Order Code RS21502
April 22, 2003

CRS Report for Congress
Received through the CRS Web

India-U.S. Economic Relations

Wayne Morrison and Alan Kronstadt
Foreign Affairs, Defense, and Trade Division

Summary

India's economy has shown relatively healthy growth since 1991 when an economic crisis caused the government to implement various economic reforms. Yet, many analysts view India's economy as falling below its potential, especially when compared to a country such as China, which has achieved far greater economic success over the past decade. The United States is India's largest trading partner. India is a relatively minor U.S. trading partner, although U.S. officials argue that it could be a potentially large market if India implemented further economic reforms. This report will be updated as events warrant.

India is a country with a long history and a large population (over 1 billion people, many of whom live in poverty). It is the world's largest democracy, a U.S. ally in the war against terrorism, and a potentially large export market. Thus, India's economic development and its trade relations with the United States are of concern to Congress.

India's Economy

Shortly after achieving independence from British rule in 1947, India pursued policies that sought to assert government planning over most sectors of the economy and strove to promote relative economic self-sufficiency. These policies included extensive government spending on infrastructure, the promotion of government-owned companies in many sectors, pervasive regulatory authority over private sector investment, and widespread use of trade and investment barriers to protect local firms from foreign competition. While some economic goals were achieved (such as rapid industrialization), the overall effects of these policies was to promote widespread inefficiencies throughout economy (e.g., unprofitable state-run firms and a constrained private sector) and to greatly restrict the level of foreign direct investment (FDI) in India as well as trade. India's real GDP growth was relatively stagnant during the 1970s, averaging about 2.7%. Piecemeal economic reforms and increased government spending during the 1980s, helped boost average real GDP growth to 6.0%.

1991 Economic Crisis and Reforms. India suffered a major economic crisis in 1991, due largely to the effects of oil price shocks (resulting from the 1990 Gulf War), the collapse of the Soviet Union (a major trading partner and source of foreign aid), and a sharp depletion of its foreign exchange reserves (caused largely by large and continuing government budget deficits).[1] The economic crisis led India, under the Indian National Congress (INC)–led government of Prime Minister Narasimha Rao, to cut the budget deficit and implement a number of economic reforms, including sharp cuts in tariff and non-tariff barriers, liberalization of FDI rules, exchange rate and banking reforms, and a significant reduction in the government's control over private sector investment (by removing licensing requirements). These reforms helped boost economic growth and led to a surge in FDI flows to India in the mid-1990s (annual FDI rose from about $100 million in 1990 to $2.4 billion by 1996; of which, more than one-third came from U.S. companies). Reform efforts stagnated, however, under the weak coalition governments of the mid-1990s. The 1997/1998 Asian financial crisis, and U.S. imposed sanctions on India (as a result of its May 1998 nuclear tests), further dampened the economic outlook. Following the 1999 parliamentary elections, the new Bharatiya Janata Party (BJP)–led government, under Prime Minister Atal Vajpayee, launched second-generation economic reforms, including major deregulation, privatization, and tariff-reducing measures. During the 1990s, real GDP growth averaged 5.6%; from 2000-2002 it averaged 4.7%.

Current Economic Conditions. By some measurements, India is one of the world's largest economies. While on a nominal basis, India's 2002 GDP was $485 billion, on a purchasing power parity (PPP) basis, it was $2.7 trillion, making it the world's 4th largest economy (after the United States, China, and Japan).[2] However, its per capita GDP on a PPP basis (a common measurement of a nation's living standards) was $2,610, equal to only 7.2% of U.S. levels. Poverty is perhaps India's greatest problem. According to the World Bank, India has 433 million people (44.2% of the population) living below the international poverty measurement of less than $1 per day.[3]

According to official Indian trade data, its 2002 exports and imports were $43.6 billion and $51.1 billion, respectively.[4] According to the World Trade Organization (WTO), in 2001, India was the world's 30th largest merchandise exporter and the 27th largest importer.[5] India's principal exports in 2002 were textiles (22% of total), gems and jewelry (16.8%), and chemicals and related products (14.5%), and its top three imports were petroleum (27.4% of total), pearls and precious and sem-precious stones (9.0%), and gold and silver (8.9%). Its top three trading partners were the United States, the United Kingdom, and Belgium. India's top three destinations for its exports were the United

[1] The central government's budget deficit as a percent of GDP averaged over 7% from 1980 to 1990. The high level of government debt became unsustainable as the high right of government borrowing raised real interest rates, sparked inflation, and undermined faith in the currency.

