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POLICY BRIEF

"Mobilizing the State: Indian Economic Diplomacy in the 21st Century"

The Centre for Policy Research, New Delhi hosted a workshop on "Mobilizing the State: Indian Economic Diplomacy in the 21st Century" on 5 - 6 June, 2014. The recommendations that emerged are detailed in this policy brief. This policy brief is not a consensus document. Instead, it seeks to highlight the diverse views that were expressed at the conference while sketching possible areas for consensus. The recommendations expressed do not necessarily reflect the views of the Centre for Policy Research.

KEY RECOMMENDATIONS

Capacity-Building across Government Institutions and Business Associations:

- *Facilitate regular inter-ministerial meetings at the cabinet level*
- *Facilitate more frequent dialogue between government and business associations*
- *Update Indian arbitration and tax laws to encourage international business investments*
- *Introduce the Goods and Services Tax (GST) to ensure fair pricing mechanisms and uniform taxation structures*
- *Double the annual number of IFS officers joining and encourage contractual appointments and lateral hiring within the MEA*
- *Leverage India's growing development assistance program to more effectively realize strategic interests by holding inter- and intra-ministerial meetings on India's strategic interests and current engagement in specific countries*

Market Integration and Trade:

- *Create an Economic Intelligence Unit based within the Ministry of Finance or Ministry of Commerce, which would also coordinate with India's intelligence agencies*
- *Assume a more active role in international institutions for financial reform, regulation and coordination*
- *Create a National Offset Authority to better leverage Indian defence imports*
- *Internationalize the rupee by, for example, fostering the use of bilateral local currency swap agreements*
- *Double resources allocated towards constructing high-capacity road and rail networks within India and also to India's bordering countries in order to facilitate the export of Indian goods and greater connectivity to India's Northeast*
- *Create an Asian buyer's club of large energy importing countries*

Expanding Regional and Global Links:

- *Appoint an officer at large Indian missions to better engage with the Indian diaspora*
- *Gain market access through triangulated efforts with multinational companies*
- *Encourage Indian national and sub-national leaders to engage in economic diplomacy*
- *Focus efforts to increase economic engagement with specific markets*

INDIAN ECONOMIC DIPLOMACY IN THE 21ST CENTURY

Summary of Workshop

While economic diplomacy has always been an integral part of India's foreign policy, it has received greater emphasis since the liberalization of the Indian economy in the 1990s. India's economic strategy during the first three decades of independence was largely based on import-substitution and license-raj, while its economic diplomacy focused on securing development assistance. This overall economic policy framework did not change even during Indira Gandhi's government. In 1970, a more stringent industrial licensing policy was adopted in the wake of decreasing foreign aid from major western donors and the devaluation of the rupee. Rising sentiments against the concentration of economic power within India also translated into more restrictive measures against big business by the Indian government.

India's economic policy and its relationship with Indian businesses underwent further changes when Rajiv Gandhi initiated a more concerted effort to introduce economic liberalization and increased reliance on the private sector during the 1980s. But the real game changer was the liberalization of the Indian economy in 1991. The end of the Cold War and the 1991 balance of payment crisis triggered a shift in India's economic strategy, moving it towards a trade-based model and further increasing the importance of economic diplomacy in India's growth story.

With the onset of the 21st century, Indian business enterprises started playing a more crucial role in advancing India's economic interests abroad. The Indian private sector today is eager to see the state engaged more deeply in economic diplomacy in order to help acquire new markets for Indian goods, to boost India's international investments, and to pave the way for Indian firms to pursue business ventures abroad. And the Indian state has recently begun playing a greater role in economic diplomacy, pushing the interests of the business community through myriad ways, including its growing development cooperation program, greater diaspora engagement, and sub-national economic diplomacy.

The newly elected government under Prime Minister Modi has already signaled a key role for economic diplomacy in its foreign policy agenda. However, questions about what responsibilities the government should keep and what private businesses should undertake, which ministry should be the nodal ministry for coordinating economic diplomacy, and how government and business can work together in advancing Indian economic diplomacy need to be addressed.

