

Failure to Launch



Exports would create American jobs, and India's new public-investment program offers a huge opportunity. So why aren't we tapping it? **By Bruce Stokes**

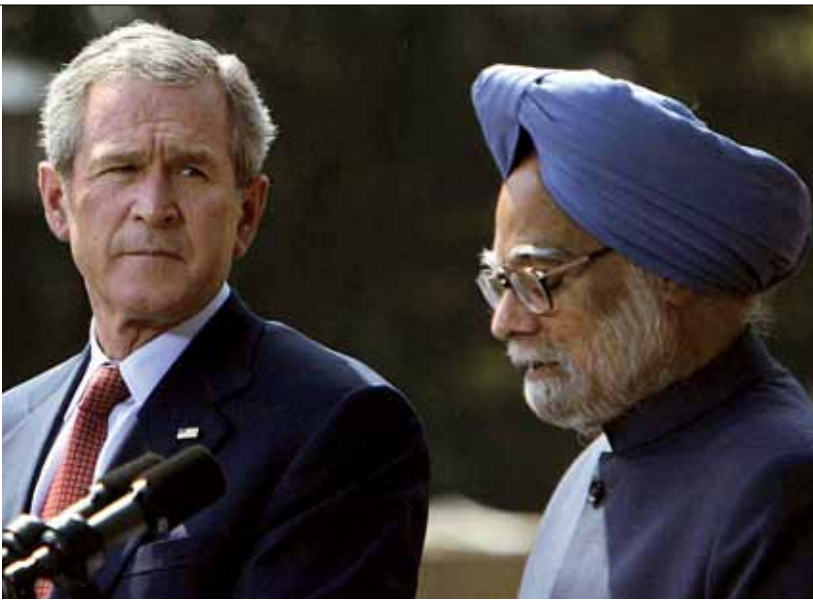


If you build it: India intends to spend billions on new construction.

NEW DELHI—What a difference \$2.7 billion makes. The Delhi airport was once a crowded, dirty, chaotic portal into India's capital city. A visitor's ensuing ride into town could take hours, as cars, overloaded trucks, and three-wheeled auto rickshaws

jockeyed with pedestrians and cows along a congested, poorly maintained roadway. Today, thanks to that enormous public investment, the sleek, spacious Indira Gandhi International Airport rivals those in Beijing or Hong Kong for both efficiency and creature comfort. And travelers can speed downtown in half the time on the new subway or a recently completed expressway.

After years spent talking about the need to improve its overtaxed and crumbling infrastructure, India is finally doing something about it. Nearly four miles of roads are being completed every day. Three dozen nuclear power plants are under construction or on the drawing board, and the country hopes to build 800 universities over the next decade. Overall, the Indian government intends to



Suitors: Prime Minister Manmohan Singh with President George W. Bush (top), signing the nuclear pact; and with former Japanese Prime Minister Yasuo Fukuda.

spend \$1 trillion between 2012 and 2017 to improve the country's ports, railways, highways, and power-generation capacity.

India's infrastructure challenge is America's business opportunity. The impending investment boom could prove a bonanza for U.S. companies. General Electric, for example, hopes to sell hundreds of locomotives to help modernize India's rail system and gas turbines to help supply its cities with electricity. "The economic relationship between the United States and India is one of enormous untapped potential," President Obama told a business audience in Mumbai during his trip to India in November.

Much is at stake in tapping that potential, for the Obama administration as well as for the U.S. economy. The U.S.-India trade relationship is a test of Obama's promise to double American exports by 2015. The White House assumption that exports mean jobs and jobs mean reelection votes in 2012 adds up only if U.S. companies can significantly increase their sales in large and rapidly growing

markets such as India. Incremental increases in exports to small markets in Africa and Latin America won't boost hiring enough to dent the politically pivotal U.S. unemployment rate.

Moreover, the administration has vowed to rebalance economic relations with the world to avoid piling up the kinds of trade imbalances that contributed to the 2008 financial crisis. That makes it crucial for American exporters to find deep-pocketed foreign customers with big spending plans.

