India-US Relations: The Trade Factor

Teresita C. Schaffer

The economic transformation of India after 1990 was one of the major enablers of the new U.S.-India relationship that started to take shape about a decade later. It was not the only one. The end of the Cold War made both the United States and India open to the idea of crafting a new type of strategic relationship, and made possible a serious relationship on security issues. The emergence of a growing Indian-American community as the most prosperous ethnic group in the United States brought into the ranks of politically active Americans a group that was naturally – and passionately – interested in India. But India's accelerating growth and increasing engagement with the international economy have to a large extent set the tone for the expanding relationship.

India's economic success has affected the way both governments, and the people of both countries, look at one another. India was one of the fastest-growing countries in the world during much of the decade after 2000, with GDP growth topping nine percent for three straight years. This contrasted sharply with Americans' habit of looking on India as an economic laggard, the land of unfulfilled potential. India's trade was growing faster than its economy – imports and exports, which had been 11.4 percent of the economy in 1980/1, had grown to 29.7 percent by 2000/1 and to 39 percent in 2010/11.[1] This meant that India's growth was translating into opportunities for American business, and that economically, India needed to be taken seriously.

Indian perceptions also changed. Policy elites and many government decision-makers had long looked on economics as an Indian vulnerability. In the 1950s and 1960s, India's international economic priorities had to do with bringing in aid flows. By the last decade, policy circles inside and outside government had begun to see India's economic performance as a strength and its economic prospects as exciting. Advancing India's economy emerged as a strategic and foreign policy priority. Achieving this goal required not so much aid flows as trade, investment, and securing energy supplies.

The changed performance of India's economy and its much more robust economic relationship with the United States stabilized U.S.-India ties to a greater degree than in the past. Businesses in both countries could expect their economic interaction to expand, more or less regardless of what the governments did. Both governments, by the same token, have an important economic stake in protecting their bilateral relations. But with increasing economic ties come disagreements, both old and new; this has been the U.S. experience with all its significant trading partners. This paper will examine the role of trade and investment in shaping U.S.-India relations, focusing primarily on trade but looking more briefly at investment and at the bilateral and multilateral diplomacy related to both issues.

---

[1] Ministry of Finance, Government of India, *Economic Survey of India 2011-12*, table 0.1, http://indiabudget.nic.in/es2011-12/estat1.pdf.

Dimensions of U.S.-India Economic Relations: International trade now represents not only a growing share of the Indian economy, but also one widely understood to include India's most dynamic sector, information technology. The United States has always been an important trading partner for India. In the past decade, it has consistently been India's largest trading partner when one includes both goods and services, and in most years the largest export market, buying $25.1 billion, or 10.1 percent of India's goods exports.

A small number of products account for most of India's exports to the U.S. Gems and jewelry were the largest category in 2011, totally $7.9 billion. Pharmaceuticals, chemicals, textiles, auto parts, and petroleum and products together accounted for another $19 billion, and these six categories accounted for 74 percent of Indian exports to the United States. While India was a significant supplier in these categories, its largest share of the US market was on the order of 10 percent.[2]

India has also become a significant trade partner for the United States – the ninth largest supplier of imported goods (1.8 percent of the market), the eleventh largest partner for goods trade (with 1.6 percent of total), and, although the numbers here are less reliable, almost certainly one of the top suppliers of information technology products and services.[3] India consistently runs a trade surplus with the United States. U.S. exports to India are more diversified than India's exports to the United States; among the major categories, chemicals and gem diamonds together accounted for about 30 percent in 2011, and civilian aircraft varied considerably, with a high of over 20 percent in 2007 and a low of about 3 percent. US exports in 2011 included $2.8 billion in "advanced technology products" – about 13 percent of the total (and a category that overlaps with some of the others cited here). US imports of "advanced technology products" came to $1.5 billion. The diversity of U.S. exports means that many different industries have a stake in the Indian market, so that the "ownership" of trade problems is also broadly based in the US economy.[4]

Another important side of the story is harder to document with precision: the exports from India's vibrant IT industry. According to the principal industry association in India, NASSCOM, the output of India's IT and outsourcing industry was expected to top $100 billion in 2012, with over two-thirds - $69 billion – being exported. Industry figures indicate that the United States has been by far the largest purchaser of Indian IT services for at least a decade. Growth in the industry, which had been running at about 25 percent per year, has slowed to a still-impressive 10-20 percent, partly as a result of the global financial crisis. NASSCOM estimates India's share of the global market for these services at 58 percent.[5] Making the assumption that India's share of the U.S. market for IT services mirrors its global market share, this would put India's IT exports to the United States above the level of its total goods exports.

