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ASSESSING THE INVESTMENT CLIMATE AND IMPROVING MARKET ACCESS IN FINANCIAL SERVICES IN INDIA

HEARING

BEFORE THE

SUBCOMMITTEE ON
NATIONAL SECURITY AND INTERNATIONAL TRADE AND FINANCE

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

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FIRST SESSION

ON

EXAMINING U.S.-INDIA ECONOMIC RELATIONS, INCLUDING REGULATORY AND STATUTORY BARRIERS TO FOREIGN DIRECT INVESTMENT IN THE BANKING AND INSURANCE INDUSTRY AND LOOKING AT PROSPECTS FOR LIBERALIZATION OF MARKET ACCESS FOR THE FINANCIAL SERVICES INDUSTRY

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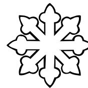

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C O N T E N T S

WEDNESDAY, SEPTEMBER 25, 2013

	Page
Opening statement of Chairman Warner	1
Opening statements, comments, or prepared statements of:	
Senator Kirk	3

WITNESSES

Arvind Subramanian, Senior Fellow, Peterson Institute for International Economics and Center for Global Development	4
Prepared statement	22
Response to written questions of:	
Senator Kirk	61
Richard M. Rossow, Director, India & South Asia, McLarty Associates	6
Prepared statement	39
Response to written questions of:	
Senator Kirk	61
Reena Aggarwal, Ph.D., Robert E. McDonough Professor of Business Administration and Professor of Finance, and Director, Georgetown Center for Financial Markets and Policy, McDonough School of Business, Georgetown University	
Prepared statement	55

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WEDNESDAY, SEPTEMBER 25, 2013

U.S. SENATE,
SUBCOMMITTEE ON NATIONAL SECURITY AND
INTERNATIONAL TRADE AND FINANCE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Subcommittee met at 2:35 p.m. in room SD–538, Dirksen Senate Office Building, Hon. Mark Warner, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF CHAIRMAN MARK R. WARNER

Senator WARNER. I call to order this hearing of the National Security and International Trade and Finance Subcommittee. Today we are going to be—the topic of the hearing is "Assessing the Investment Climate and Improving Market Access in Financial Services in India," and I thank the witnesses for being here, and I thank my good friend, the Ranking Member, Senator Kirk, for being here. And I apologize for being a couple of minutes late.

I am going to do a brief opening statement. Then I will turn it over to Senator Kirk, and I will then introduce the witnesses. Let me go ahead and I will get through this relatively quickly.

Again, I want to thank Senator Kirk for joining me. He and I are both members of the Senate India Caucus, which we are proud is the largest bilateral caucus in the Senate and something with the Prime Minister coming tomorrow we want to emphasize.

India is now the world's fourth largest economy in terms of purchasing power parity, and obviously, with Prime Minister Singh here meeting with the President, economic issues will be at the forefront of many of their discussions.

It is my hope that in this hearing we can explore some of the areas where we can improve our bilateral relationship and strengthen the foundation for a long-term strategic partnership.

One area where the relationship can blossom and I think one of the things that I think is most interesting about the U.S.-India relationship—Senator Kirk has got a deeper background in international affairs and foreign affairs than I do, but it was not that long ago where the relationship between India and the United States was tepid at best, and then we moved from that tepid to a period, particularly under President Clinton and President Bush 43, where it was quite strong, I think, our friendship; and now it

has to move into a more mature partnership. And I think those are some of the challenges we face.

But as we look at these issues, according to the Financial Times, India will have the third largest business system measured by assets by 2025. Yet as we think about this bilateral relationship, there are only three foreign banks that have more than two dozen branches to serve this country of 1.3 billion people, soon to become the world's most populous country. And at a time when India's growth is slowing, opening access to financial markets, including banking, insurance, commodities, trading, foreign exchange, and the mutual fund industry, I think there could be benefits not just to India but obviously to American companies as well.

I welcome the overtures made by the new Reserve Bank Governor Rajan to liberalize the banking system. Dr. Rajan said just 3 weeks ago that, "India has a number of foreign owned banks, many of whom have been with us for a long time and helped fuel our growth. They have been in the forefront of innovation, both in terms of improving productivity, as well as in terms of creating new products."

I like that quote. I hope he will use the central bank to encourage the government to move forward on those issues.

I am going to ask our witnesses on that subject. I will also ask our witnesses to provide their views on the overall investment climate in India, and the Indian Government has recently opened several sectors for increased financial investment. I know things like multi-brand retail have been a challenge, but I think, again, these are ways that, as we move into a more mature partnership between our two countries, where our strategic interests are so closely aligned, we need to see if we can continue to press on this.

Let me make a couple of quick comments as well on where I hope the Prime Minister's meetings with President Obama will focus later this week.

I think—and I know we had some momentum a while back, and we need to keep the momentum. I really do think we need to move forward on a bilateral investment treaty. A BIT will increase regulatory stability and reduce investor uncertainty. Particularly as you see India's economy slow a little bit, we have got to increase that investor security if we are going to have the FDI that we need to see.

Second, I believe we need to press our Indian friends on some of the aspects of their retroactive tax system. This is an area that, as somebody who was in the wireless industry and managed to do pretty well, and did investments in countries abroad, it would have—I would have felt that we were going to come back and have those licenses repriced or our tax system relooked at after the fact, it would have paused with our investment.

Finally, I hope that India will continue the process of liberalizing foreign access to their domestic market. I know that the Finance Minister said that insurance was an area that would be looked at. Again, I hope it is an area that they will pursue.

Let me also say that this—I have outlined some of the things that India needs to do to kind of encourage increased FDI and particularly opportunities for America to invest. I think this has to be a two-way street. We need to look at other ways for continued in-

vestment from Indian companies into Illinois, Virginia, and across our country. And I continue, as somebody from the tech sector, to be concerned that on H–1B and other programs that we do those in a fair way for both countries.

So I look forward to hearing from our witnesses, and I want to turn it over to the Ranking Member, Senator Kirk, for his comments.

STATEMENT OF SENATOR MARK KIRK

Senator KIRK. Thank you, Mr. Chairman. I will take your pro-Indian feelings and up them one. I have long felt that the best way out of Afghanistan is through New Delhi, is to have a military alliance with India, that we encourage India to roll into Afghanistan to be a nonterrorist base, because as I remember, the last time I was in India, the Indian military briefed me that they were fighting about 30 separate terrorist insurgencies. So the two countries have strong national security common interests which could propel the BIT forward in joint business.

My hope is eventually by being an ally of the United States that India just makes sense to both sides, being the largest democracy on Earth, and for us the most powerful democracy on Earth, it just makes sense to get rid of these barriers. And the one barrier that I would like to highlight is the requirement in India that a foreign insurance business has to be 49 percent owned by Indians.

There is a whole Nehruvian economic culture in India that has triggered a loss of a whole generation's progress, and I think, as I remember from my visit to India, the total focus of the Indian body politic was the economic and military competition with China, that because of that tradition of Indian socialism, they basically skipped a generation. And in reality, the Chinese fell behind because Mao was such a disaster economically, that had the Chinese modernized, they would have shot way ahead of India based on the performance that we have seen.

My vision for insurance is someday a good Chicago, Illinois-based company like State Farm and maybe a Virginia-based company like GEICO, so that State Farm and—those two insurance companies could fight it out across the Indian subcontinent for what could be one of the largest auto markets on the planet.

Senator WARNER. Amen. Well, I agree with Senator Kirk, and I would say one of the things I hope our witnesses will mention, he mentions the importance of the strategic defense relationship, which I concur with. Part of the challenge—again, this is a two-way street as we try to encourage India to look at purchasing American military equipment. We have to be a little more willing to kind of recognize India as an ally and partner, and that means what we sell, some of those things on those restricted lists, needs to be reexamined in light of the nature of this new partnership. So, again, I thank Senator Kirk for his comments.

We have got two incredible witnesses today: Dr. Arvind Subra—Subramanian—I apologize, sir. You would think as someone who is the co-chair of the caucus could do a little better.

[Laughter.]

Senator WARNER. He is the Dennis Weatherstone Senior Fellow at the Peterson Institute for International Economics and a Senior

Fellow at the Center for Global Development. He is a recognized authority on international economic issues. He has written on growth, trade, development, international aid, oil, India, Africa, and the World Trade Organization. His scholarship is published widely in academic journals as well as the New York Times and Financial Times. He has advised the Indian Government in different capacities, including as a member of the Finance Minister's expert group on the G–20.

Mr. Richard Rossow—I will see if I can also butcher your name a little bit, too—is Director for South Asia at McLarty Associates, leading the firm's work for clients in India and the neighboring region. Mr. Rossow has extensive business experience in India. Before joining McLarty, he was with the New York Life Insurance Company—so it is a subject I think he will be an expert on in terms of State Farm and GEICO and other competitors getting into that market—where he served as head of international government affairs and developed strategic plans for the company's global M&A work, including in India. From 1998 to 2008, Mr. Rossow served as director of operations of the U.S.-India Business Council.

Regretably, we had a third witness, Dr. Reena Aggarwal of Georgetown University, who was not able to join us for today's hearing, but we wish her well. We will make sure that her written statement will be written into the record.

Senator WARNER. Arvind, would you like to go ahead and continue?

STATEMENT OF ARVIND SUBRAMANIAN, SENIOR FELLOW, PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS AND CENTER FOR GLOBAL DEVELOPMENT

Mr. SUBRAMANIAN. Thank you very much, Chairman Warner, Senator Kirk, for providing me this opportunity to testify before you. Sorry for having such a difficult name to pronounce. My apologies.

In the short time available, I want to make two observations, one prediction, and two recommendations.

So observation number 1, the Indian economy recently encountered serious turbulence and will require important reforms to stabilize the economy. Part of this reflects, of course, India's financial integration with the world. For example, between 2010 and 2012, India received about $160 billion in foreign capital, and the threat of taper by the U.S. Federal Reserve meant that some money had to flow back, creating trouble. But, of course, India's problems have more durable domestic origins, and my New York Times piece elaborates on those, and clearly, going forward, reforms will be necessary to kind of stabilize the economy. I think fiscal consolidation by eliminating some of the wasteful subsidies and introducing what seems to be a very promising new tax, which I think is possible in the near future, these will be critical. But looming elections ahead complicate some of these challenging actions.

Observation number two is that this economic uncertainty over the last year paradoxically has triggered unprecedented liberalization of FDI and other capital inflows. This seems paradoxical, but it is consistent with international experience that governments, when facing a sense of crisis—you know, I do not have to talk

about this in this chamber at these times. When a sense of crisis looms, I think governments undertake action, and India has liberalized extensively in several sectors—multi-brand retail, defense, petroleum and natural gas, telecommunications, *et cetera.* Limits on foreign inflows, debt, equity capital have been relaxed considerably. You know, in terms of telecom, the PMA, what is called the preferential market access, at least for the private sector, has been put on stay for the moment as another encouraging sign.

My prediction number one, after having made two observations, is that my belief is that further opening to foreign investors, especially providers of financial services, is likely. A new pension-related bill has just cleared one of the two houses of parliament, and I think it has reasonable prospects for passage. And the famous draft insurance legislation, which would allow much greater FDI, up to 49 percent in the insurance sector, I think the problem it is more held up for, you know, political reasons rather than substantive. In fact, I would say there is bipartisan support for that bill, so it is a matter of time, not a matter of principle, before the insurance bill is passed.

My recommendation number one based on these observations and prediction is that the time may be ripe now for pursuing a BIT, as you had set forth in your letter, Senator Warner, and I think there are two reasons why that is the case:

One, India has actually liberalized extensively on the FDI so that domestic actions necessary to, you know, engage in international negotiations are being undertaken;

And, second, I do not think it is any secret that the fact that the United States and China are also negotiating a BIT is going to put a little bit of extra pressure on India as well. The competitive pressure to liberalize is going to begin to work. I think we should be under no illusions. There will be very difficult issues. But I think these should be overcome, at least can be overcome with some skillful negotiation and kind of realism on both sides.

My second and final recommendation is perhaps the most important. A bilateral investment treaty in my view is but a stepping stone for creating a broad and strategic framework for U.S.-India economic relations. Senator Kirk, you alluded to some of the defense imperatives. But I think this framework is essential, and it would include as a critical element, I think, embracing the principle of and working toward or at least initiating preparatory work toward a free trade agreement in the future.

Now, why is this framework necessary? I think for about four or five reasons. Senator Warner, you referred to one of them. I think the prize is big. India is a big economy, a growing economy. Indian demand for infrastructure, imports of natural gas, financial services is going to be huge, and my colleague Brad Jensen shows that the United States has a comparative advantage in this and will have a key role in meeting Indian demand.

Second, I think the framework is necessary because India and the United States are going to face a number of challenges going forward. That is just in the nature of having a mature relationship. And I think we need a credible mechanism to resolve these ongoing challenges.

Point number three, the reason to have a framework is that India and the United States are really inflicting a lot of discrimination on each other while negotiating these free trade agreements with every other trading partner. India is negotiating free trade agreements with all of Asia, also with Europe, it is in the process, and all this discriminates against U.S. business in India. And this discrimination is very expensive because India has pretty high barriers and it is a growing market. So the discrimination on U.S. business is, I think, going to be more and more going forward, and this needs to be rectified. Of course, the United States is doing similar things to India because of the TPP and TTIP.

I think point number four, I think it is very important to realize that the U.S.-India relationship has a key role to play in keeping China tethered to the multilateral system and in more generally ensuring China's peaceful rise.

Last, but not least, I think this framework is necessary because I think the relationship needs to "go big." Going big is necessary because this is a relationship between two democracies, this is a marathon not a sprint, it is a multi-dimensional not a uni-dimensional relationship. And, paradoxically, I think going big is the best way to address even the small. I have said it before. I think you cannot solve problems relating to chicken just by talking chicken. I think you need a broader framework.

And so my colleague C. Fred Bergsten and I will soon be finalizing a book, "Breaking Ground by Breaking Barriers: An Economic Partnership of the Largest Democracies," in which we will elaborate on what this framework should consist of, its rationale, content, the impediments to achieving it and how they can be overcome.

Thank you.

Senator WARNER. Dr. Subramanian, I thank you for that.

Mr. Rossow.

STATEMENT OF RICHARD M. ROSSOW, DIRECTOR, INDIA & SOUTH ASIA, McLARTY ASSOCIATES

Mr. ROSSOW. Thank you. Chairman Warner, Ranking Member Kirk, let me also echo Arvind and thank you for this opportunity to present in front of the Committee just ahead of the Prime Minister's visit. Allow me to state the views I am expressing are my own, not of my clients or my firm. I do represent clients in the financial industry in India, but these are my own views.

First, let me share some surprising news. With a lot of talk about India's worsening fiscal situation combined with recent investor concerns, one would assume that American trade and investment into India has collapsed. But, actually, the opposite has taken place. This year, 2013, exports to India through July are up 11 percent, on track for an all-time record of exports to India. American imports of Indian products are up 5 percent, also on track for a record. Foreign direct investment into India is up 7 percent over last year in dollar terms, at $12.5 billion. And I say dollar terms because if you do it in rupee terms, it is actually up 13 percent, so what they are feeling from foreign direct investment in India is actually a pretty big increase from last year.

Even foreign institutional investment, which is often referenced as having trailed off dramatically in June, July, August, has actually perked back up in September and is net positive for the year pretty dramatically. So the numbers, real investors, real business leaders, are still make a decision to go to India despite the negativity that we read in the press every day. But as I am sure we all agree, there is a larger untapped potential, and particularly in financial services.

Now, market access into India's financial service, as has already been discussed, varies by industry from lows of 26 percent for insurance and pensions all the way up to 100 percent for a variety of activities under what India calls the nonbanking financial corporation, asset management and things like that. But I am not going to focus as much on market access. The actual line numbers and everything are included in my written testimony. But let me give you another perspective from a business point of view about the Indian market.

There is another filter that executives make when determining about whether to make their investment into India or another market, which is, What is the likely return on the investment and what are the risks?

In India, regulatory risk presents a significant barrier to business planning. India's financial regulators have been quick to reshape fundamental aspects of the sectors they govern. A financial services investor cannot reasonably assume that critical regulations governing their product distribution model or tax treatment will be stable over a 5-year window.

A powerful example of this comes from the life insurance industry, the sector that I know best. Four years back, life insurance premiums made up almost 5 percent of India's economy—5 percent from this one sector, life insurance premiums. In 2010, reacting to concerns in the market that agents were mis-selling the primary product in the market, the regulator changed how the product is structured, and the life insurance market in India has trailed off since then, and it now contributes only about 3 percent to India's GDP. That is one sector of the economy. India's regulator was reacting to a need in the industry, which was the mis-selling of a product. But unlike what we see from regulators around the world, instead of trying to change how agents sell the product, they actually changed the structure of the product. They made it less incentivized to sell and less profitable for the companies to sell.

So when you look at what has happened in India's economy and how it has declined, most people look at a top-down approach. There are these huge macro factors that have taken place that have impacted the economy. From my perspective, if you look across the variety of industries, several of which I cover in my written testimony, there are actually bottom-up reasons why a number of the key drivers of India's growth over the last 10 years have trailed off in the last couple years.

Now, there are three suggestions that I have as to how the U.S. Government can continue to support the growth of economic relations with India.

First, as has already been referenced, is sign a high standards bilateral investment treaty. But I want to reiterate that, because

it is not just about the political significance, which is typically what is mentioned when talking about the BIT. When you talk about what are the major areas that we are talking about for investor concerns right now, local content rules, FDI caps. Our model BIT has got provisions for both of those. National treatment and establishment is code for FDI caps. And our model BIT has a section on performance requirements, which India's treaty does not, that could potentially take care of some of these local content rules. So there is a lot more substance behind the BIT that I think is given credit, too, in some discussions.

Second, we need to engage more deeply with India's state-level leaders. There are a lot of smaller parties in India that actually control their own states and, thus, want to see development, and at the same time have solid representation in India's parliament. Going to these states, engaging with them, and showing partnership is critical to getting their support for reforms. And I point again to the insurance industry. The insurance regulator is based in Hyderabad, which is in the southern state of Andhra Pradesh. No other regulators or government offices are based in Andhra Pradesh. Why is it there? Because when the first bill was passed, in 1999, to open the market, a local party in that state had 29 votes. They supported the opening in exchange for getting the regulator located in their state. Those kind of deals are terrific. It gives me an opportunity to go to Hyderabad every time I go to India on insurance business.

The third suggestion is more frequent review and reshaping of the areas that we choose to engage India. The general perception is that maybe they are not moving fast on things, but that is only the things that we are talking about. They are moving extremely fast on financial inclusion, access to health care, and promoting domestic manufacturing.

