Impact of Domestic Economic Influences on Indo-US Relations

Lieutenant Colonel Vivek Chadha

India's economic metamorphosis began in 1991, with the Narasimha Rao government coming to power and its Finance Minister Manmohan Singh, introducing a series of economic reforms, which transformed India. Within a span of five years India, from endlessly remaining a potential economic power reached the threshold of economic boom. The Gross Domestic Product (GDP) saw a quantum jump from three per cent to more than double the rate per annum. Foreign Direct Investment (FDI) increased, as opportunity and potential were unleashed. Most importantly, liberalisation of the economy and growing competition witnessed Indian companies taking on global brands and gaining in self-confidence. This reflected in the zeal to carry business across continents to earn revenue and repute. Simultaneously, the jump-start of the economy also created more funds, for infrastructure development and social welfare with dependence on foreign loans reducing.

A study of the long term perspective of the Indian economy will reveal certain trends, potentials and weaknesses, which will give indicators of how and where these realities are likely to influence the economic policies of the United States as well as business groups in that country. This is especially relevant with respect to how India's economic prowness is perceived, dividends provided, and potential and benefits of FDI and scope for trade enhanced. All this is likely to be influenced by the environment, infrastructure development, relative spending potential of the population over the years, opportunities and avenues and the knowledge base to translate potential US technology and skills.

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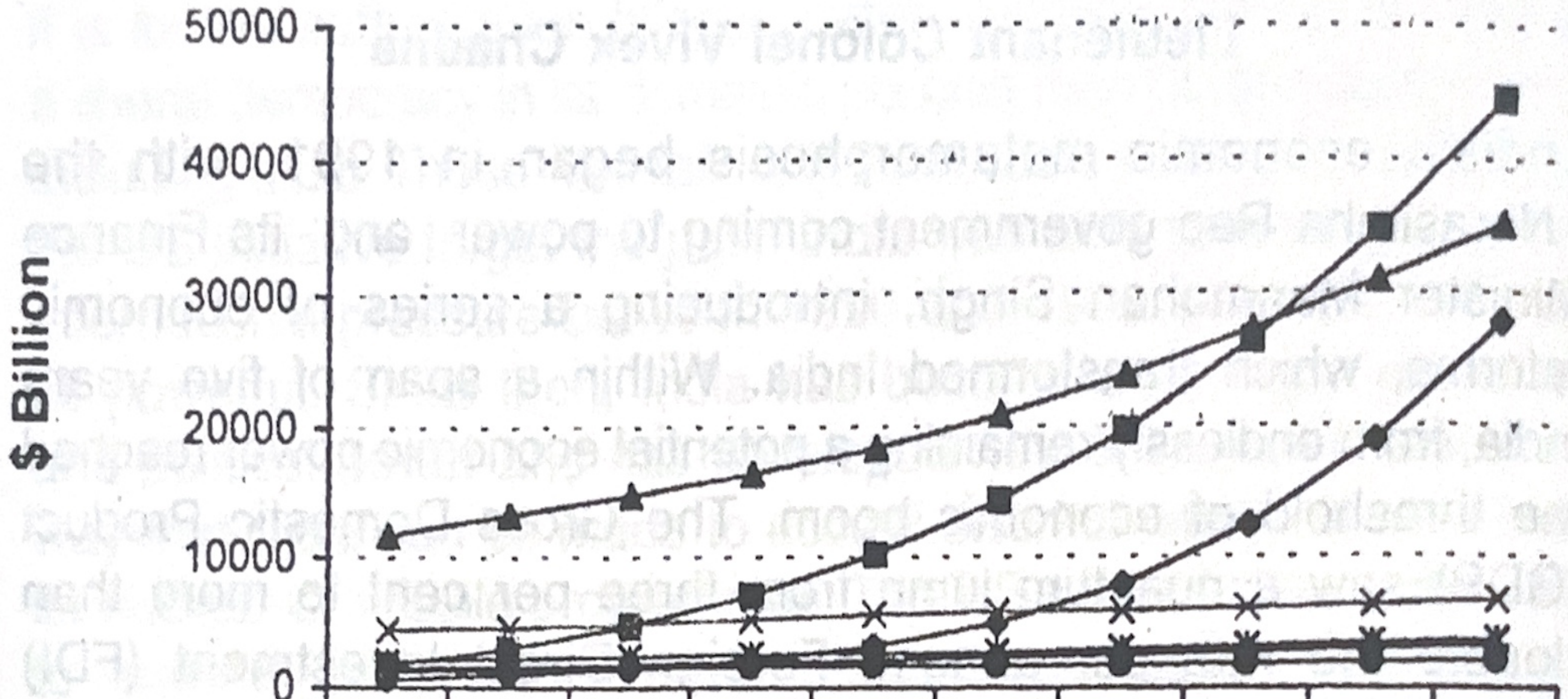
Table 1

GDP Growth ($US billion)



	2005	2010	2015	2020	2025	2030	2035	2040	2045	2050
India	604	929	1411	2104	3174	4935	7854	12367	18847	27803
China	1724	2998	4754	7070	10213	14312	19605	26439	34799	44453
United States	11697	13271	14786	16415	18340	20833	23828	27229	30956	35165
Japan	4427	4601	4858	5221	5567	5810	5882	6039	6297	6673
Germany	2011	2212	2386	2524	2604	2697	2903	3147	3381	3603
Italy	1236	1337	1447	1553	1625	1671	1708	1788	1912	2061
France	1489	1622	1767	1930	2095	2267	2445	2668	2898	3148

