

A REPORT OF THE ICRIER-  
WADHWANI CHAIR IN INDIA-US  
POLICY STUDIES

# BIT and Beyond

Advancing India-US Economic Relations

*Principal Author*

Hemant Krishan Singh

*Contributing Author*

Tincy Sara Solomon

January 2013

Boeing 787 Dreamliners bound for India



Suzlon Wind Turbines in the US



Indian Council for Research on International Economic Relations

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## The ICRIER-Wadhvani Programme of Research Studies on India-US Relations and Policy Issues

The ICRIER-Wadhvani Programme of Research Studies on India-US Relations and Policy Issues, established in September 2011, aims to promote policies that advance India's emergence as a major economy and unlock the full strategic potential of India-US relations for the 21st Century.

The Programme places special emphasis on accelerating India's economic progress through enhanced India-US co-operation in trade, investment, infrastructure, energy, defence and high technology.

The ICRIER Programme works closely with its counterpart Wadhvani Chair at CSIS in Washington D.C., to create a policy climate through knowledge sharing so that the public and private sectors in India and the US can work together for the benefit of both societies.

The ICRIER-Wadhvani Programme has been established by ICRIER with the generous support of the Wadhvani Foundation.

*ICRIER does not take specific policy positions; accordingly, all views, positions, and conclusions expressed in this publication should be understood to be solely those of the author(s).*

Cover photo: *Top* - 787 Dreamliner airplanes for Air India seen on the production line at the Boeing Commercial Airplane manufacturing facility in Everett, Washington. Reuters, Anthony Bolante, <http://in.reuters.com/news/pictures/slideshow?articleId=INRTR38UL3#a=2>  
*Bottom* - Suzlon Energy Ltd. wind turbines stand at the Edison Mission Group Big Sky wind farm in the town of Ohio, Illinois, US. Bloomberg, Daniel Acker, <http://www.bloomberg.com/news/2012-03-27/suzlon-cash-crunch-worsens-as-edison-payment-trails-debt.html>

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# FOREWORD

One of the overarching objectives of the ICRIER-Wadhvani Chair in India-US Policy Studies is to develop policy recommendations that advance India's emergence as a major economy and a strong pillar of the international community in the 21st century.

In order to boost trade and investment relations between India and the United States, consecutive sessions of the Strategic Dialogue between the two countries, held in July 2011 and June 2012, have strongly endorsed the early conclusion of a Bilateral Investment Treaty (BIT). In support of this objective, the Wadhvani Chairs at ICRIER and CSIS decided to undertake separate but co-ordinated research and make policy recommendations on a BIT, while also looking beyond to future initiatives such as an India-US FTA or CEPA.

We owe a debt of gratitude to the CSIS-Wadhvani Chair for inspiring our efforts by making an early start on their "BIT and Beyond" Report. The insights of Ambassador Karl Inderfurth and Visiting Fellow Matthew Stokes at the CSIS-Wadhvani India Chair provided a most useful and timely head start for this counterpart report of the ICRIER-Wadhvani US Chair.

Thanks are due to Dr. Rahul Khullar, former Commerce Secretary, Government of India, for sharing his views on "India-US Economic Partnership: BIPA/BIT and Beyond" at ICRIER, which marked the initiation of our research efforts on prospects for an India-US BIPA/BIT.

Over the years, ICRIER has led research on India's trade and investment policies and its "in-house" expertise was a great asset for our work on this report. With his vast experience in the Government and at the WTO, Prof. Anwarul Hoda contributed valuable guidance on India's BIPAs and CEPAs. This was supplemented by advice from Professors Arpita Mukherjee and Nisha Taneja, both leading experts on India's trade negotiations with several countries.

Special thanks are due to my Research Assistant, Ms. Tincy Sara Solomon, for long hours of painstaking research, compilation of background material and preparation of statistical charts. Thanks are also due to our colleagues at the ICRIER-Wadhvani US Chair, Aman Raj Khanna and Ramakrishnan Potti, for their support during the preparation of this report. Raj Kumar Shahi, ICRIER's IT specialist, assisted with the formatting of the contents.



I would like to record my gratitude to my friend and ICRIER colleague, Professor Parthasarathi Shome, for encouraging the ICRIER-Wadhvani Chair to transition from topical policy briefs to more long-term policy reports, and to Dr. Rajat Kathuria, Director and Chief Executive of ICRIER, for his strong support.

Professor Shujiro Urata of Waseda University, Tokyo, offered invaluable advice on regional FTAs in the Asia-Pacific, for which I am most grateful.

Finally, my sincere thanks are due to the Advisory Board of the ICRIER-Wadhvani Chair, especially Dr. Isher Judge Ahluwalia, Chairperson of ICRIER, and Dr. Ajay Kela, President and CEO of the Wadhvani Foundation, for their most valuable advice to advance the public policy advocacy and research agenda of the Chair. Last but not least, my heartfelt thanks to Ambassador Ronen Sen for guiding my work on India-US relations based on his extensive personal knowledge and experience of this “defining partnership” of the 21st century.

**Hemant Krishan Singh**  
**Chair Professor**  
**ICRIER-Wadhvani Chair in India-US Policy Studies**  
**January 1, 2013**

# BIT and Beyond

## Advancing India-US Economic Relations

### EXECUTIVE SUMMARY

The general discourse on India-US bilateral relations today uniformly begins with an affirmation of the utmost importance of economic ties. This is unsurprising, given the four-fold increase in bilateral trade and an even higher increase in investment over the last decade. Sharing democratic values and an entrepreneurial spirit, the two nations are poised to harness their economic complementarities and create mutually rewarding partnerships.

As large and vigorous democracies, India and the US accord the highest priority to enhancing jobs, social welfare and economic growth. They also face strikingly similar problems related to economic reforms and domestic political gridlock. Both tend to seek liberal market access abroad while practising their respective versions of protectionism at home, albeit to varying degrees. However, there are large economic disparities between the two countries; the vast majority of Indians do not enjoy the cushion of widespread prosperity and social security that America provides its citizens. Several challenges will need to be overcome if India and the US are to realise the full strategic potential of their economic relations.

US FDI in India has increased by nearly 30% during the last four years, while Indian investments in the US have grown by over 40%.<sup>1</sup> Given the rising volumes of bilateral trade and investment, there is every reason to conclude a Bilateral Investment Treaty (BIT), or a Bilateral Investment Promotion Agreement (BIPA) as it is known in India. A BIPA/BIT will tap synergies between the two economies and enhance these flows even further.

Owing to multiple factors, including a global slowdown and domestic macro-economic imbalances, investment in the Indian economy is receding at a juncture when continued growth requires even higher levels of savings and investment. Policy reversals and investment inhibiting measures like retrospective taxation have severely dampened business sentiment. The Indian Government at its highest levels acknowledges the need to remedy the deterioration in the investment climate by offering significantly improved conditions and opportunity to foreign investors. A BIPA/BIT with the US can reduce uncertainties and facilitate additional investment inflows, particularly if it is buttressed by

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1 Cohen, William S. "The pivot to Asia and Obama's second term." *Hindustan Times*, November 12, 2012, New Delhi ed.: p. 13. Print.

reform measures that open the Indian market to FDI. Priority areas like infrastructure, which require long-term security of investment, would stand to gain. The importance of a stable and predictable environment for FDI and FII in India, including in the areas of taxation and market regulation, cannot be overemphasised.

India's BIPAs have individual variations and are based on a model that is being reviewed in the light of recent cases in which foreign investors have invoked the Investor-State Dispute Settlement (ISDS) clause under various BIPAs. The US BIT model, which was updated for the third time in May 2012, offers broader coverage and is a more narrowly defined legal instrument designed to protect investments and enforce investor rights. India may be able to partly accommodate the US model, bearing in mind the provisions of its more recent CEPAs. While mutual accommodation on these differing model texts is possible as long as both sides display flexibility, it will be important for the concerned Ministries of the Government of India to harmonise their thinking and strike an appropriate balance between an investment friendly regime, investor protection and the sovereign regulatory functions of a developing economy. An India-US BIPA/BIT is likely to be a customised hybrid.

A measure of cautious optimism that an India-US BIT can be taken forward in 2013 would appear warranted, not least because of the favourable policy environment provided by President Obama's re-election and bipartisan support in Congress for advancing the India-US strategic partnership. However, this will to a large extent depend on the continuity of political level direction prioritising bilateral economic engagement, including the revival of dormant mechanisms like the Trade Policy Forum (TPF), which has not met since September, 2010. The TPF needs to move forward on the Trade & Investment Framework Agreement (TIFA) agenda and Private Sector Advisory Group (PSAG) recommendations made as far back as February 2011.

The US is the largest trading partner for India's thriving IT-BPO services industry. Looking ahead to the second Obama Administration, the US should bear in mind that any further curbs on outsourcing, based on unfounded and protectionist linkages with US job losses, will severely diminish its capacity to encourage market-opening economic reforms in India. In fact, the overall environment for bilateral economic relations can be greatly improved by a serious effort on the US side to ameliorate the concerns of India's IT industry, which is contributing to jobs and increasing competitiveness in the US economy.

After twenty years of politically measured liberalisation and recent policy flip-flops, India needs to impart a definitive direction to economic policy. India has already embraced globalisation for the benefits it brings. While the complex pulls and pressures of its "hyper-democracy" are understandable, India must increasingly align its domestic economic policies with the open global economic order it propagates abroad. By undertaking much needed economic reforms in key areas ranging from infrastructure to labour markets, India can derive greater welfare gains for its economy and realise its development potential.

India's existing FTAs offer relatively low levels of trade liberalisation.<sup>2</sup> As of July 2012, its trade with FTA partners comprised just 17.9% of total trade, as against 38.8% for the US and 73.8% for the EU.<sup>3</sup> If India remains committed to an open economy, it can also raise its ambitions on advanced FTAs which will help it to achieve higher levels of harmonisation with global markets and production chains. Claims of Indian exceptionalism may be politically attractive but come at an opportunity cost to the economy in an intensely competitive global environment.

The Indian government would be well advised to initiate a detailed study on the costs and benefits associated with full-fledged (WTO+ and WTO-X) FTAs,<sup>4</sup> without which India's hesitancy will remain based only on perceptions.

To become a key participant in the process of shaping the rules of globalisation, India must seek to play a more proactive role on FTAs. This will also require consideration of trade adjustment assistance programmes and safety nets, which the government can initiate in line with practices already prevailing among the developed economies.

Going beyond a BIPA/BIT, especially given the impasse at the WTO, India and the US can begin considering an FTA or similar trade and investment-enhancing instrument. India is already negotiating a relatively advanced Broad-based Trade and Investment Agreement (BTIA) with the European Union, which will provide windfall advantages to European companies over their US competitors. This should incentivise the US side to review its long-standing reticence towards an FTA with India. With US-EU FTA negotiations also likely, India should conclude the BTIA with the EU early and turn its attention towards an India-US FTA.

Negotiation of a "high quality" India-US FTA based on the India-EU BTIA model, if not the US-NAFTA template, should preferably accompany anticipated progress of market opening reforms in India.

India has recently signed on to negotiations for the Regional Comprehensive Economic Partnership (RCEP) promoted by ASEAN, even though its business and industry has major reservations about an FTA with China. An FTA with the US, on the other hand, is likely to enjoy broad support from the business sectors of both countries.

India's tremendous economic potential, backed by its democratic stability and demographic profile, has been highlighted by the US National Intelligence Council in its latest projection of global trends by 2030.<sup>5</sup> The strong support extended by the US for India's emergence as an economic power should provide ample motivation for an India-US BIPA/BIT and

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2 The proportion of tariff elimination in the India-ASEAN FTA, at 74.3%, is the lowest among ASEAN+1 FTAs.

3 Urata, Shujiro. *Regional Economic Integration in Asia: Challenges and Roles for Japan and India*, ICRIER Database, December 17, 2012. Web. Accessed on December 18, 2012.

4 WTO+ obligations refer to areas already covered by present WTO agreements, while WTO-X obligations fall outside these agreements.

5 National Intelligence Council. *Global Trends 2030: Alternative Worlds*. December, 2012. Web <<http://globaltrends2030.files.wordpress.com/2012/11/global-trends-2030-november2012.pdf>>. Accessed on December 13, 2012.

the logical sequel beyond, an FTA. However, to realise this vision, the role of determined leadership will be crucial. Generating public support for trade liberalisation will be equally essential, posing challenges for both governments.

India and the US have not cooperated with each other on global trade policy issues at the WTO, even though both countries support a multilateral, rule-based global trading regime. This must be remedied.

India does not figure prominently, if at all, in the USTR's present trade agenda. The centrepiece of this agenda is the Trans-Pacific Partnership (TPP), which excludes India and other major Asian economies like China, Japan and Indonesia. From India's perspective, the ASEAN-led Regional Comprehensive Economic Partnership (RCEP) platform for Asian economic integration offers a less ambitious but more beneficial model. While membership in the TPP and the RCEP is not necessarily mutually exclusive, overlaps can create complexities. Asia appears headed towards a patchwork of trade agreements including bilateral FTAs, RCEP and TPP. India must not rule out its future participation in the TPP, for which it does not face the hurdles that China confronts because of the latter's State-owned enterprise (SOE) dominated economy. India's highly competitive companies would in fact benefit from the TPP's transparent rules.

With emerging Asia likely to dominate global economic growth in the coming decades and the ongoing shift of geo-economic power towards Asia, India and the US should step up their dialogue on regional economic integration. Driven by vibrant bilateral economic ties, their regional approaches in an Asian century can also eventually converge.

The broad agenda for an enhanced India-US economic partnership outlined above may appear ambitious and will certainly pose domestic political challenges on both sides, not least as India heads for a general election in 2014. However, it is the fervent hope of the authors that the politics of aspiration and progress will prevail, bringing the reward of mutual prosperity to these two great democracies.

**Hemant Krishan Singh**  
**Chair Professor**  
**ICRIER-Wadhvani Chair in India-US Policy Studies**

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# ABBREVIATIONS

APEC	Asia-Pacific Economic Co-operation
ASEAN	Association of South East Asian Nations
BIPA	Bilateral Investment Promotion and Protection Agreement
BIT	Bilateral Investment Treaty
BPO	Business Process Outsourcing
BRIC	Brazil Russia India China
BTIA	Broad-based Trade and Investment Agreement
CAGR	Compound Annual Growth Rate
CECA	Comprehensive Economic Co-operation Agreement
CEPA	Comprehensive Economic Partnership Agreement
CII	Confederation of Indian Industry
CSIS	Center for Strategic and International Studies
CVD	Countervailing Duty
DIPP	Department of Industrial Promotion and Policy, Government of India
DTAA	Double Taxation Avoidance Agreement
EAS	East Asia Summit
EPCG	Export Promotion Capital Goods
ERIA	Economic Research Institute for ASEAN and East Asia
EU	European Union
FDI	Foreign Direct Investment
FEMA	Foreign Exchange Management Act
FET	Fair and Equitable Treatment
FICCI	Federation of Indian Chambers of Commerce and Industry
FII	Foreign Institutional Investment
FIPB	Foreign Investment Promotion Board
FTAs	Free Trade Agreements
FTAAP	Free Trade Area of the Asia-Pacific
GAAR	General Anti-Avoidance Rules
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product



GOI	Government of India
GSP	Generalised System of Preferences
GST	Goods and Service Tax
ICRIER	Indian Council for Research on International Economic Relations
IIA	International Investment Agreements
ILO	International Labour Organization
IPR	Intellectual Property Rights
ISA	Investor-State Arbitration
ISDS	Investor-State Dispute Settlement
ITeS	Information Technology-enabled Services
KORUS	Korea-US Free Trade Agreement
MFN	Most Favoured Nation
MOF	Ministry of Finance, Government of India
NAFTA	North American Free Trade Agreement
NAI	Notifiable Avian Influenza
NASSCOM	National Association of Software and Services Companies
NREG	National Rural Employment Guarantee Scheme
NRI	Non Resident Indians
OECD	Organisation for Economic Co-operation and Development
PSAG	Private Sector Advisory Group
PTA	Preferential Trade Agreement
RBI	Reserve Bank of India
RCEP	Regional Comprehensive Economic Partnership
ROK	Republic of Korea
SEZ	Special Economic Zone
SME	Small and Medium Enterprise
SOE	State-owned Enterprise
TBT	Technical Barriers to Trade
TIFA	Trade and Investment Framework Agreement
TPF	Trade Policy Forum
TPP	Trans-Pacific Partnership
TRIMs	Trade Related Investment Measures
TRIPS	Trade Related Intellectual Property Rights
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
USGSP	United States Generalised System of Preferences
USIBC	US India Business Council
USTR	United States Trade Representative
WIAL	White Industries Australia Limited
WTO	World Trade Organisation

# BIT and Beyond

## Advancing India-US Economic Relations

# I

## OVERVIEW

India is among the fastest growing emerging economies in Asia. Its economic growth has slowed but is projected to remain relatively robust in 2012 and 2013, despite the likelihood of a recession in Europe and feeble growth in the US.<sup>6</sup> In its recently released report on global trends, the US National Intelligence Council has projected that India will make major contributions to global growth over the next 15-20 years, and that “in 2030, India could be the rising economic powerhouse that China is seen to be today”.<sup>7</sup>

UNCTAD’s World Investment Report lists India third among the preferred host economies for FDI. The rapidly expanding Indian market offers attractive business opportunities. With its deep talent pool and “first-mover advantage”, India remains the world’s top back-office outsourcing destination.<sup>8</sup> Higher incomes and better accessibility across India has led to growing consumer spending which is expected to reach US\$ 3.6 trillion by 2020.<sup>9</sup>

While the Indian market has significant potential, it also suffers from a restrictive regulatory regime for investors. India ranks high as a closed economy in the OECD’s Foreign Direct Investment Restrictiveness Index for 2012.<sup>10</sup> The volume of US FDI in India is rising, even though the aggregate US share of FDI in India has declined.

In contrast, the US is an advanced industrialised economy with extremely low barriers to foreign direct investment. This is reflected in the size of the investment inflows it attracts.

6 United Nations. *World Economic Situation and Prospects, 2012*. New York: United Nations, 2012. Web.

7 National Intelligence Council. *Global Trends 2030: Alternative Worlds*. December, 2012. Web <<http://globaltrends2030.files.wordpress.com/2012/11/global-trends-2030-november2012.pdf>>. Accessed on December 13, 2012.

8 “India world’s best outsourcing destination: AT Kearney.” *The Economic Times*, 7 February 2011. Online.

9 The Boston Consulting Group & Confederation of Indian Industry. *The Tiger Roars- An In-Depth Analysis of How a Billion Plus People Consume*. Bcg.com, February 2012. Web. April 22, 2012.

10 Organization for Economic Co-operation and Development (OECD), FDI Regulatory Restrictiveness Index. 2012. Web.

Between 2000 and 2010, the United States has attracted the largest annual inflows of foreign direct investment in the world.<sup>11</sup> On the Foreign Direct Investment Restrictiveness Index of the OECD, the United States is close to the OECD average of “openness” toward inbound FDI.<sup>12</sup> Indian investments in the US are growing.

## India-US Trade and Investment Relations

Trade and investment constitute a vital component of the rapidly expanding relations between India and the US since the advent of India’s economic liberalisation in 1991. From a modest US\$ 5.6 billion in 1990, bilateral trade in merchandise goods has increased to US\$ 59.2<sup>13</sup> billion in 2011-12, representing an impressive 957.34% growth in a span of 21 years. Between 2010-11 and 2011-12, India-US trade grew by an impressive 30.59%. However, as a percentage of India’s total trade, the share of the US has fallen in recent years. The importance of the US to India, as both an export destination (-5.15%) and as a source of imports (-1.3%), declined between 2004-05 and 2011-12 (Tables 1 and 2). The US share in India’s global trade has declined from 10.6% to 7.45%, i.e. by 3.15%, over this period (Table 3).