Coincidentally, India's drive to increase their capacity in those three areas has also harmed our companies. The very things that India wants to do are the things that have been hurting us. If we want to avoid collateral damage on India's moves in the future, we need to make sure that the areas we are focusing our partnership are areas that India is actually moving on. Pushing rocks downhill is much easier than pushing them uphill.

So, to summarize my remarks, increased market access is critical for investors, but the lack of regulatory predictability has also diminished India's attractiveness as an investment destination.

I will conclude with a great point made by Ravi Venkatesan, who is the former Microsoft India chairman, in his new book, "Conquering the Chaos." Ravi points out that most of the growth in the world over the next 50 years is going to come from places that look a lot more like India than, say, Canada. So all of our work on helping American companies succeed in India will help ensure that American companies remain global players over the next 50 years as well. So it is pretty critical that we win in India.

Thank you.

Senator WARNER. Thank you. Thank you both.

We will do 5 minutes, and then we can just have more of an open session here.

You know, the first question, I guess—and I am starting with you, Dr. Subramanian—Mr. Rossow raised some of the good points, that American FDI has actually not declined that much. But if we look in a macro sense, I was last in India about a year past, or not even a year past, and there were concerns that India's growth might fall to 6 percent and 5 percent. Now I think we are at 4.4, and we have seen the rupee decline about 40 percent over the last 2 years. Part of that is obviously, I think, due to some of our actions at the Fed, but I guess the question I would have for both of you is: This both growth decline and decline of the rupee, is this just a cyclical challenge or is it a reflection of a greater structural concern? I will start with you and then Mr. Rossow.

Mr. SUBRAMANIAN. That is a great question, Senator Warner. The way I think about this is that, you know, there is a kind of structural problem here which is that India has relied a lot on using its IT talent, you know, the call centers and so on, to be the engine of growth. It has not done sufficiently well in mobilizing its low-skill labor in order to do manufacturing. So in one sense, therefore, I think we need a structural reboot to the economy, if that is going to happen.

But on the other side, the reason I am hopeful that that reboot will happen is actually something that, you know, Rick touched upon in his second comment, which is that the real impetus for change in India, including this kind of structural reboot, is actually happening at the level of the states. And the way it is happening is that, you know, more and more power is now with the states, particularly in economic. So what happens is that if some governments, like Gujarat or, you know, Tamil Nadu or Karnataka or Andhra Pradesh start doing well, that becomes a powerful model for other states to follow, not just in a kind of general sense, but also in the specific sense that they manage to attract capital and people to the detriment of others. So there is a kind of race to the top that this, you know, competition between states dynamic is introducing.

And what is even more hopeful is that in the last two election cycles, those governments that are delivering on governance and, you know, economic performance are getting reelected. Secretary of Defense Donald Rumsfeld used to say that, you know, you go to bat with the army that you have. In India, you go to bat with the political system you have. You know, the system is democracy, so change has to happen through democracy and through the democratic process, and this competition between states is the way in which this is happening, change is happening, which is why I think even though there are some structural problems, I can kind of see a way out back to 7-, 8-percent growth in the not too distant future.

Senator WARNER. Rick, do you think it, again—is this more cyclical or structural or—I think you partially addressed that.

Mr. ROSSOW. Yeah. I touched on one sector in particular, insurance, which, again, made up almost 5 percent of the Indian economy, and because of a regulatory change, you know, for reasons that we understand, has trailed off. Arvind mentioned another: IT services. You know, it had been growing during the heyday at 30, 40, 50 percent per year. And that has trailed off because they cannot pump out enough graduates to work. There has been some reg-

ulatory changes there as well. They removed a tax benefit that companies took advantage of.

Another sector I will point to: telecom. Telecom services, a reform in 1999, which in my opinion was India's most important reform it has ever done, called the New Telecom Policy, essentially freed up the telecom market, which also helped fuel the growth of the IT service industry because it opened up international telephony and prices came down. The New Telecom Policy, that is really when India went from 1 percent teledensity up to its current level of 80 percent or so.

People still get on stage, and they talk about India's cell phone market growing by 10 million subscribers a month. I still hear people talking about that. That is old news. In the last 12 months, India's cell phone subscribership has dropped by—let me see, I have got the number here—60 million. A 60 million drop in cell phone subscriptions. Cell phones. That was one of the fastest growing areas when India was at 9 percent. Insurance was growing by 40, 50 percent per year. IT-enabled services, the growth of those industries, still growing but not at the clip that they were. Mutual fund management. Different reasons, none of them necessarily related to Fed action, tapering, or even the lack of new reforms, not even related to that necessarily, the stuff that India could have done that would have moved 9 percent back in the day up to 15-percent growth—roads, electricity, airports, things like that.

So I think a bunch of the sectors that make up a huge chunk of the economy, individual reasons for each of them, but they just happened to come together at about the same time, different regulators, different government moves that have undercut growth or in some cases, like telecom, you just reach a certain teledensity, and it is difficult to grow past that.

Senator WARNER. Let me—I am going to make one comment and get one more question before I turn it over to Senator Kirk. I would concur with your comments about the ability to do business with the states in India. I think that is sometimes—American businesses fail to understand that. I have worked with a lot of higher education institutions in America who have been waiting for Delhi to pass a higher education reform bill, and I think recently many of them have just decided to go straight to the states. Now, they are maybe not full 4-year institutions, but I think there is a growing opportunity at the state level to emphasize that point that Arvind made.

I guess one of the things—let me go back to the BIT before my time runs out. What should we expect—recognizing Indian elections coming up, recognizing, you know, we are not exactly a model of efficient governance at this point either, what would be a realistic timeframe—if you can do this fairly briefly—do you think, that we should look at in trying to expect to get a BIT actually negotiated and passed?

Mr. SUBRAMANIAN. An honest answer would be I think it is unlikely that, you know, you could actually finish something before the next election. I think it would have to wait until after that, because it is more difficult to undertake these reforms are you are going to the elections.

But, also, I suspect that there will be, you know, some difficult issues that have to be worked through, and for both of those reasons, I would—a realistic timetable would be more toward the end of next year to 2015 rather than, you know, early 2014.

Mr. ROSSOW. I concur. I think it could happen easily before the end of the Obama administration, but to say it would be dramatically earlier than that—India has not even reviewed its—has not completed the review of its model BIT. I hear by the end of the year is what India is hoping for for that in conversations, but, you know, we are not even going to have another round of talks until that takes place.

Senator WARNER. Senator Kirk.

Senator KIRK. I would just worry that in the cases of the United States and India, it is the government that is going to screw this up. And I would say that my worry about the White House is that the White House generally has to clear all trade agreements through the AFL–CIO, who always will say no to a trade agreement, that that, I think, is strongly against the interest of my State. When you look at Illinois, we had about $1 billion in exports, up 41 percent. And when I think about our exports, I think about the people who work for Deere and Caterpillar, you know, for Moline, Peoria, and look at this enormous potential market that it should be opened up by policy of the United States and should not be blocked by policy of India clinging to a dying ember of socialism, which has hurt their country immeasurably.

That is it.

Senator WARNER. Let me move to a question I have. One of the things I am still a little uncertain on—I would like both witnesses to address this. You know, I think Prime Minister Gandhi at one point 20-odd years ago nationalized a lot of the banks. How much of the banking sector in India is now in private hands, even amongst the Indian banks?

Mr. SUBRAMANIAN. The exact number I think is that today around 74 percent of deposits and close to 72, 73 percent of assets are still managed by the state-owned banks, so about a quarter of the sector is not in state hands.

Senator WARNER. And when you are saying state owned, even like the State Bank of India, is that entirely state owned, or is there private——

Mr. SUBRAMANIAN. It is a state-owned bank, a majority ownership——

Senator WARNER. And the other state-owned institutions are 100—are they starting to move to privatize some more of these?

Mr. SUBRAMANIAN. Well, some of them have sold some partial stakes to the public, so it is not 100 percent owned by the government.

Mr. ROSSOW. Most of the stakes that the banks have sold have actually been to other Indian financial institutions, by my recollection. So Life Insurance Corporation, which, you know, like Arvind mentioned, actually owned 75 percent of life insurance sales by the government-owned insurer, and they are also a major shareholder in other government-owned corporates throughout the economy.

Mr. SUBRAMANIAN. Senator Warner, on that can I just——

Senator WARNER. Please.

Mr. SUBRAMANIAN. The one point I think I want to make is that, you know, the Indian approach to going past the socialism that Senator Kirk has rightly warned against has been much more to open and allow new entrants into the private sector rather than to take on privatization. So if you look at airlines, telecommunications, banking, the approach has been, you know, let us allow new entrants, allow private sector entry, so that you grow the private sector and shrink the public sector rather than, you know, privatize the public sector head on, because the political costs of laying off employees are much greater. And this has been a very successful model. In telecom and in airlines, where I think India has made a lot of progress, you know, basically private sector, the carriers have come in.

So in the banking sector as well, that is the policy. You know, a number of new banks, private banks, have been licensed in the last 10 years, they are doing very well—HDFC, ICICI, YES Bank, Kotak Mahindra Bank. And now, as you know, the new Governor has said in his first speech that, by January, new banking licenses will be awarded. We do not know how many and to whom, but I think we are going to get substantial new private sector entry into the banking sector.

Senator WARNER. Let me just do one follow-up question before I turn it back over to Senator Kirk. The last time I was in India, I gave a proposal to then-Finance Minister Mr. Mukherjee around electronic payments, and this may not be either of your exact expertise, but Ajay Banga, who is a good friend and CEO of MasterCard, has got, I think—and I know there are some other very provocative and, I think, really forward-leaning proposals about electronic direct payments that might be able to be used to try to cut out some of the graft and cut out some of the corruption as India looks at different distribution models, particularly the poor. Do you have any comments on that? And I know there was—my memory is fading. The American guy from California was going to come in with a major system and—in terms of a national ID system that might help allow that. What is the progress on electronic payment systems? And do you think that has the kind of hope that it at least appears to me?

Mr. ROSSOW. There are kind of three pieces to this. First is to establish, as you mentioned, the national ID—“Aadhaar” it is called—and they have got, I think, 400, 500 million people that have been signed up for it so far, with the expectation it will hit 600 million next year. That is moving along very well. Still very controversial.

Then the corollaries to that are that they are finding the relatively unbanked communities—because only about half of Indians have a bank account, and trying to establish a bank account oftentimes attached to this unique ID.

The third piece to it then, as you mentioned, is the electronic delivery of a lot of the subsidies or other payments from the government that the individuals should be getting.

In my opinion, this is the single most transformational thing taking place in India right now. As I mentioned, you know, we try to cooperate with India on a variety of fronts, but sometimes it is pushing rocks uphill. This is one where it is pushing a rock down

a hill. Every company that I consult with and talk to about what is the thing that you should be knowing in India right now, you have got to be figuring out how to take advantage of this.

For Aadhaar, there is going to be a unique ID, a biometric ID, for an insurance company. That will help you to know the identity of the citizen. You know, a lot of communities where you have got to go in and start selling different types of financial services, this is going to provide a heat map for you on where people are actually using financial services that otherwise have been completely dark before.

So I think it is transformational. It appears to be working, from what I can understand, with the exception of the third part where it has been rolled out relatively slowly, which is actually sending subsidies down the pipeline. They have got 50-something districts, I think, so far that that has been launched so far, and not every government program yet. But they are making a strong attempt to do so.

Mr. SUBRAMANIAN. I agree with completely with what Rick said, but just to add a couple of points, I think the name you were looking for, Senator Warner, is Nandan Nilekani. He is the one who is implementing this Aadhaar scheme. He was the CEO of Infosys, you know, the iconic Indian company.

I think this Aadhaar biometric identification is going to be—that along with the GST tax that they plan to implement are going to be the two kind of transformational policy actions from a macro point of view, because, you know, a lot of the subsidies that India gives out are actually very wasteful, ineffective. The former Prime Minister, Rajiv Gandhi, said that for every one rupee of subsidy, probably 15 cents—or the equivalent of 15, reaches a person, so about 80 to 85 percent waste.

So this Aadhaar biometric identification will allow many of these schemes to be kind of almost rolled into a cash-based transfer scheme, and, in fact, that has already begun. For example, the cooking gas subsidy, I think now about 500,000 people have already been converted to this. And the other point is that this is going to be enormously transformational in terms of the financial inclusion agenda of the government, which the new Governor has actually also put on top of his priorities, and that is a huge investment opportunity for U.S. business as well when there is more financial inclusion.

Senator WARNER. Senator Kirk.

Senator KIRK. Let me just follow up. When you talk about the Aadhaar ID, it just seems that to give greater and greater electronic access of large numbers of people to the Indian treasury. Then I think about is India bankable at all. You know, if it is going to accelerate the provision of subsidy services to many people, it sounds like it is less and less bankable.

Mr. SUBRAMANIAN. You mean less bankable in the sense that it is going to be better or——

Senator KIRK. I would just say that if I was buying an Indian bond, that would alarm me.

Mr. SUBRAMANIAN. Senator Kirk, I think the way to look at it is that at the moment India spends something like—I would say

something like between 3 and 5 percent of its GDP on these subsidies.

Now, if you were to reduce that from 5 percent to 1 percent and be as effective because you are targeting it better, I would buy India bonds because the fiscal situation would be much better.

Mr. ROSSOW. There are two components to it. One is money that the government is already giving directly, and the process for doing that—there are actually trucks of rupees that go down roads and deliver——

Senator KIRK. Let me actually ask you guys, the thing that I noticed when I was in India was the competition with China if we look at financial services like insurance. You know, these kind of problems you do not hear about when you are in Beijing with foreign companies, which is a strong go signal for everybody to go ahead and modernize and service that market and innovate to bring all those good things to bear in the Chinese market.

Mr. ROSSOW. Having worked in both in the insurance industry, it is more stable in China. It is much more stable. They have got a 50-percent foreign direct investment cap for life insurance versus 26 percent in India. But there are behind-the-border restrictions in China that companies face. You go to a different office to get licenses to open up in new provinces. Growth for foreign companies is slower in China than in India.

In India, once you are in, at 26 percent, the domestic companies, really there is no different treatment than there are for foreign companies.

So with China you have more regulatory stability, a greater FDI cap, than you do in India, but a little bit less transparency in terms of what might be the next regulations coming up. And also there are behind-the-border restrictions against foreign companies operating there. So it is a mixed bag. Some is good in one, and some is good in the other.

Mr. SUBRAMANIAN. Just to add, I have written a book on China recently, so I think on financial services, you know, many in manufacturing, China is much more open to FDI than India is. But in financial services, China is not very far ahead of India. You know, life insurance might be different, but in banking and other—you know, investment banking, commercial banking, retail banking, I would say that India in some sectors is actually more open than China has been.

Senator KIRK. Would that be followed by an impression that China is a better place to invest than India?

Mr. SUBRAMANIAN. I think as Rick said, I think that really there is much more regulatory uncertainty in China. The way I think about it, Senator Warner and Senator Kirk, is that, you know, if you have a top-down centralized system, you know, you can get certainty because it is basically by fiat. Or you have a system like the United States, very democratic but rule-of-law based. India is a little bit stuck in between. It is not top-down, but, you know, the bottom-up process, democratic process, is still a work in progress. So that is where I think the problem is in India.

Senator WARNER. I mean, I would argue that it might be easier to get into China, but in terms of actually getting your money out, I would take the chances on India. India is messier. Democracy is

messier. And I think as you see the long-term investments that American and other companies have made in India, that have sorted finally through the regulatory maze, they stay for a long time. I look at a lot of the big multinationals, I think, who were having—they got swept up in a euphoria about China, but are starting to have some second thoughts now as they try to say how do you actually maximize profits and take them out of the country, which raises one other—kind of moving off just the financial sector for a moment, you know—and, Arvind, I think you wrote part of this in a recent op-ed in the New York Times about why India's economy is stumbling. You talked about some of the regulatory burden. And clearly, after we saw the enormous tragedy in Bangladesh, nobody here is advocating laxer environmental or safety laws, but whether it is textile on the one hand or compared to China on the other in terms of mid-level manufacturing, you know, what would you prescribe, both of you, for India to be able to—as I think both of you recognize, the IT sector led for a long time. That is wonderful. It is high end. How do you have some of these mid-level sectors that others like manufacturing or textiles, enterprise zones, other ideas? Suggestions?

Mr. ROSSOW. They have special economic zones, and those have been a moderate success, to my understanding. But the physical infrastructure is a huge impediment to doing manufacturing in-country.

Arvind mentioned one tax reform that is on the docks, the goods and services tax. This for India's economy is the single biggest reform that they could undertake, and there is a reasonable chance it could happen, even before India's national election.

There is a parliamentary committee chaired by the opposition that recently issued a report on the goods and services tax, and it is fairly favorable. Most of the negotiations on this——

Senator KIRK. Could you educate me on the GST? Is that like——

Mr. SUBRAMANIAN. VAT. It is like a VAT.

Mr. ROSSOW. Every state, and even some local jurisdictions——

Senator KIRK. Yeah, so we would expect the whole Indian economy to slow down like the European economy under a VAT.

Mr. ROSSOW. Well, every state and local jurisdiction in India has its own customs union right now, so, for instance, an Indian CEO I was talking to a few months ago said that to move an auto product from Delhi to Mumbai, you get stopped 12 times by in-country customs duties. And there is a way around that, which is to pay a bribe. If you want to do it the right way, your truck waits in line. And I am sure you have been to India. You have seen the miles and miles of trucks that sit at every one of these checkpoints. That is what you deal with in manufacturing. And the goods and services tax, you know, one person called it "India signing a free trade agreement with itself." I think manufacturers expect that that is going to be a huge boon. But, still, the more intractable issues are the infrastructure issues where there has been very little movement on so far.

Mr. SUBRAMANIAN. But to come back to your question—I mean, I agree with everything that Rick said. I think if India could—you know, infrastructure is a lot of things, but I think more specifically,

if we could get our power, you know, under control, more investment in power, you know, make it—you know, get rid of the subsidies in power, just that one, I think, piece—because the power subsidy in India is the source of a lot of problems. If we could do that in a way that, for example, the state of Gujurat has done very effectively, if we could get more models, more investment in power, I think the kind of multiplier effect that that could have, including in kind of creating the groundwork for manufacturing, could be quite positive.

So if I were the new government in power, I would focus on, you know, getting the power sector in shape as a top priority.

Senator WARNER. I would just add, that was one of the areas I was going to head on. I think utilities are about—Indian utilities are about $35 billion in arrears at this point, collectively, and they are running at an efficiency rate of about 30 percent. When you have the threat of brownouts and blackouts, you are not going to—it is hard to make those investments, which kind of goes back to the—an area that I think we all had great expectations for and I think was one of the times, at least from my view, when the Indian American diaspora kind of came of age politically in this country was on the Civil Nuclear deal. And we are still waiting, and, you know, it seems like—I know we have got to sort through these liability issues, but either one of you want to make any predictions about this? And I know there are some expectations that maybe out of this—the predictions were that the Prime Minister was going to bring a letter with him on at least a small move forward on that item.