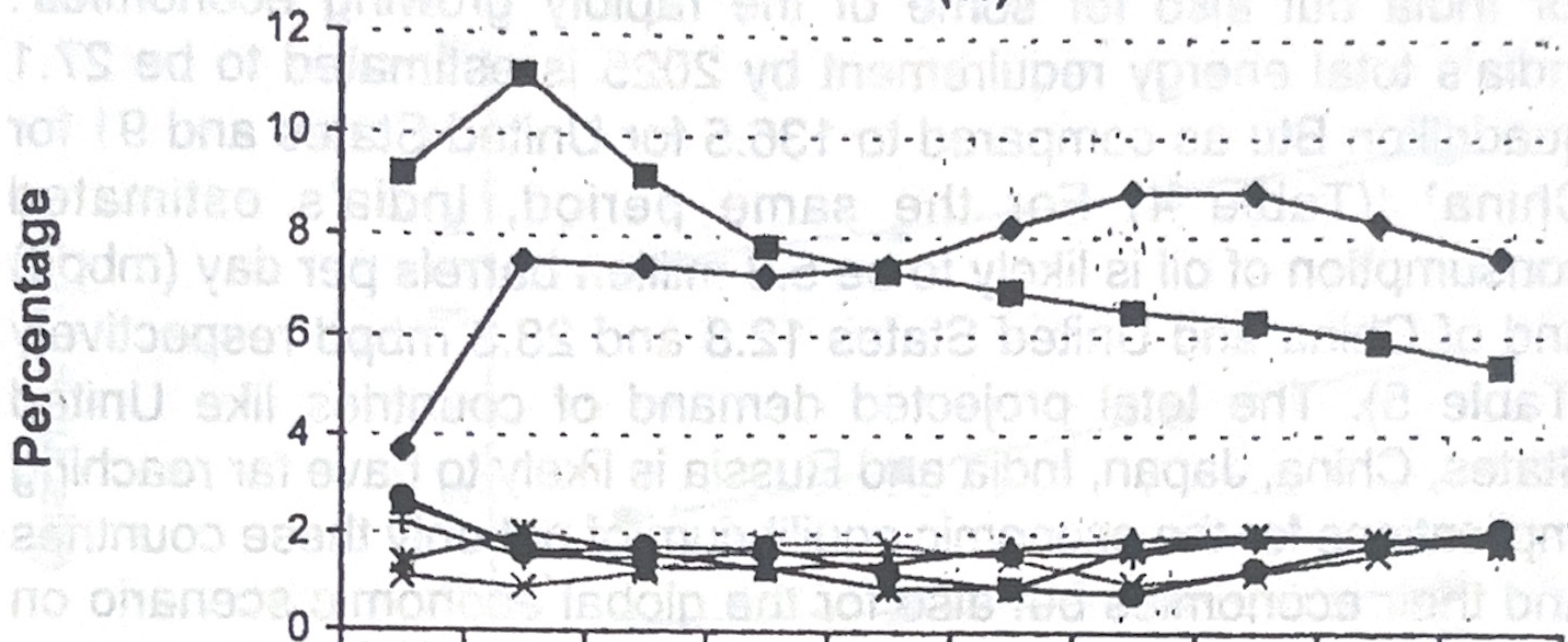
(Goldman Sachs : Global Economics Paper No: 99, 1 October 2003)

Indian Economy in Long Term Perspective

India's GDP growth assessed by a Goldman Sachs paper makes revealing study. From rate of US $604 billion in 2005, it is likely to rise to US $4395 in 2030 and US $27803 by 2050 (Table 1). The paper also compares India's development with other major countries with a similar growth potential. These include Brazil, Russia, India and China (BRIC). This phenomenal rise when compared to other important economies will make India the third largest economy by 2032. India will also have the highest rate of growth over a long-term perspective of 30 to 50 years (Table 2). It is also revealing to note that the combined purchasing pattern of the BRIC countries is likely to outstrip the G6 as early as 2009, with projections in subsequent years clearly pointing to phenomenal markets in these countries of which China and India are likely to retain the major share for spending (Table 3).

Table 2

GDP Growth (%)