---

[2] U.S. Bureau of the census, "Value of Exports, General Imports, and Imports for Consumption," http://censtats.census.gov/cgi-bin/sitc/sitcMonth.pl.
[3] U.S. Bureau of the Census, "Top Trading Partners – Total Trade, Exports, Imports," http://www/census.gov/foreign-trade/statistics/highlights/topcurmon.html.
[4] U.S. Bureau of the census, "Value of Exports, General Imports, and Imports for Consumption," http://censtats.census.gov/cgi-bin/sitc/sitcMonth.pl. Advanced technology figures from http://www.census.gov/foreign-trade/statistics/product/atp/select-ctryatp.html.
[5] "Indian IT-BPO industry, Web site of NASSCOM, http://www.nasscom.org/indian-itbop-industry.

U.S. figures – which may be based on a different definition – assess 2010 Indian services exports to the United States at $13.7 billion, still a major accomplishment.[6]

The economic impact of India's IT trade is huge, but the impact on India's perception of its own potential is even greater. The meteoric rise of the IT industry has also eclipsed the substantial acceleration in the growth and competitiveness of manufacturing in India, with such sectors as auto parts now performing on a global scale.

Shifting trade patterns: Over the past decade, India's trading partners have been rearranged. Tables 1 and 2 (at the end of the paper) detail the story in goods trade. The most striking change, as already noted, is the rise in the overall size of foreign trade: in each five-year period, both exports and imports more than doubled. China went from being a negligible trade partner in 2000/2001 to near the top of India's list five years later. The UAE is now the second largest trading partner. Both the EU and the US saw a significant drop in their market share – in part the inevitable result of the tremendous increase in Indian trade with China and the oil suppliers.

India's trade with both China and the UAE – and more broadly the Persian Gulf oil exporters – is markedly more concentrated than its trade with the United States. India's exports to China are heavily focused on iron ore; a recent drop in iron ore exports underlines India's vulnerability. The UAE's trade with India is primarily in energy products. It has become not just a supplier of crude oil but a major export market, principally for refined petroleum. The same was true to a lesser extent of India's other Middle Eastern suppliers; crude oil is both India's largest import, refined petroleum its largest export.

India has now signed three free trade agreements (FTA), with ASEAN and South Korea (in effect since 2010) and with Japan (in effect since early 2012). None of the agreements has been in place for long enough to bring about a major change in trade patterns, though this may occur in the next few years. However, a near-doubling of ASEAN's share of Indian exports preceded the FTA, and in all three cases the decision to pursue an FTA followed a mutual increase in private sector interest, reflected in growing investment and more active private sector consultative groups. At the same time, India's political and security engagement in all three places was increasing, with more active military-to-military contacts and security dialogues. And the record of surging exports over nearly two decades gave India's government and private sector the confidence to think about a significant liberalization of trade on a bilateral basis. The FTAs in East Asia were part and parcel of a broader effort to deepen India's engagement with East Asia, starting with the "Look East" policy of the late 1980s. Growing economic, political and security relationships reinforced each other.

India has also started FTA negotiations with the EU, and exploratory talks are under way with Canada and Australia. Political relations between India and these countries are solid, but not seen as strategically important from Delhi's perspective. It is the economic ties that make these countries important; accordingly, these negotiations are likely to be driven primarily by economic factors.

---

[6] Bureau of Economic Analysis, "U.S. International Services," updated March 2, 2012, at *http://www.bea.gov/international/international_services.htm*.

What determines India's trade policy? India announces changes in trade policy for the coming year at the end of February, together with the budget. Decisions on policy changes are made in a process that reflects the underlying budget decisions, with the finance and commerce ministries playing the key roles. In recent years, pre-budget consultations with people outside the national government – business groups, state governments, and politicians – have expanded, and have been given far greater publicity than they had in the past. But the final judgment on what goes into the finance minister's budget speech or the formal announcement of trade policy is a black box.