Mr. SUBRAMANIAN. I was told that, you know, the cabinet in India cleared—kind of gave the go-ahead to what is being called either sort of a pre-works agreement on the Westinghouse thing. So I am hoping that there will be some progress at least on one of the two deals with Westinghouse via a works agreement, which is, you know, basically getting the two sides together and saying let us talk, let us see what needs to be done to push this forward, because we are not even at that stage now.

Of course, the whole liability law is going to—you know, is there in the future to deal with. But at least let us get something off the ground, and that is what I am hoping will be one of the deliverables from this visit.

Mr. ROSSOW. Yes. Hearing the opposition to what the cabinet decision was and the potential work-around and liability issue, hearing how loud the opposition has been, so I do not have any internal as to what the Prime Minister is bringing, but when the opposition gets this loud on something, I tend to believe there is a little substance there. So in terms of the PM's visit, this could be potentially like the culmination of what we have been working on with the nuclear deal, if we are able to actually get a shovel into the ground on this one.

Senator KIRK. I would just say that I supported that nuclear agreement to make sure that there is steady, reliable power to this economy that hopefully could take off with reliable power.

Senator WARNER. Do either of you want to make a comment on—I think Senator Kirk—I know we are focusing mostly on business

issues at this point, but do either of you want to wade into the Afghanistan circumstance?

Mr. ROSSOW. No great expertise on my side.

Mr. SUBRAMANIAN. Yeah, you know, that is way above my pay grade.

[Laughter.]

Senator WARNER. You guys are—you can tell they are not politicians.

[Laughter.]

Senator WARNER. We obviously—again, on the defense investment side, though, there have been some disappointments and some wins. Do you have any prescriptions, both prediction-wise and also suggestions on what we can do both in terms of furtherance of our strategic partnerships? Because I agree with Senator Kirk, our interests align so often, but sometimes there is, I think, a reluctance, and understandably, in India's history to perhaps acknowledge how closely our interests align because of the long tenure of the leaders of the nonalign movement. But how can we——

Mr. SUBRAMANIAN. Sorry.

Senator WARNER. As a former wireless guy, that is the sound of money to me, Arvind, so that does not bother me.

[Laughter.]

Senator WARNER. That does not bother me at all. The audience heard an annoying sound. I heard, "Ka-ching, ka-ching."

As Senator Kirk mentioned as well, India's military and interior forces are more and more engaged in certain levels of civil unrest. This is, again, a natural place for alignment, predictions as well as what we can do from the Congress' side to help that relationship foster particularly on the procurement side.

Mr. ROSSOW. I think give Ash Carter, you know, an "attaboy." Ten years from now, when we look back on, you know, what I think most people consider treading water right now in the relationship, I think 10 years from now when you look back, or 15 years, we are going to look back on the work that Dr. Carter is doing on building a stronger relationship between the Pentagon and India's military is going to be the most transformational thing that is taking place right now with, you know—we have seen deals signed already, $10 billion. There are certain countries that we sign that much with on an annual basis, so for a 10-year period, that is not necessarily our record breaker. But they are laying the groundwork.

I mean, I think the assumption by companies that by their involvement in supporting the nuclear deal and getting involved strategically that every deal to come our way did not yield the fruit that we had hoped at the time. And we are still feeling each other out. But the process for actually engaging them and talking about how India plans to buy—and India's acquisitions right now, too, are a bit paralyzed. You know, there have been so many allegations of corruption against India's procurement process that the Minister has been going slow. So with an election, with the new Minister, maybe a new outlook on this—the process work is being done very well right now to get our two sides aligned. The deals hopefully will follow once India starts to release some of the funding that it has.

Mr. SUBRAMANIAN. Just a couple of brief thoughts on that. I think I agree with what Rick said. I think, in fact, there is so much

cooperation on defense taking place, you know, below the radar screen that has to be very promising for, you know, defense contracts and defense sales by the United States. And to be fair, I think that is—in relative terms, that has been one of the successes of the U.S.-India partnership.

A final point there is that there is, in fact, a procurement bill in India which, if it gets passed, I think will go some way toward kind of clearing up the paralysis now that has happened in procurement because of all these allegations of corruption and so on. So I am hoping that, you know, India passes this procurement bill, government procurement bill, it signs up to the government procurement agreement in the WTO, and we will see, you know, much better procurement, more open, efficient, transparent procurement, which should be good for U.S. defense suppliers as well in the long run.

Senator WARNER. I have one more question but before——

Senator KIRK. Let me just add one other thing.

Senator WARNER. Go ahead, please.

Senator KIRK. Two cases where the United States and India overlap considerably on interest is missile defense, which is why India has become such a large purchaser of Israeli missile defense military hardware. This is tremendously encouraging to see that link between Israel and India being status quo democratic powers, who I think are good bets for the defense equipment business.

Mr. SUBRAMANIAN. I agree.

Senator WARNER. I would just share one of the things—actually, the last time I was in Israel, was this notion of trying to——

Senator KIRK. I would interrupt you, Mr. Chairman.

Senator WARNER. No, please. Go ahead.

Senator KING. I just think that we ought to do a hearing in this Subcommittee on a China BIT, and I would just say that the Senator from Hawaii, Mazie Hirono, and I have decided to restart the China working group in the Senate that I had in—I put it together in the House. We had 77 members focusing on economic opportunities in the China market. I think we ought to——

Senator WARNER. We will look at that as well.

Senator KIRK.——do that for this Subcommittee's work.

Senator WARNER. Well, I want to follow up on your—before I ask my last question, I want to follow up on your last point, that one of the relationships that I do not think is acknowledged as strongly as perhaps it should be is the alignment between the United States, India, and Israel. I think already Israel is—or India——

Senator KIRK. It's a tremendous alliance.

Senator WARNER. India procures on the defense side about as much from Israel as it does from the United States or a little bit behind, and a lot of alignment of common interests. I know it is somewhat of a challenge sometimes to politically acknowledge that in India, but I think it is—anyone want to make a comment on that.

Mr. ROSSOW. I agree. I have heard the same.

Mr. SUBRAMANIAN. Yes.

Senator WARNER. Let me just close with just kind of a more general question with one specific item. I want to thank you both for your testimony, and I think we all hope that the Prime Minister and President's visit is going to be successful, and recognizes well

some of the constraints inside India until the next elections come about. I remember when I was there last year, and they said, "We have to wait until after the state elections," and then the state elections came with a little bit, not a lot of clarity, and now we have to wait for the national elections. I am starting to sound like——

Senator KIRK. Ain't democracy grand?

[Laughter.]

Senator WARNER. It is starting to sound a little bit like us. I guess, you know, one item that I want to highlight, before I ask you the general question, is that one of the things that we worked on last time I was there was, as India looks to develop its skills requirement—you know, everybody knows about IITs, and everybody knows about the incredible talented workforce that is in, again, specifically the IT sector. But, you know, India has very ambitious goals around community colleges and skills development. As we think about manufacturing elsewhere, that is an area that I believe more could be done. We have tried to initiate certain areas between some of our State community colleges——

Senator KIRK. Senator, I would like to——

Senator WARNER. Please.

Senator KIRK. I would like to follow up on one thing. One of the coolest things I have discovered in Chicago is a new project called "Englewood Codes." This is in the toughest police district in Chicago where murders have been highest, where kids learn how to code to make Web sites saying that—all of us in the United States have been put on help lines to somebody in India who does not share your circadian rhythm and does not seem to be able to talk to you very well. But my vision with these kids was if Englewood Codes could be connected to a help line and you are always talking to an American kid who may be an at-risk youth in the South Side of Chicago, that was the area that I was hoping that we would really take the Indians on IT support.

Senator WARNER. I do remember one of my first visits to India. The flip side of that was there was an Indian program that a nonprofit, an NGO, had put together called "Computers Without Walls," and it was in one of the most kind of decrepit slums around Delhi. We went. There were all these kids. It was basically a block building with computers inside. No teachers, no training. They just left the kids in, and it, again, reinforced the fact that these kids were almost self-taught and extraordinarily bright and talented. And I remember one of them came up to me, and I am coming in as the politician. They asked, you know, "Tell me what your name is." And I say, "It is Mark Warner." And I ask, "Why do you want to know my name?" He said, "Because I want to Google you to see if you are important."

[Laughter.]

Senator WARNER. And that was in 2005. I do think, you know, this is a partnership and a relationship that I believe very strongly is one of the most critical, if not the most critical relationship of the 21st century, and we have got to do all we can to continue to grow it and nurture it. We have talked about some of the financial challenges, We have talked about the BIT. We have talked about trying to move insurance up from 26 to 49. I share some of your

concerns about infrastructure. Again, the last time I was there, lots of talk about opportunities, but not even American, any other kind of—some of the large infrastructure entities have not seemed to be able to break through in a major way.

But do you have any kind of closing comments? Both of you gave great opening statements on this relationship, but do you have any closing comments that you would hope that we would see kind of the next 3, 6, 9 months as we go into the Indian election cycle in the spring of what you would hope we could do and what we as friends in the Congress of this relationship should do? Arvind and then Rick.

Mr. SUBRAMANIAN. One specific and one general, Senator Warner and Senator Kirk, if I may. I think in the short run, I think, you know, if ever the immigration bill is taken up in the House, I think that there is—I think it is a very laudable effort. You know, it is going to, from the U.S. point of view, going to bring in much more high-skilled talent into the United States, which is desirable. But I think it also has a number of restrictive elements which are not so good for the United States because it is like—you know, it is like imposing a tax on chips, you know, imposing restrictions on skilled labor coming into the United States. So it is kind of self-defeating for the United States. But at the same time, also, it kind of has—it is problematic from an Indian point of view as well. You know, the IT model is affected.

My colleague calculates, for example, that, you know, this generates a lot of revenue for Indian nationals, and, frankly, it is a symbol of cooperation, but also people-to-people cooperation.

So I think it is really important going forward to get this bill right as kind of sending a signal that this is a really important relationship.

I think more broadly, I think that I would say that the Indian economy has to recover, has to gain back its strength. And once that happens, I think we can move into a new phase where, you know, the economic relationship can blossom more. And at that stage, I think we do need to be thinking about something much more ongoing, substantive, and big, moving beyond a BIT. Because as you said, this is a long-term relationship. We need to nurture it. The potential is big. And it is a two-way relationship.

So you need a framework for addressing this, and that is why I am keen that at some point the two countries will embrace the principle of, you know, maybe even working toward an economic partnership or a free trade agreement.

Mr. ROSSOW. I would just say keep pushing. Since this level of engagement really kicked off with Secretary Kerry's visit to India in June, he brought with him a couple baskets of issues: local content rules, tax concerns, FDI, patents. Those are the four big blocks of concerns that American companies have raised that he brought up.

Since his visit—and we have had—the Vice President went out, we have had several Indian cabinet officials, now the PM, and then the Finance Minister comes back out. Since Kerry's visit, India has adopted safe harbor rules for transfer pricing, which I see are being fairly warmly received by companies. Arvind mentioned some of the

small changes, but important, that they made in FDI rules. And they postponed the introduction of the preferential market access.

So this level of engagement has actually yielded fruit on the things that were raised so prominently back then. So, you know, it is a simple thing to keep doing what we are doing. This idea that India's election precludes big moves I do not buy. The Indian electorate does not care about 99 percent about what we have talked about here. The insurance bill is not what takes an Indian to the polls. They do not pull the lever depending on how somebody voted on the insurance bill or defense trade, or nuclear, even, for that instance. You know, most voters care more about electricity and water and things like that.

So India still has some elbow room to work on these issues. So just also do not give up. I hear the same thing that you do, that elections are coming, it is too late. The single biggest decision this Government made during its first term, from 2004 to 2009, was signing the Safeguards Agreement on Nuclear Cooperation. It forced the confidence motion in parliament. Parties were jettisoned. They had to find new allies, and they barely survived the confident vote. That was 8 months away from the national election. So there is a chance to do more.

Thank you for both of your interest in this, and the India Caucus has been just a terrific advocate, and thanks for everything.

Senator KIRK. I would say eventually if we succeed, we will see State Farm and GEICO battle it across the subcontinent, and I think we both agree an American insurer should be capturing that auto market in India.

Senator WARNER. Or a well-run Indian competitor as well, as long as it is, you know, on a level playing field. And so I want to thank both of the witnesses. I think this is an issue of enormous concern. Senator Kirk and I have worked together, and I have worked with my co-chair of the India Caucus, Senator Cornyn. We got a resolution through welcoming Prime Minister Singh that he will receive from the Senate, that he will receive when he gets here, I believe tomorrow. And it points out the strengths and importance of our relationships, but one of the things that I think, as we move from a friendship into a partnership, we need to not only talk about us being two great democracies, but as partners being able to have a little—as I think, Rick, you mentioned as well, a little elbowing of each other occasionally, but continuing to work forward. And I think both of your comments about the need for this continued engagement at the most senior levels is very important.

So, again, I want to thank the witnesses, and the hearing record will remain open for 7 days for any additional comments and for any additional questions that might be submitted for the record.

With that, the hearing is adjourned. Thank you.

[Whereupon, at 3:41 p.m., the hearing was adjourned.]

[Prepared statements and responses to written questions supplied for the record follow:]

PREPARED STATEMENT OF ARVIND SUBRAMANIAN

SENIOR FELLOW, PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS AND CENTER FOR GLOBAL DEVELOPMENT

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This testimony draws upon my ongoing Peterson Institute for International Economics project with C. Fred Bergsten, *Breaking Ground by Breaking Barriers: An Economic Partnership of the Largest Democracies,* supported by the U.S.-India Business Council (USIBC) and the Smith Richardson Foundation (SRF).

Summary and Recommendations

Observation 1: The Indian economy recently encountered serious turbulence and will require important reforms to stabilize it. To some extent, India's problems reflect India's deep and ongoing financial integration with the world economy. For example, between 2010 and 2012, India received about $160 billion in foreign capital inflows. With the U.S. Federal Reserve planning to reverse its unconventional monetary policy and as the U.S. economy has rebounded, some of this money is flowing back to the United States, causing currency declines and turmoil in several emerging markets, especially India. But India's problems also have deeper, domestic origins, and require serious reforms to overcome them (elaborated in my recent New York Times article (attached)). Fiscal consolidation, based on eliminating wasteful subsidies and introducing new taxes, will be critical. But looming elections could complicate reform actions and perpetuate uncertainty and turbulence.

Observation 2: Economic uncertainty over the last year has triggered unprecedented liberalization of foreign direct investment (FDI) and other capital inflows. This seems paradoxical, at first blush, but is consistent with international experience that governments take action when a sense of crisis looms. In the last year, India has liberalized its FDI regime in several sectors-multi-brand retail, defence, petroleum and natural gas, stock exchanges, telecommunications, infrastructure—to a greater extent than in recent history. In order to attract foreign capital, the government also relaxed a number of constraints to foreign equity, portfolio, and debt inflows.

Prediction: Further opening to foreign investors, especially providers of financial services, is likely. A new pension-related bill has just cleared one of the two chambers of the Indian legislature. This bill paves the way for foreign investment—up to 26 percent—in the sector, with additional increases in the foreign limit linked to the draft insurance legislation. This insurance legislation, if passed, would allow for increased foreign ownership of insurance firms from 26 percent to 49 percent. The new Governor of the central bank has signaled an openness to reforming the financial sector and to encouraging foreign participation in the Indian banking system.

Recommendation 1: The time may be ripe for pursuing a bilateral investment treaty (BIT). The recent spate of FDI liberalization—as well as competitive pressure from U.S.-China investment negotiations—could pave the way for India to pursue a BIT. Although negotiations will have to address some difficult issues, including investor-state disputes and visa issues, the domestic actions necessary to allow international negotiations are being taken.

Recommendation 2: A BIT is but a stepping stone for creating a broad and strategic framework for U.S.-India trade. This framework would include as critical elements embracing the principle of, and initiating preparatory work toward, a free trade agreement in the medium term. This framework is necessary for a number of reasons. First, the prize is big. India has had 30 years of close to 6½ percent growth, and about 8½ percent in the last decade. In 2012, it became the world's fourth largest economy after the United States, China and Japan (PPP dollars). Its trade in goods and services is about a billion dollars. It will need investments in infrastructure, and imports of natural gas and services, in all of which the United States has comparative advantage as a supplier. Moreover, India-U.S. trade is well below potential (about 50 percent) which a free trade agreement could rectify.

Second, the framework is required to address the broader regulatory challenges facing U.S. business in telecommunications, preferential market access policies, intellectual property, tax uncertainty and others. These challenges will be ongoing and some credible mechanism needs to be in place as a means for resolving them.

Third, more importantly, it is required to address the discrimination that each country is imposing on the other. India has signed (or is negotiating) free trade and economic partnership agreements with its largest trading partners that are all

major competitors to the United States: Europe, Japan, Singapore, ASEAN, and possibly ASEAN-plus 6 (which includes China and South Korea), and Canada.

Soon, if not already, this discrimination may be the biggest challenge for U.S. business in India. These RTAs are neither as comprehensive in their coverage across and within sectors as the FTAs negotiated by the United States, nor as expeditious in the timeframe for implementation. Because India's barriers are high and the market is large and growing, the disadvantage to American companies can be substantial. The United States is inflicting similar discrimination on India by negotiating the Trans-Pacific Partnership (TPP) and Trans-Atlantic Trade and Investment Partnership (TTIP).

Fourth, the broader framework will be necessary to re-vitalize the multilateral trading system by moving beyond a Doha Round to what Aaditya Mattoo (World Bank) and I have called a China Round of trade negotiations (*http://piie.com/publications/interstitial.cfm?ResearchID=1999*). The U.S.-India relationship has a key role to play in keeping China tethered to the multilateral system and, more broadly, ensuring its peaceful rise.

Finally, the broader framework will represent "Going big". And going big is necessary because this is a relationship between two great democracies with deep commonalities; because this is a marathon not a sprint; because this is a multi- not unidimensional relationship; and because Going Big is the best way to address even the small. You can't solve problems relating to chicken (or even financial services) by only talking chicken or insurance.

I. Recent macroeconomic background, challenges, and reforms

India has experienced close to 6½ percent growth for over 30 years since 1980. As a result, India is now a 2 trillion dollar economy (measured at market exchange rates). In purchasing power terms, it became in 2012 the world's third largest economy (US$4.7 trillion). Its trade in goods and services is close to a trillion dollars, and expected to double every 7 years.

But recently, India has experienced a bout of severe turbulence. After a decade of rapid growth, averaging close to 8.5 percent, India's GDP started to decelerate from late 2010, reaching a low of 4.4 percent in the first quarter of 2013 (Figure 1).