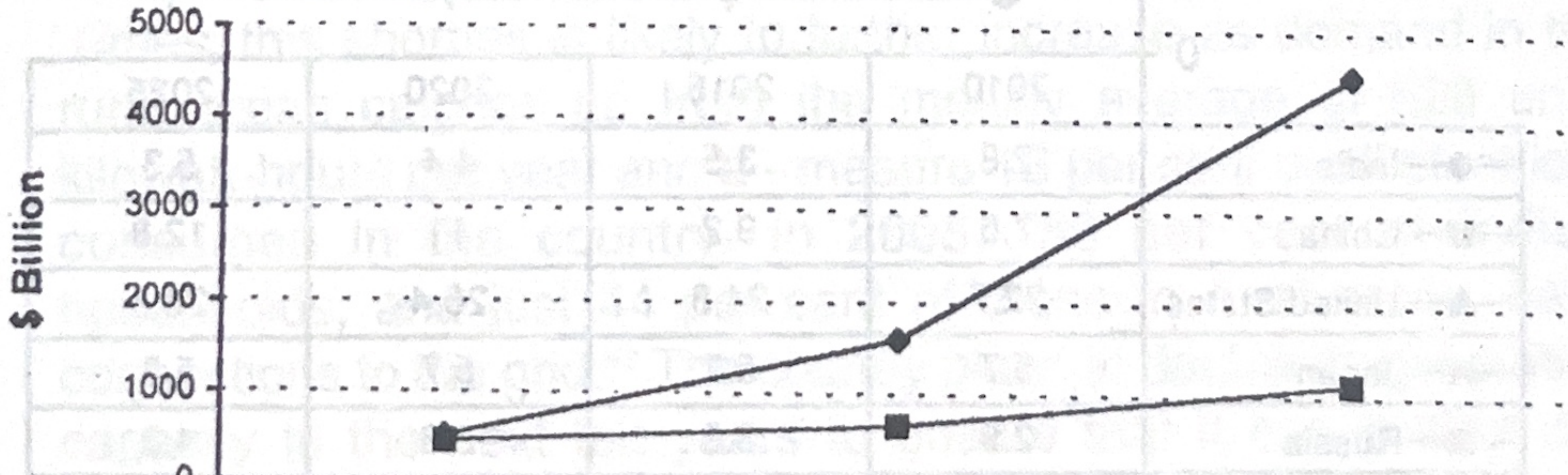


	2000-05	2005-10	2010-15	2015-20	2020-25	2025-30	2030-35	2035-40	2040-45	2045-50
India	3.7	7.5	7.4	7.2	7.4	8.2	8.9	8.9	8.3	7.6
China	9.2	11.2	9.2	7.8	7.3	6.9	6.5	6.3	5.9	5.4
United States	2.6	1.7	1.3	1.3	1.4	1.7	1.9	2	1.9	1.9
Japan	1.1	0.9	1.2	1.8	1.8	1.5	1	1.2	1.6	2
Germany	1.4	2	1.6	1.3	0.9	0.9	1.7	2	1.9	1.8
Italy	2.7	1.6	1.7	1.7	1.2	0.9	0.8	1.3	1.8	2.1
France	2.2	1.5	1.5	1.6	1.6	1.6	1.6	1.9	1.9	2

(Goldman Sachs : Global Economics Paper No: 99, 1 October 2003)

Table 3

Incremental Demand ($US billion)



	2010	2030	2050
BRICs	521	1594	4517
G6	470	656	1137

Note : BRICs - Brazil, Russia, India and China.

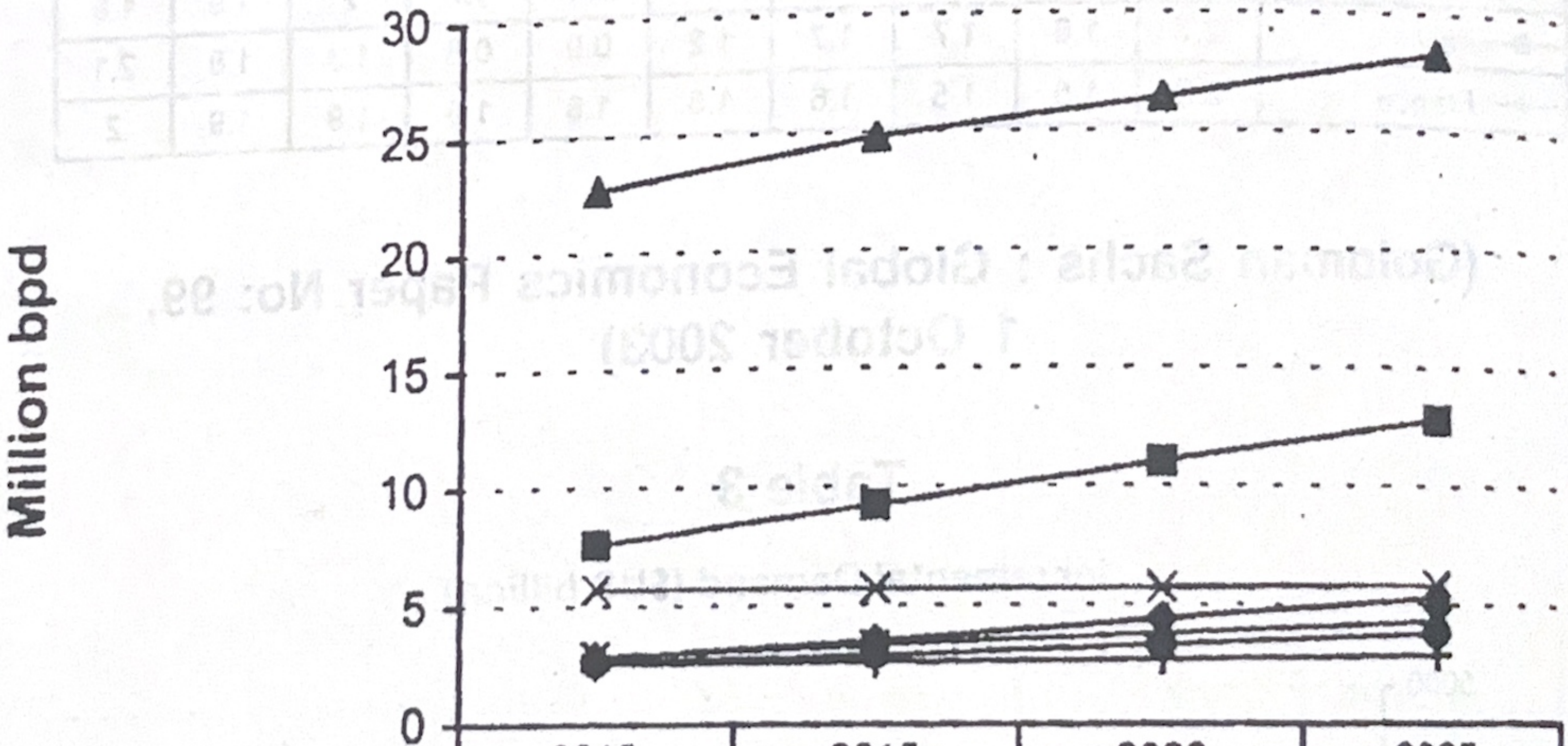
G6 - USA, UK, France, Germany, Italy and Japan.

