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India-U.S. Economic and Trade Relations

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India-U.S. Economic and Trade Relations

Summary

After decades of strained political relations, the U.S. and Indian governments are currently pursuing a "strategic partnership" based on numerous overlapping interests, shared values, and improved economic and trade relations. India is in the midst of a rapid economic expansion, and many U.S. companies view India as a lucrative market and a candidate for foreign investment. For its part, the current Indian government sees itself continuing the economic reforms started in 1991, aimed at transforming a quasi-socialist economy into a more open, market-oriented economy. However, the U.S. government is concerned that India's economic reforms are progressing too slowly and unevenly.

Bilateral merchandise trade has grown from $6 billion in 1990 to $33 billion in 2006. Although India was only the 21st largest export market for the United States in 2006, the United States has become India's leading trading partner, mostly due to the growth in India's exports to the United States. However, recent increases in trade with China have made it a close second to the United States. In 2006, the U.S. bilateral trade deficit with India totaled $13 billion.

In 2006, India's gross domestic product (GDP) grew by 9.2%, a growth rate second only to China among Asian nations. India's economic growth has also brought about the emergence of a sizeable "middle class" and the largest number of billionaires in Asia, but the country's mostly rural population remains comparatively poor and largely isolated from the benefits of growth. In addition, there is growing concern that the economy is "overheated," as evidenced by rising rates of inflation. Moreover, despite several years of strong growth, investment in infrastructure is lagging, creating a potential bottleneck for long-term economic expansion. Finally, attempts at additional economic reforms aimed at resolving these and other economic problems are constrained by India's political dynamics.

Despite the significant liberalization of India's trade and foreign investment policies, there remain a number of bilateral and multilateral trade issues between the United States and India. The United States seeks greater market access to India's agricultural market and key service sectors for its exports and for foreign direct investment. The United States is also concerned about "outsourcing," and would also like to see improvements in India's intellectual property rights protection. India, for its part, calls for the lowering of perceived U.S. barriers to agricultural and service imports, as well as an expansion of the H-1B visa program.

Many of the more prominent Indo-U.S. trade issues may have indirect implications for Congress. The growth of India's services exports to the United States has contributed to congressional consideration of possible legislation to provide greater assistance to displaced U.S. workers. Also, India's growing demand for crude oil has raised the possibility of boosting bilateral energy cooperation. Finally, the passage of the Hyde Act in 2006 (P.L. 109-401) has led to the negotiations of a bilateral peaceful nuclear cooperation ("123") agreement, which cannot go into effect without congressional approval. For a broader review, see CRS Report RL33529, *India-U.S. Relations*. This report will be updated as warranted.

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Introduction

Economic and trade relations between the United States and India have experienced a number of ups and downs since India's independence in 1947. During much of the 1950s and early 1960s, the United States was a leading trading partner for India, providing the nation with about a third of its imports. However, those economic ties quickly subsided when India fostered closer ties with the Soviet Union following the Indo-Pakistani War of 1965. For the next 40 years, political and economic relations between India and the United States were rather cool.

Since 2004, Washington and New Delhi have been pursuing a "strategic partnership" based on numerous shared values and improved economic and trade relations.[1] India is in the midst of a rapid economic expansion, and many U.S. companies view India as a lucrative market and a candidate for foreign investment. For its part, the current Indian government sees itself continuing the economic reforms started in 1991, aimed at transforming a quasi-socialist economy into a more open, market-oriented economy. However, the U.S. government is concerned that India's economic reforms are progressing too slowly and unevenly.

According to official U.S. trade statistics, bilateral merchandise trade with India has grown from under \$10 billion in 1996 to nearly \$31 billion in 2006 — a trebling in a decade. In 1996, India was the 32nd largest market for U.S. exports and the 25th largest source of imports. By 2006, India had risen to be 21st biggest export market for the United States and the 18th biggest supplier of imports. The United States' total trade with India in 2006 exceeded that with Israel, Nigeria, and Thailand.

Both governments appear to be committed to improving trade relations. On March 2, 2006, President George W. Bush and Indian Prime Minister Manmohan Singh endorsed the goal of doubling bilateral trade in three years.[2] On December 18, 2006, President Bush signed into law H.R. 5682, the Henry J. Hyde United States-India Peaceful Atomic Energy Cooperation Act of 2006 (P.L. 109-401), signaling an intent to waive restrictions on civil nuclear cooperation with India.

Despite the growth in bilateral trade and the improvement in trade relations, there are still a number of economic and trade issues between India and the United States. Both nations seek greater market access to the other's domestic markets, as

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[1] For a broader discussion of the bilateral relationship, see CRS Report RL33529, *India-U.S. Relations*, K. by Alan Kronstadt.

[2] "U.S.-India Joint Statement." Office of the Press Secretary, The White House, March 2, 2006.

well as the lowering of perceived trade barriers. In addition, both India and the United States would like to see changes in the other nation's legal and regulatory policies to help protect and promote exports and foreign direct investment. Moreover, there are significant differences in the stances of the two countries in various multilateral trade fora, including the current Doha Round of negotiations.

For Congress, resolution of some of the key economic and trade issues may involve alterations in current federal law. In particular, changes in laws pertaining to agricultural goods, pharmaceuticals, nuclear and dual-use technology, and immigration may be considered as part of an effort to foster closer trade relations with India. Plus, Congress may consider heightened oversight of U.S.-India trade relations.

This report provides a summary of India's current political climate (with a focus on its effects on the nation's economic and trade policies), its economic condition and policies, the recent trends in bilateral trade and foreign direct investment, and key economic and trade issues between India and the United States. Where suitable, the report also compares India to China to provide a different perspective on U.S. relations with both nations.

India's Political and Economic Climate

Overview

India is the world's most populous democracy and remains firmly committed to representative government and the rule of law. With a robust and working democratic system, India is a federal republic where the bulk of executive power rests with the prime minister and his or her cabinet (the Indian president is a ceremonial chief of state with limited executive powers). As a nation-state, India presents a vast mosaic of hundreds of different ethnic groups, religious sects, and social castes. Most of India's prime ministers have come from the country's Hindi-speaking northern regions and all but two have been upper-caste Hindus.

Larger than Alaska, Texas, and California combined, India is a land of great demographic, geographic, and climatological variety. From stark deserts in the west to thick jungles in the northeast, the towering Himalaya mountains of the north to the vast tableland of the Deccan Plateau of the south, and with the fertile Indo-Gangetic plain between, India dominates the Asian Subcontinent and shares long borders with its six other continental states. About one-third of the population lives in urban areas; an overwhelming majority of the remainder is engaged in the agricultural sector. Most of India's people inhabit either the alluvial soil of the Indo-Gangetic plain across the north, or the eastern and western coasts of the southern Deccan Peninsula. About 290 million Indians live in the densely-populated northern states of Uttar Pradesh and Bihar; another 100 million live in the western state of Maharashtra. These three states account for more than one-third of the country's total population.

The 543-seat Lok Sabha (People's House) is the locus of national political power, with directly elected representatives from each of the country's 28 states and 7 union territories. A smaller upper house, the Rajya Sabha (Council of States), may review, but not veto, most legislation, and has no power over the prime minister or the cabinet. Although India's political stage is crowded with numerous regional and caste-based parties, recent years have seen an increasingly dyadic battle between two major parties that vie for smaller allies in a system that now requires coalitional politics. No party has won a national election outright since 1984.

India has one of the largest and fastest growing economies in the world. India's real gross domestic product (GDP) rose by 9.2% in 2006 — a growth rate second only to China among Asian nations. The strong GDP performance in 2006 capped five years of rapid economic expansion, transforming India into the third largest economy in Asia (after Japan and China). Its recent economic success is generally attributed to a combination of internal and external factors. Internally, a series of economic reforms (begun when the current prime minister was finance minister) have stimulated solid growth of India's manufacturing and service sectors. Externally, a relatively strong global economy, combined with India's trade and investment liberalization policies, have stimulated increased trade and investment flows to and from India.

Despite the recent growth, India's economy confronts several challenges to its future prosperity. First, although the nation's manufacturing and services sectors have grown rapidly, there has been relatively little job creation. Second, its agricultural sector has experienced relatively slow growth for many years. With more than half of Indian households still reliant on agriculture for their income, the standard of living for much of the country's population remains relatively low. There are indications that most of the Indian populace remains untouched by and thus unimpressed with the country's widely touted economic boom.[3]

Third, the standard of living of India's rural and urban poor is being threatened by an emerging economic challenge — inflationary pressures. After seven years of modest inflation at or below 4% per year, inflation in 2006 was nearly 7% and has risen to about 8% in the first part of 2007.[4] India's poor have been especially hard hit by major increases in the cost of food in recent years.

In the longer run, India faces three additional barriers to economic growth — lack of infrastructure, bureaucratic obstacles, and environmental degradation. India's economy is already hindered by its inadequate transportation system and electricity shortage. Similarly, India's complex and entrenched bureaucracy frequently creates a barrier to implementing new economic policies and programs. At the same time, its large population and recent rise in industrial output are putting more and more pressure on India's environment, exacerbating existing problems in providing its people with clean, potable water, as well as clean air.

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[3] See, for example, Somini Sengupta, "Economic Boom Fails to Generate Optimism in India," *New York Times*, August 16, 2007.

[4] Data based on price indices released by India's Labour Bureau.

Even with the continued strength of the economy and the Singh government's attempt to balance its economic policies, many analysts see India facing a number of economic challenges and believe there are still several important economic reforms that India should make to increase the benefits generated by its restructured economy. In particular, critics of the current economic policies point to the unequal distribution of the benefits of the economic reforms, noting that the rapid economic growth has not brought a corresponding reduction in poverty in India, particularly in rural areas. For some, the solution is to press forward more aggressively with the economic reforms by greater liberalization of India's domestic economic and international trade policies. For others, the solution is reverse elements of the reform and refocus agriculture and India's rural population.

In March 2007, Prime Minister Singh addressed a roundtable hosted by the *Economist* magazine. In his remarks, Prime Minister Singh provided a fairly comprehensive overview of his administration's view of the current status of the Indian economy, arguing that India's economy will probably continue its rapid growth for another decade or more.[5] However, Singh also pointed out India's need for additional reforms, including changes to its banking and financial system, its labor markets, and its "public service delivery mechanisms." In light of India's past and planned reforms, he stated, "I find it surprising when I continue to hear complaints about our economy still being a relatively inward-looking economy."

The Bush Administration seems to hold a different view of India's economic conditions, maintaining that the Singh government ought to push forward more actively with its economic reforms. In September 2006, U.S. Ambassador to India, David Mulford, said to an audience in New Delhi:

> Today's business environment in India is more favorable to trade and investment. But there are signs of a pause in the reform process in recent months. Privatizations have stopped, and political reality suggests that reform of other key sectors and policies of central interest to investors will take longer than envisioned. It is important to bear in mind there are serious economic costs to any loss of momentum on the reform front. ... The solution to attracting much greater private sector investment in energy and infrastructure development is a blend of policies that includes better governance, market sensitive regulatory regimes, continued liberalization of the financial sector that enables foreign and domestic private capital to finance major projects, and the timely resolution of investor-state disputes.[6]

One U.S. trade official opined that it is only through meaningful reforms in India's vast and poorly performing agricultural sector that the country's true economic potential can be realized. This, he says, will require rural infrastructural

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[5] "Prime Minster's Address at 'The Economist' Round Table on India," *The Economist*, March 13, 2007.

[6] See [http://www.state.gov/p/sca/rls/rm/2006/72175.htm].

improvements, land reform, and changes that will allow foreign direct investment in the farm sector.[7]

Brief Political Economic History of India

A review of India's economic and trade policies over the last 60 years reveals a pattern of conceptual economic theory moderated by pragmatic political and economic considerations. Major shifts in economic policy were typically initiated with significant changes and then followed by a period of gradual adjustments.

Following its independence in 1947, the government of Prime Minister Jawaharlal Nehru of the Indian National Congress Party (INC) adopted an economic policy emphasizing rapid industrialization, import substitution, and relatively high levels of government participation in economic production. Monopolies were granted to state enterprises in a number of industries considered of economic or strategic importance. Private companies in other industries were often subject to licensing requirements and legally constrained in their size of operation. The agricultural sector was a key focus of the First Five Year Plan, with the implementation of various subsidy programs, food price controls, and restrictions on the transport of agricultural crops. Labor laws provided workers with protection from managerial misconduct, but also significantly reduced labor mobility. Both exports and imports were controlled by licenses and tariffs. Foreign direct investment was also severely restricted both by industry and size.

Successive Indian governments, still headed by Prime Minister Nehru, remained relatively true to these policies for both its First and Second Five Year Plans (1951-56 and 1956-61) with moderately successful results. Real GDP grew at an average annual rate of 3.6% for the First Five Year Plan, and 2.5% for the Second Five Year Plan. Agricultural production rose 44% and manufacturing output increased 144%. However, the economic policies were also leading to growing merchandise trade and current account deficits that were depleting India's foreign reserves.

For the Third Five Year Plan (1961-66), Prime Minister Nehru and the INC made an adjustment in its economic policies, shifting focus away from "rapid industrialization" over to a program of "self sustained growth." At the same time, India's trade policy shifted from "import substitution" to "efficient substitution of imports," which in effect opened up new trade opportunities for goods considered crucial to economic growth and development. This adjusted economic policy remained in effect until the end of the Seventh Five Year Plan in 1990.

In 1990 and 1991, India was struck by a number of political and economic shocks. On the political side, the INC refused to form a coalition government following a poor showing in the elections of 1989. The next largest party, the Janata Dal, was able to form a coalition government, headed by Prime Minister V.P. Singh, but it proved unstable and collapsed in December 1990. During the election campaign of 1991, ex-Prime Minister Rajiv Gandhi was assassinated, and P.V.

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[7] Authors' interview with Ambassador Douglas Hartwick, Assistant U.S. Trade Representative for South and Southwest Asia, Washington, DC, May 24, 2007.

Narasimha Rao was selected as the new leader for the INC. Following the INC's success in the 1991 elections, Rao became prime minister.

During the political tumult of 1990 and 1991, the combined effects of rise in oil prices (precipitated by *Operation Desert Storm* in the Persian Gulf) and the demise of the Soviet Union, a major trading partner and a key source of foreign aid, led to a rapid devaluation of the rupee, a depletion of India's international reserves, and fears of an impending severe recession. In response, Prime Minister Rao made a major and controversial change in economic policies designed to restore faith in the rupee, replenish the nation's international reserves, and stimulate economic growth. These reforms were overseen by his finance minister, Manmohan Singh.

The initial round of reforms included several elements. First, efforts were made to reduce India's perpetual fiscal deficits at both the federal and state levels. Second, the number of sectors reserved solely for the public sector were reduced from 18 industries to just three — military aircraft and warships, nuclear energy generation, and railway transport. Third, India liberalized international trade by reducing import tariffs, eliminating import restrictions, and opening up India to foreign direct investment. Fourth, India liberalized its financial markets, by dismantling its interest rate controls, reducing government regulations and permitting greater competition.

Following the initial round of economic reforms, India's real GDP growth rate accelerated from around 3-4% per year in the 1980s to 5-7% during the early 1990s. However, toward the end of the decade, India's economic growth began to slow. Some analysts attributed the economic slowdown to a failure of the federal government to continue and to complete the economic reforms initiated at the beginning of the decade. Other analysts argued that economic problems generated by the reforms were creating structural barriers to continued growth.

The ensuing debate over the merits of the 1991 reforms contributed to a second period of gradual economic reform in the second half of the 1990s and into the current decade. Since 1991, India has made a number of significant changes in the structure of its economy, including:

- The termination of state monopolies for all but three industries;
- The elimination of the "License Raj" — prior to the reforms, there was a rather elaborate system of licenses and regulations governing the establishment of a business in India, making it a very timely and expensive process to start a new concern;
- The abolition of import licenses for most commodities;
- A major reduction in average and peak tariff rates for imports;
- A reduction in domestic price controls for key consumer goods; and
- A restructuring of many of the nation's various subsidy programs.

However, some analysts argue that many Indians are skeptical about economic reforms in general, thus posing a "marketing" problem for the government in a democratic system. Some suggest that even segments of the private sector oppose reform efforts.[8] Still, representatives of the Indian business community insist that all of New Delhi's progress in economic reform has been voluntary and is not made under external pressure, and that the general path of liberalization will continue to be followed regardless of what party or coalition is in power.[9]

Current Political Climate for Economic Reform

New Delhi's current ruling United Progressive Alliance (UPA) coalition was seated in May 2004, when the INC, long associated with the Nehru-Gandhi families, won 145 of the Lok Sabha's 543 seats and built a ruling coalition with the support of 14 smaller parties. The election unseated a National Democratic Alliance (NDA) coalition led by the Bharatiya Janata Party (BJP), which had been in power under Prime Minister Atal Vajpayee since 1998. Some analysts saw in the election results a rejection of the BJP's neo-liberal economic reform program.[10] INC President Sonia Gandhi surprised supporters and opponents alike by declining to assume the office of prime minister, instead nominating her lieutenant, Manmohan Singh, a former finance minister.

The May 2004 poll results were notable for the best-ever national showing of a leftist alliance — commonly known as the Left Front — led by the Communist Party of India (Marxist) (CPI-M). Although this Left Front is not part of the UPA coalition, it provides crucial parliamentary support from the outside and was described as being "militant" in its opposition to the BJP's privatization efforts. The CPI-M seated the third largest number of parliamentarians in 2004 (43), but its vote bank is almost wholly limited to the states of West Bengal and Kerala.

Immediately following the election, investor fears that a coalition government including communists might curtail or halt India's economic reform and liberalization process apparently led to huge losses in the country's stock markets. Market recovery began when INC leaders quickly offered assurances that the new government would be "pro-growth, pro-savings, and pro-investment."[11] Indian industrial leaders also sought to assure foreign investors that Left Front members are not "Cuba-style communists," but could be expected to support the UPA reform agenda. The Chief Minister of West Bengal, Buddhadeb Bhattacharya, a CPI-M

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[8] Pranab Bardhan, "Why is Reform Unpopular?," *Outlook* (Delhi), October 6, 2006; V. Jayanth, "Why Economic Reforms Are Unpopular," *Hindu* (Chennai), January 21, 2006; N. Chandra Mohan, "The Anti-Reform Mindset," *Outlook* (Delhi), November 10, 2005.

[9] Authors' interview with Confederation of Indian Industry staff, Washington, DC, May 24, 2007.

[10] See, for example, C.P. Chandrasekhar, "The Verdict and the Way Ahead," *Frontline* (Chennai), June 18, 2004. See also CRS Report RL32465, *India's 2004 National Elections*, by K. Alan Kronstadt.

[11] "Communists to Call Shots in India's New Government," Agence France Presse, May 14, 2004; Myles Neligan, "India Election Takes Economic Toll," BBC News, May 17, 2004; "No More Bear Hugs, Warns Congress," *Business Standard* (Bombay), May 18, 2004.

member, has himself actively sought corporate investment in his state.[12] However, since coming to power, the Congress-led coalition has slowed certain aspects of its economic reform program, including suspending major disinvestment and special economic zone initiatives. These moves are widely viewed as gestures to the Left Front.[13]

While there are indications that both Prime Minister Singh and party chief Gandhi remain fairly popular figures in India, February 2007 state elections in Punjab and Uttaranchal saw INC candidates decisively defeated by the main opposition BJP and its allies, causing some pundits to suggest that national economic policies and rising inflation may be damaging the ruling coalition's standing. Some analysts saw the "neoliberal policies" of the UPA as harming its electoral position.[14] In June, eight regional parties formally launched a new "Third Front" that might emerge as a national alternative to the UPA and NDA. Well-known Tamil Nadu leader Jayalalithaa is likely to lead.[15] August 2007 political wrangling between the UPA and its Left Front allies over planned U.S.-India civil nuclear cooperation (the leftists oppose the plan) has added to political instability in New Delhi and led some to foresee early national polls if Singh's coalition loses Left Front support.[16]

Key Political Figures and Institutions

Several governmental figures and trade-related institutions wield influence over India's economic policies. The following is a selected listing of key economic players in the current government:

- **Prime Minister Manmohan Singh**, INC member and widely-respected Oxford-educated economist who, as finance minister from 1991-1995, was the architect of a comprehensive set of national economic reforms;
- **INC President Sonia Gandhi**, the Italian-born widow of former Prime Minister Rajiv Gandhi, while not formally a member of the central government, oversaw the UPA's 2004 poll victory and wields considerable influence over the coalition's policy making;
- **Finance Minister Palaniappan Chidambaram**, a Harvard-educated lawyer from the southern state of Tamil Nadu (and member a regional affiliate of the INC) who served as finance minister in the

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[12] Edward Luce, "Communists Set to Back Delhi's Reformist Budget," *Financial Times* (London), June 17, 2004; "India Inc Homes in on Red Citadel," *Indian Express* (Delhi), May 21, 2004.

[13] Pramit Mitra, "India's Economic Millstone," *South China Morning Post* (Hong Kong), June 22, 2005.

[14] Venkitesh Ramakrishnan, "Mid-Term Challenges," *Frontline* (Chennai), March 23, 2007.

[15] The new front includes such regional powerhouses as the Telugu Desam of Andhra Pradesh, the AIADMK of Tamil Nadu, and the Samajwadi of Uttar Pradesh.