The recent turbulence also reflects India's deep and ongoing financial integration with the world economy. For example, between 2010 and 2012, India received about $160 billion in foreign capital inflows. With the U.S. Federal Reserve planning to reverse its unconventional monetary policy and as the U.S. economy has rebounded, some of this money is flowing back to the United States, causing currency declines and turmoil in several emerging markets, especially India. The rupee declined by about 20 percent against the dollar within a short period of time and has now recovered some ground (Figure 2). Looming elections will remain a source of uncertainty.

But domestic factors—fiscal populism, weak governance, and policy uncertainty—have also played an important role. Consumer price inflation has remained at or close to double digits for over 3 years. There are recent signs of a let-up especially in wholesale and core inflation but fundamental inflationary pressures remain a source of serious concern (Figure 3). Another worrisome trend is the deterioration in India's external balances. India's current account deficit that has remained less than 3 percent of GDP for many years, is now about 4.5 percent of GDP (Figure 4). This current account deficit and the need to finance it has been the proximate cause of the recent troubles, including the decline in the rupee.

Underlying the problem of inflation and external imbalances is the fiscal position. As a result of rising expenditures, mainly devoted to the social sectors and transfers, which have doubled in per capita terms over the last decade, the government's budget deficit has remained close to 10 percent of GDP (Figure 5).

Late last year, in response to these adverse developments, and in order to head off a looming investment downgrade by the foreign credit ratings agencies, the government undertook reform actions. It enacted measures to reduce fuel subsidies on diesel and limit the subsidy on cooking gas. The reductions are ongoing and take the form of small but steady increases in the consumer price of diesel. It approved greater foreign direct investment (FDI) not just in multibrand retail but in aviation, broadcasting and power exchanges.

In response to the recent troubles, a number of measures have been taken to encourage foreign capital inflows into the Indian market. The qualified foreign investor (QFI) scheme has been expanded to cover a wider range of permissible investments, including mutual funds, equity and corporate bonds. Limits on inflows into Indian government and corporate securities have been increased to US$81 billion today, up from 66 billion at end-2012 while the withholding tax on these investments has been lowered to 5 percent. The limit on foreign debt borrowing (External

Commercial Borrowings, ECBs) has been raised to $40 billion today, up from 20 billion in May 2011. Within this limit, priority is accorded to ECBs for infrastructure financing. There are virtually no limits on foreign portfolio investments in the Indian equity market. In response to exchange market turbulence, some restrictions have been placed on the ability of Indians (but not foreigners) to invest or send remittances abroad.

Economic stability can be restored through major reforms to cut inefficient spending and raise taxes, thereby pruning the deficit and taming inflation. On the spending side, the subsidies for fuel, power, and fertilizers need to be cut. On the tax side, India's version of the value-added tax (the Goods and Services Tax, GST) needs to be implemented expeditiously. The GST will place the Indian finances on a sounder medium-term footing, make them more transparent, and also go some way toward creating a common market in India. These steps need not come at the expense of the poor. For example, India is implementing an ambitious biometric identification scheme that will allow targeted cash transfers to replace inefficient welfare programs.

India can still become a manufacturing powerhouse, if it makes major upgrades to its roads, ports and power systems and reforms its labor laws and business regulations. But the country is in pre-election mode until early next year. Elections increase pressures to spend. So India's weakness and turbulence may persist for some time yet.

II. Trade and Investment background

In the last decade, U.S. exports of goods to India increased about 700 percent in the last decade. Exports of services have doubled in the last 4 years. U.S. FDI has increased from US$200 million to US$6 billion.

Reflecting the combined impact of policy liberalization, technological change and India's internal dynamism, India's trade surged during the last decade (Figure 6). Exports of goods and nonfactor services surged sevenfold in just over a decade from US$60 billion to US$420 billion. And imports also increased sevenfold from US$75 billion in 2000 to US$525 billion in 2011. As the chart shows, India recovered robustly from the impact of the global financial crisis. India's openness ratio (the ratio of trade to GDP) doubled over the course of a decade from about 25 to 50 percent. Indian global integration is thus well under way.

Similarly, India's FDI has also increased but from a very low base of about US$3.5 billion in 2000 to US$43.5 billion just before the crisis. FDI has not completely recovered from the global financial crisis but recent measures should carry forward the momentum established earlier (Figure 7). India's FDI inflows remain well below those of China (which have averaged close to US$100 billion over the last decade), so India has to catch up for the nearly two decades of surging FDI that China has benefited from.

This surging trade and investment has benefited the United States and India. India's exports to the United States has increased by about 250 percent since 2000, from US$9 billion in 2000 to US$32 billion in 2011 (Figure 8a). The United States is India's largest export market. More dramatically, U.S. exports of goods to India have increased by nearly 700 percent, from US$3 billion to US$23 billion (Figure 8b). However, China has overtaken the United States as India's largest supplier of goods and services, and the United States is not even amongst the top three sources of imports for India. It is important to note that U.S.-India trade is broadly balanced unlike India-China and U.S.-China trade, so that the scope for trade frictions from exchange rate and macroeconomic policy is minimized in the case of India-U.S. trade.

Trade between India and the United States in services is also surging. Between 2006 and 2010, U.S. exports of services to India (cross-border delivery plus sales by U.S. foreign affiliates) have more than doubled from about US$12 billion to nearly US$25 billion. This remarkable growth occurred during the global financial crisis. A similar trend characterizes India's exports of services to the United States (Table 1).

In terms of FDI, two points are worth noting. First, the United States is not the largest investor (consistently) in India. According to OECD data (Figure 10), U.S. FDI to India surged from about US$200 million to nearly US$6 billion in 2010. But the United States was surpassed by the United Kingdom for the most recent period and by Japan in earlier periods. So, the potential exists for large increases in U.S. FDI to India.

Second, FDI like trade in goods and services is also increasingly becoming two-way. A study commissioned by Federation of Indian Chamber of Commerce and Industry (FICCI) showed that between 2004 and 2009, 90 Indian companies made 127 Greenfield investments worth US$5.5 billion in metals; software and IT Services;

leisure and entertainment; industrial machinery; equipment and tools; and financial services. During the same period 239 Indian companies invested in excess of US$20 billion in merger and acquisitions in different states and across a wide range of sectors. As a result, tens of thousands of direct jobs (predominantly U.S. citizens), supporting many more indirect ones, have been created.

III. Recent and Prospective Liberalization of Financial Services

India has undertaken a series of reforms in the financial sector aimed at making it more competitive but also more resilient to shocks. For example, India is one of the 14 countries (out of 27 that are Basel Committee members) that have issued final Basel III capital rules.

Two outstanding pieces of draft legislation relate to pensions and insurance. Recently, the draft pensions bill was passed by India's lower house of parliament. This bill paves the way for foreign investment—up to 26 percent—in the sector, with additional increases in the foreign limit linked to the draft insurance legislation.

More uncertain is the fate of the draft insurance legislation that would allow for increased foreign ownership of insurance firms from 26 percent to 49 percent. At the moment, there does not seem to be political consensus to ratify this bill which may have to await the conclusion of elections, currently scheduled for early next year.

However, the medium term prospects (after the next elections) for more reform of the financial services sector appear promising. Even on the insurance bill, the differences between the two main parties are more tactical, relating to extraneous political issues, than substantive. Both broadly share the objectives and content of the draft legislation.

Perhaps, more importantly, the new Governor of the central bank has signaled an interest in broader reform of the financial sector. In 2009, Dr. Raghuram Rajan authored a report which laid out a road map for reforming the Indian financial system (*http://planningcommission.nic.in/reports/genrep/rep_fr/cfsr_all.pdf*). For example, in relation to the banking system, which is still dominated by state-owned banks, he said:

> *India has a number of foreign owned banks, many of whom have been with us a long time and helped fuel our growth. They have been in the forefront of innovation, both in terms of improving productivity, as well as in terms of creating new products. We would like them to participate more in our growth, but in exchange we would like more regulatory and supervisory control over local operations so that we are not blindsided by international developments. The RBI will encourage qualifying foreign banks to move to a wholly owned subsidiary structure, where they will enjoy near national treatment on a reciprocal basis. We are in the process of sorting out a few remaining issues so this move can be made.*

He also indicated an interest to internationalize the rupee, to remain open to capital flows, and to liberalize restrictions on investment and position-taking in India's financial markets.

IV. Bilateral Investment Treaty (BIT)

The rationale for a BIT between the United States and India was succinctly laid out in a letter sent to President Obama In December 2011 by a number of Senators, including Senator Mark Warner. Matthew Stokes and Niraj Patel of the Center for Strategic and International Studies (CSIS; *http://csis.org/files/publication/121126_Stokes_BITandBeyond_web.pdf*) discuss in detail the case for a BIT between the United States and India, including the rationale, content and likely political impediments. India has signed at least 80 such agreements, including European nations, ASEAN, and Japan which arguably leads to discrimination against U.S. investors.

For India, two additional and recent developments might increase the incentives for India to embark on BIT negotiations with the United States.

First, in the last year, India has liberalized its FDI regime—to multi-brand retail, defence, petroleum and natural gas, stock exchanges, telecommunications, infrastructure—arguably to a greater extent than in recent history. In multibrand retail, some of the more onerous sourcing and other requirements were also relaxed.

This recent spate of FDI liberalization paves the way for India to pursue a BIT. Although India still has a number of sectors in which FDI is partially restricted (for example, defence production, civil aviation, banking, insurance, broadcasting, stock exchanges, depositories), the climate for liberalization has become more propitious.

Second, it will not go unnoticed in India that the United States and China have made progress in their BIT negotiations. There will therefore be competitive pressure on India to engage similarly with the United States.

Clearly, negotiations will have to address some difficult issues, including pre-establishment rights, investor-state disputes and visa issues, but the domestic actions necessary to allow international negotiations are being taken, and moreover, the external competitive pressure to do so have increased.

V. Investment climate: States versus Center

In recent years, there has been a considerable shift in economic and political power to the states. Indeed, most issues that critically concern investors—land, infrastructure, human capital, law and order—are largely the domain of states. So, even if there is an improvement in governance in the Federal Government, what happens in the states will increasingly determine India's economic fortunes.

It is not that leadership in the states is better on average than at the center, but in a decentralized India, a few visibly successful experiments can have powerful repercussions for the economy. Capital and labor can and will flow from the laggard states to the performing ones because India is broadly an economic union. The laggards will have fewer excuses for nonperformance if the experience of a neighboring state is better. In the past, the southern states were the pacesetters. This is no longer the case today. There are encouraging improvements in states across India—in the north (Delhi, Haryana, and Himachal Pradesh), west (Gujarat), east (Bihar and Chattisgarh), and Central India (Madhya Pradesh).

This competitive dynamic is one cause for hope. The other is that the Indian voter is increasingly rewarding good governance. Until recently, India's political system was characterized by anti-incumbency, with identity politics trumping good governance and economic performance. As a result, politicians had little incentive to deliver essential services and enact lasting reforms. Recently, though, Indian voters have reelected many incumbents who improved economic outcomes while throwing out poor performers, as exemplified by the ousting of the Communist party in West Bengal. These trends portend reasonable rates of economic growth in India even if the scorching rates of the past decade prove elusive.

These trends reinforce the need for outsiders to deal increasingly with state governments, especially the better governed ones. At this stage, these contacts will have to involve dealings between these state governments and the private sector and private investors. India's constitutional structure will not allow state governments to take on direct international obligations. One possibility in the future is for state governments to push the Federal Government to take on international obligations on their behalf. For example, India could join the WTO's Government Procurement agreement, in which the list of covered entities could be state government and their agencies. But in relation to the financial sector, this might be more difficult because many or most of the laws and regulations in this sector come under the domain of the Federal Government. Decentralization is not without risks. The governance of the economically best performing states is based on leaders who, while democratically elected, have few checks and balances. Decentralization has also arguably not gone far enough because the states have been very reluctant to extend its advantages to local governments, which has had a pernicious effect on urbanization. Cities in India need more autonomy and their leaders need to be held more accountable.

VI. The Way Forward: A New Strategic Framework

Trade and economic relations between India and the United States need a broad strategic framework. This framework would include as critical elements embracing the principle of, and initiating preparatory work toward, a free trade agreement in the medium term. This is so for a number of reasons.

First, the prize is big. The starting point for forging a cooperative partnership is the recognition that despite frictions, the underlying potential is enormous. In my recent book *Eclipse: Living in the Shadow of China's Economic Dominance,* I project that the Indian economy has the potential to post medium-term growth of about 8 percent. Once India navigates the current turbulence, this 4.7 trillion dollar economy will double every 7–10 years; the trillion dollar trade could also double every 7 years so that by 2018, it could reach close to 2 trillion dollars.

Moreover, currently U.S.-India trade is well below potential. They are mutual under-traders. Prachi Mishra (of the International Monetary Fund) and Devesh Roy (International Food Policy Research Institute) calculate that, all things equal, U.S. exports to India should be 50 percent greater than current levels. India's exports to the United States should be about 25 percent greater too. Emiko Fukase and Will Martin (World Bank) estimate that a comprehensive U.S.-India FTA would almost

double U.S. exports of goods and services to India; and increase Indian exports to the United States by 15 percent. While both countries would gain, the United States would gain substantially.

India will need about a trillion dollars worth investments in infrastructure, its demand for energy, including for natural gas, will be enormous, as to will its demand for services, including financial services. My Peterson Institute colleague Brad Jensen has shown that the United States could disproportionately benefit from these developments because it has a comparative advantage in supplying services.

Second, the framework is required to address the broader regulatory challenges facing U.S. business in telecommunications, preferential market access policies, intellectual property, tax uncertainty and others. These problems will inevitably be of a recurring nature. To resolve them without excessive frictions, the two countries will need an ongoing mechanism of dialog backed up by more formal arrangements, including possibly a free trade agreement.

Third, the framework is required to address the discrimination faced by U.S. business in Indian markets and vice versa. A BIT cannot be this mechanism because of its relatively narrow scope. And for that reason it offers limited scope for trading mutually advantageous concessions. The BIT, desirable as it may be, will need to be complemented in the medium term by a broader strategic framework.

Soon, if not already, this discrimination may be the biggest challenge for U.S. business in India. U.S. firms and businesses are not being targeted for direct discrimination. Rather this discrimination is happening indirectly but substantially because of India signing (or being on the verge of signing) free trade and partnership agreements with nearly all the major competitors to the United States.

A major development of India's trade policy over the last decade has been the aggressive pursuit of regional trade agreements, especially but not confined to Asia. In addition to comprehensive economic partnership agreements with Singapore and Japan, India is either negotiating or has negotiated some form of RTAs with a number of countries and regional groupings.

These include: Agreement on South Asia Free Trade Area (SAFTA) with Afghanistan, Bangladesh, Bhutan, and Maldives; India-Thailand FTA, which will include ASEAN-plus tariff concessions; India-ASEAN Comprehensive Economic Cooperation Agreement (CECA); Regional Comprehensive Economic Partnership (RCEP) Agreement among ASEAN + 6, the latter comprising Japan, Korea, and New Zealand, Australia, China, India); India—EU Broad Based Trade and Investment Agreement (BTIA); Global System of Trade Preferences (GSTP).

Now these RTAs are neither as comprehensive in their coverage across and within sectors as the FTAs negotiated by the United States, nor expeditious in the timeframe for implementation. But they signal India's interest in seeking access to markets abroad. Equally more important, the strong "Look East" nature of the policy is a reaction to China's strong and growing economic presence in East Asia.

All these agreements provide more favorable access to non-American suppliers and because India's MFN tariffs and barriers can be high in some sectors, the discrimination can be substantial. And add to that the fact of India's large and growing market, and U.S. suppliers can really be disadvantaged.

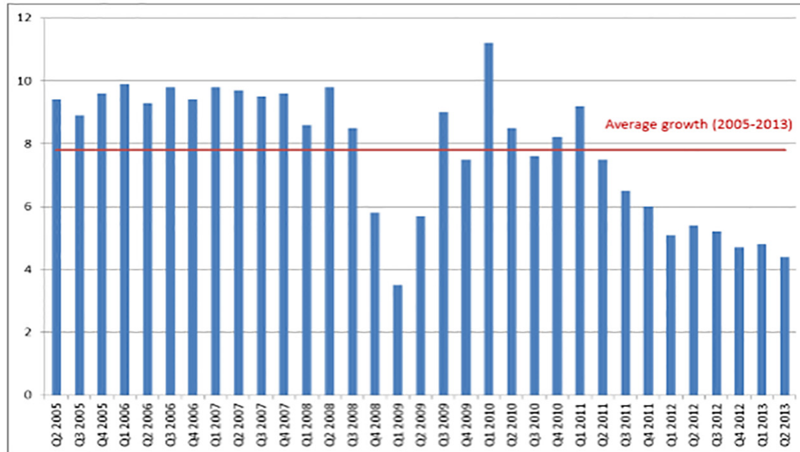
Of course, it must be added that the United States is reciprocating this discrimination (also indirectly) against Indian business when it negotiates the Trans-Pacific Partnership (TPP) and the Trans-Atlantic Trade and Investment Partnership (TTIP).

Fourth, the broader framework will be necessary to re-vitalize the multilateral trading system by moving beyond a Doha Round to what Aaditya Mattoo (World Bank) and I have called a China Round of trade negotiations (*http://piie.com/publications/interstitial.cfm?ResearchID=1999*). The U.S.-India relationship has a key role to play in keeping China tethered to the multilateral system. The United States and India, individually and collectively, have a vital interest and key role in ensuring China's peaceful rise as argued by Ashley Tellis (Carnegie Endowment for International Peace) and C. Raja Mohan (Observer Research Foundation).

Finally, the broader framework will represent "Going big". And going big is necessary because this is a relationship between two great democracies with deep commonalities; because this is a marathon not a sprint; because this is a multi- not unidimensional relationship; and because Going Big is the best way to address even the small. To put it more colloquially, "you can't solve problems relating to chicken (or even financial services) by only talking chicken (or insurance)."

