Unleashing the Market in the India–U.S. Economic Relationship, Part 1

SR-124

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Photo on the Cover—

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Project Overview: Unleashing the Market in the India–U.S. Economic Relationship

India will soon have the largest population of any country in the world. It therefore has the potential, with extensive and difficult reforms, to become the world's most important free market—a position currently held by the United States. It follows directly that the economic relationship between India and the U.S., if allowed to flourish, can greatly benefit the citizens of both.

The Heritage Foundation has initiated a multi-part project—Unleashing the Market in the India–U.S. Economic Relationship—intended to enhance India–U.S. economic relations. The project will demonstrate that free and open markets are the best way to enhance India–U.S. economic relations. To advance Indian prosperity and perpetuate American prosperity, the first order of business is for the two private sectors to do more together.

The role of the Indian and American national governments should largely be to allow specialization and comparative advantage to bring greater mutual prosperity. This can be done unilaterally, without diplomatic mediation. Official India–U.S. ties are not as vital as often assumed, particularly in India, where even many private actors reflexively see the central government as the chief economic player.

India–U.S. economic ties have expanded considerably in the past decade, but so have such ties around the world due to global integration. With the exception of Indian exports of services to the U.S., bilateral trade and investment flows remain woefully underdeveloped compared with the two countries' combined gross domestic product (GDP) and population. So much more could be happening.

Where permitted, the Indian and U.S. private sectors have formed consequential partnerships, notably in technology services. More ventures of this type may need to sidestep Delhi and Washington. Entrepreneurs and companies should no longer accept the endless wait for the national governments' green light, and instead take the initiative themselves. Much Indian economic progress has occurred despite government intervention; so economic progress must be made despite the two national governments.

An important factor is sub-national governments. Individual U.S. states have differing attitudes toward India—some seeking to block Indian labor, others welcoming Indian investment. Indian firms are aware of this, and their American corporate partners can provide information and help identify productive ventures. U.S. states themselves can more actively seek Indian partners.

Individual Indian states see wider varieties in economic policymaking than U.S. states. Certain Indian state governments will likely be unreceptive to enhancing the India–U.S. economic relationship. Others will be far more accommodating than the central government. There will be also be an audience effect: As more open and market-oriented states thrive, they will be imitated by others.

Often standing in the way of greater wealth in both countries are the two national governments, more so in India, but with a sizable U.S. contribution. The Indian central government has proven unable to implement decisive actions, and the

American federal government seems unwilling. Rather than assisting reform, the unjustified deficit spending of the American federal government is a model for what India should not be doing. In addition, the U.S. has limited aspects of the bilateral economic relationship involving services and labor, while correctly insisting that India permit expansion in aspects of the relationship involving capital and information.

The Indian central government is famously ineffective and has shown signs of predatory behavior—putting revenue ahead of what is best for the country. It has acted as a barrier in bilateral economic relations, for example in agriculture trade and financial market access. More harmful actions, such as the recent introduction of retroactive taxation of multinational corporations, discourage foreign participation in the Indian economy in general. These actions are not targeted at American firms, but chill bilateral ties nonetheless.

There are spheres that fall under the natural purview of governments, such as national defense. The Heritage project will address issues where the national governments should not intervene at all or should intervene less, such as market-access restrictions. The first type of recommendations will therefore be negative, aimed at outright removing obstacles set by the two national governments.

A second type of recommendations can be termed compensatory: how individuals, companies, and sub-national governments can outweigh the effects of unwise national policies. For instance, some harmful national tax policies can be neutralized by state-level incentives. Companies can provide partners with crucial market research and information on legal requirements needed to participate successfully in local markets despite national government barriers.

A third type is positive. American and Indian companies can take a large number of trade and investment actions that will augment the economic relationship. Similarly, sub-national governments have many regulatory and policy choices to create better local economic and business conditions. The national governments ending their intervention in some areas, other players compensating for bad national policies elsewhere, and individuals, firms, and state governments expanding free exchange on their own will greatly improve India–U.S. economic relations and benefit hundreds of millions of people.

Executive Summary

The movements of goods, services, capital, and labor between India and the U.S. are inadequate for two such large economies. There are also disputes about the movement of information, in the form of intellectual property. That is why India is not yet shining in The Heritage Foundation's *Index of Economic Freedom* (123rd of 179 countries in the 2012 edition). (The U.S. has also dropped from a classification of "free" to one of "mostly free.")

The two national governments are principally responsible for this failure. A smaller role for them and a larger one for companies and individual states in both countries, based on the principle of free and open exchange, would transform the bilateral relationship and much of the rest of the world.

The cases examined in this *Special Report* include two-way trade in goods and services, investment with additional focus on American investment in Indian mining, two-way labor mobility, and protection of intellectual property rights (IPR). These are just a start, but they illustrate how to advance the market and roll back government in the exchange of goods, capital, people, and knowledge, which constitute the basic elements of all economic relationships.

In trade, many Indian states are large enough to be individually valuable. They should act to offset national trade barriers while American companies should bypass Delhi to seek business relationships. In services trade, the U.S. government should accept the large and important import of services from India.

In investment, individual U.S. states should be more active in marketing to Indian companies. It would be helpful if the Indian central government were to remove various restrictions on multinational corporations. Even if that does not occur, Indian states can greatly improve their local investment climates. Mining in particular is largely a state matter in India, and American companies can assist the process by demonstrating their record in environmental protection and social remediation of mined areas.

In labor, American companies and universities should prod the federal government to roll back recent increases in visa fees and effective reduction in visa quotas. Indian firms should enhance credibility by doing a better job of self-policing, and Delhi should look at its own restrictions on foreign labor. In intellectual property, international negotiations have led to progress and enforcement is the most pressing issue. For that, Indian states are well positioned.

This *Special Report* is the first installment of a comprehensive project to help advance the India–U.S. economic relationship. The relationship could be vital to the two countries and the world as a whole, but its potential is far from being realized, chiefly due to the actions and inactions of the two national governments.

Progress will be faster and broader if the focus on government-to-government negotiations is replaced with an emphasis on cooperation at the level of individual companies and states. Illustrations of this improvement are sketched here for simple trade, (mining) investment, two-way labor movement, and intellectual property.