(Goldman Sachs: Global Economics Paper No: 99)

It is apparent from these basic economic parameters, that there 'will be a substantial enhancement in energy needs not only for India but also for some of the rapidly growing economies'. India's total energy requirement by 2025 is estimated to be 27.1 quadrillion Btu as compared to 136.5 for United States and 91 for China[1] '(Table 4) For the same period, India's estimated consumption of oil is likely to be 5.3 million barrels per day (mbpd) and of China and United States 12.8 and 28.3 mbpd respectively (Table 5). The total projected demand of countries like United States, China, Japan, India and Russia is likely to have far reaching implications for the economic equilibrium of not only these countries and their economies but also for the global economic scenario on a monumental scale.

Table 4

World Oil Consumption

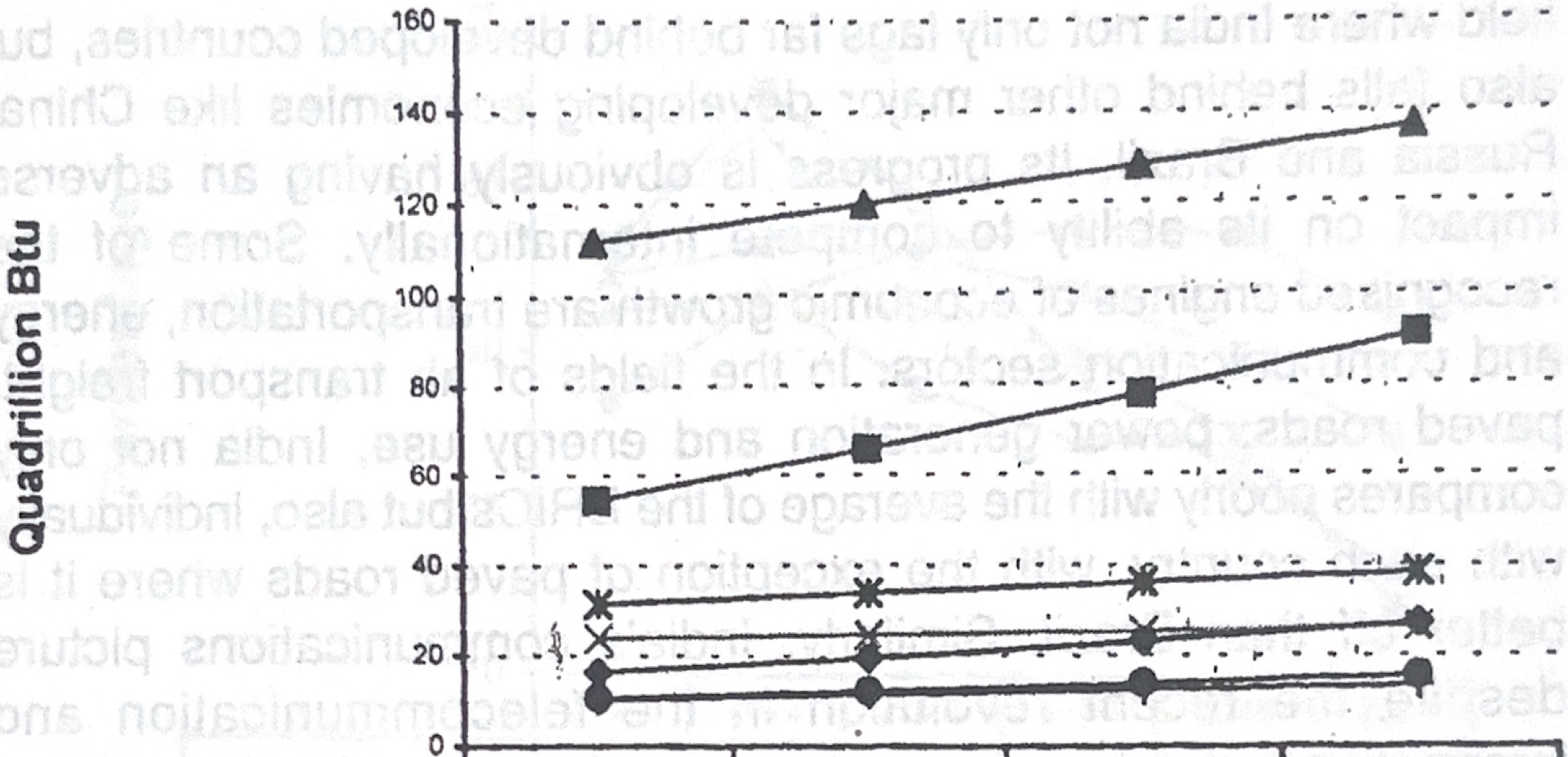


	2010	2015	2020	2025
India	2.8	3.5	4.4	5.3
China	7.6	9.2	11	12.8
United States	22.7	24.8	26.4	28.3
Japan	5.7	5.7	5.7	5.8
Russia	2.9	3.3	3.8	4.3
Brazil	2.6	2.9	3.3	3.8
South Korea	2.5	2.6	2.7	2.9

(International Energy Outlook 2004: p 164.)

Table 5

Total Primary Energy Consumption



	2010	2015	2020	2025
India	16.4	19.5	23.2	27.1
China	54.6	65.7	77.7	91
United States	111.8	119.7	127.9	136.5
Japan	23.9	24.7	25.4	26.3
Russia	31.4	33.8	36.2	38.3
Brazil	10.5	12.1	13.8	15.7
South Korea	10.1	11.3	12.3	13.3

(International Energy Outlook 2004: p 167.)