American merchandise exports to India have been increasing, more than quadrupling in the past decade off a very low base. They were up 17 percent in the first 11 months of 2010, the latest data available. While he was in India, Obama announced additional deals—including sales by Boeing of dozens of commercial and cargo aircraft—that will boost U.S. exports by nearly \$10 billion. In addition, American officials list \$19 billion in pending defense sales to India and an additional \$1 billion in exports of homeland-security equipment.

But even those successes fall far short of America's potential business in India. U.S. sales to the country are only one-fifth of American exports to China. Given the relative size of the two economies, U.S. firms should be able to sell at least twice as much to India as they currently do.

Moreover, American companies trail far behind some of their competitors in the Indian market. In 2009, U.S. exports to India were half of Europe's. "Our bilateral trade and investment is growing but not as fast as it could or should," complained Susan Schwab, the U.S. trade representative in George W. Bush's second administration. "The pace of reform and the level of uncertainty in India are holding back U.S. firms."

But the United States is also dragging its feet. American corporations have allowed themselves to be distracted for far too long by the allure of the China market, which until recently was growing much faster but now offers fewer opportunities than companies once thought they would find there. Washington has stood by while Seoul and Tokyo negotiated free-trade agreements with New Delhi. Brussels is now pursuing its own deal.

In the years ahead, U.S. prosperity—not to mention the political fortunes of the Obama administration—will depend in part on America's ability to participate in India and other burgeoning markets. But attempts so far to realize success suggest just how hard it will be. Obama's goal for the relationship will require a lot more work by both Washington and the U.S. private sector.

THE IMMEDIATE PROBLEM

The U.S.-India economic relationship has always been a shallow one. This year, U.S. merchandise sales to India will total about \$19 billion. America sells almost twice as much to Brazil, whose economy is roughly half India's size. As recently as 2000, U.S. firms exported just \$3.7 billion to India. In addition, the United States sold \$10.4 billion in commercial services there in 2008. This compares with \$15.9 billion in services that Americans sold to the Chinese.

But India sells much more to America. The United States is expected to run a merchandise trade deficit with India of about \$12 billion this year, at or near a record level, and it tallied a \$1.6 billion services deficit in 2008. This has drawn little attention from policymakers. But U.S. imports from India grew some 40 percent in 2010, more than double the rate of American exports there, a troubling trend. The U.S. trade deficit with India is relatively small: The imbalance with China, for example, is likely to be \$260 billion in 2010. But given the Obama administration's difficulties in curbing the China deficit, it needs to worry about any rising deficits else-

where that could increase the global U.S. imbalance and thus contribute to worldwide economic instability.

Nevertheless, India is unquestionably a growing market. The International Monetary Fund expects the nation's gross domestic product to grow by 8.4 percent this year and 8 percent next year. At that pace, India will soon be the world's third-largest economy, surpassing Japan.

Indian economists are more circumspect. Just last year, they confidently assumed that double-digit growth was their destiny, enabling India soon to surpass China as the world's fastest-growing major economy. But India's inflation exceeds 8 percent. To slow the rise in prices, the central bank felt compelled to increase interest rates seven times in the last 10 months, threatening to hobble future growth.

The consensus, according to interviews with economists and business leaders in India, is that rising prices are largely a product of supply bottlenecks, inefficiency in getting food to markets, power outages, and transportation breakdowns. Solving these problems requires a better infrastructure, and that is creating an opportunity for the U.S. and other foreign competitors to benefit from India's systemwide upgrade.

New Delhi hopes to invest \$200 billion a year for the next five years in roads, rail, and ports. But the country's track record on such spending is mixed. India has the second-largest mobile-phone network in the world, with 730 million cell-phone subscribers, trailing only China—suggesting that it can get infrastructure right. But in fiscal 2010, the government added only two-thirds of the power-generating capacity it had hoped to complete. It laid less than half the new rail lines it intended to build. "If we have business as usual," said Rajiv Kumar, director general of the Federation of Indian Chambers of Commerce & Industry, "the \$1 trillion will never get delivered."

The first challenge for India will be finding the money. The government hopes to raise half of its infrastructure budget from the private sector through public-private partnerships in which a company finances, constructs, and operates a port or toll road—collecting fees from users to cover its costs and profit—and then turns the facility over to the government after a defined period.