Much of the hope for progress on India–U.S. economic issues has been put on the prospects and scope of a bilateral investment treaty (BIT). When taken as a whole, the preceding recommendations could be viewed as an endorsement of an India–U.S. BIT that encompasses these sectors.

A BIT may be useful. But only a high-quality BIT—which includes sensitive topics, such as mining and intellectual property rights—can achieve the necessary progress on these and other critical bilateral economic issues. Current government-to-government talks are nowhere close to realizing such a BIT and the historical record indicates that a high-quality BIT is unlikely in the near future. Either no accord will be reached or the BIT will be largely empty of economic value.

Even if a sound BIT is eventually achieved, progress should not wait. There is much to be gained for India and the U.S. in the interim. Moreover, it is far more likely that action by individuals, companies, and states entirely outside the BIT process will eventually generate a good BIT than that a good BIT will emerge from bilateral talks. These outside actions should start immediately.

Unleashing the Market in the India–U.S. Economic Relationship, Part 1

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That is why India is not yet shining in The Heritage Foundation's *Index of Economic Freedom* (123rd of 179 countries in the 2012 edition). (The U.S. has also dropped from a classification of "free" to one of "mostly free.")[1] The two national governments are principally responsible for this failure. A smaller role for them and a larger one for companies and individual states in both countries, based on the principle of free and open exchange, would transform the bilateral relationship and much of the rest of the world.

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Challenge 1: Centrally Imposed Barriers to Trade

The India–U.S. trade relationship is thriving—mostly in services. However, rapid growth in merchandise trade has occurred on a very small base of only $13 billion in 2001, and present trade volume clearly reflects long-term underperformance.[2]

Trade in Services. India–U.S. services trade is a good model for trade in goods, direct investment, and other economic activity. American services exports to India stood at $2.56 billion in 2000, while services imports were $1.89 billion. By 2010 (latest data available), American services exports to India had quadrupled to $10.3 billion, and imports had sextupled to $13.7 billion. In 2000, India was the eighth-largest destination in Asia for American services exports; in 2010 it was the fifth largest. This is a respectable performance, but not spectacular given the high Indian overall economic growth. In 2000, India was the 10th-largest source of American services imports; in 2010, it was second only to Japan.[3] This is an outstanding economic accomplishment.

Just as important, services trade shows a reasonable match to each country's comparative advantage. American exports are led by education and are mostly unaffiliated (between parents and subsidiaries). American imports are led by technical services and are mostly affiliated—either with Indian affiliates supplying U.S. parent companies, or with Indian parent companies supplying their U.S. affiliates.[4] This pattern matches Indian comparative advantage in the raw quantity of specialized labor, and American comparative advantage in population-wide provision of skills and knowledge.

The Indian performance in services trade is quite good, stemming in part from a less regulated labor market than is the case for manufacturing. A problem arises from the U.S. government's distortion of the market for American consumption of services. Rhetoric about outsourcing has turned into more frequent visa application rejections, ad hoc fees, and proposals for tax changes. American fees and rejection rates for Indian visas have both risen sharply, in contrast to treatment of workers of other nationalities.[5] (See "Challenge 3" below, on labor market liberalization). Recent U.S. policies artificially alter incentives for services trade and labor movement and are clearly protectionist. American firms cannot easily outsource tasks to India, nor can Indian job-seekers easily obtain work visas for the U.S.[6]

Trade in Goods. Goods trade, in contrast to services trade, does not appear to reflect comparative advantage. This is because exchange is being dictated only secondarily by the preferences of individuals and companies. Trade patterns are warped by barriers imposed by governments.

American goods exports to India stood at $3.76 billion in 2001, while imports were $9.74 billion. Ten years later, American goods exports had almost sextupled to $21.6 billion, and imports had almost quadrupled to $36.2 billion.[7] This increase appears far more impressive on paper than it is in reality. Bilateral trade in 2000 was absurdly small. While Indian GDP, for instance, is roughly the same as the combined GDP of Saudi Arabia, the Netherlands, and Taiwan, each of the three economies individually ranks ahead of India in trade with the U.S. The Indian–U.S. goods trade of $58 billion should be close to the $100 billion that is taking place between the U.S. and South Korea.[8]

This failure looks even starker in light of the complementarity of two economies—the U.S. is capital-rich and land-rich, and India is labor-rich, both in low-margin sectors and in terms of absolute numbers even in some high-margin sectors. India does not make full use of its labor endowment, but the size of the labor force and the comparatively high cost of American labor still leave clear gains from trade in low-margin goods, some of which are not being realized.

The low volume suggests that comparative advantage is being distorted by government actions; this is borne out by trade components. In 2001, exports from India to the U.S. were highly concentrated. Jewelry was by far the largest at $2.6 billion, more than one-fourth of the total by itself. The next-largest item was men's and boy's shirts at $500 million. In 2011, jewelry was again first at $6.5 billion, followed by oil products at $3.4 billion.

Seen in a vacuum, these numbers may appear reasonable. Seen in the context of American exports to India, they are not. Ten years ago, American exports were diversified, with only aircraft exports exceeding $250 million in value. The second-largest export was cotton, at almost $200 million. Fast forward to 2011: The volume is higher but the situation is arguably worse. The top American export to India by far is also jewelry, again, at $3.6 billion, one-sixth of the total. Fertilizers were next, followed by waste and scrap, the only other categories that exceeded $1 billion.

In isolation, the gross volume of a two-way jewelry trade might make sense. It does not make sense that completely different economies should specialize in jewelry. It is close to absurd, as well as economically harmful, that two economies with combined population of 1.5 billion should engage first and foremost in horizontally integrated jewelry trade, especially given the openness of the American market and India's vast technology and commodity needs. Jewelry is not an important export in any other U.S. trade relationship. The other top American exports to India, waste and scrap in particular, are also not reflective of comparative advantage.

