

U.S.-India Insight

VOLUME 6 | ISSUE 7 | AUGUST 2016

Nearing a Dead End on the Path to U.S.-India Trade Cooperation

RICHARD M. ROSSOW



At the end of August, the U.S. and Indian governments will hold the final Strategic and Commercial Dialogue of the Barack Obama administration, likely marking the last substantive bilateral summit with an economic focus. The past seven years in U.S.-India relations will be remembered for the excellent progress made toward establishing a shared security vision, progress that sharply accelerated once Prime Minister Narendra Modi took office in May 2014.

Negligible progress in developing a shared vision on real trade integration, however, already weighs down potential progress in other areas.

There have been two “targets of opportunity” for establishing stronger connective tissue on trade; the first is India’s entry into the Asia-Pacific Economic Cooperation (APEC) organization. Some Indian officials profess a desire for APEC membership if and when expansion occurs. Many U.S. officials have responded coolly, concerned that India’s trade officials are not truly embracing a “pro-trade” mindset. The second target is a bilateral investment treaty (BIT). But due to changes in our respective model treaties, we are actually further from a deal than when we first announced our intention to start negotiations eight years ago.

India’s Actions Outweigh Words

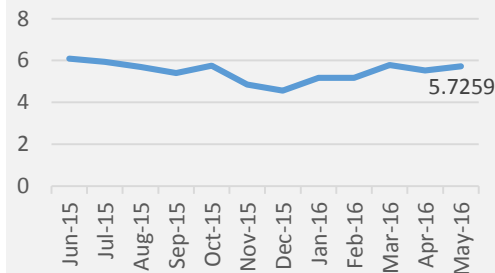
The Modi government is undoubtedly pro-investment, lifting foreign direct investment (FDI) caps and actively courting global investors. While a desire for foreign investment seems self-obvious, it is still a relatively novel development for India to embrace FDI so openly. However, trade is quite different. Despite the government of India’s intermittently stated desire to be included in a potential APEC expansion or in forging the Regional Comprehensive Economic Partnership, the Modi government has taken tangible trade-protection steps that far outweigh any verbal interest in trade integration. Three stand out:

- **Walking away from the World Trade Organization (WTO) “Trade Facilitation Agreement”:** One of the first major trade decisions by the Modi government was whether or not to implement the WTO Trade Facilitation Agreement in mid-2014. India chose to delay implementation until the country achieved a carve-out for agriculture subsidies.
- **Amending its Bilateral Investment Treaty:** After being sued by international investors in recent years under existing bilateral investment treaties, India undertook a review of its model BIT. The [final version](#), released in late 2015, makes it much more difficult to initiate investor-state dispute settlement—a primary reason for having a BIT in the first place. On top of that, India is attempting to [renegotiate existing BITs](#).
- **Cabinet Adoption of the National Capital Goods Policy:** In May 2016, the Indian cabinet approved a new [“National Capital Goods Policy”](#) drafted by the Ministry of Heavy Industries. Included in this long report

KEY DATA

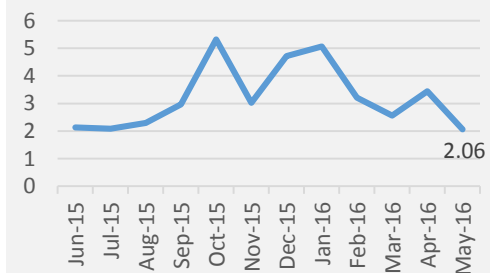
-3.2%

Change in U.S.-India goods trade, 12-month rolling average, per U.S. Census.



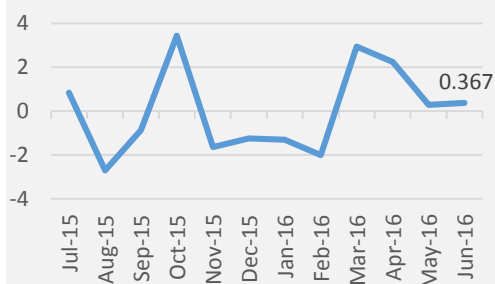
+14.9%

Change in FDI, 12-month rolling average, per RBI.



-99%

Change in FII, 12-month rolling average, per NSDL.



are provisions calling for 30 to 40 percent local content rules for capital goods, the development of local standards and certifications as a trade barrier, and calling for India's national trade policy to focus on negotiations with weaker developing countries.

U.S. officials are also following the stalled trade negotiations with other developed economies, such as the European Union and Australia.

India's Real and Perceived Concerns about Trade Liberalization

We in the United States sometimes chalk India's reluctance to embrace trade integration up to retained Nehruvian sentiments, a small team of negotiators, or other nonstrategic reasons. But there is a very real reason that India has continued its long-standing protectionist approach. India suffers from a gaping trade deficit with its largest trading partner, China. In fiscal year 2016, India exported about \$9 billion worth of merchandise to China (half the level of fiscal 2012), while India's imports from China totaled \$61.7 billion. ***India's trade deficit with China in fiscal 2016 amounted to a stunning 3 percent of India's GDP.*** And India's agriculture sector is not globally competitive, so any trade agreement that includes dramatic liberalization of agriculture markets will likely be detrimental, at least in the short term, to this massive sector. Recognizing these baseline realities must help shape the governments' attempts to find common ground on trade.


The concerns that led to the amendments to India's model BIT, however, are more difficult to forgive. A number of the arbitration cases that were triggered under the BIT flowed from India's poorly executed 2008 2G spectrum "auction" or other arbitrary government actions that impaired foreign investors' interests. It strikes at the very reason countries desire BITs—to protect investors against arbitrary government actions.

Better Ideas from Some Quarters

The government of India does not lack for strong proponents of a more proactive trade policy, but sometimes you need to dig a bit deeper to find them. A few recent examples:

- [**Report of the Expert Committee on Prior Permissions and Regulatory Mechanism, February 2016 \(Department of Industrial Policy and Promotion\)**](#): Calls for greater willingness to adopt global standards, impact assessments of new regulations, and establishing a standing body to review regulations.
- [**Make in India Strategy for Electronic Products, May 2016 \(NITI Aayog\)**](#): Calls for avoiding import substitution as a strategy, forging free trade agreements to create duty-free markets for Indian-made products, and avoiding the creation of domestic standards that will make Indian-made products unmarketable overseas.
- [**Economic Survey 2015–16, Volume 1, Chapter 8, February 2016 \(Ministry of Finance\)**](#): A large section of the Survey highlights the potential impact of global trade patterns on India's economy and the increase in India's trade thanks to existing preferential trade agreements.

There is greater awareness in the United States that we are unlikely to find a "fast track" for real trade integration with India. At such a time it is easy to succumb to frustration. However, the U.S. government must prepare to initiate a "long game"—recognize the real reasons India is reluctant to embrace trade integration and target suitable deals that accommodate India's concerns and interests. In pursuing this strategy, it should engage with like-minded groups in India—or with those that have not yet focused on the importance of trade.

 "Like" us on Facebook at facebook.com/CSISIndiaChair

 Follow us on Twitter @CSISIndiaChair and @RichardRossow