But the private sector may have trouble raising its share. Indian law restricts banks to short-term lending. Roads and ports have longtime horizons and are best financed by selling bonds. The government hopes that the private sector can raise \$350 billion through long-term borrowing, but the Indian corporate-bond market is thin because of government regulations.

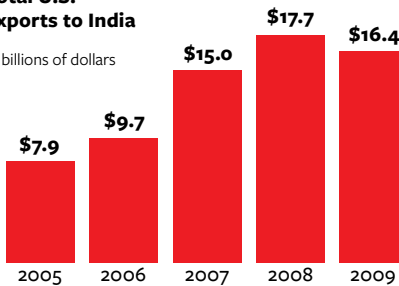
This bottleneck impedes all sorts of po-

U.S. Exports to India

Despite being the second-largest country by population, India doesn't rank in the top 10 of total exports from the U.S.

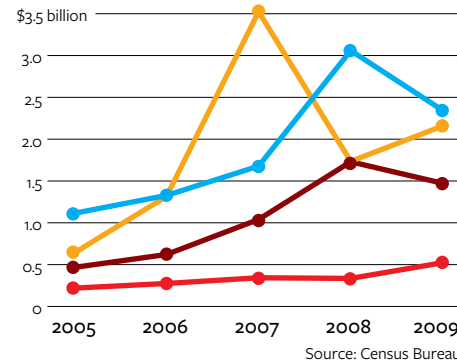
Total U.S. exports to India

In billions of dollars



Sampling of exports to India by product

FOODS AIRCRAFT
CHEMICALS GEM DIAMONDS



tential business for American firms, including those on Wall Street. New Delhi requires Indian insurance and pension funds to hold corporate debt rated AA or better. (There is no large venture-capital market in India.) Out of fear that a company's rating might be downgraded at any moment, many of those funds hold only AAA bonds, meaning that they can't invest in infrastructure projects. There also are limits on how much corporate bond debt foreigners can hold, which restricts the participation of U.S. investment funds.

The U.S. Treasury Department is trying to persuade the Indian finance ministry to allow bonds of various grades to be bundled to enhance their creditworthiness—which would give investment-fund managers greater flexibility—and to allow more foreign participation in the corporate bond market. So far, these proposals have met resistance, with Indian critics worried that such financial engineering is precisely what got Wall Street into trouble.

A solution may be at hand, however. According to background briefings by Indian government officials, New Delhi, with the support of the Indian business community, is thinking of channeling private institutional investment into an infrastructure fund that would then

buy up long-term debt from banks. Such a middleman would allow bank capital to be rolled over for investment in new infrastructure.

THE COMPETITION

Even if the Indian government can marshal and spend the planned infrastructure money, it's not clear how much of that business American companies can realistically contend for. The competition will be stiff. Japan's exports to India are one-third of the United States', for instance, but Tokyo is racing to carve out a larger share of the Indian market for Japanese companies.

Japan has agreed to provide financial and technical support for a \$90 billion industrial corridor that India plans to build between Delhi and Mumbai, a region that is home to one in seven Indians. The project includes construction of nine special industrial zones; a high-speed freight line; three seaports and six airports; a six-lane expressway; and a major power plant. The necessary money would come from the Indian government, low-interest Japanese government loans, and investment by Japanese firms. (These low-interest loans are advantages that the United States does not provide.)

Japan's goal in backing this ambitious project is to create an environment that will encourage Japanese firms to invest in manufacturing production in India because of easy access to the port of Mumbai, which will enable them to use factories in India to export to the world. In the process, Komatsu is expected to sell millions of dollars worth of earth-moving equipment (at Caterpillar's expense), Mitsubishi will sell power-generating equipment (at GE's expense), and Japanese companies will win construction contracts.

The corridor is already behind schedule, but Indian observers say it doesn't matter if some of it never gets built. Japanese firms are buying a foothold in the Mumbai region, using cheap capital raised in Tokyo that will pay off handsomely for them in the future.