[16] Sanjoy Mamunder, "Is the Indian Government Going to Last?," BBC News, August 20, 2007.

late1990s, is considered to be a highly-competent, pro-market fiscal manager;

- **Commerce and Industry Minister Kamal Nath**, an INC stalwart from the east-central Madhya Pradesh state, has launched major trade policy initiatives and is a key interlocutor for the U.S. government;
- **Planning Commission Deputy Chairman Montek Singh Ahluwalia**, a widely-respected, Oxford-educated economist who works directly under Prime Minister Singh and has close ties to Washington;
- **Oil Minister Murli Deora**, INC member and former mayor of Mumbai who was appointed in 2006, by some accounts due to pressures for a more pro-business, pro-U.S. oil minister;
- **Power Minister Sushilkumar Shinde**, an INC stalwart and former Chief Minister of Maharashtra;
- **CPI-M General Secretary Prakash Karat**, a vocal critic of many economic reforms and of India's warming relations with the United States, is the most notable leader of the UPA-supporting Left Front;
- **BJP President Rajnath Singh**, a Hindu nationalist from the Uttar Pradesh state who served in the government of former Prime Minister Vajpayee, is seen as a new-generation leader for India's main opposition party and has been critical of the UPA for slowing the process of economic reform;
- **The Federation of Indian Chambers of Commerce and Industry (FICCI)**, a nationwide grouping of corporations, chambers of commerce, and business associations that claims to speak directly or indirectly for more than 250,000 Indian business units; and
- **The Confederation of Indian Industry (CII)**, a nongovernmental industry group with a membership of more than 6,300 private and public sector organizations that employs advisory and consultative processes aimed at improving India's business climate.

Major Political Parties and Coalitions

For many years, political power in India was monopolized by the Indian National Congress. However, starting in the 1970s, INC dominance was challenged by the emergence of other, increasingly influential political parties. In 1977, nearly 30 years after independence, the Janata Dal Party's Morarji Desai became India's first-ever non-INC prime minister. Later, in the 1980s, political party fragmentation in India led to an era of coalition governments, variously led by the INC, the Janata Dal, or the BJP. As noted above, no party has won a national election outright since 1984.

India's political landscape offers no clear division between proponents and opponents of economic reform. Prime Minister Nehru and the INC oversaw decades of centralized economic planning — and today the UPA coalition relies on leftist forces that strongly oppose liberalizing policies — yet it was also later INC governments that launched India's major reform and liberalization programs. At the same time, the main opposition BJP accelerated "second generation" economic reforms during its time in power from 1998 to 2004, even as the BJP is home to some Hindu nationalist and "*swadeshi*" (self-reliance) forces that maintain a deep scepticism of neo-liberal economic systems.

The UPA and the Indian National Congress. Generally perceived as being a center-left coalition, the UPA is an alliance among the INC and 14 smaller regional parties, including the Bihar-based Rashtriya Janata Dal (RJD) and the Dravida Munnetra Kazhagam (DMK) of Tamil Nadu. INC members hold about two-thirds of the coalition's 219 Lok Sabha seats, as well as all of the four major cabinet posts (External Affairs, Defense, Home, and Commerce). In forming a government, the UPA coalition created a "Common Minimum Program," a document providing the basic principles of governance that would guide the UPA, along with a policy framework for specific issue-areas.[17] Left Front support for the UPA — which is necessary for the coalition to maintain majority status in the Parliament — has been predicated on government strategies that were seen as compatible with the provisions of the Common Minimum Program.

In addition to taking credit for India's dramatic economic growth during the 1990s and criticizing the BJP for "mismanaging" the economy in general and reform efforts specifically, the INC's economic agenda for the 2004 elections, entitled "An Expanding Economy, A Just Society," called for achieving up to 10% annual GDP growth, while also seeking a shift of emphasis from a rapid rate of growth to "a specific pattern of growth" that would benefit all segments of the population, with ambitious (and far from realized) promises to "abolish" an array of societal ills, including hunger, unemployment, poverty, and illiteracy. A major aspect of this proposed effort would involve creating "a congenial atmosphere" for both domestic and foreign investment. The INC also blamed the BJP-led government for abject failure in the agricultural sector (which employs more than two-thirds of India's workforce), vowing major public investments in rural infrastructure.[18]

The NDA and the Bharatiya Janata Party. The right-leaning NDA, which held power in New Delhi from 1998-2004, is dominated by the BJP, which holds nearly three-quarters of the alliance's 189 Lok Sabha seats (12 smaller regional parties hold the remainder). The surprise emergence of the BJP as a national political force in the early 1990s gave voice to a repudiation not only of the Nehru-INC secular version of Indian nationalism, but also of its concepts of state-directed economic planning. Instead, the BJP called for major liberalization efforts, including abolition of India's complex system of permits and licenses, as well as a selling off of most public sector enterprises. Many early BJP economic policy recommendations were, in fact, adopted by Prime Minister Rao's INC government in the early 1990s.

However, the BJP subsequently moderated some of its liberalization policies, and also had to deal with tensions between Hindu nationalism and the entry into India of major multinational corporations, which some feared would lead to an erosion of "Hindu culture." This led to measured support for trade protectionism and what the

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[17] See the UPA's May 2004 Common Minimum Program at [http://pmindia.nic.in/cmp.pdf].

[18] Congress Party 2004 Economic Agenda at [http://aicc.org.in/economic_agenda.php].

party called "calibrated globalization."[19] While also asserting a goal of "complete eradication of poverty and unemployment," the BJP's 2004 economic agenda was more enthusiastic about unfettered continuation of economic reform efforts and did not place the same degree of emphasis on "social justice" as did the INC. The NDA's premier statement in 2004 promised an energetic continuation of economic reforms across a multitude of sectors.[20] BJP leaders subsequently have been critical of the INC-led government for significantly slowing the reform process, sometimes accusing the UPA of buckling under pressure from leftist parties. Moreover, the BJP has been critical of the way in which the Singh government has entered into an agreement on civil nuclear cooperation with the United States, claiming that provisions of such an agreement will constrain India's nuclear weapons program.

Organized resistance to proposed economic reforms has come from Hindu nationalist groups that were influential under the BJP government from 1998 to 2004. As a "sister organization" to the Rashtriya Swayamsevak Sangh — a leading Hindu nationalist organization — the Swadeshi Jagaran Manch (SJM) has taken the lead in efforts to forward the *swadeshi* (self-reliance) cause. According to the SJM, "The Western notion of a global market does not fit into the *swadeshi* approach," nor does the "Western notion of individual freedom, which fragments and compartmentalizes family, economy, culture, and social values ...." Such anti-globalization policies continue to enjoy limited, but still substantial backing among Indians. The swadeshi lobby did, however, welcome the UPA's Common Minimum Program document in 2004.[21]

The Left Front and the CPI-M. Long-time and bitter rivals of the INC, India's major communist parties now provide outside support to the INC-led ruling coalition as part of their mutual efforts to keep the BJP from power. The current Left Front alliance is dominated by the CPI-M and, secondarily, the Communist Party of India, which combine to account for about 85% of its 60 Lok Sabha seats. During the 1950s — and in correspondence with growing Soviet support for the new Indian state — India's various communist groups resolved to abjure revolutionary ideology and work within the parliamentary system. These parties, however, remain proponents of government-directed economic and industrial development, moderate land reform programs, and strong labor protection laws. Initially and still nominally opposed to the essence of New Delhi's reform and liberalization efforts since 1991, communist party leaders in their stronghold of West Bengal have continuously sought both domestic and international investments in their state, thus demonstrating a willingness to compromise in some areas of economic policy. Still, such leaders maintain an intensive focus on caste-based and poverty issues, styling themselves as the champions of minority groups and farmers, along with a deep-seated scepticism about the intentions and goals of U.S. and Western political, military, and economic interests in India.

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[19] Craig Baxter, op. cit, p. 113-114; "More Globalization," *Indian Express* (Delhi), January 30, 2004.

[20] BJP 2004 Economic Agenda at [http://bjp.org/Press/mar_3104a.htm]; NDA 2004 Agenda at [http://www.bjp.org/Press/NDA%20Agenda.htm].

[21] Swadeshi Jagaran Manch at [http://www.swadeshi.org]; "Swadeshi Sings Cong Praise," *Telegraph* (Calcutta), June 2, 2004.

On economic policy, the Left Front has taken firm stands against raising limits of foreign direct investment, against government efforts to privatize public sector enterprises, and against the government's initial plans to launch hundreds of Special Economic Zones in India. Along with its considerable influence at the national level, the Left Front wields administrative power in the states of Kerala and West Bengal, where important trade unions have caused disruption in the course of major strikes and protests over inflation and unemployment.[22]

Since 2004, the Left Front has accused the UPA government of "serious violations" of the Common Minimum Program, including its planned disinvestment from a major public sector undertaking (PSU) in the summer of 2006. Communist parties characterize such moves as "anti-working class, neoliberal" policies being pushed by the UPA coalition. Moreover, these parties view New Delhi's apparent pro-U.S. foreign policy tilt as accentuating such neoliberal initiatives.[23] It is the Left Front's opposition to "alliance" with the United States that is at the root of its vehement opposition to planned U.S.-India civil nuclear cooperation.

Regional Factors and Variations[24]

India's political and economic situation is complicated by sharp regional contrasts in its economy. While some cities and states are relatively prosperous and modern, many others are seriously underdeveloped with significant poverty. These regional disparities not only have substantive impact on economic policies, they also influence the nation's politics. What follows is a brief summary of India's major geographic regions. (See **Figure 14**, "Map of India.")

The West. Western India is a relatively prosperous region of the country. The state of Maharashtra, home to Mumbai (formerly Bombay) — a megacity, the world's third most populous and India's business and entertainment capital — is among the most urbanized of states, with some 42% of its citizens living in cities, more than half of these in slums. Despite an abundance of urban poor, the state ranks relatively high in measures of health, education, and infrastructure, and Mumbai itself has some of the world's highest real estate prices. Further to the west, the state of Gujarat has a particularly productive agricultural sector and is said to be the region's most lucrative investment environment, with social and infrastructure measures nearing those of Maharashtra. Other western states of Rajasthan and Madhya Pradesh rank in the middle-range on such measures. In the southwest, the small state of Goa — a former Portuguese colony — has the country's highest per capita income.

The North. The Delhi National Capital Territory is another Indian megacity. It is also the most affluent of India's administrative districts, with a per capita income

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[22] "Strike Shuts Down Indian States," BBC News, December 14, 2006.

[23] Venkitesh Ramakrishnan, "Challenging Neoliberalism," *Frontline* (Chennai), June 30, 2006.

[24] Much of the state-specific information in the regional overviews comes from "The State of the States," *India Today* (Delhi), September 11, 2006.

double the national average. In fact, along with Delhi, the medium-sized northern states of Punjab, Himachal Pradesh, and Haryana form India's most prosperous region, as well as its largest market for many products and services. However, immediately to the east, Uttar Pradesh is the most populous and among the poorest of Indian states, consistently ranking low in development measures. Further to the north and isolated by mountainous terrain is the Jammu and Kashmir state, which has been suffering the effects of a religious-based insurgency since 1989. Still, "J&K" has relatively low poverty rates.

The South. Much of the recent global attention on India has focused on its fast-growing states of Karnataka and Andhra Pradesh, which (along with Delhi) have been at the forefront of the country's widely-touted software and information technology boom. Their respective capital cities — Bangalore and Hyderabad — have earned fame as emerging hubs for high-technology research and services, as well as for business process outsourcing (BPO) centers which serve many of the world's largest corporations. Other major southern states are Kerala, known for its social infrastructure and a 91% literacy rate, and Tamil Nadu, with its major commercial and industrial capital of Chennai (formerly Madras), said by some to be India's best-governed state. Despite the massive infrastructural and environmental problems caused by the rapid growth of its cities, India's southern region has been dubbed the country's most liveable by *India Today* magazine.

The East. The numerous states of India's east and northeast face historical and geographical disadvantages that include inaccessibility and several ongoing armed insurgencies. This region thus continues to be India's least developed and its infrastructure remains quite poor. Bihar, India's poorest state, consistently ranks at or near the bottom of most development indices, and Orissa, Jharkhand, and Chhattisgarh are similarly challenged. West Bengal, with the megacity and former British colonial capital of Calcutta (now officially called Kolkata) is eastern India's fastest-growing and most important commercial and industrial center, even as jute and tea represent major cash crops. A stronghold of India's communist parties, West Bengal was also the site of major and lethal March 2007 protests against the establishment of a new special economic zone (SEZ). The "Seven Sisters" — smaller northeastern states connected to the rest of India by a 20-mile-wide "Chicken Neck" — are relatively sparsely populated and are distinguished by considerable religious and ethnic diversity. One result has been armed tribal and separatist conflicts, some of which pre-date Indian independence, that present major obstacles to economic development.

Maoist Insurgency

India suffers from an increasingly lethal and disruptive conflict with "Naxalites" — Maoist insurgents ostensibly engaged in violent struggle on behalf of landless laborers and tribals. As many as 20,000 armed rebels, active mainly in inland areas of southern, eastern, and central India, claim to be battling oppression and exploitation in order to create a classless society. Their opponents call them terrorists and extortionists. The groups get their name from Naxalbari, a West Bengal village and site of a militant peasant uprising in 1967. In 2006, Prime Minister Singh identified a worsening Maoist insurgency as "the single biggest internal security challenge" ever faced by India, saying it threatened India's democracy and "way of life." The U.S. State Department's *Country Reports on Terrorism 2006* warned that actions of the Maoist insurgents "grew in sophistication and lethality" during 2006.[25] Naxalites now operate in about half of India's 28 states; Andhra Pradesh and, more recently, Chhattisgarh have been particularly hard hit (Naxalites were behind a 2003 landmine attack that nearly killed the chief minster of Andhra Pradesh). Related violence caused more than 700 deaths in 2006, including nearly 300 civilians, and has not waned in 2007.

The insurgents are seen to have a detrimental effect on economic development in some regions of India. During his first visit to Hyderabad in 2005, U.S. Ambassador to India David Mulford reportedly said that he and potential U.S. investors had been concerned about Maoist violence in Andhra Pradesh, but received "good answers" about the investment climate from area business leaders.[26] Still, Maoist attacks on roads, railways, and other infrastructure targets can retard development in affected areas, and the rebels are most active in those Indian states that contain the great bulk of the country's coal supplies, raising a further threat to energy security.[27]

India's Current Economic Condition

Over the last five years, India has been one of Asia's fastest growing economies. **Figure 1** shows India's nominal gross domestic product (GDP) for the years 2002 to 2007. In nominal terms, India's GDP grew from 24.5 trillion rupees in 2002 to 40.3 trillion rupees in 2006 — an increase of 64% in four years — and is projected to reach 45.6 trillion rupees in 2007. When converted into "real" GDP using a purchasing power parity conversion,[28] India's GDP rose from \$3.2 trillion in 2002 to \$4.4 trillion in 2006, and is projected to increase to \$4.7 trillion in 2007.

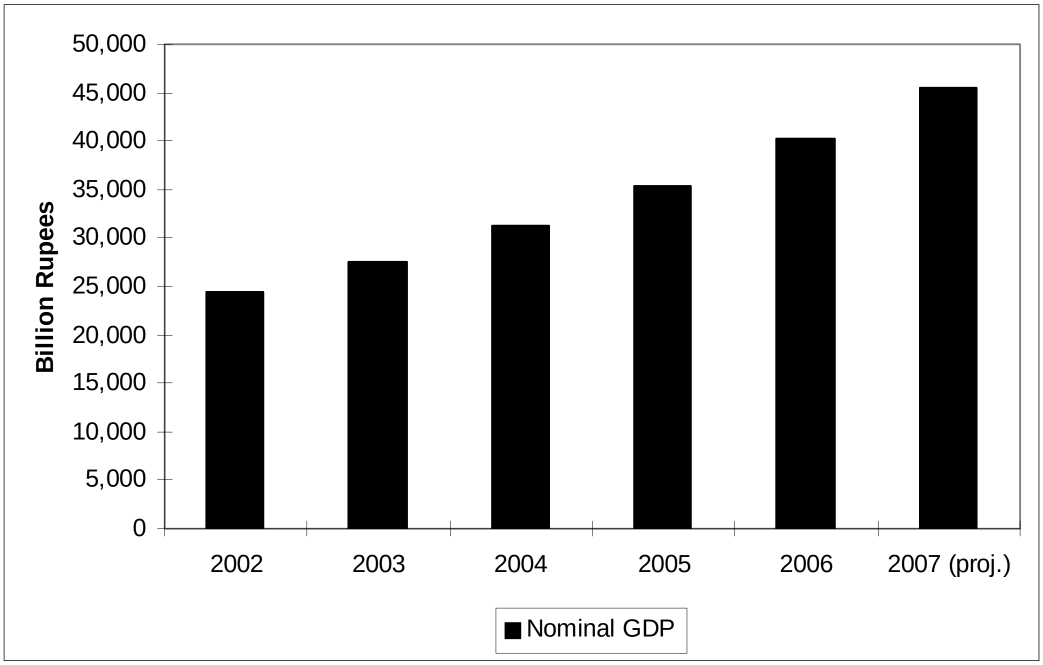
[25] "A Specter Haunting India," *Economist* (London), August 17, 2006; Department of State report at [http://www.state.gov/s/ct/rls/crt/2006/82734.htm].

[26] "Indo-US Ties at All-Time High: Mulford," *Economic Times* (Delhi), January 29, 2005.

[27] Mark Sappenfield, "In Heart of India, A Little-Known Civil War," *Christian Science Monitor*, May 1, 2007.

[28] Purchasing power parity converts one currency into another by using an exchange rate designed to equalize the relative purchasing power of the two currencies relative to a defined set of commodities. The simplest and best known "purchasing power parity" conversions is The Economist's "Big Mac Index" that compares currencies based on the relative prices for a Big Mac in different nations.

Figure 1. India's Nominal Gross Domestic Product, 2002-2007



Source: Global Insight

Sectoral Shift to Services

Much of India's economic growth has been the result of the expansion of its manufacturing and service sectors. **Table 1** provides a sectoral breakdown of India's real GDP for fiscal years 1996, 2001, and 2006.[29] Although the value of all three sectors increased, growth in the services sector exceeded that of the manufacturing sector, and the manufacturing sector grew faster than the agricultural sector. As a result, the portion of GDP contributed by the agricultural sector fell, the share of the manufacturing sector declined slightly, and the contribution of the services sector rose.

The dominance of the services sector in India's GDP hides the continued importance of agriculture to the Indian population. An estimated 71% of India's population in 2006 lived in rural areas, with over half of those people living in villages of less than 5,000 people.[30] While there has been growth in non-agricultural employment in India, about two-thirds of India's male population in 2004 continued to work primarily in agricultural activities.[31]

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[29] India reports its official economic data using its fiscal year, which runs April-March.

[30] *Selected Socioeconomic Statistics India 2006,* p. 14.

[31] "Employment and Unemployment Situation in India, 2004-05," National Sample Survey Organization, India, September 29, 2006.

Table 1. Sectoral Breakdown of India's GDP

	FY1996	FY2001	FY2006
Agriculture	28.0%	23.9%	19.7%
Manufacturing	28.1%	27.2%	26.2%
Services	43.9%	48.9%	54.1%

Source: Ministry of Statistics, India

Another worrying aspect of the recent restructuring of India's economy has been a surprising lack of job creation. In other nations, when the economy exhibited rapid economic growth, along with a shift from agriculture to manufacturing to services, there was a corresponding rise in manufacturing and service employment. However, in India's case, the level of job creation has been low. According to a recent International Monetary Fund country study of India, "employment in the organized sector has remained roughly unchanged at about 27 million over the past decade and a half."[32]

Some analysts attribute this to the nature of the manufacturing and services that dominate India's economic growth, claiming that they are typically higher-skilled, professional jobs in contrast to the low-skill work generated in nations that previously experienced rapid economic growth. Others point to India's restrictive labor laws as being a major barrier to job creation.

Declining Poverty, Emerging Middle Class

The living conditions for much of India's rural population have improved, but conditions for many remain quite meager. As of 2002, only 27% of India's rural households had access to tap water; over half relied on tube wells or hand pumps for water. Nearly half of India's rural household do not have electricity for lighting, and less than 10% possess a telephone, either landline or cell phone. One government study found that 77% of Indians — more than 830 million people — live on less than 20 rupees (about 50 cents) per day.[33] The U.N. Development Program ranked India 126th out of 177 countries on its 2006 human development index (between Namibia and Cambodia), up from 127th in 2005.

At the other end of the income scale, India has a substantial number of wealthy people and a large and growing urban middle class. A byproduct of India's growth is the emergence of a relatively prosperous and substantial middle class. India has long had a small wealthy sub-population in both its urban centers and rural

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[32] IMF Country Report No. 07/63, p. 26. The "organized sector" refers to non-government salaried or wage employment in the following sectors — agriculture, hunting, forestry, and fishing; mining and quarrying; manufacturing; utilities; construction; wholesale and retail trade; tourism; transportation, storage, and communications; and various services.

