seen as a serious obstacle to further development, the potential of its workforce is considered an important growth factor, given the young average age, good English skills and high levels of education. A prognosis from 2001 – compiled following the population census conducted in the same year – came to the conclusion that India in 2020 will have about 325 million people aged between 20 and 35 and would then have more young working people than China. In contrast to the industrial countries and in particular China with increasingly older populations, India is ascribed a "demographic dividend".

But appearances are deceptive. Low levels of growth in the past, a population spurt and a state education policy that over the years has neglected primary education in favour of higher education imply that a quarter of the men and half the women in India are illiterate. And in the 680,000-odd villages and increasingly in large city slums too, the next generation is growing up chronically undernourished and educated poorly, if at all. The official number of children who do not go to school but contribute to the family income by begging or doing physical work is estimated to be 20 million. Non-governmental organisations (NGOs) however, peg the figure closer to 40 million.

Conditions in the higher education sector too do not hold out much hope for a demographic dividend. True, India currently has 369 universities and 18,064 colleges and therefore ranks among the countries with the highest number of higher education institutions. However, here too, the figures must be seen against the demographic background: of 120 million young people aged between 17 and 23, only 12 million receive college or university education, which is usually substandard. According to a study conducted in 2005 by the National Association of Software and Service Companies, only 25 per cent of the graduates were sufficiently qualified to work in a foreign or Indian technology company. The computer service company Infosys says that in 2006, of 1.3 million candidates only 2 per cent fulfilled its employment requirements. A serious problem for all modern business sectors is the fact that contrary to the common assumption in the country, only around 5-7 per cent of the population is proficient in English.

The Federation of Chambers of Indian Industry and Commerce draws attention to the "huge gap" between the rapidly growing need among businesses for qualified workers and the actual number of well-educated young people. In the biotechnology sector, the additional need for scientists holding doctorates is 80 per cent; it is anticipated that in 2010 there will not be enough qualified people around to fill the 500,000-odd vacant posts in the technology sector. The companies fear that the lack of a qualified workforce will cause even greater fluctuation in the modern service companies (already between 40 per cent and 60 per cent) and will push the annual salary increments beyond 10 per cent to 20 per cent, currently the norm for the sector. It is only a question of time before India loses its comparative employment advantage due to a lack of workers and rising wages and before Indian and foreign companies begin the search for suitable locations outside India.

I.5 Governance and Rule of Law

India owes its high economic growth to the reforms launched in 1991 under Manmohan Singh, then Finance Minister and now Prime Minister. After decades of mismanagement and autarchy, these reforms catalysed the decisive breakthrough to a market-oriented economy and integration into the global economy. The process must now be continued with further reform. Privatisation of inefficient public enterprises, dismantling of export barriers, agricultural reforms, promotion of the manufacturing industry and comprehensive improvements in infrastructure, education and taxation are some conditions that India must fulfil to overcome the challenge of economic, social and demographic development. To this end, it needs a government that can take action and work towards development and the common good, a transparent and efficient administration and the rule of law across the nation.

India sees itself as a secular democracy in which all citizens are equal before the law, regardless of sex, religion, caste and ethnicity. Nevertheless, the primary focus of the political debate is on granting privileges such as subsidies, quotas or benefits for vote banks and advocacy groups belonging to particular castes, religions, tribal groups or regions. Clientele-based subsidies for housing, electricity, water, fuel, fertiliser and basic food supplies that now account for a quarter of government expenditure are more or less sacrosanct and always result in people asking for more, despite doubts about whether these subsidies actually benefit the genuinely needy. Quotas that enable Dalits, members of the lower castes and tribal groups to obtain admission to universities or to obtain government jobs have caused conflicts between parties and between members of "underprivileged" sections of society. Parties that know how to capitalise on what the people covet most and can mobilise the respective vote banks go on to win elections. In contrast, political ideologies, election programmes or economic policy concepts are of no importance when forming a party, when campaigning for elections or when forging government alliances.

