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India's Economy in 2016: Progress & Potential

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India's Economy
in 2016:
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Overview

The rise to power in May 2014 of a center-right, business-friendly government, led by Narendra Modi, was welcomed not only in India but around the world. Mr. Modi promised to rid the country of a burdensome bureaucracy created by India's socialist legacy. His support for private enterprise and the promise of a no-nonsense style of governance was expected to bolster India's economic growth, taking the rate of growth into double digits annually.

India is currently the world's fastest growing economy, according to World Bank estimates, with a real GDP growth rate of 7.0% in 2016. It is expected to continue growing at least at 7 percent per year for several years.¹ Over the last few years India has managed many successes on the economic front. It has combatted inflation, dropping from 10.9% in 2013 to 5.22% in 2016.² Foreign Direct Investment (FDI) amounted to \$78.5 billion in net inflows between 2014 and 2015.³ The Indian government says that FDI has grown to \$95.2 billion since Prime Minister Modi took over, as of September 2016.⁴ The state's foreign exchange reserves stood at \$360.3 billion at the end of the year.⁵ However, the value added in manufacturing as a percentage of GDP fell slightly from 16.5% in 2013 to 16.24% in 2015.⁶

According to the World Bank's annual ranking of business friendliness of countries, India has improved its standing in "Ease of Doing Business" over the last two years.⁷ At the end of Mr. Modi's two years in office, India ranks 39th in the 2016 World Economic Forum Global Competitiveness Index.⁸ It also moved up in the Economic Freedom rankings published by the Heritage Foundation in 2016, from 128th to 123rd.⁹

¹ "World Bank - Global Economic Prospects," last modified January, 2017,

<https://openknowledge.worldbank.org/bitstream/handle/10986/25823/9781464810169.pdf>

² "India - CPI Inflation," accessed January 10, 2017, <http://www.inflation.eu/inflation-rates/india/historic-inflation/cpi-inflation-india.aspx>

³ "Foreign direct investment, net inflows (BoP, current US\$)," World Bank, accessed January 11, 2017, <http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD>

⁴ Department of Industrial Policy and Promotion, "Fact Sheets on FDI from May 2014 to September 2016," *Ministry of Commerce and Industry*, (India, September 2016)

⁵ "India - Manufacturing, Value Added (% of GDP)," World Bank, accessed January 12, 2017, <http://data.worldbank.org/indicator/NV.IND.MANF.ZS>

⁶ Ibid.

⁷ "Ease of Doing Business Index," Doing Business, World Bank, accessed January 10, 2017, <http://data.worldbank.org/indicator/IC.BUS.EASE.XQ?locations=IN>

⁸ "Global Competitiveness Rankings 2016-2017," World Economic Forum, accessed January 10, 2017 <http://reports.weforum.org/global-competitiveness-report-2015-2016/competitiveness-rankings/>

⁹ "2015 Index of Economic Freedom," Heritage Foundation, accessed January 9, 2017, http://www.heritage.org/index/pdf/2015/book/index_2015.pdf

Following up on its election promises, the BJP-led government relaxed foreign-investment rules in numerous sectors of the economy, especially defense, seeking to attract foreign investment.¹⁰ The Modi administration also worked towards reducing bureaucratic regulations and pushed through legislative proposals to simplify bankruptcy procedures and strengthen intellectual property rights (IPR).¹¹ The government has also fast-tracked the building of roads, expansion of highways and rail infrastructure.¹² On the taxation front, the long-overdue Goods and Services Tax (GST), that seeks to unify different tax regimes under a singular system of taxation, was passed in August 2016 and is to be implemented by April 2017.¹³

Even as India moved up on its “Ease of Business” rankings, the World Bank report pointed out there were areas where India needed improvement in sectors such as agriculture, where growth stalled, and in efforts to bridge a growing rural-urban divide.¹⁴ While FDI rules have been eased in some sectors international investors feel disadvantaged because of the persistent issues with regards to the IPR.¹⁵ According to an IBEF (India Brand Equity Foundation) report, in January, 2017 Mr. Nitin Gadkari, Minister of Road Transport and Highways, and Shipping, announced the government’s target of Rs. 25 trillion (US\$ 376.53 billion) investment in infrastructure over a period of three years. However, according to the same report India still needs to invest Rs. 31 trillion (US\$ 454.83 billion) over the next 5 years to meet development targets.¹⁶ Finally, on the taxation front, a key reform that has been sought by both domestic and foreign investors has been the repeal of retroactive taxation that has yet to happen.¹⁷