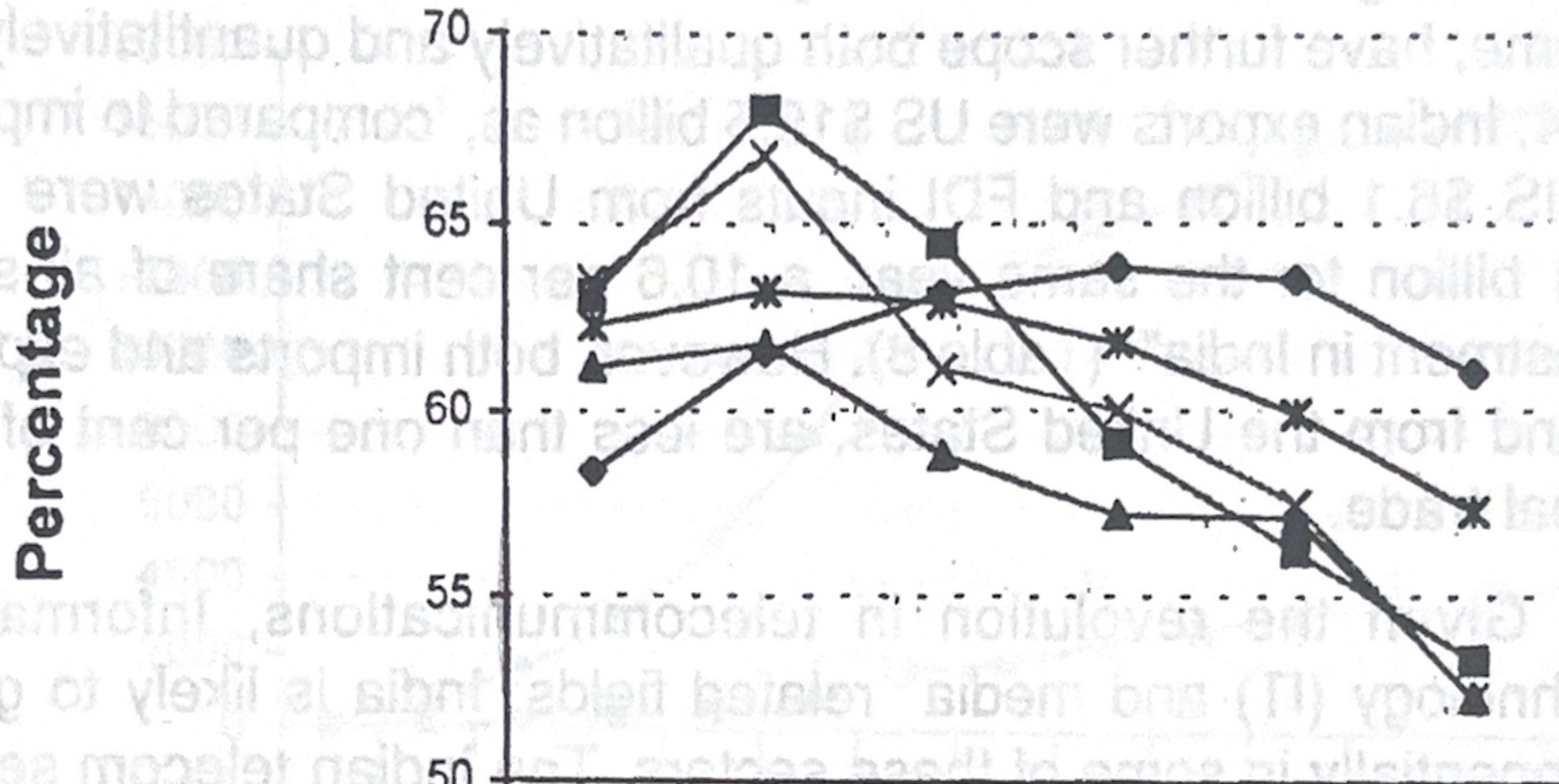
Electricity generation has steadily grown at 5.5 per cent in India. However, despite the increase, supply fell short by 12.1 per cent for the financial year 2004-05.[2] According to the *Economic Times*, this shortfall is likely to further increase as demand in the rural areas catches up from the measly average of 526 units kilowatt-hours per year and a meagre 13 per cent of all electricity consumed in the country. In 2005, "56 per cent of India's households, and just 44 per cent of those in rural areas, have connections to the grid."[3] The country plans to double its generation capacity in the next ten years to ensure that it can sustain the impressive growth rate of over six per cent that has been sustained for over fifteen years. This is a major challenge for the Indian economy if it has to sustain its ongoing momentum and remain attractive to foreign investment and capital. It is also an attractive market for renewable energy sources and nuclear energy.

It is evident from models of most modern countries that economic progress of both individuals and countries is closely tied with the degree of development of basic infrastructure. This is one field where India not only lags far behind developed countries, but also falls behind other major developing economies like China, Russia and Brazil. Its progress is obviously having an adverse impact on its ability to compete internationally. Some of the recognised engines of economic growth are transportation, energy and communication sectors. In the fields of air transport freight, paved roads, power generation and energy use, India not only compares poorly with the average of the BRICs but also, individually with each country, with the exception of paved roads where it is better off than Brazil. Similarly, India's communications picture despite the recent revolution in the telecommunication and information technology sector does-not compare well with the other three BRIC countries.[4] It is expected that India is likely to experience a major growth in these fields with substantive initiatives in progress in all these sectors.

Yet another factor, which will influence growth of economy and increasing opportunities within and outside the country is the availability of manpower in the working age group. In this field, India is likely to take the lead with a consistently increasing pool of manpower availability both in terms of percentages as well as sheer numbers (Table 6). It takes a mere look at the percentages, and more importantly, at the total population to get an idea about the number of people likely to be available in India, which will undoubtedly make up for the deficiencies in other major countries (Table 7). According to demographer A R Nanda, by year 2020; "the US would be short of 17 million people in working age, China of 10 million, Japan nine million and Russia six million. Indians would then be absorbed into some of these economies."[5] When this is seen in relation to the "2.5 million IT, engineering and life sciences graduates a year, besides about 650,000 post graduates in science"[6], the perspective becomes clearer.

