Falling short: How bad economic choices threaten the US-India relationship and India's rise

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A study by authors at the American Enterprise Institute explains how a US-India strategic partnership built on weak economic foundations will likely flounder.

The United States and India are natural allies: Republicans and Democrats alike believe in the goal of a strong India, as a symbol of democratic capitalism, a counterweight to Chinese hegemony, an ally against radical Islam, and a global growth engine. In 2008, many in Washington viewed the signing of the historic US-India civil nuclear deal as the advent of a dynamic partnership with the potential to transform Asia and the world.

But today US-India ties are often characterised as unrealistic or oversold. On the one hand, Washington and New Delhi are engaged in more than 30 dialogues discussing everything from counterterrorism to clean cookstoves. On the other, economic and trade ties are on the decline even before the two giants have established a relationship worthy of their combined GDP of US$20 trillion. It also does not help that India's economic growth over the past 18 months has plunged to 4 per cent a year, the slowest in a decade. Will India live up to the forecasts of strategic prominence in Washington?

AEI authors argue that the key to fulfilling the strategic potential of the US-India relationship is to foster a vibrant entrepreneurial Indian economy linked to America by ideas, capital, people, and technology. To enable this, the study recommends initiatives both from the US and Indian sides.

The United States should start by amending the comprehensive immigration reform bill that tilts the playing field against Indian IT firms in America like Infosys, Tata, and Wipro, and toward their American competitors, by imposing increased provisions and high visa fees. India should be able to access liquefied natural gas exports on a routine rather than a case-to-case basis. The United States should support India's membership in the Asia-Pacific Economic Cooperation (APEC) – the world's largest trading bloc – as a step toward eventual inclusion in the Trans-Pacific Partnership. In addition, the United States should recognise a trend toward greater federalism and deepen relations with the fastest industrialising states like Gujarat, Maharashtra, Karnataka, Tamil Nadu, the National Capital Region, and Andhra Pradesh. It is also high time that both the countries picked up on the long overdue negotiation of a bilateral investment treaty to boost foreign investor confidence, further economic ties, and protect Indian firms in the United States.

For its part, India needs to encourage innovation by increasing intellectual property rights protection to foreign drug companies. Permanently scrapping a preferential market access policy that discriminates against foreign firms would also allay investor concerns about draconian local content requirements for technology purchases. Retroactive taxation, as seen in the case of Vodafone, along with the proliferation of sudden and indecipherable tax rules should also be done away with. India should also create conditions that allow American firms to participate in her nuclear industry. (The United States has not been able to sell a single nuclear reactor since the 2008 deal.)

Perhaps most importantly, India needs to fix its economy. Over the past two years, India's economic prospects have begun to come into question. Having ceded its coveted position to countries like Ghana and Indonesia, India can no longer call itself the fastest growing democracy or the fastest growing major economy after China, making India a harder sell for an ambitious strategic partnership with the United States. India remains one of the toughest big economies in which to do business.

While the authors cannot overstress the importance of kickstarting the incomplete second-generation reforms, specific areas such as land, goods and services tax, labour and skills, and power, could bring immense potential for much-needed economic growth. The new land bill – drafted without taking into account private sector concerns – is more complicated and will likely hurt the manufacturing sector and retard urbanisation and employment. A long-delayed goods and services tax would not only unify the Indian market but also likely eliminate distortions and create more transparency and efficiency. Indian labour laws need a major overhaul to reduce restrictions on small and medium businesses to boost formal sector business and employment, but the education system and skills programmes also need a revamp to suit the modernising economy. Finally, much work needs to be done to eliminate power shortages by privatising loss-generating state electricity boards and ending a government monopoly on coal.

To sum up, a strong India is in America's strategic interest, as this will enable India to pursue a more prominent role in the world in ways that naturally complement US goals. But for this to happen Indian business must be encouraged to flourish and develop a deep relationship with the American business community. For now this doesn't seem to be happening.

Click here to download the complete study, "Falling Short: How bad economic choices threaten the US-India relationship and India's rise". It is co-authored by Sadanand Dhume and Julissa Milligan, with Aparna Mathur and Hemal Shah, at the American Enterprise Institute in Washington DC.

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