



Information Technology Industry Council

“U.S.-India Trade Relations: Opportunities and Challenges”

Testimony of

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Before the

Subcommittee on Trade

Committee on Ways and Means

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Mr. Chairman, Ranking Member Rangel, and members of the Subcommittee – thank you for the opportunity to testify at today's hearing on the opportunities and challenges in the bilateral economic relationship between the United States and India. I am Dean Garfield, President and CEO of the Information Technology Industry Council, known as ITI. ITI is a global trade association representing 47 of the world's most innovative, forward-thinking technology companies.

Chairman Nunes, my congratulations to you on being selected to chair the Trade Subcommittee. As a Californian, representing a district in the heart of the Central Valley -- the world's most productive food resource -- and hailing from a third-generation farm family, you know first-hand the critical role international trade plays in key sectors of the California economy, including of course, information technology.

Today's topic – trade relations with India – is timely to say the least. The U.S.-India economic relationship is one of the most strategically important and yet least understood bilateral partnerships on our nation's trade agenda. That is certainly true for the information and communications technology, or "ICT," industry. The United States and India have been the sources of countless innovative ICT success stories over the past two decades. Both nations are poised for many more. The bilateral economic relationship truly reflects our own industry. Our two countries compete and collaborate, creating innovations and opportunities that are felt throughout the world. Thanks to the quality of skilled American and Indian talent, almost every global ICT product development, supply chain, and support chain in our industry is fueled in some manner by both countries.

Unfortunately, despite this extraordinary bilateral success, the Government of India is implementing, or considering implementing, a number of major policy decisions we believe would undermine, if not outright dismantle, the progress India has made as a power in the global ICT marketplace. Moreover, these policies will undermine the ability of U.S. and foreign ICT companies to compete fairly in this important market.

Let me highlight two of these key policies important to our industry, though there are more.

Last year, India rolled out its preferential market access policy, or "PMA," which is designed to force both the public and private sectors in India to procure domestically produced electronic and ICT products and services.

The second is India's current decision to stand on the sidelines during the on-going negotiations to expand the Information Technology Agreement (ITA), a highly successful trade pact India, the United States, and 73 other World Trade Organization (WTO) members are party to.

Both policies reflect India's current focus on developing its own advanced ICT manufacturing capabilities, which it considers the next essential step for economic development and the future of its growing middle class. While we certainly do not oppose India's objective to build a stronger manufacturing base, we do

have concerns with some of the methods it has chosen. These policies have put India crossways not just to the United States. They are also at odds with both the broader economic ideals shared among many global partners, and with the engines of India's own emergence on the global stage.

Before discussing what these policies mean for U.S.-India trade relations, it is important to put them in the context of the development of that relationship for the ICT sector. This helps to underscore the significance of these policies and the risks they present to the exciting future we believe awaits our industry and both countries.

Any comparison of India and the United States typically first begins with our shared commitment to democratic principles – us being the oldest, and India being the largest, democracies on the planet. The growth of the U.S. bilateral economic relationship is rooted in shared economic principles, starting with India's economic reforms in 1991. Through these and additional reforms, as well as the growth of the global ICT sector, the bonds between our two countries have become more dynamic as India's innovative and entrepreneurial minds started to take hold of that country's destiny.

When describing public policies that matter most to the ICT industry, we often talk about the importance of preserving an entrepreneurial ecosystem. In the United States, such an ecosystem has been inherent in our culture since Jamestown and Plymouth Rock. But public policies that support, incentivize and fuel our entrepreneurial spirit are often taken for granted, and this is a big reason why ITI exists. We welcome the opportunity to work with policymakers to advance our innovative potential. At the same time, to effectively do our work, we also find ourselves opposing policies that risk hindering that potential, and perhaps destroying it entirely.

In a dynamic global economy, among the greatest threats to an open, entrepreneurial ecosystem are policies that attempt to restrict the flow of global commerce. The reverse is certainly true as well. In a closed, stagnant, struggling economy, the best ways to unleash an open, entrepreneurial ecosystem include policies that foster the flow of global commerce and investment, and tear down boundaries and barriers to the development and production of goods and services.

Within the last 25 years, India has been a poster child for these fundamental truths.

While innovators and entrepreneurs have been openly celebrated in the United States for centuries, that has not always been the case in India. Over the last few centuries, India's innovative potential has been hampered through a combination of colonial administration and, since its independence, economic dysfunction. Both factors limited the development of a thriving trade relationship between the United States and India.

For its first 45 years of independence, India's economic governance adhered to a socialist, centralized framework. Government-imposed domestic production schedules and licenses, and high import tariffs were the hallmarks of that system and key barriers to economic progress.