**Table 1: Share of the US as an export destination for India**

Year	India’s Exports to US (US\$ billion)	Growth %	% share of total Exports	India’s Total Exports (US\$ billion)
2004-05	13.8	19.80%	16.50%	83.5
2005-06	17.4	26.10%	16.80%	103.1
2006-07	18.9	8.70%	14.90%	126.4
2007-08	20.7	9.90%	12.71%	163.1
2008-09	21.1	1.90%	11.41%	185.3
2009-10	19.5	-7.60%	10.93%	178.8
2010-11	25.3	29.47%	10.07%	251.1
2011-12	34.7	37.36%	11.35%	306.0

Source: Ministry of Commerce, Government of India

11 United Nations UNCTAD, Inward Foreign Direct Investment Stock, Annual, 1980-2010

12 Organization for Economic Co-operation and Development (OECD), FDI Regulatory Restrictiveness Index. 2012. Web.

13 Department of Commerce, Government of India, accessed on December 7, 2012.

**Table 2: Share of the US as a source of Indian Imports**

Year	India's Imports from US (US\$ billion)	Growth %	% share of total Imports	India's Total Imports (US\$ billion)
2004-05	7	39.20%	6.30%	111.5
2005-06	9.5	35.00%	6.40%	149.2
2006-07	11.7	24.10%	6.30%	185.7
2007-08	21.1	79.50%	8.40%	251.7
2008-09	18.6	-11.80%	6.10%	303.7
2009-10	17	-8.60%	5.90%	288.4
2010-11	20.1	18.13%	5.42%	369.8
2011-12	24.4	22.04%	5.00%	489.3

Source: Ministry of Commerce, Government of India

**Table 3: Share of the US as a Proportion of India's Global Trade**

Year	India's total Trade with US (US\$ billion)	Growth %	% share of total trade	India's total trade (US\$ billion)
2004-05	20.8	25.70%	10.60%	195.1
2005-06	26.8	28.80%	10.60%	252.3
2006-07	30.6	14.20%	9.80%	312.1
2007-08	41.8	36.60%	10.10%	414.8
2008-09	39.7	-5.00%	8.10%	489
2009-10	36.5	-8.10%	7.80%	467.1
2010-11	45.3	24.90%	7.30%	620.9
2011-12	59.2	30.59%	7.45%	795.3

Source: Ministry of Commerce, Government of India

Meanwhile, the share of India's trade with Asia has increased from 50.6% to 55.5% as its trade diversifies and expands (Chart 1).<sup>14</sup>

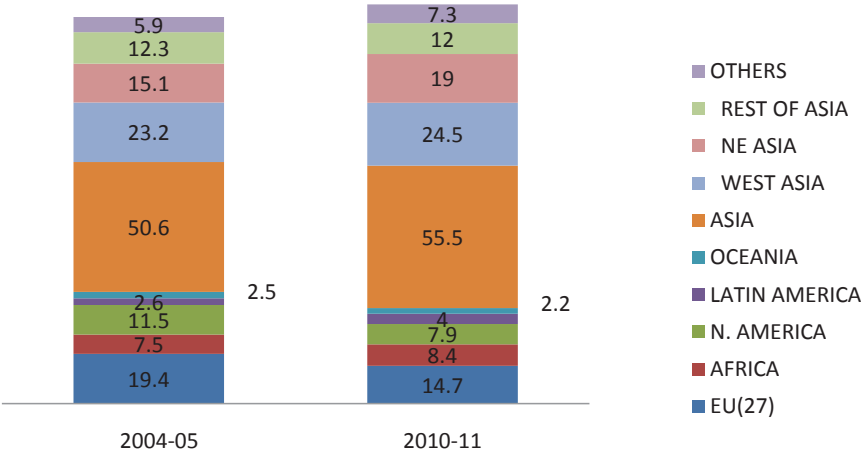
The factors underlying these changes in trade patterns include:<sup>15</sup>

- Free Trade Agreements (FTAs) with ASEAN and other Asian countries
- Policy response to risks of excessive dependence on western markets experienced during global downturns
- Increasing momentum of trade with developing countries and emerging markets in Africa and Latin America
- Growing confidence among Indian exporters and businesses in venturing forth, supported by policy initiatives

14 Khullar, Rahul. *India-US Economic Partnership: BIPA/BIT and Beyond*. Presentation at ICRIER on May 1, 2012.

15 *Ibid.*

**Chart 1: India's Total Trade: by Region (% share)**

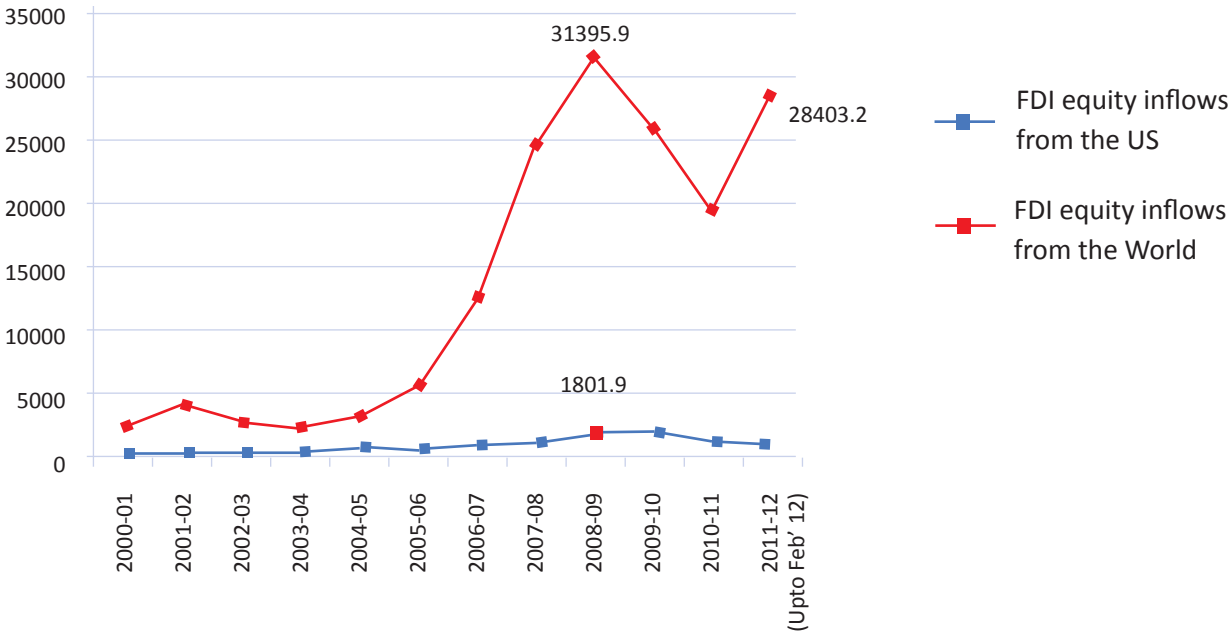


Source: Ministry of Commerce, Government of India

India's FTAs with important economic partners in Asia (Japan, Republic of Korea, Singapore and Malaysia) have generally boosted bilateral trade volumes with these countries, which should spur consideration of an FTA by India and the US.

In terms of investments, the aggregate US share of total FDI inflows into India has declined significantly, from 20.8% in 2004-05 to a mere 6% in 2010-2011. As Chart 2 indicates, the growth rate of FDI (equity) inflows from the US has been lower during this period than from the rest of the world.

**Chart 2: FDI Inflows from the US and rest of the World into India (US\$ million)**



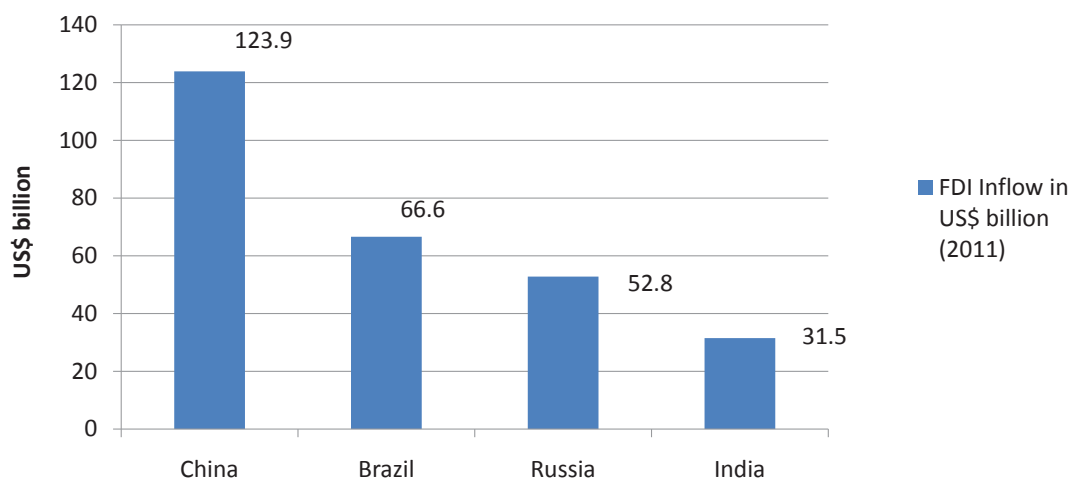
Source: Ministry of Commerce, Government of India

However, the rapid growth of bilateral trade and investment volumes in recent years indicates numerous synergies between the two economies. Business sentiment on both sides is buoyant. Frequent exchanges of high-level visits designed to promote economic relations have provided further momentum. The early conclusion of a BIT/BIPA, endorsed by the multi-sectoral Strategic Dialogue between the two countries in July 2011 and June 2012, is being seen as a belated but essential step towards realising the enormous potential of India-US trade and investment relations.

## India's Growing FDI Gap and the Need for Market Reforms

As per UNCTAD's World Investment Report 2012, during 2011 India received the lowest FDI inflows among the BRIC countries (Chart 3). It is also noteworthy that India has recorded a current account deficit of 4.2% of GDP in 2011-12.<sup>16</sup> India's need for fixed capital formation is falling far behind its domestic funding capacity, not least because the economy remains burdened by a large fiscal deficit that reached 5.9% of GDP in 2011-12. These twin macro-economic shortfalls need to be bridged by higher FDI and FII flows.

**Chart 3: FDI inflows into BRIC nations**



Source: World Investment Report, UNCTAD

After an impressive growth trajectory over the last twenty years, India is now facing severe macroeconomic stress, which has brought down GDP growth in the first quarter of 2012 to a meagre 5.3% and annual growth for FY 2011-12 to 6.5% - the lowest in nine years. FY 2012-13 Q1 (April-June) growth has remained an anaemic 5.5%, with fixed investment rising 0.7% compared with 14.7% a year earlier.<sup>17</sup> Q2 (July-September) growth has again

<sup>16</sup> Export Import Bank of India (EXIM). *India's Macroeconomic Indicators*. Updated July 2, 2012. Web. < <http://www.eximbankindia.com/index.asp> >

<sup>17</sup> "Growing Dismally." *The Indian Express*, September 1, 2012, New Delhi ed.: p. 14. Print.

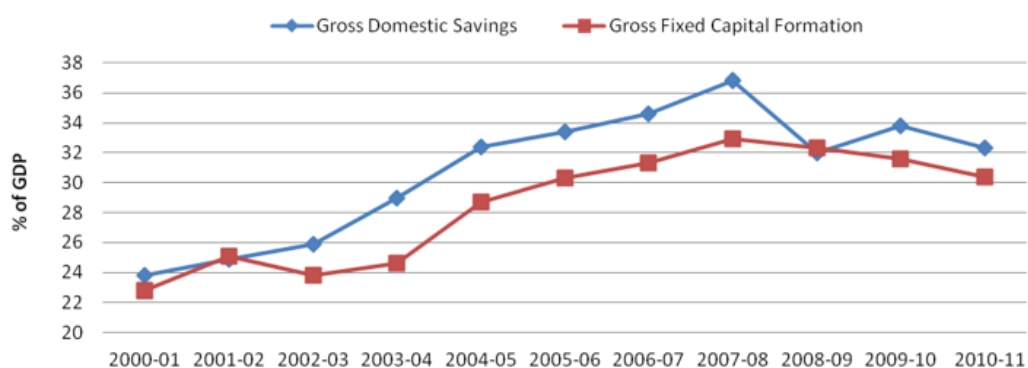
fallen to 5.3%. With declining levels of investment, there is little prospect of “animal spirits” returning to India’s faltering “growth story” during the rest of the current fiscal.

Overall foreign direct investment inflows, including both net FDI and FII portfolio flows, declined 83% year-on-year to just US\$ 2 billion in the April-June quarter of FY 2012-13.<sup>18</sup> FDI inflows have since recovered to US\$ 14.8 billion in the period April-October 2012, but still remain 27% below the previous year.<sup>19</sup>

Investment in the Indian economy is receding at a juncture when continued growth requires higher levels of savings and investment. In its approach to the Twelfth Five Year Plan, the Planning Commission had projected that “in order to sustain high rates of growth while maintaining moderate inflation, investment rate has to be higher than in the past, especially in areas where supply side bottlenecks could trigger inflation. Thus the average investment rate needed during the Twelfth Plan period is estimated to be 38.5% of GDP for 9.0% growth with 4.5-5.0 average inflation.”<sup>20</sup> In addition, “the rate of fixed capital formation needs to improve to around 33.5% of GDP” from the average of around 31% of GDP in the Eleventh Plan.<sup>21</sup>

In contrast with this desired higher level of investment, economic experts have pointed out that gross fixed investment has fallen from its peak of 33% of GDP in 2007-08 to about 28% in the second half of 2011-12.<sup>22</sup> According to Dr. Shankar Acharya, a former Chief Economic Adviser to the Government of India, until “critical infrastructure bottlenecks are sorted out, and there is a marked improvement in fiscal imbalances, the investment climate and financial sector health, it is hard to see how India’s growth can break out of its current five to seven per cent band. The economic and social welfare losses of such avoidably low growth are massive.”<sup>23</sup>

**Chart 4: Gross Domestic Savings & Gross Fixed Capital Formation (% GDP)**



Source: Reserve Bank of India

18 RBI statistics cited in *The Times of India*, August 11, 2012

19 Department of Industrial Policy and Promotion (DIPP) statistics cited in *The Times of India*, December 22, 2012.

20 Planning Commission, Government of India. *Faster, Sustainable and More Inclusive Growth - An Approach to the Twelfth Five Year Plan*. October 2011. Web.

21 *Ibid.*

22 Acharya, Shankar. “Crisis Still Building.” *Business Standard*, August 27, 2012, English ed. Online.

23 *Ibid.*



Meanwhile, recent litigations against the Indian government by some foreign corporations<sup>24</sup> have led to calls for reviewing existing and proposed commitments under Bilateral Investment Promotion and Protection Agreements (BIPAs), contributing to poor investor sentiment. The predictability of India's business environment has also been severely shaken by retroactive tax and General Anti-Avoidance Rules (GAAR) enforcement measures in the FY 2012-13 Budget, obliging the government to review their implementation. Proposed taxation reforms like a Direct Tax Code and a nationwide Goods and Services Tax (GST) are also likely to be delayed.

In this scenario, the Indian government needs to remedy the deterioration in the investment climate and welcome greater FDI inflows by offering higher predictability and protection to foreign investors. The US is the world's leading investor, holding 14.8% of total global FDI stock in 2010.<sup>25</sup> A BIPA/BIT with the US would facilitate additional investment inflows in priority areas, particularly if it is buttressed by reform measures that open the Indian market to FDI.<sup>26</sup> By offering additional safeguards to US companies giving them the confidence to expand their operations, India will be better placed to regain a higher growth trajectory. Similarly, the conclusion of a BIPA/BIT can offer Indian investors better protection for their US assets and more assured access to the US market.

An India-US BIPA/BIT alone, however, will not provide a boost to investor sentiment in the absence of wider economic reform measures.<sup>27</sup> The windfall that was reaped by India from its economic liberalisation of 1991 has run its course. With goods and services trade surpassing 40.5% of GDP in 2011,<sup>28</sup> the Indian economy stands globalised. Investment decisions – by foreign or Indian companies – are now weighed against the prospects of market potential, comparative advantage, economic infrastructure, political risk and predictability of the regulatory environment. Seeking better returns, Indian companies themselves have substantially increased their investments abroad since 2009-10 even as their domestic investment decisions have stalled.<sup>29</sup>

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24 (a.) In July 2010, White Industries Australia Limited won a case against GOI under the India-Australia BIT; (b.) In Feb 2012, Russia's Sistema sent an arbitration notice to GOI under India-Russia BIT on cancellation of 21 Sistema Shyam Tele Services Ltd. licences by the Supreme Court; (c.) In March 2012, Norway's Telenor filed a case under the India-Singapore CECA on cancellation of 22 telecom licences; (d.) In April 2012, Vodafone served notice of dispute against the Indian government initiating the dispute settlement process under the India-Netherlands BIT on account of imposition of retrospective tax.

25 UNCTADstat Database

26 On September 14, 2012, the Indian Government announced its boldest liberalisation package since 2004, which included 51% FDI in multi-brand retail, relaxation of conditionalities to single-brand retail ventures, 100% FDI by foreign airlines in domestic aviation, FDI relaxations in broadcasting and power exchanges, divestment in four state-owned enterprises and cuts in fuel subsidies. ("Indian Reform, TakeTwo", *The Wall Street Journal*, September 17, 2012.)

27 On October 4, 2012, the Indian Cabinet approved further liberalisation measures to hike FDI in the Insurance sector to 100% and permit foreign investment in pensions. However, these are subject to legislation being passed by Parliament.

28 World Bank database, accessed online on December 3, 2012.

29 Baru, Sanjaya. "Altering Expectations." *The Indian Express*, August 10, 2012, New Delhi ed.: p. 11. Print.



At the same time, rhetorical assertions apart, the political appetite in India for pursuing further economic reforms to sustain rapid growth has receded. While inter-dependence and globalisation have been widely accepted as the desirable norm, India's avowed stake in maintaining an open global economic order is largely posited only in the external context of mobility of capital, technology, services and labour.<sup>30</sup> It is becoming increasingly difficult for India to endorse globalisation on the one hand while ignoring severe constraints that restrict trade and economic space in the Indian domestic market on the other.<sup>31</sup> Indeed, without introducing market mechanisms into core sectors like energy and power, and opening up the retail, insurance, pensions, banking, civil aviation, mining, agriculture and defence sectors, India will find it increasingly difficult to lift the country's sagging investment rate.

To cite an example of this FDI- market liberalisation linkage, the warehousing and supply chain infrastructure sector in India has no FDI restrictions but has attracted no FDI as "modern supply chain infrastructure cannot develop in a vacuum. No one will invest in infrastructure, where there is no large scale retail/wholesale, demanding its creation."<sup>32</sup>

For US investors, early enactment of a Government Procurement Bill and the long-pending Foreign Universities Bill, as well as the resolution of issues related to the Nuclear Liability Bill, will send a strong signal and accelerate investments.

In recent public affirmations, India's leaders have acknowledged the need for economic reform.

Setting out his priorities on August 6, 2012, India's new Finance Minister, P. Chidambaram, indicated that "the key to restart the growth engine is to attract more investment, both from domestic investors and foreign investors."<sup>33</sup>

In his Independence Day Address on August 15, 2012, Prime Minister Manmohan Singh linked economic growth with national security and reaffirmed that his government "will leave no stone unturned to encourage investment in our country so that our entrepreneurs can make a substantial contribution to our economy." He was equally categorical on FDI, saying that "to attract foreign capital, we will have to create confidence at the international level that there are no barriers to investment in India."

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30 Tellis, Ashley J. "Nonalignment Redux- The Perils of Old Wine in New Skins." *Carnegie Endowment for International Peace*, July 2012. Washington DC. Web.

31 *Ibid.*

32 Federation of Indian Chambers of Commerce and Industry (FICCI). *Survey on Key interventions needed to further the Growth of Supply Chain Logistics sector in India*. FICCI, New Delhi, 2010. Print.

33 Baru, Sanjaya. "Altering Expectations." *The Indian Express*, August 10, 2012, New Delhi ed.: p. 11. Print.

Finally, in his address to the nation on September 21, 2012, to defend the government's package of reforms,<sup>34</sup> Dr. Manmohan Singh once again underlined the importance of reviving investor confidence, domestically and globally, to reverse India's economic slowdown.

It is thus abundantly clear that facilitating higher FDI inflows by creating a policy environment for rapid economic growth is now a high priority for India. An empowered, high-level National Investment Board is under consideration for major FDI projects. However, with domestic political constraints and a general election looming in 2014, the government's resolve is likely to be tested.

## BIPAs and BITs of India and the US

The United States initiated its BIT programme in 1981 and has negotiated agreements with 47 countries till date. In addition, with the exception of US free trade agreements with Bahrain, Israel and Jordan, US free trade agreements (covering an additional 18 countries) include investment chapters that are comparable to BIT agreements.<sup>35</sup> However, with only 47 BITs in force, the US has lagged behind rest of the world. In comparison, Germany, China, Switzerland and the United Kingdom have each signed more than 100 BITs, and Italy, France, the Netherlands, Belgium, Luxembourg, and South Korea have all signed more than 80 BITs.<sup>36</sup> In the last 10 years, the United States has negotiated only two investment agreements, with Uruguay and Rwanda. At present, the US is negotiating BITs with China and India. With China, there have been six rounds of negotiations<sup>37</sup> since 2009, while there have been four rounds of negotiations with India since 2007.

In contrast, India has 82 BITs, including with several Asian and European economic powerhouses, of which 72 are in force. Additionally, India's comprehensive economic partnership agreements (CEPAs) with Japan and South Korea and its comprehensive economic co-operation agreements (CECAs) with Malaysia and Singapore include investment chapters that are similar to BIT agreements.

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34 On September 14, 2012, the Indian Government announced its boldest liberalisation package since 2004, which included: 51% FDI in multi-brand retail, relaxation of conditionalities to single-brand retail ventures, 100% FDI by foreign airlines in domestic aviation, FDI relaxations in broadcasting and power exchanges, divestment in four state-owned enterprises and cuts in fuel subsidies. ("Indian Reform, Take Two", *The Wall Street Journal*, September 17, 2012)

35 U.S. free trade agreement in force with the following countries all have investment chapters that are largely comparable to a BIT: Australia (omits investor-state dispute settlement), Canada, Chile, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Korea, Mexico, Morocco, Nicaragua, Oman, Peru and Singapore. U.S. trade promotion agreements with Colombia and Panama also include comparable investment chapters.

36 Broadbent, Meredith, and Robbins Pancake. *Reinvigorating the U.S. Bilateral Investment Treaty- A Tool to Promote Trade and Economic Development*. Center for Strategic & International Studies (CSIS), Washington D.C., June 2012. Web.

37 Barshefsky, Charlene, et al. *United States to Resume Bilateral Investment Treaty Negotiations on the Basis of a Revised Model Treaty*. WilmerHale, May 15, 2012. Web <http://www.wilmerhale.com/pages/publicationsandNewsDetail.aspx?NewsPubId=89748>. Accessed on December 30, 2012.

