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Promoting U.S. and Indian Prosperity Through Freer Trade and Economic Liberalization

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The establishment of the U.S.–India Trade Policy Forum in 2005 was an important step for improving trade and economic ties between the U.S. and India. With the conclusion of a nuclear agreement between the two countries, many expect a flood of investment and trade deals for U.S. firms interested in entering India's growing market. At the end of the day, it is the financial potential, associated risk, and ease of making a deal that drive foreign investment and trade. Obstacles to trade and investment, such as corruption and a maze of bureaucracy and regulation, will block greater economic engagement with even America's closest allies. Policymakers in both America and India must understand the opportunities and challenges that could either aid or hinder the translation of growing goodwill into economic gains for both countries. Advancing freer trade and investment policies is a key part of improving the two countries' relationship and spreading prosperity.

India's Bustling Economy. India is growing fast. Between 2001 and 2005, India experienced average annual GDP growth of over 6 percent. The International Monetary Fund (IMF) forecasts that India's economic expansion continued in 2006, with its GDP growing by 8.3 percent. The Indian economy should continue growing at around 7 percent for the next two years, driven by strong performance in India's services and industry sectors, according to the IMF.[1]

The strength of India's services industries and the income they have generated have resulted in the creation of a growing middle class with higher levels of disposable income for consumer goods. Market-oriented reforms initiated in the early 1990s and continuing fitfully today are at the heart of India's current economic boom. Slow progress in liberalizing foreign investment, reducing tariffs, reforming the financial sector, privatizing state-owned firms, adopting more prudent fiscal and monetary policies, and improving the protection of intellectual property rights has helped bolster economic growth, promote trade, and attract foreign investment.

As a result of these expanding trade and investment opportunities, America has become India's largest trading partner. In 2006, the U.S. imported $21.8 billion worth of goods from India, consisting mainly of apparels, textiles, gemstones, and jewelry. In the same year, U.S. exports of aircraft, business and telecommunications equipment, gemstones, chemicals, and other goods to India were valued at almost $11 billion, making India a top destination for U.S. goods.[2]

The U.S. is investing more in India, with total direct investment estimated at more than $5 billion from 2005 to 2006, making the United States India's largest investment partner.[3] India's government controls and monitors the inflow of foreign direct investment (FDI), but generally welcomes FDI in certain priority sectors, including power generation,

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telecommunications, ports, roads, and mining. Moreover, firms such as Microsoft, Dell, and Intel have announced large investment projects in India, taking advantage of its supply of low-cost, highly skilled labor to staff new research and development centers and technical support operations.

The Future of India's Economy. For India to sustain high growth in the longer term and generate economic opportunity for the quarter of its population that still lives in poverty, it will need to implement further reforms to attract more investment. For all the progress that India has made to date, barriers to future economic prosperity remain.

In general, infrastructure remains inadequate to support growth; bureaucratic regulations, rules, and procedures are numerous and non-transparent, adding to the cost of doing business; privatization proceeds too slowly, limiting the economic gains that flow from a more competitive environment; labor laws are restrictive and impede job creation; tariffs and non-tariff barriers remain prohibitive, denying consumers and firms access to a wider variety of less expensive imports; fiscal deficits are high and crowd out private investment; foreign investment and ownership remain restricted and controlled; corruption is pervasive; and the protection and enforcement of intellectual property rights is weak.

India's score in The Heritage Foundation/*Wall Street Journal 2007 Index of Economic Freedom* reflects these policy issues. With a score of 55.6 percent, India is the 104th freest nation in the world and 19th out of the 30 countries making up the Asia-Pacific region. While India's score has improved 3.3 percent over the last year, slow and inconsistent reform continues to hold it back from its true economic potential.

The decentralization of economic power from the federal government to state governments has resulted in sharply divergent levels of economic performance and opportunity across the country. Some states, such as Tamil Nadu and Maharashtra, have embraced economic liberalization, resulting in increased investment and improved living standards. Other states have shunned economic reform, further entrenching protectionist policies. Loosening central control of economic policy has spurred state-level reform and competition; however, it has also resulted in greater levels of regulatory inconsistency and additional red tape.

Until these barriers to trade and investment are addressed and the burdens of regulation and bureaucracy are reduced across all states, the Indian economy will remain unable to tap into its real economic potential, leaving development and living standards at a lower overall level and improving more slowly than need be. The state governments should adopt the open-market policies of the highest performers, and the federal government should ensure that state-level regulations are generally consistent to reduce the cost of doing business within India and with India's trade partners.

Freeing Trade. India has the opportunity to advance a trade and investment liberalization program through its bilateral economic forum with the U.S. and through multilateral negotiations within the World Trade Organization (WTO). Initial meetings of the Trade Policy Forum have been successful, with the United States and India agreeing to a number of actions aimed at resolving the most contentious bilateral trade issues, including:

- Cooperation on an action plan and provision of technical assistance to promote a more robust intellectual property rights regime in India;
- Initiation of a Bilateral Infrastructure Investment Program that will focus on identifying investment opportunities, incentives, and challenges in key infrastructure sectors;
- Agreement on resolving several sanitary and phytosanitary (SPS) issues that restrict international trade; and
- Continued discussions on tariff structures defining trade in specific sectors.

Even more critical to India's long-term economic potential is progress in the Doha Development Round of trade negotiations in the WTO. As a leader

1. International Monetary Fund, World Economic Outlook Database, September 2006.
2. U.S. Census Bureau, Foreign Trade Statistics, at *www.census.gov/foreign-trade/balance/c5330.html#2006* (February 15, 2007).
3. U.S. State Department, "Background Note: India," December 2006, at *www.state.gov/r/pa/ei/bgn/3454.htm* (February 20, 2007).

of the G-20 group of developing nations, India refuses to negotiate trade cuts without developed countries' commitment to deep concessions on subsidies and market access for agriculture products. India's government worries that competition from Chinese factories and American farms represents too great a threat to its economy. But protectionism is no answer to these worries.

As part of a broad package of economic reforms, freer trade would help bring needed investment in infrastructure and other sectors and promote India's diversification out of less competitive sectors. Freer trade would bring India's consumers a wider variety of cheaper products, helping them stretch their incomes further than before. Freer trade would promote greater efficiency and productivity, advance longer term economic growth, and help spread the wealth and opportunity generated from that growth across more of India's workers, lessening the pervasiveness of poverty.

Trade liberalization alone is not enough to promote economic opportunity and prosperity in India. Effective reforms to labor, investment, regulatory, and other policies are also needed to improve economic prospects for the rich and poor alike. While it may seem a politically daunting task to expand upon the current pace of reform, India will benefit in the long run by opening markets quickly.

While there is a short-term adjustment cost associated with dismantling trade and investment barriers, the long-term benefits far exceed that cost. India should not only embrace freer trade on a bilateral level, but also globally. India should be a leader in encouraging global trade negotiations, not helping them fail.

Conclusion. An improved political climate is not enough to break down the many barriers to economic activity between the U.S. and India. However, stronger political ties have translated into achieving greater progress in official two-way discussions focused on addressing bilateral economic concerns. While the World Bank, the IMF, and other institutions have applauded India for implementing economic reforms, more are needed. Continued progress, regular official dialogue on promoting stronger economic ties with the U.S., and positive contributions to multilateral trade negotiations should lead to the dissolution of the obstacles to greater economic opportunity for Indians. The result would be a higher standard of living for both American and Indian entrepreneurs and consumers.

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