Comparative advantage not being permitted to operate means that individuals and firms are not allowed to determine outcomes by themselves. When it comes to goods, the Indian central government is the chief culprit. In recent years, India has been the world's chief imposer of protectionist measures, usually in the name of cracking down on dumping. Targets include chemicals and audio-visual products, both potentially important in bilateral trade.[9] More disturbing, there are high trade barriers across major sectors where there is strong Indian demand—agriculture, defense, health care, and energy.

Agricultural products see very high Indian tariffs, with bound tariff rates averaging over 100 percent compared to, say, 36 percent for Brazil.[10] American fruit and poultry exports are either inhibited or blocked altogether.[11] India is now the largest arms importer in the world, and the U.S. the largest exporter. But India requires the reinvestment of 30 percent of the value of the transaction, so the best companies and products may not be selected.[12]

Still-weak patent protection in pharmaceuticals inhibits imports into India, reduces the incentive to tailor drugs for India, and disproportionately harms American firms as industry leaders.[13] India is chronically short of electric power, yet equipment imports are restricted. Tariffs are high and firms not producing in India often cannot compete for tenders. For solar energy, an American strength, the Indian government requires joint ventures.[14]

Solution 1: Bypassing National Governments and Empowering Entrepreneurs

In the name of protecting its farmers, India was the chief obstacle to the Doha Round in autumn 2008.[15] Since then, the U.S. has been the chief obstacle, showing little interest in advancing current talks at the World Trade Organization (WTO). The best way to enhance bilateral goods trade is to bypass these two national governments. Indian states have their own trade barriers, but they can also act to offset national policies that interfere with their particular comparative advantages. Agriculture and health care are examples.

Indian food imports to the U.S. have soared in the past 10 years. This is due in part to higher prices inflating the sales totals, but also because of much larger import volumes.[16] Indian states can neutralize national trade barriers with incentives, and many have the size to qualify by themselves as high-priority customers for American companies. "Shopping trips" by Indian state officials can help create reliable, long-term, and price-competitive farm trade relationships. Better agriculture ties would also allow specialization within those states that would lead to export opportunities, serving as a model for other states. Alternately, U.S. states could come to Indian counterparts to demonstrate the scale and flexibility of American agricultural supply.

In health care, the action is centered on companies. For example, the American company Abbott Laboratories bought a division of the Indian company Piramal Healthcare, Ltd. Not coincidentally, Piramal now plans to invest $1 billion in the U.S.[17] Subsidiary operations can be used to expand business despite the presence of trade restrictions, enabling the flow of goods to be determined more by market demand than by government restrictions. American and Indian companies, in health care and elsewhere, should try to ignore Delhi–Washington relations and evaluate the complimentarity between the two economies.

Success breeds success. Due to large investments, several Indian firms may develop relationships with American states. These projects will involve import of inputs and export of outputs. U.S. firms should do the same with Indian states, perhaps led by manufacturers of consumer products. These states would then import more American inputs. As relationships mature and Indian workers acquire training, exports back to the U.S. could explode.

The path for the U.S. is simple: Stop interfering and rely on an open market. Growth could be especially powerful if Indian states improved their logistics, to complement the large labor force.

Challenge 2: Untapped Investment Potential

There is a considerable two-way investment relationship between the U.S. and India amounting to a total of over $30 billion through 2010.[18] The U.S. is currently the fifth-largest source of foreign direct investment (FDI) in India after Mauritius, Singapore, the U.K., and Japan,[19] and Mauritius is a transit point for investment by other nations, including the U.S.

American investments cover almost every sector in India that is open for private participants. American companies have brought in some of the best business practices, the most valuable technology, and, most important, generated thousands of jobs in India. The U.S. has also been the primary catalyst in building India's offshoring services, which accounts for more than 55 percent of the global outsourcing market and back-office services.[20]

Happily, India and the U.S. are in the midst of tapping their immense potential for investment collaboration, especially in services. This slow but ongoing process was reinforced by the Indian government's September 2012 announcement of liberalization measures aimed at increasing foreign investment in aviation, broadcasting, power, and, most dramatically, retail.[21] Continuing the process, however, requires more sub-national involvement, as well as restraint from national governments.

The Indian Investment Climate. Since the 1991 economic reforms, India has properly dismantled a number of controls in the areas of industrial policy, taxation, trade, and foreign investment. De-licensing of industry, curbing of public-sector prerogatives, easing of competition controls, trade reforms, deregulation of interest rates, and opening of capital markets were among the changes undertaken to encourage capital inflows.

The establishment of various agencies to facilitate investment has led to substantially more FDI. The proportion of FDI inflows that require explicit government approval dropped from 62 percent in 2001 to just 14 percent in 2010. The proportion entering India through the automatic route, which does not require review, grew from 22 percent in 2001 to 74 percent of the total in 2010.[22] This is a clear reflection of a more favorable policy environment.

Further, the ratio of realized FDI (including that which does not need review) to FDI that does need explicit government approval ranged between 20 percent to 25 percent before 1991, signifying a great deal of rejection by the Indian government. The ratio increased to more than 220 percent in 2008, representing not only more approvals of FDI, but more that does not require government review.[23]

From 1991 to 2000, most FDI came through government approval routes rather than through the automatic route of the Reserve Bank of India. The government then eased foreign investment regulations by increasing equity caps and making more sectors eligible for the automatic route. The Foreign Investment Implementation Agency, established in 1999, has also been crucial in reducing cumbersome procedures and delays.[24] The reform period also witnessed an increase in FDI through technical collaboration. Finally, since 2005 there has been increasing "green field" foreign investment (starting a new company) rather than acquisition—a sign of more Indian openness.

Although a major share of FDI still comes from only a few countries, the reforms have encouraged a diversification of sources. In 1991, approved FDI came from 29 countries. This increased to almost 90 countries by 2008. India's FDI inflows were around 5 percent of the level of China's FDI inflows in 2000, and stood at around 30 percent at the onset of the global crisis in 2008.