The trade policy announcement is typically very specific: duties will be raised, lowered, or eliminated on particular items – laptop computers, specific pieces of machinery, and so on. Explanations may be offered or not; the press will in any event fill in explanations. The more fundamental drivers of trade policy – whether the government should tilt toward openness or protection, how heavily it should weight the revenue impact of tariff reductions and what trade projections it should use in doing so – are rarely the subject of formal government announcements, though they are frequently debated in the media and among political and business elites. The most common pattern, seen for example in India's free trade areas, is that the government moves ahead, puts together a deal that it considers favorable, with informal consultations along the way, and when such an initiative succeeds it can serve as a precedent.

India's initial steps toward a trade agreement with Sri Lanka illustrates the process. In 1998, leaders of the two countries signed a free trade agreement. When it was put into effect about two years later, officials in both countries had agreed on a list of covered products that included practically nothing that the two countries actually traded. Over the next 5-10 years, however, the list of eligible products had expanded to provide quite extensive trade coverage – and to boost trade from both countries. Put more simply, an agreement that started out as eyewash wound up benefiting both sides. It was followed by an agreement with Bangladesh, which was spared the initial "eyewash" phase. The most recent move down this road has been with Pakistan, politically much harder. The Pakistan agreement will move according to a political timetable, but in a sense Bangladesh and Sri Lanka cleared the economic path for it.

Politics, and especially state and coalition politics, have a critical input into trade policy. Coalition partners and state leaders rarely create new trade initiatives, but they can block the central government very effectively. Two contrary examples come from West Bengal and Gujarat.

The feisty chief minister of West Bengal, Mamata Banerjee, has effectively vetoed a string of Indian government economic initiatives, including a river agreement with Bangladesh and a move to allow foreign direct investment in retail trade. These moves were intended primarily to demonstrate her power to thwart the central government, and to insert herself into as many decision processes as possible, in part to improve her bargaining power in a quest for central government fiscal goodies. She opted not to throw a body-block across a trade agreement with Bangladesh that would open the Indian market to Bangladeshi textiles. The reasons were not clear, but her power play may have been accomplished by the moves she did make.

The chief minister of Gujarat, Narendra Modi, is a tireless administrator and a creative user of the power of the state to open up new economic possibilities. He has, for example, privatized the state-owned ports in his state, and generated huge new business for them. He might be expected to be a champion of other moves to open the economy. In practice, however, he has used his own power, but has been selective about getting into fights over central government policy. Gujarat, for example, has not announced whether or not it will allow foreign direct investment in retail now that the central government had made its controversial policy change.[7] On the other hand, Modi is one of the chief ministers who objected to the central government's efforts to take over the country's anti-terrorism machinery, which he and others saw as a direct challenge to state-level police authority.

The government has made a string of missteps over the past two years, leaving it with coalition partners poised to make trouble and the opposition determined to oppose. The government's champion of open trade, Prime Minister Manmohan Singh, is not the only – or even the primary – center of power: that honor goes to Sonia Gandhi, who is at best agnostic about trade liberalization. Nonetheless, the government brought in the redoubtable P. Chidambaram as finance minister, and in late September 2012 announced a "big bang" of policy reforms, including the much-talked about opening to foreign investment in retail. The first reaction suggests that the government will ride out the inevitable political storm, and the economy will benefit. But the economy and the badly divided political scene will be closely intertwined.

Impact on U.S.-India multilateral cooperation: Unlike most issues that the Indian and U.S. governments work on together, the two countries' most important economic relationships are fundamentally private. Companies buy and sell; companies decide to invest, and set the size, nature and location of their investments, without involvement by the "sending" government. Indian government policy influences the market for U.S. exports and investment mainly through its overall economic policies and the many factors that determine how, and how fast, its economy is growing. The U.S. government has less impact, but has a powerful interest in ensuring that its exports can expand and its companies' investments can prosper. The overall state of the global economy, and specifically the health of the U.S. economy, however, has become a major factor in setting the prospects for Indian exports and outbound investment. Put another way, during its years of slow growth, India was largely insulated from both the promise and the peril of the international economy. It now participates in both.