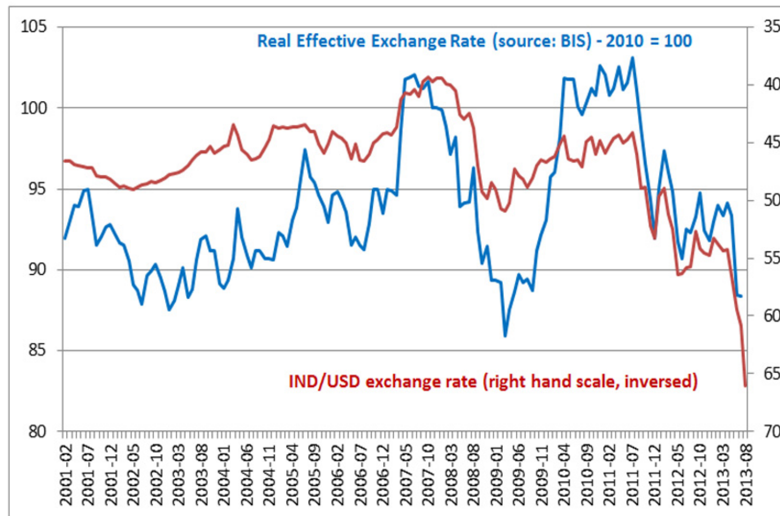
My colleague C. Fred Bergsten and I will soon be finalizing a book, *Breaking Ground by Breaking Barriers: An Economic Partnership of the Largest Democracies,* which will elaborate fully on such a broad framework, its rationale, content, the impediments to achieving it and how they might be overcome.

Figure 1. India: Quarterly GDP Growth, 2005–2013 (in percent)



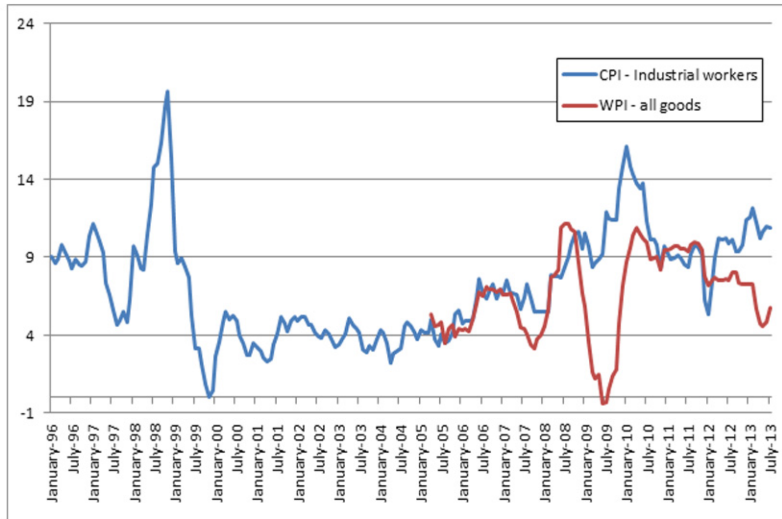
Source: Reserve Bank of India

Figure 2: India: Exchange Rate Developments, 2001–August 2013



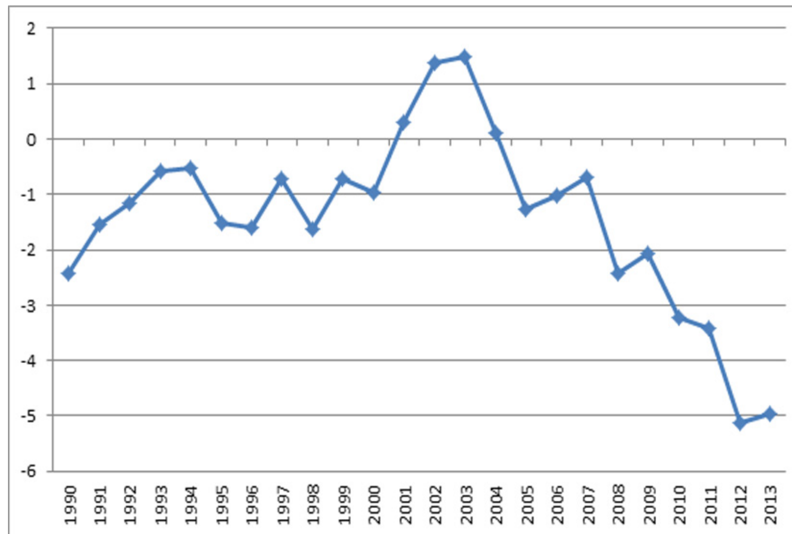
Source: Bank for International Settlements

Figure 3. India: Inflation, 1996-2013 (in percent)



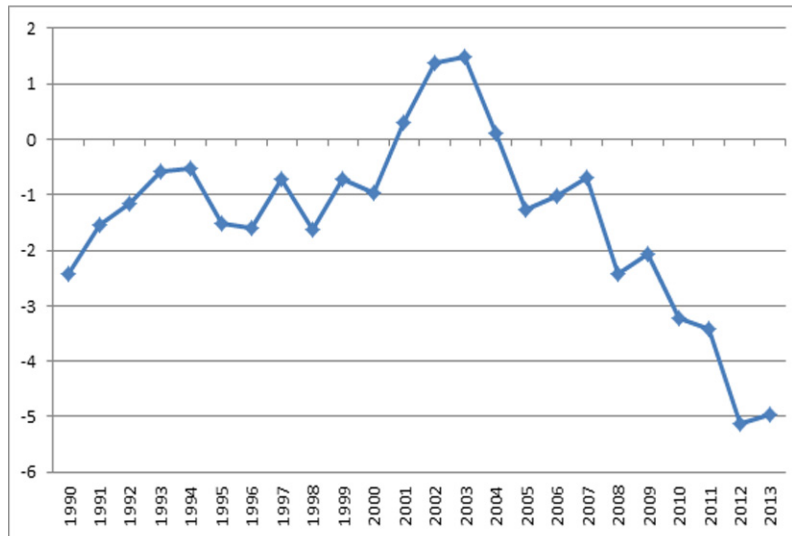
Source: IMF, International Financial Statistics

Figure 4. India:Current Account Deficit (in % of GDP)



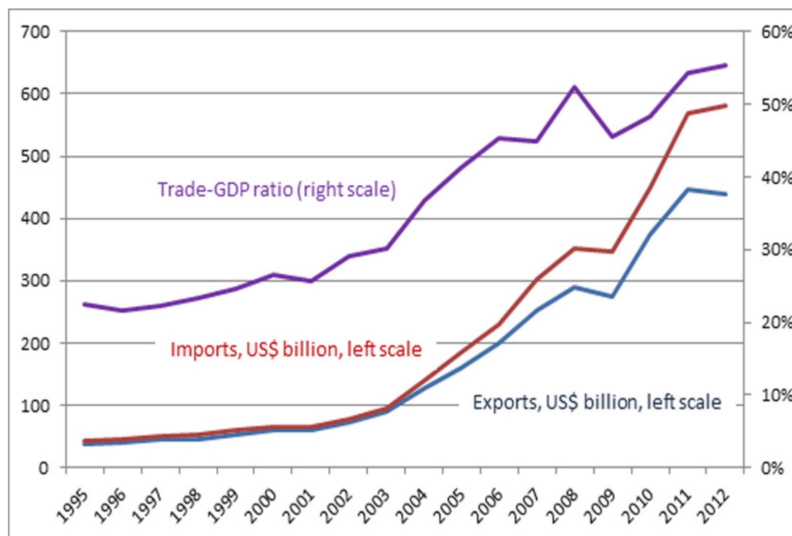
Source: IMF, World Economic Outlook

Figure 5: India: Government Budgetary Position (Net lending in percent of GDP)



Source: IMF, World Economic Outlook

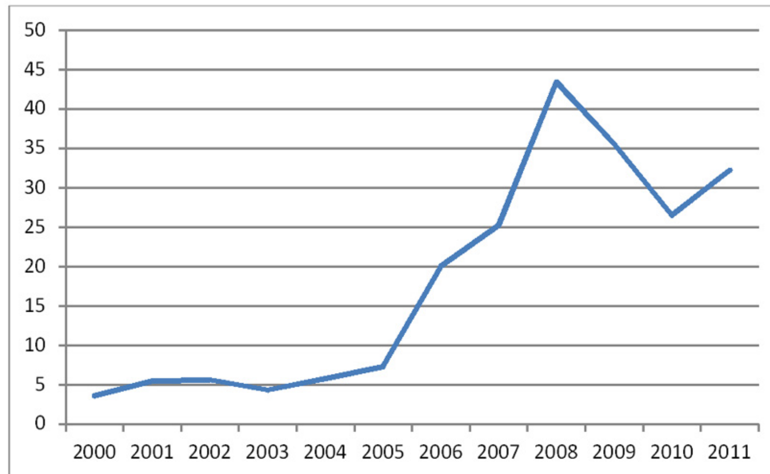
Figure 6. India: Trade in Goods and Services, Trade Openness Ratio, 2000–2011



Source: World Bank, World Development Indicators

Figure 7. India: Foreign Direct Investment, Net Inflows

(US$ billions)



Source: World Bank, World Development Indicators

Figure 8a. India: Top 5 Export Markets in 2011 (US$ bn.) 1/

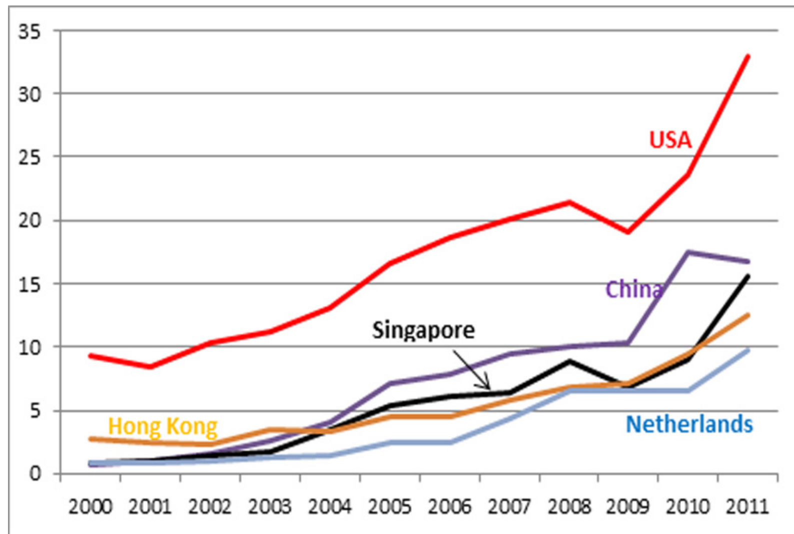
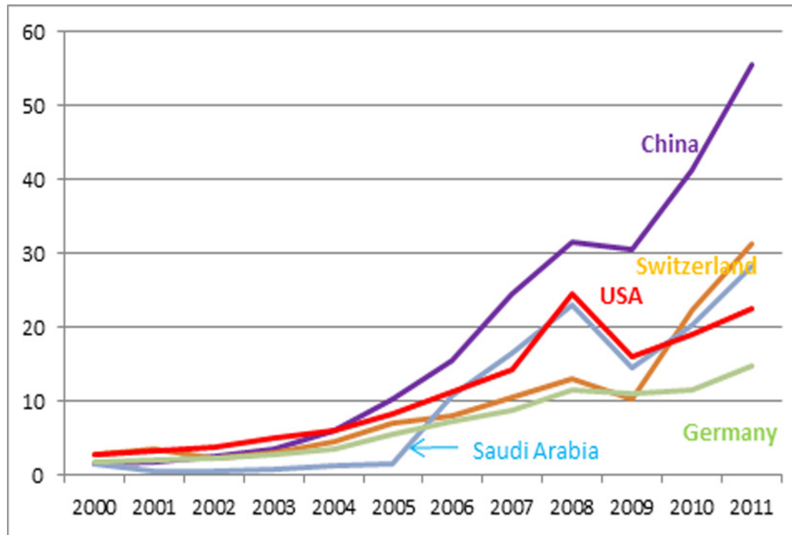
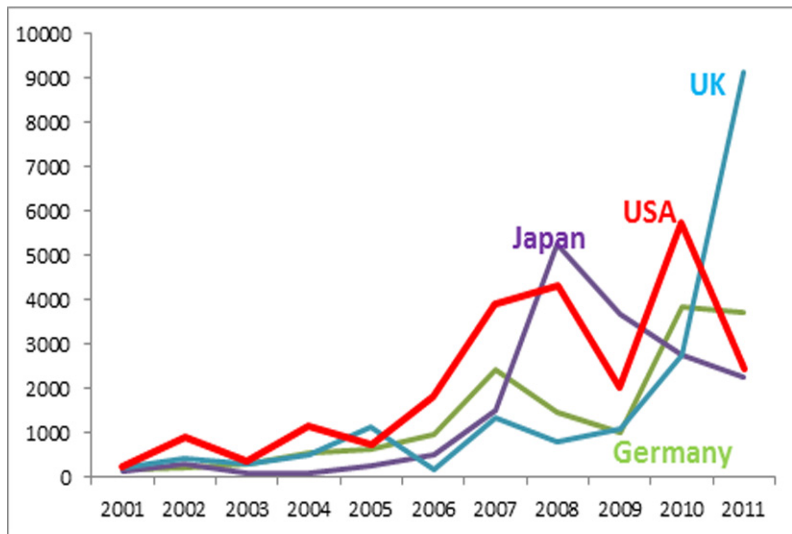


Figure 8b. India: Top 5 Sources of Imports in 2011 (US$ bn.) 1/



Source: OECD STAN Bilateral Database
1/ Excludes India's trade with the United Arab Emirates

Figure 9. Top OECD Foreign Direct Investors in India, 2001–2011, (million of US dollars)



Source: OECD

Table 1. India-US Trade in Services, 2006-2010

US Exports to India						
Year	**2006**	**2007**	**2008**	**2009**	**2010**	**% Change, 2010-2006**
Cross-border	6533	8747	10189	9890	10317	58%
Foreign sales by US firms	5455	7305	9755	13064	14238	161%
TOTAL	**11988**	**16052**	**19944**	**22954**	**24555**	**105%**
India's Exports to US						
Cross-border	7437	9825	12465	12447	14155	90%
Foreign sales by Indian firms	3633	5159	6540	7070	7314	101%
TOTAL	**11070**	**14984**	**19005**	**19517**	**21469**	**94%**

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ATTACHMENT

August 30, 2013

Why India's Economy Is Stumbling

By ARVIND SUBRAMANIAN

WASHINGTON — FOR the past three decades, the Indian economy has grown impressively, at an average annual rate of 6.4 percent. From 2002 to 2011, when the average rate was 7.7 percent, India seemed to be closing in on China — unstoppable, and engaged in a second "tryst with destiny," to borrow Jawaharlal Nehru's phrase. The economic potential of its vast population, expected to be the world's largest by the middle of the next decade, appeared to be unleashed as India jettisoned the stifling central planning and economic controls bequeathed it by Mr. Nehru and the nation's other socialist founders.

But India's self-confidence has been shaken. Growth has slowed to 4.4 percent a year; the rupee is in free fall, resulting in higher prices for imported goods; and the specter of a potential crisis, brought on by rising inflation and crippling budget deficits, looms.

To some extent, India has been just another victim of the ebb and flow of global finance, which it embraced too enthusiastically. The threat (or promise) of tighter monetary policies at the Federal Reserve and a resurgent American economy threaten to suck capital, and economic dynamism, out of many emerging-market economies.

But India's problems have deep and stubborn origins of the country's own making.

The current government, which took office in 2004, has made two fundamental errors. First, it assumed that growth was on autopilot and failed to address serious structural problems. Second, flush with revenues, it began major

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redistribution programs, neglecting their consequences: higher fiscal and trade deficits.

Structural problems were inherent in India's unusual model of economic development, which relied on a limited pool of skilled labor rather than an abundant supply of cheap, unskilled, semiliterate labor. This meant that India specialized in call centers, writing software for European companies and providing back-office services for American health insurers and law firms and the like, rather than in a manufacturing model. Other economies that have developed successfully — Taiwan, Singapore, South Korea and China — relied in their early years on manufacturing, which provided more jobs for the poor.

Two decades of double-digit growth in pay for skilled labor have caused wages to rise and have chipped away at India's competitive advantage. Countries like the Philippines have emerged as attractive alternatives for outsourcing. India's higher-education system is not generating enough talent to meet the demand for higher skills. Worst of all, India is failing to make full use of the estimated one million low-skilled workers who enter the job market every month.

Manufacturing requires transparent rules and reliable infrastructure. India is deficient in both. High-profile scandals over the allocation of mobile broadband spectrum, coal and land have undermined confidence in the government. If land cannot be easily acquired and coal supplies easily guaranteed, the private sector will shy away from investing in the power grid. Irregular electricity holds back investments in factories.

India's panoply of regulations, including inflexible labor laws, discourages companies from expanding. As they grow, large Indian businesses prefer to substitute machines for unskilled labor. During China's three-decade boom (1978-2010), manufacturing accounted for about 34 percent of China's economy. In India, this number peaked at 17 percent in 1995 and is now around 14 percent.

In fairness, poverty has sharply declined over the last three decades, to about 20 percent from around 50 percent. But since the greatest beneficiaries were the highly skilled and talented, the Indian public has demanded that growth be more inclusive. Democratic and competitive politics have compelled politicians to

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address this challenge, and revenues from buoyant growth provided the means to do so.

Thus, India provided guarantees of rural employment and kept up subsidies to the poor for food, power, fuel and fertilizer. The subsidies consume as much as 2.7 percent of gross domestic product, but corruption and inefficient administration have meant that the most needy often don't reap the benefits.

Meanwhile, rural subsidies have pushed up wages, contributing to double-digit inflation. India's fiscal deficit amounts to about 9 percent of gross domestic product (compared with structural deficits of around 2.5 percent in the United States and 1.9 percent in the European Union). To hedge against inflation and general uncertainty, consumers have furiously acquired gold, rendering the country reliant on foreign capital to finance its trade deficit.

Economic stability can be restored through major reforms to cut inefficient spending and raise taxes, thereby pruning the deficit and taming inflation. The economist Raghuram G. Rajan, who just left the University of Chicago to run India's central bank, has his work cut out for him. So do Prime Minister Manmohan Singh, also an economist, and the governing party, the Indian National Congress. These steps need not come at the expense of the poor. For example, India is implementing an ambitious biometric identification scheme that will allow targeted cash transfers to replace inefficient welfare programs.

India can still become a manufacturing powerhouse, if it makes major upgrades to its roads, ports and power systems and reforms its labor laws and business regulations. But the country is in pre-election mode until early next year. Elections increase pressures to spend and delay reform. So India's weakness and turbulence may persist for some time yet.

Arvind Subramanian, a senior fellow at both the Peterson Institute for International Economics and the Center for Global Development, is the author of "Eclipse: Living in the Shadow of China's Economic Dominance."

Subcommittee on
Security and International Trade and Finance
Senate Banking Committee

Assessing the Investment Climate and Improving Market Access in Financial Services in India

September 25, 2013

Written Testimony

By

Richard M. Rossow
Director, India & South Asia
McLarty Associates

Subcommittee on Security and International Trade and Finance
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Chairman Warner, Ranking Member Kirk, Distinguished members of the Committee.

I would like to thank this Committee for holding this timely hearing. Financial services firms have consistently been at the forefront of private sector engagement with India and look forward to continuing in this role going forward.