Although both India and the US have publicly expressed interest in concluding a BIPA/BIT, doubts and reservations persist. In acknowledging that the two countries have agreed to resume technical discussions on the “possibility” of an India-US BIT, US Trade Representative Ron Kirk has sounded cautious on the prospects of a speedy conclusion.<sup>38</sup>

It is only to be expected that negotiators will face complex challenges in ironing out differences in the respective BIPA/BIT model texts and their clauses. From the Indian side, there has been an aversion to the inclusion of non-trade/non-investment provisions, which are a standard feature of the “high quality” US model. While a revised version of the US BIT model text was unveiled in May 2012, the Indian side is re-evaluating its BIPA model in the light of recent developments.<sup>39</sup> Presuming that India is ready to move forward, it may seek a greater balance between investor safeguards and national regulatory space than has been the case so far. Other aspects of this ongoing review may include closing loopholes which extend MFN provisions to third countries.

Impediments to India’s trade and investment with the US also agitate the Indian business community, ranging from high H1B/L1 visa fees, growing visa rejections and the US’s reluctance to negotiate a totalisation agreement even though there are some 300,000 temporary Indian workers in the US. While these issues do not strictly fall within the ambit of a BIPA/BIT, they represent an important element which cannot be ignored by the government of India in BIT negotiations with the US.

Despite these existing constraints, there is today considerable bipartisan support on Capitol Hill in favour of advancing the US-India strategic partnership. Once the dust settles on the just concluded US presidential election, which inevitably throws up protectionist pronouncements (and adverse reactions in India), there could be ample support for the conclusion of a BIT to boost trade and investment opportunities, especially since enhancing jobs and improving economic growth are important political priorities for both democracies.

On the Indian side, progress on a BIT awaits an ongoing review of BIPA provisions. Given recent high-level policy pronouncements, this review will hopefully ensure that India remains an attractive destination for FDI.

A measure of cautious optimism that an India-US BIT will progress in 2013 would appear warranted. However, whether this will happen – in 2013 or later – will to a large extent depend on political-level direction prioritising bilateral economic engagement and the revival of dormant mechanisms like the Trade Policy Forum (TPF).

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38 Kannan, Indrani. “Long way to go for India-US investment treaty, says Kirk.” *Business Standard*, October 5, 2011. Online.

39 Khullar, Rahul. *India-US Economic Partnership: BIPA/BIT and Beyond*. Presentation at ICRIER on May 1, 2012.

# BIT and Beyond

## Advancing India-US Economic Relations

### III

## INDIA'S INVESTMENT CLIMATE

### Existing Regime and Trends

July 1991 marked perhaps the most significant turning point in India's political economy. Largely with one "big bang" reform moment, the burden of State control over the productive capacities and enterprise of the Indian people was lifted. The sheer scale of change was unprecedented, covering as it did the liberalisation and reform of trade, tariffs, exchange rate, industry, financial markets and taxes. India's doors were opened to foreign investment in many sectors.<sup>40</sup>

As a result, with GDP growth averaging around 7% over the past two decades, India's economic landscape stands transformed; there has been more progress on lifting millions out of poverty than over the preceding 40 years. A growing middle class of 300 million has emerged.<sup>41</sup>

More than any other factor, India's economic success – and opportunity – transformed the way the world looks at India. It became an emerging power and was invited to join the inaugural East Asia Summit in 2005, marking India's return to its historical geo-economic and geo-strategic role in Asia.

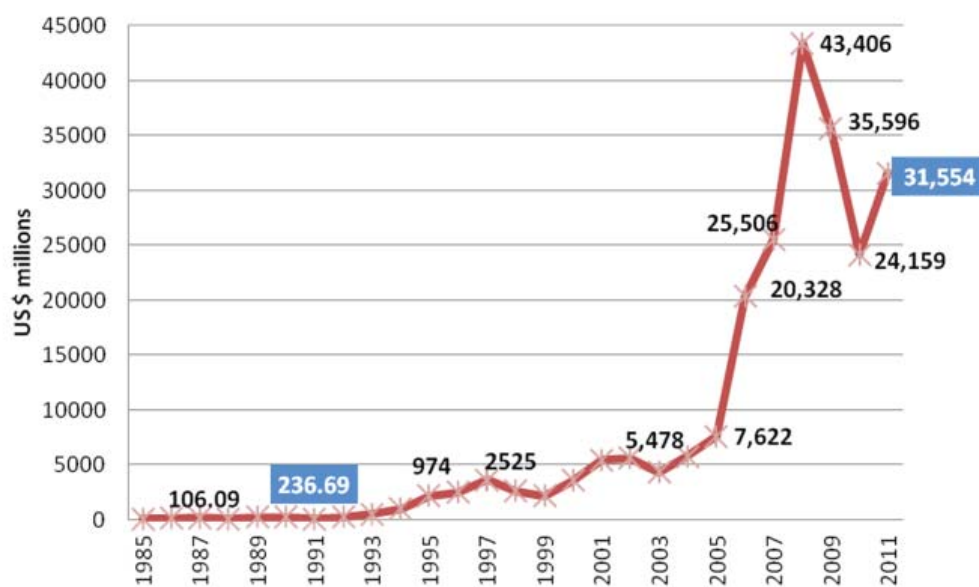
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40 Singh, Hemant K. "India's Prevailing Political Economy: The Logic of Reform." *ICRIER-Wadhvani Chair in India-US Policy Studies*, Issue Brief, Vol.1, Issue 1. [http://icrier.org/ICRIER\\_Wadhvani/Index\\_files/ICRIER-Wadhvani%20Chair-%20ISSUE%20BRIEF-OCT%202011.pdf](http://icrier.org/ICRIER_Wadhvani/Index_files/ICRIER-Wadhvani%20Chair-%20ISSUE%20BRIEF-OCT%202011.pdf)

41 *Ibid.*

The liberalisation and deregulation of the Indian foreign investment regime has resulted in significant inflows of foreign direct investment (FDI), which began picking up in 1992-93 with US\$ 252 million and recorded investment inflows of US\$ 31,554 million in 2011 (Chart 5).

**Chart 5: Investment Inflows into India**



Data source: UNCTADstat<sup>42</sup>

These changes in FDI policies were complemented by Bilateral Investment Promotion and Protection Agreements (BIPAs) and Double Taxation Avoidance Agreements (DTAAs) with several economic partners.

The gradual evolution of India's liberalised investment regime over the past two decades can be seen in Table 4.

<sup>42</sup> Accessed on August 24, 2012

**Table 4: Evolution of India's Investment Regime**

Period	Liberalisation measures
Pre-1991	<ul style="list-style-type: none"> <li>The Licensing system, governed by the Industries (Development and Regulation) Act of 1951, allowed the government to regulate investment decisions</li> </ul>
1991-96	<ul style="list-style-type: none"> <li>Approval of 51% foreign ownership in 35 priority sectors, which was further expanded to 111 industries, with equity ownership limits upto 50%, 51%, 74% and 100%<sup>43</sup></li> <li>Removal of general ceiling of 40% under the Foreign Exchange Regulation Act (FERA) on foreign ownership in FDI projects<sup>44</sup></li> <li>Sectors reserved for Small Sector Industries (SSI) were opened up for foreign investment upto 24% of equity ownership</li> </ul>
1997-99	<ul style="list-style-type: none"> <li>Foreign Investment Promotion Board (FIPB) was set up to provide single-window clearance for FDI projects not under automatic approval</li> </ul>
2000-05	<ul style="list-style-type: none"> <li>Consistent with its WTO-TRIMs commitments, dividend-balancing requirements were abolished for foreign investors by 2000; the indigenisation requirement in 2001; and the trade balancing requirement in 2002<sup>45</sup></li> <li>Foreign Exchange Management Act (FEMA) was introduced in 2000, which broadened the scope of FDI outflows</li> <li>FDI up to 100 per cent under the automatic route in construction activities subject to some guidelines<sup>46</sup></li> </ul>
2006-09	<ul style="list-style-type: none"> <li>FDI allowed up to 100% in most activities/sectors<sup>47</sup></li> <li>Progressive liberalisation of the FDI policy regime, and simplification of procedures<sup>48</sup></li> <li>Liberalisation of FDI policies in sectors such as telecom, retail<sup>49</sup></li> <li>Expansion of coverage of FDI to credit information companies and commodity exchanges; widening access of foreign firms to local equity markets<sup>50</sup></li> </ul>
2010-Sept.'12	<ul style="list-style-type: none"> <li>In November 2011, the government notified 51% FDI in multi-brand retail but later stalled implementation.<sup>51</sup> This pause was lifted in September 2012, with caveats</li> <li>In January 2012, 100% FDI was allowed in single-brand retail<sup>52</sup></li> </ul>

43 Department of Industrial Policy & Promotion (DIPP). *FDI Policy-Rationale and Relevance of Caps*, Discussion Paper. June 23, 2011. Web.

44 Rao, K S Chalapati, M R Murthy, and Biswajit Dhar. "Foreign Direct Investments in India since Liberalisation: An Overview." *Journal of Indian School of Political Economy*, July-September 1999. Print.

45 Organisation for Economic Co-operation and Development (OECD), *OECD Investment Policy Reviews for India*, 2009. Web.

46 Reserve Bank of India, Government of India. *Annual Report*, 2004-05. Web.

47 Reserve Bank of India, Government of India. *Annual Report*, 2005-06. Web.

48 Reserve Bank of India, Government of India. *Annual Report*, 2006-07. Web.

49 Reserve Bank of India, Government of India. *Annual Report*, 2007-08. Web.

50 Reserve Bank of India, Government of India. *Annual Report*, 2008-09. Web.

51 "Multi-Brand FDI to Go to Cabinet Soon." *The Economic Times*, November 18, 2011, New Delhi ed.: p. 1. Print.

52 "Govt notifies 100% FDI in single-brand retail." *Business Standard*, PTI, January 10, 2012, New Delhi ed. Online.

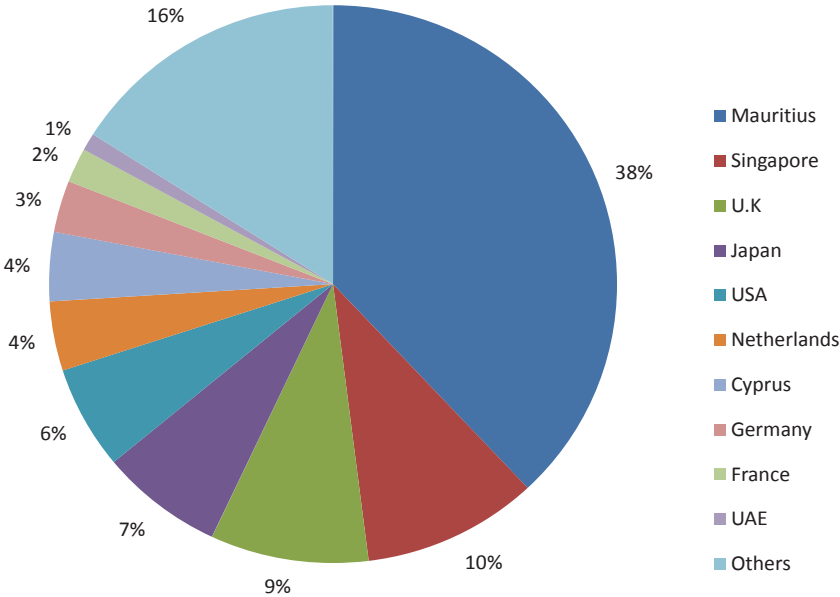
Inflows of foreign technology and capital have greatly benefited Indian industry and accelerated the integration of the Indian economy with the processes of globalisation. Nevertheless, sectoral limitations and restrictions continue to be in place through FDI caps and industrial licensing requirements. The existing regulatory regime in some of the main areas of interest to foreign investors is given in *Annexure-I*. A progressive rollout of further FDI liberalisation has been anticipated for the past several years but has begun to materialise only in September 2012, mainly because of domestic political constraints.

However, there is no room for complacency. In the latest Global Competitiveness Report released by the World Economic Forum in September 2012, India ranks 59<sup>th</sup> among 144 countries surveyed. It has slipped 10 places in the last three years, behind BRICS economies South Africa and Brazil and 30 places behind China.<sup>53</sup> From labour laws and regulations to lagging infrastructure and centre-state co-ordination, there is need for institutional and structural reforms that facilitate FDI.

The profile of FDI in India can be seen at Chart 6 (share of top investing countries), Chart 7 (sectors attracting the highest equity inflows) and Table 5 (leading FDI destinations).

## Profile of Foreign Direct Investments in India

Chart 6: Share of Top Investing Countries in FDI Equity Inflows

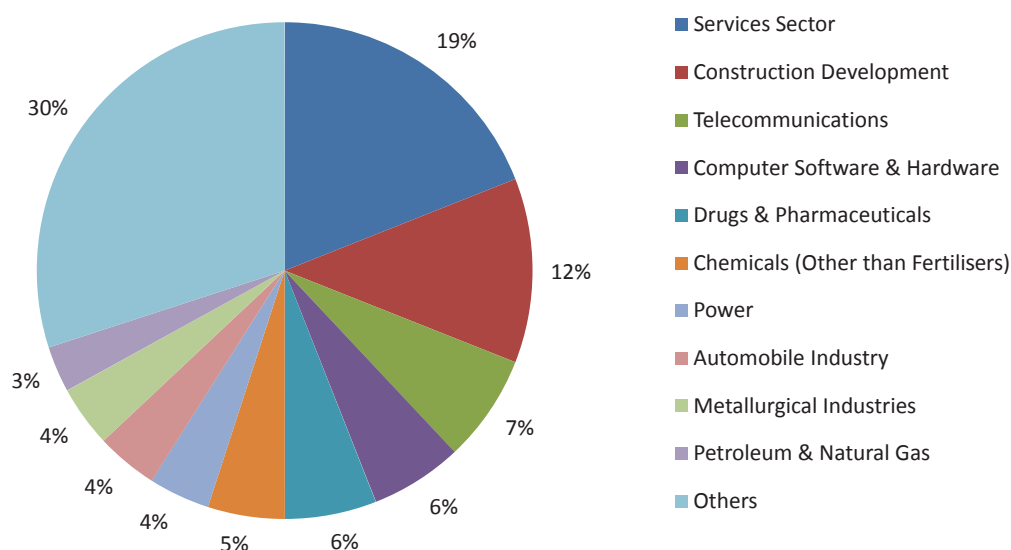


Source: Factsheet on Foreign Direct Investment (FDI), from April 2000 to June 2012, DIPP, accessed on September 10, 2012

53 Dhume, Sadanand. “Great Indian Expectations.” *The Wall Street Journal*, September 6, 2012. Online.



**Chart 7: Sectors Attracting Highest FDI Equity Inflows, April 2000 to June 2012**



Source: Factsheet on Foreign Direct Investment (FDI), from April 2000 to June 2012, DIPP, accessed on September 10, 2012

**Table 5: Top 10 FDI Destinations in India (April 2000 to June 2012)**

Rank	Region	States covered	% age to total inflows (US\$)
1	Mumbai	Maharashtra, Dadra & Nagar Haveli, Daman & Diu	32
2	New Delhi	Delhi, adjacent parts of UP and Haryana	19
3	Bengaluru	Karnataka	6
4	Chennai	Tamil Nadu, Puducherry	5
5	Ahmedabad	Gujarat	5
6	Hyderabad	Andhra Pradesh	4
7	Kolkata	West Bengal, Sikkim, Andaman & Nicobar Islands (U.T.)	1
8	Chandigarh	Chandigarh, Punjab, Haryana, Himachal Pradesh	1
9	Kochi	Kerala, Lakshadweep	1
10	Bhopal	Madhya Pradesh, Chhattisgarh	1

Source: Factsheet on Foreign Direct Investment (FDI), from April 2000 to June 2012, DIPP, accessed on September 10, 2012

While it is not the intention of this report to debate at length the unfinished agenda of economic reforms, an indicative list can be seen in Box 1.<sup>54</sup> A combination of governance deficit, inaction on reforms and premature focus on unaffordable welfare programmes through legal entitlements has created burdensome dependencies instead of empowering

54 Singh, Hemant K. “India’s Prevailing Political Economy: The Logic of Reform.” *ICRIER-Wadhvani Chair in India-US Policy Studies*, Issue Brief, Vol.1, Issue 1. [http://icrier.org/ICRIER-Wadhvani/Index\\_files/ICRIER-Wadhvani%20Chair-%20ISSUE%20BRIEF-OCT%202011.pdf](http://icrier.org/ICRIER-Wadhvani/Index_files/ICRIER-Wadhvani%20Chair-%20ISSUE%20BRIEF-OCT%202011.pdf)



the economy with more growth and jobs.<sup>55</sup> Wealth creation cannot be sustained without conditions that facilitate enterprise and investment. India is learning that economic growth is not ordained and its future trajectory is dependent on productivity enhancing reforms. Indian companies are finding it more beneficial to invest abroad, reflecting higher returns and fewer constraints on conducting business.

With the recent deterioration of India's macro-economic parameters and declining GDP growth, there is urgent need to attract greater FDI inflows in diverse sectors, including banking, insurance and pensions, retail, civil aviation, infrastructure and defence. If the government is able to muster the political will and consensus for further reforms, a renewed impetus for investment and efficiency gains from FDI liberalisation can make it possible for the Indian economy to rebound to higher levels of sustainable growth within a couple of years. As matters stand, FDI has fallen 67% on a year-on-year basis in Q1 (April-June) of FY 2012-13, to just \$ 4.43 billion. While FDI has since recovered to \$ 14.8 billion in the period April-October 2012, inflows are still 27% lower than in the same period of the previous year.<sup>56</sup>

Liberalisation of FDI in multi-brand retailing became a test case for investor sentiment after the Indian Government announced (November 2011), and then stalled a notification on this issue because of a political furore. Studies conducted by ICRIER as far back as 2004 recommended the opening up of FDI in multi-brand retail.<sup>57</sup> There is ample empirical evidence to suggest that increased competition in the retail space results in lower prices, improving consumer welfare and benefiting low-income households the most. It also leads to far greater efficiencies in supply chain management through investment in back end infrastructure, including cold storage for farm products. Countries throughout East Asia have gained from FDI in retail over the past two decades. China has attracted considerable FDI inflows for retailing and wholesaling, benefiting its economy and consumers alike. The Indian Commerce and Industry Minister, Anand Sharma, has pointed

## Box 1: India's (pending) Stage II Economic Reforms

- Institutional reform of governance to ensure accountability, transparency and predictability, in line with the pace of economic transformation.
- Continued emphasis on physical infrastructure, particularly power, roads and ports, with projected infrastructure investments of US \$ 1 trillion or 10% of GDP during the 12<sup>th</sup> Plan (2012-2017).
- Land acquisition reform to remove a major constraint to infrastructure, industry and urbanization.
- Reform of environmental and regulatory frameworks hampering extractive industries, particularly coal.
- Stage-II liberalisation covering multi-brand retailing, banking, insurance, capital markets, pensions, postal services and defence production.
- Pricing reforms to remove inefficiencies in power, water, food, petroleum and fertilizers, which remain a major drain on the economy.
- Labour market reform to promote organized sector employment and create flexibilities for seasonal demand and contractual labour.
- Demographic dividend-linked reforms to provide quality education and skill development on a mass scale, with emphasis on "employability".
- Completion of taxation reforms with a Direct Tax Code and a single nationwide Goods and Services Tax (GST).

55 Singh, Hemant K. "India's Prevailing Political Economy: The Logic of Reform." *ICRIER-Wadhvani Chair in India-US Policy Studies*, Issue Brief, Vol.1, Issue 1. [http://icrier.org/ICRIER\\_Wadhvani/Index\\_files/ICRIER-Wadhvani%20Chair-%20ISSUE%20BRIEF-OCT%202011.pdf](http://icrier.org/ICRIER_Wadhvani/Index_files/ICRIER-Wadhvani%20Chair-%20ISSUE%20BRIEF-OCT%202011.pdf)

56 Department of Industrial Policy and Promotion (DIPP) statistics cited in *The Times of India*, December 22, 2012.

57 Joseph, Mathew, et al. "Impact of Organized Retailing on the Unorganized Sector." *Indian Council for Research on International Economic Relations (ICRIER)* May 2008. Print.

out that “opening up FDI in multi-brand retail will bring in much needed investments, technologies and efficiencies to unlock the true potential of the agricultural value chain.”<sup>58</sup>

Interestingly, prohibition on FDI in multi-brand retail is not an entry ban but a restriction on the operating mode. Foreign retailers are present in India through wholesale cash and carry, exclusive licensing and distribution, single brand outlets, wholly-owned manufacturing subsidiaries and franchising arrangements. There was little economic logic to maintaining curbs on multi-brand retail, which was finally notified by the government in September 2012.

One of the most important challenges to be met for India’s economic rebound is in the area of infrastructure investments. New investments have slowed down substantially and existing investments are at risk with elongated gestations and input supply shortages, affecting the viability of projects going on-stream.<sup>59</sup> According to the Reserve Bank of India (RBI), inflows of investments in the telecom sector have shriveled, while those in roads, ports and airports have also fallen sharply. Mounting losses of public sector utilities have affected the investment climate in the power sector.<sup>60</sup> Investments in the mining sector are sorely needed.<sup>61</sup> The government is under pressure to deliver time-bound decisions under a transparent framework in order to remove infrastructure sector bottlenecks.