Product shortages were the norm, and foreign investment and imports into India were severely limited, making foreign exchange tightly controlled. In the 1970s, an Indian businessperson could only purchase \$8 per day of foreign currency. An Indian computer services firm seeking to import a foreign-made computer had to wait as long as three years to get an import license, and once gained, the firm faced a tariff

of 101 percent, which included an import duty, a countervailing duty, an auxiliary duty, and a tax levy to help pay for the war in Bangladesh.

Yet, important and auspicious ingredients existed in India. The government invested in higher education that focused on engineering. Product shortages, especially for spare parts on capital equipment, fueled creativity and innovation. And, of course, one of the legacies of colonial rule was a large population of educated, English-speaking professionals.

In 1991, three economic shocks to India's system placed them at a major policy crossroads: Oil price hikes caused by the first Gulf War; the collapse of the Soviet Union, India's largest trading partner and foreign aid source; and severe fiscal imbalances that dried up its limited store of foreign exchange reserves.

The government responded with a series of economic shocks of its own to put the economy on a more open, liberalized course. The policies it pursued during and after 1991, which helped give rise to a global ICT sector, included:

- Severe reductions in import tariffs and quantitative controls on imports, which enabled India's emerging ICT sector to buy the electronics, hardware and software it needed at competitive prices;
- Devaluation and convertibility of India's currency, the rupee, which would reduce the cost of India's services exports;
- Increased access to international capital markets for Indian-based firms;
- Opening of India's equity markets to foreign institutional investors;
- Encouragement of foreign direct investment in joint ventures;
- Allowance of full foreign equity in key economic sectors, one of them being information technology; and,
- Tax and incentives at the federal and state level targeted at foreign-owned ICT companies.

The 1991 reforms were a combination of dramatic and incremental measures, but the overall effect of this move to a more open, liberalized economy was extraordinary. Average GDP growth since 1991 has more than tripled. The emergence of India's ICT industry helped to contribute to rapid productivity growth. Perhaps most significant, economic liberalization could do what centralized government could not: dramatically reduce poverty. An estimated 431 million fewer Indians lived in extreme poverty in 2009 than in 1991.

The prospects for India's future growth appear even stronger. In 2009, a McKinsey study predicted that continued economic liberalization would triple Indian incomes over the next two decades, and boost India's middle class to more than half a billion people.

Liberalization was one among a number of key factors that unleashed the Indian IT software and services industry, including tax and investment incentives, access to a deep pool of English-speaking engineering talent, and revolutions in global telecommunications. By the mid-1990s, the world's leading software and services companies were building development centers in India, and Indian-based ICT services firms established themselves in key markets in the United States and Europe.

The global ICT industry has unleashed the productive potential of numerous sectors, such as financial services, health care, energy, transportation, retail, and entertainment. The ability of a financial institution

to transfer billions in investment capital at the click of a mouse, or a consumer to buy an airline ticket at the touch of a smart phone screen, are due largely to a global ICT chain that is dominated and operated 24/7/365 by research, development, and maintenance centers in the United States and India.

Liberalization is far from complete in India. Many Indian industries remain subject to foreign investment barriers, and U.S.-based companies in these sectors continue to struggle to gain access India's markets. While liberalization has been vibrant in some sectors, and slow to incremental in others, the foundation of an open economy is there, fueled by a professional workforce of dynamic innovators, managers, and entrepreneurs.

Nineteen ninety-one was in part the first crack in India's massive concrete dam of state-sponsored protectionism. More reforms to further liberalize the economy have been introduced since then in areas ranging from tax reform to tariff relief.

Among the most significant for our industry was India's willingness to sign on to the ITA in 1997. Worried about the impact of lower ICT tariffs on its manufacturing sector, New Delhi was at first reluctant to join the ITA. But that country's software and services industries understood the critical importance to its future of having unfettered access to imports of innovative, affordable ICT technologies from around the world. Ultimately, reason prevailed, and India's leadership took the wise decision to join this ground-breaking agreement.

Despite more than two decades of determined efforts to further open India's economy, challenges remain. While lured to India to tap into an innovative and entrepreneurial workforce, our companies face numerous regulatory challenges and the persistent remnants of ambivalence toward business from public sector officials. We experience it in a regulatory and enforcement context, including random and often disturbing enforcement actions by officials.

For instance, *The Wall Street Journal* recently reported there is a backlog of 140 transfer pricing cases between the United States and India, which is an unusually high number. The Indian tax authorities frequently take tax positions that are inconsistent with the rest of the world, creating a significant risk of double taxation and expensive tax controversy, which are further impediments to trade. The excessive number of large-dollar tax controversies demonstrates the need for improvements in the fairness, predictability, transparency, consistency, and efficiency of Indian tax law, collection, due process, and dispute resolution.

