



## A CHANGING INDIA'S OPPORTUNITIES FOR THE U.S.

### INTRODUCTION

Americans have been encouraged by India's policy changes since Indian Prime Minister Rajiv Gandhi assumed office after the assassination of his mother, Indira, in 1984. He has begun fundamental reforms to turn India away from its socialist economy and openly is calling for closer Indo-U.S. economic ties. Trade and investment activity between the two nations already has increased dramatically. The U.S. has responded positively to Gandhi's economic liberalization by itself promoting increased trade and direct investment.

Despite improvement on the economic front, Indo-U.S. relations remain very cool in other areas. There is political tension between the two countries, for example, because India is angered by Washington's commitment to strengthen Pakistan's security, as required by the 1959 Mutual Defense Treaty. U.S. concerns for Pakistan have been heightened, moreover, because of the serious threat now posed by the 150,000 Soviet occupation troops in neighboring Afghanistan. India, however, continues to view Pakistan as a primary foe. The two countries have fought three wars since their bloody separation in 1947, when Great Britain granted independence to the subcontinent.

Gandhi has yet to extend his reforms to foreign policy. Virtually alone among nonsocialist states, India refuses to condemn the Soviet invasion of Afghanistan, even though many Indians privately admit that the growing Soviet involvement in South Asia is not in their country's interest.

With India in flux, the Reagan Administration should design a new strategy for dealing with New Delhi. The goals of this strategy should be to persuade New Delhi to take a stand opposing the Soviet invasion of Afghanistan, foster improved Indo-Pakistani relations, promote South Asian regional cooperation, prevent nuclear proliferation in the region, encourage India to continue economic liberalization, and expand Indo-U.S. economic ties. Ultimately, Washington should try to encourage India to reverse its pro-Soviet tilt.

Specifically, the U.S. should make clear to New Delhi that American military assistance to Pakistan is essential, given the threat posed by Soviet occupation troops in neighboring Afghanistan, and should stress that a weakened Pakistan eventually could threaten India's security. India should be reminded that massive military aid to Pakistan will end when the Afghan crisis is resolved and that India thus should press the Soviets for withdrawal of their troops.

The U.S. government should take steps to improve Indo-U.S. economic relations by allowing sales of some American high technology goods, which have been prohibited in the past because of possible military applications. The U.S. also should call on New Delhi to reform further its import restrictions, foreign investment controls, public industrial sectors, and tax structure. To assist in India's adjustment to these changes, the U.S. should be prepared to offer New Delhi economic assistance.

While the goals of this new strategy clearly will serve U.S. interests in South Asia, they also will benefit India. The brutal Soviet action against Afghanistan and its attempts to intimidate Pakistan reveal the threat that Moscow poses to the entire region. A concerted effort to end Soviet incursions in South Asia and to ease the historic animosities between Pakistan and India will do much for regional independence and stability.

Furthermore, the Soviets have little to offer India in trade. By contrast, expanding Indo-U.S. economic relations could help India navigate its transition in which it must discard restrictive policies that have inhibited its economic development. The U.S. will in turn benefit from expanding economic access to India, the world's second largest market.

## INDIA, PAKISTAN, AND THE U.S.

Tensions between the U.S. and India are deep-rooted and span most of India's nearly 30-year history as an independent nation. At times, Indian leaders seemed to be cultivating the image as spokesmen for anti-Americanism. They routinely excoriated the U.S. at the United Nations and other international bodies. They lectured the U.S.

endlessly about the evils of the U.S. policy of containment and ridiculed the massive U.S. foreign aid and foreign investment programs for Third World nations as "American imperialism." For years, when it came to attacking U.S. policy, Indians could be expected to be at the forefront. It was a posture which the Soviet Union predictably endorsed and encouraged.

When the U.S. concluded a mutual defense treaty with Islamabad in 1959 and, a decade later, began to improve relations with Beijing, India feared the formation of a loose U.S. alliance with its two greatest foes, Pakistan and China. It probably was this which prompted New Delhi in 1971 to sign a friendship treaty with Moscow. Together with rapidly expanding economic and military cooperation, this seemed to make India a de facto Soviet client.