FDI equity flows from fiscal year (FY) 2006 to FY 2010 were almost seven times the preceding five years, though the definition of FDI expanded during this period. Average annual FDI equity flows increased from $1.72 billion between 1991 and 2000 to $2.85 billion between 2001 and 2005, then to $19.73 billion from 2006 to 2010.[25]

Another notable feature is that inflows through the explicit approval route have dropped from more than 60 percent of the total in 2000–2001 to a little over 13 percent in 2009–2010 and inflows through the automatic route have increased from 22 percent in 2000–2001 to 74 percent in 2009–2010 (the remainder is accumulation of shares). The financial sector in particular received around 19 percent of FDI equity flows from 2005 to 2008. Most of the FDI equity in the financial sector, around 65 percent, has come through the automatic route, due to relaxed norms.[26]

Indian policy then stagnated for a number of years after the global economic downturn, but was revived by the surprise liberalization announcement led by retail. FDI from the U.S. into India from FY April 2000 to FY March 2011 amounted to $9.44 billion, or 7.3 percent of total FDI into India. During FY 2011, FDI inflows from the U.S. were $1.17 billion, or 7 percent of the total. The share of FDI equity flows from the U.S. fell from 20 percent between 1991 and 2000 to 14 percent between 2001 and 2004, and again to 7.3 percent from 2005 to 2009.[27]

However, foreign investment has increasingly been routed through Mauritius, the top source of investment in India from 2000 to 2011.[28] Mauritius's zero tax on capital gains makes it an attractive place to establish holding companies. As India became more attractive as an investment destination, the standing India–Mauritius tax treaty led to a surge of investment recorded as coming from Mauritius,[29] some of which is actually American investment.

The U.S. Investment Climate. Similarly, India's investments in the U.S. have also accelerated. Indian companies' green field investments in the U.S. between 2004 and 2009 amounted to nearly $5.5 billion. The average investment per project exceeded $45 million, with 10 Indian companies accounting for more than 70 percent of the total. Metals, information technology, media and entertainment, industrial machinery and equipment, and financial services were the principal sectors. Major investments came from JSW Steel ($1 billion), Tata Consulting Services ($274 million), and the textile- and steel-oriented Welspun Group ($246 million).[30]

During FY 2009 and FY 2010, Indian companies made 536 outbound acquisitions globally, of which 105 were in the U.S. The latest data show 25 outbound acquisitions, worth $3.3 billion, by Indian companies in the U.S., from a total of 101 outbound acquisitions in the first three months of FY 2011.[31] This growing flow of capital from India to the U.S. reflects the increased integration of the two economies and has brought many benefits, in particular job creation.

Given the relative strength of American finance, financial investment largely runs from the U.S. to India. The State Bank of India and the Industrial Credit and Investment Corporation of India have started operations in the U.S., though limited in scope to date.

India has attracted Fortune 500 companies, such as Morgan Stanley, as well as American private equity and venture capital. The relaxation of banking norms and development of corporate bond markets will attract more. There is also huge potential for Indian banking, insurance, and pensions to draw American investment. The Indian insurance sector has only 50 participating firms and $50 billion in gross premiums, versus an American market of 1,000 insurers and gross premiums exceeding $700 billion.[32] American insurers have the experience and capital to help expand the Indian market.

Solution 2: Deeper, Broader Liberalization

Both India and the U.S. can, and should, do better on investment.

What the U.S. Should Do. The maturity of the American financial sector means that opportunities for Indian institutions are limited—there is simply not much space to operate. But if India is willing to permit more American financial access, U.S. regulators should seek ways to enable Indian banks to expand both their operations and their range of services.

For Indian investors in the U.S. more broadly, many American states already compete for foreign investment. Indian firms and their American partners should maintain ongoing contacts with interested states to determine how the local investment environment can be improved.

Some restrictions on Indian investment in the U.S. actually originated in Delhi. Progress has been made here too. Indian companies are now permitted to invest up to 400 percent of their net worth in overseas joint ventures and wholly owned subsidiaries. Listed Indian companies can invest 50 percent of their net worth in portfolio investment abroad.[33] Previously, there were tighter limits due to fear of capital outflow. There has also been a helpful increase in the ceiling for Indian mutual funds to invest overseas, from $5 billion to $7 billion.[34] In finance, Delhi could go further and allow Indian investors to participate in overseas derivatives trade subject to a specified ceiling.

Many of the individual policy changes could and should be incorporated into a bilateral investment treaty (BIT). Preliminary talks were held in 2009 and there has been only rhetorical progress since then, due largely to an internal American review of its model BIT document.[35]

There are, of course, contentious issues to be resolved, such as how to handle arbitration and contrasting labor and environmental standards. But it is also the case that the U.S. is missing business opportunities as the Indian government moves forward with economic agreements with Japan, Korea, Malaysia, and others. Noticeable movement in BIT negotiations might improve the climate for both countries' investors.

What India Should Do. India has undertaken major reforms to attract foreign investment from all sources, including the U.S. Beyond the steps taken by the Indian federal government in September 2012, the limit on foreign institutional investment in the Indian debt market has recently been raised from $15 billion to $20 billion.[36] Further steps are possible and advisable.

One further step would be to permit all types of investors—nonresident Indians and foreign institutional investors, among others—to invest in any asset class they choose (stocks, mutual funds, etc.). Right now, the central government steers foreign investors away from some assets, employing, among other measures, outright quotas.[37] The investment process could be streamlined by establishing only one window for clearance of all portfolio investment and debt management and harmonizing the regulation of futures, forwards, and options. Similarly, there should be less, or no, distinction between FDI and portfolio investment, to allow investors to freely choose their preferred method.

These changes will deepen Indian capital markets. In general, the simple creation of more transparent and accessible laws and regulations would be useful to all Indian market participants, including American and other foreign investors.

There are also broader steps India could take. India is far behind China, for example, in labor market efficiency and infrastructure. In important factors affecting foreign investors, such as registering properties and enforcing contracts, India ranks much lower than China.[38]

India's Need for Western FDI in Resource-Based Industries

Recent developments have more or less frozen any significant new foreign investments in Indian mining. These developments, chiefly quarrels between different participants, cover a gamut of issues—concerns over pricing of rights and royalties, profit sharing, environmental issues, and impact on local communities, among others. Investment in commodity sectors from the West in general and the U.S. specifically can go a long way to ease the socioeconomic burden India has placed on itself. Mining is largely a state matter, and state decisions and corporate behavior are vital in enabling this investment.