Allow me to state that the views that I am expressing are my own, not of my firm or clients. I do represent clients in the financial services sector that do business in India.

Reality Check- What do Trade and Investment Numbers Show?

When discussing India's trade and investment environment, I always start with a simple reality check: Are American executives making the decision to do business there? With all of the negative press around India's recent economic performance, the paralysis on economic reform, and weakening currency, one would expect that businesses are directing their resources elsewhere.

The real numbers are surprisingly positive. U.S. goods exports to India in the period of January to July 2013 are up 11.4% over the same period last year (U.S. Census data). And last year was our largest export total on record at $22.1 billion, so there is a reasonable chance we will have a new record level of exports to India this year. U.S. imports from India have also increased, up 5.4% year-on-year.

Foreign Direct Investment inflows into India were $5.39 billion in the first quarter of India's 2013-14 fiscal year (which starts April 1), as compared to $4.42 billion during the same period in fiscal 2012-13 (per India's Department of Industrial Policy & Promotion, or DIPP). Total FDI into India for 2013 through July- $12.5 billion, versus $11.8 billion the previous year. That's a 7% increase in dollar terms, and a 13% increase in Rupee terms.

Total FDI into India (USD Billions)	2012	2013
January through March (Q4/2013)	$5.88	$5.51
April through June (Q1/2014)	$4.42	$5.39
Total January through July	**$11.8**	**$12.5**
Total for Year	$22.7	?

** Per India's Department of Industrial Policy and Promotion*

It is important to note that total Foreign Direct Investment into India in 2012 had dropped 34% from 2011 when it hit $34 billion. So we are unlikely to hit a new record this year. However, this does show that investors view the opportunity as roughly equivalent to last year.

I will mention that it is difficult to measure the U.S. share of that FDI due to the fact that a great deal of foreign investment into India is routed through India's treaty partner nations, and therefore is counted in India's statistics as originating in these treaty countries. For example- per official statistics, Mauritius and Singapore account for 55% of FDI so far this year (DIPP). So it is not possible to state definitely whether American firms are leaning into India or leaning away. But the international trend-line is stable.

Even the story on Foreign Institutional Investment is likely better than a casual observer may expect. While FII declined between June and August, it has rebounded in September and stands at around +$7.8 billion for the year (per the Securities & Exchange Board of India).

So, despite the news headlines about India's economic crisis, the numbers show that despite worsening macro-economic data, American business leaders are still betting on India in ever-higher numbers. But as I am sure we all agree, there is a larger untapped potential.

Market Access to India's Financial Services Market

Moving on to the main topic of this Committee Hearing: India's openness to investment by American financial services firms varies by sector. Most sectors comprising India's financial services industry are treated quite independently in terms of the openness to foreign trade and investment. The full list of sectors and their market access regulations are included in my written testimony as Annex 1, but I will briefly provide an overview of market access in a few key sectors.

India allows up to 100% foreign direct investment in some sectors, notably asset management companies and other activities included under a general "Non-Banking Finance Companies" license, such as merchant banking, financial consulting, and more.

For traditional banking, foreign companies can establish branches in India and hold 100% ownership, but face a slow process for getting branch approvals which precludes fast, large-scale growth. So far only two American banks have more than a single office.

U.S. Bank	Branches
Citibank	42
Bank of America	5
American Express Banking	1
J.P. Morgan Chase	1
Bank of New York Mellon, Wells Fargo	1 Rep Office
Wells Fargo	1 Rep Office

**The above is per the Reserve Bank of India monthly report from March 31, 2013.*

Foreign banks can also enter India as subsidiaries and own 74%. The Reserve Bank of India has announced its intention to incentivize foreign banks to shift from branch operations to subsidiaries, and has hinted that it may allow foreign banks to hold 100% after conversion. It is important to note, however, that India's banking rules cap the voting rights of any private shareholder in a bank to 26%, which was increased from 10% in December with the passage of the Banking Laws Amendment in Parliament.

Market access in the insurance industry tends to get a great deal of attention. The foreign direct investment cap in insurance is among the lowest of any sector in India- 26%- and unlike virtually every other sector in the Indian economy, the foreign investment cap is specifically noted in the governing legislation (with Parliament's approval of the Pension Fund Regulatory Development Authority Bill in September 2013, that sector also now has the foreign investment cap included in the guiding legislation). So enacting an increase in this cap is more difficult than most other sectors as it requires an amendment by Parliament. This Government first stated its intention to do so back in 2004 just after it was elected, but the Bill has not yet been approved by Parliament.

U.S. Insurers in India	Type
MetLife	Life
Prudential	Life
American International Group	P&C
Liberty	P&C

**The above is per the current list from the Insurance Regulatory Development Authority*

India's Attractiveness as an Investment Destination- Not Just About Market Access

While market access issues are important and tend to get the high-level attention, an American executive looking at India will have an additional, entirely different filter for judging the investment potential: Can the company achieve better returns by investing in India than other investment options provide, inclusive of potential risks?

The most important risk that an American financial services firm faces in India is the risk of frequent, dramatic shifts in the regulatory environment. These regulatory shifts can cause fits for companies already in the market, and give pause to potential new investors.

To make a broad generalization, regulators in India are increasingly focused on customer protection: a laudable goal, but there are powerful instances of where regulatory over-reach has crippled the growth of financial services industries. Furthermore, there is a sense among Indian regulators and government officials that companies will always find a way to deal with regulations, as though the net impact of any regulation on a company's bottom line is not going to be significant.

I know the term "regulatory predictability" is frequently raised as a key concern for investors, but let me show how that opaque term is actually more meaningful to a business leader than the fiscal deficit, current account deficit, currency fluctuations or other macroeconomic indicators.

Until 1999, India's life insurance sector was a monopoly controlled by the Government-owned Life Insurance Corporation (LIC). Life insurance premiums made up 2.15% of the economy. In 1999, the Government passed the Insurance Regulatory and Development Authority Act, allowing private companies to compete in the market and allowing up to 26% foreign direct investment. Within two years the first private firms were licensed by the Insurance Regulatory Development Authority (IRDA).

The life insurance industry grew at a torrid pace. Several private insurers reported increases in new life insurance premiums of 100% or more per year. By 2009 life insurance premiums were $55.9 billion: 4.6% of India's GDP.

In the spring of 2010, a regulatory jurisdictional dispute arose between the Securities and Exchange Board of India (SEBI) and IRDA over regulation of the dominant type of insurance product, called a Unit Linked Insurance Product (ULIP, which invests premiums into investment accounts). The Ministry of Finance intervened and clearly authorized IRDA to continue regulating the products, but forced IRDA to adopt tough new rules on how the products could be structured and how agents selling these products could be compensated. Life insurers saw their fees cut, and agents saw their commission rates reduced by 50%. There was no "notice & comment" period, or any studies of the impact of these regulations. Life insurers had to take all their existing products off the market and re-submit new versions. There was an entire week in late 2010 that not a single ULIP was sold in all of India, while just before this change ULIPs had constituted around 85% of life insurance sales.

To put this into context, the National Association of Home Builders (NAHB) estimates that housing construction contributes roughly 5% of U.S. GDP. Imagine if a U.S. regulation forced all home construction to stop for an entire week.

To be sure, there was a rational reason behind the regulatory changes: the fact that some of these products were being sold inappropriately, primarily by agents who promised unrealistic returns. In most countries, regulators would instead establish stricter rules on how the products are sold, rather than enacting regulations that make the products themselves less appealing to sell and be bought.

The impact of this one regulatory change? Life insurance premiums have decreased every year since. Premiums accounted for only 3.19% of GDP in 2012. Through the first quarter of fiscal 2013, premiums are still on the decline (per IRDA's June 2013 "Monthly business figures – Life"). This is a 31% drop in the sector's contribution to GDP.

Looking outside the life insurance industry, another example of the impact of regulations crippling a large industry can be found in India's mutual fund sector. Again, due to concerns about protecting consumers, in August 2009 the Securities and Exchange Board of India (SEBI) banned entry loads on the sale of mutual funds. The industry had, until then, been averaging annual increases of Assets Under Management of approximately 13%. In the two years following this regulatory change, the sector's AUM declined by 6% and 5%. In November 2012, SEBI re-introduced commissions--payable annually as part of the customer's asset management fee--and the industry has seen a turnaround.

A third example is playing out as we speak. On June 28, 2013 the Reserve Bank of India (RBI) issued "Draft Guidelines on Wealth Management/Marketing/Distribution Services offered by Banks." Included in these Draft Guidelines is a proposal to ban incentives for the sale of insurance products through banks. Approximately 30% of private sector life insurance sales are conducted by bank partners (called "Bancassurance"). If the RBI does enact a ban on incentives for selling insurance through banks, it is likely this key distribution channel will be greatly reduced.

The underlying theme in these examples is that regulators are currently focused on consumer protection, and not the expansion of their relevant industries. But instead of governing sales practices, the regulators choose to discourage the sale and purchase of the products. These types of quick, dramatic changes shape the sentiments of current investors, discourage new investment, and may ultimately hurt the consumers they want to protect.

How to Increase Investment into India

On high-level market access issues, I believe the various institutions in the U.S. that engage with India---Congress, White House, Treasury, Commerce, State, the U.S. Trade Representative's Office--have done an admirable job of maintaining the drumbeat on the importance of economic reforms when engaging their Indian counterparts.

When it comes to promoting regulatory consistency, we have more limited options. India's financial regulators operate largely free of influence from their own elected officials. Apart from banking, competition in India's financial services sectors is relatively new, and regulators are tinkering with the mixture of protection and promotion. We should encourage our friends in India to learn from their own work so the instances of overshooting the intended outcome diminish over time. India is increasingly open to learning from "international best practices," and we should continue to use this angle to provide assistance as requested.

I have three specific recommendations on how the U.S. engages India that I firmly believe can play a role in triggering game-changing shifts in the investment environment:

1. **Push Harder to Conclude a High-Standards Bilateral Investment Treaty**

   There is a wide gap between the commitments in the revised U.S. Model BIT and India's model treaty (called a Bilateral Investment Promotion Agreement, or BIPA). India does not include "National Treatment at Establishment": code for removing FDI caps. India also does not typically include an article on "Performance Requirement," which would potentially alleviate the local content concerns raised by America's information technology, telecommunications, electronics, and other industries. I will note that India did include a section on Performance Requirements in its BIPA with Kuwait (Annex 2). While the Performance Requirement language in the India Kuwait BIPA is far less exhaustive than the U.S. Model BIT, it does provide a starting point.

   India is in the process of reviewing its own model treaty, which has frozen negotiations for more than a year. We should encourage India to conclude this process and return to negotiations as quickly as possible.

2. **Continue and Escalate Engagement with Key State Leaders**

   While the supposed "rise of state leaders" often cited by experts and the press is typically overstated (Congress and BJP, the nation's 2 main national parties, currently hold 18 states-- up from 10 states in 1998), there are important state-level parties which have a strong influence on policy reforms because they:

   a. Control their home state, thus are directly interested in encouraging development; and,
   b. Hold a relevant number of Parliament seats, thus could potentially vote in favor of reforms.

   We should increase our engagement with these state leaders and encourage them to support economic reforms from the Central Government that can help unlock increased investments into their own states. Amb. Nancy Powell has already made state engagement in India a key tenet of her tenure, and these actions should be increased.

The state of Andhra Pradesh is an important example of how key state leaders can become champions of reform. The insurance regulator, IRDA, is based in Hyderabad. This is a strange phenomenon, considering all the other financial regulators are based in Mumbai (or in the case of the pension regulator, PFRDA, in New Delhi). A key reason the insurance regulator is in Hyderabad is that when the bill to open the sector was moving to Parliament for a vote in 1999, the Andhra Pradesh-based Telugu Desam Party used its 29 votes to support the bill.

3. **Constantly Review and Reshape Our Areas of Engagement with India**
The United States Government is capable of engaging India on a wide range of topics simultaneously. India, however, cannot always reciprocate on so many fronts simultaneously due to a variety of limitations. The resultant mismatch in expectations often leads to frustration on our side as U.S. officials sometimes find their Indian counterparts unresponsive or indifferent to our proposals. And it also leads to similar sentiments in India about the United States.

But if we are able to dynamically review and reshape the ways we engage India, we can achieve a much higher level of engagement and satisfaction. While foreign commentators often claim that India's reform process is stalled, in some areas that perception does not match reality. Quite a few truly transformational exercises are taking place. But the changes are not aligned with what we consider our highest priorities so they get less attention than deserved. Whether our guiding aim in engaging with India is simply promoting commerce, or if it is encouraging the growth of a large democratic nation in an unstable region, I am confident that if we have the flexibility to find the open doors to push upon, we can establish more realistic expectations for the relationship.

One key example where the Government of India is clearly putting a great deal of time, money, and energy is on establishing a unique identification number for all the nation's citizens. At the same time, the Government is trying to establish a bank account for everyone given an identification. In tandem with these moves, the Government is now launching an innovative program to begin direct electronic transfers of Government subsidies and other payments to recipients. The net result of this move, if it works: the 500 million Indians currently outside the formal financial sector may be rapidly pulled in, given bank accounts, a credit card, and having various subsidies sent to them directly-- cutting down on leakages in the system.

When we see an important initiative like the unique ID/financial inclusion/direct benefit transfer taking place in India, we must be quick to reshape our engagement to focus efforts in ways India will find beneficial. There will be resultant commercial opportunities, development opportunities, and a higher degree of goodwill.

Looking Forward

I am very hopeful for Dr. Raghuram Rajan's tenure as the new Governor of the Reserve Bank of India (RBI). While I want to be careful to not overstate the impact he can have on the nation's economy, I am heartened by his inaugural speech at RBI in which he stated, "To the existing traditions of the RBI, which will be the bedrock of our work, we will emphasize two other traditions that become important in these times: transparency and predictability." As I hope I have successfully conveyed, the lack of predictability has diminished India's attractiveness as an investment destination.

The RBI plays a leadership role among India's financial regulators. Hopefully this emphasis on transparency and predictability will carry throughout the system. It is among the lowest-hanging fruit that India can grasp to make itself a more attractive investment destination for America's financial services firms.

I will conclude my remarks with a terrific point made by the former chairman of Microsoft India, Ravi Venkatesan, in his new book "Conquering the Chaos." Ravi points out that much of the world's growth in the next 50 years will come from places that look more like India than Canada. Helping America's financial services firms get in the door and compete on a level field in India will prepare them to remain competitive in the future.

America has much to learn, and much to teach, in this process. I know American financial services firms appreciate the attention given to their issues by this Committee.

Annex 1: Market Access Regulations for Financial Services, per India's Department of Industrial Policy and Promotion

Taken from the DIPP's "Consolidated FDI Policy, April 5, 2013" with additions from Press Note 6 of 2013.

6.2.17.2	**Banking –Private sector**		
6.2.17.2.1	Banking –Private sector	74% including investment by FIIs	Automatic up to 49% Government route beyond 49% and up to 74%
6.2.17.2.2	**Other conditions:**		
	(1) This 74% limit will include investment under the Portfolio Investment Scheme (PIS) by FIIs, NRIs and shares acquired prior to September 16, 2003 by erstwhile OCBs, and continue to include IPOs, Private placements, GDR/ADRs and acquisition of shares from existing shareholders. (2) The aggregate foreign investment in a private bank from all sources will be allowed up to a maximum of 74 per cent of the paid up capital of the Bank. At all times, at least 26 per cent of the paid up capital will have to be held by residents, except in regard to a wholly-owned subsidiary of a foreign bank. (3) The stipulations as above will be applicable to all investments in existing private sector banks also. (4) The permissible limits under portfolio investment schemes through stock exchanges for FIIs and NRIs will be as follows: (i) In the case of FIIs, as hitherto, individual FII holding is restricted to 10 per cent of the total paid-up capital, aggregate limit for all FIIs cannot exceed 24 per cent of the total paid-up capital, which can be raised to 49 per cent of the total paid-up capital by the bank concerned through a resolution by its Board of Directors followed by a special resolution to that effect by its General Body. (a) Thus, the FII investment limit will continue to be within 49 per cent of the total paid-up capital. (b) In the case of NRIs, as hitherto, individual holding is restricted to 5 per cent of the total paid-up capital both on repatriation and non- repatriation basis and aggregate limit cannot exceed 10 per cent of the total paid-up capital both on repatriation and non-repatriation basis. However, NRI holding can be allowed up to 24 per cent of the total paid-up capital both on repatriation and non-repatriation basis provided the banking company passes a special resolution to		

	that effect in the General Body. (c) Applications for foreign direct investment in private banks having joint venture/subsidiary in insurance sector may be addressed to the Reserve Bank of India (RBI) for consideration in consultation with the Insurance Regulatory and Development Authority (IRDA) in order to ensure that the 26 per cent limit of foreign shareholding applicable for the insurance sector is not being breached. (d) Transfer of shares under FDI from residents to non-residents will continue to require approval of RBI and Government as per para 3.6.2 above as applicable. (e) The policies and procedures prescribed from time to time by RBI and other institutions such as SEBI, D/o Company Affairs and IRDA on these matters will continue to apply. (f) RBI guidelines relating to acquisition by purchase or otherwise of shares of a private bank, if such acquisition results in any person owning or controlling 5 per cent or more of the paid up capital of the private bank will apply to non-resident investors as well. (ii) Setting up of a subsidiary by foreign banks (a) Foreign banks will be permitted to either have branches or subsidiaries but not both. (b) Foreign banks regulated by banking supervisory authority in the home country and meeting Reserve Bank"s licensing criteria will be allowed to hold 100 per cent paid up capital to enable them to set up a wholly-owned subsidiary in India. (c) A foreign bank may operate in India through only one of the three channels viz., (i) branches (ii) a wholly-owned subsidiary and (iii) a subsidiary with aggregate foreign investment up to a maximum of 74 per cent in a private bank. (d) A foreign bank will be permitted to establish a wholly-owned subsidiary either through conversion of existing branches into a subsidiary or through a fresh banking license. A foreign bank will be permitted to establish a subsidiary through acquisition of shares of an existing private sector bank provided at least 26 per cent of the paid capital of the private sector bank is held by residents at all times consistent with para (i) (b) above.