One of the key contentious issues in Indo-U.S. relations today is Washington's military assistance to Pakistan. The 1979 Soviet invasion of Afghanistan dramatically reshaped U.S. policy toward South Asia. Directly threatened by the Soviet action, Pakistan broadened its cooperation with the U.S. in such key areas as efforts to negotiate a Soviet withdrawal, providing refuge for more than two million Afghans who had fled their war-torn country, offering safe haven for Afghan freedom fighters, and distributing U.S. supplies and arms to them. In response, the Soviet Union has attempted to intimidate Pakistan by conducting regular military reconnaissance flights over its territory and mounting occasional air strikes against Afghan resistance bases in Pakistan.

In 1981 the Reagan Administration began an aid program to Pakistan that by the end of 1987 will total more than \$3.2 billion. This makes Pakistan the fourth largest recipient of U.S. aid after Israel, Egypt, and Turkey. Ronald Reagan has made it clear that U.S. military aid to Pakistan is in direct response to the Soviet invasion of Afghanistan. It is not designed to mold a close, long-range strategic partnership with Islamabad. Explains a U.S. analyst: "All the U.S. expects from the Pakistani military is an enhanced Pakistani capacity to protect Pakistan's territory under stressful conditions...anything remotely resembling an old-fashioned military alliance is unacceptable to Pakistan and has not been sought by the U.S."<sup>1</sup>

Having fought three wars with Pakistan since 1947, India has been harshly critical of U.S. military assistance to Islamabad, claiming that such aid enhances Pakistan's offensive capability against India. But with a 3 to 1 edge in air power, 2 to 1 advantage in ground forces and a clear superiority in naval forces, India retains a distinct

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1. Leo E. Rose, "United States and Soviet Policy Toward South Asia," Current History, March 1986, p. 99.



advantage in the South Asia military balance. The U.S. Department of Defense stresses that, even with U.S. military assistance, Pakistan's military forces have not acquired "the size or sophistication to pose an aggressive threat to India."<sup>2</sup> The Soviet Union predictably has joined India in accusing the U.S. of fueling an arms race in South Asia. Yet over the last three years, Moscow has supplied India with twice the number of weapons that the U.S. has transferred to Pakistan.

## INDO-SOVIET RELATIONS

A second critical issue in Indo-U.S. relations is New Delhi's warm bond with Moscow. Economic, military, and cultural relations between India and the USSR have been extremely close since the two countries signed their 1971 friendship treaty. By offering low prices on major weapons systems such as fighter aircraft, and warships, technology transfers, and generous licensing agreements, the Soviet Union has become India's major source of military hardware. Soviet Mig-21 and Mig-27 fighters are being produced under license in India, as is the advanced T-72 tank. Last year, Moscow agreed to supply India with the state-of-the-art Mig 29--before the new warplane had been fully deployed in Warsaw Pact nations. India has reportedly ordered 40 of these sophisticated jets. More than 80 percent of all Indian weapons are Soviet-made or produced in India with Soviet permission.

Though the Soviet Union is India's second largest trading partner after the U.S., economic relations may have reached their zenith. As India attempts to modernize its economy and attract foreign high technology, the Soviet Union has less to offer India compared with the West. Financial transactions between Moscow and New Delhi, moreover, are limited to Russian rubles, which are accepted as payment almost nowhere in the world. The result: India's huge trade surplus with the Soviets can be spent only in the Soviet Union.

Moscow has an elaborate propaganda network within India. In New Delhi alone, at least 500 Soviet officials work in various capacities. The Soviet Embassy publishes and distributes 48 publications in twelve of the languages spoken in India, while the Soviet Information Agency systematically supplies material to Indian media. Three Soviet radio stations broadcast in eight Indian

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2. Statement of Deputy Assistant Secretary of Defense for Near Eastern and South Asian Affairs Kenneth D. Burns before the House Subcommittee on Asian and Pacific Affairs, February 28, 1985.

languages. And in the past two decades, more than 400 Soviet university textbooks have been published in India.<sup>3</sup>

India's close and perhaps deepening relationship with the Soviet Union belies New Delhi's self-proclaimed commitment to the nonaligned movement and self-sufficiency. Still, there seems to be growing Indian concern over Indo-Soviet trade arrangements and Moscow's invasion of Afghanistan. Some Indians admit that "the scales today in the field of Indo-Soviet relations are heavily tilted against us....It imposes unacceptable strategic obligations and hamstrings our foreign policy."<sup>4</sup> India sides with the Soviet Union against the U.S. on almost every issue at the United Nations and other international bodies. India even voted against the United Nations resolution that merely implied that Soviet forces should be withdrawn from Afghanistan. This passed the U.N. by a vote of 122 to 19, with 12 abstaining. New Delhi is the only major noncommunist nation to have good relations with the Soviet puppet regime in Kabul. And New Delhi abstained on the U.N. resolution calling for the withdrawal of the pro-Soviet Vietnamese forces from Cambodia, which passed 114 to 21 with 16 abstaining.