For several years, a bloated bureaucracy had been trying to control and regulate the economy while also implementing state development and employment programmes. Clientelism and corruption consequently flourished unchecked. As this bureaucracy survived the economic reforms relatively unscathed, the government passed a law - the Right to Information Act - in 2005 that strengthened the rights of citizens vis-à-vis the state. This Act makes it mandatory for authorities to provide information, improves transparency and accountability in the system and helps curb corruption.

Sluggishness and corruption are also hallmarks of the Indian legal system. Laws are not enforced, countless posts for judges have been vacant for years and the number of pending legal cases that have yet to be opened has swelled to 27 million. The waiting lists include cases of murder and corruption, theft and kidnapping, rape, dowry deaths and human trafficking. It is estimated that at the current rate of disposal the Indian judiciary would require about 350 years just to settle pending cases. According to Transparency International, the estimated amount paid in bribes to district and trial courts in just 12 months was 580 million dollars. In other words, there is no guarantee of legal security - neither for Indian citizens nor for foreign investors.

I.6 Population and employment

The global demographic trend of people living longer and having fewer children is evident in India too. Since the 1950s, the absolute birth rate has come down by half - from six to three children per woman - while life expectancy has risen from 40 to 64 years. However, as there was only a slow decline in the already high birth rate (which continues to be high), the population grew threefold - from 370 million in 1950 to 1.1 billion today. By 2050, it will increase by a further 500 million people (medium variant). At the same time, India is on course towards facing the problem of an ageing populace because the number of people over the age of 60 will rise from 90 million today to 300 million in 2050. Outside the family, there is virtually no provision for care for the elderly. A person who can no longer earn a living because he or she is old or sick, depends on financial assistance from working family members. Where would they find work in the future?

As development was neglected in the 1950s, 1960s and 1970s, 73 per cent of the population still lives in rural areas. This is a decline of just 10 per cent since 1950. Yet, absolute figures reveal the extent of the mounting pressure on resources such as water and land. The rural population rose from 297 million in 1950 to 816 million in 2005. That is a full three times more people than India had at the time of independence in 1947. An immediate consequence of particularly high growth among the rural population was - and still is - the continued parcelling of land. Between 1971 and 1995/96, the average size of farms decreased from 2.3 hectares to 1.4 hectares. In the same period, the number of farms with less than 2 hectares of agricultural land rose from 49 million to 93 million. Even today agriculture is not in a position to guarantee an income that can provide for a decent standard of living.

It is difficult to find work outside agriculture. Decades of investment in heavy industry combined with rigid labour laws created relatively few jobs in the manufacturing industry and surplus workers migrated from agriculture to the service sector. With 49 per cent in the financial year 2001-02, this sector accounted for almost half the GDP while the industry sector for only a quarter. In fact surging economic growth has added to the importance of the service sector in India. While the industry's share between 1996-97 and 2005-06 rose only moderately from 24.9 per cent to 26.4 per cent, that of the service sector rose from 43.6 per cent to 55.1 per cent.

The overwhelming majority of jobs in the service sector are simple and poorly paid. In comparison, the one million people employed in the business process outsourcing (BPO) sector (accounting, text processing, credit card management, call centres, etc.) and software production in 2005 and around whom the India hype essentially revolves are hardly of consequence. In total, only 35 million people or 7 per cent of the workforce were employed in the formal sector and here too mainly in public service. The Indian economy is dominated by precarious employment conditions. In 2005, 435 million people or 93 per cent of the workforce were employed in what is known as the informal sector, characterised by an almost complete lack of legal and job security.

II. German and European political strategies and their perception in India

Relations between Germany and India have generally been good even in the past when India was a close political and economic ally of the Soviet Union. Following the demise of the Soviet Union and the end of the Cold War era, India intensified cooperation with international organisations and sought greater political and economic exchange particularly with the US but also with Germany and Europe. Generally speaking, the interest in pursuing close cooperation with India increased as the country liberalised its economy and opened up to the outside world. There are several indications that this interest will continue in the future.

First, India plays an important role in shaping multilateral agreements. In World Trade Organisation (WTO) negotiations it increasingly acts as the mouthpiece for developing countries. India's cooperation on global environmental policy is essential, as it will be one of the largest energy consumers in the 21st century. The country's future defence policy is crucial to the non-proliferation of weapons of mass destruction and the future of the moratorium on nuclear testing. In other words, Germany and Europe must develop a partnership with India also with regard to achieving the multilateral goals of their respective foreign policies.