We are also seeing a range of problematic testing and certification requirements on our products that are unworkable and veer markedly from global norms. Starting April 3, for example, the Indian government will impose new and onerous testing and registration requirements for a broad range of ICT products that, if implemented, will effectively exclude foreign companies from that market. These new requirements were developed with limited industry consultations; deviate in significant and impactful ways from international norms; cannot be implemented as published due to the lack of testing capacity and infrastructure; and will make it nearly impossible for companies to import a wide range of ICT products.

It is important to understand that India has seen slowing economic growth in recent years. Once nearing 10 percent annually just a few years ago, India's growth rate slipped to 5.1 percent in 2012. Foreign Direct Investment has also fallen in the last year. The *Press Trust of India* recently reported that India received roughly \$14 billion in the first nine months of the current fiscal year compared to \$23 billion in 2011-12.

In addition, India is confronting significant challenges to meet the demands of a growing workforce. Despite the dramatic gains in India's economy attributed to its skilled professionals, the proportion of its youth population enrolling in college is a mere 15 percent. While the ICT sector will continue to be a major driver of India's exports and growth, the government sees the fostering of a robust manufacturing sector as its next key development component.

Given the extraordinary role liberalized, and incentive-based economic policies played in launching India's ICT sector, the logical playbook for manufacturing would be more of the same. Instead, New Delhi has taken a number of steps backward, placing its global leadership in ICT services at risk.

This comes into bold relief with India's adoption of the PMA policy. In February 2012, India issued that policy in final form. It imposes local content requirements of up to 100 percent on procurements of "electronic products" by: 1) government; and 2) private sector entities with "security implications for the country." India claims it needs made-in-India products for two key reasons: first, to ensure cybersecurity; and second, to develop India's advanced manufacturing base to boost domestic employment.

A half-dozen guidelines to implement the PMA mandate have been announced by Indian ministries since early last year. Most have focused on government procurement. Although India is a member of the WTO, it is not a signatory to the Government Procurement Agreement (GPA), and thus can apply local content requirements, such as the PMA, to government procurements.

In October 2012, however, a fundamentally bad policy became worse when India issued draft guidelines that would apply the PMA to purchases of a defined list of telecom products by private-sector telecom operators/licensees. These draft private-sector guidelines raise significant questions regarding India's commitment to the rules-based trading system established under the WTO, including the fundamental principle of "national treatment." In addition, India's threat of invoking national security as the grounds for interference in private sector procurements of ICT equipment in this case creates a dangerous precedent for other countries to mirror.

Despite an intense, year-long effort by global industry -- along with governments in Washington, Tokyo, Brussels, Seoul, and other capitals -- to convince India to drop the WTO-inconsistent components of the PMA policy, India seems poised to move forward with implementation anyway. Even worse, there is every indication the application of the PMA to private sector procurements will spread beyond telecom to other areas, including financial services and transportation.

To be sure, we support India's desire to build robust ICT and ICT-enabled manufacturing sectors, as well as to protect its legitimate security interests. India's commitment to advance its economy and grow its middle class will create numerous opportunities for increased trade for U.S.-based industries, including ICT. But just as India utilized market-based incentives to build a competitive and innovative ICT software and services industry, India should be promoting and building investment in domestic manufacturing and infrastructure through market-based incentives.

We also certainly understand India's focus on the security of its people. It is a common cause of both our countries, and many more, and for that reason, requires greater innovative collaboration among governments and industry. India's approach to cybersecurity as embodied in the PMA runs counter to global norms, which acknowledge that the best approaches to security are based on risk management and

public-private partnerships. The security of ICT products or components is dependent upon *how* they are developed, produced, and deployed, not by *where* they are manufactured.

Cyber threats know no national boundaries. The same goes for the solutions to combat those threats. Those solutions can be invented anywhere, and often are. The PMA policy makes effective global collaboration more difficult, and would shut India off from the most innovative security technologies. Given India's international influence, the broader ramifications of using security to justify protectionism include other countries being motivated to take similar actions.

The PMA policy certainly does not bode well for our industry, threatening to shut us out of a significant portion of the Indian ICT market. The policy's coverage in terms of market segments is so broad it could easily capture \$9.3 billion, or roughly half, of India's \$20.5 billion ICT market. If PMA remains in place without major changes, it sets a highly unhelpful example, encouraging other governments to adopt similar policies to close off their own markets to foreign competition. This would have a cascading effect on U.S. companies. We call this the "contagion effect," and it's real, as we see other governments turn increasingly to similar problematic approaches.