India's trade relationships are no longer set by its external friendships. Continuing friendly relations with Russia, for example, have not altered the fact that its share of Indian trade has hovered around 1 percent for the past decade, nor has India's strategic rivalry with China retarded the dramatic increase in their trade. But an important trade relationship does increase the significance of a country in India's foreign policy. India's decision to invite the King Abdullah of Saudi Arabia to be chief guest at its national day celebration in 2006 was based in part on that country's position as India's main supplier of energy. Since then, India has continued to build up its ties with Saudi Arabia and to diversify its commerce. The Saudi decision to hand over a

---

[7] "More States for FDI in Multi-Brand Retail," *Business Standard,* August 14, 2012, http://business-standard.com/india/news/more-states-for-fdi-in-multi-brand-retail-scindia/483228/.

Lashkar-e-Taiba operative trained in Pakistan and alleged to be involved with the 2008 Mumbai bombings may have been one result.

The United States, however, is really in a category by itself. It is important to India in so many different areas: trade and investment, but also security and its position in the three most important regions for Indian interests – South and East Asia, and the Persian Gulf. The most important factor is U.S. standing as the centerpiece of the international system. At the same time, the United States remains the critical way for Indian politicians and political elites to measure their success in maintaining India's "strategic autonomy," still the gold standard by which India's foreign policy is judged in political circles. So Indian political leaders and security managers are trying both to benefit from close relations with the world's most powerful country, and to avoid appearing in any sense in a subordinate or dependent role vis a vis the United States.

India and the United States have always had an easier time cooperating bilaterally than multilaterally. The dramatic improvements in U.S.-India relations of the past two decades have not changed this basic dynamic. India's foreign policy and trade officials resist tempering their multilateral policies to fit their ties with the United States. This is true in the United Nations, especially in the General Assembly, where India has for decades used the Non-Aligned Movement as its primary source of partners for building voting coalitions. It is even more a factor in the World Trade Organization (and its predecessor organization, GATT), where the issues on which the United States seeks Indian support are much more likely to have real political "legs" in India. A case in point is the disagreement on agricultural trade in the Doha Round of trade negotiations. Every Indian politician – and any Indian minister of commerce – is dependent on the rural vote, and relishes the opportunity to tell the Indian TV audience that he refused to be pushed around by the rich countries (or by the Americans). The same logic applies to international environmental negotiations, as we saw in Copenhagen and at subsequent environmental meetings. Environmental issues do not have the same TV resonance as agricultural trade, but they are managed by the same cadre of experts in multilateral diplomacy who represent India in the United Nations.

Interestingly, the pattern of India-China relations is the opposite: Chinese academics and former officials who follow relations with India, and their Indian counterparts, comment that India and China find multilateral relations far easier than bilateral; both are easier than regional discussions, which one Indian official described as "awful." Indian negotiators are considered "tough" by their Chinese interlocutors on bilateral issues. India and China are both frequently in the position of resisting the U.S. position in global negotiations, including both trade and environmental issues. Given India's strategic concerns about China and its important economic stake there, it may also suit India's larger foreign policy to define an area where it can work smoothly with China. This is especially the case in view of the increasingly active U.S.-India dialogue on East Asia.

There are exceptions to this pattern of fractious U.S.-India dealings in global institutions. Some global issues have become accepted areas for U.S.-India cooperation, notably peacekeeping (at the UN) and the operation of the G-20. India's votes in the IAEA with the United States and against Iran (and in one case also against Russia and China) were clearly influenced by their relationship with Washington; they also reflected the prime minister's stated policy that India did not want any more nuclear-armed neighbors. India's UNSC votes with the United States on Syria were made easier by the fact that most of the Arab world opposes the Syrian regime. India's vote with the United States on the UN Human Rights Committee resolution on Sri Lanka was the product of Tamil politics inside India.

This record suggests that the occasions where India shifts its position in a global institution in order to accommodate the United States will be rare. Other approaches may be more effective in securing some level of multilateral cooperation. In trade negotiations, a quid pro quo may be the most effective approach. The WTO is fundamentally a forum for negotiations, so negotiating a deal fits the institutional culture. India's trade officials drive a hard bargain, however. In addition, the US should try to leverage the U.S.-India dialogue on East Asia, and have it spend some time on economic issues. This might facilitate coalition-building on economic issues that affect both India and its East Asian neighbors.