Over time, the private sector has contributed significantly to infrastructure investment, reducing pressures on the public sector.<sup>62</sup> This has increased the importance of a favourable environment for private sector participation. Sectoral analysis of private sector involvement in infrastructure during the Eleventh Plan indicates that sectors such as irrigation, railways, water supply, sanitation, ports and power distribution have not generated the desired levels of private investment.<sup>63</sup> At this juncture, the government needs to improve the regulatory, financing and incentive structures (both taxation and debt) and project implementation-related issues that may inhibit private investment into these sectors.

During the four-year period beginning 2004-05, the Indian economy maintained a reasonable consumption-fixed investment mix.<sup>64</sup> However, in recent years, the consumption component has been the predominant driver of growth, with the contribution of the fixed investment component showing a sharp decline from the pre-global economic crisis (2005-08) levels.<sup>65</sup> Deceleration in investment is reducing the potential output of the economy, pointing to the need for rebalancing and emphasising the role of foreign investment.<sup>66</sup>

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58 Roy, Rajesh, and Paul Beckett. “India Takes Steps to Open Economy.” *The Wall Street Journal*, July 18, 2012, U.S. ed.: p. A7. Print.

59 Reserve Bank of India, Government of India. *Annual Report 2011-2012*. Web.

60 *Ibid.*

61 *Ibid.*

62 Ministry of Finance, Government of India. “Energy, Infrastructure and Communications: Chapter 11.” *Economic Survey 2011-12*, p. 251-276. <<http://indiabudget.nic.in>>

63 *Ibid.*

64 Reserve Bank of India, Government of India. *Aggregate Demand*, RBI Documents. Web. <<http://rbidocs.rbi.org.in/rdocs/Publications/PDFs/02MDAD291012F.pdf>>

65 *Ibid.*

66 *Ibid.*

At a time when India's fiscal and current account deficits are unsustainably high and necessitate recourse to foreign equity and debt flows, and the possibility of a ratings downgrade looms large, the importance of a stable and predictable environment for FDI and FII, including taxation, cannot be overemphasised. The FY 2012-13 Finance Bill, through new taxation provisions like the General Anti-Avoidance Rules (GAAR) and a retrospective tax (from April 1, 1962) amendment, has severely undermined India's investment climate. Foreign investors have been jolted by a deviation from the norm of prospective taxation, inconsistency with the balance of powers and windfall authority in the hands of the tax administration. The government has been obliged to reconsider tax provisions in the FY 2012-13 budget, appointing an expert committee headed by Dr. Parthasarathi Shome of ICRIER to review GAAR. However, to re-establish the trust and confidence of investors, both foreign and domestic, the government will have to act quickly. While GAAR can be deferred for later implementation, repeal of retrospective taxation will pose more of a challenge, not least because of the charged political atmosphere. Both Prime Minister Manmohan Singh and Finance Minister P. Chidambaram have pledged to win back investor sentiment, but how far they will succeed remains an open question.

A large quantum of foreign investments in India is routed through Mauritius, taking advantage of favourable provisions of the India-Mauritius DTAA. As a result, Mauritius has become the largest FDI source for India. Between 2000-May 2012, 38% of India's FDI flowed through Mauritius, of which 6% originated in the US.<sup>67</sup> India is estimated to lose \$ 7 billion a year in taxes from offshore accounting, including in Mauritius.<sup>68</sup> However, the small island nation vigorously contests being characterised as a tax haven.<sup>69</sup> The Shome Committee has recommended that GAAR provisions should not be used against entities seeking DTAA advantages in Mauritius.<sup>70</sup>

## The US as an Investor in India

Except for 2005, the US has remained the leading source of FDI across the globe for the past decade. The volume of US global investment flows can be seen in Chart 8. The US ranks fifth among the top investing countries in India.<sup>71</sup> US FDI stock in India is currently 6.1% of total FDI inflows (Chart 9). However, according to Ernst & Young, "the US remains the leading investor in India both in terms of projects and jobs generated, accounting for 30% of investment projects (1290), with more than 355,600 jobs created between 2007 and 2011(Chart 10). A large number of leading American companies.... have expanded their presence in India."<sup>72</sup>

67 Bahree, Megha, and Deborah Ball. "Island Tax Haven Roils India's Ways." *The Wall Street Journal*, August 29, 2012, U.S. ed.: p. B1. Print.

68 *Ibid.*

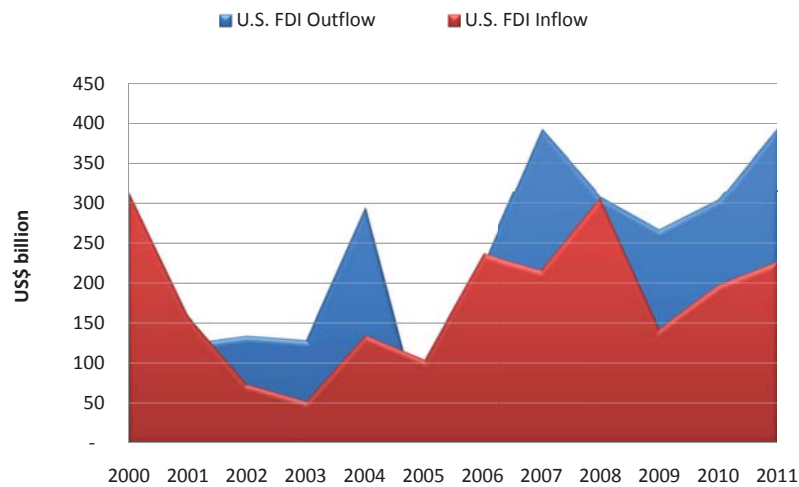
69 *Ibid.*

70 "Put off GAAR for 3 years, says PM-appointed panel." *Times of India*, September 2, 2012, New Delhi ed.: p. 1. Print.

71 Department of Industrial Policy & Promotion (DIPP). "Fact Sheet on Foreign Direct Investment." *FDI Statistics*, July 2012. Online.

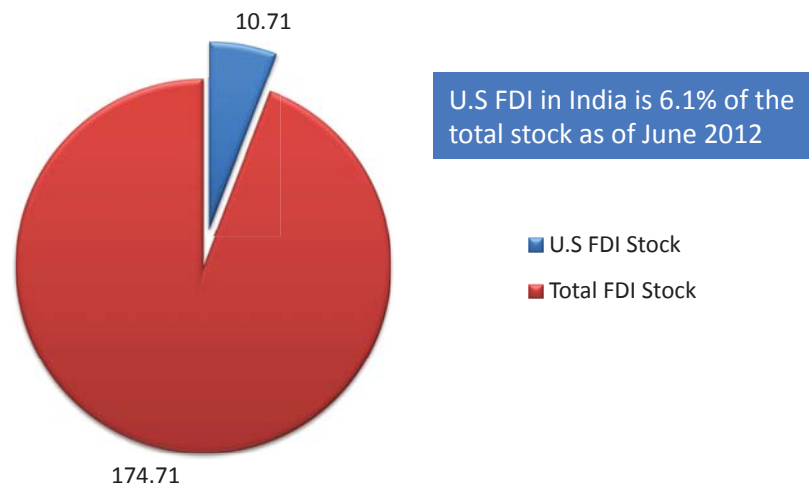
72 Ernst & Young. *Ready for the Transition: Ernst & Young's 2012 India attractiveness survey*. 2012. Web < <http://emergingmarkets.ey.com/wp-content/uploads/downloads/2012/03/india-attractiveness-final-version1.pdf>>

**Chart 8: US Global Investment Flows**



Data source: UNCTADstat<sup>73</sup>

**Chart 9: US FDI Equity Stock in India (as of June 2012, US\$ billion)**



Data Source: DIPP<sup>74</sup>

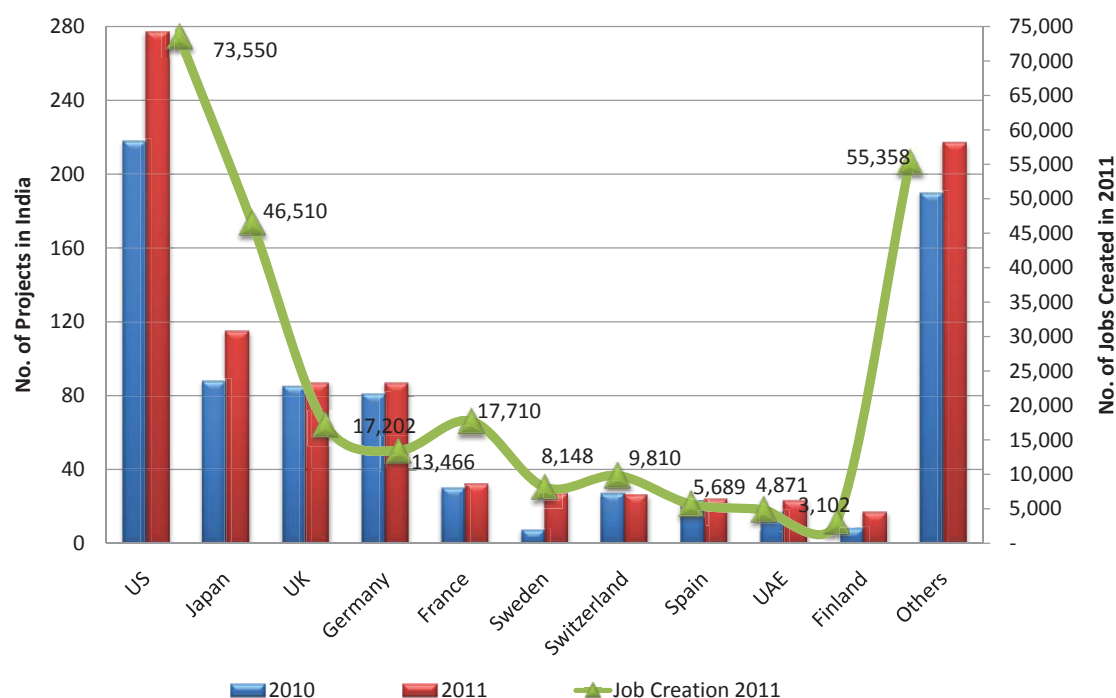
US investments in India between January 2000 and July 2012 have totaled \$10.88 billion.<sup>75</sup> Sectors which have attracted significant US FDI include professional, scientific and technical services and information technology, while manufacturing investments have remained modest. The industry body CII projects that over the coming years, infrastructure, energy, biotechnology and defence are likely to become major sectors of interest for US FDI.

<sup>73</sup> Data accessed on August 21, 2012.

<sup>74</sup> Data accessed on August 27, 2012.

<sup>75</sup> DIPP, Government of India, data accessed on December 3, 2012.

**Chart 10: FDI Inflows into India by Projects and Job Creation**



Source: Ready for the Transition, Ernst & Young's 2012 attractiveness survey, India

Table 6 shows the leading sectors that have attracted US FDI equity inflows.

**Table 6: Leading Sectors that attracted FDI Equity Inflows from the US (April 2000-June 2011)**

Sector	FDI equity Inflows (US\$ million)	% Share
Services sector	2,126.61	22%
Computer software & hardware	1,336.79	14%
Automobile industry	819.94	8%
Metallurgical industries	501.86	5%
Power	382.16	4%

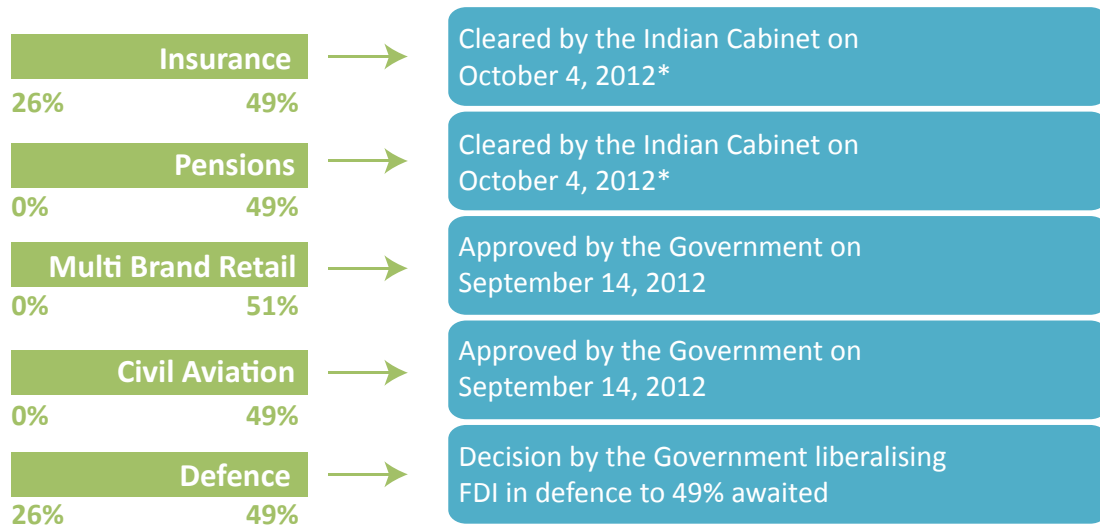
Source: DIPP<sup>67</sup>

The US has been pressing India to liberalise FDI in sectors such as insurance, financial services and multi-brand retail.<sup>76</sup> With the rapid expansion of defence transfers to India, it has also asked for the lifting of the 26% FDI cap in the defence industrial sector<sup>77</sup>, which would enable higher levels of technology transfer and co-production. The status of reforms widely anticipated by US investors can be seen in Chart 11. Recent progress should give a much-needed boost to investor sentiment.

<sup>76</sup> "Allow FDI in multi-brand retail: US to India." *Hindustan Times*, July 27, 2012. Online.

<sup>77</sup> Kumar, Vinay. "U.S. wants India to raise defence FDI ceiling." *The Hindu*, July 24, 2012, New Delhi ed. Online.

**Chart 11: Potential Sectors that await Reforms**



*\*Requires legislation by Parliament*

# Annexure I

## Sector-wise Regulation of Foreign Investment in India

Automatic route specified activities subject to sectoral cap and conditions (if any)		Prior approval from FIPB where investment is above sectoral cap for activities listed below		Prohibited list
Advertising and Film	100%	Existing Airports	74%-100%	Atomic Energy and Mass Rapid Transport System
Airports		Asset construction cos	100%	Lottery business
• Greenfield	100%	Banking (Public Sector)	20%	Gambling & Betting
• Existing	74%	Broadcasting		Chit funds
Air transport services		• FM Radio	26%	Nidhi Company
• Domestic Scheduled Passenger Airline including foreign airlines	100%	• Broadcast carriage service providers	100%-74%	Trading in Transfer Development Rights (TDR)
• For NRI	100%			
Alcohol distillation and brewing	100%	• Uplinking news and current Affairs	26%	Real Estate Business/ construction of Farm house
Automobiles	100%	• Uplinking non-news, current affairs TV channel	100%	Manufacturing of Cigars, cheroots and cigarettes, of tobacco or of tobacco substitutes
Banking (private sector)	74%	Courier services other than those under the ambit of Indian post Office Act, 1898	100%	Agricultural (excluding Floriculture, Horticulture, Development of Seeds, Animal Husbandry, Pisciculture and Cultivation of Vegetables, Mushrooms etc., under controlled conditions and services related to agro and allied sectors) and Plantations (other than Tea Plantations)
Biotechnology	100%			
Broadcast carriage service providers	100%	Defence production	26%	
Cement	100%	Petroleum and natural gas Refining (PSU)	49%	
Coal and lignite mining (for captive consumption by iron, steel, cement units)	100%	Private Security Agencies	49%	
Coffee, rubber processing and warehousing	100%	Pharmaceuticals (Existing companies)	100%	
Construction Development: townships, housing, built-up infrastructure	100%	Tea Sector – including Tea Plantation	100%	
Construction and maintenance of roads, highways, ports and harbors	100%	Test marketing for equipment for which company has approval for manufacture	100%	
Floriculture, horticulture, animal husbandry	100%	Satellite Establishment and Operation	74%	
E-commerce activities	100%	Print Media		
Education sector	100%	• Newspapers and periodicals dealing with news and current affairs	26%	
Hazardous chemicals	100%	• Publishing of scientific magazines/specialty journals periodicals	100%	
Health related services	100%	Telecommunication		



Automatic route specified activities subject to sectoral cap and conditions (if any)		Prior approval from FIPB where investment is above sectoral cap for activities listed below		Prohibited list
Hotel and tourism sector	100%	• Basic & unified access services	100%-74%	
Industrial explosives	100%	• ISP with gateways, radio paging, end to end bandwidth	100%-74%	
Industrial Parks	100%	• ISP without gateway (specified)	49%-100%	
Insurance	26%			
Mining (diamonds, precious metals, stones)	100%	## Micro and Small Enterprises (MSEs)subject to sectoral caps, entry routes & other sectoral regulations		
Non banking finance companies (conditional)	100%			
Petroleum and natural gas				
• Refining (private companies)	100%			
• Other areas	100%			
Pharmaceuticals (Greenfield)	100%			
Power generation, transmission, distribution	100%			
Textiles	100%			
Trading				
• Wholesale cash & carry	100%			
• Multi-Brand Retail	51%			
• Single Brand Retail	100%			
• Trading of exports	100%			
SEZ' s and Free Trade Warehousing Zones	100%			
Telecommunication				
• Basic and cellular services	100%			
• ISP with gateways, radio paging, end to end bandwidth	100%			
• ISP without gateway(specified)	100%			
• Manufacture of telecom equipment	100%			

Source: Investing in India, Survey Report, (November 2006), KPMG & FICCI, MEA & DIPP; Compiled by ICRIER



# BIT and Beyond

## Advancing India-US Economic Relations

### III

## LEGAL ISSUES: RECONCILING BIPA/BIT APPROACHES

India's BIPAs are based on an OECD model text of 1991, which has not been updated or revised since. However, there are variations with every BIPA and, in some cases, provisions allow for unintended "treaty shopping". Until recently, barring one case (White Industries), foreign investors appear to have been largely satisfied with their Indian experience.

The US BIT model of 1984 was revised in 2004 and has again been renewed in May 2012. The US text is based on the NAFTA template.

There is a clear difference of approach between the Indian and US model texts. India's BIPAs are loosely structured and can be interpreted widely, whereas the US BIT model, including its latest version, is a comprehensive, narrowly defined legal instrument designed primarily to protect investments and enforce investor rights.

On the Indian side, FDI is handled by the Department of Industrial Policy and Promotion (DIPP) in the Ministry of Commerce and Industry, while BIPAs come under the jurisdiction of the Ministry of Finance. This poses some structural challenges for promoting investments on the one hand and protecting investors on the other.

In the US Administration, the India-US BIT is being jointly pursued by the USTR and the Department of State.

## India's BIPAs and their Ongoing Review

Some of the key elements of India's BIPAs include:<sup>78</sup>

- purely post-establishment provisions, reflecting policy constraints to market access
- exclusion of non-trade/non-commerce/non-investment issues
- balancing investor protection with national regulatory space
- ensuring a level playing field for domestic and foreign investors

<sup>78</sup> Khullar, Rahul. *India-US Economic Partnership: BIPA/BIT and Beyond*. Presentation at ICRIER on May 1, 2012.

Recent cases in which foreign investors have invoked the Investor-State Dispute Settlement (ISDS) clause under BIPAs have resulted in calls for a thorough review of India's BIPA model. These cases include:<sup>79</sup>

i. White Industries (WIAL) vs. Coal India Ltd.

- WIAL wins 1999 ICC arbitration; awarded Au\$ 4 million
- Litigation ensues in Indian courts
- WIAL invokes arbitration again (2010) under India-Australia BIT for judicial delay amounting to denial of justice and violation of BIT on grounds of:
  - Fair and equitable treatment (FET)
  - Free transfer of funds and expropriation
- Recourse to provision in India-Kuwait BIT on “effective means of asserting claims and enforcing rights”
- Tribunal dismisses other pleas but rules that “denial of effective means” to enforce rights is a violation of the India-Australia BIT; awards Au\$ 4 million with interest

ii. In February 2012, the Russian company Sistema issued notice to the Government of India to settle its investment dispute under the India-Russia BIT, arising from the cancellation of 21 Sistema Shyam Tele Services Ltd. licences by the Indian Supreme Court.

iii. In March 2012, the Norwegian company Telenor invoked the India-Singapore CECA for “compensation for all investment guarantees and damages” consequent to the Supreme Court order annulling 2G licences.

iv. In April 2012, Vodafone served notice of dispute under the India-Netherlands BIT against a retroactive tax demand by the Government of India.

From the perspective of the Indian authorities, these developments give rise to concerns on the following counts:<sup>80</sup>

- i. Bilateral investment agreements are based on a country-specific strategic give-and-take. This intent is undermined by MFN provisions which allow for “treaty-shopping.”
- ii. Perceived imbalance between host country judicial sovereignty, regulatory space, public interest, sovereign policy goals, investor responsibilities and level playing field between domestic and foreign investors on the one hand and investor rights based on internationally driven investor protection on the other.

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79 Khullar, Rahul. *India-US Economic Partnership: BIPA/BIT and Beyond*. Presentation at ICRIER on May 1, 2012.