We believe the PMA policy is also not good for India's economic future because it strikes directly at the progress of its recent past. It discourages foreign ICT entities from investing in India, disrupts the global supply chain of ICT vendors that many Indian businesses helped to create and build, raises the price of ICT goods for Indian consumers, and restricts India's access to the best ICT technologies, including those that would improve cybersecurity.

India's unwillingness to join the ITA expansion talks in Geneva is at once surprising and disappointing to us. The ICT industry regards the ITA as one of the most commercially successful trade agreements in the WTO. From 1996 to 2008, total global two-way ITA product trade increased more than 10 percent annually, from \$1.2 trillion to \$4.0 trillion. In the process, the ITA has helped drive innovation, accelerate productivity, increase employment, lower consumer prices, and bridge communities across the globe in ways unimagined 16 years ago, when the agreement was forged. Yet, while the high-tech sector has exploded with new and improved products since the ITA came into force, the product scope of the agreement has never been expanded.

But since last May, trade negotiators from large and small economies, both developed and developing, have been in active negotiations to finally bring the ITA up to date by significantly expanding product coverage. Estimates suggest ITA expansion will increase U.S. exports of ICT products by \$2.8 billion annually, boost revenues of American ICT firms by \$10 billion, and support the creation of roughly 60,000 new U.S. jobs. For the world, ITA expansion is projected to boost global GDP by \$190 billion.

Yet, driven by the perceived impacts on its manufacturing base, India appears reluctant to support the ITA and has been expressing "buyer's remorse" for joining the agreement in the first place. We find this puzzling. The ITA has played a pivotal role in building India's IT-enabled services industry by providing access to myriad innovative and affordable ICT equipment through tariff elimination. Moreover, while imports of tech goods have outstripped exports, in recent years, as India's ICT services industry has become more advanced, India's growth rates of ICT goods exports far exceed imports. According to the WTO, from 2005-2010, the annual rate of India's tech goods export growth was 35 percent versus only 10 percent for tech goods imports.

Just as India's ICT industry benefitted from tariff-free products as building blocks for its development and growth, its emerging manufacturing industry also would benefit from similar foundational economic building blocks, such as ICT goods. To impose tariffs on these goods would be counterproductive to promoting a strong, competitive, advanced manufacturing industry. ICT tariffs are especially harmful because they raise the cost of tech goods and services in virtually every sector of a country's economy, causing businesses and individuals to invest less in ICT and lowering productivity. Indeed, one study done by Indian economists found that for every \$1 in tariffs India imposed on tech imports (in the years before joining the ITA), it incurred an economic loss of \$1.30 due to decreased productivity.

Other emerging economies are embracing ITA expansion, from Malaysia to Costa Rica to Croatia. One must ask, after more than two decades of building its global leadership, will India now stand by and let its competitors reap the investment and trade benefits of being more fully integrated into the global supply chains that will inevitably flow from an expanded ITA?

Bottom line, the PMA, India's reluctance to join the ITA expansion negotiations, and a range of other economic and trade policies, suggest a significant reversal in India's broader growth strategy, and potentially, a similar reversal in our bilateral economic ties. Moreover, many of these policies appear specifically designed to disadvantage U.S. and foreign ICT companies seeking to compete fairly in India. The enlightened and progressive economic policies of two decades ago that enabled India to become a global powerhouse in software and services now seems to be in retreat.

Given the critical importance of the Indian market to the tech sector, the U.S. economy and global economy, this trend is the focus of great concern for us and many other nations. So we deeply appreciate your decision to convene this timely hearing this morning. We are committed to continuing the dialog with India in an effort to find better solutions.

As I noted earlier, India is both competitor and collaborator with the United States and many other countries. Global competition is the rising tide that raises all boats. What's at stake is the shared commitment to the economic ideals that have unleashed innovators and entrepreneurs in India, and reinvigorated innovators and entrepreneurs here in the United States. That is why we urge the U.S. government, and like-minded governments around the world, to intensify their efforts to get India back on a track that once again embraces market-driven approaches and open markets. "Forced localization" policies, such as the PMA, taken to their logical conclusion mean the end of vibrant global supply chains. They cannot stand. They are a real threat to our economic model, to the American economy, and to American jobs.

As we address these problems with India, we recognize this may mean some difficult conversations and consideration of the full range of policy options, but too much is at stake to do otherwise. India is too big and too important in the global context to let this slide. We recognize that India faces many daunting challenges. We all do. Our greatest hope is that we can work together to meet those challenges in the spirit of collaboration that has made the last 22 years so enriching and rewarding for both our countries. Our industry considers India a close friend and valued partner, and close friends and partners owe it to each to have frank and honest discussions when differences arise. It is in that spirit that I offer this testimony today. Thank you.