Second, Germany already ranks as one of India's most important trading partners. As long as the economic upsurge in the country continues, India offers a growing market for German products. This is especially true of the machines and equipment required to develop infrastructure and allow the country to further industrialise. The energy sector, particularly alternative energy, offers scope for cooperation, as do education, research and technology. German products are known for their quality and are even status symbols in India.

Third, for an EU strategy based on peace and democracy, it is important that India be integrated into the dialogue on security policy. There is still the danger of an uncontrolled arms race among the nuclear powers, China, India, and Pakistan. Political conflicts in neighbouring countries like Bangladesh, Nepal, Pakistan and Sri Lanka also underline the importance of winning over India as a partner for an Asian security policy.

Fourth, as one of the largest recipients of German development aid and as an "anchor country", India is of special importance to German development cooperation. The size of its population alone means that development in India must be successful if the Millennium Development Goals (MDGs) are to be achieved in Asia.

Berlin and Brussels have acknowledged India's importance. Since 2000, annual summits have been held between India and the EU, accompanied by parliamentarian and civil society dialogue forums. At the fifth summit in The Hague in 2004, a "strategic partnership" was agreed upon between India and the EU with a focus on multilateral, economic and development cooperation, cultural and scientific exchange and better institutional parameters for Indo-European relations. A year later, a political declaration and plan of action were passed in Delhi with a view to intensifying the partnership in several fields of policy. This was followed in 2006 by the establishment of many more dialogue forums and task forces in fields such as security policy, energy, immigration, human rights, climate and environmental policy. The seventh summit held in Helsinki in October 2006 concentrated on continuing with the plan of action and working towards a trade and investment agreement.

Germany and India too are now working more closely together. Ever since the "Agenda for Indo-German Partnership in the 21st Century" was passed in 2000, the governments of both countries have seen themselves as "natural partners" with common values. The mutual support with regard to the reform of the United Nations Security Council strengthened the perception on both sides that Germany and India can be reliable partners in multilateral initiatives. Likewise, cooperation in the fields of energy, science, research, technology and cultural exchanges has increased while cooperation in foreign and security policy has been slow to take off. At the last meeting between heads of state in April 2006, there was the prospect of a cooperation agreement on defence policy.

Trade between Germany and the EU on the one hand and India on the other forms the core of the cooperation. In 2006, the EU with a share of 20 per cent of the total imports was India's largest supplier and Germany was its fourth most important trading partner. While India may rank only 29 on Germany's list of important trading partners, the goal declared by the two countries in 2004 of doubling the annual bilateral trade to 100 billion euros by 2010 is likely to be achieved. In contrast, direct German investments in India - primarily in the fields of chemicals, pharmaceuticals, machinery, software and plant construction - declined in the past years.

All this progress notwithstanding, cooperation between the EU and India is still comparatively modest. India is yet sceptical about closer cooperation with the EU. The reason behind this may be that often the 27 EU member-states do not act in unison. Moreover, India believes that the EU's interest in South Asia and its influence in the region are limited in comparison with that of the US. It also bothers India that the Asia policy pursued by Germany and Europe focuses on China even though Germany and the EU otherwise cite democracy, the rule of law and human rights as inalienable principles in their foreign policy.

An objective analysis of the economic potential, common interests and political differences is a prerequisite for more intensive cooperation. On the German side, this also demands a more in-depth study into the possible scenarios of India's future economic, social and political development.

III. Scenarios

III.1 Assumptions

As in the past, India's political scenario, economic strengths, expected living conditions in 2020 and the nature of its role in international relations depend primarily on those at the political helm in India itself.

This is not to suggest that external political and economic impacts would not affect India's future development:

- Even today India has no option but to import almost 75 per cent of the oil it needs. As indigenous energy reserves dwindle while the country's oil consumption rises due to sustained economic growth, India will become increasingly vulnerable to rising oil prices. The Government of India was able to cushion the impact of the 25 per cent increase in oil prices between January and July 2007 with subsidies from the national budget. However, an "oil price shock" of over 100 dollars per barrel would be felt in the real economy because either the businesses and households would have to bear the brunt of higher prices or higher subsidies would prevent the state from making crucial investments (for example, in infrastructure).