80 *Ibid.*

This has made it necessary for the Indian government to consider a broad review of its BIT strategy to remedy existing imbalances, including through:<sup>81</sup>

- Re-negotiation of BIPAs
- Clarifications on broad, open-ended provisions like “creating favourable conditions for investors”, “fair and equitable treatment”, “free transfer of capital” etc.
- Incorporation of domestic policy objectives and suitable exception clauses

While the logic of governmental reconsideration of BIPAs is well understood, there is need to caution against any tendency to undermine their basic purpose to promote and protect investments.

ISDS cases filed under international investment agreements were the highest ever in 2011 (450).<sup>82</sup> It is not merely the provisions of BITs but also their interpretation by arbitration bodies which are being seen as a problem. If such decisions curb the sovereign power of developing countries under “fair and equitable” treatment clauses, leaving little or no scope for governmental decision making and regulation in public interest, BITs can end up restricting all prospective powers of sovereign states.

There are also concerns about bias in ISDS cases in internationally arbitrated disputes.<sup>83</sup> Of the 15 lawsuits filed against the US Government under the ISDS clause in FTAs with various nations, the US has won every time. This has, for example, led to concerns in South Korea on two counts:<sup>84</sup>

- Infringement of national/judicial authority: By challenging policies of host nations, US investors could distort public policies
- Reverse discrimination against citizens of host nation: If rulings go in the US investor’s favour, it would create an unfair advantage for the investor over local firms by exempting the former from certain policies<sup>85</sup>

This basically implies that in negotiating BITs, Indian negotiators must remain aware that the host state’s sovereign regulatory functions – whether of the executive, legislature or judiciary – can fall under the ambit of BITs **unless specifically excluded**.<sup>86</sup> Taxation, an area where there is considerable regulatory uncertainty in India at the present time, is no exception to this norm.

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81 Khullar, Rahul. *India-US Economic Partnership: BIPA/BIT and Beyond*. Presentation at ICRIER on May 1, 2012.

82 UNCTAD, United Nations. *Latest Developments in Investor-State Dispute Settlement*. IIA Issues Note No.1, 2010. New York and Geneva: United Nations, 2010. Web.

83 Eun-joo, Jung. “Unearthed documents illustrate pitfalls of ISD clause.” *The Hankyoreh*, January 3, 2012, English ed. Online.

84 *Ibid.*

85 The Trade Promotion Authority Act, enacted by the US Congress in 2002, empowers the executive to carry out investment negotiations to ensure that foreigners would not receive greater rights than US citizens.

86 Ranjan, Prabhash. “Renegotiating a BIT.” *The Indian Express*, July 17, 2012, New Delhi ed.: p. 10. Print.

At the same time, investor-state arbitration (ISA) is the central element in any investment agreement,<sup>87</sup> which grant foreign investors the right to take legal action against the sovereign regulatory measures of the host state. While this can squeeze regulatory room, the elimination of ISA most certainly reduces the effectiveness of BITs in protecting foreign investment.

Seeking radical changes to ISA provisions can have an adverse impact on India's investment climate, as well as place growing Indian investments abroad at risk.

According to legal experts, the real challenge posed by BIPA commitments “does not stem from the investor-state dispute settlement provision, but from the broad substantive protections covered in the treaty, which do not balance investor protection with India's right to regulate. The way forward for India is to focus on renegotiating such provisions and narrowing the scope as per its developmental priorities.”<sup>88</sup>

UNCTAD, which has analysed arbitral interpretation processes involving international investment agreements (IIAs), has provided valuable insights for balancing investor protection and developmental imperatives. UNCTAD's advice is summarised in the following paragraphs:<sup>89</sup>

“Countries and negotiators are learning from their experiences and new challenges lie ahead as the first generation of treaties comes up for renewal and renegotiation. Specifically, given the kinds of interpretations the scope and definition clauses have had in recent years, concern has grown over the actual coverage of IIAs and whether they are offering too wide a field of support for investors and the various categories of investments that specific treaties have been found to protect...”

“Such concerns result in a changing environment for negotiators and a change in negotiating objectives. In particular, it is now open to discussion whether IIAs have become too one-sided in that expansive interpretations of the scope of coverage and protection offered by such agreements have led to fears that the host country's national policy space and right to regulate have been unduly curtailed in ways that might adversely affect genuine development policy objectives (UNCTAD 2003, chapters V and VI). In addition, given the emphasis placed by host countries on investor and investment promotion, it may be useful for protection to be more targeted covering not all investments, but only investments that can contribute to development...”

“This entails two objectives in particular. First, IIAs should be focused on investment that generates development benefits and, secondly, that the stability and predictability of the legal system, required by investors and their investments, is enhanced by clear and focused rules.”

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87 The exception is Australia, which excludes ISA from its BITs.

88 Ranjan, Prabhash. “Renegotiating a BIT” *The Indian Express*, July 17, 2012, New Delhi ed.: p. 10. Print.

89 UNCTAD, United Nations. *Scope and Definition-UNCTAD Series on Issues in International Investment Agreements II*. New York and Geneva: United Nations, 2011. Web.

These findings and observations of UNCTAD have been cited to enhance understanding of the issues involved, not to hinder progress on an India-US BIPA/BIT.

## The US BIT Model

While India undertakes its review of BIPAs, the US perspective on negotiating a BIT with India is quite clear. A recent State Department policy document on US-India relations has defined US objectives as follows:

“We are aiming for a high-quality agreement that expands on recent reforms to provide still greater openness to investment; strong rules to protect investors and guarantee transparency; and effective means for resolving disputes should they arise.”<sup>90</sup>

As of now, US investors in India are governed solely by domestic law. US negotiators will seek to ensure that an India-US BIT offers ample additional protections, including against regulatory uncertainties and policy rollbacks. For instance, the kind of opt-outs offered by the Government of India to state governments on FDI in multi-brand retail, which can allow post-investment policy reversals, carry the potential of creating future investor-state disputes under India’s various BIPAs, even in the absence of an India-US BIT.<sup>91</sup>

The NAFTA-based US BIT model includes a host of additional elements not covered in Indian BIPAs, ranging from pre-establishment rules (which have market access implications) to prohibitions on performance requirements, environmental and labour standards, transparency, intellectual property, financial services and effective enforcement of ISDM. Bridging these obvious gaps between the Indian and the US models will clearly pose a challenge for negotiators, but a closer examination of the latest US BIT text indicates that given an element of flexibility on both sides, mutual accommodation may be possible. The main issues can be summarised as follows:

- i. **Pre-establishment rules** will pose a hurdle if insisted upon by the US side. Agreeing to unrestricted pre-establishment national treatment protection is tantamount to renouncing the sovereign space for regulating FDI. India will hopefully continue to progressively liberalise its market, but accepting a blanket provision of this nature is not a likely prospect.

US BITs contain pre-establishment rules under “National Treatment” and “Most-Favoured Nation Treatment” provisions. India’s CECAs/CEPAs have comparatively restrictive provisions which are likely to define the broad limits of coverage acceptable for India.

- ii. On **prohibitions against performance requirements**, middle ground can be reached on the basis of India’s commitments under its CECA/CEPAs with Singapore, South Korea and Japan.

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90 US Department of State, *The United States and India: A Vital Partnership in a Changing World*, October 26, 2012. <http://www.state.gov/s/d/2012/199801.htm>, accessed on November 30, 2012.

91 Ranjan, Prabhash, and Deepak Raju. “A BIT about Walmart.” *The Indian Express*, November 28, 2012.

- iii. Provisions under the US BIT model on **investment and environment** fall within the ambit of “respective environmental laws and policies, and multilateral environmental agreements to which they are both party”.

Similarly, provisions on **investment and labour** fall under respective national statutes or regulations, as well as respective obligations as members of the ILO.

Neither of these environment and labour related provisions are under ISDS enforcement, which has drawn the following critical comment from the Harvard Law & Policy Review blog:<sup>92</sup>

“The Model BIT is largely like its earlier iterations, except for a few new articles regarding labour and environmental Law (Articles 12 and 13). Unfortunately, the new provisions remain fairly toothless. While a large portion of the Model BIT is devoted to how investment disputes can be resolved by binding arbitration, the environmental and labour provisions are only supported by a weak consultation procedure. Moreover, the new articles do not flesh out requirements to protect the environment; they merely require states to hold up their own law despite their wish to violate to attract investment.”

Nevertheless, residual concerns on the Indian side will need to be addressed as environment and labour clauses, even while not subject to ISDS, can become a source of non-tariff barriers and bilateral contention. Consultative mechanisms can be considered, if required.

- iv. The US BIT text includes exceptions for “**non-conforming measures**”. The India-Korea CEPA also contains provisions on non-conforming measures. India may seek to suitably restrict the MFN clause to prevent “treaty shopping”.
- v. **Intellectual Property Rights** (IPRs), from India’s perspective, can be addressed only within the norms and standards of the TRIPS regime.

This is one area of potential disagreement where both sides will need to tread carefully, particularly as India’s liberalised FDI policy in the pharmaceuticals sector could undergo changes in order to preserve room for making life-saving generic drugs available at affordable prices. India’s 2005 IPR law already includes language against perpetual “evergreening” by pharmaceutical firms by applying stricter standards for renewing expiring patents.<sup>93</sup>

In its definitions, the US BIT model text lists IPRs as a distinct form of “investment”. The implications have been analysed at some length in a US legal blog<sup>94</sup> and can be seen in *Annexure-II*. However, the main point that emerges from this commentary is that “the apparent protections in the revised US model BIT are not sufficient to allow India the flexibility that it has pursued in terms of IP protection.” The challenge for negotiators will be to find an acceptable formulation that gives India appropriate

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92 Kingston, Hudson. “One of these things is not like the other: Why the US Model BIT will not adequately protect the world environment.” *Harvard Law & Policy Review*, the HLPR blog, June 6, 2012. Web. July 14, 2012. < <http://hlpronline.com/2012/06/one-of-these-things-is-not-like-the-other-why-the-u-s-model-bit-will-not-adequately-protect-the-world-environment/>>

93 Ahmed, Rumman, and Amol Sharma. “Novartis Fights India for Cancer Pill Patent.” *The Wall Street Journal*, August 19, 2012, U.S. ed.: p. B3. Print.

94 McGrady, Benn. “Access to Medicines: India-United States BIT Negotiations.” *O’Neill Institute for National and Global Health Law*, May 15, 2012. Web. August 21, 2012 <<http://www.oneillinstitutetradeblog.org/access-to-medicines-india-united-states-bit-negotiations/>>



flexibility on governing IPRs in the context of pharmaceuticals – and public access to generic medicines – within the ambit of TRIPS.

India may have TRIPS compliant laws in place, but there are widespread concerns related to copyright piracy in software, optical media and publishing as well as weak protection and enforcement of intellectual property rights. India remains on the USTR's Intellectual Property Rights Priority Watch List. India should be prepared to accommodate US concerns on tighter IPR compliance.

## Conclusions

Bridging these gaps between the BIT and BIPA model texts will require flexibility, confidence building and mutual reassurance. This may imply that negotiations, when they commence in earnest beyond the current phase of “technical” discussions, will take time and could well be prolonged. India may be able to accommodate some elements of the US BIT model, and an eventual India-US BIPA/BIT is more likely to be a customised or hybrid version.

A comparative chart listing key provisions of US BITs and India's CEPAs/CECAs is given in Table 7. Apart from labour, taxation and financial services, the investment chapters of India's CEPAs/CECAs cover some of the main provisions of US BITs.

In conducting a review of India's existing BIPA model, it will be important for the concerned Ministries and Departments of the Government of India to harmonise their thinking and strike an appropriate balance between an investment friendly regime, investor protection and sovereign regulatory functions. Once that has been achieved, it will be equally important to utilise BIT negotiations with the US to address legal apprehensions and establish good working mechanisms between the two governments to handle investment-related problems whenever these may arise in the future. The need for informed decision-making and pragmatic adjustments is critical for a successful outcome.

**Table 7: Comparison of US BITs and India's CEPAs/CECAs**

Provisions of US BIT model text covered in Investment Chapters of India's recent CEPAs/CECAs	Indian BIT Model	US BIT Model (2012)	India-Japan CEPA	India-Korea CEPA	US-Australia FTA	India-Singapore CECA	India-Malaysia CECA
<b>Pre-establishment Provisions</b>	X	✓	✓	✓	✓	✓	✓
<b>Provision on Environment</b>	X	✓	✓	✓	✓	X	X
<b>Provision on Labour protection</b>	X	✓	X	X	X	X	X
<b>Prohibition on Performance requirements</b>	X	✓	✓	✓	✓	✓	X
<b>Non-conforming Measures</b>	X	✓	X	✓	✓	X	X
<b>Investment State Arbitration provision</b>	✓	✓	✓	✓	X	✓	✓
<b>Transparency Requirement</b>	X	✓	X	✓	X	✓	✓
<b>Taxation Clause</b>	X	✓	X	X	X	X	X
<b>Financial Services</b>	X	✓	X	X	✓	X	X

# Access to Medicines: India-United States BIT Negotiations

May 15, 2012 Written by Benn McGrady

Over at the International Law Curry blog, Shashank Kumar has raised the pressing question of how the heightened friction (on trade issues at least) between India and the United States might affect negotiation of a bilateral investment treaty (BIT) between the two countries. The question of how an India – US BIT might affect the Indian pharmaceutical industry (and access to medicines) is likely to be one of the most controversial issues in the negotiations. Hence, it is worth examining how the revised US model BIT, which was released last month, governs this issue.

On its face, the US model BIT appears to offer India a high degree of flexibility in terms of how it governs intellectual property rights (IPRs) in the context of pharmaceuticals. Article 6 governs expropriation and compensation. Paragraph 5 states:

***This Article does not apply to the issuance of compulsory licenses granted in relation to intellectual property rights in accordance with the TRIPS Agreement, or to the revocation, limitation, or creation of intellectual property rights, to the extent that such issuance, revocation, limitation, or creation is consistent with the TRIPS Agreement.***

Article 6 is also to be interpreted in accordance with Annex B. Paragraph 4 of this Annex explains what is meant by indirect expropriation. Specifically, paragraph 4(b) states:

**Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.**

Leaving aside the question of what constitutes a regulatory action under this provision, on its face, the US model BIT would appear to offer India a good deal of flexibility. However, the claims Philip Morris has brought against Uruguay and Australia highlight some issues, particularly with respect to Article 6.5.

In each of its claims, Philip Morris is arguing that tobacco packaging and labeling measures result in expropriation of its property rights. The rights in question include intellectual property rights (trademarks), goodwill and licenses. Hence, the claims are only partially about intellectual property rights. This raises the question of whether Article 6.5 would remove measures affecting licenses, the value of a business, or goodwill from the scope of the BIT. In this respect, the definitions section in Article 1 suggest that intellectual property rights are distinct from other associated property rights. Under Article 1, the term investment “means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk.” The



definition goes on to recognize that an investment may be in the form of IPRs. A separate sub-paragraph confirms that an investment may be in the form of a license (to the extent this confers a right under domestic law). The fact that IPRs are in a separate sub-paragraph from licenses could suggest that Article 6.5 does not apply to licenses.

The recent US Special 301 Report also gives some indication of the types of claims that foreign investor might like to bring under a future India – US BIT. A key section states:

**The United States will closely monitor developments concerning compulsory licensing of patents in India following the broad interpretation of Indian law in a recent decision by the Controller General of Patents, while also bearing in mind the Doha Declaration on TRIPS and Public Health found in the Intellectual Property and Health Policy section of this Report. The United States urges India to provide an effective system for protecting against unfair commercial use, as well as unauthorized disclosure, of test or other data generated to obtain marketing approval for pharmaceutical and agricultural chemical products.**

This language foreshadows expropriation claims relating to compulsory licensing (perhaps with respect to the value of assets other than IPRs) and for the disclosure of test data concerning an investor's investment in a way that permits generic pharmaceutical manufacturers to rely on that data in regulatory approval processes, such as by showing the bioequivalence of a generic drug and a patented drug. The Special 301 report also raises questions concerning the enforcement of intellectual property rights and delays in Indian courts. Arguably, this could foreshadow claims for denial of justice or with respect to fair and equitable treatment under a future BIT.

None of this analysis is intended to suggest that states with BITs in place cannot maintain Indian style IP laws without paying compensation to foreign investors (that question is beyond the scope of this post). The point is merely that the apparent protections in the revised US model BIT are not sufficient to allow India the flexibility that it has pursued in terms of IP protection.

*(O'Neill Institute for National and Global Health Law, <http://www.oneillinstitutetradeblog.org/access-to-medicines-india-united-states-bit-negotiations>)*

# BIT and Beyond

## Advancing India-US Economic Relations

### IV

## INDIA-US TRADE AND ECONOMIC RELATIONS

### The US and Trade Policy Issues in Asia

International trade is a highly sensitive and emotive political issue in the US, not least at a time when unemployment remains stubbornly high at around 8%. While partisan divides tend to be blurred during an economic downturn, Republicans are relatively more inclined towards free trade while Democrats are more prone towards protectionism. The resulting polarisation frequently implies gridlock in Congress, which is the ultimate authority on trade issues. At a time of unprecedented economic hardship, the US public can tend to mistakenly attribute job losses to off-shoring and outsourcing, which has been played up in an election year. In any event, presidential leadership is crucial to advance trade issues with Congress, and there appears to be little prospect of that happening anytime soon.

Before his election as President in 2008, Barack Obama was no different from the Democratic Party's mainstream, calling for the renegotiation of NAFTA and questioning free trade policies, neither of which he actually pursued after assuming office. Nonetheless, it is significant that the Obama Administration has not negotiated a single new FTA or even sought "fast track" trade negotiating authority from the Congress.

The centrepiece of the USTR's trade agenda under Obama is the Trans-Pacific Partnership (TPP), an initiative inherited from the Bush Administration which is now projected as a part of the US "pivot" towards Asia. Eleven countries are presently negotiating the "high standard" (i.e. WTO+) TPP, with the eventual goal of an APEC-wide Free Trade Area of the Asia-Pacific (FTAAP). Progress on TPP has been slow and its welfare gains, without the participation of major Asian economies like China, Japan, India and Indonesia, will be relatively modest. The Peterson Institute estimates that the TPP (11 countries) will yield a nominal gain of 0.1% to US income. APEC has made little progress on trade among its 21 members for the past two decades, but the US has chosen a trans-Pacific platform for regional economic integration. India is not an APEC member.

The earlier target of completing TPP negotiations in 2012 will be missed, even as questions grow about its impact and intent. Divisions over TPP were evident at the APEC Summit

hosted by Russia in September 2012 and are becoming more apparent following the ASEAN and EAS Summits held in November 2012.

Countries like India (and Indonesia) see little value in accepting the TPP's "gold standard" rules covering stricter labour and environment standards, stronger intellectual property rights, regulatory discipline of state-owned enterprises, liberalisation of the services sector, IT services and freedom of the Internet, or indeed elements of the TPP's rules of origin which contain protectionist provisions for US cotton yarn<sup>95</sup>. China sees the TPP as an extension of US security interests in the region in the guise of a trading bloc.<sup>96</sup> Japan is a fence sitter because of domestic concerns related to agriculture and services, but its main growth markets are in any case in emerging Asia. Its interest in TPP is more strategic than economic; despite tensions with China, it is unlikely to abandon the Regional Comprehensive Economic Partnership (RCEP) option which it has long pursued through ASEAN.

The ASEAN-led RCEP platform for Asian economic integration, which was endorsed by the China-Japan-Korea Trilateral Summit in May 2012 and by ASEAN Economic Ministers in August 2012, and was formally launched by the ASEAN 10+6 leaders in November 2012, offers a less ambitious but far more beneficial model from India's perspective. Table 8<sup>97</sup> indicates the considerable welfare gains from RCEP for ASEAN 10+6 countries, with India among the leading beneficiaries.

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95 "Partners and Rivals." *The Economist*, Banyan Column, 22-28 September 2012. Online.

96 *Ibid.*

97 Urata, Shujiro. *Regional Economic Integration in Asia: Challenges and Roles for Japan and India*, ICRIER Database, December 17, 2012. Web. Accessed on December 18, 2012.

**Table 8: Impact of ASEAN-led FTAs on GDP (% change)**

	ASEAN+6			ASEAN+3	
	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
<b>China</b>	-0.03	4.65	4.64	-0.05	4.49
<b>Japan</b>	0.04	0.64	0.56	0.02	0.63
<b>Korea</b>	0.38	2.67	2.28	0.34	2.64
<b>Indonesia</b>	0.13	4.35	4.13	0.11	4.15
<b>Malaysia</b>	0.62	9.53	8.95	0.57	9.24
<b>Philippines</b>	0.12	5.95	5.51	0.11	5.77
<b>Singapore</b>	-0.02	3.83	3.65	-0.02	3.63
<b>Thailand</b>	0.59	7.46	7.17	0.56	7.21
<b>Vietnam</b>	1.61	11.04	10.17	1.60	10.79
<b>Cambodia</b>	0.38	8.59	7.17	0.29	8.38
<b>Myanmar</b>	0.07	6.15	5.36	0.07	6.00
<b>Lao PDR</b>	0.40	5.99	4.69	0.40	5.94
<b>Brunei and East Timor</b>	1.86	6.98	6.14	1.86	6.92
<b>Australia</b>	0.11	1.27	1.20	-0.03	-0.03
<b>New Zealand</b>	0.08	1.94	1.77	-0.04	-0.02
<b>India</b>	0.45	3.40	2.70	-0.03	-0.07
<b>Hong Kong</b>	0.00	0.02	0.02	0.00	0.02
<b>China, Taipei</b>	-0.10	-0.18	-0.15	-0.11	-0.17
<b>NAFTA</b>	0.00	-0.02	-0.02	0.00	-0.02
<b>EU25</b>	-0.03	-0.09	-0.09	-0.02	-0.08
<b>Latin America</b>	-0.02	-0.05	-0.05	-0.02	-0.04
<b>Rest of the World</b>	-0.03	-0.08	-0.09	-0.03	-0.07

Note: Scenario 1: ASEAN+6: tariff elimination  
 Scenario 2: ASEAN+6: tariff elimination, trade facilitation, co-operation  
 Scenario 3: ASEAN+6: tariff elimination (excluding agriculture and food products)  
 trade facilitation, co-operation  
 Scenario 4: ASEAN+3: tariff elimination  
 Scenario 5: ASEAN+3: tariff elimination, trade facilitation, co-operation

The RCEP has twin objectives: to achieve a “modern, comprehensive, high-quality and mutually beneficial economic partnership agreement establishing an open trade and investment environment in the region”; and to “boost economic growth and equitable economic development, advance economic cooperation and broaden and deepen integration in the region”. The RCEP negotiations are set to begin in early 2013 and be completed by the end of 2015.<sup>98</sup> Offering greater flexibility and differential treatment to less developed ASEAN states, the RCEP will perhaps be an easier trade agreement to negotiate than the high-standard TPP. The decision by China, Japan and South Korea to negotiate a trilateral FTA from early 2013 will facilitate progress on the RCEP.