To analyze these pressing challenges to India's economic diplomacy, the Centre for Policy Research, New Delhi hosted a workshop on "Mobilizing the State: Indian Economic Diplomacy in the 21st Century" on 5 - 6 June, 2014. The participants of the workshop presented their research and engaged in discussions on the various facets of Indian economic diplomacy, including capacity constraints, trade barriers, the role of sub-national actors, infrastructural deficit, diaspora engagement and India's role in international financial institutions. While identifying the strengths of India's foreign and economic diplomacy, the panelists highlighted the major lacunae hindering India's economic engagement since the turn of the century. The need for India to better leverage its economic policies in order to realize larger political and strategic goals emerged as a major theme across panels. The key recommendations and the summary of the discussions from the workshop are detailed in this policy brief.

CAPACITY-BUILDING ACROSS GOVERMENT INSTITUTIONS AND BUSINESS ASSOCIATIONS

Indian foreign policy has been dominated by political and security concerns while economic objectives have taken a backseat. However, the success of India's economic diplomacy lies in creating an environment for integrating Indian businesses with global markets with government support.

Compartmentalized bureaucratic structures within ministries prevent coordinated actions

In India's economic diplomacy paradigm, there are three main ministries that deal with India's economic engagement - the Ministry of Finance, the Ministry of External Affairs and the Ministry of Commerce and Industry. The Joint Secretaries and Directors at these ministries deal with the majority of the investment negotiations. However, there is little coordination between the Joint Secretaries across the different ministries and as a result, there is no concerted effort to create a uniform policy and process for India's economic engagement abroad. Such a compartmentalized bureaucratic structure often leaves ministries ill-equipped to recognize the broader consequences of advocating a particular policy. To foster better-informed policy prescriptions, the ministries should institutionalize regular cross-departmental meetings at the cabinet level.

Capacity constraints affect integration of economic and strategic goals

Capacity constraints also hamper Indian diplomatic establishments. Indian foreign missions are usually geared towards addressing security and political prerogatives, less so economic diplomacy. Moreover, the number of Indian Foreign Service officers is infamously inadequate to meet India's broader strategic goals. MEA staffing needs to expand considerably – ideally doubling the annual intake of IFS officers and allowing for contracting-in of specialized personnel. Although the creation of the Development Partnership Administration within MEA as a nodal agency for implementation of development projects abroad is welcome, the lack of development specialists as well as the lack of monitoring and evaluation of Indian aid projects continues to undermine the efficacy of Indian foreign assistance.

Inflexiblility during trade negotiations affect economic interests

India's trade, including services, has recently crossed 60 percent of its GDP. Despite this, India's bilateral and multilateral trade treaties are often not in sync. For example, the India-ASEAN FTA has been affected by differences in India's bilateral treaties with countries like Malaysia, Thailand and Singapore. India is also regularly, though possibly unfairly, criticized for taking an unwavering stance during trade negotiations to the extent of collapsing trade talks like the India-ASEAN FTA and the Doha Round at the WTO. A participant opined that this could possibly explain India's exclusion from advantageous trade partnership discussions such as the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP). It is in India's economic and commercial interest that its economic diplomacy efforts aim to reach reasonable compromises in trade negotiations and involve businesses at the same.

Lack of engagement between government and businesses

Indian businesses are hardly involved in policy formulation. Increased government - business interaction is observed only during the formulation of the annual budget, where business associations often lobby for better taxation norms. There is a need to facilitate frequent dialogue between the government and business associations. A monthly dialogue between the various arms of the government involved in economic diplomacy and business associations like the Confederation of Indian Industry (CII) and the Federation of Indian Chambers of Commerce and Industry (FICCI) can help bring a fresh perspective. With a more thorough understanding of each other's capacities, constraints and strengths, the Indian government and India's commercial establishments can hope to effectively focus their efforts to realize broader commercial, political and strategic interests.

