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Trade and Investment Are Key to Strengthening U.S.–India Relations

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In the coming years and decades, the strategic interests of the United States and India are highly likely to become increasingly intertwined. Both sides want democracy to spread and thrive, and both seek to contain terrorism and counterbalance the downside security risks in the rapid rise of China. Stronger economic ties are essential to developing a relationship that is deep and resilient enough to support these objectives.

Growing Bilateral Trade

Making the most of U.S.–India trade and investment linkages has not been easy. Until the early 1990s, India's economy was closed. Average tariffs exceeded 200 percent, non-tariff barriers were extensive, and foreign direct investment (FDI) was largely blocked.

Economic liberalization in 1991 changed this. India's ratio of bilateral trade to gross domestic product (GDP) has increased from 15 percent in 1990 to 53 percent in 2013. Average non-agricultural tariffs have fallen below 15 percent, quantitative restrictions on imports have been largely eliminated, and foreign investment norms have been relaxed in a number of sectors, such as defense, auto parts, and insurance. As a result, despite some continuing trade frictions, total trade in goods and services between the U.S. and India has grown five-fold since the turn of the century to approximately $100 billion.

Trade Friction

Although India has steadily opened up its economy, the *2014 Index of Economic Freedom,*[1] published by The Heritage Foundation and *The Wall Street Journal,* ranked India a dismal 142nd in both trade freedom and investment freedom. India's average tariff rate is 7.2 percent, and non-tariff barriers, including tariff-rate quotas on corn and dairy imports, have driven up domestic prices. At 30 percent to 40 percent, India's average agricultural tariffs are among the highest in the world.

There are many bureaucratic barriers to foreign investment. For example, foreign banks are not permitted to own more than 5 percent of a private Indian bank's assets without approval by the Reserve Bank of India. Among the seven new foreign banks that opened branches in recent years, none were from the United States. India is also one of the few countries that practically bans foreign investment in retail trade.

Trade figures indicate why the U.S. has become restless with India. While the U.S. has run a persistent trade deficit in goods with India, the deficit has increased dramatically in recent years, rising from $3 billion in 2009 to $19 billion in 2013. Trade in private services with India (exports and imports) totaled $30 billion in 2012 (the latest data available). The U.S. service trade deficit with India was $7 billion in 2012. In 2013, India was the 18th largest exporting market for U.S. goods, while the U.S. was the 10th largest export market for India. Although

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trade deficits really do not matter in the overall economic scheme of things, they matter to politicians in Washington.

In recent weeks, there have been signs that bilateral trade frictions are beginning to ease. In November, the United States and India held their first round of formal trade talks in four years. This followed on the heels of a successful U.S. push to overcome unrelated Indian objections to the $1 trillion landmark Trade Facilitation Agreement (TFA)—the first multilateral agreement to be concluded since the World Trade Organization was created 20 years ago. If eventually ratified, the TFA will reduce the costs and administrative burdens associated with moving goods across borders. This could be a game changer in India, where customs officials generally require extensive documentation, inhibiting the free flow of trade and causing lengthy processing delays.

The Next Steps

The U.S. and India should quickly build on this recent momentum by pushing:

- **A bilateral investment agreement (BIA).** The U.S. should set a firm date to pass a BIA with India—something both have been working on for a decade. The foreign investment ownership ceilings placed on many Indian sectors are too low to lure outside investment, which would lead to corporate restructuring.

- **Foreign direct investment.** FDI is the centerpiece of Prime Minister Narendra Modi's economic reforms, yet thus far he has liberalized foreign ownership shares in only the defense and insurance sectors (49 percent each). Up to now, India has liberalized a large number of export-oriented manufacturing sectors, but only a limited number of service sectors because foreign service firms are more likely to compete with local Indian companies. To show he is serious about a BIA with the U.S. and FDI in general, Modi should liberalize ownership shares in the service sectors, such as transportation, finance, or even retail.

- **APEC membership.** In his last two years in office, President Barack Obama should support India's entry into the Asia–Pacific Economic Cooperation (APEC) and encourage Modi to make the economic reforms and trade liberalizations necessary to make APEC a positive force for India.

- **Indian tax enforcement reform.** India's tax laws deter foreign investors. The question is whether the new administration can reverse India's notoriously aggressive tax treatment of foreign investors. Global investors are watching the Vodafone case very carefully—Vodafone is accused of owing $2 billion in back taxes to Indian authorities. A favorable ruling for Vodafone would go a long way in assuaging foreign investors.

- **Copyright enforcement.** India and the U.S. share enormous common interests in copyright enforcement. As Patrick Kilbride, executive director of the U.S. Chamber of Commerce Global Intellectual Property Center, has noted, both countries are invested in seeing their filmmaking industries thrive: Hollywood in the U.S. and Bollywood in India. Focusing on this trade issue first could build momentum in more problematic areas.

Conclusion

The U.S. is right to have focused so closely on India during the Bush and Obama Administrations. Given its size and potential economic growth rate, India holds the greatest potential to influence regional dynamics in a way favorable to American interests in peace, stability, liberty, and prosperity. Over the long term, the sort of U.S.–India relationship most conducive to these ends must have a strong basis in economic freedom.

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1. Terry Miller, Anthony B. Kim, and Kim R. Holmes, *2014 Index of Economic Freedom* (Washington, DC: The Heritage Foundation and Dow Jones & Company, Inc., 2014), http://www.heritage.org/index/.