- Indian companies competing with foreign firms for a market share are directly affected by changes in the exchange rate. In the second quarter of 2007 alone, the Indian currency appreciated by 7 per cent against the US dollar. This was the rupee's strongest appreciation in a quarter in the last 30 years. A further pronounced fall in the value of the US dollar (likely, given the current high deficit of both the state budget and the trade balance in the USA) would cause Indian companies to suffer corresponding losses to revenue and profit.

- Crises in the international financial markets also affect the financial markets in India. Nothing illustrates the emergence of the India hype more clearly than the boom on the Bombay Stock Exchange. The Sensex, the barometer of activity on the Bombay Stock Exchange, shot up from just under 3,000 to over 15,000 points between mid-2002 and mid-2007. A fivefold increase in market capitalisation within a few years means that there is considerable potential for a backlash. A global stock market crash would cause stock quotations in India to plummet and so disrupt the investment and consumption patterns of the middle and upper classes.

- Relations between India and Pakistan could deteriorate. The two countries that have waged three wars against each other since independence enjoy relatively peaceful relations today. However, peace efforts may falter yet again, either because of increasing conflict between the government and opposition in Pakistan and/or because violent attacks by terrorist groups trigger internal turmoil in India. Both could prompt the Indian government to break off talks with Pakistan on security and detente. Any serious deterioration in diplomatic relations would cause the risk premium on state and private lending abroad to rise substantially and thus deter foreign investors.

In an attempt to work out options for action available to India's political leadership and the conceivable scenarios that each decision could result in, we will base our premise on the best of all possible worlds for India in the period leading up to 2020: India is spared external shocks such as exploding oil prices or a collapse of the international financial system and, as in the past, the global economy continues to grow at a historically high rate.

It goes without saying that the demographic and natural contexts for all scenarios are the same: the population will grow an approximate 240 million by 2020 (medium variant) and there will be mounting pressure on the environment due to rising air pollution, continued deforestation, falling ground water levels and contaminated rivers.

III.2 The hype-disaster scenario

The development initiated by the economic reforms in the early 1990s continues: the threat of state bankruptcy in 1991 left the government with no option but to abolish the 'licence raj' system. The Indian model of socialism thus lost a vital instrument with which to suppress the private sector. Freed of the straitjacket of state-controlled imports, investments, prices and loans, the private sector now unleashed its enormous potential and soon made India one of the fastest growing countries. The India hype had emerged. Where to now?

The high growth rates allow politicians to ignore the fact that a series of additional reforms as demanded by research institutions and several political party think tanks must be addressed. By 2020, the system of countless, arbitrary inspections (''inspector raj'') will thus either not slacken its hold at all or do so only in some sub-sectors. Labour laws too will not be adapted to Organisation for Economic Co-operation and Development

(OECD) standards or will be adapted only much later. The education system will not undergo fundamental reform. An urgently required land reform that clearly defines matters of ownership and property, as well as measures to modernise agriculture in economic, ecological and social terms remain undone. Instead of continuing with the reforms, the government tries to circumvent bottlenecks and blockades by creating Special Economic Zones (SEZs), granting special permissions and introducing new editions of innumerable social programmes.

This bypass policy will initially be good enough to allow India to experience high economic growth for the next two or three years. Then, however, it will no longer be possible to erase the lapses of the past.

The growing demand for highly qualified workers is met with a rapidly dwindling offer in the labour market. The first to feel the lack of qualified staff are high-tech companies. Next, there are not enough English-speaking school-leavers who can fulfil the requirements of the less demanding work in call centres, for instance. There is considerable fluctuation among company workforces, as they repeatedly exploit new and better opportunities. Ultimately the government increases the expenditure on education, but implementation is slow to take off because responsibilities are unclear and well-qualified teachers are lacking across the board.