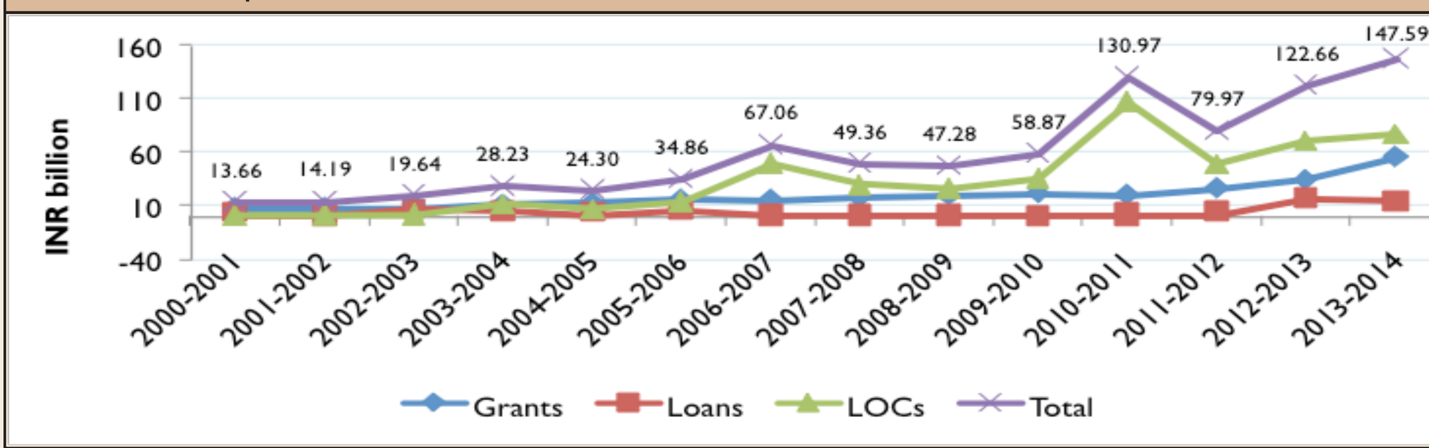
A rapidly rising development assistance program, inadequately implemented and leveraged

India's development assistance program has risen in volume, growing seven-fold since the turn of the century. Yet India has been slow to follow through on commitments and to take advantage of the goodwill it engenders in order to promote or protect its economic and commercial interests. For example, despite enjoying goodwill and close development assistance-based ties, India has lost important investment opportunities in countries like Myanmar to China, due to India's lengthy bureaucratic procedures and lack of ministerial coordination. Beijing, on the other hand, has a far more streamlined bureaucratic process with inter-ministerial coordination, leading to successes in commer-plomacy. Morever, despite the formation of a Development Partnership Administration (DPA) section within the Ministry of External Affairs, India still has few civil servants working on Indian development cooperation. There is also little power or

Case Study: Post Pokhran Damage Control
CII's role in fighting US sanctions

In the aftermath of India's 1998 nuclear tests at Pokhran, India was subjected to harsh economic sanctions by the USA. During this time, the MEA and representatives from India's private sector engaged in a coordinated effort to ameliorate relations between the two nations. Additionally, the Confederation of Indian Industries (CII) encouraged members that had major investments in the US to put pressure on the American administration to remedy bilateral relations. The CII also reached out to Fortune 500 companies, industry chambers in the US and to top US universities to highlight the mutual benefits of greater economic engagement with India. In addition, the CII and the MEA jointly organized visits of US officials, senators and industrialists to India to create a favorable environment for bilateral relations to move forward.

Indian Development Assistance : 2000/01 to 2013/14



Source: Grants and Loans from India Budget 2000/01 to 2013/14 and Lines of Credit from EXIM Bank database incentive for the MEA officials to create transparency and efficiency in India's development cooperation program, including the contracting out of projects. India needs to better leverage its growing development assistance program to more effectively realize strategic interests, by holding inter- and intra-ministerial meetings on India's current engagement in specific countries.

Lack of dispute settlement mechanisms and rigid tax regimes

Business investors in India remain dissatisfied with the inadequate dispute settlement laws. Reliance Industries, for example, has sought foreign arbitration in London for dispute settlements with the Indian Ministry of Petroleum and Natural Gas. Despite assurances from the Indian government, many businesses such as Vodafone, Mcleod Russel and others are also seeking recourse under foreign arbitration, underlining the weakness of India's domestic arbitration and dispute settlement laws.