The European Union is mounting a similar effort to grow its market share in India: Brussels launched free-trade negotiations with New Delhi in 2007. Deliberations have taken far longer than anticipated, thanks to Indian reluctance to reduce tariffs on some products and European insistence on certain labor and environmental provisions. But both Indian and European trade officials now say they will finish by mid-2011.

Initial E.U. studies showed that such a deal could increase exports to India by nearly one-third, doubling the overall share of E.U. exports that go there. Manufacturers (particularly the auto industry) and providers of business services would be the prime beneficiaries. The final accord is likely to be less ambitious than initially anticipated, but it will

give Siemens and other European firms better access to the Indian market than their American competitors have.

To date, the United States has been a bystander in this competition for the emerging Indian market. Americans have long been skeptical of grand projects on the scale of the Delhi-Mumbai corridor, worrying that they smack of overly ambitious government planning and use of public funds to subsidize private undertakings. Despite the interest of both nations' business communities, U.S. officials, wary of appearing to encourage the outsourcing of jobs, have held back ambitions to deepen commercial relations through a formal free-trade agreement that would involve a bruising fight on Capitol Hill.

Given what Japan and Europe are now doing to bolster their trade with India and the potential that their efforts could erode the U.S. market share there, the Obama administration may not be able to afford the luxury of such ideological and political inhibitions. "We are at an inflection point in the economic relationship," said Marshall Bouton, president of the Chicago Council on Global Affairs. "But we have not figured out where to go next in deepening and thickening this relationship."

AMERICAN HURDLES

Several barriers slow American efforts to capture some of India's looming infrastructure bonanza. "Even though India has made tremendous strides to open up its economy," Commerce Secretary Gary Locke said in New Delhi this week, "there is much work left to be done. While many tariffs have come down, others remain, ranging from 19 percent levies on civil-aviation aircraft to 26 percent on X-ray film. When there are not outright tariffs, there are other, nontariff barriers that limit trade and investment, including mandatory technology-transfer requirements for telecom equipment; limits on foreign direct investment in key sectors; and inadequate protection of intellectual-property rights."

Another problem is corruption. India ranks 87th out of 174 countries in public corruption, according to the annual survey by Transparency International, a nongovernmental watchdog. That is worse than Brazil, China, and South Africa—all countries that compete for the American business community's attention.

The U.S. Foreign Corrupt Practices Act formally bars American citizens from paying bribes to foreign officials to obtain business.

American executives in India, including those at large American multinationals who spoke on background, grouse that they often have to walk away from deals involving payoffs that would run afoul of U.S. law, conceding business opportunities to their less legally constrained Chinese, European, and Japanese competitors. (Cynics in India, including leaders of the business community who spoke on background, report that many U.S. firms are not above looking the other way when their Indian subcontractors grease the palms of local officials.)

Still, American corporate leaders do not advocate weakening Washington's stance against corruption, because graft is not only a moral issue but also an economic one. Indian business leaders estimate that bribes eat up at least 15 cents of every dollar of infrastructure spending. So until New Delhi gets a better handle on corruption, graft will constrain the Indian market for U.S. exports and investment.

Prospects for immediate ethical improvement don't look good. A corruption scandal involving the award of mobile-phone licenses has gridlocked the Indian government for months. Prime Minister Manmohan Singh is widely admired abroad for spearheading India's economic transformation beginning in the early 1990s, but he is criticized at home for his handling of the scandal. A recent Cabinet reshuffle has touched off speculation about his successor, and some opposition members of Parliament predict that the government may need to call an early election.