Consequently, wages and salaries skyrocket. At first, Indian and foreign companies try to woo skilled workers from abroad, particularly Indians who have migrated in search of work, by offering them diverse incentives to induce them to return. Then the companies begin to hold back with their investments. Confronted with high wages and lack of qualified workers, the ongoing and costly chicanery of the ''inspector raj'' system and monstrous labour laws, it is likely the initial foreign companies that set up base in India would start to withdraw and look for newer more economic pastures. This would be closely followed by even the large global Indian companies that would then start to contribute significantly towards raising the levels of wealth in other locations rather than contribute to the Indian economy. The decision of domestic and foreign companies to look out for suitable locations outside India is also propelled by the increasingly difficult living conditions in the cities thanks to pollution, traffic congestion and water shortages.

While the substantial rise in income levels benefits primarily the middle class and graduates with a good college or university education who are just embarking on their careers, property owners are happy about soaring house and land prices and about their rental income. As the authorities in the large cities have for years neglected to identify adequate living and office space and to grant building licences, the tenants are the ones who lose out. Even the production and marketing of food and other daily needs fall far short of meeting the growing demand. The rapid rise in the cost of living means that the lower classes - a good four-fifths of the total population - suffer substantial losses on their real income.

In an effort to curb inflation, the Reserve Bank of India has no option but to tighten its monetary policy. During the financial years 2004-05 to 2006-07, the credit volume required by companies and households increased by a total of 30 per cent each year. As a result, large sections of the new middle class are unable to repay their loans and several small companies are giving up. The disruption of investment and consumption patterns puts an end to the India hype. India is caught in a long-lasting recession that casts a harsh light on the country's structural problems.

In rural India, where about 1 billion people will be living by the year 2020, the situation is deteriorating. The rising price of inputs and equipment combined with a hopeless struggle against foreign competition drive the farmers *en masse* to ruin. A shortage of land and a lack of employment opportunities prompt millions to leave for the cities in search of work and food. It is virtually impossible for the uneducated rural refugees to find jobs here as the ''inspector raj'' system coupled with rigid labour laws have prevented employment-intensive industries from being established. The infrastructure collapses under the onslaught of masses of people. Electricity and water are available only on certain days of the week, the air is polluted and cities sink in garbage. Large parts of Delhi, Bangalore, Mumbai and other mega cities are left to fend for themselves.

Not only did the economic boom widen the chasm between the lower and upper income groups, but it also exacerbated the economic and social differences between the backward and developed states. In especially poor regions, sections of the population join the struggle being waged by Maoist guerrilla groups. In 2007, the Naxalites were already active in one-third of India's territory and have taken control in several districts. In 2020, Naxalite activities are likely to be reported from almost every State and it is imperative that the Central and State Governments do their utmost to halt the spread of Naxalism.

During the India hype, it was generally agreed upon that India would emerge as one of the leading countries in the world in both political and economic terms. Instead, virtually insurmountable problems have piled up in India and the year 2020 may see the country's influence not extend beyond South Asia. The strategic partnerships of the boom years will have no effect. Global interest in India cools off and the prime focus now is to contain a country equipped with conventional and nuclear weapons.

III.3 The "big bang" scenario

In this scenario, the reforms launched at the start of the 1990s are resolutely continued with. To convince the people of its willingness to reform, the government starts with itself and brings about fundamental changes in the state apparatus. Ministries that have been superfluous since the privatisation drive of the 1990s are abolished; others are merged - for example, the four ministries responsible for energy supply; reducing the number of ministries from 46 to 15 or 20, as is the norm in OECD countries. Downstream authorities are accordingly reduced or streamlined.

The 'inspector raj' system is classified as "unreformable" by the government and consequently abolished. Instead, simple and transparent rules are introduced to monitor enterprises. From now on, enterprises must be certified to prove that they observe environmental and social standards. At the government's suggestion, Parliament lifts the labour laws and soon enacts new laws conforming to OECD standards.

Most State Governments implement agricultural reforms. New ownership structures are defined in clear, transparent land registers. Land can be bought and sold and can be rented and leased out. The Central and State Governments endeavour to modernise agricultural production and marketing and to set up labour-intensive industries in rural areas. In view of catastrophic infrastructure, education and health, the government dismantles existing regulations and is open not only to the private sector playing a major role in restructuring and expanding these sectors but also to obtaining FDI for this purpose.