In addition, India's apparent application of retrospective tax measures - where taxes could be levied from the year 1962 on companies for cross-border deals - has significantly damaged India's reputation as an investment destination.

Since India stands at a lowly 159 out of 189 countries in tax legislation in the Ease of Doing Business Index, the Indian government should put in place a stable and non-adversarial taxation regime and update local arbitration laws. Introducing the Goods and Services Tax could ensure fair pricing mechanisms and a uniform taxation structure, making it easier for companies to operate businesses in India. Until such laws are amended, the government needs to allow Indian businesses to make use of foreign arbitration.

MARKET INTEGRATION & TRADE

In 2012/2013, India's outbound foreign direct investment (FDI) flows stood at nearly US $9 billion, a five-fold increase in the last ten years. Clearly, Corporate India is fast emerging as a major global player. The Indian government, however, has often fallen short of supporting India's business interests abroad.

Few institutions to leverage business and strategic goals abroad

Indian government and businesses often have similar goals, but there is little coordination taking place between them. A more focused effort by the Indian government to create institutions that integrate Indian businesses with global markets will benefit both India's businesses and the Indian government. For example, setting up an Economic Intelligence Unit (EIU) within the Ministry of Finance or the Ministry of Commerce could help the Indian government more effectively monitor business developments that affect India's strategic interests.

Further, creating institutions like the National Offset Authority (NOA) that would enable India to link its defence imports to leverage gains in other sectors will prove beneficial. Through the NOA, India could effectively leverage its position as the largest importer of defence equipments to realize broader benefits from particular defence deals - ideally even persuading defence partner countries to bring in high-end technologies whose benefits are not restricted to the defence sector alone. Participants also suggested fast-tracking the setting up of NOA and EIU so that India can more effectively leverage its commercial successes to realize broader strategic interests.

Need for greater role in multilateral financial institutions

India has been pushing for the implementation of major voting rights reforms at the IMF, which would shift

National Offset Authority to leverage India's Defence Procurement

The global defence industry is highly oligopolistic and it lacks the impetus of market forces that boost competitiveness and efficiency. Defence equipment therefore has no open market pricing and large defence import contracts can significantly change the fortunes of such industries. Being a sensitive sector, major defence contracts are negotiated between governments. India's defence production is limited and largely state-owned. Because of the nature of the international defence market, an increase in the FDI cap in defence to 100 percent from the current 26 percent may not help in achieving market competitiveness. However, India can leverage its position as one of the largest defence equipment-importers by setting up the NOA to gain cost-effectiveness in its defence import contracts.

power towards developing countries, including India. These reforms were approved by the IMF in 2010, but the U.S. Congress has thus far refused to ratify these changes. India should use the G-20 and other fora to make clear that a failure to expeditiously implement governance reforms at the IMF will force India to turn towards other international financial institutions, including the BRICS Bank, thereby decreasing the relevance of the IMF in the longer term. India should also build up on its active follow up of the Basel Committee for Banking Supervision for stronger banking norms and play a more pivotal role in regional payments/financial arrangements like the Asian Clearing Union and the BRICS Bank, which shall be in India's long term interest.

Poor connectivity within India and across India's border states affects regional economic integration

Infrastructure development is key to facilitating trade and investment. Indian projects like the Golden Quadrilateral, the Delhi-Mumbai Industrial Corridor and the Kaladan Multi-Modal Transport Project have been successful. However, road and rail infrastructure in many parts of the country, notably in India's Northeast region remains woefully underdeveloped. Roads connecting India to neighbouring countries also remain poorly developed. To highlight one notable example, the Asian Highway project that is under construction across Southeast Asia reaches India's border at the town of Moreh, Manipur and deteriorates into a narrow road on the Indian side. There are many other examples of such yawning infrastructure gaps, which, if left unaddressed, will make it much harder for India to promote trade and investment, especially through its border regions. India should therefore substantially increase the resources it presently allocates towards the construction of high-capacity road and rail networks within India as well as across bordering countries.