At the United Nations, in fact, India is one of the most persistent anti-U.S. members. Last year, India supported the U.S. in U.N. votes only 8.9 percent of the time. This was not far from Libya's 6.9 percent level of support or Cuba's 6.2 percent support for the U.S. and almost exactly the same as Nicaragua's 8.4 percent support. Only fourteen countries at the U.N. last year backed the U.S. less than did India. In fact, Washington won more support from Mongolia, East Germany, the USSR, and Uganda than from India.

#### RAJIV'S ECONOMIC BREAKTHROUGH

One bright spot in Indo-U.S. ties is economics. Gandhi is nudging India away from the socialist policies of his mother and grandfather, Jawaharlal Nehru, who was Indian Prime Minister from 1947 to 1964. Gandhi also has begun dismantling heavy government regulation and bloated bureaucracies. He appears impressed by the rapid economic growth of his free market Asian neighbors such as South Korea, the Republic of China on Taiwan, and Sri Lanka. He has called for free market reforms to utilize better India's considerable natural resources and huge pool of manpower. By this he hopes to accelerate

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3. Vinod Ghildiyal, "Infiltration in India's Mass Media: An Analysis of Soviet Strategies," February 1985, p. 1.

4. Rama Swarup, "Indo-Soviet Military Connection: Long Term Security Implications," East-West Centre, New Delhi, 1984, p. 13.

India's economic growth, which has averaged 3 to 4 percent annually in the past three decades. This is a very mediocre performance for a developing nation.

Successful execution of India's new economic policies can serve as a model for other Third World countries and can reinforce the free market efforts launched recently by Sri Lanka, Pakistan, and Bangladesh. More important, if India's markets expand and are opened to foreign goods, India can become an engine of growth for the entire region.<sup>5</sup> One of the economic tragedies of the area since World War II has been the thick and high wall of protection with which India has barred foreign products. This has stunted economic growth and kept living standards dismally low for hundreds of millions of South Asians.

Gandhi's five-year economic plan, unveiled in March 1985, launches a wide-ranging economic liberalization program. Freed from tight licensing restrictions, for example, are two dozen industrial sectors, including oil exploration, telecommunications, electronics, industrial machinery, and petrochemicals. Antitrust restrictions have been eased. In the past, industrial companies with assets of \$15 million were required to seek approval for expansions, but the recent reforms have raised this limit to \$75 million. And the government has abolished high import duties for computers and opened the computer and electronics industries to foreign investment.

While foreign investors unwisely are generally limited to a 40 percent equity participation in Indian enterprises, this level can be as high as 100 percent if all the goods produced by the venture are exported. Furthermore, exceptions to the 40 percent limit are selectively granted for ventures involving high technology transfers. Foreign firms have no problem repatriating their profits.

American direct investment in India increased from \$7.5 million in 1984 to \$33.2 million last year. U.S. investment in India now totals over \$500 million. Even IBM, which pulled out of India in 1978 when denied majority equity in its operations there, is now considering the sale of computers to India as well as a software export tie-up with Indian firms. IBM's renewed interest is in response to India's more favorable trade and investment atmosphere. Gandhi's goal is to spur economic growth and modernization by attracting foreign investment and technology transfers.

Gandhi's program also has reduced personal and corporate taxes dramatically. Last year, the top personal income tax rate was reduced

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5. For an overview of free market reforms in South Asian nations, see James A. Phillips, "Disillusioned with Socialism, South Asia Experiments with Free Enterprise," Heritage Foundation Asian Studies Center Background No. 42, March 12, 1986.



from 61 percent to 50 percent, and the maximum corporate tax rate declined from 55 percent to 50 percent, with assurances from the Indian government that these new rates will remain in effect for at least five years. Also, the 12.5 percent income tax surcharge and the estate duty were abolished, and wealth taxes were lowered. Increased business activity resulting from these tax breaks has produced a 25 percent growth in tax revenue during the first half of the current fiscal year.