But the reality is that, while Indian and U.S. security interests are quite well aligned, especially in the Indian Ocean and East Asia, the same is not necessarily true of their international economic interests. On the trade side, the major gap in global trade liberalization since World War II has been agriculture. U.S. agricultural exporters have for a couple of decades been determined to expand their international markets. However, opening agricultural trade is a tough political call for Indian politicians. Trade liberalization is negotiated – and much of what India might seek in return is equally hard for the United States. Immigration is a huge issue, and legally and bureaucratically the United States does not consider it "international trade." On environmental issues, both India and the United States are trying to avoid externally imposed obligations to reduce carbon emissions. With China emerging as the biggest polluter, there may be an opportunity to make common cause, but India will be very wary that such an approach would carry an unacceptable cost for India.

What lies ahead? India and the United States a long and stubborn list of trade disagreements. The best known complaints from the U.S. side include differences over protection of intellectual property rights, liability issues for nuclear trade, and a string of investment-related issues, notably investment caps or bans in certain areas (insurance, multi-brand retail). India's list includes restrictions, fees, and refusals of business-related visas. In the past decade, government to government negotiations have made incremental progress on several of these – and significant progress on the issue of U.S. export licenses on high technology equipment – but the issues never completely go away. Even the high points of U.S.-India relations in the past decade have seen little headway in crossing these complaints off the list.

Every report that has been produced on moving the U.S.-India economic relationship forward has urged that the two governments take on these issues and resolve some of the longest-lasting. That is good advice, but it runs into political constraints on both sides. Some progress may take place by judicious use of action-forcing events, but these may be hard to tee up in the nearly two years that remain before the next elections in both India and the United States.

In the long term, one way to square this circle would be to propose a more ambitious framework within which both India and the United States could achieve bigger goals. One example would be a bilateral FTA. This would be an extraordinarily difficult undertaking. Support for trade opening in the United States is low, and will certainly not revive until the economy picks up. India and the United States have very different concepts of what an FTA should look like. India's current agreements cover a much lower share of their trade than current U.S. policy would consider acceptable. India is currently in an inward-looking phase, with a government beset by coalition problems and an opposition determined to embarrass them, and has been turning to remedies that would restrict, or at least not open, trade (example: their recently announced official list of approved medications). But as a long term goal, this kind of big vision might create a sense of common purpose and point the way to some preliminary steps that would eventually change the landscape.

Table 1

Indian Imports, $ million

Source: India, Ministry of Commerce Web Site

Country	2010/11	%	2005/6	%	2000/1	%
All	369.8	100%	149.1	100%	50.5	100%
US	20.4	5.50%	9.4	6.30%	3.0	6.00%
China	43.5	11.70%	10.9	7.20%	1.5	2.90%
UAE	32.7	8.86%	4354.1	2.92%	0.6	1.30%
ASEAN	30.6	8.30%	10.9	6.90%	4.1	8.20%
Japan	8.6	2.30%	4.0	2.70%	1.8	3.60%
S Korea	10.5	2.87%	4.5	3.00%	0.9	1.80%
South Asia	2.2	0.60%	1.4	0.90%	0.5	1.00%
EU	44.5	12.00%	26.0	17.40%	10.7	21.10%

Table 2

Indian Imports, $ million

Source: India, Ministry of Commerce Web Site

Country	2010/11	%	2005/6	%	2000/1	%
All	369.8	100%	149.1	100%	50.5	100%
US	20.4	5.50%	9.4	6.30%	3.0	6.00%
China	43.5	11.70%	10.9	7.20%	1.5	2.90%
UAE	32.7	8.86%	4354.1	2.92%	0.6	1.30%
ASEAN	30.6	8.30%	10.9	6.90%	4.1	8.20%
Japan	8.6	2.30%	4.0	2.70%	1.8	3.60%
S Korea	10.5	2.87%	4.5	3.00%	0.9	1.80%
South Asia	2.2	0.60%	1.4	0.90%	0.5	1.00%
EU	44.5	12.00%	26.0	17.40%	10.7	21.10%