Lack of internationalization of the rupee hampers economic growth and trade

India's tepid efforts to internationalize the rupee have affected economic growth and trade. In order to better internationalize the rupee, India should consider entering into more bilateral currency swap agreements while also promoting rupee invoicing. Using the rupee, especially for trade invoicing, would save on transaction costs and increase the demand for Indian currency - in the process strengthening it.

Reactive instead of proactive decision-making

Indian decision-making on trade and market integration has often followed a 'tipping-point model,' where changes are made only when it becomes obvious that a particular policy has become totally ineffective. Reactive as opposed to proactive decision-making on trade and market integration by bureaucrats and other policymakers is partly to blame.

Lack of coordination with other energy importers leads to high prices of oil, coal and Liquified Natural Gas (LNG)

Presently, India along with Japan, China and South Korea are amongst the world's largest energy importers. Despite the considerable demand for coal, oil and LNG, these four nations end up paying high prices – often up to four times the 'Henry Hub' price, the North American benchmark for LNG for example. To ensure access to energy at cheaper rates, India along with China, Japan and South Korea should aim to create a 'buyer's club' of energy importers through which the four countries can more effectively leverage their vast energy purchases to negotiate better prices for oil, coal and LNG.

In the wake of alleged manipulation of the global crude oil pricing benchmark (BRENT) and the concerns regarding the credibility of the global oil benchmarking architecture, India should consider taking the lead in promoting newer price reporting agencies and exchanges with better transparency and standards.

EXPANDING GLOBAL LINKS

India's relations with nations outside its immediate neighbourhood have been bolstered by a high volume of trade and development assistance, as well as its widely scattered and extensive diaspora. For instance, Indian remittances are the largest in the world touching US$ 71 billion in 2013, twice as much as India's FDI inflows and over US$ 10 billion higher than Chinese remittances. A sizable 38 percent comes from North America alone, while 27 percent comes from Gulf countries and 18 percent from Europe. Thus, ties with nations that have a large Indian diaspora require careful nurturing by the Government of India through innovative outreach strategies.

India's energy success story
Case Study: GAIL-Cheniere Deal

Shale gas discovery in the US is now turning it into an LNG exporter. The Indian public sector enterprise (PSE) GAIL (India) Ltd. has entered into agreements with two of USA's largest LNG exporters, Cheniere Energy Partners LP in 2011 and Dominion Resources Inc. in 2013. This indicates an increasing involvement of Indian PSEs in the global energy market to sustain India's energy needs. Both deals involved Sales and Purchase Agreements (SPAs) for the supply of LNG over 20 years from 2017. Due to these contracts, GAIL has emerged as one of the largest Henry Hub LNG portfolio holders, providing it an opportunity to import LNG at lower prices from the US. Subsequently, the US Congress passed the Domestic Prosperity and Global Freedom Act (HR 6) to expedite LNG export to allies such as India and Japan, helping these nations secure vital economic goals.

Continued weak engagement with the Indian diaspora

The Indian diaspora is a major source of skill and expertise for the development of the country. Apart from remittances, the diaspora helps build India's clout abroad via invaluable contributions to the economies and societies of host nations. Furthering this clout is the large and growing volume of Indian FDI flows abroad. The United States, for example, received US$ 20 billion in investments from India - something that India has been unable to leverage. In the past, the Indian embassy in Washington hosted a weekly power breakfast to connect with local NRIs, forging much needed connections between potential Indian investors and local partners, as well as providing a platform for the exchange of ideas. Drawing on the success of this initiative and the commendable efforts by the Ministry of Overseas Indian Affairs (MOIA) to arrange new institutional linkages to tap into the tremendous potential offered by human capital, overseas employment possibilities and philanthropic potentials of the Indian diaspora, the Government of India should foster greater institutional engagement with the Indian diaspora. India should designate one IFS officer at each mission to serve as a Diaspora Officer and organize outreach events at each Indian Embassy or High Commission in countries that have a large Indian community. Further, the MOIA, which organizes the annual Pravasi Bharatiya Divas festival in India, should encourage India's missions abroad to host similar small-scale events to more widely recognize the contributions of Indians abroad.