<sup>98</sup> “Joint Declaration on the Launch of Negotiations for the Regional Comprehensive Economic Partnership.” Phnom Penh, November 20, 2012.

Another important factor which will provide impetus to the RCEP is the role that the Economic Research Institute for ASEAN and East Asia (ERIA) is playing under three pillars, “namely, ‘Deepening Economic Integration’, ‘Narrowing Development Gaps’ and ‘Sustainable Development’, covering a wide range of policy areas, such as trade and investment, economic integration, SME promotion, human resource and infrastructure development, connectivity as well as energy and environment issues.”<sup>99</sup>

If the RCEP negotiations are successful, it can bring together 16 economies with a GDP of \$20 trillion, one-third of global GDP. Asian growth has tapered but is largely holding up thanks to domestic demand, boosting region-wide interest in efforts to enhance trade and investment.<sup>100</sup> This largely explains the eagerness of ASEAN countries and their +6 partners (China, India, Japan, South Korea, Australia and New Zealand) to transition from bilateral FTAs with ASEAN to a regional pact. The RCEP can accelerate the global economy’s shift towards Asia and may reduce the salience of the US-led TPP, which currently includes only smaller Asian economies. Some regional leaders have also cautioned Asian governments against over-extending themselves in separate RCEP and TPP negotiations.<sup>101</sup>

TPP’s rule-based “comprehensiveness and quality” approach contrasts with the RCEP’s “inclusiveness and flexibility” for narrowing development gaps. The era of the US “leading with strength” on trade issues is not a likely prospect in a scenario where the world’s future economic activity will be dominated by emerging Asia. That said, India would do well to consider that while it may currently have reservations about the TPP, it will face difficulties with the China-dominated RCEP as well, not least as the Indian business community will resist the idea of an FTA with China.

Membership in the TPP and RCEP is not necessarily mutually exclusive, but overlaps can create unnecessary inefficiencies and complexities<sup>102</sup>. A potential tussle between the RCEP and TPP needs to be avoided, even though it is difficult to see how exactly gaps between the two will be bridged for the benefit of member states. The US interest in not being marginalised by regional economic integration in Asia is perfectly understandable, but it also cannot afford to be seen to back initiatives that divide Asia, a notion which China can exploit to pose as a champion of Asian integration<sup>103</sup>. In the best case scenario, Asia’s “Arc of Advantage and Prosperity” will comprise a patchwork of trade agreements including bilateral FTAs, the RCEP, the TPP and a China-Japan-Korea trilateral FTA. Future negotiations may be able to resolve how the RCEP and TPP will be aligned to arrive at an FTAAP, but this is by no means a certainty.

The US has been reluctant to move on an FTA with ASEAN. However, recognizing the regional implications of the launch of RCEP, it has announced a US-ASEAN Enhanced

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99 Chairman’s statement of the Seventh East Asia Summit, Phnom Penh, November 20, 2012.

100 Curran, Enda. “Asian Leaders Push Regional Trade Pact.” *The Wall Street Journal*, November 19, 2012. Online.

101 *Ibid.*

102 Robles, Theresa. “Testing the (Pacific) Waters: Philippines’ Options in Regional Economic Integration.” *S. Rajaratnam School of International Studies, RSIS Singapore Commentary*, No. 178/2012, September 24, 2012. Online.

103 Singh, Hemant K. “ASEAN Centrality Key to Stability.” *The Economic Times*, 26 July 2012, New Delhi ed.: p. 13. Print.

Economic Engagement (E3) Initiative at the US-ASEAN leaders' meeting in Phnom Penh in November 2012. As RCEP works on an open accession principle, and does not prohibit members from acceding to other trade pacts, the door remains open for the US to join this economic integration platform at a later stage.

India and the US should step up their dialogue on regional economic integration in Asia. Driven by vibrant bilateral economic ties, their regional approaches in an Asian century must also eventually converge. As India's economic liberalisation progresses, it can also aspire to join the US-led TPP.

The outlook for a possible India-US FTA is outlined in Chapter VI.

## US-India Trade Policy Forum (TPF)

India does not figure prominently, if at all, in the USTR's present trade agenda. The new US model BIT, released after three years of consideration, reveals a continuing fixation with non-trade issues, including labour and environment. While India currently enjoys perhaps the largest Country Caucus in Congress, its members are continuously reminded of problem areas with India, from market access to local content, which tend to reinforce the protectionist narrative. It cannot, therefore, be presumed that there is a special opportunity for carrying the BIT forward in 2013, even though conditions appear relatively favourable.

At the same time, there is a decided interest on the part of the US to seek closer trade and investment ties with Asia's third largest economy for both bilateral and regional considerations. The US has made several high-level overtures towards India during 2012 and its ongoing "rebalancing" towards the Asia-Pacific would clearly be incomplete without the inclusion of India in both the security and economic dimensions of US engagement with the region. Complementarities between the technology and innovation-driven US economy and the demographic opportunity-driven Indian economy reinforce the logic of economic partnership.

The US-India Trade Policy Forum (TPF) was launched in July 2005 as part of the strategic dialogue between India and the United States and is designed to expand bilateral trade and investment relations between the two countries.<sup>104</sup>

A Private Sector Advisory Group (PSAG) was constituted as a supplementary body of the TPF in 2007 to provide private sector inputs on bilateral trade and investment and to make policy recommendations on economic partnership. In March 2010, India and the US also signed a "Framework for Co-operation on Trade and Investment Agreement" (TIFA) to foster a trade-enhancing environment through sectoral initiatives.

These TPF-led bilateral mechanisms have essentially under-performed in practice. The last (seventh) meeting of the TPF took place in Washington D.C. in September 2010. In January

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<sup>104</sup> Ministry of Commerce, Government of India. "Commercial Relations and Trade Agreements: Chapter 7." *Annual Report 2010-11*, p. 87-124.



2012, the 8<sup>th</sup> TPF meeting was called off at the last minute, reportedly because there was little likelihood of progress on market access issues in areas prioritised by the US side.<sup>105</sup> This was disappointing to say the least, as even when the TPF is unable to make major breakthroughs, it can serve as a confidence building mechanism for dialogue on a host of issues related to trade and investment that are important for both countries.

On its part the PSAG, comprising leading non-government experts, has met twice and commissioned five studies, which include the following:

- i. Harnessing mutual benefits from innovation-driven globalisation through a “US-India Technology Trade Agreement”
- ii. Delivering Urban Infrastructure in India: Avenues for Indo-US Participation
- iii. Improving Logistics Infrastructure and Services in India – Stimulating Contribution by the US Private Sector
- iv. Status, Issues and Prospects for Cooperation between India and the US in the Education Sector, in the context of India-US Economic Relations
- v. Strengthening India-US Economic and Trade Relations in Agriculture

In February 2011, the PSAG submitted a report on the first three studies listed above to the Trade Policy Forum. However, the PSAG’s recommendations have not received a governmental response, undermining the important role it was designed to play in bilateral economic relations. In particular, the PSAG’s significant proposal for a US-India Technology Trade Agreement, inspired by the TIFA, has not elicited a response from the TPF.

Similarly, under the TIFA Agreement, the two governments had agreed to work together to support greater involvement by small and medium enterprises in each other’s markets, pursue initiatives in the development of India’s infrastructure, and to collaborate on clean energy and environment services, information and communication technologies and other key sectors. However, no concrete activities have been ongoing under the TIFA.

## India-US Trade

Commercial and economic relations constitute an essential component of the expanding India-US bilateral partnership. For the US, India has moved up from being the 25<sup>th</sup> largest trade partner to the 13<sup>th</sup> largest in just over a decade.<sup>106</sup> The growth of bilateral merchandise trade between 2004-05 and 2010-11 can be seen in Chart 12. In terms of more recent data, India’s merchandise exports to the US from January-June 2012 totaled US\$ 19.88 billion and imports US\$ 10.18 billion, indicating continued growth.<sup>107</sup>

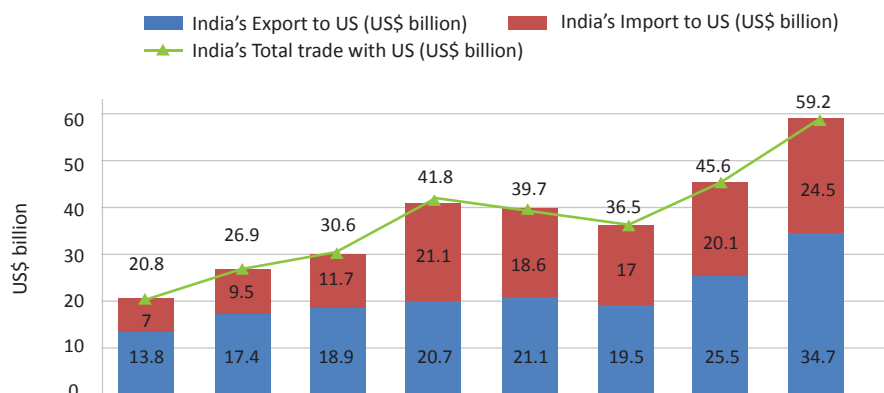
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105 Mishra, Asit R, and Elizabeth Roche. “India-US Trade Talks Postponed Indefinitely.” *Live Mint*, January 9, 2012. Online.

106 Remarks by Ambassador Nancy J. Powell at the American Chamber of Commerce’s 20th Annual General Meeting, Embassy of the United States, New Delhi, April 27, 2012

107 Embassy of India, Washington D.C, 2012. India-US Bilateral Trade, September 19, 2012. Web.

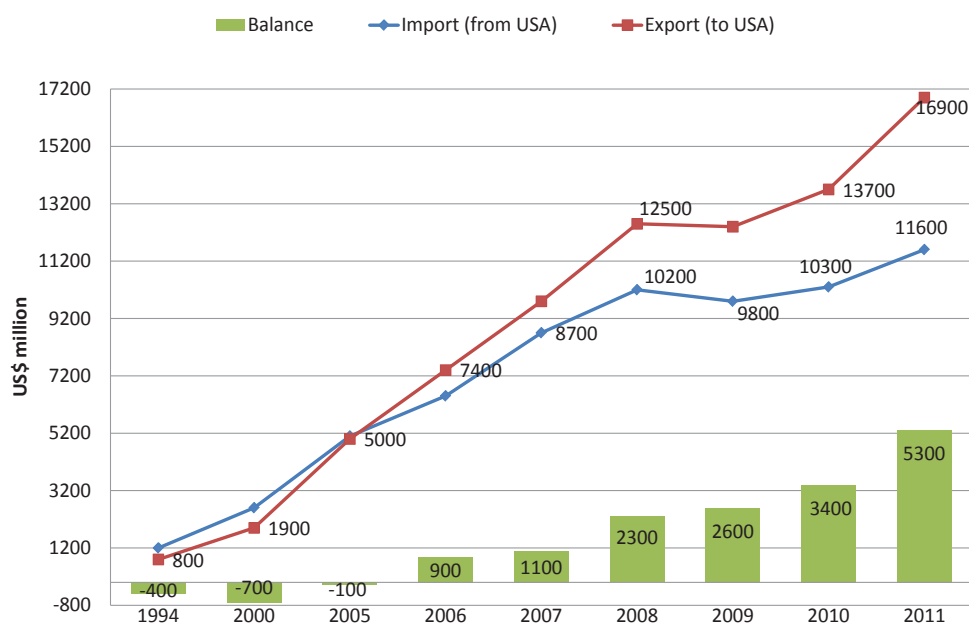
**Chart 12: India's Bilateral Merchandise Trade with the US**



Source: Export Import Data Bank, Ministry of Commerce, Government of India

Similarly, trade in services has also shown a steady upward trend (Chart 13).

**Chart 13: India-US Trade in Services**



Source: USTR<sup>108</sup>

While statistics tend to differ depending on the source and the timeframe, India-US merchandise trade totalled US\$ 59.2 billion in 2011-12,<sup>109</sup> and two-way services trade at US\$ 42.50 billion in 2009.<sup>110</sup> This would validate the assumption that India-US bilateral trade (goods and services) will exceed US\$ 100 billion in 2012-13.

108 United States Trade Representative USTR. *U.S.-India Bilateral Trade and Investment*. <<http://www.ustr.gov/countries-regions/south-central-asia/india>>. Web. September 19, 2012.

109 Export Import Data Bank, Department of Commerce, Government of India, accessed on December 7, 2012.

110 Ministry of External Affairs, Government of India. *India-United States of America Relations*. New Delhi, September 20, 2012. Online.



## Impact of the US GSP Scheme on Indian Trade

The USGSP scheme is designed to encourage economic growth in the developing world by stimulating export earnings and industrialisation. In the absence of an FTA with the US, this scheme provides significant benefits for Indian trade. A study conducted by ICRIER<sup>111</sup> in 2011 indicates a downtrend in GSP imports into the US, both in absolute terms and as a proportion of MFN dutiable imports. As a proportion of total dutiable imports from India, GSP imports grew from 19% in 2000 to 46% in 2006, before sliding back to 23% in 2010. The study cites structural deficiencies for lower GSP imports from India and suggests remedial measures, including expansion of product coverage, moderating competitive need limitations, minimising discretionary decisions, eliminating the requirement of reciprocity and unification of all unilateral preferential schemes. India was the leading beneficiary of the US GSP scheme in 2011.<sup>112</sup>

## India-US WTO Disputes

India and the US have not cooperated with each other at the WTO, even though both countries are strong supporters of a multilateral, rule-based global trading regime. Their tendency to blame each other at the most important forum for world trade does not reflect the otherwise robust and expanding India-US economic partnership and should be remedied.

Since 1996, India has filed eight cases against the US at the WTO, whereas the US has filed five cases against India. These have covered patent protection, anti-dumping and countervailing measures, quantitative restrictions, duties on import and import prohibition. The most recent disputes include:

- *Countervailing measures in certain Hot-Rolled Carbon Steel Flat products from India (DS436)*<sup>113</sup>

In March 2012, the US Commerce Department imposed Countervailing Duty (CVD) on certain steel rods imported from India, contending that these products were heavily subsidised and, therefore, led to an unfair pricing mechanism.<sup>114</sup> In April 2012, India challenged this assertion. Mutual consultations held in May-June 2012 were unsuccessful in resolving the dispute.

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111 Hoda, Anwarul, and Shravani Prakash. "Is the US GSP scheme benefiting India's trade?" *Indian Council for Research on International Economic Relations (ICRIER)*, Policy Series No.7, November 2011. Print.

112 United States Trade Representative USTR. 2012. *GSP by the Numbers*. <<http://www.ustr.gov/sites/default/files/GSP%20by%20the%20numbers.pdf>> Online.

113 World Trade Organisation (WTO). *Dispute Settlement: Dispute DS436, 2012. United States-Countervailing Measures on Certain Hot-Rolled Carbon Steel Flat Products from India*. September 15, 2012. Web.

114 Basu, Nayanima. "Are India, US on the brink of trade war?" *Business Standard*, August 2, 2012, New Delhi ed. Online.

■ *Measures concerning the importation of certain agricultural products from the United States (DS430)*<sup>115</sup>

In March 2012, the United States requested consultations with respect to prohibitions imposed by India on the import of various agricultural products from the US, purportedly because of concerns related to Notifiable Avian Influenza (NAI).<sup>116</sup> The US claims that India is violating the agreements on Sanitary and Phytosanitary Measures and Technical Barriers to Trade of the WTO.<sup>117</sup> During consultations held in April 2012, the Indian side clarified that import restrictions on certain agricultural products were not applicable against the US since the latter had notified freedom from NAI to the OIE. India's restrictive measures have been taken with the legitimate objective of protecting human and animal health and food safety and these are consistent with WTO norms. Consequently, India has declined to accept the establishment of a WTO panel.

## Other Issues

Services exports contributed 8.9% of India's GDP in 2011-12. During this period, India's software exports totalled US\$ 62.2 billion and accounted for 44.14% of total services exports.<sup>118</sup> Indian IT companies have complained that exceedingly high rates for H1B and L1 visas from 2010 onwards as well as the exponential growth rate of visa rejections are unfairly limiting their access to the US market. There have been periodic reports that India might take up this case with the WTO's dispute settlement body. While India has long championed Mode 4 access issues at the WTO, there is need for more innovative approaches and models, including Mode 3 linked corporate transfer quotas under a BIPA/BIT or an FTA. These issues are elaborated further in Chapter V.

India and the US have clashed at the WTO on agricultural issues, but there is room for making progress. India provides large input subsidies to agriculture, which are becoming unsustainable. The US extends loans and various forms of direct payments. India is gradually reducing tariffs, especially in areas where there are domestic production shortfalls. The US has low tariffs, except in the case of sensitive products like dairy, sugar and cotton. In the absence of a new WTO deal or a bilateral FTA, agricultural trade can be boosted through the relaxation of Sanitary and Phytosanitary (SPS) restrictions. This can be a core agenda of a re-energised Trade Policy Forum (TPF) and will certainly help relieve some of the trade related tensions which cloud bilateral economic relations.<sup>119</sup>

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115 World Trade Organisation (WTO). *Dispute Settlement: Dispute DS430. India-Measures Concerning the Importation of Certain Agricultural Products from the United States*. September 15, 2012. Web.

116 *Ibid.*

117 Basu, Nayanima. "Are India, US on the brink of trade war?" *Business Standard*, August 2, 2012, New Delhi ed. Online.

118 Export Import Bank of India (EXIM). *India's Macroeconomic Indicators*. Updated July 2, 2012. Web. < <http://www.eximbankindia.com/index.asp>>

119 Hoda, Anwarul. ICRIER WTO Chair. 2012.

# BIT and Beyond

## Advancing India-US Economic Relations

# V

## INDIAN FDI AND PRESENCE IN THE US MARKET

### India's Increasing Outward FDI

Recent years have witnessed the increasing participation of developing economies as a source of global FDI. In 2011, they accounted for 17.5% of global FDI stock valued at US\$ 3.7 trillion, up from only 10.8% of FDI stock totaling US\$ 857 billion ten years ago. Outward FDI from developing economies reached US\$ 384 billion in 2011, 22.6% of total global FDI flows.<sup>120</sup>

With progressive liberalisation of outward investment since 1992, India has been no exception to this trend. As a natural byproduct of globalisation, India's investments abroad have been driven by the desire to secure better access to markets, production networks, technology, management skills and strategic resources.<sup>121</sup> In 2011, FDI outflows from India rose 12% to US\$ 15 billion.<sup>122</sup> Leading destinations for Indian FDI are listed in Table 9 and major sectors for these FDI outflows in Table 10.

120 UNCTAD, United Nations. *World Investment Report 2012*. Switzerland: United Nations, 2012. Web.

121 Khan, Harun R. "Outward Indian FDI – Trends and Emerging Issues." Presentation at Bombay Chamber of Commerce & Industry, Mumbai on March 2, 2012. Reserve Bank of India (RBI), 2012.