Table 6

Working Population (%)

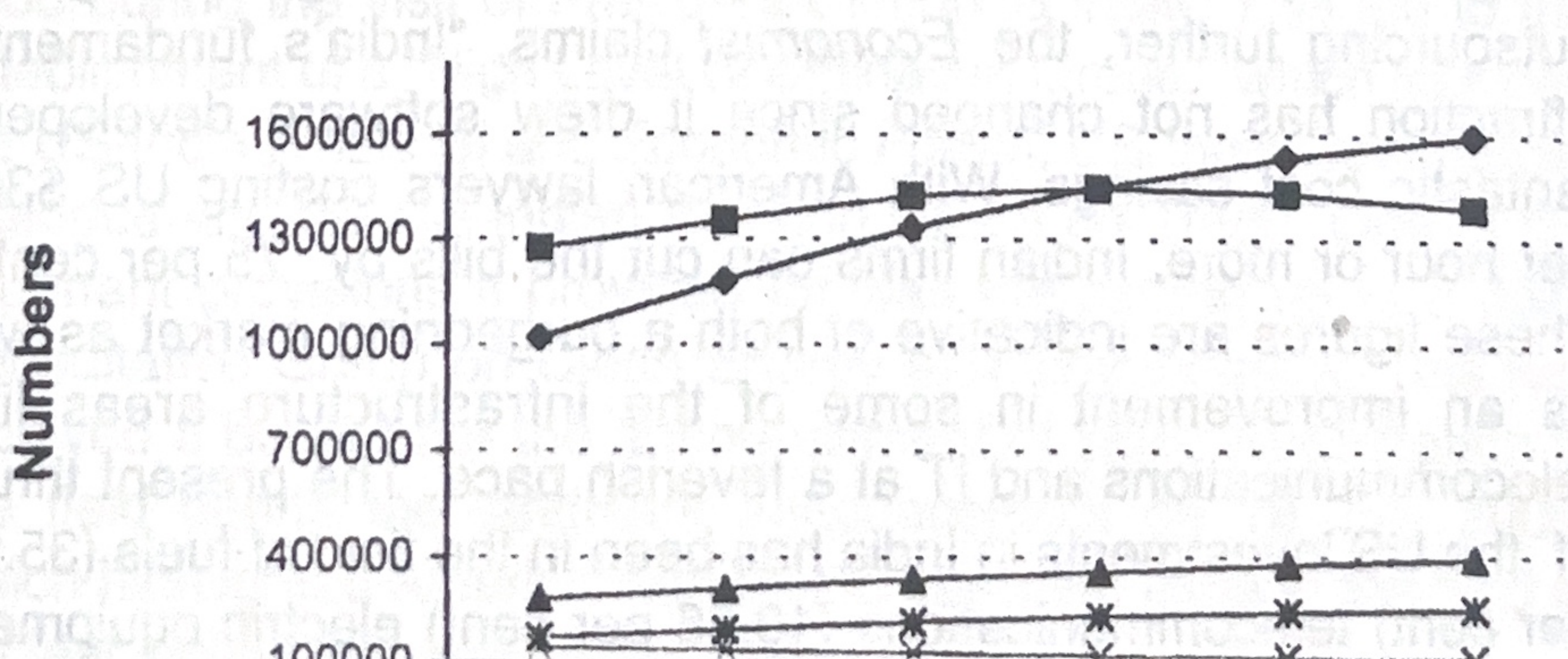


	2000	2010	2020	2030	2040	2050
India	58.4	61.6	63.1	63.8	63.5	61
China	63.1	68	64.5	59.1	56.2	53.3
United States	61.2	61.8	58.8	57.2	57.1	52.3
Russia	63.5	66.8	61.1	60	57.5	52.3
Brazil	62.3	63.2	62.9	61.8	59.9	57.3

Source : (www.esa.un.org/unpp/)

Table 7

Total Population (thousands)



	2000	2010	2020	2030	2040	2050
India	1021084	1183293	1332032	1449078	1534402	1597734
China	1273979	1354533	1423939	1446453	1433431	1392307
United States	284154	312253	338427	360894	379544	394976
Russia	146560	140028	133101	125325	118334	111752
Brazil	173858	198497	219193	235505	246766	253105

Source : (www.esa.un.org/unpp/)