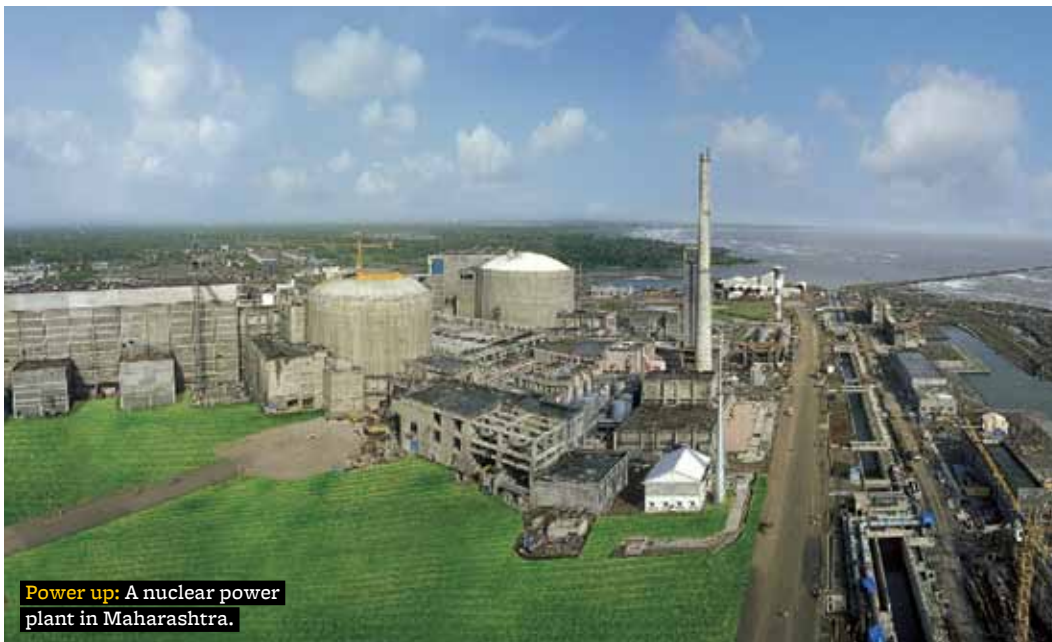
Other industry-specific problems loom. The most high profile and immediate one involves American companies awaiting implementation of the U.S.-India Civil Nuclear Cooperation deal.

In 2005, India consented to separate its civilian and military nuclear facilities and to place its civilian nuclear program under international safeguards. In return, the United States agreed to lift constraints on exports to India of American nuclear technology. The deal was the cornerstone of Bush administration efforts to forge closer ties with India. U.S. nuclear firms hoped that it would help them cash in on India's plans to triple the percentage of electricity generated by nuclear power by 2030.

It took Congress until 2008 to approve the agreement. The Indian Parliament followed suit in August 2010. But the legislation that implements the deal in India makes foreign and domestic sup-

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U.S. Commerce Secretary Gary Locke



Power up: A nuclear power plant in Maharashtra.

pliers of equipment, raw materials, and services for civilian nuclear reactors—not just the plant operators—legally liable for damages 80 years after construction in the event of a nuclear accident. (This caveat reflects Indian resentment over inadequate compensation for thousands of victims of a 1984 chemical leak at a Union Carbide plant in Bhopal.)

American business leaders contend that such liability will inhibit them from bidding on Indian nuclear projects. Indian officials say there is no way to revisit the issue, but they promise to address the concerns when they write the regulations. “Americans’ capacity to participate will in no way be hindered by this liability bill,” promised one senior government official.

Russian and French competitors for nuclear projects have also complained about the liability issue. But American officials worry that Moscow and Paris will ultimately indemnify their companies against such risk in ways that Washington does not, effectively denying business to GE, Westinghouse, and other U.S.-based firms. “The Obama administration has done all it can to move the agreement forward,” said Nicholas Burns, who helped negotiate the deal as the undersecretary of State for political affairs in the Bush administration and now teaches at Harvard University. “It is now up to the Indian government to give the assurances it must on the liability issue to permit the agreement to be finally operational.”

More, however, is at stake. “The civilian nuclear deal is not only important in itself,” the Chicago Council’s Bouton observed. “It is also a signal to the American business community about whether the large boulders that have previously obstructed doing business in India can be cleared aside.”

Political turmoil could derail other potential economic opportunities for the United States in India. The telecom corruption scandal stalemated the December parliamentary session, for example, delaying legislation that would have made it easier for U.S. universities to participate in the coming boom in Indian higher education.

Indian demand for American educational services is high. More Indians now study on American campuses than do students from any other nation. Many who can’t make it to the United States take classes online. Indians account for the largest number of users of online courses offered by the Massachusetts Institute of Technology, for example.