The Mining Trust Deficit. At the core of the mining problem is a trust deficit in India of two related types. The first is the widespread belief that mining companies indulge in environmentally exploitative and socially harmful practices. The second is the widespread belief that national and local government is unable to control them. As a result, most new projects have been halted and most policy measures frozen, while corruption has actually intensified.[41]

Conventional arguments against mining are largely drawn from India's historical experience, featuring low compensation for land forcibly taken and extremely poor quality or absent environmental regeneration practices. The government has started with poor processes in allocation of mining rights with limited transparency and little use of open auctions.[42] It also largely ignores its own rules and regulations in the environmental domain. Divergences from the minimum regulatory and legal norms are rarely punished, and justice has evaded displaced communities.[43] Though Indian policymakers may have been well-meaning, they have devised laws and regulations that suffer from limited use of market forces that can act as a natural discipline.

How America Can Help. Developed-country multinationals have been subject to better quality regulation, are necessarily more sensitive to image and public-relations issues, and offer better technologies and processes. Resource companies in these countries function under a far more effective regulatory regime, with better controls imposed on them in ethical practices, environmental safeguards, and rehabilitation. Over time, the governments in most developed countries have largely succeeded in reaching a mutually acceptable accommodation with large resource extracting firms.[44]

In contrast, the environmental practices being followed by India's largest coal mining firms are abysmal, despite the fact that Coal India is a public-sector company. It is frequently in the news for violations of the government's own environmental norms.[45] Of course, what is true of public-sector entities can be true of private entities, too. International companies operating in countries such as India will also be subject to weak regulation. However, norms are imposed, not just by regulators within boundaries, but sometimes also across national boundaries.

Peabody Energy, the world's largest private coal company is a case in point. The first three-quarters of the 20th century saw many instances where Peabody was viewed as insensitive to local communities and environmentally irresponsible. Legislation such as the 1970 and 1990 Clean Air Acts contributed to Peabody's significantly improved record in these domains.[46] The year 2007 saw the company invest in a 650-megawatt near-zero emission GreenGen clean-coal project in Tianjin, China.[47]

The second important force that impacts developed-country firms more than those in developing countries is public pressure to operate in a responsible manner. This pressure works through stock markets but more so through the media, especially regarding foreign operations. It thus has a larger ambit than a national boundary.[48] But international companies' most important advantage by far stems from their long experience of resource development in diverse circumstances and consequent access to superior technologies and processes. Whether it is efficiency in mining, environmental impact, resettlement, or rehabilitating a closed mine, a long list can be generated where mining firms from developed countries have a far superior set of technologies.

As conditions stand today, most of these firms are unable to operate in India. This is largely due to the Indian central government's inability to devise a strategy seen to benefit ordinary people. The government must first explicitly recognize that mining in developed countries is done far more efficiently, has far lower negative externalities, and has offered superior resettlement and rehabilitation. This should serve as justification to open the mining sector to all companies, international and domestic.

In the U.S., the federal Surface Mining Control and Reclamation Act was passed on August 3, 1977, and fully implemented by 1982. The law allowed mining in land hitherto used for farming *as long as companies could demonstrate that they could restore 100 percent of crop productivity in a reasonable time.* The decades that followed **(Continued)**

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forced mining companies in the U.S. to undertake a range of initiatives aimed at clean mining with full land rehabilitation.[49]

Studies have also demonstrated that U.S. companies tend to have greater levels of efficiency than developing country firms; for example, American coal mining firms are far more efficient than Chinese miners irrespective of the scale of operations.[50]

It Can Work. Mining would not be the first sector to achieve a breakthrough. One was achieved in telecommunication, and benefits are there for all to see. Today, India has among the best telecommunication service for the price, benefitting ordinary people far more than the closed regime of the past. Indian and international companies have collaborated and competed, new technology has entered benefitting hundreds of millions of consumers, and hundreds of thousands of jobs have been created.[51] In mining, given the fears related to the environment and local communities, consensus needs to be built, backed by a sound monitoring and enforcement regime. The consensus will be achievable as long as certain aspects—full rehabilitation of land, minimal environmental costs for larger communities, and so on—are treated as non-negotiable. As long as firms can demonstrate the capacity to achieve these goals, in any part of the world, they should be allowed to participate in an open and fair bidding process. Part of the revenues earned thereby should be allocated for building and strengthening monitoring and enforcement capabilities.

This discussion makes plain how individual states and firms can enhance mining if the Indian central government does not interfere. States allocate land and therefore control the most important aspect of mining.[52] Some states see mining as an employment tool but others will be more interested in revenue. Even employment can expand if mining can proceed with less environmental and social turmoil.

Companies should not only approach state governments but offer to assist in creating the environmental regulations. Corruption is possible but American firms, in particular, are restricted by home country law and aware from experience that corruption will block the long-term potential of the sector.[53]

As the geographically largest developed country and the world's biggest outward investor, American companies have the most extensive experience in operating within a wide variety of regulatory and physical conditions in a way that is fair to local communities but does not strangle investment. Studying the American mining system and regulatory and legal regime and soliciting the advice of American participants would benefit Indian states, and would also benefit the U.S. in light of the Indian market for energy and metals. Improvement is also possible in the regulatory bodies of some Indian states, easing the trust deficit among civil society, government, and industry.

Actions that would attract American and other foreign investors to India are providing better, market-driven infrastructure, and loosening rigid labor laws. The central government has a role to play in the liberalization: Increasing caps in sectors with high FDI potential and putting more sectors under the automatic route would obviously be helpful.

It would also be very helpful to improve coordination between the central and state governments. A wide range of state-level actions can help attract FDI. In the Indian case, a competition among states to draw investors would be beneficial even though some states will decline to participate. An especially relevant example: Several states are moving to accumulate land in land banks that could then be offered to prime foreign investors, short-circuiting many of the land problems that have plagued multinational corporations to date.[39] For their part, companies can emphasize strategic investments that introduce foreign brands and products to pay the way for greater market access later.