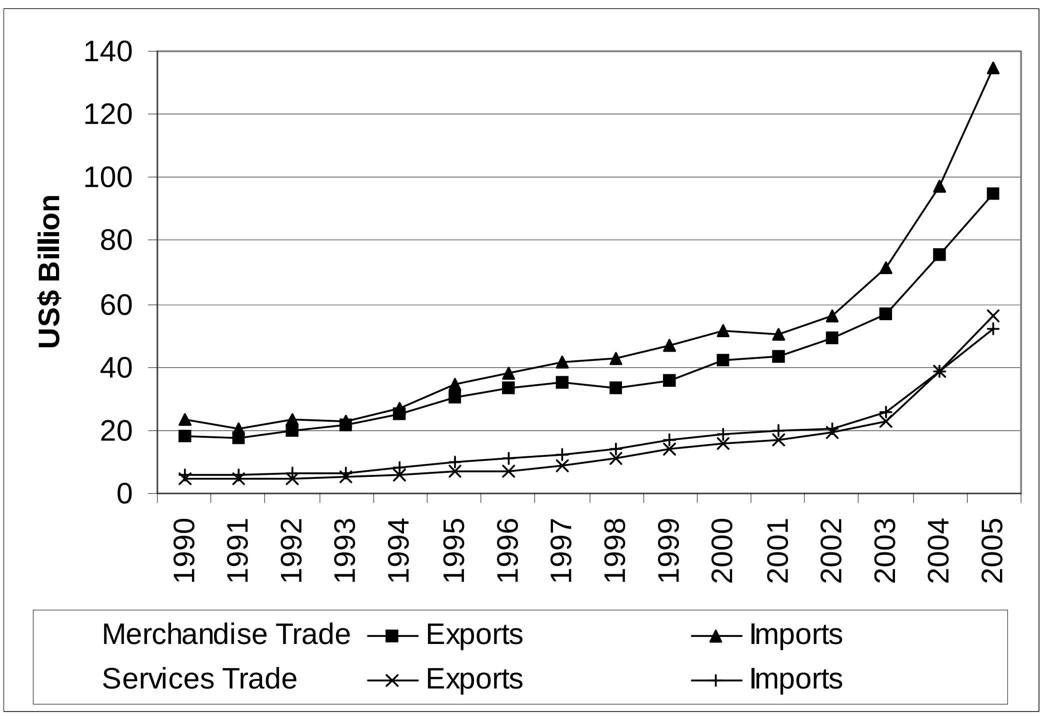
[33] "Nearly 80% of India Lives on Half Dollar a Day," Reuters, August 8, 2007.

communities. In a notable indicator of its growing wealth, India in 2007 beat out Japan as the home of the most billionaires in Asia, with 36.[34] However, its middle class was comparatively small in number. According to one estimate, India's middle class in the mid-1980s constituted less than 10% of the population.[35] Since the implementation of economic reforms, India's middle class has grown in size and affluence. Current estimates vary, but most studies indicate that less than 20% of India's households are in the middle class.[36]

Rapid Growth in Trade

The sectoral shift of India's domestic economy is partially driven by the rapid growth in the nation's trade in goods and services. **Figure 2** shows the increase in both merchandise and service trade from 1990 to 2005. Between 1990 and 1999, India's total merchandise trade doubled in value and its trade in services trebled in value. Since 1999, India's international trade growth has accelerated. Between 1999 and 2005, India's total merchandise trade and imports of services nearly tripled in value, and its exports of services quadrupled in value.

Figure 2. Growth in India's Merchandise and Service Trade, 1990-2005



Source: World Trade Organization

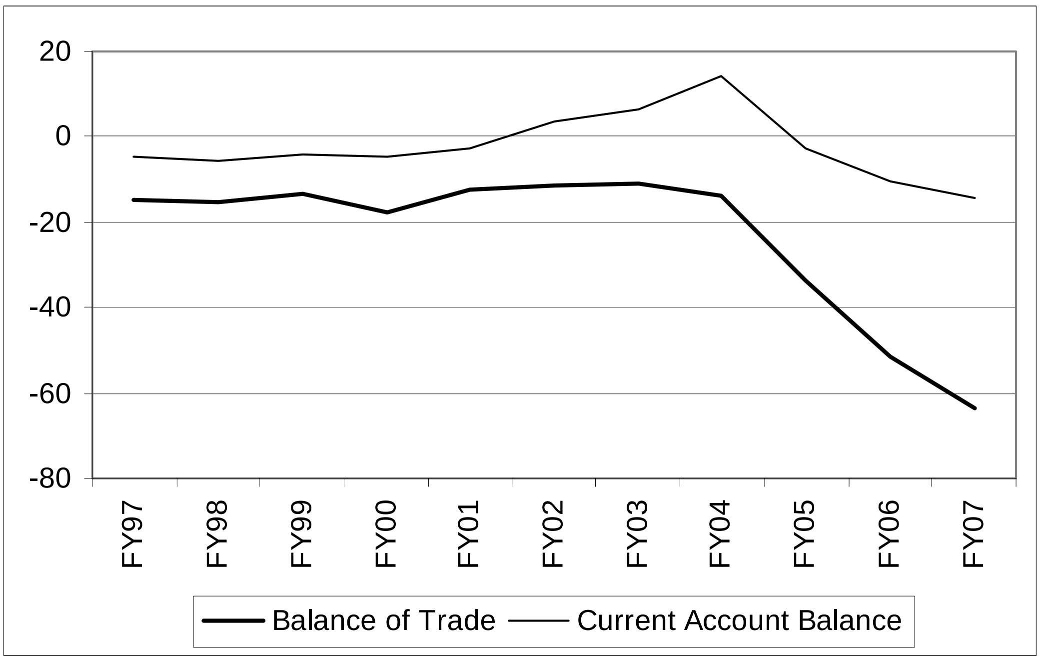
[34] "India Leads Asia Billionaire Club," *BBC News*, March 9, 2007.

[35] Das, Gurcharan, "India's Growing Middle Class," *The Globalist*, November 5, 2001.

[36] Ibid.

Balance of Trade. The overall growth of international trade has also created a potential economic problem — a growing trade and current account deficit (see **Figure 3**). From fiscal year (FY) 1997 to 2004, India's merchandise trade balance — exports minus imports — generally ran a deficit of less than $20 billion. However, since FY2004, India's merchandise trade deficit has grown from $13.7 billion to a projected $63.7 billion in FY2007. Along with this rise in India's balance of trade deficit, its current account balance has gone from a surplus of $14.1 billion in FY2004 to an estimated deficit of $14.1 billion in FY2007.

Figure 3. India's Trade and Current Account Balance (U.S. $ Billions)



Source: International Monetary Fund

Top Merchandise Exports. The recent rise in India's merchandise exports has been led by the production of oil, ores, metals, motor vehicles, and machinery (see **Table 2**).[37] In 2006, oil displaced jewelry as India's top exported commodity. Nearly three-quarters of India's oil exports in 2006 were high-speed diesel and other fuels. Also, India's exports of ores, slag, and ash increased from less than $500 million in 2000 to almost $4.6 billion in 2006, when more than four-fifths of the value came from exports of iron ore, and more than 86% of these iron ore exports went to China.

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[37] Merchandise trade data is reported according to the Harmonized Commodity Description and Coding System (HS) of tariff nomenclature, an internationally standardized system of names and numbers for classifying traded products developed and maintained by the World Customs Organization (WCO). Both India and the United States utilize the HS code.

Table 2. India's Top 10 Merchandise Exports, 2000 and 2006
(U.S. $ millions)

HS Chapter	Description	2000	2006	Percent Change
71	Jewelry	7,827.5	16,203.4	107.0%
27	Oil	1,410.7	10,479.6	642.9%
62	Non-Knit Clothing	3,744.7	5,061.2	35.2%
29	Organic Chemicals	1,615.3	4,450.8	175.5%
26	Ores, Slag and Ash	451.6	4,348.4	862.9%
72	Iron And Steel	1,175.0	4,151.6	253.3%
84	Machinery	1,221.0	4,066.0	233.0%
87	Motor Vehicles & Parts	851.6	3,204.2	276.2%
61	Knit Clothing	1,724.8	3,016.8	74.9%
73	Articles of Iron or Steel	909.6	2,749.8	202.3%
	Total Exports	42,299.4	121,259.3	186.7%

Source: Global Trade Atlas

The buildup in India's exports of motor vehicles and parts has several elements. Nearly a third of the exports — $1.257 billion in 2006 — are automotive parts, with the United States as the largest export market, purchasing almost $340 million. The second segment of India's chapter 87 exports are automobiles, worth $1.501 billion in 2006, and shipped principally to Europe. In addition, India also exported a large amount of motorcycles — nearly $319 million worth in 2006.[38]

Another notable aspect of India's recent export growth is the relatively poor performance of its past leading exports — jewelry and clothing. In 2000, India's top four exports were jewelry (HS Chapter 71), non-knit clothing (HS chapter 62), cotton cloth and yarn (HS Chapter 52), and knit clothing (HS Chapter 61). By 2006, non-knit clothing had slid to third place and knit clothing had dropped to ninth, despite the expiration of the quotas under WTO Agreement on Textiles and Clothing on January 1, 2005.[39]

Despite the rise and fall of other commodities, jewelry remained India's top export in 2006. Within jewelry, India continues to be primarily an exporter of diamonds. In 2006, two-thirds of India's jewelry exports were cut, unmounted

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[38] The top five destinations for India's motorcycle exports in 2006 were, in order: Sri Lanka, Colombia, Bangladesh, Nepal, and the Philippines.

[39] For details on clothing and textile trade after the expiration of the WTO Agreement on Textiles and Clothing, see CRS Report RL34106, "U.S. Clothing and Textile Trade with China and the World: Trends Since the End of Quotas," by Michael F. Martin.

diamonds. India's top markets for its diamonds were, in order: Hong Kong ($3.2 billion), the United States ($2.5 billion), Belgium ($1.4 billion), and the United Arab Emirates ($1.2 billion).

Top Merchandise Imports. In contrast to exports, India's top 10 merchandise imports remained relatively stable between 2000 and 2006 (see **Table 3**). Oil was and remains India's top import, and over three-quarters of its oil imports are crude oil. Jewelry remains India's second biggest import, consisting of nearly equal amounts of gold and diamonds to be used by India's jewelry manufacturing industry. The next two top import categories — machinery and electrical machinery — incorporate both consumer goods (televisions, telephones, and computers) and intermediate goods (hard disc drives and integrated circuits). Finally, the fastest growing import category among the top ten, iron and steel, was more than 90% copper imports.

Are India and China Export Rivals?

Given their similarities, one might expect China and India to be direct competitors in the global commodity markets. However, their respective official export data provides only modest support for this idea.

India and China share only one category — non-knit clothing — among their top five exports. Expanding the comparison to their top 10 exports, three more categories are added — machinery, knit clothing, and articles of iron and steel — which are India's seventh, ninth, and tenth largest exports, respectively.

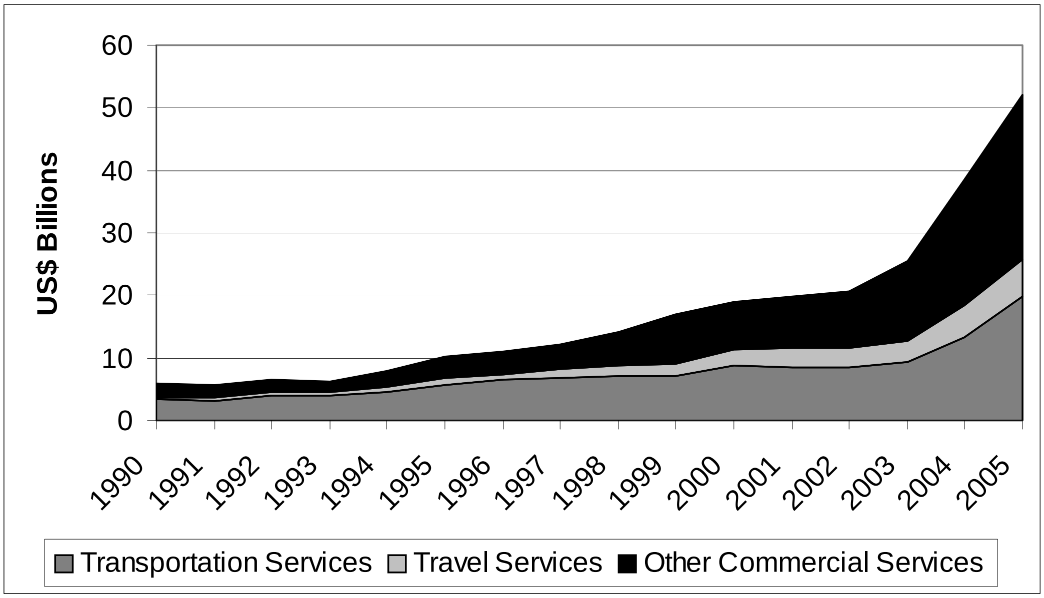
Table 3. India's Top 10 Merchandise Imports, 2000 and 2006
(U.S. $ millions)

HS Chapter	Description	2000	2006	Percent Change
27	Oil	17,535.0	45,880.0	161.6%
71	Jewelry	9,953.3	23,462.7	135.7%
84	Machinery	4,195.1	12,839.8	206.1%
85	Electrical Machinery	2,679.4	11,051.4	312.5%
72	Iron and Steel	1,000.4	5,318.3	431.6%
29	Organic Chemicals	1,594.2	5,112.1	220.7%
90	Laboratory and Medical Equipment	939.1	2,565.1	173.2%
39	Plastics	675.8	2,427.5	259.2%
15	Edible Oils	1,380.6	2,343.3	69.7%
28	Inorganic Chemicals	1,148.7	2,126.12	85.1%
	Total Imports	50,577.5	172,876.3	241.8%

Source: Global Trade Atlas.

Trade in Services. The rapid rise in India's merchandise trade has been outdone by even faster growth in trade in services. The value of India's services exports increased 250% between 2000 and 2005, while the value of its services imports increased 176%. In 2005, the total value of India's services trade was $108.3 billion, or nearly half the size of its total merchandise trade. India's services trade surplus in 2005 was $3.9 billion.

Figure 4. Growth in India's Services Exports, 1990-2005

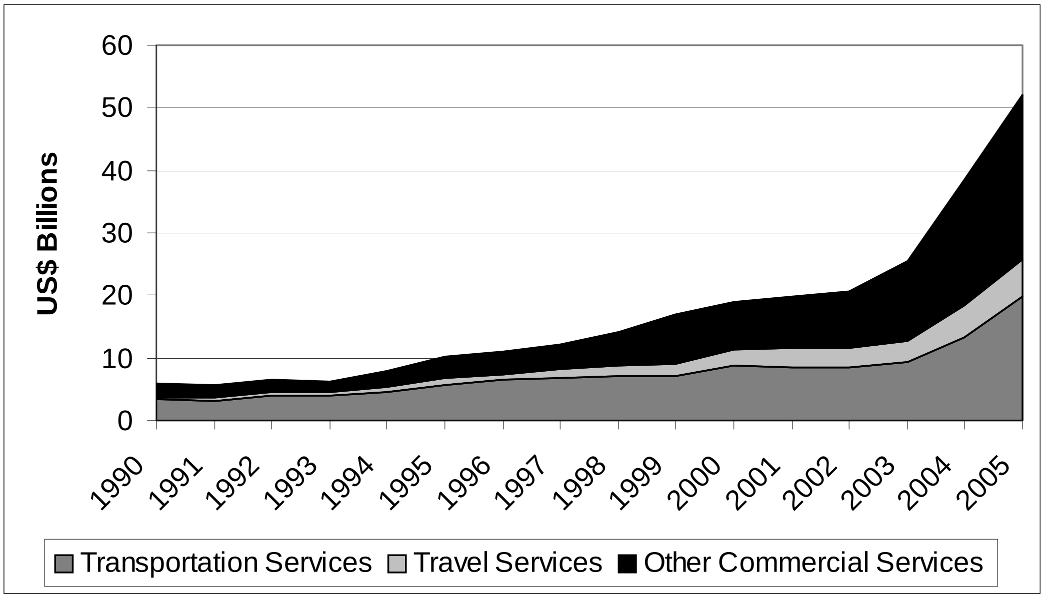


Source: World Trade Organization

Figure 4 shows the sharp increase in India's services exports from 1990 to 2005. Although both transportation and travel services experienced strong growth over this time period, much of the rapid expansion in services exports occurred in other service sectors. Over the 15 years in question, India's services exports increased from $4.6 billion in 1990 to $56.1 billion in 2005 — more than a 12-fold increase in size.

Figure 5 presents the growth in India's services imports between 1990 and 2005. The sectoral composition of growth for services imports is similar to that of exports — transportation services and travel services both increased, but the greatest growth was in the import of other commercial services. Between 1990 and 2005, the value of India's services imports grew almost nine-fold, from $5.9 billion in 1990 to $52.2 billion in 2005.

Figure 5. Growth in India's Services Imports, 1990-2005



Source: World Trade Organization

Risk of Overheating?

The structural changes in India's economy, the decline in poverty, the emerging middle class and the rapid growth in foreign trade are all seen as stoking the engines of economic growth in India. In fact, there is rising concern that India's economy may be growing too fast, raising fears of that its recent success may soon be followed by a sharp economic downturn.

Commentators often point to India's rising rate of inflation as evidence that its economy is growing too fast. After several years of very modest inflation — about 4% per year — the consumer price index (CPI) in India topped 7% in 2006 and remained high in the first half of 2007. In May 2007, the CPI for industrial workers was up 6.6% over the previous month, and the CPI for agricultural workers was up 8.2%.[40] The official government target is to bring inflation down to 4.0-4.5% in 2007, but some analysts project that the consumer price index will stay above 6%.

While Reserve Bank of India (RBI) increased interest rates and raised reserve requirements to dampening inflationary pressures in 2006 and 2007, the efforts apparently have not significantly slowed economic growth. The United Nations Economic and Social Survey of Asia and the Pacific project India's economy would grow by 9.0% in 2007, down only 0.2% from its 2006 growth rate.[41] In 2007, the

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[40] Ministry of Statistics, Government of India.

[41] United Nations Economic and Social Commission for Asia and the Pacific, *Economic and Social Survey of Asia and the Pacific 2007*, April 2007, p. 4.

International Monetary Fund (IMF) projected India's GDP would grow by 8.4% in

2007 and 7.8% in 2008.[42] IMF recommendations on how to reduce the risk of the economy overheating focus on lowering the public debt (currently about 80% of GDP), continuing to reduce the general government deficit, and promoting greater job growth.[43]

Where the anti-inflationary efforts of the RBI may have affected the economy is India's exports.[44] According to some economists, the higher interest rates have contributed to a significant appreciation of the rupee against the U.S. dollar and the Euro. The stronger rupee, these analysts maintain, is making India's exports less competitive. As will be discussed later in this report, the strength of the rupee is supposedly hitting India's jewelry and clothing exports especially hard.

India's Current Economic and Trade Policies

The UPA coalition came into office promising sustained economic growth "in a manner that generates employment." It set out to enact guaranteed employment (for minimum 100-day periods), and major public investment in social programs and in the agricultural and rural sectors. The UPA also vowed to give a high priority to the development of physical infrastructure such as roads, ports, power, railways, water supply, sewage treatment, and sanitation, even offering "explicit" subsidies to bring private sector participation in this area. Economic reforms were to be continued, but with a "human face":

> The UPA reiterates its abiding commitment to economic reforms with a human face, that stimulates growth, investment, and employment. Further reforms are needed and will be carried out in agriculture, industry, and services. The UPA's economic reforms will be oriented primarily to spreading and deepening rural prosperity, to significantly improving the quality of public systems and delivery of public services, to bringing about a visible and tangible difference in the quality of life of ordinary citizens of our country.[45]

The UPA economic priorities were largely welcomed by analysts calling for India to "get over its obsession" with GDP growth and FDI so as to better attend to the needs of common citizens, especially those in the rural, agricultural economies. These observers warn that a single-minded focus on economic expansion facilitates significant damage to the environment and to human health, as well as encouraging corruption.[46]

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[42] International Monetary Fund, *World Economic Outlook 2007*, chapter 1, p. 2.

[43] "Booming India at Risk of Overheating," *IMF Survey*, April 11, 2007, p.s 96-97.

[44] For more details on the impact of appreciating rupee and India's exports, see "The Rising," by Shankkar Aiyar, *India Today*, June 4, 2007.

[45] See the UPA's May 2004 Common Minimum Program at [http://pmindia.nic.in/cmp.pdf].

[46] See, for example, Prashant Bhushan, "Get Over the GDP-FDI Obsession," *Outlook* (Delhi), January 5, 2006.

The UPA economic program also addresses many of the economic challenges listed in a July 2006 World Bank report. According to the World Bank, India's most pressing economic issues are:

- improving the delivery of core public services such as healthcare, education, and power and water supply for all India's citizens;
- making growth more inclusive by diminishing existing disparities, accelerating agricultural growth, improving th job market, and helping lagging states grow faster;
- sustaining growth by addressing its fiscal and trade deficits, and pushing ahead with reforms that facilitate growth; and
- addressing HIV/AIDS before the epidemic spreads to the general public.[47]

Economic Policies of the UPA Government

Prime Minister Singh took office in 2004 insisting that development would be a central priority of the UPA government, with reforms aimed at reducing poverty and increasing employment. He also emphasized that privatization was not part of UPA ideology and that major public sector concerns would not be sold off. The appointment of Harvard-educated lawyer and economic reformer Palaniappan Chidambaram to head the Finance Ministry, and a UPA Common Minimum Program emphasizing economic growth and increased investment, were welcomed by most business interests, even if the pace of privatization and labor reform efforts was expected to slow.