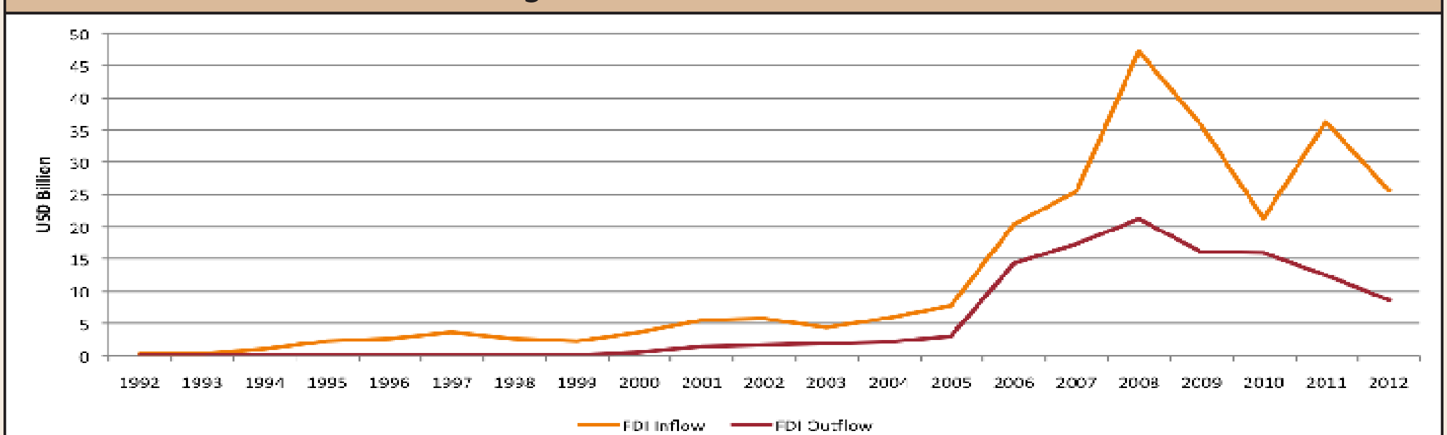
Worsening balance of payments deficit despite growing trade volume

India has encountered worsening balance of payments despite rapidly increasing trade volumes. A striking example is India's trade with China, which has increased 22 fold since 2001. On China's top-export list, India's position went from the 19th spot to the 7th spot, while on China's top import list India has only moved from the 19th spot to the 18th spot over the same period, indicating a deepening bilateral trade deficit. A possible explanation is that while India imports a high volume of capital and consumer goods, it exports mainly raw materials and other primary goods. This trend might change in the future if India adopts manufacturing-led export. Since wages in China are now beginning to increase by 15-20 percent annually, the Chinese government is attempting to move to consumption fuelled economic growth, thereby creating an immense opportunity for Indian exports.

Missed regional investment opportunities due to lack of triangulated efforts with multinational companies

While large transnational corporations have managed to exploit investment opportunities in South Asian countries, large Indian corporations have often missed out due to poor channels of engagement and inadequate local connections and know-how, which deter private investors from venturing into unchartered markets. The French oil company Total for instance, has had a prominent presence in Myanmar for years, with significant support from the French government. Indian private and state-owned companies such as ONGC should try to gain market access through triangulated efforts with multinational companies in countries such as Myanmar. This would lead private companies to be far more willing and able to tap the tremendous investment potential from economic engagement with these markets.

India : Inward and outward foreign direct investment flows, annual, 1992-2012



Source: UNCTAD Statistics

Failure to leverage development cooperation in Africa

India has also failed to leverage its soft power influence in countries around the world. One of these vital sources of influence is India's development cooperation program, which is growing in volume and diversity. Of the official lines of credit (EXIM bank loans at concessional rates) disbursed by India since 2004, over 60 percent have been channelled to Africa. Yet, the prevailing perception in Africa is that India is a relatively small and insignificant stake-holder/contributor on the continent and India's growing international prosperity and clout remain largely unknown. Better marketing and leveraging of India's development cooperation efforts in Africa would enhance India's ability to engage with rapidly growing economies in Africa. Suggestions to this end included designating a point of contact at the political level who is empowered by the Prime Minister to deal with large regions such as Africa. This individual would be tasked with the responsibility of building important bridges connecting governments as well as public and private institutions between India and Africa.