122 UNCTAD, United Nations. *World Investment Report 2012*. Switzerland: United Nations, 2012. Web.

**Table 9: Top Ten Country-Wise Overseas Investments by Indian Companies***(US\$ billion)*

Country	2008-09	2009-10	2010-2011	2011-2012*	Total
Singapore	4.06	4.2	3.99	1.86	14.11
Mauritius	2.08	2.15	5.08	2.27	11.57
Netherlands	2.79	1.53	1.52	0.7	6.54
United States of America	1.02	0.87	1.21	0.87	3.97
United Arab Emirates	0.63	0.64	0.86	0.38	2.51
British Virgin Islands	0	0.75	0.28	0.52	1.55
United Kingdom	0.35	0.34	0.4	0.44	1.53
Cayman Islands	0	0.04	0.44	0.14	0.62
Hong Kong	0	0	0.16	0.31	0.46
Switzerland	0	0	0.25	0.16	0.41
Other countries	7.65	3.19	2.65	1.23	14.71
<b>Total</b>	<b>18.58</b>	<b>13.71</b>	<b>16.84</b>	<b>8.88</b>	

*Source: RBI (\*Till February 2012)***Table 10: Major Sector-wise Overseas Investments by Indian Companies***(US\$ billion)*

Period	2008-09	2009-10	2010-2011	2011-2012*	Total
Manufacturing	10.18	5.35	5.04	2.74	23.31
Financial Insurance, Real Estate Business & Business Services	3.55	4.41	6.53	2.53	17.02
Wholesale & Retail Trade, Restaurants & Hotels	1.17	1.13	1.89	1.00	5.19
Agriculture & allied activities	2.38	0.95	1.21	0.41	4.95
Transport, Communication & Storage Services	0.31	0.38	0.82	1.34	2.85
Construction	0.35	0.36	0.38	0.37	1.46
Community, Social & Personal Services	0.39	0.18	0.70	0.18	1.45
Electricity, Gas & Water	0.14	0.84	0.10	0.04	1.12
Miscellaneous	0.12	0.11	0.18	0.10	0.51
<b>Total</b>	<b>18.59</b>	<b>13.71</b>	<b>16.85</b>	<b>8.71</b>	<b>57.86</b>

*Source: RBI (\*Till February 2012)*

## Indian Investments in the US

A study on India-US economic engagement jointly undertaken by the US World Affairs Institute and FICCI in 2010 indicated that during the period 2004-09, investments made by Indian companies in the US totaled nearly US\$ 26 billion.<sup>123</sup> These included:

- 127 green-field investments by 90 Indian companies worth US\$ 5.5 billion, creating 16,576 jobs in the US
- 372 acquisitions by 239 Indian companies with a total reported deal value of US\$ 21 billion<sup>124</sup>

According to CII estimates, cumulative Indian investments in the US market between 2000 and 2010 stood at US\$ 6.6 billion, of which US\$ 4.2 billion was invested between 2007 and 2010, indicating an upward trend.

Another survey conducted by the CII-India Business Forum in 2011 covering 36 Indian companies<sup>125</sup> in the US indicated that IT-BPO services comprise the largest segment followed by healthcare, pharmaceuticals and life sciences and manufacturing and financial services. Of 72 Mergers and Acquisitions conducted by surveyed companies since 2005, 41 transactions were in the IT services sector. Other findings of the CII study with respect to the IT sector include:

- a. Surveyed IT companies had made investments worth US\$ 1.4 billion since their inception
- b. In 2011, their collective revenues totaled US\$ 18.9 billion and annual payroll US\$ 2.2 billion

NASSCOM, an IT/ITeS industry body, estimates that Indian technology companies have invested over US\$ 5 billion in some 128 acquisitions in the US between FY 2007 and FY 2011-Q1 and the direct workforce employed by Indian IT companies has nearly doubled over the last five years from 58,000 in FY 2006 to 107,000 in FY 2011.

## Role of the Services Sector in India's Economy

In 2011-12, the services sector enjoyed the largest share in India's economy, both in terms of contribution to GDP (59%) and GDP growth (8.9%).<sup>126</sup> The services sector is by far the most significant catalyst for the growth of the Indian economy and provides the most

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123 Jain, Vinod K, and Kamlesh Jain. "How America Benefits from Economic Engagement with India." *India - US World Affairs Institute, FICCI, University of Maryland and Robert H Smith School of Business*, 2010. Online < [http://c.yimcdn.com/sites/www.india-us.org/resource/resmgr/files/executive\\_summary\\_6.14.2010.pdf](http://c.yimcdn.com/sites/www.india-us.org/resource/resmgr/files/executive_summary_6.14.2010.pdf)>. Accessed on August 11, 2012.

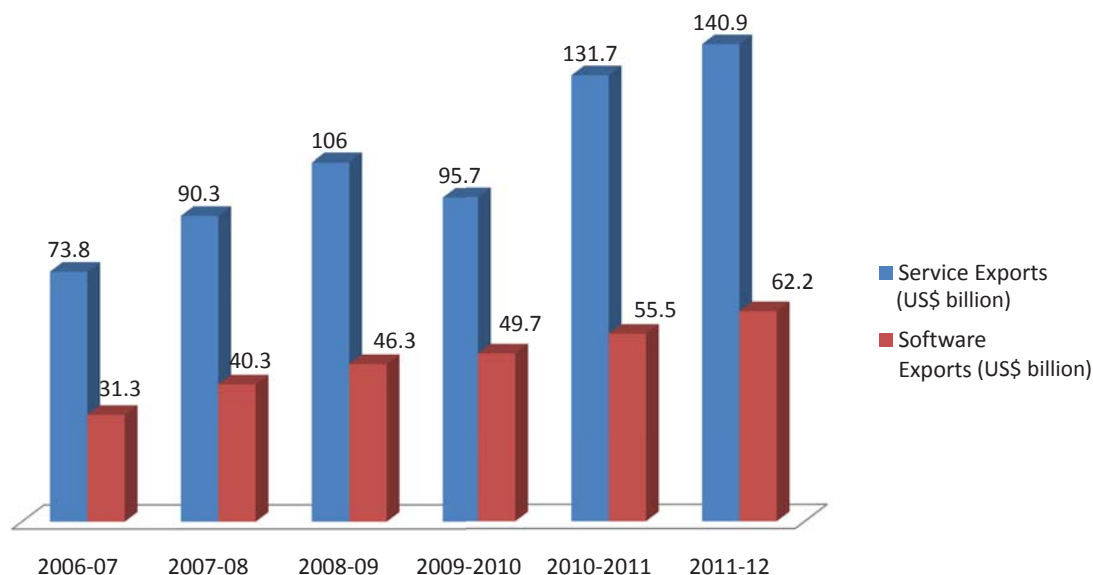
124 Reported deal value pertains to only 267 (out of 372) M&A transactions cited above.

125 Confederation of Indian Industry (CII). *Indian Roots, American Soil: Adding Value to U.S. Economy and Society*. 2012.

126 Export Import Bank of India (EXIM). *India's Macroeconomic Indicators*. Updated July 2, 2012. Web. <<http://www.eximbankindia.com/index.asp>>

valuable opportunities for entrepreneurship and innovation. Services exports have grown steadily since 2006-07. Likewise, the share of revenue earned by software exports has also been rising (Chart 14).

**Chart 14: India's Services Export Revenue**



Source: India's Macroeconomic Indicators, EXIM Bank

It is estimated that by 2020, the IT-BPO industry's exports (excluding hardware) will increase to US\$ 175 billion and its domestic revenue to US\$ 50 billion.<sup>127</sup>

## Indian IT Services Exports to the US

In 2011-12, revenue from India's IT-BPO services totalled US\$ 87.6 billion, of which US\$ 68.7 billion came from exports (Table 11). The US share in these exports in 2012 is estimated at nearly 62% (Table 12), making the US the largest trading partner for India's IT-BPO industry. In addition to being the main destination for exports, the US also leads in the number of technology companies that partner with Indian companies to provide services to markets worldwide.<sup>128</sup> This two-way technology and innovation driven partnership symbolises both the quality and the potential of India-US economic relations today.

<sup>127</sup> Mittal, Som. *India's IT Industry in the 21st Century: Vanguard of the Services Export Revolution*. Presentation at ICRIER-KAS Seminar on June 14, 2012.

<sup>128</sup> NASSCOM. *India's Tech Industry in the US: A Contribution Review*. Web. Accessed on August 20, 2012.

**Table 11: Overall Growth Performance of the IT-ITeS Sector***Value (US\$ billion)*

	2007-08	2008-09	2009-10	2010-11(E)	2011-12(P)	Growth Rate(%) 2011-12	CAGR (%) 11th Five Year Plan
Total IT-BPO Services Revenue	52.1	59.9	64	76.3	87.6	14.8	13.9
Exports	40.4	47.1	49.7	59	68.7	16.4	14.2
Domestic	11.7	12.8	14.3	17.3	19	9.7	12.8

*Source: Economic Survey 2011-12, Ministry of Finance***Table 12: IT-BPO Region-wise Exports from India (Share in %)***Value (US\$ billion)*

Country/ Region	2007		2008		2009		2010		2011		2012	
	Export	Share	Export	Share	Export	Share	Export	Share	Export	Share	Export	Share
USA	19.2	61.53	23.8	58.91	28.31	60.1	30.09	60.56	36.26	61.5	42.57	61.96
UK	5.6	17.95	7.7	19.06	8.71	18.5	8.91	17.94	10.16	17.24	11.58	16.86
Europe (Excl UK)	3.9	12.5	5.3	13.12	5.89	12.5	6.02	12.12	6.84	11.59	7.79	11.34
Asia	2	6.41	3.3	8.17	3.3	7	3.63	7.3	4.42	7.5	5.25	7.65
RoW	0.51	1.62	0.3	0.74	0.9	1.91	1.04	2.09	1.28	2.17	1.5	2.18
Total	31.21	100	40.4	100	47.1	100	49.69	100	58.96	100	68.7	100

*Source: NASSCOM*

Owing to misplaced concerns regarding the impact of outsourcing, Indian IT/ITeS companies have been the target of vigorous anti-outsourcing campaigns as well as legislative measures in the US. Some of these are listed in Box 2. The most significant among the measures is the near doubling of H-1B and L-1B visa fees. At the same time, the visa rejection rate for Indian professionals is inordinately high, with the US Citizenship and Immigration Service more likely to deny a petition for new (initial) L-1B visas from an Indian-born professional than nationals of other countries (Table 13).<sup>129</sup> State Department figures indicate that between FY 2010 and 2011, the number of L-1 visas issued by US posts in India declined by 28% while the number of visas issued in the rest of the world increased by 15%.<sup>130</sup> A NASSCOM survey of select Indian companies with operations in the US indicated a 40% visa rejection

129 “L-1 Visa Approvals Decline Significantly at U.S. Posts in India in 2011.” *National Foundation for American Policy*, NFAP Policy Brief, November 2011. Web < [http://www.nfap.com/pdf/L1\\_Visa\\_Approvals\\_In\\_India\\_Decline\\_in\\_2011\\_NFAP\\_Policy\\_Brief\\_Nov2011.pdf](http://www.nfap.com/pdf/L1_Visa_Approvals_In_India_Decline_in_2011_NFAP_Policy_Brief_Nov2011.pdf)>. Accessed on November 10, 2012.

130 *Ibid.*



average across visa categories in 2010.<sup>131</sup> This raises concerns in India about a deliberate policy change in the US or even the use of the visa regime as a potential trade barrier.

NASSCOM contends that while public concerns about high unemployment in the US are understandable, a careful examination of US non-farm payroll data suggests that sectors such as construction, retail and manufacturing have been the largest contributors towards unemployment/job losses. If anything, the US technology sector has been adding jobs. The number of H1 visas issued to Indian companies out of the overall annual cap of 65,000 is too small to make any significant impact in a working population of 150 million. Even as the US economy is making a slow recovery in terms of employment, Indian IT companies continue to add jobs (Chart 15) in the US. NASSCOM estimates that currently, India's technology industry supports 280,000 jobs in America and has contributed \$15 billion to the US treasury over the past five years.

This has become an emotive and high profile issue on which repeated demarches by the Indian side have not elicited a response from US counterparts. The movement of service professionals has long been an important component of India's trade and investment policy and remains a serious point of contention with the US, which has largely tended to regard this as an immigration issue. From all indications, India may seek WTO consultations with the US on visa fees, which restrict the movement of Indian professionals and discriminate against Indian software companies in the US market.

While there are domestic sensitivities on both sides, this issue cannot be wished away in any serious discussion of India-US economic relations. India's IT industry has helped enhance the competitiveness of US companies. Out of the top 15 technology companies in India, 10 are from the US. Once the dust settles on the US Presidential election, it would be preferable to make a fresh start on resolving Mode 4 issues related to the movement of business professionals.

## Box 2: US Anti-Outsourcing Measures

1. State of Ohio order to curb off-shoring (August 2010): Ohio banned the outsourcing of government IT and back office projects to offshore locations such as India.
2. Border Security Bill (August 2010): The bill nearly doubles skilled-worker H-1B and L-1 visa fees, to as high as \$4,500 per applicant, for any company with at least 50 employees in which foreigners are more than 50% of its US work force. Typically, all Indian companies leveraging Indian talent are impacted by this bill.
3. James Zadroga 9/11 Health and Compensation Act of 2010 (December 2010): The 9/11 Act extends the duration of the earlier increase in H-1B and L-1 visa fees from four years (as enacted under Border Security Bill) to five years. The Act also imposes a 2 per cent excise tax on goods and services purchased by foreign suppliers of services (such as Indian IT/ITeS companies).
4. Centralisation of L visas in Chennai (November 2011): From December 1, 2011 all applications for L-1 visas are processed in Chennai. All applicants from across India have to undertake travel to Chennai, adding further to costs for Indian companies.
5. US Call Center Worker and Consumer Protection Act: This bill, tabled in the House of Representatives, seeks to make businesses that move call centres abroad ineligible for grants or guaranteed loans from the US government, while also imposing other stringent compliance requirements.

(Source: NASSCOM and CII)

131 "US business visa rejections at 40%: Nasscom." *The Times of India*, May 22, 2012. Online <<http://timesofindia.indiatimes.com/business/india-business/US-business-visa-rejections-at-40-Nasscom/articleshow/13366271.cms>>. Accessed on July 16, 2012.

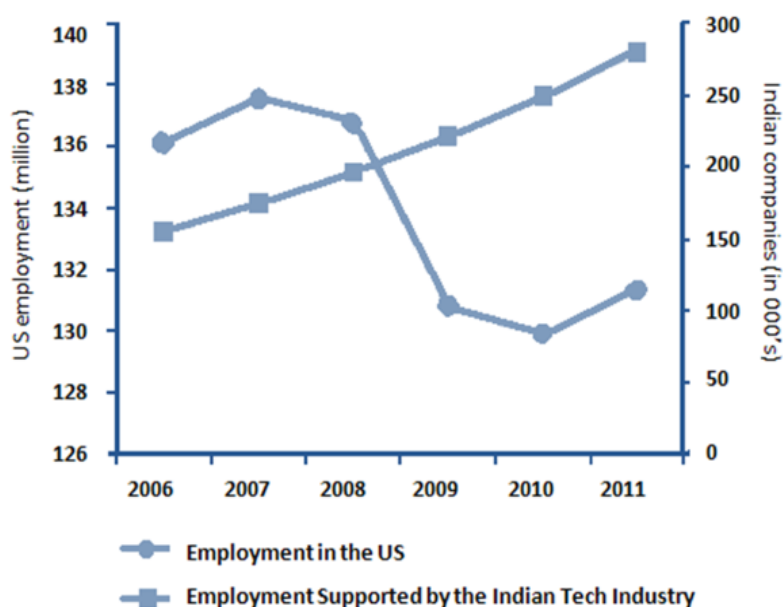


**Table 13: L-1B Denial Rates for New Petitions by Country of Origin: FY 2006 to FY 2011**

Fiscal Year	India	Canada	China	France	Germany	Japan	Mexico	United Kingdom
FY 2006	1.7%	1.9%	1.6%	4.8%	2.2%	2.0%	6.0%	3.0%
FY 2007	0.9%	1.1%	2.5%	3.2%	1.4%	0.3%	2.2%	1.4%
FY 2008	2.8%	2.0%	2.1%	3.8%	1.6%	1.7%	2.3%	2.7%
FY 2009	22.5%	2.9%	5.9%	6.3%	4.7%	4.4%	15.1%	4.1%
FY 2010	10.5%	2.2%	5.3%	2.4%	3.2%	2.0%	5.5%	3.1%
FY 2011	13.4%	2.9%	3.6%	6.1%	3.2%	1.9%	3.6%	2.7%

Source: National Foundation for American Policy

**Chart 15: Total Employment in the US vs. Employment supported by the Indian Tech Industry**



Source: NASSCOM

## Totalisation Agreement

Another source of contention is the absence of a Totalisation Agreement between the two countries. This implies that around 300,000 Indian professionals working in the US lose their social security contributions if they do not complete 10 years of employment in the US, which most do not.<sup>132</sup> According to the industry body NASSCOM, Indians on H1 and

<sup>132</sup> “Budget 2012: Speed up Indo-US Totalisation agreement.” *The Economic Times*, February 27, 2012. Online.

L1 visas contribute around \$1 billion in social security taxes in the US per annum, without deriving future benefits.

Negotiations on an India-US Totalisation Agreement began in 2006 and two formal rounds of discussions have taken place. There has been no progress.

From the US side, the problem is that India is not deemed to meet the conditions prescribed by the US Social Security Act, which regulates Totalisation Agreements, the primary reason being that the Indian pension system remains too loosely structured. This Act stipulates that the following statutory requirements must be met before the US can commence negotiations with another country:

- a. The negotiating country must have a system of “general application”, meaning that its social security system covers the majority of the working population. In the United States, Social Security covers 97 per cent of the working population. This is currently not the case in India.
- b. The negotiating country must have a system that provides periodic benefits to the worker and/or to his/her family upon death, disability or retirement, similar to Social Security in the United States.

India maintains that it has multiple social security plans for workers in both the organised and unorganised sectors. Welfare benefits are also extended through large-scale social security programmes like the Employees Provident Fund and the National Rural Employment Guarantee (NREG) scheme.

The Indian side has argued that India has signed Totalisation Agreements with several European countries whose social security systems are different from the Indian system as well as the US system. India has also recently concluded a social security agreement with Japan. Systemic differences should not, therefore, be an obstacle to progress on a Totalisation Agreement with the US.

## Conclusions

Looking towards the future, both India and the US are likely to benefit from the expansion of two-way trade and investment in Services. The overall environment for economic relations can be greatly improved by a serious US effort to accommodate Indian concerns on visas for Indian professionals and their social security contributions. India can hardly be faulted for raising these issues of concern to the most successful component of its services industry. On its part, the USIBC regularly pursues the demands of the US IT industry with the Indian government for redressal.

Economic challenges in the US, which include the political management of the so-called “fiscal cliff” by the end of 2012, may further fuel protectionism and the tendency to draw unfounded linkages between US job losses and outsourcing. With growing shortfalls of

science and engineering tech workers, harsh immigration curbs only undermine growth and innovation in the US.<sup>133</sup>

Looking ahead to the second Obama Administration, it is to be hoped that there will be no attempt to legislate tax penalties for outsourcing. This would further exacerbate existing Indian concerns over visa costs and restrictions and alienate the entrepreneurial segment driving high technology ties that have come to symbolise a dynamic India-US relationship. While the well-founded grievances of India's IT sector must not be allowed to vitiate the overall trend of an expanding economic partnership, the US would also do well to consider that further curbs on outsourcing will severely diminish its capacity to extol the virtues of globalisation and encourage market opening economic reforms in India.<sup>134</sup>

The India-US Technology Trade Agreement proposed by the PSAG in February 2011 is designed to harness the complementarities between the two countries in the IT sector for mutual benefit. A sectoral agreement on these lines may well provide a better way to address the current misperceptions on both sides.

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133 "At Cliff's End." *The Times of India*, Editorial Page, November 12, 2012, New Delhi ed.: p. 20. Print.

134 Sibal, K. "Obama Election." *Tehelka*, November 2012

# BIT and Beyond

## Advancing India-US Economic Relations

# VI

## BIT AND BEYOND

While the emphasis may vary, the general discourse on India-US bilateral relations today uniformly begins with an affirmation of the utmost importance of economic ties. This is unsurprising, given the four-fold increase in bilateral trade and an even higher increase in investment over the last decade. One of the cornerstones of the transformed India-US relationship has been the US commitment to India's emergence as an economic power. The two nations share not only democratic values but also an entrepreneurial spirit, while their economic complementarities provide for mutually rewarding partnerships. There are multiple dialogue fora, at both government and business levels, which are meant to promote the prospects and potential of economic relations. And yet, there are underlying complexities, as in any relationship between major powers, that sometimes suggest that we are talking past each other – or, as in the case of the US-India Trade Policy Forum (TPF), not at all.

There are several reasons for this anomaly. To begin with, as large and vigorous democracies, both India and the US tend to seek liberal market access abroad while practicing their respective versions of protectionism at home, albeit to varying degrees. With a combination of urgently required economic reforms and domestic political gridlock, the world's largest and oldest democracies face strikingly similar problems.<sup>135</sup> However, it needs to be borne in mind that there are large economic disparities between the two countries: the US is the world's most advanced industrialised economy while India is still struggling to develop and eradicate poverty. The great majority of Indians do not enjoy the cushion of widespread prosperity and social security that America provides to its citizens.

Even though the US has led the world on free trade for the past 60 years or more, trade liberalisation remains a highly sensitive political issue in US domestic politics. Whether it is the economic rise of Japan in the past, or of China, or more recently of India, adverse trade impact gets the blame and job losses are mistakenly attributed to foreign competition, including off-shoring and outsourcing. America's pursuit of free trade, in the GATT and the WTO eras, has run parallel with trade adjustment subsidies and safety nets. It is politically

<sup>135</sup> "At Cliff's End." *The Times of India*, Editorial Page, November 12, 2012, New Delhi ed.: p. 20. Print.

difficult to end this protectionist narrative or indeed the widespread scepticism on FTAs that tends to prevail in a tough economy. As previously mentioned in this report, the Obama Administration has not proposed any new FTAs or even sought Fast Track trade negotiating authority from Congress.