In brief, from the start, the Singh government has attempted to walk a tightrope of economic policies designed to maintain its informal coalition government. Any sharp shift, either to the left or the right, might bring about sufficient political opposition from coalition members to destabilize the government. As a result, economic policies over the last three years have been characterized as being modest in scope and uneven in implementation. Eighteen months after taking power, for example, the UPA government was coming under fire for not pushing through a single major economic reform initiative.[48]

Many analysts have attributed the government's sidelining of reform initiatives to the influence of the Left Front, yet resistance to economic reform may run deep among a broader spectrum of ordinary Indians, many of whom are distrustful of the motives of an oftentimes corrupt political class.[49] This pattern of fitful gradualism is demonstrable by reviewing the key areas where the Singh government has attempted to make substantive changes in the Indian economy.

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[47] [http://siteresources.worldbank.org/SOUTHASIAEXT/Resources/DPR_overview.pdf].

[48] Clay Chandler, "India's Bumpy Ride," *Fortune*, October 31, 2005; N. Chandra Mohan, "The Anti-Reform Mindset," *Outlook* (Delhi), November 10, 2005.

[49] Anjana Pasricha, "India's Communist Parties Slow Pace of Economic Reform," VOA News, June 18, 2006; Pranab Bardhan, "Why Is Reform Unpopular?," *Outlook* (Delhi), October 6, 2006.

UPA Budgets. Because India's government continues to be a major economic force even after the economic reforms of the 1990s, the federal budget is an important indicator of government priorities. In FY2006/2007, the federal expenditures were 11.2% of GDP, and the fiscal deficit was 3.8% of GDP. By comparison, U.S. government expenditures for FY2006/2007 were 19.9% of GDP, and the fiscal deficit was 1.3% of GDP.[50]

The UPA's first budget, released in July 2004, generally was lauded by Indian industrial groups as "progressive and forward-looking."[51] Subsequent budgets were similarly greeted by business interests, even as the prime minister and finance minister were seen to be tempering some of their more reformist instincts with heavy social and anti-poverty spending.[52]

India's federal budget for FY2007/2008 is an apparent response to the criticisms of economic reforms from both ends of the political spectrum. In part, the budget continues the past program of liberalization, while also giving greater attention to the agricultural sector and efforts to provide more assistance to India's poor. Such efforts are still viewed by the Left Front as being insufficient; this faction accuses the Singh government of prioritizing expenditure reduction over services for the poor. Meanwhile, opposition BJP leaders have criticized UPA budgets for slowing or even abandoning economic reform programs.[53]

One of the more difficult components of the government's budget is its efforts on poverty reduction. In August 2005, the lower house of India's Parliament passed a $9 billion jobs bill promising guaranteed work for up to 25 million of India's poorer citizens. Some critics called the initiative the kind of "socialism" that diverts scarce resources to efforts that have failed in the past, with most funding being lost to administrative costs and corruption. Yet the World Bank supported the policy, predicting it would help sustain growth.[54] Having rebuffed the previous critics, in February 2006 the Singh government formally launched the country's most ambitious anti-poverty initiative that would provide guaranteed jobs for one member of each of India's 60 million rural households.

Another chronic budgetary problem is balancing needs with resources. As described below, India has seriously underinvested in infrastructure for decades.

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[50] Congressional Budget Office figures.

[51] "Reformers Take Control," *Far Eastern Economic Review* (Hong Kong), June 3, 2004; "CII Applauds UPA's Maiden Budget," Confederation of Indian Industry Press Release, New Delhi, July 8, 2004.

[52] Paranjoy Guha Thakurta, "Leftward Shift in Indian Economy," BBC News, February 28, 2005; Paranjoy Guha Thakurta, "India's 'Left-of-Center' Budget," BBC News, February 28, 2007.

[53] "Budget a Victim of Fiscal Fundamentalism: CPI-M," Indo-Asian News Service, February 28, 2007; "Budget Weak on Reforms: Sinha," *Statesman* (Delhi), March 5, 2006.

[54] Anuj Chopra, "India Moves to Spread Wealth," *Christian Science Monitor*, August 25, 2005; Paul Watson, "India Moves Toward Guaranteed Jobs Program for Rural Poor," *Los Angeles Times*, August 25, 2005.

However, a culture of tax evasion limits funds for public services. One report has only 30 million Indians paying any taxes and only 15% of federal government revenue coming from tax collection.[55]

Privatization. India continues to retain remnants of its pre-reform "democratic socialist" economy. Three strategic sectors of the economy — railroads, nuclear power, and military aircraft and warships — remain state monopolies and closed to the private sector. However, the Singh government is continuing the privatization policies of its predecessor, but at a more gradual pace. Within the government, the Department of Disinvestment of the Ministry of Finance oversees India's privatization program.

The privatization slowdown has not proven to be acceptable to elements of the UPA coalition. In July 2006, Prime Minister Singh announced that all government disinvestment decisions would be put on hold following opposition from the DMK party, a powerful Tamil Nadu-based member of the ruling coalition. The move was criticized by industrial groups. Barely a month later, the Singh government announced that it was abandoning plans to sell more than a dozen state-owned companies in what many analysts saw as a gesture to the Left Front parties which support the ruling coalition in New Delhi.[56] However, the government appeared to be renewing its efforts in 2007 with a February decision to join a disinvestment process involving three publicly-owned power companies.[57]

Labor Reforms. Domestic business interests and potential foreign investors complain that India's labor laws are biased against employers and often prevent them from making high-risk investments. A culture of strict government oversight of the labor market is illustrated by the existence of 47 national laws and nearly 180 state-level laws meant to monitor its functioning. Work stoppages cause millions of lost human-days of labor each year and the country's courts are clogged by hundreds of thousands of pending labor disputes.[58]

In February 2005, Prime Minister Singh unveiled a blueprint for labor sector reforms. Singh later admitted that Indian labor laws were "rigid," reportedly saying, "We cannot move straightforward to the Western or the American model of hire and fire, quite frankly. I don't see that there is today a climate of opinion which will go to that extreme."[59] More than two years after it was announced, and despite the

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[55] Sunil Jagtiani, "For Indians, the Tax Man Rarely Cometh," *Christian Science Monitor*, March 8, 2006.

[56] Saritha Rai, "In a Blow to Reform Plans, India Halts Privitizations," *New York Times*, August 17, 2005.

[57] Jo Johnson, "Delhi's U-Turn on Privatization Criticized," *Financial Times* (London), July 7, 2006; "Disinvestment Back on Track," *Hindu* (Chennai), February 9, 2007.

[58] Rajesh Mahapatra, "India May Look Into Labor Law Changes," Associated Press, July 6, 2006; Kaushik Basu, "Why India's Labor Laws Are a Problem," BBC News, May 15, 2006" "India: Need for Labor Reforms," World Bank Press Release, February 26, 2007.

[59] "Indian PM: Coalition Pressure Limiting Govt Reforms," Dow Jones International News, (continued...)

prime minister's efforts to create a working consensus on the issue, the reform initiative has been effectively stalled by the UPA's Left Front allies.[60]

Infrastructural Development. The urgent need for extensive investment in India's infrastructure is rarely questioned. The premiere report of the U.S.-India CEO Forum from March 2006 identified India's poor infrastructure as one of two key impediments to increased bilateral trade and investment relations (the other being India's dense bureaucracy).[61] At a 2005 Economic Summit in New Delhi, Finance Minister Chidambaram acknowledged the problem, telling an audience of international business leaders and policy makers that India needs major investments in infrastructure such as roads, ports, and electricity generation. He asserted that a more liberal policy on bringing in foreign capital would be a key to this endeavor.[62] Electricity shortages are especially acute and are widely believed to be seriously hindering the country's economic potential.[63] Reports indicate that massive flooding in Mumbai in the summer of 2005 further exposed what was called India's economic "Achilles heel" (poor infrastructure). Another representative story describes the "utter chaos" common at New Delhi's international airport and the deterrent effect this can have on foreign visitors.[64]

The Singh government is attempting to address decades of underinvestment in infrastructure, but financing problems continue to hinder this effort. New Delhi estimates that the country will need up to $350 billion in infrastructure investment over the next five years. Some of this funding may come from India's record-high pool of foreign exchange reserves, and Indian officials hope that as much as one-quarter will come from foreign investors. Further reform in India's financial sector may be key to raising capital for infrastructure projects.[65] In FY2007/2008, the central government plans to spend more than $46 billion on infrastructure

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[59] (...continued)
August 25, 2005.

[60] Henry Chu, "Rising Food Prices Hit Indians in Wallet, Politicians at Polls," *Los Angeles Times*, March 10, 2007.

[61] See [http://planningcommission.nic.in/reports/genrep/USIndia.pdf].

[62] Rajesh Mahapatra, "Finance Minister: India Must Be More Open," Associated Press, November 27, 2005.

[63] Somini Sengupta, "Electricity Crisis Hobbles an India Eager to Ascend," *New York Times*, May 21, 2007.

[64] Rajat Bhattavharya, "Can India Make Its Great Economic Leap Forward?," Reuters, August 4, 2005; Muneeza Naqvi, "Winter Chaos at New Delhi Airport Highlights India's Infrastructure Woes," Associated Press, January 3, 2007. A 2005 business magazine feature article called India "the global economy's idiot savant" due to its ability to produce hundreds of thousands of well-educated engineers each year while still possessing a "chronically abysmal infrastructure" (Clay Chandler, "India's Bumpy Ride," *Fortune*, October 31, 2005).

[65] Authors' interview with Indian trade official, Washington, DC, May 25, 2007.

development.[66] According to the Indian Planning Commission's Committee on Infrastructure (created in August 2004), current initiatives include a 15-year, multi-billion-dollar project to widen and pave 40,000 miles of national highways; a $5 billion plan to build a dedicated freight railway; extensive renovation of 276 seaports, including bringing 12 major ports up to "world-class standards"; the modernization and expansion of the New Delhi and Mumbai airports (which were privatized in 2006), along with other major airports such as those in Kolkata and Chennai; further expansion of telecommunication networks; and large-scale investment in new power plants.[67] Some of these efforts are not without their opposition from well-entrenched stakeholders, however.[68]

Special Economic Zones. One of the more controversial elements of India's recent economic reforms are the special economic zones (SEZs) across the country. Modeled in part after China's SEZs, the goal was to develop new industrial areas near India's rural population to create alternatives to agricultural employment. Firms operating in the SEZs are expected to be net foreign exchange earners. Investment may come from public or private companies; foreign companies may also operate in the SEZs. There are a number of tax, tariff, and regulatory incentives offered to companies that operate in the SEZs. At the time of this writing, a total of 234 SEZs have been approved by the Indian government.

The most controversial aspect of the SEZ policy is the acquisition of land. Indian law grants the Indian states the power of eminent domain over land, with relatively little recourse for the land owner to appeal the compensation for appropriated land. In some cases, the land acquired for the SEZs was take from local farmers, rather than from fallow areas. Some farmers have complained about their displacement from the land, which they viewed as a source of economic stability and their primary store of wealth.

The SEZ policy has elicited energetic opposition from interest groups representing the political left and right, alike. Some critics says that building SEZs on fertile agricultural land will impoverish farmers without adequate compensation. Even INC chief Sonia Gandhi openly opposed exposing farmers to "unscrupulous developers." Other opponents, including India's finance minister, warn that the government will be denied billions of dollars in tax revenues lost due to special

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[66] "Poor Infrastructure Hurting India's Growth - Fin Min," Dow Jones International News, May 8, 2007; Ben Klayman, "India Infrastructure May Need $80 Bln Foreign Funds," Reuters, October 27, 2006; "India Boosts Infrastructure to Attract Foreign Investment," *Today* (Singapore), March 1, 2007.

[67] See [http://infrastructure.gov.in]. See also Surojit Gupta, "India Picks Up Infrastructure Pace, More Needed - Analysts," Reuters, November 13, 2006.

[68] For example, recent efforts to clear slums in Mumbai and Bangalore were met with energetic and oftentimes successful resistance movements (John Larkin and Eric Bellman, "In India, the Path to Growth Hits Roadblock: Slums," *Wall Street Journal*, March 17, 2006).

concessions offered to participating firms. In October 2006, the Left Front parties demanded extensive curbs on the SEZ initiative.[69]

There have been a number of violent protests and deaths associated with the establishment of SEZs in India. In January 2007, at least seven people were killed during protests about the establishment of an SEZ in Nandigram, West Bengal. Reports implicate the local police and supporters of the ruling CPI-M Party in the deaths. Then, on March 14, at least 11 more protesters were killed in Nandigram, again during demonstrations against the SEZ. As a result of the continued protests and violence, the SEZ policy has been put on hold by Prime Minister Singh.

India's Trade Policies

India's trade policies have generally been coordinated with its overall economic policies. Prior to the economic reforms of the 1990s, India utilized a fairly comprehensive import licensing system to control the import of goods. The import of a number of products was banned and over 1,400 products faced quantitative restrictions.

With the advent of the economic reforms, India started a gradual process of transforming its import control mechanisms from quantitative restrictions to a tariff-based system that favored the import of some types of products, but deterred the import of other types of products. In some cases, tariff rates were significantly raised when the import restrictions were lifted. A side effect of the change in trade policy was the rising importance of import tariffs for India's federal budget. In fiscal year 1996/97, tariffs provided one third of India's gross tax revenue.[70]

Over the last few years, India has been simplifying its import policies by lowering tariffs, reducing the variation in tariff rates, and eliminating import licensing requirements. The stated goal is to reduce tariffs towards levels found among Association of South East Asian Nations (ASEAN) members.[71]

However, while India has been lowering its various import barriers, it has become a leading nation in the filing of antidumping measures with the WTO. Following the passage of the 1995 amendment to its 1975 Customs Act, which established India's antidumping and countervailing duty procedures, India began filing a large number of antidumping notifications. Between 1995 and 2001, India made 250 such notifications. As of June 30, 2006, India had 174 antidumping measures in force on products from 30 different WTO members, including 11 measures on U.S. products.[72]

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[69] Paranjoy Guha Thakurta, "Economic Zone Plans Polarize India," BBC News, October 2, 2006; Jo Johnson, "Left Demands Put India's SEZs in Doubt," *Financial Times* (London), October 19, 2006.

[70] "Trade Policy Review - India," WTO Trade Policy Review Body, May 22, 2002, p. 31.

[71] Ibid, p. 25.

[72] "Semi-Annual Report under Article 16.4 of the Agreement - India," WTO Committee on

(continued...)

Tariff Rates and Enforcement. India's tariff system has long had a reputation of being complex and opaque. Besides having a comparatively high average tariff rate, India also had a more dispersed range of tariff rates, even among similar types of products.[73] Moreover, India had many exemptions or exceptions to the standard "most favored nation" (MFN) tariff rate, making it difficult for foreign companies to determine the correct tariff rate for their exports. Finally, there were frequent reports of uneven enforcement of existing tariff laws, as well as claims of arbitrary evaluation of imported goods.

Most of these perceived problems with India's tariff system have improved with the lowering of its average tariff rate and the simplification of its tariff schedule. In fiscal year 1991/92, just before the start of its economic reforms, India's average tariff rate was almost 130%.[74] According to the WTO, in fiscal year 1997/98, India's average tariff rate was 35.3%, with a peak rate of 260%, but by fiscal year 2001/2002, the average rate had declined to 32.3%, with a peak rate of 210%.[75] By 2005, India's average tariff rate was down to 19.5%.[76]

Along with the lowering of tariff rates, India also reduced the number of different tariff rates it charged. For fiscal year 2006/07, the tariff rate became 30% for most agricultural goods and 12.5% for most non-agricultural goods. However, the peak tariff rates for agricultural goods is 100% and for non-agricultural goods is 182%.

Two product categories that remain exceptions to India's tariff reduction and simplification are textiles and clothing. Prior to the elimination of import licenses for textile and clothing imports in April 2001, India introduced specific duties for a range of fabrics and apparel. These duties generally involved the imposition of the higher of two tariffs — one calculated on a percentage basis; the other calculated by a fixed amount per kilogram or square meter. According to one estimate, depending on the unit price of the imported textile or garment, the implicit tariff rate could be as high as 63%.[77] In fiscal year 2006/07, many products in HS chapters 50 to 63 still face this two-track duty system.

Import Restrictions. Although most of India's import restrictions have been lifted, there remain a small set of goods that are either prohibited, controlled or monitored. Import bans are either due to existing international obligations (for example, the international ban on trade in ivory) or on health and safety concerns. In March 2007, India banned the import of live poultry, pigs, and pig meat products

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[72] (...continued)
Anti-Dumping Practices, November 27, 2006.

[73] For this report, the average tariff rate is the simple, unweighted average of the tariff rates.

[74] "India & Bangladesh: Bilateral Trade," The World Bank, December 2006, p. 10.

[75] "Trade Policy Review - India," WTO Trade Policy Review Body, May 22, 2002, p. 31.

[76] "2007 Trade Policy Agenda and 2006 Annual Report," Chapter II - World Trade Organization, p. 7.

[77] "India & Bangladesh: Bilateral Trade," The World Bank, December 2006, p. 13.

from countries with bird flu outbreaks.[78] India also controls the import of some products by means of stringent regulations.[79] Finally, India regulates imports by means of monitoring import flows. Among these items are: milk products, fruits, nuts, coffee, tea, spices, cereals, oilseeds, edible oils, alcoholic products, silk, and toys.

U.S. Trade Barrier Assessment. In its 2007 report on foreign trade barriers, the United States expressed concern about several other aspects of India's trade policy beyond its tariff rates and import restrictions.[80] According to the report, India provides trade-distorting subsidies for di-ammonium phosphate (DAP) fertilizer. Also, the report is critical of Indian Customs for the "extensive documentation" it requires, as well as its apparent application of "discretionary customs valuation criteria to import transactions." In addition, the United States is concerned about India's standards and certification requirements, especially as they pertain to sanitary and phytosanitary measures. In some cases, the United States believes that the scientific basis of the standards is questionable; in other cases, it sees the certification requirement as forming a non-tariff trade barrier.

India-U.S. Economic and Trade Relations

Economic and trade relations between the United States and India have been problematic in the past, but are currently considered comparatively cordial. U.S. policymakers often identify in the Indian political system shared core values, and this has facilitated increasingly friendly relations between the U.S. and Indian governments. In addition, the trade and investment reforms implemented by India over the last 15 years have generally fostered improved trade relations. Indian officials opine that the two national economies present "complimentary business interests rather than a standard developed-developing relationship."[81] However, the improvement in trade relations has been punctuated by episodic problems, generally based on political — rather than economic — differences of opinion. A major divergence came on May 13, 1998, when the United States imposed trade sanctions on India in response to its nuclear weapons tests.

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[78] "Government Bans Live Poultry from Bird Flu-hit Nations," Reuters (India), March 13, 2007.

[79] For example imported second-hand automobiles must meet the following conditions: 1. Be no more than three years old; 2. Comply with India's Motor Vehicle Act of 1988; 3. Have right-hand controls and steering; 4. Register speed in kilometers per hour; 5. Be certified "road-worthy" for at least five years after import; and 6. pass an safety and emissions inspection. Even when the vehicle is approved for import, it can only enter via specific ports.

[80] U.S. Trade Representative, "2007 National Trade Estimate Report on Foreign Trade Barriers," March 31, 2007.

[81] Authors' interview with Indian trade official, Washington, DC, May 25, 2007.

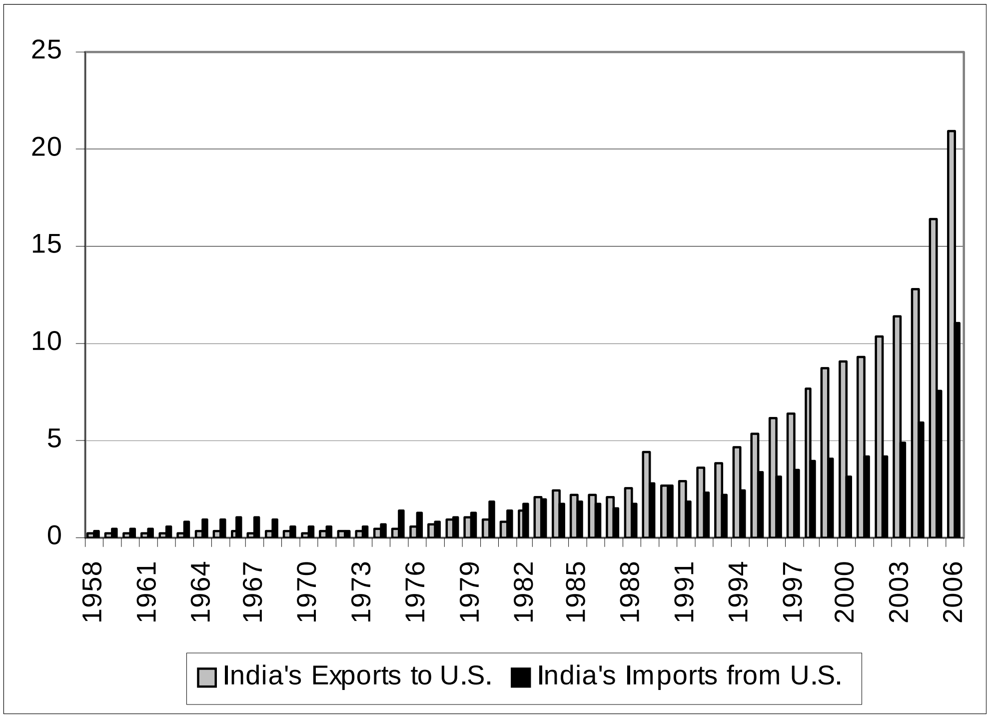
Trends in Merchandise Trade

Regardless of which nation's trade statistics are considered, the value of merchandise trade between India and the United States has picked up dramatically over the last 20 years. In 1986, according to U.S. trade statistics, the total value of bilateral trade with India was $4.0 billion. By 2006, the total value of bilateral trade had risen to $31.9 billion — nearly an eight-fold increase. However, despite the rapid growth in the value of trade, the relative importance of the other nation to its total trade declined markedly in the late 1960s — a decline from which it has not recovered.