There are other indications that Gandhi's reforms are beginning to stimulate the economy. India's Gross National Product in fiscal 1986 grew 4 percent, compared to 3.6 percent in 1985, while annual industrial output growth during that same period increased from 5.8 percent to 6.5 percent. Gross profits of India's 83 largest companies in 1985 increased 18.3 percent over 1984 levels. During the first five months of this year, India's total imports rose 25 percent. The Indian stock market is booming once again, and the purchase of securities rose 50 percent during the fiscal year that ended in March 1986. Supply-side economic principles are working in India.

#### RESPONDING TO A CHANGING INDIA

India's changing economic policies offer opportunities for strengthening Indo-U.S. economic relations. Last year, U.S. exports to India totalled \$2.4 billion while imports from India amounted to \$1.6 billion. The U.S. mainly sells India fertilizers, oil and gas exploration equipment, and chemicals and it buys oil, textiles, and gemstones. Although the U.S. is India's largest trading partner, India ranks 24th on the U.S. trading list. Since Gandhi's assumption of power, however, American businesses are taking a keener interest in expanding trade with India. According to Dr. Caroline Beeson, Executive Director of the India-U.S. Business Council at the U.S. Chamber of Commerce, the number of U.S. firms in the Council's membership has increased 100 percent over the last year.<sup>6</sup>

A foundation for closer Indo-U.S. economic relations was established in November 1984 by the signing of a comprehensive Memorandum of Understanding (MOU) between Washington and New Delhi. The MOU is designed to ease restrictions on the transfer of U.S. high technology products to India. Prior to the MOU, the U.S. barred a number of high-tech transfers to India because of the possibility that they had military or nuclear applications. While the MOU stipulates close U.S. review of Indian high-tech requests, more than 60 of these, which had been pending, have now been approved according to a State Department aide. As such, the flow of U.S. technology to India has

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6. Interview with The Heritage Foundation, June 18, 1986.

increased significantly. Last year India purchased \$1.3 billion in high technology goods from the U.S., twice as much as the previous year.<sup>7</sup> These goods included main frame computers, avionics, and advanced communications equipment.

This year's most significant technology transfer has been Control Data Corporation's sale of \$500 million in advanced computers to India. This project could eventually result in \$2 billion in direct and indirect business for Control Data. Commenting on the package, a Reagan Administration official said it would give the U.S. "the inside track over the next decade in the computerization of India".<sup>8</sup>

Understandably in light of the very close Indo-Soviet relations, the most sensitive area of Indo-U.S. trade involves defense items or products with possible military applications. In the past, U.S. military sales to India have been virtually nonexistent, except in such rare and distant cases as when China invaded disputed territories in northern India almost a quarter century ago. Indicative of the changing Indo-U.S. relations, however, the Reagan Administration recently assured New Delhi that the U.S. will "give serious consideration to requests which India may wish to make for U.S. military and dual-use equipment."<sup>9</sup> This is likely to lead to cooperation in aircraft technology. The U.S. recently approved the sale of sophisticated General Electric jet engines to India. The Pentagon, meanwhile, is studying the possibility of helping India design and produce its own fighter aircraft.

#### NUCLEAR PROLIFERATION IN SOUTH ASIA

Nuclear proliferation in South Asia is a central issue in U.S. relations with New Delhi. India exploded a nuclear bomb in 1974, but does not seem to have produced additional weapons. Yet India continues developing its nuclear technology and refuses to sign the nuclear nonproliferation treaty. New Delhi argues that it faces a significant threat from China and Pakistan.

There are growing concerns that India may be developing a nuclear weapons missile delivery system. Six years ago, for example, India launched a satellite. Three years later, it successfully tested a rocket that could be converted to an inter-continental ballistic missile (ICBM) with a range of over 3,000 miles.

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7. India Express, New Delhi, February 8, 1986, p. 1.

8. The Wall Street Journal, February 2, 1986, p. 25.

9. Ibid., Statement of Deputy Assistant Secretary of Defense Kenneth D. Burns.



Since India's 1974 nuclear bomb test, Pakistan has developed its own nuclear technology program, although it is uncertain whether Islamabad has exploded a nuclear bomb. The Pakistan nuclear program prompted the Carter Administration to halt military assistance to the country in 1979. The so-called Symington Amendment prohibits arms sales to nations engaged in nuclear weapons development. By 1981, however, Congress waived the Symington Amendment to allow Reagan to aid Islamabad in response to the threat posed to Pakistan's security by the Soviet invasion of Afghanistan. U.S. military shipments to Pakistan were resumed; the 1982-1987 aid package amounts to \$3.2 billion.