In order to attract more investment in financial sectors, an area of particular American comparative advantage, long-pending proposals, such as lifting the 10 percent cap on foreign voting rights in banks, the long-fruitless attempt to raise the FDI cap in insurance from 26 percent to 49 percent, and reforms in pension sectors would be especially helpful.[40] Other measures to enhance India–U.S. investment relations could include (1) a facilitation desk in interested Indian states to guide foreign investors, (2) better connections between industry associations in the two countries, and (3) encouragement from all parties for a more active role by the Indian community overseas, given its unique position.

Challenge 3: Limited Labor Mobility Between the U.S. and India

Any Indian who has attempted to obtain a U.S. work visa knows that the process can be fraught with challenges. Perhaps surprisingly, for the smaller number of Americans attempting to work in India, the reverse is also true. Navigating the U.S.–Indian combined labor market involves a thicket of laws, regulations, and confusing puzzles that can leave job-seekers frustrated. While changing the labor market will inevitably require a certain level of government engagement, such change can be driven by the demands of the private sector, rather than by bureaucratic whim.

The two labor markets are enormous. The combined formal labor markets exceed 200 million people. The combined informal labor markets, dominated by India, exceed 400 million people.[54]

Indians Working in the U.S. In 2006, there were 1.5 million Indian-born individuals living in the U.S., of whom 42 percent were U.S. citizens. Generally speaking, these immigrants were highly skilled, with 74 percent possessing a bachelor's degree and 41 percent possessing an advanced degree, numbers that dwarf U.S. averages.[55] As of 2010, there were more than 2.9 million people of Indian origin in America with a decadal growth rate of 69 percent.[56] While the data does not distinguish according to work status, it does show that 60 percent of lawful permanent Indian-born residents in America work in managerial positions, and 15 percent of Silicon Valley start-ups are run by Indians, many of whom are in the U.S. on a work visa.[57]

Of ethnic Indians who are now in the U.S. but born elsewhere, 30 percent work in science and engineering,[58] while another 5 percent are physicians. In the grand scheme of the U.S. labor market, most Indian immigrants are job creators. They are entrepreneurs or people who add to the U.S. economy with their skills, rather than "job-takers"—low-skill immigrants whose primary contribution to the economy is to take existing low-skilled jobs, which they are willing to do for a lower price than Americans.

In 2007, 44 percent of Indian-born individuals who were granted permanent residency were sponsored by their employers, while another 28 percent were immediate relatives of a U.S. citizen (mostly spouses). The number of illegal immigrants from India had grown to 270,000 by 2006, a matter of some concern. However, even in 2006, more than 80 percent of Indian immigrants were legal.[59] Despite current restrictions, Indian family incomes are almost $70,000, above the U.S average.[60] Indian Americans, largely Gujarati, control 35 percent of hotel rooms in the U.S., and over half of American H1-B and L visas—generally given to immigrants with advanced technical skills—are issued to Indians.[61]

Americans Working in India. While there have been improvements in the past few years for Americans working in India, the regulatory environment retains many unfriendly restrictions.

Further, India seems to be going in the wrong direction. The new law on employment visas bans foreigners from accepting employment at less than $25,000 per year. Twenty-five thousand dollars is a considerable sum in India and foreigners could live well on such an amount except in Delhi, Mumbai, and a few other cities.[62] This is a question of saving employment for a small number of elite Indians; the average Indian would not be harmed. The visa rule deprives Indian organizations of access to the global labor market and reduces the exposure of foreigners to the Indian economy, which can only hurt India in the long term.

An illustration: Due to labor regulations, there are multiple barriers for highly qualified American physicians even simply to donate their time. This is especially strange in light of India's demand for more extensive health care. Many of India's top-class private hospitals cater heavily to medical tourists, who would welcome U.S. physicians on staff. If these hospitals pushed for American physicians to work more easily in India, it could greatly boost medical tourism, thus adding thousands of jobs for Indians as well.[63]

At the same time, despite the large numbers of Indian university graduates, there is a dearth of those with the breadth of training necessary to manage in an international technology company.[64] Employment of American technology managers could enable these companies to expand. The commercial aviation sector, where growth is impeded by lack of trained pilots, would greatly benefit from allowing more U.S. pilots.[65]

Solution 3: Unilateral Liberalization of Labor Markets

These Indian and American labor markets would benefit greatly from practical, business-driven reform, as would the world as a whole, given their size. The U.S. federal government in particular must refrain from harmful action; the rest is up to Indian and American firms.

What the U.S. Should Do. Given the high skill level of most Indian immigrants to the U.S., there are two areas where concerted action could make an immediate difference:

1. Universities should press for passage of labor law reform that permits highly trained people in specified fields to be exempted from immigration quotas, and

2. Indian and U.S. companies should clean up application procedures to reform the L and H-1B visa processes.

The Stopping Trained in America Ph.D.s from Leaving the Economy (STAPLE) Act was proposed in the 112th Congress by Representative Jeff Flake (R–AZ). It would have "amend[ed] [the] Immigration and Nationality Act to authorize certain aliens who have earned a Ph.D. degree from an American institution of higher education in a field of science, technology, engineering, or mathematics to be admitted for permanent residence and to be exempted from the numerical limitations on H-1B non-immigrants."[66]

With its clear emphasis on recruiting the sort of talent in science, technology, engineering, and mathematics (STEM) that predominates among Indian immigrants, the STAPLE Act or an equivalent needs the help of American universities and other labor-market reformers. Allowing STEM graduates to be able to remain in the U.S. will further increase the prestige of U.S. degrees and make the U.S. an even more attractive destination for top foreign students. Pushing labor market reform is not just good public policy for universities to advocate, it is good for their business side.

With respect to U.S. visas, there are a variety of possible reforms. Most important, there has been a recent surge in the rejection of Indian visas.[67] Approved L-1 visas, used to transfer Indian employees to the U.S., fell 27 percent in 2010. Despite this, at 27,000, Indian L-1 visas still dwarf the U.K., the second-largest provider of such visas at 5,900.[68]

In 2010, the Obama Administration inaugurated a substantially increased fee for H-1B and L-1 applications.[69] The legislation was authored by Senator Charles Schumer (D–NY), with the explicit intent of going after leading Indian IT companies. India has threatened to take the fee before the WTO as illegal, on the grounds that it violates U.S. commitment to free trade in services. India may have a strong case to overturn as a restraint of trade, but its willingness to actually proceed is in question.