EXPANDING REGIONAL LINKS

Given that India has large stakes in the growth and stability of South Asia and considering its deep historical, cultural, economic and geographic linkages with the region, South Asia features prominently in India's foreign policy engagement. Though India has always strived to maintain better relations with its neighbours, India's political reservations on reintegrating South Asia has allowed external actors like China to assert its presence in the region. The participants of the workshop reiterated the importance of neighbouring countries in India's economic diplomacy and affirmed the role of sub-national actors in strengthening India's bilateral relations with its neighbours.

Greater support for sub-national economic diplomacy

Border states are critical drivers of economic diplomacy with great potential to deepen India's engagement within the region. The growing priority that India attaches to sub-regional initiatives such as BIMSTEC (Bay of Bengal Multi-Sectoral Initiative for Technical and Economic Cooperation), the Mekong-Ganga Economic Cooperation (MGC), and the BCIM Forum (Bangladesh China India Myanmar) provide an opportune institutional entry point for sub-national actors in India's economic diplomacy. Indian border states are not only facilitating India's engagement with its neighbourhood, but are also requesting greater autonomy in negotiating trade and commercial ties with its neighbours. For instance, the state of Tripura has successfully lobbied the Indian government to allow it to sell electricity across its border to Bangladesh. Similarly, representatives from the government and the private

Cross Border Energy Cooperation Case Study: Palatana Power Plant

A major success story of sub-national economic diplomacy is the construction of the Palatana power plant in Tripura which was made possible by excellent sub-national links between Tripura's Chief Minister and Sheikh Hasina, the Prime Minister of Bangladesh. Consequently, Bangladesh allowed heavy equipment and building material coming from the Haldia port in West Bengal to pass through its port at Ashuganj. In return, the Tripura Power Cooperation (OTPC) developed the jetty at the Ashuganj port, widened the road that passes through the Sultanpur-Akhaura border, constructed bypasses on water-bodies and successfully lobbied the Central Government in New Delhi to sell 100MW of excess power to Bangladesh from the Palatana plant.

sector from the Indian state of Punjab recently played a pivotal role in convincing the Indian government to export electricity across the border to Pakistan. Gujarat is also keen to improve trade relations with Pakistan and has been pitching for energy cooperation with Pakistan's Sindh province.

While external policy remains the ambit of the Centre, consulting state governments on relevant foreign policy measures will ensure coherence as India aims to realize its strategic interests in its neighbourhood. India should encourage cross-border official visits by central and state government officials in order to bolster bilateral ties.

Barriers to cross-border trade

To enable border states to play a more effective role in India's economic diplomacy, institutional bottlenecks and logistical logjams will need to be addressed without delay. The lack of infrastructure connectivity and a stringent visa regime hinder the growth of bilateral relations and prospects of people-to-people contact. Although security concerns exist, opening up of borders by simplifying and expediating visa norms for all neighbouring countries would spur trade and bring prosperity on both sides of the border - thereby further bringing stability to the region.

Most of India's border states suffer from poor cross-border road connectivity and very few land border crossings have integrated checkposts. The dearth of integrated checkposts coupled with restrictive regulations for cross-border trade act as non-tariff barriers, deterring legitimate trade. Creating integrated checkposts, resumption of border haats, doing away with complicated procedural requirements, and easing visa norms would help encourage legitimate economic activity and trade.

Workshop on "Mobilizing the State: Indian Economic Diplomacy in the 21st Century"

Dr. Pratap Bhanu Mehta, President at the Centre for Policy Research introducing keynote speaker Dr. Montek Singh Ahluwalia

Dr. Sanjaya Baru gives an overview of Indian economic diplomacy

C Raja Mohan gives the concluding remarks at the workshop on Day 2

Jaimini Bhagwati, Former Ambassador to the EU and the UK, addresses the gathering on Day 2