India's Merchandise Trade with the United States. **Figure 6** shows the value of India's exports to and imports from the United States from 1958 to 2006, according to data reported by the Indian government to the International Monetary Fund (IMF). The graph shows that both India's exports to and imports from the United States were relatively low in value and subject to fluctuations from 1958 to about 20 years ago. However, since the mid-1980s, U.S. imports from India have steadily increased in value while India's exports to the United States have shot up dramatically.

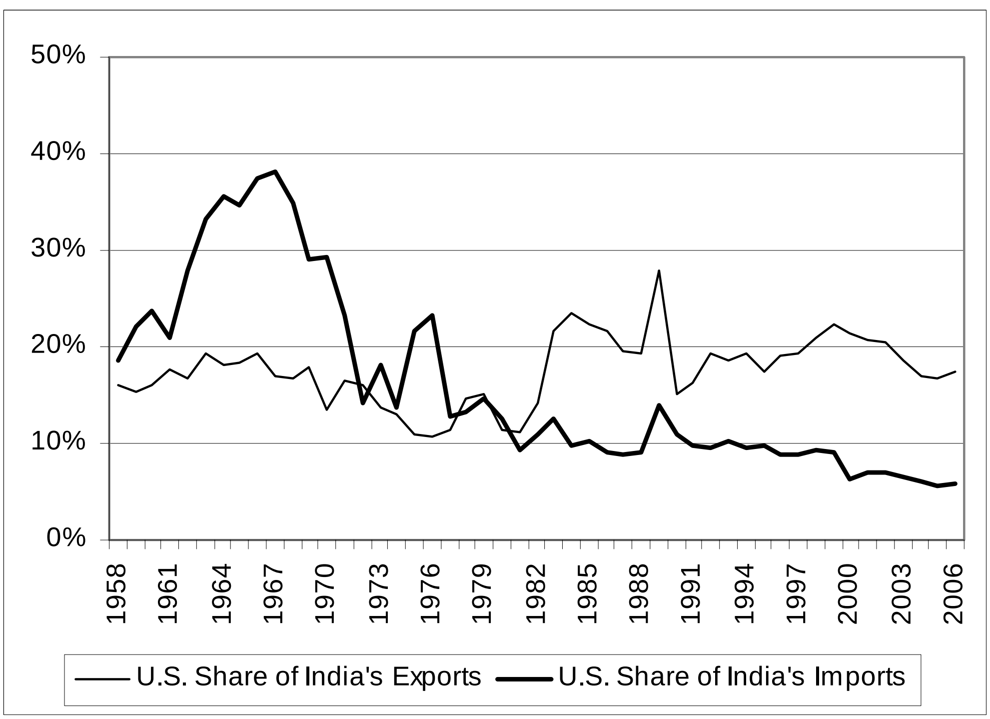
Despite the recent strong growth in trade flows in both directions, the relative importance of the U.S. for India's imports has actually declined over the last 40 years, while its share of India's exports has rebounded (see **Figure 7**). In the mid-1960s, nearly one-fifth of India's exports went to the United States, and the United States supplied India with over one-third of its imports. In 1981, the United States had declined in importance, purchasing just over 11% of India's exports and supplying less than 10% of its imports. In 2006, the United States purchased 17.4% of India's exports — almost the same percentage as in 1961 — but only provided India with 5.9% of its imports. As a result, the United States was India's largest export market in 2006, and its third largest source of imports.

Figure 6. India's Merchandise Trade with the United States, 1958-2006 (U.S. $ Billions)



Source: *Direction of Trade Yearbook*, International Monetary Fund, various years.

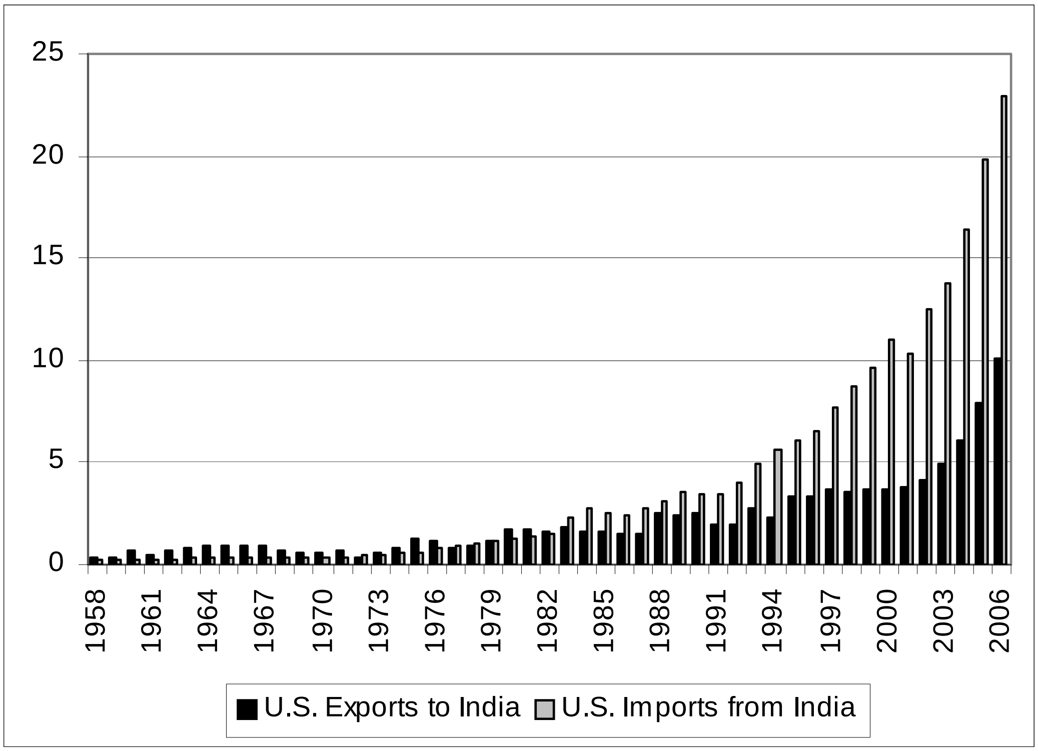
Figure 7. U.S. Share of India's Merchandise Trade, 1958-2006



Source: *Direction of Trade Yearbook*, International Monetary Fund, various years.

U.S. Merchandise Trade with India. An examination of U.S. statistics for bilateral trade with India reveals a similar pattern as India's data. Figure 8 shows official U.S. trade statistics for the same time period as **Figure 6**. In value terms, U.S. exports to India and India's exports to the United States are comparatively low in value and flat until the mid-1980s. After a significant increase in the 1980s, U.S. imports from India rise rapidly starting in the early 1990s. U.S. exports to India also pick up in value starting in the early 1990s, but not at the same pace as imports from India.

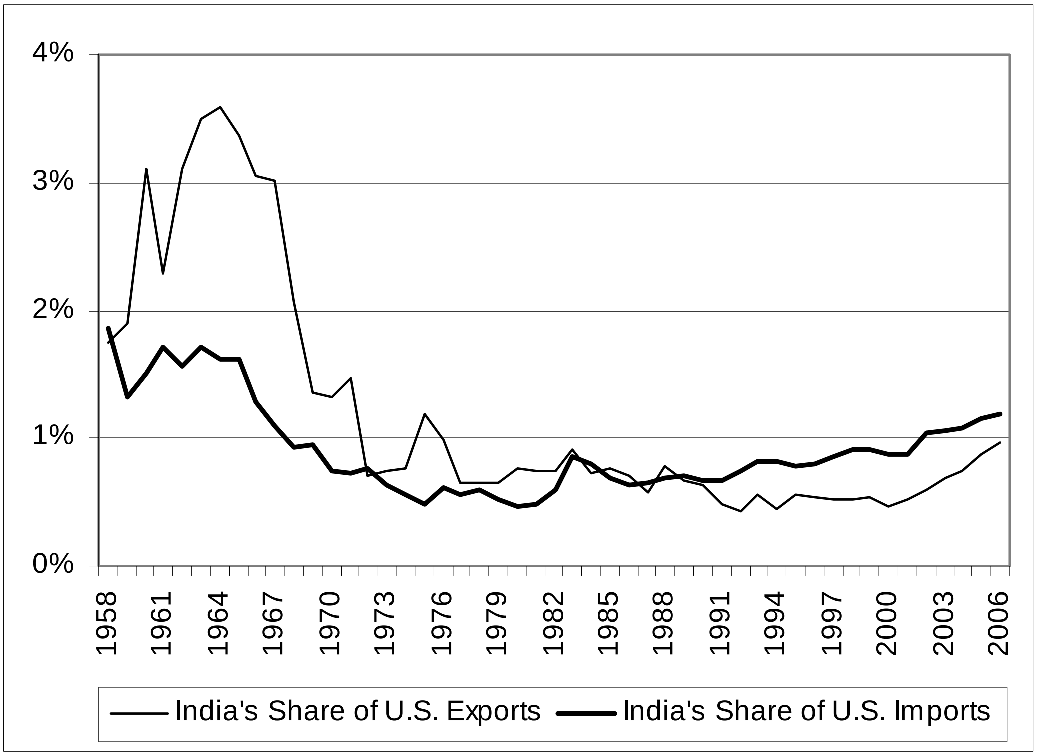
Figure 8. U.S. Merchandise Trade with India, 1958-2006 (U.S. $ Billions)



Source: *Direction of Trade Yearbook*, International Monetary Fund, various years.

The role of India in U.S. merchandise trade flows has undergone a similar, but less dramatic, change as was seen for the importance of the United States for India's trade (see **Figure 9**). In the mid-1960s, India provided the United States with about 3% of its imports and purchased about 1.5% of its exports. Both of these percentages slid to under 1% in the 1970s. Since then, India's importance as a supplier of U.S. imports has risen slightly and slowly to 1.2% while India's share of U.S. exports has increased modestly to 1.0% after falling to 0.4% in the early 1990s. As a result, India was the 21st largest export market for the United States in 2006 and its 18th largest supplier of imports.

Figure 9. India's Share of U.S. Merchandise Trade, 1958-2006



Source: *Direction of Trade Yearbook,* International Monetary Fund, various years.

Top Traded Commodities. There are some differences between official U.S. and Indian trade data on what the top traded commodities are between the two countries. In some cases, the difference is only in the value and ranking of the leading traded goods. However, in other cases, there are significant differences in the value of goods exchanged, leading to differences in the top traded items. **Table 4** lists the top five commodities imported and exported according to U.S. and India trade statistics in 2006.

Table 4. Top Five Traded Commodities: U.S.-Indian Bilateral Merchandise Trade, 2006

(U.S. $ Billions)

Rank	Exports (HS Code)		Imports (HS Code)	
U.S. Data				
First	Machinery (84)	1.671	Jewelry (71)	5.866
Second	Aircraft (88)	1.623	Woven Apparel (62)	2.079
Third	Electrical Machinery (85)	1.091	Electrical Machinery (85)	1.245
Fourth	Jewelry (71)	0.924	Knitted Apparel (61)	1.163
Fifth	Optical & Medical Equipment (90)	0.688	Misc. Textile Articles (63)	1.105

Rank	Exports (HS Code)		Imports (HS Code)	
Indian Data				
First	Jewelry (71)	4.760	Machinery (84)	1.814
Second	Woven Apparel (62)	1.839	Electrical Machinery (85)	1.254
Third	Knitted Apparel (61)	1.098	Optical & Medical Instruments (90)	0.764
Fourth	Misc. Textile Articles (63)	1.014	Fertilizers (31)	0.685
Fifth	Machinery (84)	0.940	Aircraft (88)	0.625

Source: *Global Trade Atlas*; HS chapter numbers in parentheses.

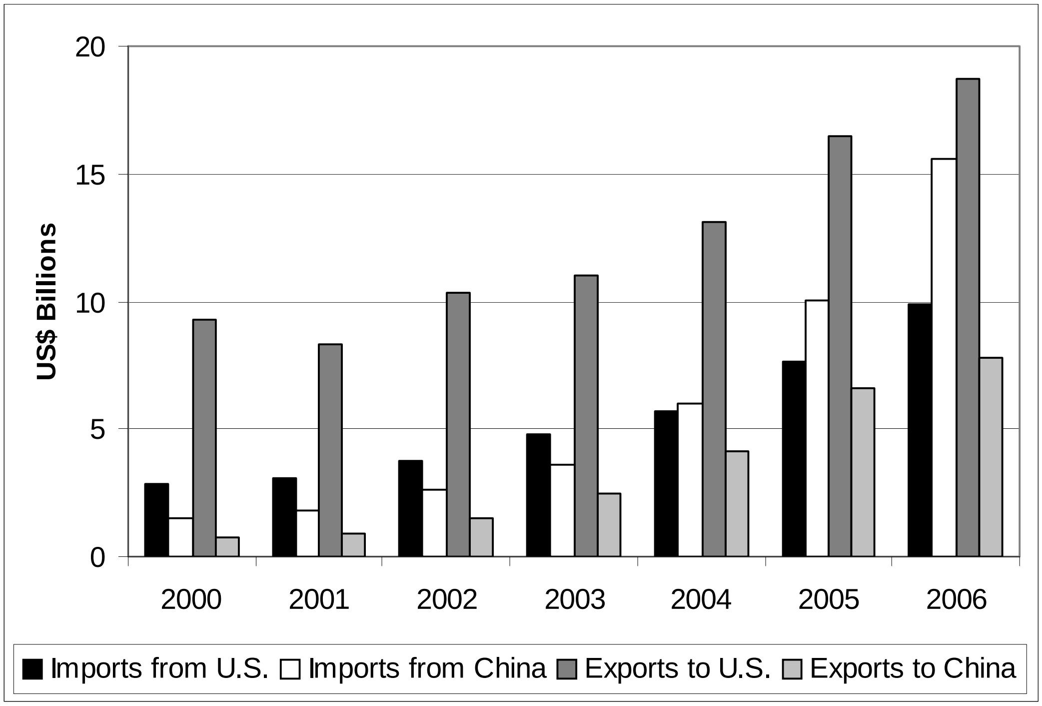
The United States and India agree that the top U.S. exports to India in 2006 included machinery, electrical machinery, optical & medical instruments, and aircraft, but disagree on the value of those exports and their relative ranking. Similarly, both nations report that the top Indian exports to the United States in 2006 included jewelry, woven apparel, knitted apparel, and miscellaneous textile articles. There are differences between the two countries over the last commodity in their respective top five exports to each other. U.S. data indicates that missing commodity category for top five exports to India is jewelry, but Indian data says it is fertilizer. Similarly, Indian trade authorities list machinery as its fifth largest export to the United States, but U.S. trade figures place electrical machinery as the country's third largest import from India.

Emerging Competition from China. While there are minor differences in the trade figures for bilateral U.S.-India merchandise trade, both nations recognize that China is a rising competitor to the United States.[82] According to India's trade statistics, China became India's leading source of imports in 2004, displacing the United States (see **Figure 10**). In 2000, U.S. exports to India were worth nearly $2.9 billion — nearly twice the value of China's exports to India. By 2004, China's exports to India totaled $6.0 billion, and U.S. exports to India were $5.7 billion. In 2006, U.S. exports to India totaled $9.9 billion, but China's exports to India had risen to $15.6 billion.

The United States remains India's leading trading partner on the strength of India's exports to the United States. The value of such exports more than doubled from $9.3 billion in 2000 to $18.7 billion in 2005. Over the same time period, India's exports to China increased from $0.7 billion to $7.8 billion — a more than 10-fold increase. As a result, India's total trade with the United States rose from $12.2 billion in 2000 to $28.6 billion in 2006, while its total trade with China jumped from $2.2 billion to $23.3 billion.

[82] For example, the U.S. International Trade Commission published a report in September 2006, "U.S.-China Competition in the Indian Market," by William Greene, Office of Economics Working Paper No. 2006-09-A.

Figure 10. India's Trade with the United States and China, 2000-2006



Source: Global Trade Atlas.

To summarize, from both the U.S. and Indian perspective, there has been a recent rapid increase in bilateral merchandise trade flows, with India's exports to the United States our performing U.S. exports to India. However, despite the rise in the value of bilateral trade, the relative importance of the other country to the nation's external trade volume has remained small and is well below levels seen in the decade immediately following India's independence. Also, over the last five years, India's trade with China has grown more rapidly than trade with the United States. As a result, China has already surpassed the United States as India's leading source of imports, and may soon become India's largest trading partner.

Trade in Services

According to the U.S. Bureau of Economic Analysis, bilateral trade in services in 2005 totaled just over $10 billion — about one-third the size of the nation's merchandise trade with India (see **Table 5**). However, many analysts believe that bilateral trade in services has greater potential for rapid growth in the near future than merchandise trade. As a result, there is increased interest in service trade relations between the United States and India, including a proposal for a U.S.-India free trade agreement in services.[83]

In contrast to merchandise trade, bilateral service trade was nearly balanced in 2005, after a period of service trade surpluses for the United States. Between 2000

[83] "U.S.-India Free Trade Agreement in Services: An Analysis of Issues for Discussion," by Dr. Jayanta Roy with Pritam Banerjee, Confederation of Indian Industry, July 2004.

and 2005, bilateral services trade increased 130%, compared to 90% growth in bilateral merchandise trade over the same five year span.

Table 5. Indo-U.S. Trade in Services, 2000-2005
(US$ Billions)

Year	U.S. Exports	U.S. Imports	Total Trade	Trade Balance
2000	2.539	1.898	4.437	640
2001	3.003	1.815	4.818	1.189
2002	3.255	1.809	5.064	1.445
2003	3.760	1.972	5.732	1.788
2004	4.461	2.889	7.350	1.572
2005	5.193	5.018	10.211	174

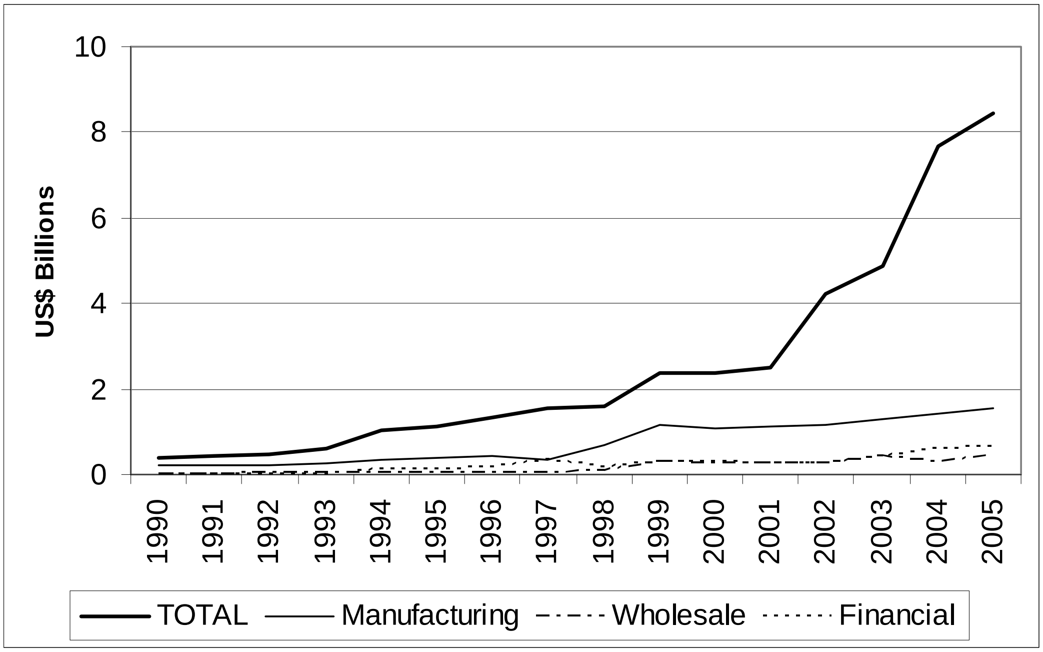
Source: U.S. Bureau of Economic Analysis

Trade in transportation services is a major component of the bilateral trade. In 2005, the United States exported about $1.5 billion worth of transportation services to India, and imported a nearly identical amount of such services from India. India and the United States also exchanged a large amount of professional services, with U.S. exports worth $462 million in 2005 and imports of $597 million.

Foreign Direct Investment

The recent growth in U.S. foreign direct investments (FDI) in India parallels the growth in bilateral trade. After steady, modest growth during the 1990s, U.S. investments in India rose dramatically between 2001 and 2005, according to official U.S. data (see **Figure 11**). Between 1990 and 2000, U.S. investments in India rose from $372 million to $2.4 billion — an increase of over $2 billion over 10 years. Over the next five years, U.S. FDI in India increased by over $6 billion to $8.5 billion. Over the 15 year period, the total value of U.S. FDI in India increased 22-fold.