Indian firms can themselves do better. Visa fraud remains a problem, and the Indian central government has a tendency to "look the other way." For long-term access to the U.S. labor market, Indian firms must strictly adhere to regulations, even if they are, at times, politically motivated. This adherence will show good faith, boost credibility, and help demonstrate the gains brought by Indian workers.[70]

However, restraint is plainly needed on the part of the U.S. federal government. The Administration and Congress must stop raising barriers to highly skilled immigrants. American companies can play a helpful role in educating policymakers about the net harm to the U.S. economy from these barriers. American technology companies, many of which rely on Indian workers and outsourcing entities, can also assist Indian partners in understanding U.S. law.

What India Should Do. India should create a friendlier labor market for American workers. Indian corporations, many of which now represent major global brands, need global talent. Leading Indian corporate houses should guide the way, joining with India-based multinationals to press for the liberalization of vague, politically determined work-visa rules put in place in 2009.

Certain categories of jobs were no longer eligible for visas under any circumstances even though almost any position a U.S. national would take and for which an Indian company would hire is one where that person contributes a valuable skill not met by India's labor market. The original tightening affected 70,000 foreign workers, with those with expertise in the struggling power sector hardest hit.[71]

If India is to become a global economic power, it needs more international expertise, not less. Any foreigner who has worked in or around even the best Indian organizations can tell stories of insufficient global awareness reducing the effectiveness of Indian companies. The companies themselves must push for liberalization of India's labor laws to make it easier for American and other foreign professionals to offer their expertise. This would pay obvious dividends for all, especially India.

Challenge 4: Continuing Positive Trend on IPR Protection

The "2012 Special 301 Report" of the United States Trade Representative was published in April, and India continues to be on the Priority Watch List. The list consists of the countries that present the most pressing concerns regarding insufficient IPR protection or enforcement.[72] While India's continuing inclusion on the list is not the only relevant indicator—a comparable document does not exist on the Indian side—it provides a reasonably good depiction of American complaints against India. The relevant section begins with a strong statement: "India made limited progress on IPR protection and enforcement in 2011, and its legal framework and enforcement system remain weak."[73]

Because of variations in IPR laws across countries, friction is inevitable. However, despite continuing India–U.S. testiness in IPR, the positions today are far less divergent than they used to be. In IPR, the trend for bilateral economic relations and beyond has been clearly positive, with global benefits. The goal should be to protect and extend that trend. However, India–U.S. government-to-government negotiations are not necessarily the best tool for reaching this goal.

India Improving. The American report makes reference, first, to the 2010 Copyright Amendment Bill, which partially incorporates some provisions of World Intellectual Property Organization (WIPO) Internet-related treaties. Second, on patents, it notes "concerns with respect to the prohibition on patents for certain chemical forms absent a showing of increased efficacy." Third, there is reference to patent application backlogs and streamlining of patent opposition proceedings. Fourth, there are complaints about compulsory licensing provisions, especially in the context of pharmaceuticals (these may indeed be getting worse.) Fifth, there are additional concerns over unfair commercial use and unauthorized use of test or other data submitted before obtaining marketing approval for pharmaceuticals and agro-chemicals. Sixth, there is the issue of piracy and counterfeiting of medicines.[74]

Despite all this, the review shows very considerable improvement from the days of the WTO's Uruguay Round (1986–1994) and the period leading up to it. India's conformity with American and international standards has greatly increased—progress can be made. The main role for the Indian central government is to neither backslide on enforcement of existing laws nor to issue new regressive laws, such as compulsory pharmaceutical licensing requirements, that force firms to share their intellectual property with local manufacturers, ostensibly in the cause of the public health.

Any form of IPR protection confers a limited monopoly for a stipulated period of time. There is also a trade-off between the short-term goal of keeping prices in check despite the presence of the monopoly and the long-term goal of stimulating research and development and investments. These arguments were visited and re-visited during the Uruguay Round and there were WTO agreements on IPR, with additional agreements through WIPO, the U.N., and the International Union for the Protection of the Varieties of New Plants.[75]

In contrast to its record in bilateral negotiations, especially with the U.S., India responded well to the international agreements. The Copyright Act was amended in 1999, the Trade Marks Act in 1999, the Designs Act in 2000, and the Patents Act in 1999, 2002, and 2005. New legislation was enacted on Semiconductor Integrated Circuits Layout Design in 2000, Plant Varieties and Farmers' Rights in 2001, and Biological Diversity in 2002.[76]

Regulations followed the enactment of legislation and supplemented them. India also signed the Patent Cooperation Treaty in 1998, the Paris Convention in 1998, and the Budapest Treaty in 2001, with the Madrid Protocol being considered for ratification. After the Trade Marks Act was amended in 1999, there remained no direct legal obstacles to signing the Madrid Protocol, though there may be systemic problems in actually adhering to the requirements, in trademark offices and at the state level.[77]

Similarly, before amendments to the Indian Patents Act, Indian patent law was incompatible with WTO obligations and, accordingly, India lost disputes before the WTO. This situation has also changed considerably. India went through a WTO trade policy review mechanism (TPRM) in 2011. The WTO Secretariat's report shows that there is no issue of non-compliance, including with regard to prohibitions of certain patents, compulsory licensing, and protection of test data.[78]

The WTO review does take note of section 3(d) of the Indian Patent Act:

> Section 3(d) of the Patent Act refers to the scope of patentability of pharmaceutical and other chemicals and calls for proof of efficacy of the substance. The claimed substances should differ significantly in properties from the known substances with regard to efficacy, which needs to be proved at the time of filing or during the patent application to prove inventive step.[79]

While complaints have been advanced about this test of patentability, the secretariat found no violation of the WTO agreement. The compulsory licensing provisions are not a violation of the WTO agreement either. The U.S. has understandable criticisms on a bilateral basis but the case for non-compliance with WTO requirements, even on section 3(d) of the Indian Patents Act, cannot be made. It remains important for India to turn away from new actions that would cause it to fall out of compliance, such as patent invalidations at odds with decisions made elsewhere.