In November 2016, Mr. Modi launched the demonetization drive of November 2016 under which high-denomination banknotes, which made up 86% of the national

¹⁰ Rajesh Roy and Newley Purnell, “India Relaxes Foreign Direct Investment Rules,” *The Wall Street Journal*, June 20, 2016, accessed January 9, 2017, <http://www.wsj.com/articles/india-relaxes-foreign-direct-investment-rules-1466434994>

¹¹ FE Bureau, “Government Announces New IPR Regime,” *Financial Express*, May 14, 2016, accessed January 9, 2017, <http://www.financialexpress.com/economy/govt-announces-new-ipr-regime/255072/>

¹² “Roads in India, Road Infrastructure, Road Sector, Key Developments and Investments,” India Brand Equity Foundation, accessed January 10, 2017, <http://www.ibef.org/industry/roads-india.aspx>

¹³ Rimi Dutt, “What You Should Know About GST: A Quick Summary,” *Huffington Post*, August 3, 2016, accessed January 9, 2017, <http://www.huffingtonpost.in/2016/08/03/what-you-should-know-about-gst-a-quick-summary/>

¹⁴ “India Development Update - Financing Double Digit Growth,” World Bank, accessed January 10, 2017, <http://documents.worldbank.org/curated/en/543111468194942579/pdf/106456-P156828-PUBLIC-MAKE-PUBLIC-8PM-DC-JUNE-19-IDU-Jun16-vweb.pdf>

¹⁵ Nayanima Basu and Amity Sen, “India still has impediments to FDI in some retail, finance areas, rues USTR,” *Business Line*, October 9, 2016, accessed January 4, 2017, <http://www.thehindubusinessline.com/economy/india-still-has-impediments-to-fdi-in-some-retail-finance-areas-rues-ustr/article9240945.ece>

¹⁶ “Infrastructure Sector in India, Infrastructure Industry, Development,” India Brand Equity Foundation, accessed January 10, 2017, <http://www.ibef.org/industry/infrastructure-sector-india.aspx>

¹⁷ “Fixing India’s Retroactive Tax,” *Wall Street Journal*, January 7, 2016, accessed January 10, 2017, <http://www.wsj.com/articles/fixing-indias-retroactive-tax-1452212156>

currency, were scrapped.¹⁸ It is too soon to assess the long-term impact of this politico-economic move though according to all estimates there will be a negative impact on India's economic growth.¹⁹ For instance, automobile sales, especially those of vans, two-wheelers and three-wheelers have been hit hard, with total automobile sales dropping to the lowest levels since 2000.²⁰ Investment has been affected as well, according to data from the Centre for Monitoring Indian Economy. Before the November 8th announcement of demonetization, there were 227 investment proposals valuing Rs 81,800 crore. After the announcement, the next seven weeks comparatively only saw 177 investment proposals valuing just Rs. 43,700 crore rupees.²¹

This report analyzes the reforms implemented by the Modi Administration in terms of their immediate impact, pace of implementation and future implications. It also examines reforms promised by the government but not implemented so far along with studying the future challenges and opportunities for the Indian economy.

¹⁸ Mihir Sharma, "India goes Cashless," *Bloomberg*, November 8, 2016, accessed January 9, 2017, <https://www.bloomberg.com/view/articles/2016-11-09/india-gets-rid-of-cash-too-soon>

¹⁹ Kiran Sharma, "India Growth Down to 7% on Demonetization: World Bank," *Nikkei Asian Review*, January 12, 2017, accessed January 13, 2017, <http://asia.nikkei.com/Politics-Economy/Economy/India-growth-down-to-7-on-demonetization-World-Bank>

