



The Challenge of Trade

Tackling the Achilles' Heel in the US-India Partnership

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THE CHALLENGE

If there is one relationship that can be considered truly transformative in India's foreign policy, it is the one with the United States. India has about thirty strategic partnerships in the world, but it is hard to think of any relationship more consequential than the one with America.¹ From the Next Steps in Strategic Partnership in 2004 to the new framework for India-US Defense Relations in 2005, the Indo-US nuclear cooperation agreement in 2008, the agreement on the India-US Defense Technology and Trade Initiative in 2012, the recognition of India as a Major Defense Partner in 2016, and the signing of LEMOA (Logistics Exchange Memorandum of Agreement) and COMCASA (Communications and Compatibility Security Agreement), the journey has been breathtaking and is ongoing. Defense trade, which was a lowly \$1 billion in 2008, is now well over \$20 billion.

By 2017, the US had bought into the concept of the "Indo-Pacific" propounded by the late Japanese leader Shinzo Abe.² It was also around the same time that the Quad (Quadrilateral Security Dialogue comprising the US, India, Australia, and Japan) was reinvigorated and given shape by the US and Japan.

Indo-US ties have gone from strength to strength. There are some fifty bilateral dialogue mechanisms between the two countries.³ This is unprecedented in bilateral relationships that India has with any other country.

Despite all of the above, cooperation on trade, investment, and intellectual property has been bedeviled by seemingly intractable issues. The US is one of the few countries with which India has a favorable trade balance. Conversely, the US suffers a trade deficit when it comes to India. In 2021, the US was India's largest trading partner, with two-way trade totaling \$160 billion. Out of this, the US has a trade deficit of about \$50 billion.

This has been a sore point between the two countries, with the United States contending that India remains a closed economy with high tariff barriers, particularly in agriculture, and cumbersome nontariff barriers. Because India has what is known as “tariff slack”—a gap between its applied tariffs, which it actually charges, and its bound tariffs, which under World Trade Organization (WTO) rules it cannot breach—it can actually raise its applied tariffs without violating its WTO obligations. India does this from time to time, causing uncertainty for US exporters.

India also opposes the continued US “Section 232” steel and aluminum tariffs, to which it retaliated with tariffs of its own. It speaks to the vibrancy of bilateral ties and the sheer power of market forces that despite all this, trade has shown an upward swing. Indeed, the US surpassed China to become India’s top trading partner in 2021-22.

The services trade, which includes IT and consultancy, freight, banking, and shipping, has been more balanced than other sectors. Total Indian services exports stand at over \$250 billion annually, out of which 60 percent are destined for the US. Investment ties also have potential, with Indian investment in the US reaching approximately \$13 billion and supporting over seventy thousand jobs. And there are over two hundred thousand Indian students in the United States, contributing \$8 billion annually to the US economy. US concerns include investment barriers, such as India’s limits on foreign ownership and its local presence requirements. For India, the questions are those of visa availability and the need for a “totalization agreement,” which would address the problem of Indian nationals who work in the United States for a short time but are still required to pay into US pension and gratuity funds, from which they do not benefit when they return to India.

Intellectual property rights (IPRs) have always been an area of contention between the two countries. Thus, India remains on the United States Trade Representative’s (USTR) Priority Watch List in 2022.⁴ The USTR’s Special 301 Report concedes that India’s enforcement of IPRs has gradually improved, that increased staffing has reduced patent examination times, and that engagement with the US on IPRs issues has accelerated. Despite this, the report concludes that there continues to be a lack of progress on long-standing concerns raised in prior Section 301 reports. It adds that India remains one of the world’s most challenging major economies with respect to protection and enforcement of IPRs.

On digital trade, there has been a positive development. A political agreement on this issue was reached between the two countries in November 2021. In exchange for India’s commitment to transition from its Digital Services Tax to a newly concluded global tax framework, the US agreed to terminate additional, already suspended, duties on certain goods from India.

On defense, bilateral trade has risen from next to nothing in 2008 to a whopping \$20 billion. The United States named India a Major Defense Partner in 2016. India was also granted Strategic Trade Authorization tier 1 status in 2018, allowing it license-free access to dual-use technologies. Reports have suggested that the US is preparing a military aid package for India to the tune of \$500 million. The objective would be to reduce Indian dependence on military

platforms from Russia. The major challenge is how to provide India platforms like fighter jets, naval ships, and battle tanks. A breakthrough could happen in 2023.

COOPERATIVE SOLUTIONS

The premier forum for resolving trade and investment issues between India and the United States is the Trade Policy Forum. This was established in 2010 but for a variety of reasons became dormant after 2017. After a long gap, it met in Delhi in November 2021. It has five focus groups: agriculture, innovation, investment, services, and tariff/nontariff barriers.