Figure 11. Growth in U.S. Investments in India, 1990-2005



Source: U.S. Bureau of Economic Analysis

Despite the rapid growth in U.S. investments in India, the nation remains a relatively small destination for overseas U.S. investors. As of 2005, less than one-half of one percent of U.S. direct investment overseas was located in India. U.S. investments in India are about half the size of its investments in China, less than a quarter of the size of U.S. investments in Hong Kong, and nearly a sixth the size of U.S. investments in Singapore. Overall, India ranked 31st in 2005 for locations for overseas U.S. direct investments.

If the United States views India as a growing, but comparatively minor market for its overseas investments, the United States is an important source of foreign direct investment for India. According to India, the United States had $4.913 billion in investments in India as of December 2005, making the United States the second biggest investor in India and representing 16.1% of all foreign direct investment in India.[84]

There are, however, forces that may increase the importance of India for U.S. companies looking for overseas investment opportunities. With multinational firms anticipating increased labor costs and a growing labor shortage in China, India's large, educated, English-speaking young workforce may become more appealing.

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[84] The largest source of FDI in India in 2005 was Mauritius.

Nearly two-thirds of the recent FDI in India went into the manufacturing rather than services sector.[85]

Meanwhile, Indian companies have in recent years been buying up overseas firms. An example of Indian company actively involved in overseas FDI is the Tata Group. In 2000, the Tata Group bought Britain's Tetley Tea brand. In June 2006, a Tata subsidiary purchased Eight O'Clock Coffee for $220 million, which has a majority share in the U.S. branded whole bean coffee market.[86] Then, in January 2007, Tata Steel took over Corus, a European steel company, for over $11 billion.[87] According to an IMF report, India's overseas acquisitions for the first nine months of 2006 totaled over $7.2 billion.[88]

Bilateral and Multilateral Trade Relations

Bilateral Agreements and Relations. India and the United States have not signed either a bilateral trade agreement or bilateral investment treaty. Their bilateral trade relations are principally governed by the terms of their memberships in multilateral organizations, such as the World Trade Organization (WTO) and the International Monetary Fund (IMF). There are, however, four specific bilateral relationships that have affected or will likely affect trade relations between India and the United States.

Civil Nuclear Cooperation.[89] India's status as a non-signatory to the 1968 Nuclear Nonproliferation Treaty (NPT) has kept it from accessing most nuclear-related materials and fuels on the international market for more than three decades. New Delhi's 1974 "peaceful nuclear explosion" spurred the U.S.-led creation of the Nuclear Suppliers Group (NSG) — an international export control regime for nuclear-related trade — and the U.S. government further tightened its own export laws with the Nuclear Nonproliferation Act of 1978. In a major policy shift, the July 2005 U.S.-India Joint Statement asserted that, "as a responsible state with advanced nuclear technology, India should acquire the same benefits and advantages as other such states," and President Bush vowed to work on achieving "full civilian nuclear energy cooperation with India."[90] As a reversal of three decades of U.S. nonproliferation policy, such proposed cooperation stirred controversy and required changes in both U.S. law and in NSG guidelines. India reciprocally agreed to take its own steps, including moving 14 of its 22 nuclear reactors into permanent

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[85] Keith Bradsher, "A Younger India is Flexing Its Industrial Brawn," *New York Times*, September 1, 2006; Mark Sappenfield, "India's Economy, Now With Muscle," *Christian Science Monitor*, November 1, 2006.

[86] Anjana Pasricha, "India Companies Expand Overseas," VOA News, April 2, 2006; "India's Tata Coffee to Buy US Firm for $220 Mln," Reuters, June 25, 2006.

[87] Alam Srinivas, "Corus Takeover: Who is Ratan Tata?" BBC News, January 31, 2007.

[88] "IMF Country Report No. 07/63," February 2007, p. 9.

[89] See also CRS Report RL33016, *U.S. Nuclear Cooperation With India*, by Sharon Squassoni.

[90] See [http://www.whitehouse.gov/news/releases/2005/07/20050718-6.html].

international oversight by the year 2014 and placing all future civilian reactors under permanent safeguards.

After many months of deliberation and multiple hearings involving Administration and non-governmental experts, the 109th Congress passed enabling legislation near the end of its term. President Bush signed the Henry J. Hyde United States-India Peaceful Atomic Energy Cooperation Act of 2006 (or "Hyde Act") into law in December 2006 (P.L. 109-401). The final bill language made significant procedural changes to the Administration's original legislative proposal, changes that sought to retain congressional oversight of the negotiation process, in part by requiring the Administration to gain future congressional approval of a completed peaceful nuclear cooperation agreement with India (this is often referred to as a "123 Agreement," as it is negotiated under the conditions set forth in Section 123 of the Atomic Energy Act). Congressional conferees also provided a 30-page explanatory statement (H.Rept. 109-721).

U.S. proponents of the civil nuclear initiative with India assert that, in addition to bringing India "into the nonproliferation mainstream," it has the potential to reduce pressures on global energy markets, reduce carbon emissions/greenhouse gases, and benefit progress of the broader U.S.-India "global partnership."[91] India seeks access to U.S. nuclear technology as part of a national program to improve its energy infrastructure. U.S. business interests are eager benefit through the export to India of nuclear reactors, fuel, and support services. The U.S. Chamber of Commerce, which, along with the U.S.-India Business Council, lobbied vigorously in favor of President Bush's initiative, speculated that civil nuclear cooperation with India could generate contracts for American businesses worth up to $100 billion, as well as generate up to 27,000 new American jobs each year for a decade.[92] However, foreign companies such as Russia's Atomstroyexport and France's Areva may be better poised to take advantage of the Indian market. Moreover, U.S. nuclear suppliers will likely balk at entering the Indian market in the absence of nuclear liability protection, which New Delhi does not offer at present.

In 2007, U.S.-India negotiations toward finalizing a 123 Agreement proved contentious, as New Delhi expressed significant dissatisfaction with some aspects of U.S. conditions (these included provisions to end civil nuclear cooperation in the event that India tests a nuclear device, and an absence of assurances of uninterrupted fuel supplies or prior authorization for India's reprocessing of spent fuel). Influential political elements in India — including the Left Front, the main opposition BJP, and members of the nuclear scientific community — voiced strong disapproval of the proposed deal, and these domestic political pressures constrained the space in which Indian leaders were able to maneuver on the issue. However, in July, the United States and India announced having concluded negotiations 123 Agreement, calling it a "historic milestone" in the bilateral strategic partnership. New Delhi appeared

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[91] See "U.S.-India Civil Nuclear Cooperation Initiative Fact Sheet," U.S. Department of State, at [http://www.state.gov/r/pa/scp/2006/62904.htm]; Condoleezza Rice, "Our Opportunity With India," *Washington Post*, March 13, 2006.

[92] See Sridhar Krishnaswami, "'Indo-US N-deal a Historic Opportunity,'" *India Abroad*, March 22, 2006, at [http://www.rediff.com/news/2006/mar/22ndeal.htm].

to have been successful in negotiating reprocessing rights, assured fuel supplies, and no automatic termination if it conducts further nuclear weapons test. Indeed, subsequent reports suggested that U.S. negotiators had made considerable concessions to Indian demands and that the agreement could face resistance from some in Congress if its legal stipulations are seen to deviate from those found in the Hyde Act (the 123 Agreement can become operative only through a Joint Resolution of Approval from Congress).[93] Civil nuclear cooperation with India cannot commence until the NSG allows for such cooperation, and until New Delhi concludes its own safeguards agreement with the International Atomic Energy Agency.

Verified End User Program. In March 2006, President Bush pledged to create a verified end user (VEU) program with India. Also known as the "Trusted Customer" program, the VEU program would facilitate the license-free sale of otherwise controlled U.S. exports to approved Indian end users. As described by U.S. Commerce Secretary Carlos Gutierrez in a February speech, the VEU program would provide qualified Indian companies "access to U.S. technology products in a faster, more efficient, and more transparent manner."[94] According to Secretary Gutierrez, the VEU Program will be operational in a "few months."

The United States is pressing India to strengthen its export control systems and meet the standards specified in the Wassennaar Arrangement[95] and the Australia Group.[96] While India's strengthening of its export controls is not a precondition for the VEU program, the United States has indicated that it will exclude certain

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[93] Somini Sengupta , "In Its Nuclear Deal With India, Washington Appears to Make More Concessions," *New York Times*, July 28, 2007; Carol Giacomo, "India Nuclear Deal Said Complies With US Law," Reuters, July 25, 2007; "US Congress to Scrutinize Nuclear Pact With India," Agence France Presse, August 3, 2007. A July letter to President Bush signed by 23 Members of the House stressed the need for any civil nuclear cooperation agreement with India to conform to "the legal boundaries set by Congress." The letter noted that the U.S. Constitution provides Congress with the sole authority to regulate foreign commerce, and it expressed ongoing concerns about "India's deepening military-to-military relationship with Iran ... [which] places congressional approval of the Agreement for Nuclear Cooperation in jeopardy."

[94] "U.S. Commerce Secretary Carlos M. Gutierrez Remarks to the U.S.-India High Technology Cooperation Group," Department of Commerce, February 22, 2007.

[95] The Wassenaar Arrangement is a multilateral agreement aimed at controlling exports of conventional weapons and related dual-use goods and military technology. For more details, see CRS Report RS20517, *Military Technology and Conventional Weapons Export Controls: The Wassenaar Arrangement*, by Richard F. Grimmett. The United States is a participant in the Wassenaar Arrangement; India is not.

[96] The Australia Group is "an informal arrangement which aims to allow exporting or transshipping countries to minimise the risk of assisting chemical and biological weapon (CBW) proliferation." For more information, see the Group's web page: [http://www.australiagroup.net/]. The United States is a participant in the Group; India is not.

chemicals and Wassenaar items from the program if India does not tighten its export controls.[97]

U.S. Generalized System of Preferences. India is a beneficiary of the U.S. Generalized System of Preferences (GSP) Program, which "provides duty-free tariff treatment to certain products imported from designated developing countries."[98] In 2006, India received GSP preferential treatment for $5.7 billion of its exports to the United States, of which $2.4 billion, or 42%, was jewelry or jewelry-related products (HTS chapter 71).

Some in the 109th Congress discussed discontinuing India's inclusion in the GSP Program, in part due to India's stance on the Doha Round of negotiations. In May 2006, the then-Senate Finance Committee Chairman questioned the renewal of the GSP Program, pointing to India and Brazil as "two of the countries most responsible for holding up the Doha negotiations."[99] In September 2006, the then-Senate Agriculture Committee Chairman called for U.S. Trade Representative Susan Schwab to consider revising the GSP Program to exclude advanced developing countries such as Brazil and India.[100] However, no action was taken by the Bush Administration to remove India from the GSP Program.

U.S.-India Economic Dialogue. During the Indian prime minister's July 2005 visit to Washington, D.C., he and President Bush agreed to revitalize the U.S.-India Economic Dialogue. The Economic Dialogue has four main fora — the U.S.-India Trade Policy Forum, the Financial and Economic Forum, the Environmental Dialogue, and the Commercial Dialogue. At the July 2005 session, India and the United States agreed to three new initiatives under the Economic Dialogue — the Information and Communications Technology Working Group, the CEO Forum, and the U.S.-India Agricultural Knowledge Initiative — and reconstituted the High Technology Cooperation Group. The objective of the Economic Dialogue is to seek ways to resolve outstanding economic and trade issues, develop administrative capacity, and provide technical assistance. In general, meetings of the Economic Dialogue or its constituent groups consist of government officials from both nations, as well representatives of the Indian and U.S. private sectors.[101]

World Trade Organization and Other Multilateral Relations. In addition to their direct bilateral relations, India and the United States interact on economic and trade issues in several multilateral fora. Both countries are members of the WTO, IMF, the World Bank, the Asian Development Bank (ADB), and other

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[97] "U.S., India to Haggle over Export Control Changes at HTCG Meeting," World Trade Online, February 23, 2007.

[98] For more details about the GSP Program, see CRS Report RL33663, *Generalized System of Preferences: Background and Renewal Debate,* by Vivian C. Jones.

[99] Statement of Senator Charles Grassley at a Senate Finance Committee hearing on the Nomination of Susan Schwab to be United States Trade Representative, May 16, 2006.

[100] Letter from Senator Saxby Chambliss to U.S. Trade Representative Susan Schwab, September 19, 2006.

[101] See [http://www.state.gov/p/sca/rls/fs/2006/62493.htm].

other topical mulitlateral organizations.[102] In other multilateral organizations, one nation may be a member, but the other nation may have informal ties to the group or interest in its activities. For example, while the United States is a member of the Asia Pacific Economic Cooperation (APEC) and India is not, there are indications that India would be interested in joining APEC when its current moratorium on new members ends. Similarly, India is a member of the East Asian Summit (EAS)[103] and the South Asian Association for Regional Cooperation (SAARC),[104] but United States is not. While the United States has a rather ambivalent attitude about the EAS, it and has applied for observer status with SAARC.

Doha Round Negotiations.[105] Current discussions among WTO members regarding the Doha Round have placed the United States and India on opposing sides of key issues. When a half-year long suspension in negotiations ended earlier this year, India and the United States were joined by the European Union and Brazil to form a core group seeking to resolve the outstanding issues. The key outstanding issues for the Doha Round center around trade in agricultural goods, non-agricultural market access (or NAMA), trade in services, and trade remedies. At present, differences on trade in agricultural goods are foremost among the four remaining issues, and is generally viewed as the lynchpin for the successful completion of the Doha Round. It is generally understood that resolution of all the outstanding issues must occur for a successful outcome to the Doha Round, in part because the four key issues are to varying degrees linked to one another.

India's Commerce Minister, Kamal Nath, has blamed U.S. intransigence for the Doha Round's collapse. In November 2006, during a visit to New Delhi to discuss trade issues with top Indian leaders, U.S. Agriculture Secretary Mike Johanns urged India to match "ambitious" U.S. offers and "lead the way toward unlocking the Doha negotiations by offering real market access."[106] Indian officials later rejoined the negotiations, but, in June 2007, claimed the talks had "collapsed" due to lack of convergence among the major actors. Trade Representative Schwab later expressed U.S. surprise at how "rigid and inflexible" India (and Brazil) were during the June

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[102] These topical multilateral organizations include the International Labor Organization, the World Health Organization and similar groups.

[103] The current members of the East Asia Summit are the 10 members of the Association of South East Asian Nations (ASEAN), plus Australia, China, India, Japan, New Zealand, and South Korea.

[104] The current members of SAARC are Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.

[105] For additional information about the Doha Round negotiations see CRS Report RL33144, *WTO Doha Round: The Agricultural Negotiations*, by Charles E. Hanrahan and Randy Schnepf; CRS Report RL32060, *World Trade Organization Negotiations: The Doha Development Agenda*, by Ian F. Fergusson; CRS Report RL33085, *Trade in Services: The Doha Development Agenda Negotiations and U.S. Goals*, by William H. Cooper; and CRS Report RL33634, *The World Trade Organization: The Non-Agricultural Market Access (NAMA) Negotiations*, by Ian F. Fergusson.

[106] "India Blames U.S. for Failure of WTO Talks," *Hindu* (Chennai), July 26, 2006; Secretary Johanns at [http://newdelhi.usembassy.gov/pr112106b.html].

negotiations and she suggested that "some countries ... really don't want a Doha round outcome."[107]

Proposed Regional Free Trade Agreements. During the suspension of the Doha Round negotiations, interest in alternative means of trade promotion and investment liberalization grew. In Asia, one of the more popular alternatives discussed was the formation of a regional free trade agreement. At the 2006 APEC meetings in Vietnam, the United States proposed the creation of a Free Trade Association of the Asia-Pacific, or FTAAP.[108] As envisioned by the United States, the FTAAP would include the current APEC members only, thereby excluding India.

At the second meeting of the East Asian Summit, held in conjunction with the January 2006 ASEAN Summit held in Cebu, Phillippines, one of main agenda items was a proposal to form a pan-Asian free trade association that would include current ASEAN members plus Australia, China, India, Japan, New Zealand, and possibly Russia. The United States, which was not invited to the summit, was not being considered for membership in the pan-Asian FTA because it is not an Asian nation. India had already expressed its support for the idea of a pan-Asia FTA before the summit took place.[109] The United States opposes the idea, preferring its FTAAP model of an Asian FTA.

Asian Development Bank.[110] The United States and India are both members of the Asian Development Bank (ADB) — one as a developed country and a contributor of funds; the other as a developing country and a recipient of funds. According to the most recent ADB Annual Report, India received $567.2 million in assistance in 2005, including $440.3 million in loans, $100 million in "special funds" (primarily tsunami relief support), and $20.6 million in equity and guarantees.[111] Outside of the tsunami relief assistance, most of the ADB's 2005 support in India went to infrastructure development projects. Since joining the ADB in 1966, India has received nearly $15 billion in ADB assistance.

The United States has pledged to contribute $461 million to the ADB's Asian Development Fund between 2005 and 2008. However, Congress set the U.S. support for the ADB for FY2006 and FY2007 at $99 million. For FY2008, the Bush Administration has requested $133.85 million: $115.25 million for its annual contribution and $18.6 million to pay a portion of its arrears.

One important issue of note emerging from the ADB is a proposal to create an Asian Currency Unit (ACU), to be overseen by the ADB. The ACU is envisioned

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[107] "U.S. Says Doha Risks Being Delayed for Several Years," Reuters, July 5, 2007.

[108] For more about the FTAAP proposal, see CRS Report RL31038, *Asia Pacific Economic Cooperation (APEC) and the 2006 Meetings in Hanoi, Vietnam,* by Michael F. Martin.

[109] "Manmohan Singh Sells his Vision of Pan-Asian FTA," by C. Chitti Pantulu, *Daily News & Analysis* (India), May 5, 2006.

[110] For more information about the Asian Development Bank, see CRS Report RS21437, *The Asian Development Bank,* by Martin A. Weiss.

[111] Asian Development Bank, *Annual Report of the Bank 2005*.

as a unit of account, determined by a weighted average of regional currencies, to be used by financial market participants for regional settlement of payments and invoicing of trade transactions. According to the ADB, over time the ACU may be transformed into a regional currency, much like the Euro.

India has expressed a desire to be part of the ACU, but Finance Minister Chidambaram has admitted the "Asian Currency Unit is not going to happen overnight."[112] India is also aware of resistance among the ASEAN nations to include India in the ACU. The United States has expressed misgivings about the ACU proposal in general, raising concerns about "mission creep."[113]

Key Economic and Trade Issues

Besides the general multilateral and bilateral economic and trade issues described above, there are several sectoral or topical issues of significance between India and the United States. Some of these issues interplay with more general issues, such as the Doha Round negotiations or the bilateral trade balance. What follows is a brief summary of each of these issues, arranged in alphabetical order.

Agricultural Goods

In India and the United States, there is interest in improving market access to each other's markets in anticipation of greater trade in agricultural goods. In 2006, the United States exported over $300 million in agricultural goods (including over $42 million in prepared foods) to India, and imported $1.3 billion in agricultural goods from India (see **Table 6**).

Table 6. Trade in Agricultural Goods: India and the United States, 2006
(US$ Millions)

	U.S. Exports to India	U.S. Imports from India
Agricultural Goods - Total	300.0	1,327.1
Animals & Animal Products	6.6	327.9
Vegetable Products	232.0	754.4
Animal & Vegetable Oils & Fats	18.1	43.8
Prepared Foods	42.6	200.7

Source: U.S. International Trade Commission

[112] "India to be Part of Asia's Common Currency," *Time of India*, May 7, 2006.

[113] Rick Carew, "Asian Development Bank's Future At Crossroads," *Dow Jones Newswires*, May 8, 2006.

U.S. exports of live animals and animal products are hindered by Indian import restrictions and cultural norms. Cattle and beef imports are subject to import controls because of the risk of "mad cow" and "hoof in mouth" disease, as well as the Hindi and Buddhist prohibitions of eating beef and Muslim prohibitions of eating pork. Similarly, on March 14, 2007, India stopped the import of poultry, poultry products, pigs, and pork products from countries infected with avian influenza to protect the public health.[114] Other U.S. products — such as coffee, tea and most grains[115] — are effectively kept out of India by tariff rates as high as 100%. A July 2007 Indian government reported determined that U.S. wheat was unfit to be imported into India due to the presence of pervasive weeds.[116]

On March 6, 2007, the United States requested WTO dispute settlement consultations with India over the customs duties it imposes on imports of wine and distilled spirits, claiming that charges for "additional duty"and "extra additional duty" increased the imposed tariff rate to 150% to 550%.[117] The European Union (EU) also requested consultations over the same issue. India has committed to the WTO to bind its tariff on wine and spirits to no more than 150%.

On March 30, 2007, Indian Trade Minister Kamal Nath said that India knew its import duties on wine and alcohol were "high" and that "this situation would be corrected."[118] However, at an April 10 meeting of WTO Dispute Settlement Board, India blocked the first attempt by the European Union to request the creation of a dispute settlement panel to address India's import regime for wine and alcohol. The dispute panel was approved at a subsequent meeting of the WTO Dispute Settlement Board on April 24, 2007.