	A subsidiary of a foreign bank will be subject to the licensing requirements and conditions broadly consistent with those for new private sector banks. (f) Guidelines for setting up a wholly-owned subsidiary of a foreign bank will be issued separately by RBI (g) All applications by a foreign bank for setting up a subsidiary or for conversion of their existing branches to subsidiary in India will have to be made to the RBI. (d) (iii)At present there is a limit of ten per cent on voting rights in respect of banking companies, and this should be noted by potential investor. Any change in the ceiling can be brought about only after final policy decisions and appropriate Parliamentary approvals.		
6.2.17.3	**Banking- Public Sector**		
6.2.17.3.1	Banking- Public Sector **subject to** Banking Companies (Acquisition & Transfer of Undertakings) Acts 1970/80. This ceiling (20%) is also applicable to the State Bank of India and its associate	20% (FDI and Portfolio Investment)	Government
6.2.17.4	**Commodity Exchanges**		
6.2.17.4.1	1 Futures trading in commodities are regulated under the Forward Contracts (Regulation) Act, 1952. Commodity Exchanges, like Stock Exchanges, are infrastructure companies in the commodity futures market. With a view to infuse globally acceptable best practices, modern management skills and latest technology, it was decided to allow foreign investment in Commodity Exchanges. 2 For the purposes of this chapter, (i) "Commodity Exchange" is a recognized association under the provisions of the Forward Contracts (Regulation) Act, 1952, as amended from time to time, to provide exchange platform for trading in forward contracts in commodities. "recognized association" means an association to which recognition for the time being has been granted by the Central Government under Section 6 of the Forward Contracts (Regulation) Act, 1952 (iii)"Association" means any body of individuals, whether incorporated or not, constituted for the purposes of regulating and controlling the business of the sale or purchase of any goods and commodity derivative. (iv)"Forward contract" means a contract for the delivery of goods and which is not a ready delivery contract. (v) "Commodity derivative" means-		

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<tr><td></td><td colspan="3">• a contract for delivery of goods, which is not a ready delivery contract; or
(ii) a contract for differences which derives its value from prices or indices of prices of such underlying goods or activities, services, rights, interests and events, as may be notified in consultation with the Forward Markets Commission by the Central Government, but does not include securities.</td></tr>
<tr><td>6.2.17.4.2</td><td>Policy for FDI in Commodity Exchange</td><td>49% (FDI & FII) [Investment by Registered FII under Portfolio Investment Scheme (PIS) will be limited to 23% and Investment under FDI Scheme limited to 26%</td><td>Automatic</td></tr>
<tr><td>6.2.17.4.3</td><td>Other conditions:</td><td></td><td></td></tr>
<tr><td></td><td colspan="3">(i) FII purchases shall be restricted to secondary market only and
(ii) No non-resident investor/ entity, including persons acting in concert, will hold more than 5% of the equity in these companies.
(iii) Foreign investment in commodity exchanges will be subject to the guidelines of the Department of Consumer Affairs/ Forward Markets Commission</td></tr>
<tr><td>6.2.17.5</td><td colspan="3">Credit Information Companies (CIC)</td></tr>
<tr><td>6.2.17.5.1</td><td>Credit Information Companies</td><td>49% (FDI & FII)</td><td>Automatic</td></tr>
<tr><td>6.2.17.5.2</td><td colspan="3">Other Conditions:</td></tr>
<tr><td></td><td colspan="3">(1) Foreign investment in Credit Information Companies is subject to the Credit Information Companies (Regulation) Act, 2005.
(2) Foreign investment is permitted under the Government route, subject to regulatory clearance from RBI.</td></tr>
<tr><td></td><td colspan="3">(3) Investment by a registered FII under the Portfolio Investment Scheme would be permitted up to 24% only in the CICs listed at the Stock Exchanges, within the overall limit of 74% for foreign investment.
(4) Such FII investment would be permitted subject to the conditions that:
(a) No single entity should directly or indirectly hold more than 10% equity.
(b) Any acquisition in excess of 1% will have to be reported to RBI as a mandatory requirement; and
(c) FIIs investing in CICs shall not seek a representation on the Board of Directors based upon their shareholding.</td></tr>
<tr><td>6.2.17.6</td><td colspan="3">Infrastructure Company in the Securities Market</td></tr>
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6.2.17.6.1	Infrastructure companies in Securities Markets, namely, stock exchanges, depositories and clearing corporations, in compliance with SEBI Regulations	49% (FDI & FII) [FDI limit of 26 per cent and an FII limit of 23 per cent of the paid-up capital]	Automatic
6.2.17.6.2	**Other Conditions:**		
6.2.17.6.2.1	FII can invest only through purchases in the secondary market		
6.2.17.7	**Insurance**		
6.2.17.7.1	Insurance	26%	Automatic
6.2.17.7.2	**Other Conditions:**		
	(1) FDI in the Insurance sector, as prescribed in the Insurance Act, 1938, is allowed under the automatic route. (2) This will be subject to the condition that Companies bringing in FDI shall obtain necessary license from the Insurance Regulatory & Development Authority for undertaking insurance activities.		
6.2.17.8	**Non-Banking Finance Companies (NBFC)**		
6.2.17.8.1	Foreign investment in NBFC is allowed under the automatic route in only the following activities: (i) Merchant Banking (ii) Under Writing (iii) Portfolio Management Services (iv) Investment Advisory Services (v) Financial Consultancy (vi) Stock Broking (vii) Asset Management (viii) Venture Capital (ix) Custodian Services (x) Factoring (xi) Credit Rating Agencies (xii) Leasing & Finance (xiii) Housing Finance (xiv) Forex Broking (xv) Credit Card Business (xvi) Money Changing Business (xvii) Micro Credit (xviii) Rural Credit	100%	Automatic
6.2.17.8.2	**Other Conditions:**		
	(1) Investment would be subject to the following minimum capitalisation norms: (i) US $0.5 million for foreign capital up to 51% to be brought upfront		

	(ii) US $ 5 million for foreign capital more than 51% and up to 75% to be brought upfront (iii)US $ 50 million for foreign capital more than 75% out of which US$ 7.5 million to be brought upfront and the balance in 24 months. (iv)NBFCs (i) having foreign investment more than 75% and up to 100%, and (ii) with a minimum capitalisation of US$ 50 million, can set up step down subsidiaries for specific NBFC activities, without any restriction on the number of operating subsidiaries and without bringing in additional capital. **The minimum capitalization condition as mandated by para 3.10.4.1, therefore, shall not apply to downstream subsidiaries.** (v) Joint Venture operating NBFCs that have 75% or less than 75% foreign investment can also set up subsidiaries for undertaking other NBFC activities, subject to the subsidiaries also complying with the applicable minimum capitalisation norm mentioned in (i), (ii) and (iii) above and (vi) below. Non- Fund based activities : US $0.5 million to be brought upfront for all permitted non-fund based NBFCs irrespective of the level of foreign investment subject to the following condition: It would not be permissible for such a company to set up any subsidiary for any other activity, nor it can participate in any equity of an NBFC holding/operating company. **Note:** The following activities would be classified as Non-Fund Based activities: (a) Investment Advisory Services (b) Financial Consultancy (c) Forex Broking (d) Money Changing Business (e) Credit Rating Agencies (vii) This will be subject to compliance with the guidelines of RBI. **Note:** (i) Credit Card business includes issuance, sales, marketing & design of various payment products such as credit cards, charge cards, debit cards, stored value cards, smart card, value added cards etc. (ii) Leasing & Finance covers only financial leases and not operating leases. (vi) (2) The NBFC will have to comply with the guidelines of the relevant regulator/ s, as applicable

Annex 2: Comparison of Performance Requirement Sections in the U.S. Model BIT and India's BIPA with Kuwait

Performance Requirements under India's BIPA with Kuwait	4. Once established, investment shall not be subjected in the host Contracting State to additional performance requirements which may hinder or restrict their expansion or maintenance or adversely affect or be considered as detrimental to their viability unless such requirements are deemed vital for reasons of public order, public health or environmental concerns and are enforced by law of general application.
Performance Requirements under 2012 U.S. Model Bilateral Investment Treaty	Article 8: Performance Requirements 1. Neither Party may, in connection with the establishment, acquisition, expansion, management, conduct, operation, or sale or other disposition of an investment of an investor of a Party or of a non-Party in its territory, impose or enforce any requirement or enforce any commitment or undertaking: (a) to export a given level or percentage of goods or services; (b) to achieve a given level or percentage of domestic content; (c) to purchase, use, or accord a preference to goods produced in its territory, or to purchase goods from persons in its territory; (d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment; (e) to restrict sales of goods or services in its territory that such investment produces or supplies by relating such sales in any way to the volume or value of its exports or foreign exchange earnings; (f) to transfer a particular technology, a production process, or other proprietary knowledge to a person in its territory; (g) to supply exclusively from the territory of the Party the goods that such investment produces or the services that it supplies to a specific regional market or to the world market; or (h) (i) to purchase, use, or accord a preference to, in its territory, technology of the Party or of persons of the Party12; or (ii) that prevents the purchase or use of, or the according of a preference to, in its territory, particular technology, so as to afford protection on the basis of nationality to its own investors or investments or to technology of the Party or of persons of the Party. 2. Neither Party may condition the receipt or continued receipt of an advantage, in connection with the establishment, acquisition, expansion, management, conduct, operation, or sale or other disposition of an investment in its territory of an investor of a Party or of a non-Party, on compliance with any requirement: (a) to achieve a given level or percentage of domestic content; (b) to purchase, use, or accord a preference to goods produced in its territory, or to purchase goods from persons in its territory; (c) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment; or (d) to restrict sales of goods or services in its territory that such investment produces or supplies by relating such sales in any way to the volume or value of its exports or foreign exchange earnings. 3. (a) Nothing in paragraph 2 shall be construed to prevent a Party from conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with a requirement to locate production, supply a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory.

	(b) Paragraphs 1(f) and (h) do not apply: (i) when a Party authorizes use of an intellectual property right in accordance with Article 31 of the TRIPS Agreement, or to measures requiring the disclosure of proprietary information that fall within the scope of, and are consistent with, Article 39 of the TRIPS Agreement; or (ii) when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal, or competition authority to remedy a practice determined after judicial or administrative process to be anticompetitive under the Party's competition laws.13 (c) Provided that such measures are not applied in an arbitrary or unjustifiable manner, and provided that such measures do not constitute a disguised restriction on international trade or investment, paragraphs 1(b), (c), (f), and (h), and 2(a) and (b), shall not be construed to prevent a Party from adopting or maintaining measures, including environmental measures: (i) necessary to secure compliance with laws and regulations that are not inconsistent with this Treaty; (ii) necessary to protect human, animal, or plant life or health; or (iii) related to the conservation of living or non-living exhaustible natural resources. (d) Paragraphs 1(a), (b), and (c), and 2(a) and (b), do not apply to qualification requirements for goods or services with respect to export promotion and foreign aid programs. (e) Paragraphs 1(b), (c), (f), (g), and (h), and 2(a) and (b), do not apply to government procurement. (f) Paragraphs 2(a) and (b) do not apply to requirements imposed by an importing Party relating to the content of goods necessary to qualify for preferential tariffs or preferential quotas. 4. For greater certainty, paragraphs 1 and 2 do not apply to any commitment, undertaking, or requirement other than those set out in those paragraphs. 5. This Article does not preclude enforcement of any commitment, undertaking, or requirement between private parties, where a Party did not impose or require the commitment, undertaking, or requirement.

PREPARED STATMENT OF REENA AGGARWAL, PH.D.

ROBERT E. MCDONOUGH PROFESSOR OF BUSINESS ADMINISTRATION AND PROFESSOR OF FINANCE, AND DIRECTOR, GEORGETOWN CENTER FOR FINANCIAL MARKETS AND POLICY

MCDONOUGH SCHOOL OF BUSINESS, GEORGETOWN UNIVERSITY

SEPTEMBER 25, 2013

Thank you Chairman Warner, Ranking Member Kirk, and distinguished Members of the Subcommittee for giving me the opportunity to testify at today's hearing.

I am Dr. Reena Aggarwal, Robert E. McDonough Professor of Finance and Director of the Georgetown Center for Financial Markets and Policy at Georgetown University's McDonough School of Business. The Georgetown Center for Financial Markets and Policy provides objective and unbiased *Thought Leadership for Global Finance.* As indicated in my bio, I serve on the boards of three U.S. financial services firms, none of which operate in India. I am pleased to provide testimony on assessing the investment climate and improving market access in financial services in India.

Current Investment Climate

Short-Term Problems

In the short-run, the investment climate in India looks bleak. The last few months have seen devaluation of the rupee by 22 percent, economic growth has slowed from a high of 10.5 percent in 2010 to 4.4 percent in 2013, and the growth rate is expected to be below 5 percent in 2013–2014. The current account deficit has reached 4.8 percent of GDP. At the same time, inflation of 5.8 percent is a challenge. If the situation continues to deteriorate, then the threat of a ratings downgrade exists. India cannot afford to have its current rating of BBB- drop, particularly because any further drop would imply a rating below investment grade.

- Devaluation of the Indian rupee was expected; however, the sharp devaluation over a very short time period of time has shaken investor confidence. The weakening of the rupee makes oil imports more expensive, and India relies heavily on oil imports. The devaluation has already led major Indian oil refiners to announce an increase in petrol prices and diesel prices.[1] An increase in oil prices will put further pressure on both inflation and the current account deficit. At the same time, the weak rupee benefits Indian exporters, and we should see a pick-up in exports.
- In addition to the weak macroeconomic conditions, there is political uncertainty with elections coming up in May 2014. Therefore, the government is not expected to take bold measures in the short-term to improve the investment climate.
- Estimates of earnings growth for Indian corporates have been cut by analysts. The Indian stock markets have been weak, and volatility has increased.[2]

If the macroeconomic conditions continue to remain weak then investors are likely to stay away from India both for FDI and portfolio investment. In the short-run, the Indian economy and the financial sector face a number of challenges.

Long-Term Opportunities

However, the weak macroeconomic situation is not likely to persist, and economic growth should start to pick-up. Macroeconomic growth is a strong indicator of growth in the financial sector. As economic conditions improve in India, the financial sector will also benefit. In the long-run, there are tremendous opportunities for foreign firms to participate in the Indian banking and financial sector.

- India has huge needs for financing. Infrastructure investment is expected to be $1 trillion over a 5-year period, amounting to 10 percent of GDP.[3] The government's ambitious plans include 20,000 kilometers of new and upgraded roads, 120 bridges, $250 billion investment in electric plants and power grids, and 17

[1] Reuters. "IOC to raise petrol, diesel prices from Sunday," September 1, 2013. *http://in.reuters.com/article/2013/08/31/india-fuel-prices-idINDEE97U04J20130831.*

[2] The Economic Times. "Sensex Outlook by Morgan Stanley," September 4, 2013. *http://articles.economictimes.indiatimes.com/2013-09-04/news/41765729__1__broad-market-earnings-sensexearnings-growth-bear-case-scenario.*

[3] Urban Land Institute and Ernst & Young. *Infrastructure 2013: Global Priorities, Global Insights.* Washington, DC: Urban Land Institute, 2013.

new airports. Most of these projects will be public-private partnerships with half the investment expected to come from the private sector.

- The middle class is expected to grow from about 20 percent of the population in 2015–16 to above 37 percent by 2025–26. The middle class and the younger generation have the spending power, they have a strong credit culture, and they are becoming financially sophisticated. This has resulted in growing demand for credit cards, auto loans, home loans, retirement planning, and wealth management.
- The Indian corporate sector is globalizing and conducting acquisitions around the world. These activities require advisory expertise and financing from around the world, a competitive advantage for foreign banks.
- Financial penetration and inclusion is a major issue in India. A large segment of the Indian population is excluded from formal banking services with only 1 in 6 villages having access to banking services. Only 35 percent of the population has bank accounts.[4] As shown in Figure 1, India has far fewer ATMs and bank branches (relative to its population) than other emerging markets such as Brazil and South Africa. The government has launched an aggressive program of financial inclusion that presents both challenges and opportunities for foreign financial firms.

Financial Services in India

The financial sector is the backbone of any economy and is critical for economic development. However, the financial crisis of 2008 has shown that the financial sector can become the epicenter of a major economic crisis. Both developed and developing economies have started to take a more cautious approach to financial development and financial innovation.

The question whether foreign financial institutions can profitably operate in India has several dimensions to it, two of the most important ones being 1) the business opportunity and 2) regulation and government policies. In some cases, the business opportunity is not compelling. For example, Fidelity decided to exit India even though the asset management business in India is not burdened with ownership restrictions. After 4 years, Wells Fargo decided to close its real estate investment arm citing lack of profitability. Businesses operate in order to make profits, and if profit margins are not sufficient to compensate for risk, businesses will not operate in that market. The financial services sector is highly regulated all over the world. Regulation and governmental policies place several restrictions on foreign banks and insurance companies that make the cost of doing business in India higher than several other countries. The biggest issues are uncertainty and ambiguity in policy, as I will discuss later. Recently, both UBS and Morgan Stanley have decided not to pursue their banking license in India. But, they will continue to conduct business in India as a nonbank financial institution. At the same time, other financial institutions have entered the Indian market in recent years, including Credit Suisse, ANZ and ICBC.

Banking in India is still dominated by public sector banks, accounting for 73 percent of the banking sector assets which reached $1.5 trillion. As of March 2013, there were 43 foreign banks operating in India with 333 branches. Overall, demand for credit has grown, and deposits are expected to see healthy growth. Access to the banking system has improved; however, there is much to be done in terms of financial inclusion and meeting the needs of the Indian people.

Opportunities for Foreign Financial Institutions

The three largest foreign banks in India are Standard Chartered, Citibank and HSBC. As shown in Table 1, the average profitability of foreign banks in India is higher than that of all private sector banks, and much higher than that of public sector banks. The profitability of foreign banks in India is also higher than their operations in most other countries. During the period, 2007–2012, among the three largest foreign banks in India, the profitability of Standard Chartered was the highest. For 2012–13, Citibank in India reported a significant increase in profits partly due to increased demand for loans from small and medium companies, as well as for mortgages and trade loans for global clients, and partly due to payoff from cost cutting. However, the market share of foreign banks in India is still very small.

- Foreign banks have been successful in the credit card business and have captured a disproportionate share of the credit/debit card market. Their customers hold 27 percent of all credit cards in India. Increased consumerism will result

[4] The World Bank. Global Financial Inclusion Database.

in continued strong growth credit card use. Reserve Bank of India (RBI) has recently encouraged the use of debit cards over credit cards. Prior to 2012, banks could charge 1–2.5 percent for debit and credit card transactions, but now, banks are only allowed to charge 0.75–1 percent for debit card purchases while credit card fees remain the same.