[2] PPP data reflects foreign data in national currencies converted into U.S. dollars, based on a comparable level of purchasing power these data would have in the United States.

[3] The World Bank notes that India has made significant progress in reducing poverty, especially in recent years. It estimates that India's poverty rate in the 1970s was over 50% Official Indian government poverty rate measurements differ from World Bank data; it estimates that the poverty rate at 26% (at the end of the 1990s), down from 36% in 1993/1994.

[4] India reports its trade data according to fiscal year, which runs from April-March. The cited data are for April 2001-March 2002. Source: *Indian Ministry of Commerce*.

[5] The World Bank estimates that, based on the size of India's economy, its level of trade should be $150 billion higher than it currently is.

States (19.5% of total), the United Arab Emirates, and Hong Kong, and its top sources for imports were the United States (6.1% of total), Switzerland, and Belgium.

Comparisons Between India and China. Many analysts argue that India's economy has failed to live up to its potential, especially relative to other developing countries, such as China, which has a comparable population size, but has enjoyed far greater economic development in recent years. **Table 1** indicates that both India and China experienced significant growth in population, GDP and per capita GDP (both measured on a PPP basis), trade, and FDI over the past 12 years. However, on several economic fronts, India lost significant ground to China.

Table 1. Selected Comparative Data for India and China: 1990 and 2002

	India		China		India's Size Relative to China	
	1990	2002	1990	2002	1990	2002
Population (millions)	850	1,046	1,139	1,284	74.6%	81.5%
GDP, PPP basis ($billions)	1,189	2,732	1,583	6,032	75.1%	45.3%
Per Capita GDP in $PPPs	1,400	2,610	1,390	4,700	100.1%	55.5%
Exports ($millions)	17,975	46,232	62,090	293,753	28.9%	15.7%
Imports ($millions)	23,438	55,035	42,354	278,151	55.3%	19.8%
FDI stock ($millions)	1,592	26,255	68,513	445,287	2.3%	5.9%

Note: PPP refers to purchasing power parity. Such data reflect the purchasing power of foreign data in U.S. dollars.
Source: Economist Intelligence Unit.

In 1990, India's economy (GDP, PPP basis) was about three-quarters the size of China's, but by 2002 it was less than half. India's living standards (per capita GDP, PPP basis) was slightly greater than China's in 1990, but by 2002 it had fallen to 55.5% of China's. India's exports relative to Chinese exports fell from 28.9% in 1990 to 15.7% in 2002, while imports dropped from 55.3% to 19.8%. India made small gains in FDI flows relative to China over this period (rising from 2.3% to 5.9%), however, the total level of FDI stock in China was substantially higher than that going to India in both periods. In fact, FDI flows to China in 2002 alone (nearly $53 billion) were more than double the cumulative stock of FDI in India through 2002 ($26 billion). Many economists attribute the sharp widening economic gaps between India and China to differences in the pace and scope of economic and trade reforms undertaken by each country, where China has substantially reformed its trade and investment regimes (which has contributed to sharp rises in GDP growth, trade, and FDI flows), India's economic reforms have been far less comprehensive and effective. For example, China's average tariff has fallen from 43% in 1992 to12% in 2002. India's average tariff during this period dropped substantially, from 128% to 32%, but still remains among the highest in the world.