India continues to exploit its competitive advantage in the information technology (IT) and software sectors but also addresses traditional problems such as illiteracy, rural backwardness and discrimination against women, tribals and Dalits. The public education system is radically reformed and guarantees free access to all. Private schools and universities as well as vocational training institutes significantly help improve levels of training and employability among large sections of the population. The government tries to be more transparent and efficient to accommodate the interests of citizens and improve the environment for enterprises and business of all sizes. The legal system and police force are reformed and the rule of law prevails in all walks of life.

An integrated and competitive agricultural sector is gradually developing in rural India. Farmers form loan, purchase and marketing cooperatives that foster ongoing improvement in the agricultural sector with regard to communication and services as well as transport, storage and marketing. Thus the producer's share of the retail prices for agricultural products, currently only one-fifth in India, approaches the international norm of one-third the share. Rising income levels in rural India slow down rural-urban migration, allowing the cities more time to prepare for the growing pressure of population.

In this scenario too, the hype comes to an end but is not followed by a catastrophe. Growth will not be as spectacular as in 2004 to 2007 but economic development will be more balanced and sustained. By 2020, India's GDP will increase by an annual average of 6 -7 per cent and not by 8 - 10 per cent. India will still be far from becoming a world power, but as a stable regional power it is a global player and has the opportunity to become a world power.

III.4 Between "hype-disaster" and the "big bang"

A number of interim levels are conceivable between the hype-disaster scenario and the big bang scenario. But India is walking a thin line. If the steps toward reform do not follow soon after the big bang (that is, partial and slow implementation instead of comprehensive and rapid), then an interim-level scenario would also tip over and produce similarly disastrous results. This danger is present because reforms do not depend solely on whether governments think they are necessary or not, but also on governments being able to implement them.

This is unlikely to be easy in India. The next elections too will probably produce a coalition with several parties like the current United Progressive Alliance made up of about a dozen parties. None of the national parties will obtain an absolute majority. So far there is little to show that the Bharatiya Janata Party (BJP) could succeed in resolving the contradiction between its appearance as a radical Hindu party and the necessity to appeal to broad sections of the electorate, which rules out a clear majority for the BJP. It seems equally unlikely that the gradual decline of the Congress Party that started several years ago could prompt internal party discussions about the necessity for restructuring so that the party once again becomes an option for the majority of voters.

In the foreseeable future, both parties will continue to be the most important national parties, yet will be unable to govern without the support of the numerous small, especially regional, parties. Therefore there will be enough veto players also in future government alliances who will stifle reform. Moreover, we can hardly expect the clientelism orientation of Indian politics to change. Issues specific to caste, religion, tribes and regions will continue to determine politics much more than discussions about programmes and reforms.

As the two large parties do not pursue radically different economic policies, it can be assumed that the process of reform started in 1991 will not be reversed even if there is a change of government. However, whether the extent and speed of the reforms can ensure that India develops towards a big bang scenario is questionable. Since 1991, reforms have been held up under both Congress-led and BJP-led governments, the last time being 2006 when the government suspended the privatisation of unprofitable public enterprises.

Given the limited scope for manoeuvrability in the implementation of reforms, it is to be expected that future Indian governments will not prioritise structural reforms but will look for the case-by-case solutions that are already an integral part of economic policy. Instead of pursuing a fundamental reform of labour and taxation laws that would facilitate country-wide investments and exports, the government is setting up SEZs. In contrast to the rest of the country, SEZs are ensured adequate electricity and water, a well-developed road network and easier administrative regulations. While the tax deficit caused by the SEZs is estimated at 0.9 per cent of the GDP, most studies claim that the 240-odd SEZs will have either limited or no macroeconomic benefits. But the political fallout is considerable because the creation of SEZs, each of which covers at least 1000 hectares, is usually fiercely resisted by the local population. Case-by-case solutions also foster discrepancy; while a few urban centres develop rapidly and are increasingly integrated into the global economy, entire regions remain stuck at the lowest level of development.