Perhaps the last area of complaint is trade secrets. The TPRM report finds no major fault there, either, at least in terms of WTO requirements:

> Trade secrets are protected either through contract law or through the equitable doctrine of breach of confidentiality. The Indian Contract Act (Section 27) provides some sort of limited protection as it bars any person from disclosing information acquired as a result of a contract. It is also common to insert a confidentiality clause in a technology transfer or other licence agreement to maintain the confidential nature of the subject matter, not only during the employment period of the employees and contractors but also after its termination, though for a fixed period. Aggrieved parties may seek action through the civil courts by obtaining an injunction preventing a third party from disclosing the trade secrets, return of all confidential information and proprietary information, and compensation for any loss suffered due to disclosure of trade secrets.[80]

In addition, memoranda of understanding (MOUs) have been signed on IPR with Australia, France, Japan, and Switzerland; with patent offices in Europe, Germany, and the U.S.; and with WIPO, among others.[81] The signing of WIPO treaties in particular goes beyond the basic WTO principles. There is no mandatory requirement that those be signed—signing and ratification indicates a willingness to accept IPR protection as a desired objective. There is, consequently, a strong case that India's legal framework on IPR has improved, even if incrementally, and even a case to be made that it is no longer weak by international standards.

America Learning? There is a tendency on the part of the U.S. to presume that every country's legal regime, as well as global norms, must go beyond the WTO to conform to that prevalent in the U.S. This may not be possible to achieve on a bilateral basis. While global IPR laws are indeed moving closer to those in the U.S., expectations of complete identity are unjustified, especially in the near term.

There remain serious issues with delays in approvals, streamlining dispute settlement, improving policing, and similar problems. Counterfeiting and substandard drugs are another manifestation. Even here, incremental improvements have been made, though the speed has been slow. There are also systemic problems with the Indian justice system, but these are not specific to IPR.

The problems are now more with enforcing IPR law in India, not the law per se. Changing laws to adhere to international commitments is quicker and easier than changing the enforcement of newly enacted law, and work on the latter clearly remains to be done. This is better understood as a state problem than a national one, as the central government's ability is limited to improve the IPR enforcement that is supposed to occur at the local level. American companies and even government representatives should focus more on improving states' capacities than inducing Delhi to pass more laws. There is certainly much work to be done in this area.

From the Indian side, however, it is also the case that the occasional American IPR law has been held to be in violation of WTO requirements. For example, the European Union has problems with section 110(5)(B) of the U.S. Copyright Act and with section 211 of the U.S. 1998 Omnibus Appropriations Act. Under the former, most commercial premises (bars, restaurants, retail shops) can retransmit music without paying royalties to copyright holders. In 2000, a WTO panel found that this was incompatible with the WTO's rules on Trade-Related Aspects of Intellectual Property.[82] That finding did not end the dispute:

> Under the terms of a now-expired arbitration agreement, the US had in the past provided compensation directly to the EU right holders. The EU is not satisfied that the level of compensation was proportionate to the damage suffered, and in any event the compensation stopped in December 2004. The EU thus urges the repeal of the provision.[83]

Under the latter, there were problems with registering or renewing trademarks that had Cuban connections, for example, Havana Club rum:

> In 1997, drink giant Bacardi purchased the Havana Club trademark, the related goodwill and any rum business assets that still existed from the Arechabalas. This led to a dispute on the ownership of the trademark in the United States and to the

enactment of Section 211 at the behest of Bacardi.[84]

In 2002, the WTO ruled that Section 211 violates the national treatment and MFN (most favored nation) principles. Yet bills to repeal Section 211 are still pending in the U.S. Congress.[85]

Solution 4: Acknowledge Progress and Refocus

Trade disputes and friction between countries are inevitable. However, the India–U.S. dispute over IPR is currently being blown out of proportion. It was a major issue in the past, but very considerable progress has been made as part of India's progress globally on IPR. To maintain the positive momentum, India should consider several of the suggestions in the Special 301 Report:[86]

- IPR violations, including unauthorized disclosure of corporate secrets by regulators, cannot be excused by industrial policy goals.
- The backlog of patent applications should continue to be reduced.
- Enforcement of patent laws should be strengthened.
- National IPR officials should coordinate much more closely with state governments.

Progress on remaining issues will come more from better implementation by Indian states, where considerable work remains, rather than from government-to-government talks. The U.S. in particular must recognize this. While there are problems in IPR, if one draws up a list of priorities in the bilateral relationship at the national level, it should no longer be near the top.

Conclusion: Getting Away from Delhi and D.C.

This *Special Report* is the first installment of a project to help advance the India–U.S. economic relationship. The relationship could be vital to the two countries and the world as a whole, but its potential is far from being realized, chiefly due to the actions and inactions of the two national governments.

Progress will be faster and broader if the focus on government-to-government negotiations is replaced with an emphasis on cooperation at the level of individual companies and states. Illustrations of this improvement are sketched here for simple trade, (mining) investment, two-way labor movement, and intellectual property.

Much of the hope for progress on India–U.S. economic issues has been put on the prospects and scope of a bilateral investment treaty (BIT). When taken as a whole, the preceding recommendations could be viewed as an endorsement of an India–U.S. BIT that encompasses these sectors.

A BIT may be useful. But only a high-quality BIT—which includes sensitive topics, such as mining and intellectual property rights—can achieve the necessary progress on these and other critical bilateral economic issues. Current government-to-government talks are nowhere close to realizing such a BIT and the historical record indicates that a high-quality BIT is unlikely in the near future. Either no accord will be reached or the BIT will be largely empty of economic value.

Even if a sound BIT is eventually achieved, progress should not wait. There is much to be gained for India and the U.S. in the interim. Moreover, it is far more likely that action by individuals, companies, and states entirely outside the BIT process will eventually generate a good BIT than a good BIT will emerge from bilateral talks. These outside actions should start immediately.

It will require a great deal of work for sub-national actors to lead India–U.S. economic relations forward. But the rewards will be vast.

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