U.S.-Indian Economic Relations

In 2002, U.S. exports to, and imports from, India totaled $4.1 billion and $11.8 billion, respectively (see **Table 2**), resulting in a $7.7 billion trade deficit. India was the

27th largest U.S. export market and the 19th largest supplier of U.S. imports. Between 1998 and 2002, U.S. exports increased by 16% while U.S. imports from India rose by 44%.[6] Major U.S. exports to India included computers, aircraft, and electrical machinery. Top U.S. imports from India were non-metallic manufactured minerals (mainly processed diamonds), clothing and apparel, and textile yarns and fabrics. Because India is a developing country and meets other criteria set in U.S. law, $2 billion worth of its exports entered the United States duty-free under the Generalized System of Preferences (GSP). Indian government data list the United States as India's second largest source of FDI (after Mauritius),[7] accounting for $3 billion (or 16%) of total FDI flows to India from 1991 through July 2001.[8]

Table 2. Major U.S.-Indian Trade Commodities: 1998-2002
($millions)

	1998	1999	2000	2001	2002
Total U.S. Exports	**3,545**	**3,707**	**3,663**	**3,764**	**4,098**
Office machines and automatic data processing machines (i.e., computers)	175	218	367	349	371
Transport equipment (mainly aircraft and parts)	454	424	312	394	331
Electrical machinery, apparatus, appliances, and parts	214	213	264	311	306
Total U.S. Imports	**8,225**	**9,083**	**10,686**	**9,738**	**11,818**
Nonmetallic mineral manufactures	2,062	2,499	2,768	2,180	2,931
Articles of apparel and clothing	1,642	1,646	2,002	1,934	2,064
Textile yarns and fabrics	893	988	1,119	1,050	1,260

Source: U.S. Department of Commerce.

Major U.S.-Indo Trade Issues

India's sizable population and large and growing middle class make it a potentially large market for U.S. goods and services.[9] However, a number of factors hamper increased economic ties. First, in addition to maintaining high tariff rates on imports

---

[6] In May 1998, the United States imposed a number of economic sanctions against India (and Pakistan) for conducting nuclear tests. Such sanctions may have dampened U.S.-Indo economic relations over the past few years, although some sanctions were removed shortly after they took effect and all were lifted after the September 11 terrorist attacks against the United States. See, CRS Report RS20995, *India and Pakistan: U.S. Economic Sanctions*, by Dianne Rennack.

[7] Many foreign firms invest in India through Mauritius for tax purposes.

[8] U.S. Commerce Department data on U.S. FDI flows to India differ from Indian data. Commerce estimates total U.S. FDI in India at year-end of 2001 (on a historical cost basis) at $1.7 billion.

[9] Estimates of the size of India's middle class widely differ. Using Indian standards, estimates of the middle class run as high as 300 million people. The Commerce Department estimates that India has 20 million "well-off consumers" with annual incomes exceeding $13,000, and 80 million people with incomes over $3,500, and 100 million people with incomes over $2,800.

(especially on products that compete with domestic products), India also assesses high surcharges and taxes on a variety of imports. Major non-tariff barriers include sanitary and phytosanitary restrictions, import licenses, regulations that mandate that only public sector entities can import certain products, discriminatory government procurement practices, and the use of export subsidies.[10] A variety of restrictions are placed on foreign services providers and on the level of permitted FDI in certain industries. Second, India continues to maintain a number of inefficient structural policies which affects it trade, including price controls for many "essential" commodities, extensive government regulation over many sectors of the economy, and extensive public ownership of businesses, many of which are poorly run. Third, despite India's attempt to develop internationally competitive information technology industries (such as software), U.S. government officials charge that India has a poor record in protecting intellectual property rights (IPR), especially for patents and copyrights. The International Intellectual Property Alliance (IIPA) estimates that IPR piracy in India cost U.S. firms $468.1 million in lost trade in 2002.[11]

India's extensive array of trade and investment barriers has been criticized by U.S. government officials and business leaders as an impediment to its own economic development as well as to stronger U.S.-Indian ties. For example, in U.S. Ambassador to India, Robert Blackwill has stated that the lagging bilateral performance of trade and investment is "the missing piece in our bilateral relationship." Deputy U.S. Trade Representative Jon Huntsman asserted in February 2003 that progress in transforming the U.S.-Indian economic relationship has been "too slow." Among the reasons for a lack of progress, he identified India's "grudging attitude" toward imports that produces "multiple, onion-like barriers" to potential exporters. He also noted that "India's tariff and tax structure undermines its commitments in the WTO," and that India's high agricultural support prices have encouraged overproduction in that sector.