IV. Options for action open to German and European foreign policy

It is in the interest of Germany and the EU to exhaust all options that would enable India to meet its demographic, economic and social challenges. Should the most populous democracy in the world succeed in sustaining its economic growth, not only would India constantly reduce the number of poor that has swollen to over 800 million people over the last decades, but would possibly also contribute to peace and wealth in a conflict-ridden region and would create something of a counterweight to its authoritarian neighbour China.

Whether India in 2020 will come up with results that correspond to those of the big bang scenario in as many fields as possible, depends primarily on India itself. But Germany and the EU can offer to initiate political dialogue and can offer bilateral and multilateral cooperation in areas that go beyond global governance and security policy to include several other issues such as environment and energy, trade and business, labour and social policy, administration and the rule of law. As there is no common EU foreign policy, India prefers bilateral alliances with the important European countries, depending on the constellation of interests.

Conditions for greater cooperation with India in the foreseeable future are particularly good. For one, India's foreign policy since the end of the Cold War is driven far less by political and ideological motives than by economic ones. The political leadership is no longer satisfied to be leader of the Third World but strives to make India a world power. In order to ensure the high economic growth rate required here, India now vies for foreign investments and market access with other threshold countries, especially China. Second, the reorientation of India's foreign policy strategy is nowhere near complete. In the near future, the Indian government will continue to explore its options and scope for flexibility without tying itself down to partners or concepts. While India continues to strive for closer cooperation with the US, the sole superpower, it avoids all forms of unilateralism and will retain its multilateral approach in foreign policy in the years to come. This opens up options for Germany and Europe and their respective foreign policies should seize the opportunity, particularly in fields that have hitherto been neglected in favour of economic relations.

Science and education lend themselves particularly well to this context. Germany and India lack experts, particularly scientists and engineers. India has nowhere near the capacity required to accommodate its students in these fields; in Germany, in contrast, few students are interested in these subjects and hence seats are available in educational facilities. Nevertheless, only a handful of the 160,000 young Indians who study abroad each year, go to Germany. A reason for this reluctance is undoubtedly the language barrier. Other reasons include the lack of suitable postgraduate courses and the strict conditions that students must fulfil to obtain a work permit in Germany after graduation. The German government should make a concerted effort to improve conditions for students from India. It should also initiate talks with the Indian government on creating the legal conditions required for German universities to set up teaching and research institutions in India. A marked increase in student exchanges and a network of German and Indian scientists would constitute vital components of the cultural dialogue between the two countries.

The rule of law that percolates through all aspects of life and an efficient, people-friendly public administration are important areas in which Germany can offer to cooperate with its Indian partners. A burgeoning bureaucracy and the poor enforcement of rights and the law in India pose considerable problems that jeopardise the democratic system and economic development. Besides the natural sciences and engineering, it would therefore be expedient for Germany to also offer cooperation in the theory and practice of public administration.

The German government pursues the goal of creating equal opportunities for women and men in all fields of life. To this end it promotes organisations and projects in several countries and is greatly involved in numerous bodies of the EU, the Council of Europe and the UN. India faces the challenge of improving conditions for women and girls if it wants to become a world power. To achieve this, it must rapidly make up for lost ground in this field too and avoid the mistakes of other countries. Germany's proposals of how it could support India in its efforts to do so need to be better defined.

India, Germany and the EU share an interest in establishing an international order based on the principles of democracy, human rights, peace and security in which supranational institutions play pivotal roles. As is to be expected, India on the one hand and Germany and the EU on the other also have irreconcilable ideas, for example, in the matter of the Nuclear Non-Proliferation Treaty that India has not signed even though it opposes the proliferation of nuclear weapons. Yet, common values and mutual tolerance for different perspectives are viable conditions for the relationship between India and Germany and/ or the EU. Developing these relations, regardless of the scenario in which the partner sees itself in 2020, should continue to be the goal of German and European foreign policy towards India.

On the authors: Peter Gey is Resident Representative and Project Director of the New Delhi Office of the Friedrich-Ebert-Stiftung. Renate Tenbusch is Project Director and Matthias Jobelius Project Manager in the New Delhi Office of the Friedrich-Ebert-Stiftung.

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