India and the United States should take the following steps:

- 1.** The United States must restore Generalized System of Preferences (GSP) status for India as soon as possible. Although in monetary terms this step would be worth only about \$6.6 billion to India, it would more importantly serve as a significant confidence-building measure. It is also linked to the bigger issue of the US recognizing India as a developing country, entitled to special and differential treatment (S&DT) in the WTO. Currently, by opposing S&DT for India, the US lumps India together with China. But as the US knows, India has much higher levels of poverty than China; some estimates put it at five hundred million in a population of 1.4 billion. Indeed, China's per capita income is over \$10,000 while India's is below \$2,500.⁵ This is an easy case, and the sooner the United States can align its policy with India's economic reality, the better it will be for the US-India strategic partnership.
- 2.** Pending the convening of the full Trade Policy Forum (which should meet at least once every six months, even if virtually), the individual focus groups could start work immediately. The tariff/nontariff group's first move should be to get rid of the excessive tariffs imposed by the US under Section 232, followed by removing India's retaliatory tariffs. This can be followed by withdrawal of the dispute cases that India and the United States have filed against each other in the WTO. India must provide some assurance to the United States that there will be no further increases in tariffs over and above the applied levels, at least for products of interest to the US.
- 3.** The innovation focus group of the Trade Policy Forum can deal with all outstanding issues regarding IPRs. India is negotiating free-trade agreements with both the European Union and the United Kingdom, and one of the subjects there is IPRs. India should keep this in mind, so that whatever it does with the EU and the UK can be applied to the US *mutatis mutandis*.
- 4.** Relevant focus groups of the Trade Policy Forum may deal with outstanding issues relating to services and investment. As noted earlier, the Forum seeks to activate its working groups in the fields of agriculture, tariffs, services, investment, and intellectual property. In January 2023, Minister Piyush Goyal and Ambassador Katherine Tai directed the working groups to reconvene quarterly and identify specific trade outcomes to ensure that the India-US relationship begins to reach its full potential. This relationship is far

too important to be left only to the bureaucracies of the Ministry of Commerce and of the USTR. It is important for ministers on both sides to be constantly engaged, and even involve the White House and the Prime Minister's Office if need be.

5. In the future, India and the United States must cooperate in the newly minted Indo-Pacific Economic Framework for Prosperity (IPEF).⁶ The US Indo-Pacific Strategy promises to support India's continued rise and regional leadership.⁷ In this context, it is noteworthy that India joined the IPEF as a founding member. The IPEF has four pillars: trade, supply chains, clean energy (decarbonization and infrastructure), and tax/anti-corruption. At the IPEF Ministerial held in Los Angeles in September 2022, India decided to join three of the four pillars and put off joining the trade pillar. It is important that India join this pillar without delay. It is hard to separate the trade pillar from the other three; all of them are interlinked. If the IPEF is meant to write the rules of Globalization 2.0, then India cannot but be part of it. Although this view is gaining ground, India needs assurance that the US will recognize its developing-country status and give it a reasonable transition period to meet the standards of countries like the US. India is certainly moving in the right direction. But with 30 to 40 percent of the population living in abject poverty, without a social safety net, it cannot be expected to make rapid progress on issues that will impact employment and cost of living.

CONCLUSION

The Indo-US strategic partnership has gone from strength to strength. But bilateral trade, investment, and commercial ties have not kept pace with sectors like defense. More important, they have the potential to impede and even imperil the bilateral strategic partnership in the Indo-Pacific beyond. It is necessary to act in a timely manner to ensure this does not happen.

The following measures may be taken to put relations in this area back on track:

1. The US should restore GSP for India and recognize its sui generis nature, that is, a low-income developing country with sectors of excellence, such as IT.
2. Both countries should remove forthwith the duties imposed by one another on steel, aluminum, etc.
3. Both countries should withdraw each other's disputes at the WTO.
4. A 2+2 meeting involving the State Department/USTR on the one side and the External Affairs Ministry/Ministry of Commerce on the other should convene.
5. Minister Goyal and USTR Tai should meet at least twice a year.
6. Prime Minister Narendra Modi and President Joe Biden should meet annually, setting aside some time to look at the trade, investment, and IPRs, so that effective political intervention can resolve problems in time.

The importance of Indo-US trade and economic cooperation cannot be overstated. India and the US must now work closely to deliver on their rhetoric by taking concrete actions. We must not get bogged down by tariffs, disagreements over GSP, and WTO disputes. Rather, India and the United States must get these problems out of the way, so that the issues discussed above can get the attention they deserve.

NOTES

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7. White House, "Indo-Pacific Strategy of the United States," National Security Council, February 2022, <https://www.whitehouse.gov/wp-content/uploads/2022/02/U.S.-Indo-Pacific-Strategy.pdf>.



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