²⁰ Amrit Raj, "Auto sales feel demonetisation jitters, fall to 16-year low in December," *Livemint*, January 11, 2017, accessed January 17, 2017, http://www.livemint.com/Industry/n8yj3dvEdJqlhPytT8buNN/Auto-sales-plunge-most-in-16-years-on-Narendra-Modis-demone.html?li_source=LI&li_medium=news_rec

²¹ Asit Ranjan Misra, Anuja, "Demonetisation: How long will the effects of Modi's shock therapy linger?," *Livemint*, January 6, 2017, accessed January 8, 2017, <http://www.livemint.com/Politics/p3OYObOB1iIHUAOXfNp79M/Demonetisation-How-long-will-the-effects-of-Modis-shock-th.html>

Reforms and Reactions

Mr. Modi's election campaign of 2014 was run primarily on an ambitious economic agenda that aimed to reboot the Indian economy and drastically reduce corruption. In 2016, we have seen strides made in attempting to reach those goals. Improving the ease of doing business has been an underlying theme for many economic reforms implemented by the Modi administration. We saw this motivate the following key areas of policy reform in 2016: taxation, infrastructural improvements, intellectual property rights (IPR) policy, and currency (demonetization).

In order to support major economic reforms, India requires major upgrades to physical infrastructure. Additionally, to increase procedural efficiency the Modi administration aims to create a common market through the Goods and Services Tax (GST) Bill, and increase protection of IPR as seen in 2016 policy. A complete list of all reforms can be found in the Appendix of this report.

Taxation

A single market with predictable taxes is a sine qua non for attracting investment and ease of business. In August 2016, the Constitution Amendment Bill for the Goods and Services Tax (GST) was passed by the Parliament's Upper House.²² A value-added tax, GST aims to unify the local and national tax levies into one payment, which effectively unifies the "country's 29 states and 1.3 billion people into a common market for the first time."²³ The benefits of the new taxation system allow for a single market to occur, eliminate redundancies and distortions that stem from varying levels of taxes between individual states, and reduce the size of the informal economy.²⁴ Economists believe that by implementing GST there would be a "boost [of] economic output by 1-2 percentage points a year."²⁵

However, current negotiations within the body in charge of implementing the tax, the GST Council, indicate that the new tax will not reduce inefficiencies but

²² "One nation, One tax," *The Economist*, (The Economist, August 06, 2016, accessed December 29, 2016) Available at: <http://www.economist.com/news/asia/21703370-tax-overhaul-will-have-welcome-if-unpredictable-consequences-one-nation-one-tax>.

²³ Ibid.

²⁴ "Taxation in India: Take it easy" *The Economist*, November 5th, 2016, accessed January 05, 2017, <http://www.economist.com/news/leaders/21709546-india-risks-squandering-benefits-ground-breaking-economic-reform-take-it-easy>.

²⁵ One nation, One tax," *The Economist*, August 06, 2016, accessed December 29, 2016, <http://www.economist.com/news/asia/21703370-tax-overhaul-will-have-welcome-if-unpredictable-consequences-one-nation-one-tax>.

introduce a “complex set of rates for different goods - perhaps seven or more, ranging from 4% to 26%. This will distort the economy by nudging producers towards goods subject to the lowest taxes.”²⁶ The increased level of complexity stems from the division of fiscal power/resources between the federal and state governments. The constitution allows the federal government to tax the production of goods but only permits the states to tax their consumption.²⁷ The federal government only receives 45% of their revenue from indirect taxes but 80% of state's' revenue stems from these indirect taxes leading to a series of difficult negotiations between the state and federal governments that have yet to be resolved.²⁸ The deadline for arriving at a consensus on the issue was April 1st, 2017 when the tax was expected to roll out but has been pushed back to the start of third quarter (July-September).^{29,30}

Infrastructure

In 2016, a significant amount of focus was given on improving physical infrastructure, connectivity and energy.³¹ One of the main aims of the Modi government initiatives is to increase the level of connectivity and ease of inter-city and inter-state travel. In order to accomplish this goal the Modi administration has planned to improve three main modes of transportation: roads, airports, and rail networks. Currently, it is estimated that India requires \$454.83 billion to upgrade its overall infrastructure throughout the nation, which includes energy infrastructure, repairing bridges and dams, roads, and urban infrastructure.³² The Modi administration began these initiatives by increasing the budgetary allocation for roads and railways in the Union Budget of 2016 to \$31.98 billion.³³