Indo-US Economic Relationship and Prospects

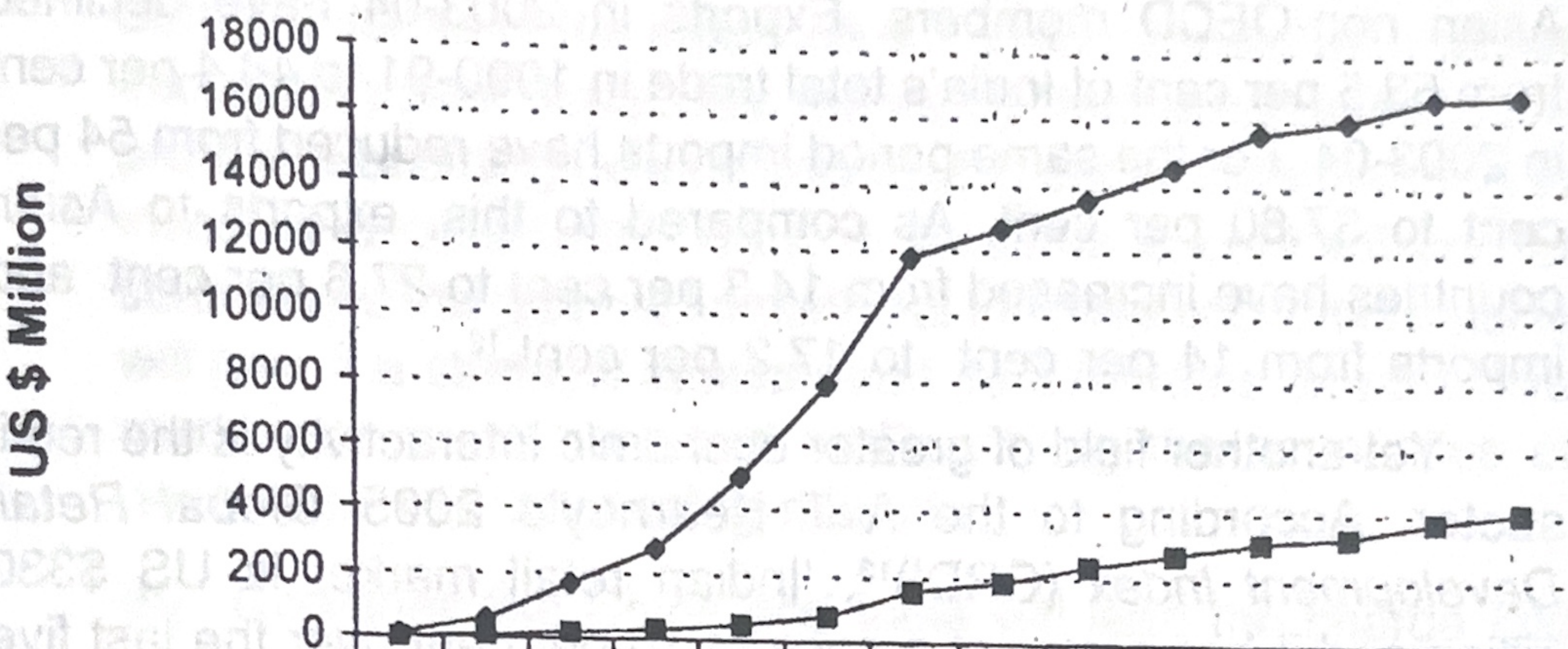
Specifically, with regard to relations with the United States, the existing levels of trade though, substantially better in terms of volume, have further scope both qualitatively and quantitatively. In 2004, Indian exports were US $15.5 billion as, 'compared to imports of US $6.1 billion and FDI inputs from United States were "US $4.1 billion for the same year, a 10.6 per cent share of all such investment in India"[7] (Table 8). However, both imports and exports to and from the United States, are less than one per cent of US global trade.

Given the revolution in telecommunications, Information Technology (IT) and media related fields; India is likely to grow exponentially in some of these sectors. The Indian telecom sector is growing at approximately 20 per cent per annum, which has resulted in increase in tele-density from 1.94 per cent in 1999 to 7.02 per cent in 2004. This is accompanied by growths of 13 per cent in cable TV subscribers, 18 per cent in TV set owners, 27 per cent in PC penetration, 28 per cent in cell phones, 30 per cent in telephones and 58 per cent in internet subscribers in the next four years.[8] It is also estimated by NASSCOM and McKinsey that "exports from India's IT industry and from "Business Process Offshoring" (BPO) – both from services "outsourced" to Indian firms and those performed by Indians abroad – are on track to reach US $60 billion a year by 2010."[9] Taking the logic of outsourcing further, the *Economist* claims, "India's fundamental attraction has not changed since it drew software developers: fantastic cost savings. With American lawyers costing US $300 per hour or more, Indian firms can cut the bills by 75 per cent.[10] These figures are indicative of both a burgeoning market as well as an improvement in some of the infrastructure areas like telecommunications and IT at a feverish pace. The present thrust of the US investments in India has been in the field of fuels (35.93 per cent) telecommunications (10.56 per cent) electric equipment including software (9.5 per cent), food processing (9.43 per cent), and the service sector, finance and non-finance (8.28 per cent).

However, the future holds a lot of promise in the fields of software development, telecommunications, infrastructure and knowledge based industries like pharmaceuticals and biotechnology. The power sector has also been opened up for foreign investment and there is a concerted thrust towards increasing the share of cleaner energy sources, which has led to

Table 8

YEARWISE CUMULATIVE FDI



	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 till Aug
Approved	76	547	1676	2788	5035	7908	1178	1268	1353	1451	1560	1603	1671	1685
Inflow	11	55	203	322	537	808	1545	1892	2323	2742	3109	3392	3788	4133

(Source : Indian Embassy Washington Web Site) http://indianembassy.org/Economy/economy.htm#Foreignpercent20 Directorpercent20Investment

an ongoing energy dialogue between the two countries on the basis of the "Agreed Principles - Institutional Dialogue Between the United States and India," which were agreed upon in March 2000 during the visit of President Clinton to India. This led to the establishment of a "High Level Coordinating Group," which included the US-India Financial and Economic Forum, US-India Commercial Dialogue and the US-Indian Working Group on Trade. One of the important provisions it provided for was the setting up of a Joint Consultative Group on Clean Energy and Environment. This has received a boost after the announcement of likely co-operation in the field during the landmark announcement on 18 July 2005, which highlighted American interest in assisting India in the field of nuclear power generation for civil use.

There has also been a marked increase in trade, between India and the United States in the recent years. In 2004, exports from India grew by 18.37 per cent to US $14.328 billion whereas for the same period imports grew by 22.73 per cent to US $5.532 billion. However in comparative terms when seen in perspective of the exponential growth of Indian trade with China, which rose from US $5 billion to US $13.6 billion from 2002 to 2004; a degree of cautious enthusiasm needs to be maintained. Trade with Organisation for Economic Co-operation and Development (OECD) countries has shown a downward trend when compared with Asian non-OECD members. Exports in 2003-04 have declined from 53.5 per cent of India's total trade in 1990-91 to 46.4 per cent in 2003-04. For the same period imports have reduced from 54 per cent to 37.80 per cent. As compared to this, exports to Asian countries have increased from 14.3 per cent to 27.6 per cent and imports from 14 per cent to 17.2 per cent.[12]