The United States has also expressed concern about India's application of its sanitary and phytosanitary (SPS) regulations on certain U.S. exports.[119] The United States questions some of the scientific basis for India's SPS regulations. It also believes that some of the SPS standards are not in accord with internationally recognized standards. Plus, the United States has indicated that India has failed to notify other nations of changes in SPS regulations in a timely fashion. In particular, the U.S. Trade Representative has objected to India's proposed import and labeling requirements for genetically modified foods.[120]

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[114] "India bans live poultry imports amid bird flu scare," *Agence France Presse*, March 14, 2007.

[115] Barley, oats, buckwheat, and canary seed may be imported duty free; the tariff on wheat is 100%. Most other grains face tariff rates between 60% and 80%.

[116] "US Wheat Not Fit to Be Imported," *Times of India* (Delhi), July 16, 2007.

[117] "United States Files WTO Case Against India Challenging Excessive Duties on U.S. Wine and Spirits," press release, U.S. Trade Representative, March 6, 2007.

[118] "India to 'Correct' Import Duty on Wine, Spirits," *Reuters*, March 30, 2007.

[119] The 2006 Foreign Trade Barriers report specifically mentions almonds, apples, bovine semen, dairy products, pulses, poultry, pet food and forest products as affected exports.

[120] "USTR to Oppose India's Proposed GMO Import Regulations," *Inside Trade*, July 7,

(continued...)

For its part, India has also indicated dissatisfaction with U.S. SPS regulations with regards to the treatment of Indian agricultural goods. For example, one long-standing source of tension between the two nations is a 17-year old ban on the import Indian mangoes into the continental United States. The mango ban was a subject of discussion during President Bush's trip to India in March 2006, during which President Bush promised to have the ban lifted. On March 12, 2007, when the U.S. Department of Agriculture's Animal and Plant Health Inspection Service (APHIS) issued a final rule allowing, under certain conditions, the import of mangoes from India.[121] However, according to India's Commerce Department, the estimated cost of compliance with the new rule is about $3 per mango, rendering the Indian mango uncompetitive.[122]

Other than issues of threats to public health and unfair SPS rules, India's concern about agricultural imports from the United States also includes the U.S. farm subsidy program.[123] India, along with a number of other nations, views the current U.S. farm support program as a form of trade-distorting export subsidy and is calling on the United States to significantly reduce the annual limit on farm assistance. India has rejected the proposed U.S. limit of $22 billion as insufficient, pointing out that the actual level of support in 2006 — $19 billion — was already below the U.S. offer. India, the United States, Brazil, and the European Union are actively discussing the agricultural support programs as part of the reinvigorated Doha Round negotiations.

Clothing and Textiles

Trade in clothing and textiles is a major issue in U.S. relations with India for two key reasons. First, as shown in **Table 4**, clothing and textiles are among the top five India exports to the United States. Second, following the termination of the WTO's Agreement on Textiles and Clothing (ATC) on January 1, 2005, most experts predicted that the global manufacturing of clothing and textiles would restructure, and that China and India would emerge as major production sites. By implication, it was expected that U.S. clothing and textile imports from India (and China) would jump beginning in 2005, as production shifted from other nations to India (and China). As a result, the termination of the ATC might cause a spike in the U.S. bilateral trade deficit with India.

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[120] (...continued)
2006.

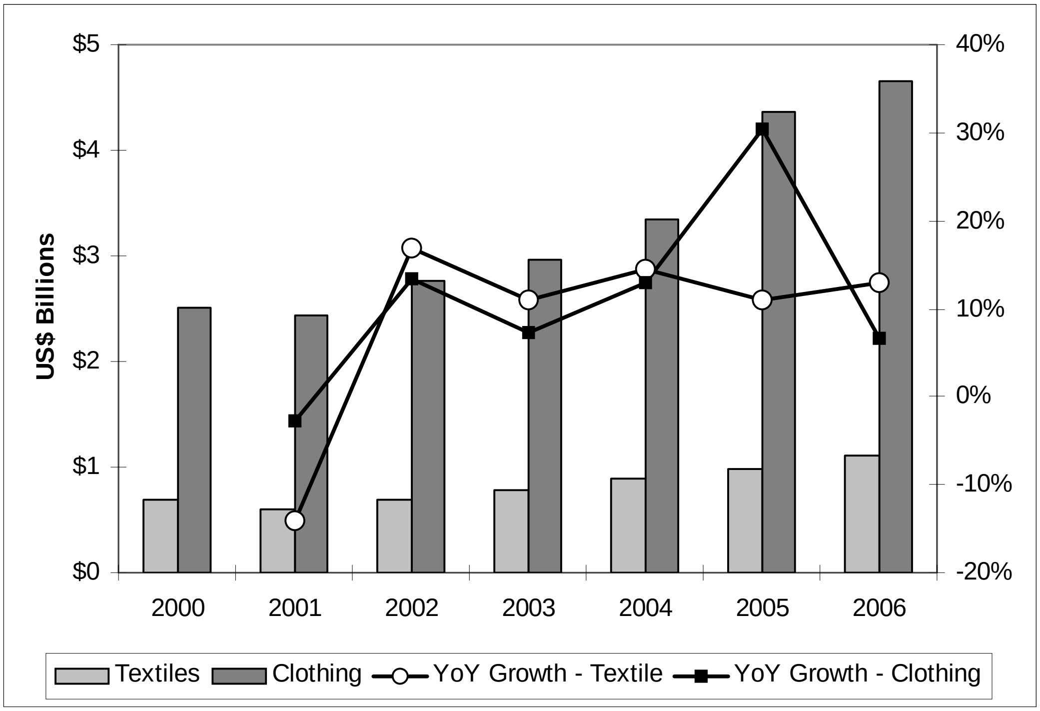
[121] "USDA to Allow Mango Imports from India," U.S. Department of Agriculture, March 13, 2007. The ruling stipulates that the mangoes must be irradiated in an APHIS-certified facility and be accompanied by a phytosanitary certificate.

[122] Amiti Sen, "Uncle Sam to Miss Indian Mangoes Again," *Economic Times* (India), March 6, 2007.

[123] For more information about the U.S. farm support program and the Doha Round, see CRS Report RL33144, *WTO Doha Round: The Agricultural Negotiations*, by Charles E. Hanrahan and Randy Schnepf.

The U.S. trade data on textile and clothing imports from India appear to support the predictions for clothing, but not textiles (see **Figure 12**). Clothing imports, which had been increasing by about 10% per year for the previous three years, rose by over 30%, or more than $1 billion, in 2005, and then returned to the previous growth rate. By contrast, textile imports from India did not spike in either 2005 or 2006, but grew at a rate similar to the previous three years.

Figure 12. U.S. Textiles and Clothing Imports from India, 2000-2006



Source: U.S. International Trade Commission

The sharp increase in clothing imports from India did not, however, translate into an unusual rise in the U.S. bilateral trade deficit with India (see **Table 7**). According to U.S. trade figures, the nation's bilateral trade deficit with India grew in a rather uneven pattern between 2000 and 2006. The increase in the trade deficit between 2004 and 2005 was large — over $1.5 billion — but not that much larger than the year before or the increase between 2001 and 2002.

Table 7. U.S. Trade Balance with India, 2000-2006

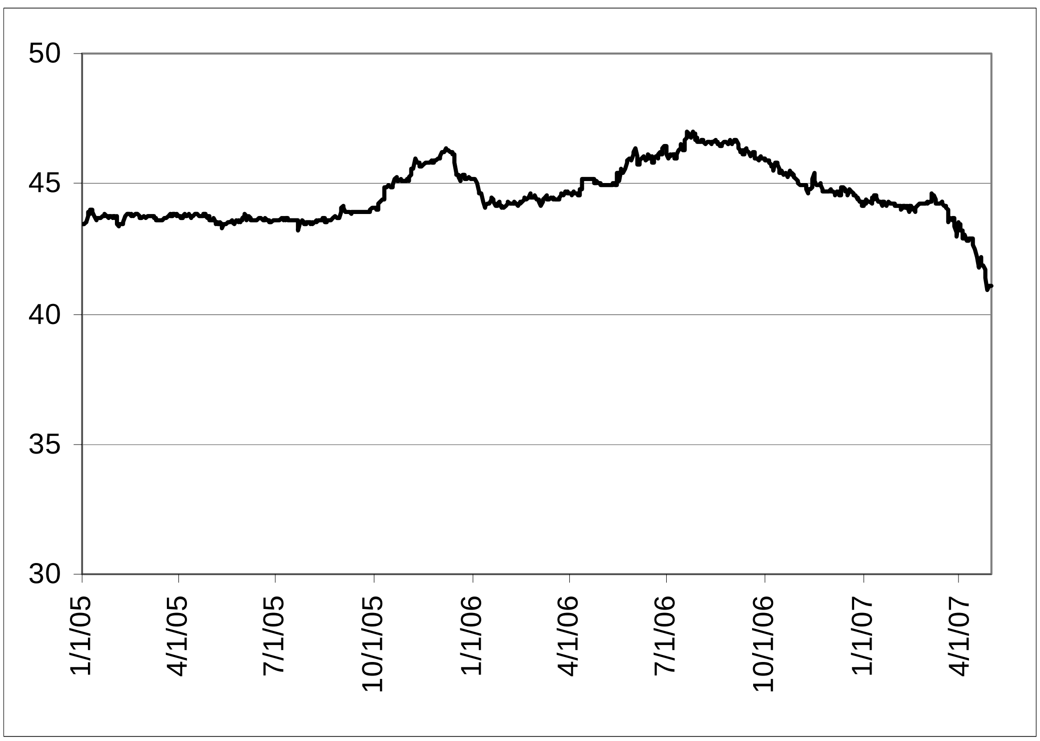
Year	U.S. Trade Balance with India (U.S. $ Billions)	Year-on Year Growth
2000	-7.381	
2001	-6.527	11.6%
2002	-8.352	28.0%

Year	U.S. Trade Balance with India (U.S. $ Billions)	Year-on Year Growth
2003	-8.766	5.0%
2004	-10.342	18.0%
2005	-11.917	15.2%
2006	-11.735	-1.5%

Source: WTO Direction of Trade Yearbooks

While the debate over the impact of the termination of the ATC on global trade patterns continues, another factor — the relative value of key currencies — appears to be influencing the global clothing and textile market. For India, the dramatic strengthening of the rupee against the U.S. dollar (see **Figure 13**) has apparently hurt the nation's clothing and textile exports to the United States.

Figure 13. Exchange Rate: Indian Rupees per U.S. Dollar, 2005-2007



Source: [http://www.oanda.com].

Between July 1, 2006, and March 1, 2007, the value of the Indian rupee gained 4% against the U.S. dollar, as the exchange rate declined from 46.126 rupees per U.S. dollar to 44.287 rupees per U.S. dollar. However, over the next two months, the strengthening of the rupee accelerated, so that by the middle of July, the exchange rate stood at 40.423 rupees per dollar — or an appreciation of 9.1% in less than four months.

According to some market observers, the appreciation of the rupee has reversed two years of growth of clothing and textile exports to the United States. Official U.S. trade statistics for the first six months of 2007 show a 1.5% year-on-year decline in the value of textile imports from India and a 0.6% year-on-year decline in the value of clothing imports.[124] D.K. Nair, secretary-general of the Confederation of Indian Textile Industry, said that the slowdown in U.S. demand along with the strengthening of the rupee are causing serious harm to India's clothing and textile industry.[125]

The more recent appreciation of the rupee is making it even more difficult for India to remain competitive. At another forum, Nair stated,

> Supply side problems like unworkable labor laws that restrict the garment industry to SMEs [small and medium enterprises], high transaction costs that render exports uncompetitive and infrastructure weaknesses have been infusing production inefficiencies into the textile and clothing industry. What is new is perhaps the steep appreciation of the rupee during the last few months, and particularly during the last couple of weeks.[126]

Dual-Use Technology and Military Trade

The forthcoming Verified End Users (VEU) Program is perceived as portending a period of greater trade in dual-use technology and military equipment between the United States and India. Because the Export Administration Act (EAA) of 1979 (P.L. 96-72,) expired in August 2001, exports of dual-use technology to India are currently restricted or controlled by International Emergency Economic Powers Act (IEEPA) (P.L. 95-223).[127] Munitions and military equipment are controlled by the Arms Export Control Act (P.L. 94-3297).[128]

India is seen as a large and promising market for U.S. exporters of military equipment and dual-use technology. From 1998 to 2005, India was the leading arms purchaser among less industrialized countries, signing arms transfer agreements worth $20.7 billion. Most of these agreements were made with Russia, upon which India has long relied for its procurement of military equipment. India's future defense procurement budget could total as much as $35 billion over the next two

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[124] U.S. trade data from U.S. International Trade Commission; textiles include HTS chapters 50-60; clothing includes chapters 61-63.

[125] "Textiles, Jewellery May Drag Exports," *The Financial Times* (India), April 16, 2007.

[126] "Re Hurts: Textile Exports to US Dip after Long Time," by K.G. Narendranath, *Economic Times* (India), April 12, 2007.

[127] For this report, dual-use technology refers to products that have both military and civilian applications, including but not limited to nuclear technology.

[128] For more information about the Export Administration Act, see CRS Report RL31832, *The Export Administration Act: Evolution, Provisions, and Debate*, by Ian F. Fergusson.

decades.[129] Officials from both the U.S. and Indian governments assert that greater defense trade should be an important aspect of future bilateral relations.[130]

As a result of New Delhi's increased defense expenditures, the issue of U.S. arms sales to India has taken a higher profile in recent years. In 2002, the Pentagon negotiated a sale to India of 12 counter-battery (or "Firefinder") radars sets worth a total of $190 million, the largest such bilateral arms deal to date. In 2006, New Delhi approved a $44 million plan to purchase the *USS Trenton*, a decommissioned American amphibious transport dock. The ship, the second largest in the Indian navy, set sail for India as the *INS Jalashva* in June 2007 carrying six surplus Sikorsky helicopters purchased for another $39 million. In May 2007, the Pentagon notified Congress of the possible sale to India of six C-130J Hercules transport aircraft (manufactured by Maryland-based Lockheed Martin) which, along with associated equipment and services, could be worth more than $1 billion.[131] The Pentagon reports military sales agreements with India worth $336 million in FY2002-FY2006.

American defense firms eagerly pursue new and expanded business ties with India, lobbying most recently at India's biennial air show in Bangalore in February 2007, where 52 U.S. companies exhibited their wares and sought deals. According to U.S. Ambassador to India Mulford, there is a widespread expectation in the United States that U.S. companies should get "favorable treatment" following American gestures to India, even as he denied there was any "negotiated *quid pro quo*" related to planned bilateral civil nuclear cooperation. Still, some top Indian officials express concern that the United States is a "fickle" partner that may not always be relied upon to provide the reciprocity, sensitivity, and high-technology transfers sought by New Delhi.[132]

Nevertheless, the Indian government reportedly possesses an extensive list of desired U.S.-made weapons, including PAC-3 anti-missile systems, electronic warfare systems, and possibly even combat aircraft. The 2005 unveiling of the Bush Administration's "new strategy for South Asia" included assertions that the United States welcomed Indian requests for information on the possible purchase of F-16 or F/A-18 multi-role fighters, and indicated that Washington is "ready to discuss the sale of transformative systems in areas such as command and control, early warning, and missile defense." India is expected in 2007 to issue a tender for the purchase of 126 new fighter jets in a deal that could be worth up to $10 billion. Lockheed Martin and Illinois-based Boeing are competing with aircraft built in Russia, France, and Sweden.

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[129] See CRS Report RL33696, *Conventional Arms Transfers to Developing Nations, 1998-2005*, by Richard F. Grimmett, p. 16; "India's Defense Imports to Touch $35 Bn by 2026: Antony," India PR Wire, January 8, 2007.

[130] Nicholas Burns, "'Heady Times' for India and the U.S.," *Washington Post*, April 29, 2007; authors' interview with Indian trade official, Washington, DC, May 25, 2007.

[131] See [http://www.dsca.osd.mil/PressReleases/36-b/2007/India_07-33.pdf].

[132] Rajesh Mahapatra, "U.S. Ambassador Says Nuke Deal Does Not Oblige India to Buy American Jets," Associated Press, February 2, 2006; "Defense Firms Seek Sales in India," *Chicago Tribune*, December 21, 2006.

The enthusiasm of U.S. defense companies themselves is somewhat dampened by India's Offset Policy for defense procurements. Introduced in 2005, the Offset Policy requires that foreign defense contracts worth more than 3 billion rupees (about $74 million) include an offset purchase, investment, or transfer of technology worth at least 30% of the total contract. The direct purchases may include goods or services from India's defense industry, and the investments should be made in either India's defense industry or organizations conducting defense research and development. Some U.S. companies object to India's Offset Policy and have lobbied for its termination.

Trade in dual-use technology with India is subject to the provisions of the IEPPA. As a result, U.S. companies wishing to export dual-use products to India must secure an export license from the Department of Commerce's Bureau of Industry and Security (BIS). In addition, some exports to India (including certain computers) are subject to post-shipment verification to ensure that the products are not being re-exported to other restricted locations. Finally, the BIS maintains a list of entities to which the export of dual-use technology is generally prohibited. At the time of this writing, the list includes four Indian entities and/or their subordinates.[133]

At a February 2007 meeting of the U.S.-India High Technology Working Group, there was extensive discussion of the possibility of removing some or all of the Indian companies from the BIS entities list, as well as eliminating or alleviating the restrictions on dual-use technology trade with India. Assistant Secretary of Commerce for Export Administration Chris Padilla appeared to signal a willingness to consider a relaxation of export restrictions during the HTCG meeting, saying, "There may be some remainders of Cold War-type treatment that we may be able to address and clean up in our regulations."[134]

However, there are some indications that the United States would like to see India tighten its export control regime before relaxing its exports controls on India. While emphasizing that tighter export controls were not a precondition to the implementation of the proposed VEU program, Assistant Secretary Padilla implied that the scope of VEU program might be constrained by the status of India's export controls.[135]

Foreign Direct Investment

Although current levels of U.S. foreign direct investment (FDI) are relatively low when compared to China, there is strong private interest in the Indian market for U.S. companies in certain industries. Annual FDI to India from all countries rose

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[133] The Indian entities are Bharat Dynamics Limited, three subordinates of Defense Research and Development Organization (DRDO), selected subentities of the Department of Atomic Energy, and four subordinate of the Indian Space Research Organization (ISRO).

[134] "U.S., India to Haggle over Export Controls Changes at HTCG Meeting," *World Trade Online*, February 23, 2007.

[135] "U.S. to Press India for Tighter Export Controls to Facilitate VEU Program," *World Trade Online*, February 21, 2007.

from about $100 million in 1990 to nearly $6 billion for 2005, then nearly doubled in one year to more than $11 billion in 2006. About one-third of these investments was made by U.S. firms; in recent years, the major U.S.-based companies Microsoft, Dell, Oracle, and IBM announced plans for multi-billion-dollar investments in India. However, current Indian law restricts foreign ownership in many industries to varying degrees, making FDI less attractive to many U.S. companies.

At present, India strictly prohibits FDI in four industries: retail trade (except single-brand outlets); atomic energy; lottery business; and gambling and betting. For other sectors of interest to U.S. companies — including broadcasting, pharmaceuticals, banking, financial services, insurance, defense production, mining, oil and natural gas, and telecommunications — FDI limits range from 26% to 100% of total equity, both across and within sectors. In addition, depending on the sector and the size of the FDI, the investment may be subject to administrative approval.[136]

In late 2006, India announced it is considering new legislation on FDI.[137] The so-called FDI Promotion Act would cover all aspects of FDI, including entry conditions, dispute settlement, incentive programs, approval procedures. The Indian government is also considering a proposal to create uniform FDI limits within each sector, as well as raise some of the current FDI limits.[138] Prospects for these two proposals are uncertain. However, New Delhi did increase the FDI limit for the telecommunications industry from 49% to 74% in March 2007.[139]

Especially closely watched are opportunities for investment in India's potentially vast retail sector. Foreign involvement in his sector is a sensitive issue for Indians; in March 2005, Commerce Minister Nath said, "We are very clear that if at all FDI is permitted into retail trade it should lead to incremental economic benefits and not substitute ongoing activities. There is no question of replacing or displacing what we have: it must add to economic activity."[140] New Delhi subsequently commissioned a report on FDI in the retail sector and, in January 2006, Nath announced new regulations that allow foreign investors to own up to 51% of retail outlets selling only single-brand goods. India has a particularly large number of small merchant shops — perhaps the highest per capita number worldwide — meaning that tens of millions of citizens could be adversely impacted by the appearance in India of "big-box" retailers.[141]

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[136] See India's FDI policy at [http://dipp.nic.in/publications/fdi_policy_2006.pdf]. FDI statistics available at [http://dipp.nic.in/fdi_statistics/india_fdi_index.htm].

[137] G. Ganapathy Subramaniam, "New FDI Law Under Consideration," *The Economic Times* (India), November 28, 2006.

[138] Bipin Chandranv "Uniform Sectoral FDI Unlikely," *Financial Express* (India), March 15, 2007.

[139] "Government Raises FDI Limit in Telecom to 74%," *Times of India,* (Delhi), March 22, 2007.

[140] Sheela Reddy, "'Chillies: Just an Allegation'" (interview), *Outlook* (Delhi), March 7, 2005.