New Delhi hopes to more than double domestic enrollment in higher education in the next decade by opening thousands of colleges and hundreds of universities, including 14 innovation institutions, which the government would like to partner with American schools. Additional opportunities could open up for cooperation in vocational education between



Buy American: GE hopes that Indian firms will purchase new locomotives.

Indian institutions and the American community-college system. “There is a great opportunity in terms of investment,” says Kapil Sibal, the minister for human-resource development. To help realize this business potential, Obama and Singh agreed to convene a higher-education summit this year.

But legislation that would allow foreign educational providers to establish campuses in India and to grant degrees is stuck in the gridlocked Parliament. Moreover, the bill’s current provisions require an \$11 million good-faith deposit by foreign universities and bar for-profit educational institutions. Such stipulations may severely constrain American interest in the Indian higher-educational market. “If India can pass the necessary legislation to open up its own system,” said Burns, who has been working on Harvard’s efforts to deepen cooperation with India, it might “create a network of ties that will benefit India and also help American universities to create a new international future for themselves.”

WHO REALLY BENEFITS?

Lost amid the Obama administration’s hopes for the Indian market is hard-nosed cost accounting about the benefits for the U.S. economy. The president asserted that the export sales he announced during his Indian visit would support 54,000 American jobs. That number will grow if the administration is successful in its ambition to double U.S. sales to India. Yet the payoff could be less than Americans hope. The propulsion systems for the locomotives that GE wants to sell to India will come from the United States, for instance, but much of the labor-intensive final assembly will be done in India.

U.S. defense contractors will be under growing pressure to build in India much of the equipment they hope to sell to the Indian military, or to offset their cost with the production of other goods in India. Such offset issues were a major problem for U.S. military sales to Japan in the 1980s—and a replay with India is almost inevitable. “President Obama’s trip here was successful,” one Indian business leader quipped, “because he avoided

two words: outsourcing and offshoring.” With unemployment at 9 percent in the United States, he may not be able to dodge that issue in Washington.

Fear of job losses to India is one reason the Obama administration, like the Bush administration before it, has been gun-shy about a formal effort—such as a free-trade agreement or some kind of bilateral investment treaty—to deepen Indian-American economic ties. The Confederation of Indian Industry and the U.S.-India Business Council both support a U.S.-India free-trade deal. “We have one with Japan, one with Korea, and one in the works with the European Union,” said Pritam Banerjee, head of international policy and trade for the Indian confederation. “It makes no sense not to have one with the United States.”

Rahul Khullar, India’s commerce secretary, said, “The real concern from an American perspective should be that there will be trade diversion”—meaning others will sell things to India if the U.S. won’t—“once these deals [with other nations] go through. Who will benefit? It’s German, Korean, and other firms that will face no tariffs.”

Nevertheless, Schwab, the former U.S. trade representative, said, “I am not sure that India and the U.S. will be ready for a quality free-trade agreement anytime soon. But we should not lose sight of the fact that there is so much the two governments could be doing to improve trade and investment short of such a deal.”

What those efforts might be is not clear. The drive to negotiate a bilateral agreement that would, in principle, spur U.S. investment in India and lead to more American exports there, has gone nowhere for years, with Indian officials contending that the ball is in the Americans’ court. So Washington is left to cheerlead for U.S. companies chasing one-off sales like the Boeing deal. Unfortunately, they are often stymied by bureaucratic and political inertia. With no overarching political commitment on either side to a deeper economic relationship, such roadblocks will continue to impede trade.

This lack of vision may prove shortsighted. Obama’s promise to double U.S. exports—and his ability to deliver on that job-creating commitment—affect his reelection prospects. Moreover, the indebted U.S. economy needs to increase its exports as fast as possible. India is the world’s second-fastest-growing large market. American companies need to diversify their international business to be less dependent on China, which is increasingly not a market but a competitor. And India needs all of the help it can get to build out its infrastructure to realize its economic potential and meet the needs of its rapidly growing population.

The mutual interests are clear. The only thing missing is the political will—in both capitals—to do something about it. ■