The Minister of Road Transport, Nitin Gadkari, announced that the government aims to invest \$376.53 billion to improving infrastructure over the next three years. Additionally, the Modi administration made efforts to attract increased foreign

²⁶ “Taxation in India: Take it easy” *The Economist*, November 5th, 2016, accessed January 05, 2017, <http://www.economist.com/news/leaders/21709546-india-risks-squandering-benefits-ground-breaking-economic-reform-take-it-easy>.

²⁷ “Tax reform in India: The truck stops here,” *The Economist*, November 08, 2014, accessed December 30, 2016, <http://www.economist.com/news/finance-and-economics/21631147-fix-indias-indirect-tax-system-overdue-it-may-fall-short>.

²⁸ Ibid.

²⁹ Economic Times Bureau, “GST: Centre, states fail to resolve dual control issue” *The Economic Times*, November 21st, 2016, accessed January 05, 2017, <http://economictimes.indiatimes.com/news/economy/policy/gst-consensus-eludes-on-jurisdiction-over-assessee-between-centre-and-states/articleshow/55525528.cms>

³⁰ PTI, “GST may be implemented in July-September,” *The Indian Express*, January 11, 2017, accessed January 19, 2017, <http://indianexpress.com/article/business/economy/gst-may-be-implemented-in-july-september-quarter-of-2017-18-deutsche-report-4469773/>.

³¹ India Brand Equity Foundation, “Infrastructure Sector in India, Infrastructure Industry, Development,” November, 2016, accessed January 12, 2017, <http://www.ibef.org/industry/infrastructure-sector-india.aspx>

³² Ibid.

³³ Ibid.

investment in the infrastructure sector by making it easier for a wider variety of people to invest. One of these ways has been through the creation of online portals.³⁴ The Modi administration has made great strides in attracting foreign investment as a source of funding to drive the infrastructure projects envisioned. The Asian Development Bank and BNP Paribas have all reached multi-million dollar agreements with the Modi government and parts of the Indian private sector to invest in infrastructure.³⁵ The Construction Industry Development Board of (CIDB) of Malaysia and the French government have also expressed interest in multi-billion dollar ventures within the infrastructure sector.³⁶

The Securities and Exchange Board of India has implemented reforms that allow units of “infrastructure investment trusts (InvITs)” to be issued publicly so as to acquire funds from public investors.³⁷ Reforms to increase the flow of money into the infrastructure sector are vital in providing financial support for the plans the Ministry of Road and Highways wishes to implement. The government’s aims include launching 10 new airports over the course of the next year, building five “greenfield expressways” across the country, and investing \$137 billion in railway expansion projects over the next five years.³⁸

In addition to physical infrastructure, the Modi administration has also made strides in the energy sector. India ranks third out of 40 countries on Ernst and Young’s Renewable Energy Country Attractiveness Index.³⁹ As outlined in Hudson Institute’s annual report on Narendra Modi, *Modi: Two Years On*, Mr. Modi’s aim was: increasing production capacity and efficiency, reducing import dependence, and expansion of sector to include renewables.⁴⁰ The signing of the Paris Agreement in April 2016 was a major step towards increasing reliance on renewables as India pledged to reach 75 gigawatts of renewable energy by 2022.⁴¹

The Modi administration has allocated 100 billion INR for renewable energy investments. Another achievement for the Modi administration was the unveiling of the world’s largest solar farm in Kamuthi, Tamil Nadu.⁴² The 10 sq. km facility

³⁴ Ibid.

³⁵ Ibid.

³⁶ Ibid.

³⁷ Ibid.

³⁸ Ibid.

³⁹ Warren Ben, “Renewable Energy Country Attractiveness Index,” *Ernst and Young*, October 2016, accessed January 16, 2017, [http://www.ey.com/Publication/vwLUAssets/EY-RECAI-48-October-2016/\\$FILE/EY-RECAI-48-October-2016.pdf](http://www.ey.com/Publication/vwLUAssets/EY-RECAI-48-October-2016/$FILE/EY-RECAI-48-October-2016.pdf).