Yet another field of greater economic interactivity is the retail sector. According to the A T Kearney's 2005 *Global Retail Development Index* (GRDI)[13], 'Indian retail market is US $330 billion and it has grown at a pace of 10 per cent over the last five years. Quoting Mike Moriarty, Vice President, A T Kearney, a news report stated, "The message for retailers on India is clear: move now or forego prime locations and market positions that will become saturated ,quickly," It added, "Global retailers that missed opportunities to capture first-mover advantage in China can make up for it in India."[14] However, it is important to keep in mind that irrespective of India's increased trade with China, "Wal-Mart's supply chain pulled in US $ 18 billion worth of goods in 2004 from five thousand Chinese suppliers."[15] The Chinese spokesman of Wal--Mart added, "If Wal-Mart were an individual economy, it would rank as China's eighth--biggest partner, ahead of Russia, Australia and Canada."[16] This is the reality that India needs to pitch its standards against.

The last factor is not economic in essence, yet in practice it has had a greater impact than some others. India and some regions in the United States have an almost 12 hour difference in their time cycles. This has worked to the benefit of India as it gave the opportunity to exploit any 24 hour cycle to the optimum between the two countries. When combined with the strength of India's knowledge based service industry and the knowledge of English, this has helped fuel economic inter dependence and growth in a unique manner.

Conclusion

The basic facts bring out some very interesting conclusions, which are likely to impact Indo-US relations. These are:

(a) China's phenomenal GDP growth along with some other fast growing economies of the world like India, Brazil and

Russia will be watched closely by the United States. This growth, when translated into economic possibilities highlight issues of rise of China as an economic counterpoise to United States in terms of the influence it is likely to wield as a global economic power. It also has the vast potential for participative profit in a booming economy for global companies planning to invest and outsource. Thus, it presents a contradiction of sorts where the growing influence of Chinese economic muscle will give it a strategic impact even as it remains an attractive market for investment and profit, driving the economies of developed and developing markets.

(b) Countries like China and India will lead the charge into the world economic power club with only two countries of the present G-6, United States and Japan figuring in the list by 2050, making Asia the hub of economic growth. This is likely to lead to growing competition for economic space, advantage and leverage between major developed countries like the United States and Japan and emerging countries like China and India unless complementary symbiotic growth continues to fuel economies as prevalent in the existing scenario.

(c) Though there may be differences in strategic perspective between major powers to include United States, China, Japan and India, yet economic compulsions in terms of need for investment, technology and business in developed countries and markets, cheap outsourcing and offshore practices in fast developing economies, have ensured a closely interlinked relationship, which is proving to be a win-win situation for all countries. This is borne by the fact that both India and China have positive trade surpluses with the United States. Simultaneously, it has improved the profitability of companies in Japan and America who have benefited because of advantages offered in services and a competitive production base.

(d) There is likely to be a substantial growth of Indo-US trade as is indicative by the trends available. However, the pace, is likely, to be influenced by, appreciation of the mutual benefits of the relationship, resolution of contentious issues like property rights, tariffs and further liberalisation of the Indian economy.

Differences of opinion are likely 'to remain on the pace, and sectors open for liberalisation, as the Chinese example could serve as a test bed for Indian policy makers.

(e) Even as India's trade volumes increase substantially, the advantages offered by markets and businesses in China and Southeast Asia are likely to compete for business stakes in the long run, especially if prickly issues are not resolved.[17] This will present a challenge for the United States in an increasingly competitive market.

(f) India's highest GDP growth in the long-term and the allied benefits of trade and investment are likely to remain a major attraction influencing bilateral relations. These factors present India, along with China as the most attractive economic destination with a long term potential, which can be a major impact on US profitability and sustainability as a world economic leader.

(g) Increasing energy requirements of both oil and combined sources especially by fast developing economies like India and China as well as developed countries like United States will continue to fuel demand and keep the importance of energy sources as the engine of global economy at a very high level. This will impact strategic relations of all the three countries with major oil and gas producing nations - in some cases notwithstanding poor counter-terrorism, human rights and democracy records. It also highlights the importance of clean alternative energy as a critical need for India's fast burgeoning economy.

(h) Relatively poor infrastructure status in India is likely to have negative economic implications for the country. This is specifically relevant to bilateral economic relations with the United States as also in terms of retaining a competitive edge with other major growing economies. Therefore, one of the major fields of cooperation between India and the United States is likely to be nuclear power generation as a clean source of fuel for India, to help the country bridge the gap between growing needs and limited availability of crude oil and the adverse impact of fossil fuels on the environment.

(j) The limited levels of FDI coming from the United States are a reflection of the vast potential which could benefit both countries. The 2004 levels indicate less than 3 per cent of total American investment in India, despite the fact that India is considered the top retail destination in the latest A T Keamey's 2005 Global Retail Development Index (GRDI)[18]. However, this trend is likely to change with growing interest in India steadily translating into a better percentage of FDI when compared to the approval to investments ratio of 14.87 per cent in 1991 to 24.52 per cent in 2004.[19] (See Table 8)

(k) The advantage in terms of manpower surplus in the working age group and more specifically of an English speaking, technically qualified workforce will not only spearhead India's services sector but also its manufacturing, outsourcing and offshore trade. They also have the potential to fill in these slots in the international market.

(l) India's emergence as a knowledge power is in US interest as it is India, which has the socio-economic capability and geo-strategic congruence to assist the United States to remain ahead of China in its quest io remain the pre-eminent power in the world.

The threat of containment for both India and the United States is emerging as one of the most important concerns. However, it needs to be noted and emphasised that this threat is as much if not more from "economic containment" as it is from "strategic containment". The threat of this form of containment will not be through weapons and conventional armies but from adoption of the rules of globalisation, knowledge, infrastructure development, free trade area treaties and armies of economic warriors.

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