There are strong suspicions that Pakistan is engaged in covert efforts to obtain nuclear weapons technology. In 1984, for example, three Pakistanis were arrested in Texas and charged with attempting the illegal export of high-speed electronic switches that could be used to trigger a nuclear explosion. Beijing long has been thought to aid Pakistan's nuclear weapon's program. India, therefore, remains very nervous about Pakistan's activities in this area and criticizes the U.S. for not doing more to curtail Pakistani atomic research.

## CONCLUSION

In principle, Indo-U.S. relations should improve dramatically under Rajiv Gandhi. This is already occurring in trade and investment. Significant improvement in political relations, however, seems very doubtful unless India begins to change its basic policies relating to the Soviet Union and its invasion of Afghanistan.

There are a number of steps that the Reagan Administration could take to strengthen Indo-U.S. economic ties and to encourage New Delhi to reconsider its pro-Soviet foreign policy. Among them:

- 1) Encourage the U.S. businesses to explore trade and investment opportunities with India and praise the economic reforms of Gandhi, urging him to further liberalize. Specifically, India should continue to lower tariff and nontariff barriers to imports and ease restrictions on foreign investment. These will spur domestic competition and improve the efficiency and productivity of Indian industries. New Delhi should consider devaluing the rupee to improve the competitiveness of Indian exports. A growing trade deficit could create public and private sector pressures favoring renewal of market restrictions. If the U.S. were to increase economic assistance, it would help India through this transition period as it opens its markets to greater competition and aims at higher growth rates.

India also should check the growth of its huge and largely inefficient state-run industries and consider appropriate

privatization measures. A good place to start is the energy industry, which currently absorbs the largest share of government expenditures.

India's tax reforms, which have already proved beneficial, should be extended. Simplifying the maze of special tax rules will increase administrative efficiency. Also, India's tax structure should be made more equitable. Agricultural incomes continue to be virtually untaxed, and salaried workers bear most of the tax burden. India should broaden its revenue base and allow for continued reduction of average tax rates.

2) Ensure the smooth transfer of U.S. technology where appropriate. Reagan has made it clear that the U.S. will consider India's requests to buy technology that may have military applications. Those involved in the review process should expedite evaluation of India's requests.

3) Foster improved Indo-Pakistani relations. Last year, a half dozen meetings between Prime Minister Gandhi and Pakistan President Zia ul-Haq had encouraging results. The two leaders pledged not to attack the other's nuclear facilities and agreed to participate in the new South Asia Regional Cooperative Association. The U.S. should urge the continuance of this dialogue.

4) Emphasize to India that U.S. military assistance to Pakistan is designed to bolster that country's security in the face of a clear threat from the Soviet Union and also to form a part of U.S. efforts to aid Afghan freedom fighters and to press for the withdrawal of Soviet forces from Afghanistan. The U.S. should stress that, while the weapons conceivably could be used against India, Soviet domination of Pakistan would pose a much more serious danger to New Delhi.

5) Continue pressing India on the Afghanistan issue. Indians admit privately that they oppose the Soviet invasion. Gandhi should endorse this view publicly. At the same time, the Indian government should use its good offices to urge Moscow to withdraw its troops from Afghanistan.

6) Step up pressure on Pakistan to cancel its nuclear weapons development program.

7) Continue efforts to stop Sikh terrorists from using the U.S. as a base of operations against India and Indians. New Delhi was very grateful when the FBI uncovered an assassination plot against Rajiv Gandhi during his visit to the U.S. last year.

U.S. strategic goals in South Asia are to secure the withdrawal of Soviet troops from Afghanistan, check the growth of Soviet influence in the region, prevent nuclear proliferation, and encourage the development of South Asian free market policies. Pivotal to the realization of these goals is the reduction of Indo-Pakistani

tensions. Better relations between New Delhi and Islamabad would for the first time open the door to effective regional cooperation among South Asian nations and thus reduce the need for political, military, or economic dependence on the Soviet Union.

Improved Indo-U.S. relations also would serve these goals and promote the national interests of both countries. Closer cooperation between the world's two largest democracies would work to inhibit the Soviet Union's attempts to expand its influence in South Asia and elsewhere.

The mutually beneficial nature of U.S. trade relations with nations such as Singapore, Hong Kong, the Republic of China on Taiwan, and South Korea is well known. Expansion of New Delhi's economic liberalization program together with closer Indo-U.S. economic ties will bolster the efforts of India and its South Asian neighbors to achieve growth rates rivaling those of other Asian "economic miracles."

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