- Foreign remittances to India were approximately $70 billion in 2012 and provide foreign banks a competitive opportunity with their global network, although it is a saturated market.
- High net worth individuals and total wealth holdings are expected to grow from $362 billion in 2009 to $2.95 trillion in 2020.[5] This presents opportunities in the wealth management sector due to the growing number of high-net-worth individuals, few regulatory issues, and demand for innovative products.
- Indian firms are interested in diversifying their revenue base outside of India. Foreign banks have a competitive advantage in helping finance Indian corporates' acquisitions abroad. They have bigger balance sheets and a lower cost to fund dollar and foreign currency transactions; therefore, they can lend at cheaper rates than local banks.
- The two largest stock exchanges in India are the National Stock Exchange and the Bombay Stock Exchange. The stock market has been hit hard in 2013 and India has been one of the worst performing countries. In April 2013, the government increased the limits for investment by FIIs, and they are now allowed to invest up to US$25b in longterm government bonds and up to US$51b in corporate bonds. Starting in January 2012, foreign individuals are allowed to invest directly in the market. Previously, they were allowed to invest only through mutual funds or institutional investments. Credit default swaps (CDS) were introduced in 2011 in order to bring liquidity to the bond market. CDS provide buyers with protection against credit risk in the event of default or bankruptcy by the bond issuer.
- There are no ownership restrictions on asset management foreign firms in India. Assets under management have grown by a rate of 23 percent over the last decade (Figure 2), but margins are a challenge. Indian Corporates invest through mutual funds due to tax advantages but retail participation is very low, and most assets flow to fixed income funds. The culture to invest in gold and property continues to be strong.
- Mobile and online banking products can provide foreign banks a low-cost alternative to branches to leapfrog their penetration in the market and compete with local banks that have a vast branch network. There are almost 1 billion mobile subscribers in India.

Regulatory Challenges and Uncertainty faced by Foreign Financial Firms

- One of the major issues facing foreign banks is RBI's proposal that existing foreign banks of a certain size form a wholly owned subsidiary (WOS) in India rather than operate as branches of their overseas parent companies. RBI's motivation is to "ring fence" the Indian financial system in order to restrict foreign banks from shrinking their operations in India as happened during the 2008 crisis. The RBI sees this approach as helping to 1) insulate the Indian unit from troubles at the parent-level; 2) protect Indian depositors by having a clear definition of laws pertaining to jurisdiction; 3) foster better regulatory oversight control during a crisis; 4) encourage focused management and corporate boards as well as effective corporate governance. The WOS would have a separate board of directors and would be capitalized separately. If foreign banks, such as Citibank, Standard Chartered, HSBC, opt for creating wholly owned subsidiaries, then they will be treated the same as other local banks and will not have the restrictions on opening new branches. However, they will also be required to lend 40 percent of their total portfolio to priority sectors, such as agriculture, small enterprises, and low-cost housing. Some might argue that the branch structure with some modifications could address RBI's concern and the WOS is not the best way to achieve RBI's objectives. A WOS structure with its own capital base would not benefit from a global bank's infrastructure and would impose higher costs.
- According to the regulators, wholly owned subsidiaries of foreign banks would not get full national treatment but would be in a much better position than the foreign bank branches operating in India but less than that of domestic banks.

[5] Deloitte. *Growth Opportunities for financial services in India: Investing for the long term in the world's largest democracy.* New York City: Deloitte Development LLC, 2012.

This raises several questions: What activities will be limited? Why should a WOS not get full national treatment? Why would a WOS need to meet priority lending if they don't get full treatment?

- Banks that operate only in the wholesale market, *e.g.,* JPMorgan, Morgan Stanley, can keep their branch status as long as they operate fewer than 20 branches. Banks operating more than 20 branches will need to meet the 40 percent priority lending requirements, instead of the current 32 percent. Earlier, there was some concern that all foreign banks would be required to become a foreign subsidiary.
- There is much regulatory uncertainty in the financial sector in India. RBI first issued its road map for foreign banks in 2005, and it is still in the process of sorting it out. Only now some clarification is emerging on important questions such as: Who would need to convert to a wholly owned subsidiary? Will banks not servicing retail customers be allowed to operate as a branch? How will RBI determine systemically important banks and will they be mandated to operate as a WOS? What would be the tax consequences of converting to a WSO? Will there be control/voting restrictions on the WOS?
- The insurance sector in India is controlled by the public sector with one major player. Attempts to change the direct investment cap from 26 percent to 49 percent have not been successful in Parliament.
- Several foreign insurance companies are looking to exit their joint venture insurance venture due to regulatory uncertainties.

Summary and Conclusion

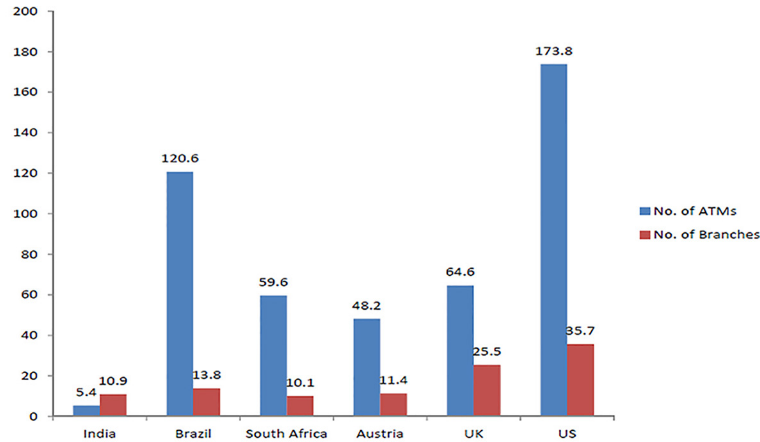
There are many opportunities for foreign financial services firms in India in the long-term. India is not only an emerging market but also proving to be an emerging power. It is not an option for a global financial services firm not to be present in the Indian market.

- India has reached a critical juncture in its economic development. The country desperately needs foreign investment to support growth. This presents an opportunity for foreign firms to invest in India.
- The bureaucracy in India presents a challenge to foreign firms looking to participate in the market. Currently, there is much uncertainty surrounding policy due to continuous changes in regulation, inconsistencies in interpretation and enforcement, and ambiguity. At the same time, there are areas in which regulators have made it easier for foreign firms to conduct business. Regulators, such as Securities and Exchange Board of India (SEBI) which was formed only in 1992, have played a positive role in the development of Indian capital markets. This offers promise for the future.
- India is also being held back by massive corruption, lack of transparency, and political bickering. Based on Transparency International's Corruption Perception Index, in 2012, India ranked 94 out of 176 countries.
- Foreign firms will require a great deal of patience when doing business in India, and some may run out of patience and consider exiting the market. If the playing field is not level, then foreign firms will not operate in the market.
- In order for firms to succeed in India, they will have to figure out how to serve the "bottom of the pyramid." Based on the country's needs, national priorities, and government regulations formulated to support those priorities, firms will need to reach the poor and those living in rural areas. They will also need to improve their distribution to small and medium sized firms. This will require them to offer localized products and services and devise innovative strategies that will allow them to be successful with these segments of the market. Technology can prove fruitful in reaching out to these segments in a cost effective way.
- Foreign firms will need to be part of the solution in helping solve the plight of India's rural poor and address other development issues that the country faces. Financial inclusion is a huge problem in India. A large portion of the population is unbanked, resulting in a large shadow banking system. Foreign banks have only 21 ATMs in rural India which is home to 830 million people.
- The Indian government can help remove the uncertainty and ambiguity in policies and regulations regarding banks and insurance companies. This will boost investor confidence and encourage foreign investment across the economy.
- India needs foreign capital to meet its growth needs and fulfill its ambitious infrastructure program. The telecomm sector in India has been very successful in penetrating the rural Indian market; the financial sector should be similarly

incentivized to innovate and reach the masses, while clearly recognizing that the risk needs to be managed.

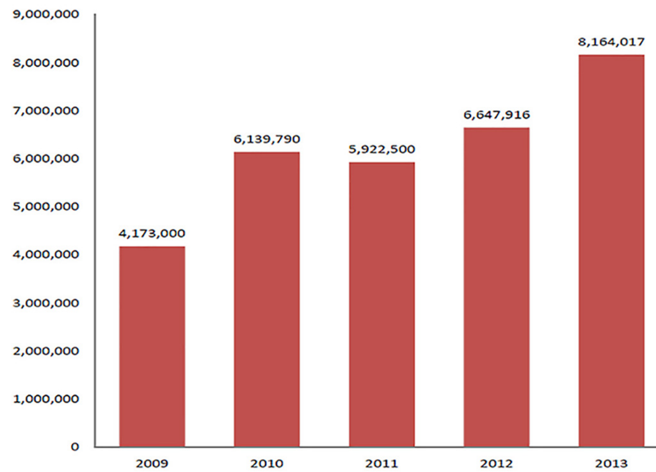
- Recently, there has been some easing of restrictions on foreign investment in government and corporate bonds. As the financial sector matures, it is important for the country to develop a vibrant bond market, securitization market, and consider sovereign bonds eventually leading to municipal bonds.

Figure 1: Financial Inclusion around the World



Source: The World Bank, Global Financial Inclusion Database.
Note: No. of ATMs and branches is per 100,000 adults.

Figure 2: Growth in Average Assets under Management (in mn INR)



Source: "Indian mutual fund industry: Unearthing the growth potential of untapped markets," PwC, 2013.

Table 1: Public Sector, Private Sector, and Foreign Banks in India

	2007-08	2008-09	2009-10	2010-11	2011-12
Panel A: Public Sector Banks					
No. of banks	28	27	27	26	26
No. of offices	55103	57850	61630	65217	69498
Profit per employee	0.37	0.47	0.53	0.59	0.64
Cost of Funds (CoF)	5.85	6.06	5.35	4.91	6.06
Wages as % to total	14.66	13.88	14.79	17.50	13.72
Return on Assets	1.00	1.03	0.97	0.96	0.88
Net NPA Ratio	0.99	0.94	1.10	1.09	1.53
Panel B: Private Sector Banks					
No. of banks	23	22	22	21	20
No. of offices	8325	9241	10452	12031	13408
Profit per employee	0.57	0.62	0.72	0.94	1.06
Cost of Funds (CoF)	6.15	6.27	4.83	4.60	5.84
Wages as % to total	10.35	10.83	12.73	14.53	12.29
Return on Assets	1.13	1.13	1.28	1.43	1.53
Net NPA Ratio	1.09	1.29	1.03	0.56	0.46
Panel D: Foreign Banks					
No. of banks	28	31	32	34	40
No. of offices	277	295	308	317	323
Profit per employee	2.11	2.54	1.69	2.75	3.40
Cost of Funds (CoF)	4.36	4.46	2.83	3.11	3.83
Wages as % to total	19.95	19.44	23.48	23.30	20.01
Return on Assets	2.09	1.99	1.26	1.75	1.76
Net NPA Ratio	0.77	1.81	1.82	0.67	0.61
Panel E: Citibank					
No. of offices	40	41	43	43	43
Profit per employee	3.77	4.51	1.83	2.86	3.60
Cost of Funds (CoF)	4.08	3.56	2.67	2.72	3.00
Wages as % to total	15.75	17.56	20.02	20.47	18.65
Return on Assets	2.24	2.12	0.96	1.37	1.64
Net NPA Ratio	1.23	2.63	2.14	1.21	0.90
Panel F: Standard Chartered Bank					
No. of offices	91	91	95	95	95
Profit per employee	2.02	2.38	2.63	2.64	2.31
Cost of Funds (CoF)	4.92	4.89	3.04	3.49	4.40
Wages as % to total	18.98	21.09	24.38	25.49	20.80
Return on Assets	3.13	2.87	3.03	2.44	1.49
Net NPA Ratio	1.04	1.37	1.40	0.27	0.70
Panel G: Hongkong & Shanghai Banking Corporation					
No. of offices	47	47	50	50	50
Profit per employee	1.67	1.61	1.17	2.32	3.47
Cost of Funds (CoF)	4.39	4.82	3.17	3.06	3.73
Wages as % to total	21.41	18.01	21.28	21.59	19.30
Return on Assets	1.82	1.51	0.88	1.68	1.98
Net NPA Ratio	0.58	1.42	2.31	0.91	0.62

Source: Reserve Bank of India

RESPONSE TO WRITTEN QUESTIONS OF SENATOR KIRK FROM ARVIND SUBRAMANIAN

Q.1. The trade relationship between the U.S. and India is not limited to goods, but also includes skills and ideas. For this reason, I have continually supported maintaining and expanding the H–1B visa program to allow high skilled workers, from India and other countries, to fill employment vacancies in American companies. Can you speak to the importance of immigration reform in the context of trade with India?

A.1. Did not respond by publication deadline.

Q.2. Bilateral Investment Treaties mean different things to different countries. What would such a treaty mean to the United States?

A.2. Did not respond by publication deadline.

Q.3. What elements/standards should be included in the BIT to make it a valuable agreement for U.S. firms? What features should be included to add value for Indian firms?

A.3. Did not respond by publication deadline.

Q.4. You mention that in addition to the BIT, what other strategic goals should the U.S. be pursuing to further enhance bilateral trade and investment between the U.S. and India?

A.4. Did not respond by publication deadline.

Q.5. Elections in India have to take place before May next year. Given it is election season, do you think that additional reforms in the financial services sector can be accomplished?

A.5. Did not respond by publication deadline.

Q.6. Investor pessimism has led to international investors withdrawing roughly $12 billion in shares and debt from India's markets since the beginning of June this year. What measures do you think that the Indian Parliament and Central Bank could make to shore up investor confidence?

A.6. Did not respond by publication deadline.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR KIRK FROM RICHARD M. ROSSOW

Q.1. The trade relationship between the United States and India is not limited to goods, but also includes skills and ideas. For this reason, I have continually supported maintaining and expanding the H–1B visa program to allow high skilled workers, from India and other countries, to fill employment vacancies in American companies. Can you speak to the importance of immigration reform in the context of trade with India?

A.1. Movement of persons is an important issue to any modern company with international operations. The most skilled people for certain business functions may reside in any part of the world. In other cases, some functions simply do not need to be replicated in every market. So, need only a small number of these technical experts spread around the company's global footprint, ready to help individual operations with key issues. So being able to move team members in and out of certain jurisdictions allow companies to run more efficiently.

In the India context, it takes on a heightened level of importance. The IT services industry, which sends a large number of the H–1B visa holders to the United States, is a visible and influential constituency in India. IT services exports made up nearly 4 percent of India's GDP in fiscal year 2012–13, at around $69.1 billion. The industry played a critical role in encouraging India's continued engagement with the West on economic issues. And the success of India's IT service industry has given confidence to other industries in India that they, too, can compete globally. America wants to see India engaged in global economic issues, and India's IT services industry has been at the forefront in pushing domestically for this engagement.

To put is in its simplest terms: Visas are important to India's IT services firms. India's IT services firms are important to American interests. Therefore, a supportive U.S. visa policy toward India's IT services firms is important to American interests.

Q.2. This year the Indian Parliament considered increasing the FDI caps for the insurance sector from 26 percent to 49 percent. This same proposal has been considered for nearly a decade with no progress. In your opinion, what is some of the rationale for Indian Parliament not approving this increase? Why is this increase so critically needed?

A.2. Parliament has not been able to approve the deal purely for political reasons. Voters in India are generally unconcerned with FDI-related issues. Voters are more concerned about availability of water, power, education and related issues. So the opposition parties that continue to push back against allowing a vote on the FDI increase in insurance are doing so for their own interests instead, as opposed to conveying the interest of their constituents.

What political muscle the Congress-led Government has leveraged to get successful votes on difficult issues has largely been spent on laws that increase social programs. These include the Food Security Bill, the Land Acquisition Bill, and the Mahatma Gandhi Rural Employment Guarantee Bill.

The increase is quite important to India's insurance industry. Premiums, in particular for the life insurance industry, remain depressed from their 2009 level. Insurers have shed staff and agents, and the Government-owned Life Insurance Corporation is again dominating the sector. Private companies need an infusion of capital to regain their footing and expand their operations. Moving the FDI cap to 49 percent will also allow the domestic and foreign companies to bear business risks—and rewards—more equally.

Q.3. Just as we have seen through the promulgation of regulations required under Dodd-Frank here in the United States—often the

greatest challenge to financial firms can be regulatory uncertainty. There are a number of regulatory/legislative proposals being considered in India—is this uncertainty an issue for financial firms in India?

A.3. Regulatory uncertainty is definitely a concern in India, as highlighted in my written and verbal testimony in front of this Committee. In recent years the regulator has dramatically overhauled the internal structure of the market's dominant product. Commission rates for sales channels have been slashed. And government-owned banks will soon be forced to break their existing distribution deals with domestic and foreign insurers to accommodate government concerns about sales practices.

Apart from the regulatory changes that have been introduced, there are also major alterations to the regulatory framework that remain in limbo. For example, the Finance Ministry has been reviewing a change to India's tax code (The Direct Tax Code) that would have steeply increased the corporate tax rates for the life insurance industry. And the regulator, Insurance Regulatory & Development Authority (IRDA), continues to look at ways to alter the existing banc assurance (bank-led sales of insurance) relationships. These pending changes have been hanging over investors' heads for many years. Without clear guidance as to how these issues will ultimately be addressed, investors cannot easily develop medium-term business plans reliant on a particular strategy.

Q.4. The first exchange in Asia was established in India in 1875. The Indian stock exchanges have more companies listed than any other country partly because India has a strong history of entrepreneurship. Does India have the potential to become a major global financial hub? What are the impediments?

A.4. I would love to say that Mumbai, a place I hold dear, will be a major global financial hub. But frankly the impediments to getting there are so great, it is difficult to see happening in the coming decades. One popular list for ranking the world's top financial centers, the Global Financial Centres Index (GFCI), ranks India in 66th place.

Allow me to point out a few of the obstacles I see to fulfilling this long-held goal:

1. **More Openness to Global Markets:** Until India removes foreign investment caps in all financial services, as well as other impediments to equal national treatment, foreign firms will not make India a base of operations. To do so, the local market must have great weight. So far, this is not the case for India.
2. **Dominance of State-Owned Enterprises:** In the banking and insurance fields, government-owned companies are still dominant. In the life insurance industry, in fact, the government-owned competitor has started to take market share away from the 23 private companies. There are many reasons for the continued dominance of government-owned financial firms, and result in a less-competitive domestic market.
3. **Regulatory Consistency:** As outlined in my testimony, financial services regulations in India change too dramatically,

too fast. When a company decides to establish a major international base of operations in a market, the investor wants stability in how that entity will be treated—both in terms of its local exposure, as well as its international exposure. Open, stable and transparent rules governing tax policy, foreign exchange convertibility, labor mobility, and other core functions are critical.

4. **More Talent:** While India has a large population, investors find a dearth of key talent such as actuaries for life insurance firms. Colleges are altering curriculums to try to keep up, but the pace of India's growth and the quality of some educational institutions mean that the country's technical experts are in high demand, with too few coming through the pipeline.
5. **Better Living Conditions:** For many foreigners, living in Mumbai can still be considered a hardship post. Traffic is horrendous, flooding during Monsoon season is dangerous. Public transportation is decrepit. And the space for building a "New Mumbai"—as an international hub—is sorely lacking.