Trade tensions have continued to swirl during the just concluded US Presidential election. Even as there is an across-the-board recognition that future economic activity during this century will be dominated by Asia, US attitudes towards trade policy are lagging behind. In taking the lead on a “21<sup>st</sup> century” TPP, the US has notionally bifurcated its Asian trade and security policies and in the process, Asia as well. This may reflect the Obama Administration’s internal debates before joining the East Asia Summit (EAS), but the practical outcome is that Asian security has been allocated to the Asia-centric EAS while economic integration rests with the trans-Pacific TPP.

The “high quality” TPP will deliver meagre welfare gains without the participation of Asia’s major economies – China, Japan, India and Indonesia. This leaves the US vulnerable to criticism that it is carving up Asia, and gives a boost to a less ambitious but more inclusive ASEAN-led Regional Comprehensive Economic Partnership (RCEP) among the 16 founder members of the East Asia Summit. As Asia’s economies continue to outpace the rest of the world by significant margins, the US will find it increasingly difficult to dictate terms on trade. The RCEP negotiations, to be launched in early 2013 and completed by the end of 2015, reaffirm a growing interest among the most dynamic economies of Asia to boost intra-regional trade, investment and connectivity, accelerating the global economy’s shift towards Asia.

India’s “hyper democracy” has political sensitivities on trade and economic issues of its own. India claims to have embraced globalisation for the benefits it brings but readily restricts market freedoms domestically. Indian companies invest abroad to take advantage of better business conditions but hardly press for accelerated reform at home, hedging against increased foreign competition.

India’s corporate sector has long complained about a host of restrictions and barriers in the US, from access to technology to L-1 visas for business professionals. The targeting of outsourcing is an unfortunate example, which greatly exercises Indian public opinion. In the Indian perception, the US has been taking unilateral measures since 2010 to hurt Indian commercial interests, particularly those of the highly successful IT-ITeS sector, which is the showcase of the Indian services-led economy. Ironically, the US IT industry is equally exercised about protectionist measures in India such as “forced localisation” requirements which discourage US businesses from investing.

There is need for some fresh thinking and more innovative approaches on the part of Indian IT/ITeS companies, industry associations and the government on WTO Mode 4 access issues. Overseas operations and investments related to services trade and the delivery of services increasingly require business models that bring higher returns and create greater efficiencies without the need to deploy large numbers of temporary business professionals to subsidiaries or clients abroad. Commercial presence, or WTO Mode 3, offers better prospects for India’s ambitions to become a global factor in services trade. Investment-

linked quotas for corporate transferees, negotiated as part of BIPA/BITs or FTAs, require greater prioritisation.

Both sides have to go beyond the litany of complaints that hold each other responsible for an impasse on trade issues, whether multilateral (Doha Round) or bilateral. India-US cooperation at the WTO needs to be reinstated. The US-India Trade Policy Forum can hopefully be re-energised in the new Presidential term beginning 2013. If that transpires, the TPF can move forward on the TIFA agenda and PSAG recommendations, which have long languished. In fact, the PSAG needs to be empowered to contribute meaningfully to bilateral economic relations.

The 2012 US Presidential election has thrown up contrasting views on wealth creation versus wealth distribution. Nevertheless, America for long has pursued successfully the template of economic freedom and believes in the relentless capacity of US capitalism for unparalleled creativity and innovation. The role of government is limited in a system where 70% of GDP is generated outside the state.

India, on the other hand, having progressed from forty years of self-reliance and autarchy to constrained liberalisation in 1991, is yet to evolve a definitive consensus on the fundamental characteristics of its economic direction, of which prolonged debates in 2011-12 over FDI in multi-brand retail and other reform measures are a symptom. The 2004 “Manmohanomics” mantra of a democratic market economy driven by “economic efficiency” and “social equity” has gradually been replaced by a newer version of economic distributionism that prioritises entitlements over empowerment. “Licence raj” statism has made a comeback. Recent economic reforms have been made possible only by unrelenting signs of macro-economic stress that have brought India’s GDP growth projections down by nearly 3% between 2010 and 2012, a sorry statistic which speaks for itself.

This lack of a stable direction for economic policy is most evident from the fact that India strongly supports an open global economic order abroad while maintaining restrictive economic and trade practices at home. The past year has seen flip-flops on policies and retrograde proposals on retrospective taxation that have severely dented the investment climate. Political gamesmanship, corruption scandals and corporate transgressions have not helped settle the debate over the economy, but the silver lining is that there is unlikely to be a rollback of the past twenty years of politically measured liberalisation. How much more is to follow and in what time frame is another question.

The political constituency for reform can grow only if the unprecedented strides made by the Indian economy following liberalisation in 1991 are explained to the broad masses. The middle class has expanded and poverty levels have declined faster during the past two decades than at any other time in Indian history. The nation’s abundant youthful dynamism can best be harnessed only by unshackling the economy. Reforms of governance also need to keep pace for India to fulfil popular aspirations.

The recent spurt of reform measures announced by the Indian Government will hopefully set the trend for regaining the momentum of economic growth. From the perspective of reviving investment, both domestic and foreign, the role of a predictable regulatory

environment and taxation regime is critical. Policy reversals or policy paralysis, as recent developments have shown, can only squander India's development potential at the expense of future generations – and national security.

An India-US BIPA/BIT is undoubtedly desirable and is a core building block for enhanced trade and investment between the two countries, not least given the sheer volume of bilateral flows. US FDI in India has increased by nearly 30% over the past four years, while Indian investment in the US grew by over 40% during the same period.<sup>136</sup> An India-US BIPA/BIT will most likely be a customised hybrid, requiring flexibility on both sides to harmonise their respective models through a strategic give-and-take.

That said, whether a BIT can be negotiated and finalised in 2013 will largely depend on three factors: continuous high-level direction, mutual accommodation, and more rigorous levels of specialisation and inter-ministerial co-ordination among Indian negotiators than has been the case so far.

It would be useful also to assess the prospects for a more ambitious economic partnership, going beyond the BIT to an FTA or similar trade and investment-enhancing instrument, which might, at present, seem like a remote possibility.

The US and the EU have become the two main “hubs” of PTAs and are estimated to account for around 80% of the rules that regulate the functioning of world markets.<sup>137</sup> US trade agreements tend to cover fewer areas but include more legally binding obligations, both in WTO+ (GATS, TRIPS, TRIMs and TBT) and WTO-X (environment and labour standards) areas.<sup>138</sup> EU agreements, on the other hand, have wider coverage but permit “legal inflation”, mainly in development-related provisions, reflecting an element of flexibility.<sup>139</sup>

India lags behind the US and the EU in terms of both the quality and the utilization of its FTAs. For instance, the proportion of tariff elimination in the India-ASEAN FTA is just 74.3%, the lowest among the ASEAN+1 FTAs. This implies that India will find it harder than other ASEAN+1 partner countries in negotiating the ASEAN10+6 RCEP (Table 14).<sup>140</sup> The share of India's trade with FTA partners, as of July 2012, is also a meagre 17.9%, as opposed to 38.8% for the US and 73.8% for the EU (Table 15).<sup>141</sup>

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136 Cohen, William S. “The pivot to Asia and Obama's second term.” *Hindustan Times*, November 12, 2012, New Delhi ed.: p. 13. Print.

137 Horn, Henrick, Petros C Mavroids, and André Sapir. “*Beyond the WTO? An Anatomy of EU and US Preferential Trade Agreements.*” *The World Economy*, Wiley Blackwell, vol. 33(11), pages 1565-1588, November 2010. Print.

138 *Ibid.*

139 *Ibid.*

140 Urata, Shujiro. *Regional Economic Integration in Asia: Challenges and Roles for Japan and India*, ICRIER Database, December 17, 2012. Web. Accessed on December 18, 2012.

141 *Ibid.*



**Table 14: Tariff Concessions in ASEAN+1 FTAs (%)<sup>142</sup>**

	AANZFTA	ACFTA	AIFTA	AJFTA	AKFTA
<b>Brunei</b>	99	99.9	82.6	96.1	97.8
<b>Cambodia</b>	86	86.7	84.1	na	85.5
<b>Indonesia</b>	93	89	50.4	88.1	90.3
<b>Lao PDR</b>	91	96.4	77.5	na	85.4
<b>Malaysia</b>	96	99.9	79.9	93.6	93.5
<b>Myanmar</b>	86	86.9	73.6	na	87.5
<b>Philippines</b>	95	86.5	75.8	96.8	97.9
<b>Singapore</b>	100	100	100	100	100
<b>Thailand</b>	99	88.3	74.3	96.9	93.7
<b>Vietnam</b>	91	na	69.7	na	83.8
<b>Australia</b>	100	--	--	--	--
<b>New Zealand</b>	100	--	--	--	--
<b>China</b>	--	94.6	--	--	--
<b>India</b>	--	--	74.3	--	--
<b>Japan</b>	--	--	--	86.5	--
<b>Korea</b>	--	--	--	--	92.2

Note: na indicates the data is not available

AANZFTA: ASEAN-Australia-New Zealand FTA

ACFTA: ASEAN-China FTA

AIFTA: ASEAN-India FTA

AJFTA: ASEAN-Japan FTA

AKFTA: ASEAN-Korea FTA

Figures indicate the proportion of tariff elimination in terms of tariff lines.

**Table 15: FTA Trade Coverage Ratio: As of July 2012 (% share of trade with FTA partners in Total Trade)<sup>143</sup>**

Chile	91.2
Mexico	81.4
Peru	75.6
EU	73.8
Canada	67.1
Singapore	62.7
ASEAN	60.0
New Zealand	47.0
US	38.8
Korea	34.0
Australia	26.0
Japan	18.6
<b>India</b>	<b>17.9</b>
China	16.2

<sup>142</sup> Urata, Shujiro. *Regional Economic Integration in Asia: Challenges and Roles for Japan and India*, ICRIER Database, December 17, 2012. Web. Accessed on December 18, 2012.

<sup>143</sup> *Ibid.*



India is already negotiating a relatively advanced Broad-based Trade and Investment Agreement (BTIA) with the European Union (EU-27). While matters related to trade in goods (tariffs) have progressed, pending issues remain with non-tariff barriers, services and investments related to services. The EU has shown a degree of openness on the movement of professionals through an “intra-corporate transferee directive”, which could make it possible for Indian professionals to access all 27 member states. Given the limited utility of English and the availability of multilingual European workers, Mode 4 issues have reduced significance in BTIA negotiations.

It is noteworthy that despite negotiating on behalf of 27 states, the EU has reportedly been flexible and pragmatic. The conclusion of the India-EU BTIA will provide windfall advantages to European companies over their US competitors. This should incentivise the US side to review its long-standing reticence towards an FTA with India. At the same time, there is also some likelihood of movement on a US-EU FTA, a prospect which Indian negotiators should not lose sight of as they work to finalise the long delayed India-EU BTIA and turn their attention towards an India-US FTA.

India’s FTA negotiations in Asia have tended to be prolonged. The India-ASEAN FTA on services and investments has finally been concluded in December 2012, but bilateral FTAs with some EAS member countries are still pending. This is partially a reflection of the fact that Indian negotiators face major challenges of both capacity and internal co-ordination. However, what is of greater concern is the issue of policy consistency. As India adopts economic reforms through domestic laws and regulatory changes, these must be flexible enough to accommodate the trade and investment provisions of future FTAs. For instance, India can hardly expect harmonised commitments from the EU-27 under the BTIA while offering virtual opt-outs to Indian states on FDI in multi-brand retail. If such loopholes lead to post-investment policy reversals, they are certain to trigger investor-state legal disputes under BIPAs or the proposed India-US BIT.

Beyond these issues lies the challenge of considering WTO+ and WTO-X elements in future FTAs with advanced industrial economies covering government procurement, intellectual property rights, environment and labour standards, investment and capital movement. India has to create the room for looking beyond its comfort level represented by a restricted RCEP to aspire for the “high quality” TPP. Apart from WTO-X elements such as environment and labour, TPP provisions are intended to prevent state-owned enterprises from enjoying unfair advantages. This would pose major difficulties for China with the TPP. India as a market economy does not have this disadvantage and its highly competitive companies would in fact stand to gain from the TPP.

A tabular comparison between the India-ROK CEPA and the US-ROK FTA (KORUS) is given in *Annexure-III*.

If India can raise its ambitions on FTAs, it will be able to achieve higher levels of harmonization with global markets and production chains. Claims of Indian exceptionalism may be politically attractive but come at an opportunity cost to the economy in an intensely competitive global environment. The Indian government would do well to initiate a

detailed study on the costs and benefits of full-fledged (WTO+ and WTO-X) FTAs. Until that is done, India's hesitancy will remain based only on perceptions, unsubstantiated by stakeholder views and economic data.

To become a key participant in the process of shaping the rules of globalisation, India must seek to play a more proactive role on FTAs. This will also require consideration of trade adjustment assistance programmes and safety nets, which the government should initiate in line with practices already prevailing among the developed economies.

Past studies have indicated that an India-US FTA "could boost Indian welfare by removing trade barriers and providing a stable framework for the growth of information technology outsourcing."<sup>144</sup> This premise is unlikely to have much traction in the US at present, given protectionist measures and apprehensions related to outsourcing. The India-US Technology Trade Agreement drafted by the PSAG offers a better approach to maximizing benefits accruing from the free flow of technology exchanges. An India-US FTA in services will be welfare enhancing and trade creating, as their levels of growth and expertise complement each other.<sup>145</sup> However, such piecemeal or sectoral initiatives are unlikely to advance the prospects of rapidly expanding trade and investment relations adequately. A comprehensive approach towards an India-US FTA would deliver far greater advantages for both economies.

Negotiation of a "high quality" India-US FTA, whether based on the India-EU BTIA model or the US-NAFTA template, should accompany anticipated progress of market opening economic reforms in India. Business sectors of both India and the US are likely to be supportive of a bilateral FTA.

In a transitional Presidential election year, the US State Department has been the main driver of progress on a BIT and wider India-US economic engagement. However, its power over US domestic politics is at best limited, while the trade agenda is controlled by Congress and the USTR. It is only to be hoped that both India and the US will invest efforts early in the new year to revive the Trade Policy Forum as a robust instrument of trade and investment promotion.

If the US shows some flexibility and India remains committed to an increasingly liberalised economy, there can be substantial gains to both sides from a BIT and its logical sequel, an FTA. India's emergence as an economic power, which both countries unequivocally support, should provide ample motivation. Generating public support for trade liberalisation will be equally essential, posing challenges for both governments. To take this vision forward, the role of determined leadership will be crucial.

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144 Lawrence, Robert Z, and Rajesh Chadha. *Should a U.S.-India FTA Be Part of India's Trade Strategy?*, India Policy Forum, 2004. Print.

145 Roy, Jayanta, and Pritam Banerjee. *US-India Free Trade Agreement - An Analysis of Issues for Discussion*. Confederation of Indian Industry (CII), 2004. Print.

## Comparison of India-ROK CEPA &amp; US-ROK FTA

Domains	India-Korea CEPA (2009)	KORUS FTA (2012)	Comments
<b>Trade in Goods</b>	<ul style="list-style-type: none"> <li>India has committed to reduce or eliminate tariffs from 85% of its tariff lines, while Korea will reduce or eliminate tariffs from 93% of its tariff lines<sup>146</sup></li> <li>Tariffs will be reduced or eliminated in a period of 10 years</li> <li>Base rates provided by India for Korean exports were higher than the base rates that Korea provided for Indian exports<sup>147</sup></li> <li>Follows Negative List approach, with 1889 items</li> </ul>	<ul style="list-style-type: none"> <li>Korea has committed to eliminate 97% of its tariff lines and the US 93% within five years. In 10 years, 100% of Korean tariff lines and 99% of US tariff lines will be duty free<sup>148</sup></li> <li>In the agriculture sector the KORUS agreement would effectively eliminate tariffs on nearly two-thirds of all US agricultural exports to Korea</li> <li>Follows Negative List approach</li> </ul>	<ul style="list-style-type: none"> <li>US exports to Korea faced an average applied tariff of 12.1%, while the average US tariff on Korean exports was 3.5%<sup>149</sup>. Elimination of tariff lines under KORUS would imply that market access for the US in the Korean market is higher than for Korea in the US market</li> </ul>
<b>Trade in Services</b>	<ul style="list-style-type: none"> <li>Follows Positive List and provides comprehensive services coverage</li> <li>The India-Korea CEPA agreement includes a detailed chapter on movement of natural persons and offers Mode 4 commitments in the category of professionals</li> </ul>	<ul style="list-style-type: none"> <li>KORUS uses a negative list approach for opening Korea's services and financial services market<sup>150</sup></li> <li>Although there are no obligations regarding the movement of natural persons in the FTA text,<sup>151</sup> Korea was included in the US visa waiver program as a preferential treatment in 2008</li> </ul>	<ul style="list-style-type: none"> <li>India has been demanding Mode 4 mobility for its professionals and has consistently urged the US to ease visa constraints which hurt its investments and trade flows</li> <li>However, the US maintains that visa matters do not fall under the purview of the USTR and the State Department</li> </ul>
<b>Investment</b>	<ul style="list-style-type: none"> <li>Follows Positive List</li> <li>Measures are based on WTO TRIMs</li> </ul>	<ul style="list-style-type: none"> <li>Follows Positive List</li> <li>Measures are based on WTO TRIMs+</li> </ul>	<ul style="list-style-type: none"> <li>The US follows WTO+ provisions, India is not yet ready for WTO TRIMs+ agreements</li> </ul>

146 Taneja, Nisha. "Indo-Korea and Indo-Japan CEPA." *Asian Development Bank Institute*, May 17, 2012. Web. Accessed on October 13, 2012.

147 *Ibid.*

148 Choi, Jong-hyun. "KORUS FTA: Action or Inaction?" *The National Bureau of Asian Research*, 2012, <<http://www.nbr.org/downloads/pdfs/NBR/Choi-KORUS-FTA.pdf>> Online. <<http://www.nbr.org/downloads/pdfs/NBR/Choi-KORUS-FTA.pdf>> Accessed on November 13, 2012.

149 "Montana Korea Connect." US Korea Connect, Korea Embassy USA, 2012 <[http://www.mwctc.org/uploadedFiles/News/2012-06%20US%20Korea%20Connect\\_Montana%20State%20Brochure\\_Embassy.pdf](http://www.mwctc.org/uploadedFiles/News/2012-06%20US%20Korea%20Connect_Montana%20State%20Brochure_Embassy.pdf)> October 30, 2012. Online. Accessed on November 24, 2012.

150 United States Trade Representative (USTR). *USTR Releases Preliminary Analysis of KOREA-EU Free Trade Agreement*, Washington D.C. Press Release, October 2009. Web

151 Under a Congressional mandate, immigration issues cannot be discussed with trade pacts. USTR and State Department are not allowed to discuss movement of professionals under FTA negotiations.

Domains	India-Korea CEPA (2009)	KORUS FTA (2012)	Comments
<b>Government Procurement Agreement (GPA)</b>	<ul style="list-style-type: none"> <li>• Although there is no separate chapter on government procurement, there is a cooperation provision on liberalisation of government procurement<sup>152</sup></li> <li>• The General Financial Rules (GFRs) issued by the MOF lay down the rules and procedures for procurement at the Centre. The rules framed by individual departments and at the state and local level are based on their individual interpretations of the GFRs<sup>153</sup></li> <li>• Hence, different procurement practices apply at the Centre and state levels<sup>154</sup></li> </ul>	<ul style="list-style-type: none"> <li>• Applies to the entities of the central level of government for value equal to or greater than a specified value limit</li> <li>• Restricted Areas- <ul style="list-style-type: none"> <li>○ <i>Korea</i>: National security and defence, procurement for the purpose of maintaining public order, agricultural, fishery and livestock products, single tendering procurement, set-asides for some SMSEs</li> <li>○ <i>United States</i>: Agricultural goods, shipbuilding activities of NOAA, some FSC classified goods, specialty metals, goods and services to safeguard nuclear materials/technology, oil purchases related to Strategic Petroleum Reserve, procurement by the Transportation Security Administration and Federal Aviation Administration, set-aside for small or minority-owned businesses</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• India has not opened up its government procurement market for international bidding. However, it is an observer at the WTO-GPA and has also put up a draft government procurement bill, based on the UNCITRAL model, for discussion</li> </ul>
<b>Intellectual Property Rights</b>	<ul style="list-style-type: none"> <li>• IPRs are protected in accordance with the provisions of the TRIPS agreement</li> </ul>	<ul style="list-style-type: none"> <li>• IPR provisions in KORUS are much more demanding than WTO-TRIPS</li> <li>• These commitments fall under WTO-X sphere</li> </ul>	<ul style="list-style-type: none"> <li>• India's stand is very defensive in this regard; it is not ready for TRIPS + agreements</li> </ul>
<b>Environment</b>	<ul style="list-style-type: none"> <li>• Does not cover an explicit clause on environment protection; however the Investment chapter includes a provision on this</li> </ul>	<ul style="list-style-type: none"> <li>• Covers elaborate section on environment protection</li> </ul>	<ul style="list-style-type: none"> <li>• India may be willing to consider appropriate labour and environment clauses in investment or trade agreements</li> </ul>
<b>Labor</b>	<ul style="list-style-type: none"> <li>• Does not cover Labor Standards</li> </ul>	<ul style="list-style-type: none"> <li>• Covers Labor Standards</li> </ul>	

152 Taneja, Nisha. "Indo-Korea and Indo-Japan CEPA." *Asian Development Bank Institute*, May 17, 2012. Web. Accessed on October 13, 2012.

153 *Ibid.*

154 *Ibid.*

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# NOTES

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