Economic Analysis

The Obama visit: What did India gain?

Sumedh Deorukhkar / Alicia Garcia Herrero

U.S. President Barack Obama's two day trip to India earlier this week may be high on symbolism and bonhomie but nevertheless made meaningful headways in closing the gaps on long-pending issues that dampened trade, investment and strategic relations between the world's largest democracies. In this flash, we look beyond the much publicized 'bear-hug' to list 4 key positive takeaways from the Obama visit and their economic implications for India.

Takeaway #1: Clearing the impasse on civil nuclear deal: a 'break-through' but still really 'work in progress'. The two nations resolved a long standing deadlock on the implementation of a 2008 civil nuclear deal, which was hamstrung by India's enactment of a liability law that exposed US nuclear plant vendors to excessive legal proceedings. Under the new arrangement, suppliers would be indemnified against unlimited liability through an insurance pool. If successfully implemented, renewed investments by US vendors would help in reducing India's widening energy deficit and aid infrastructure growth. However, the break-through alone may not assuage concerns of US nuclear vendors given the lack of details on insurance pool, threat of legal challenges to the executive order and the issue of economic viability of imported reactors in India.

Takeaway #2: Closer cooperation towards strengthening India's defense capabilities. The two leaders endorsed efforts to enhance collaboration in defense technology transfer and co-development. India still imports an unreasonably high share (70%) of its defense equipment needs, a bulk of which (76%) come from Russia followed by the US (7%). Thus, steps to upgrade India's domestic defense industry are imperative. In this context, policy efforts, including recent lifting of foreign investment limits in defense (49% from 26%) and deeper Indo-US defense ties bode well for India's domestic defense sector and the economy in general.

Takeaway #3: Commitment to invest USD 4 billion in India – focus on renewable energy sector. The pledge includes - 1) USD 1 billion in financing by the U.S. Export-Import Bank to export 'Made in America' products, 2) USD 1 bn to be lent by U.S. Overseas Private Investment Corporation to small and medium enterprises in rural India, and 3) USD 2 bn committed by U.S. Trade and Development Agency for renewable energy. Meeting unmet demand for electricity in rural India, which constitutes 47% of 1.2 billion population, through renewable sources can greatly reduce India's kerosene subsidy bill and minimize resource intensity of the economy. Share of renewable energy in India's total installed power capacity has jumped from just 2% in 2002 to 13% currently. While greater foreign investments would help boost India's renewable energy sector further, it needs to be complemented by government efforts to tackle regulatory barriers, resolve land acquisition issues, ease infrastructure constraints and mitigate storage and distribution losses.

Takeaway #4: India has other options beyond cooperation with China. Diplomatic interpretations of Mr. Obama's visit centered on US efforts to make India its south Asian anchor and a strategic counterweight to China in its 'pivot Asia' strategy. This notwithstanding, we expect stronger links with the US – the only bright spot in the developed world today – to help India improve its trade balance at least bilaterally. This would contrast with its rapidly deteriorating trade deficit with China, which recorded a huge USD 31 bn in 2013.

Bottom-line: We believe that the U.S. President's short visit to India certainly has long term positive implications for India, especially so given that the Modi government has kept up the tempo on wide ranging reforms since its landslide victory last May. That said, most reforms have been enacted through executive action while legislation remains a significant obstacle for the new Government given its lack of majority in the upper house of Indian parliament. This would weigh on India's ability to push through difficult structural reforms across land acquisition, labor, mining and taxation, which require legislative approval.