[141] Mark Sappenfield, "India's 40 Million Shopkeepers Brace for Wal-Mart Effect,"
(continued...)

Intellectual Property Rights

The U.S. Trade Representative listed India on the U.S. Special 301 Priority Watch List in 2007, despite recognition of improvements in India's IPR laws, regulations and enforcement.[142] On the administrative side, the United States urged India to "improve its IPR regime by providing stronger protection for copyrights, trademarks, and patents, as well as protection against unfair commercial use for data generated to obtain marketing approval."[143] The U.S. Trade Representative has also indicated that the United States would like to see India join the World Intellectual Property Organization's (WIPO) Internet Treaties.[144] On the enforcement side, the United States claimed that piracy of copyright materials was "rampant."[145]

Opponents of inserting "data exclusivity"[146] clauses into Indian law assert that they constrict India's generic drug industry's ability to compete both domestically and internationally, and place a large financial burden on firms that must repeat expensive clinical trials. By removing the availability of inexpensive and oftentimes life-saving medications, the argument goes, would have a seriously detrimental resulting impact on public health.[147]

India appears to have been active in its IPR enforcement during 2007. On February 6, 2007, India joined 11 other Asia-Pacific entities in a combined sting operation that arrested 870 people and seized nearly 5 million pirate DVDs and VCDs.[148] The operation was called "Operation Trident," and involved operations in Australia, China, Hong Kong, India, Indonesia, Japan, Malaysia, New Zealand, the Philippines, Singapore, South Korea, Taiwan, and Thailand. In India, there were 110 raids, with 118 arrests.[149]

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[141] (...continued)
Christian Science Monitor, December 18, 2006; Sanjoy Majumder, "Supermarkets Devour Indian Traders," BBC News, May 21, 2007.

[142] The "Special 301 Priority Watch List" is a list of countries that are the focus of increased bilateral attention by the U.S. Trade Representative's office concerning the protection of intellectual property rights.

[143] "2007 Special 301 Report," U.S. Trade Representative, p. 26.

[144] The WIPO Internet Treaties include the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty. India is a member of the WIPO, but is not a party to either of these treaties.

[145] "2007 Special 301 Report," U.S. Trade Representative, p. 26.

[146] Data exclusivity refers to the period of time after approval of a new drug before a competitor can rely on data submitted in the original approval process for its own filing.

[147] Sarah Hiddleston, "India and the New Data Exclusivity Trap," *Hindu* (Chennai), August 29, 2006.

[148] "Asia Haul Nets 5m Pirated Discs," *CNN*, February 6, 2007.

[149] "4.8 Million Pirated Discs Seized, 870 Arrested in Asia-wide Movie Piracy Operations," *MPA Asia-Pacific*, February 7, 2007.

Operation Trident occurred while India was hosting the first-ever International Meeting on Intellectual Property and Development. Organized by India's Department of Industrial Policy & Promotion (DIPP), the meeting included representatives from 22 countries, including the United States. The focus of the February 5-7 meeting was on the relationship between intellectual property rights (IPR) and economic development.

In addition, in May 2007, the U.S.-India Business Council (USIBC) in conjunction with the Federation of Indian Chambers of Commerce and Industry (FICCI), implemented a "Bollywood-Hollywood" anti-piracy initiative aimed at stopping the illegal copying and distribution of U.S. and Indian entertainment videos.[150] The initiative seeks to reduce video piracy both in India and the United States, where the growing popularity of Bollywood movies has given rise to a growing problem of video piracy.

The relationship between IPR and economic development has been of interest to India for several years. In 2003, a group of developing countries, including India, circulated a paper at the WTO making recommendations on actions that could be taken to foster greater technological transfer to developing countries.[151] The United States and other WTO members objected to the paper's analysis, which suggested that the TRIPS agreement and its IPR protection provisions were hindering technological transfers. In October 2005, India, Pakistan, and the Philippines submitted another paper on the subject of technological transfer and the TRIPS agreement that focused on ways to encourage technical assistance, promote the performance of technological development work by multinational corporations in developing countries, and facilitate the mobility of scientists and technicians under the GATS agreement.[152] The U.S. response to the second paper was more favorable.

The second paper became the focus of discussion in 2006 of the WTO's Working Group on Trade and Transfer of Technology (WGTTT), a body established in 2001 at the Doha Ministerial Conference. According to the USTR's 2007 Trade Policy Agenda, the United States expects that the paper will also dominate WGTTT discussions in 2007.

Beyond the usual concerns expressed by the software, movie, and publishing industries about IPR protection, the U.S. pharmaceutical industry has of late been very actively seeking improved IPR protection in India. In particular, it would like to improve patent protections, secure test data exclusivity, and limit pre-grant opposition to patent applications. India's pharmaceutical industry, for its part, believes that the level of IPR protection sought by the U.S. companies exceeds those provided for in the TRIPS agreement, and will effectively prevent the introduction of generic drugs in India in the future.

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[150] "Move to Stop Bollywood-Hollywood Piracy," *The Economic Times*, May 25, 2007.

[151] The paper was entitled, "Possible Recommendations on Steps that Might be Taken with the Mandate of the WTO to Increase Flows of Technology to Developing Countries."

[152] A copy of the second paper is available at [http://www.wto-pakistan.org/Documents_Resources/paper_TTT_pak.doc].

Jewelry

India is a leading exporter of jewelry, especially diamonds and diamond jewelry, to the world and to the United States. In 2006, the United States imported $5.9 billion worth of jewelry (HTS71) from India, or 25.5% of all imports from India. Of this, $3.3 billion (55.5%) were diamonds and diamond jewelry and another $2.4 billion (41.0%) was precious metal jewelry.

The depletion of many of India's diamond mines has pushed its industry to source its diamonds from overseas. In 2005, India imported nearly $10.6 billion worth of diamonds. This has raised concerns about the possible import of so-called "conflict diamonds."[153] In January 2003, India, the United States, and 53 other countries endorsed a UN initiative called the Kimberley Certification Process that certifies that the diamonds do not come from Angola, Liberia, Sierra Leone, and Congo. In 2005, India considered lowering the FDI limit for diamond mines from 100% to 74% in an effort to close a possible back door for the import of "conflict diamonds."[154] However, there are claims that uncut "conflict diamonds" are still finding their way into India, especially into the markets in Surat.[155] If true, then there is high likelihood that "conflict diamonds" could also be making their way into the U.S. consumer market.

Oil

The rapid growth in India's economy has also meant a rapid increase in its demand for oil. Although India has proven oil reserves, production is nearly at capacity, while demand continues to rise. According to the U.S. Department of Energy's Energy Information Agency (EIA), India produced an average of 846,000 barrels per day (bbl/day) of "total oil liquids" in 2006, and used an average of 2.63 million bbl/d of oil, resulting in a shortage of nearly 1.8 million bbl/d. In addition, according to the EIA's estimates, India's oil demand increased by 100,000 bbl/d in 2006, and will increase by similar amounts in 2007 and 2008, leading to the nation's growing "energy deficit."[156]

In order to fill its oil gap, India national oil companies have been actively seeking overseas sources of crude oil, involving the acquisition of equity in some cases. According to EIA, the most active Indian oil company overseas is ONGC Videsh Ltd., which holds interests in 25 oil and natural gas projects in 15 different countries in Africa, Asia, the Americas, and the Middle East. Indian companies have

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[153] For more information on the issue of "conflict diamonds," see CRS Report RL30751, *Diamonds and Conflict: Background, Policy, and Legislation*, by Nicholas Cook.

[154] "Fear of `Conflict Diamonds' Entering Country — Mines, Industry Ministries Differ over 100% FDI in Diamond Mining,"*The Hindu Business Line* (Chennai), December 12, 2005.

[155] "Blood Diamonds: A Stain on India's Glittering Trade," *The Taipei Times*, January 22, 2007.

[156] "Country Analysis Brief: India," U.S. Department of Energy, Energy Information Agency, January 2007.

also been actively involved in Sudan's oil industry, as well as the operation of the major oil pipeline and terminus in Port Sudan.[157]

India's growing oil demand, along with China's growing demand, are contributing factors in the a tightening global petroleum market and higher crude oil prices. Competition for crude oil and energy in general is becoming an important issue in Asia, pressing nations to develop trade relations outside of the region.[158] For example, India is pursuing closer relations with the repressive regime in neighboring Burma (Myanmar), with an interest in energy cooperation and to counterbalance China's influence there. In response, the United States is exploring ways to foster cooperation with friendly nations with respect to global petroleum market. Legislation specifically on energy cooperation with India has been introduced in both the House of Representatives and the Senate.

Trade in Information Technology and Other Services

At present, most of the focus of Indo-U.S. service trade is in the information technology (IT) sector. Over the last few years, U.S. companies have been outsourcing many aspects of their IT work to India and other nations. According to one recent study, U.S. banks will increase the share of their IT work overseas from 6% to 30% by 2010, representing a transfer of over $10 billion of IT services.[159] The study also predicted that the nature of the overseas IT work will shift from "low-level applications" to more sophisticated IT activities. Another study projected that U.S. IT outsourcing would increase at a compound annual growth rate of 5.9% over the next five years, reaching a total value of $17.7 billion in 2011.[160] This later study indicated that an impending shortage of IT skills among government employees will be one of the key stimuli of the outsourcing.

U.S. companies are not limiting their activities in India to IT; they are also utilizing India to provide a growing array of services related to the financial sector. On April 11, 2007, Citigroup announced the elimination of 17,000 jobs — or nearly 5% of its global workforce — and the relocation of 9,500 jobs to "low-cost" locations.[161] However, in the same news story, sources close to Citigroup said that between 5,000 and 8,000 jobs would be moved to India in the near future. Most of these relocated jobs would involve equity research, investment banking, and back-office transaction-related services.

Meanwhile, India's domestic IT industry is attempting to branch out of the lower value-added activities (such as call centers and payroll processing) into higher

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[157] ibid.

[158] For more information on the Asian energy market, see CRS Report RL32466, *Rising Energy Competition and Energy Security in Northeast Asia: Issues for U.S. Policy*, by Emma Chanlett-Avery.

[159] "America to Increase Offshoring Tech to India," *Financial Express* (India), March 2, 2007.

[160] "IT Outsourcing in U.S. to Increase at 5.9%," *The Times of India*, February 16, 2007.

[161] "Citigroup to Ramp Up India Headcount," *Economic Times* (India), April 11, 2007.

value-added services (such as product design, software development, and chip engineering). Many U.S. companies are establishing tech centers in India to take advantage of the greater availability and lower cost of Indian engineers. Plus, leading Indian IT companies — such as Tata, Infosys, Wipro, Satyam, and HCL Technologies — are developing their international IT service capacity.

H-1B Visas. The growth of trade in IT services has placed pressure on the U.S. H-1B visa program. The H-1B visa permits U.S. companies and universities to temporarily employ foreign workers who have the equivalent to a U.S. bachelor's degree. While there is an annual quota of 78,200 visas, exemptions have allowed the U.S. Citizenship & Immigration Services to issue over 100,000 H1-B visas in 2004 and 2005. Recipients of an H1-B visa may remain in the United States for up to six years (ten years for Defense Department related work) so long as they remain employed by the same company. H1-B visas are not transferable.

Both U.S. and Indian companies have complained that the current quota is too restrictive, making it difficult for U.S. companies to hire enough engineers and technicians to remain competitive in the global market. Also, some companies would like to see the creation of a new visa category that would allow foreign nationals to work and/or train in the United States for a short period of time. However, there is opposition to the expansion of the current H1-B program. In May 2007, two senior U.S. Senators wrote letters to nine Indian companies that account for nearly one-third of all H1B visas issued in 2006 and requested further details about their use of the special visa program. The Senators expressed concern that fraud and abuse in such programs may have negative impact on U.S. workers.[162]

Implications for the 110th Congress

Given the relatively positive relationship between the United States and India, most of the economic and trade issues between India and the United States are developing trends with few direct legislative implications. One of the exceptions is in the energy sector, where there are bills before Congress concerning U.S.-Indian energy cooperation. However, in some cases, there is pending or possible congressional legislation that may have an indirect impact on U.S.-Indian relations. What follows is a summary of the more prominent issues or topics in U.S.-Indian relations.

Energy Cooperation

There currently is legislation before 110th Congress on the subject of U.S.-India energy cooperation. The United States-India Energy Security Cooperation Act of 2007 (H.R. 1186) would "promote global energy security through increased cooperation between the United States and India in diversifying sources of energy, stimulating development of alternative fuels, developing and deploying technologies that promote the clean and efficient use of coal, and improving energy efficiency."

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[162] See a statement and sample letter from Senator Richard Durbin and Senator Chuck Grassley at [http://durbin.senate.gov/record.cfm?id=274241].

Both the Energy Diplomacy and Security Act of 2007 (S. 193) and the Renewable Fuels, Consumer Protection, and Energy Efficiency Act of 2007 (S. 1419) would, *inter alia*, establish a U.S. petroleum crisis response mechanism in conjunction with China and India. A section of the International Climate Cooperation Re-Engagement Act of 2007 (H.R. 2420) would create Foreign Commercial Service attaches and deploy these to India (and China) for the purpose of promoting U.S. exports in clean and energy efficient energy technologies. The New Direction for Energy Independence, National Security, and Consumer Protection Act (H.R. 3221), introduced in July 2007, contains similar provisions. Moreover, and as noted above, an initiative to launch civil nuclear cooperation with India was provisionally endorsed by the 109th Congress in the Hyde Act (P.L. 109-401) and any future "123 Agreement" guiding such cooperation must be approved by Congress.

Immigration

Immigration reform is a major issue for the 110th Congress.[163] The Comprehensive Immigration Reform Act of 2007 (S. 1348), currently being considered by the Senate, would alter the eligibility requirements for H-1B visas under the Securing Knowledge, Innovation, and Leadership Act of 2007 (SKIL Act of 2007), and limit the number of "market-based visas" to 115,000 per fiscal year. While this is an increase from the current limit, it is below the level sought by both Indian and U.S. information technology companies. Nor does the bill address the industry's desire to see the creation of a new visa category for short-term training of foreign nationals in the United States.

The Farm Bill

Many provisions of the current omnibus farm bill, the Farm Security and Rural Investment Act of 2002 (P.L. 107-171), expire in 2007.[164] India, along with Brazil and other nations, have argued that certain aspects of the current U.S. farm program are "trade distorting,' and are pushing the United States to change various agricultural programs, including its farm subsidies.[165] It was previously hoped that the Doha Round would be completed in time for Congress to consider the enabling legislation under Trade Promotion Authority (TPA), and that any changes in U.S. agricultural policy could be including the enabling legislation. However, since the Doha Round discussions are not completed, Congress is considering the expiring programs without the benefit of knowing the terms of any new WTO obligations. The recently introduced H.R. 2419 provides for the continuation of the expiring farm

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[163] For more information on the immigration issue, see CRS Report RS22574, *Immigration Reform: Brief Synthesis of Issue*, by Ruth Ellen Wasem.

[164] For a summary of the agricultural issues before the 110th Congress, see CRS Report RL33934, *Farm Bill Proposals and Legislative Action in the 110th Congress*, coordinated by Renée Johnson.

[165] For more detail on agricultural issues in the Doha Round discussions, see CRS Report RL33144, *WTO Doha Round: The Agricultural Negotiations*, by Charles E. Hanrahan and Randy Schnepf.

programs, but may not prove to be in compliance with the results of any agreement coming out of the current Doha Round discussions.

Foreign Direct Investment

The 110th Congress is considering legislation pertaining to the operation of the Committee on Foreign Investment in the United States, or CFIUS, an interagency committee that overseas the security implications of foreign investments in the United States.[166] While U.S. laws governing FDI are generally viewed as being very liberal, there has been recent concern about the security implications of some proposed overseas investments, especially their implications for national defense and port security. Proposed legislation would require CFIUS to investigate all foreign investment transactions in which the entity is owned or controlled by a foreign government, regardless of the nature of the business. Given the recent increase in Indian FDI in the United States, this could cause some tension with India, as well as weaken U.S. efforts to persuade India to lower its current barriers to FDI.

Outsourcing and Displaced Workers

The growth of outsourcing various services to India, as well as other nations, is a serious concern for many U.S. workers. Current U.S. law provides some assistance to "displaced workers" via the Trade Adjustment Assistance (TAA) program authorized by the Trade Act of 1974 (P.L. 93-618), the Worker Adjustment and Retraining Notification (WARN) Act of 1988 (P.L. 100-379) of 1988, and the Workforce Investment Act of 1998 (P.L. 105-220).[167] However, various groups and individuals have called upon Congress to revisit these programs, and strengthen the provisions protecting U.S. workers from job losses caused by outsourcing.

There are currently two bills before Congress that offer additional assistance and/or protection to displaced U.S. workers. The Trade Adjustment Assistance Reform Act (H.R. 1729) expands eligibility for displaced textile and apparel workers for trade adjustment assistance, arguably in response to the growth in clothing and textiles imports from India. The second bill, the Worker Empowerment Act (S. 1330), would amend the Social Security Act to provide for wage insurance for dislocated workers.

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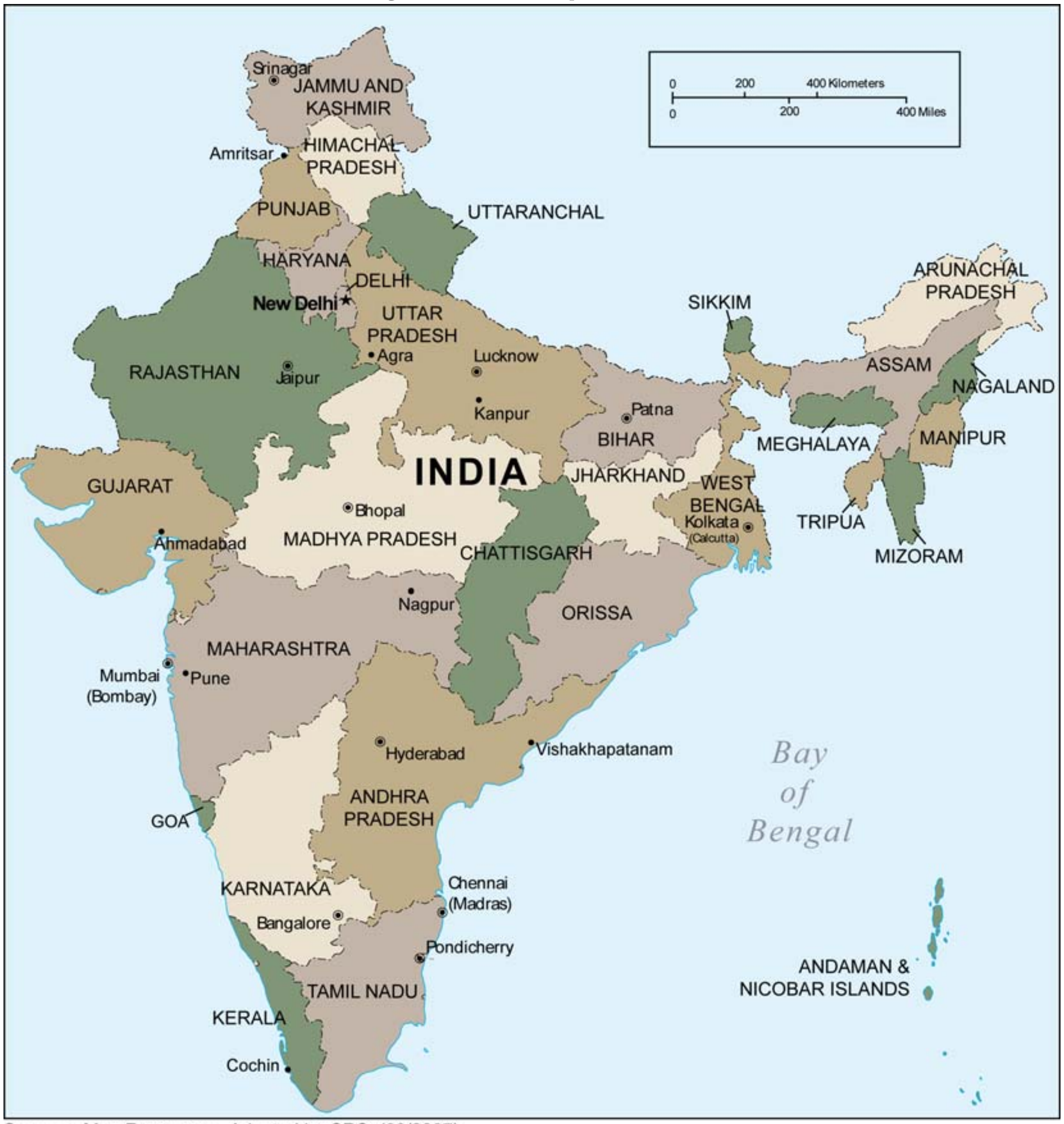
[166] For more information on FDI in the United States and CFIUS, see CRS Report RL33984, "Foreign Direct Investment: Current Issues," by James K. Jackson.

[167] For more information on outsourcing and U.S. worker assistance, see CRS Report RL32292, "Offshoring (a.k.a. Offshore Outsourcing) and Job Insecurity Among U.S. Workers," by Linda Levine.

Figure 14. Map of India



Source: Map Resources. Adapted by CRS. (08/2007)