Prospects for India's Further Economic Reform

India faces a number of significant challenges to its goals of sustaining healthy economic growth and further reducing poverty. Many economists argue that India needs to substantially liberalize its trade and investment regimes, accelerate privatization of state firms, cut red tap and crack down on corruption, and substantially boost spending on its in physical and human infrastructure.[12] However, large and continuing government deficits, and the high level of public debt (equal to over 60% of GDP) severely hampers the ability of the government to boost spending for needed infrastructure projects, without major reforms to the tax system and significant cuts in government subsidies.

---

[10] Historically, India maintained extensive non-tariff barriers on many imports, based on balance-of-payments reasons. However, in 1999, a WTO dispute resolution panel ruled that these restrictions were no longer justifiable, which prompted India (in 2001) to remove many of its quantitative import restrictions (although many of these barriers were replaced with high tariffs).

[11] Concerns over India's poor IPR protection record led the United States in 1992 to impose economic sanctions against India by suspending GSP benefits for certain imports. Some GSP benefits were restored in 2001after some improvements were made. However, IPR piracy remains a serious problem in India.

[12] On the political front, tensions with Pakistan and continued violence in the disputed territory of Kashmir pose serious threats to India's long-term economic health.

Organized resistance to many of the desired reforms comes in large part from Hindu nationalist groups that are increasingly influential since the BJP's ascendance in 1998. The "Forty Points of Hindu Agenda," as outlined by the World Hindu Council in 1997, includes an explicit call for an Indian economic policy "based on Swadesh" (or self-reliance). As a "sister organization" to the Rashtriya Swayamsevak Sangh (RSS) – itself the major Hindu nationalist organization – the Swadeshi Jagaran Manch (SJM) has taken the lead in efforts to forward the *Swadeshi* 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 ..." The SJM is resolved to oppose any further globalization of India's economy, claiming that the "invasion" of FDI has caused "unprecedented unemployment" and the closure of thousands of small-scale industries.[13] Another affiliated group, the Bharatiya Mazdoor Sangh, lobbies in opposition to any further liberalization of India's labor laws. Protection of India's agriculture and textile industries is viewed as especially vital. These kinds of anti-globalization policies continue to enjoy limited, but still substantial, backing among Indians.[14]

Despite the sometimes considerable resistance to further progress with India's economic reforms, most analysts believe that major state elections in 2003 and scheduled national elections in 2004 will not alter New Delhi's general policy direction in any meaningful way. Top BJP figures appear eager to move forward with privatization, and a solid December 2002 BJP electoral victory in the western state of Gujarat has provided fresh impetus for these efforts. The main opposition INC, while posturing itself as a protector of public sector jobs, has assisted in the reform process. Still, many observers argue that a sometimes fractious national coalition government is unlikely to amass the parliamentary votes necessary to push through legislation on controversial major economic reforms (such as those dealing with the financial and agricultural sectors), or to significantly reduce the government's budget deficits, barring a major economic crisis. Thus, New Delhi's movement on key reform issues could remain slow in the near- and medium-term.[15] Still, India's near-term economic prospects appear to be positive, according to various private economic forecasting firms. For example, DRI/WEFA projects India's real GDP will rise by 5.7% in both (fiscal year) 2003 and 2004, while the Economist Intelligence Unit projects real GDP growth at 5.9% and 6.6% respectively.[16]

---

[13] See the Swadeshi Jagaran Manch at [http://www.swadeshi.org].

[14] During the autumn of 2002, New Delhi's efforts to move forward with the privatization of the country's two largest oil concerns – Bharat Petroleum and Hindustan Petroleum – ran into considerable resistance from the so-called *Swadeshi* lobby. The acrimony raised concerns about a potential split in the ranks of the ruling coalition.

[15] "India Risk: Government Effectiveness Risk," Economist Intelligence Unit, April 9, 2003; "Govt Win in Gujarat May Revive India's Selloff Program," Dow Jones International News, December 5, 2002; Rajesh Ramachandran, "Cong Get Economic Slogans to Take on BJP," Times of India (Delhi), March 31, 2003.

[16] DRI-WEFA, *Global Insights: India*, April 16, 2003. Economist Intelligence Union, *Country Report, India, April 2003 Updater*, April 1, 2003.