

The high cost of doing business in India and the reform it demands

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In an interconnected world, geopolitical turmoils can have intended and unintended impacts on how the factors of production – land, labour, capital and enterprise – interact with each other. The impact on these interactions is not always direct. Systemic geopolitical risks can also take the form of negative externalities, indirectly affecting these interactions.

For instance, the global auto industry is undergoing a tectonic shift due to China's rare earth export restrictions. The restrictions are supposedly a retaliation to the United States' trade protectionist measures imposed on several trading partners including China. Multinational car manufacturers are reporting a potential delay and derailment in short and medium car production targets. Japan's Suzuki, USA's Ford and other European car manufacturers have reportedly shut operations, albeit temporarily, for some car models.

To mitigate the impact of such systemic geopolitical risks, businesses and governments both, independently and collectively, are exploring alternative strategies. For example, global car manufacturers responded to China's restrictions swiftly by lobbying governments to seek resumption of rare earth exports. Moreover, to reduce dependence on China's rare earth exports, car manufacturers are weighing options such as diversifying their supply chain and redesigning auto components which require low-to-zero rare earth inputs.

Government's too actively responded with policy instruments. For instance, the Indian government is considering a Production-Linked Incentive (PLI) scheme to establish domestic production and capacities. This is in addition to a proposed incentive scheme to encourage the recycling of critical materials in India. Collectively, the Indian government is reportedly in talks with some firms to increase the rare earth mineral stockpile.

In a globalised world economy, government interventions by one nation can indeed induce market distortions in another. The distortions are amplified when there are few domestic or international alternatives available. However, governments' holistic macro-level response often misses the nuances that shape complex and dynamic interactions between factors of production. Market distortionary instruments such as end-user conditions or country-specific-exports are not always government-induced.

Enterprises can also induce market distortions. For instance, a micro-Indian importer of PolyVinyl Alcohol (PVA – HS code) from five nations argues that PVA-manufacturers across the globe have been imposing Actual User Conditions (ACU). This means that some PVA manufacturers will supply only to those entities that use PVA in their production process. These conditions are not country-specific. However, many Indian PVA importers and traders, despite meeting other supplier re-

quirements, have been unable to import from those ACU-imposing PVA manufacturers.

In other words, market-distorting instruments, either imposed by nations or businesses, have the potential to influence market dynamics. By limiting a firm's market entry and challenging a firm's survival, the instruments adversely affect the availability of a diverse range of essential raw materials to importers, traders and other downstream industry users.

Besides market-distorting instruments, nuances in day-to-day business operations also influence factorial interactions. These operations could be regarding meeting daily banking needs, clearing customs or meeting challenges posed by a deficit in logistical infrastructure. All of this leads to an increase in business costs and raises a question about the ease of doing business in India.

Micro, small and medium enterprises (MSMEs) in India routinely complain about banking difficulties faced by them in accessing capital. An Indian importer said that while he had no difficulties in accessing capital from his banking partners – reflecting a broader economic trend reported by Niti Aayog about the credit share of micro and small enterprises increasing from 14% in September 2020 to 20% in September 2024 – there were other problems in the system.

The difficulties, the importer argues, were about daily banking operations. He described the communication lapse between customers and the bank's managerial staff as 'harassment in disguise'. *"After going back and forth with the junior, middle, and senior managers at the bank, I was so frustrated that I asked them to close my bank account,"* he said.

To add to this, there is an undefined increase in charges for banking and other financial services. *"Nowadays, Indian banks have a full menu of bank charges with a gradual increase of 5% a year. For exam-*

ple, if the Telegraphic Transfer charges were Rs 500 earlier, now it has increased to Rs 550-600. It is a huge cost for businesses," he said.

Most importantly, the rise in banking charges appears to come with no justification, transparency or accountability from the bank. He said, *"I see that a new trend is emerging in the banking system, wherein the banks, in fine print, make you sign on the dotted line that if any charges are levied by any bank officer for any reason, regardless of the percentage of charges, it will not be reversed under any circumstances."*

Clearing customs is another area of difficulty. India is known to have one of the toughest customs clearance systems in the world. As a result, business costs rise due to the time spent travelling to the landing port and explaining price differences – since the same product imported from different countries may be seen as undervalued at Indian ports - as well as due to additional financial expenses.

A delay in the release of imports could lead to detention and demurrage charges being borne by the importing enterprise. For instance, a 40-foot container could cost businesses INR20,000 - INR25,000 per day in detention and demurrage charges alone.

Businesses in India also face various types of logistical infrastructural challenges. A crumbling infrastructure in the form of pot-hole filled roads and long delays at toll booths has been a problem for decades. To compound matters for businesses particularly engaged in international trade, container imbalance and poor port logistics and poor handling of cargo at ports, has been adding to costs.

Additionally, poor port logistics that are unable to handle heavy traffic or port congestion do not help. *"Sometimes it takes up to four days for a container to go to the yard because the port congestion is so high. Now the shipping yard gives you two days free, but if your container does not ar-*

rive within the stipulated two free days, they cannot do anything. They will start charging you. Due to port congestion, which is beyond our control, we are still required to pay ground rent to the yard company. This, even though we have not utilised the space at all. All this is done systematically and electronically. You cannot do anything about this.” Financially, port congestion can lead to “detention and demurrage charges from Rs 8,000-10,000. Then it exponentially increases to Rs 20,000 in week two, Rs 40,000 in week three, going up to Rs 80,000/day.”

While global and regional geopolitical crises affect domestic trade, the key to reducing their impact lies in a country’s eco-

nomie resilience. The Indian government, though late to act, has started implementing macro- and micro-economic policies in this area. However, the expected economic benefits from policy transmission continue to remain muted in India.

To unlock India’s manufacturing prowess, the Indian government needs to go beyond the obvious variables and respond on a war footing with policies that enable and facilitate optimal factorial interactions. Perception management can take India only so far. Strengthening the domestic environment is key to making India a lucrative market.

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