

U.S.-INDIA INSIGHT

*“Unlocking the full potential
of the U.S.-India relationship”*

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Advancing U.S.-India Economic Ties: BIT
and Beyond

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On the eve of next week’s third annual “U.S.-India Strategic Dialogue” in Washington, hosted by Secretary of State Hillary Clinton and her counterpart, External Affairs Minister S.M. Krishna, what do the two countries see as their top priority for moving the bilateral relationship forward?

In separate remarks, the U.S. ambassador to India, Nancy Powell, and India’s ambassador to the United States, Nirupama Rao, addressed this question—and provided identical responses. Said Powell on her arrival in New Delhi as the new U.S. envoy: “My top objectives as Ambassador for this partnership are going to be: Bolstering bilateral trade and investment and expanding business opportunities.” Said Rao last week in Washington: “Let me highlight some priority areas: Firstly, the strengthening of the economic partnership.” An opportunity has recently presented itself that will allow the United States and India to do precisely what the two ambassadors propose.

Enter the “Model BIT”

After a three-year interagency review, the Office of the U.S. Trade Representative (USTR) and the State Department announced in April that they had finalized a “Model BIT,” or bilateral investment treaty, which the United States uses as the foundation for agreements on investor protection and to promote two-way economic partnerships with other countries.

Among the many benefits that promote capital investment, BITs require nondiscriminatory national treatment and most-favored-nation treatment for the full period of the investment, place limits on expropriation, restrict performance requirements such as local content and technology transfer, and offer binding international dispute arbitration between investors and states.

Now that the Model BIT is in hand, USTR and the State Department should proceed expeditiously with negotiations with those countries that want to strengthen trade and investment ties with the United States. India is the right place to start.

Why BIT and India?

First, India holds great promise as a potential economic partner for the United States. However, this potential is far from realized. Despite being on track to become the world’s third-largest economy, India is only our 13th-largest trade partner. Secretary Clinton acknowledged this during a visit to India in May: “There is much more potential to unleash. We should be working toward having one of the world’s largest trading relationships, and we need to continue to reduce barriers and open our markets to greater trade and investment.”

From “Timely Warning” to
“Call for Action”

The announcement that India’s GDP growth slowed to 5.3 percent last quarter, a nine-year low, was just the latest in a slew of bad news for the Indian economy. In April, Standard and Poor’s lowered its outlook for the Indian economy, and in May the Indian rupee fell to an all-time low, vis-à-vis the dollar. India’s economic slowdown has global ramifications and is of particular significance for the U.S.-India relationship. Yet despite recent struggles, there is a general consensus that India’s economic and fiscal problems are not insurmountable. But where to start? Why not with these three: FDI, GST, and GAAR? All are already on the table.

Of late, the Indian government has considered several economic reforms that have either been held up or were reversed due to political pressure. To begin with, last fall the government decision to allow foreign direct investment (FDI) in the multi-brand retail sector (supermarkets and “big box” stores) was quickly rescinded after strong and vocal political opposition. Although this certainly would have some adverse effects on India’s mostly mom-and-pop retail shops, the overall benefits to the economy from increased capital investment, improvements in supply chain management, and higher tax revenue would far outweigh the disadvantages. Second, the current government has made little progress on enacting the goods and services tax (GST), a value-added tax that has been languishing in the central and state parliaments for years. GST would both simplify a tax code riddled with exemptions and broaden the tax base, necessary steps for India to address its burgeoning debt and deficit. Third, in May the government delayed the implementation of the General Anti-Avoidance Rules (GAAR), new tax regulation aimed at reducing tax evasion, because its ambiguities troubled investors. Once the

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One way to do that is through a BIT, something the United States and India have been discussing, on and off, since 2008. But while the two countries continue to express their interest in concluding a BIT, other prominent trading partners have moved ahead. Today India has investment agreements with 80 countries including all major European nations, with the 10 member states of the Association of Southeast Asian Nations (ASEAN), and with Japan and South Korea. The European Union is expected to finalize a free trade agreement with India this year.

This track record of trade and investment agreements with India puts the United States out of step with the rest of the world and puts U.S. investors at considerable disadvantage compared to their foreign competitors.

Second, even as the volume of U.S.-India trade continues to grow—it is expected to surpass \$100 billion for the first time this year—the share of Indian trade that involves the United States is dropping. According to India’s Ministry of Commerce and Industry, the United States accounted for 10.6 percent of all Indian trade in 2005–2006. It dropped to 7.3 percent in 2010–2011.

Third, over the past two years, U.S. investors have had their hopes repeatedly raised about new opportunities in the Indian market, only to see those hopes dashed as a result of stalled economic reforms, inadequate measures to open up foreign direct investment (FDI), and most recently, retroactive decisions on tax laws in the budget. A determined effort by the United States and India to conclude a BIT could help assuage growing investor uncertainty in India.

Fourth, support exists on Capitol Hill for having the United States and India expedite BIT negotiations. Ten members of the Senate India Caucus, led by Senators Mark Warner (D-VA) and John Cornyn (R-TX), have written to President Obama, urging him to move forward: “The tremendous potential of a BIT with India to protect and promote growth-producing American investments abroad, attract Indian investment into the United States, put our companies on equal footing with international counterparts in India and strengthen ties with a strategic partner is too significant to ignore.”

Finally, Indian leaders agree that the time is right for BIT but suggest the two countries should envision something even more ambitious. India’s foreign secretary, Ranjan Mathai, stated earlier this year in an address at CSIS: “While we should expeditiously conclude a Bilateral Investment Treaty, we must look beyond it, too. The United States is the only advanced economy in the world with which India has not concluded or is pursuing a Comprehensive Economic Partnership Agreement.”

Beyond BIT

That “BIT and beyond” signal also should be sent at the June 13 “U.S.-India Strategic Dialogue.” Secretary Clinton and Minister Krishna should underscore the commitment of the two governments to bolster trade and investment opportunities by setting a timeframe to conclude a BIT. They should also indicate an interest in encouraging a more visionary free trade agreement. While explicitly targeting a more ambitious comprehensive agreement would admittedly be a bold next step, in Secretary Clinton’s own words: “There is much more potential to unleash.”

objectionable sections are removed, going forward with GAAR might still deter some investors, but it would also help improve tax collection. Allowing multi-brand FDI and implementing GST and GAAR would be bold steps toward getting India’s fiscal and economic house in order, but at the moment these reforms remain merely strong proposals and not effective policies.

Finance Minister Pranab Mukherjee referred to the S&P downgrade as a “timely warning,” but New Delhi should instead view the recent economic data as a “call for action.” All three of these proposals will be unwelcome by some in India, but they are necessary to increase government revenues, decrease the deficit, and signal to investors that the government is serious about reform and promoting sustained growth. Political courage, rather than diluted and delayed half-measures, would help regenerate excitement and optimism about India’s economy. Given current U.S. economic woes, perhaps the upcoming U.S.-India Strategic Dialogue can spur a discussion on how leaders in both countries can advance their respective economic reform agendas in a contentious political environment.

—Sameer Punyani

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