⁴⁰ Aparna Pande, Husain Haqqani, “Modi: Two Years On,” *Hudson Institute*, September 2016

⁴¹ Hari Pulakkat, “A tough to-do list for India from Paris’ COP21 climate summit,” *Economic Times*, December 22, 2015, accessed January 2017, http://articles.economicstimes.indiatimes.com/2015-12-22/news/69237515_1_energyefficiency-energy-experts-renewable-energy.

⁴² Al Jazeera Reporter, “India unveils the world’s largest solar power plant,” *Al Jazeera*, November 30th 2016, accessed January 15, 2017, <http://www.aljazeera.com/news/2016/11/india-unveils-world-largest-solar-power-plant-161129101022044.html>

has a capacity of 648 MW, which can power 150,000 households.⁴³ With pollution levels across India skyrocketing this year, India's solar energy reforms come as a step in the right direction as India is predicted to become the world's third biggest solar market in the upcoming year.⁴⁴

Demonetization

On November 8th 2016, the Government of India withdrew the Legal Tender status of all 500 INR and 1000 INR denomination banknotes. According to the Reserve Bank of India's (RBI) press release, this policy was meant to "tackle counterfeiting Indian banknotes, to effectively nullify black money hoarded in cash and curb funding of terrorism with fake notes".⁴⁵ All holders of the discontinued notes were informed that they could tender their notes at RBI or other bank branches, in exchange for having the sum credited into their bank accounts.

This policy received a variety of praise as well as criticism. The Reserve Bank of India issued a press release on November 8th, 2016, which claimed that the rationale for this move was threefold. Firstly, it aimed to deal with the issue of counterfeiting Indian notes, to "effectively nullify" black money, and to curb terrorist funding via counterfeit notes.⁴⁶ Advocates of the policy, such as prominent economist and member of NITI Aayog, Bibek Debroy, argued that demonetization would assist with the reduction of the cash-GDP ratio which (at 12.5% in 2015) has been increasing despite the increase in economic growth.^{47, 48}

Critics of the policy, however, point to the crippling impact resulting from the removal of 86% of the nation's currency without proper planning i.e. shortage of currency & ATM machines not configured to handle new currency.^{49, 50} Removal of cash from circulation has led to a fall by 1-1.5% in November for consumption and a fall in business investment "from an average of 2.4trn rupees (\$35bn) a quarter to just 1.25trn rupees in the one just ended, according to [the] Centre for Monitoring

⁴³ Ibid.

⁴⁴ Ibid.

⁴⁵ Alpana Killawala, "Withdrawal of Legal Tender Status for Rs. 500 and Rs. 1000 Notes: RBI Notice" *Reserve Bank of India*, November 08, 2016.

⁴⁶ Ibid.

⁴⁷ Ajay Singh, "Demonetisation is only one part of clean-up of economy: Bibek Debroy tells First Post" *First Post*, December 28, 2016.

⁴⁸ Elaine Ou, "India's Misguided War on Cash," *Bloomberg News*, November 21, 2016, accessed January 10, 2017, <https://www.bloomberg.com/view/articles/2016-11-22/india-s-misguided-war-on-cash>

⁴⁹ Ibid.

⁵⁰ Asian Development Outlook Supplement: Asia's Economies Steady Despite Global Uncertainty," *Asian Development Bank*, December 2016, accessed January 03, 2016, <https://www.adb.org/sites/default/files/publication/216421/ado-supplement-dec-2016.pdf>.

Indian Economy.”⁵¹ According to reports, daily wage and seasonal agricultural laborers have either been working without pay - as farmers do not have the currency on hand to pay these workers - and many workers have returned home.⁵²

Real estate has been hit hard with luxury home prices projected to fall by 25-30% post-demonetization. There has already been a drop in property registration rates, with Mumbai, India's financial capital and most lucrative real estate market, seeing a fall of 20% and the state of Maharashtra a fall of 40%.^{53,54} Furthermore, the Delhi-NCR market saw housing sales fall by 53% in between October and December. This trend continued with housing sales falling in major cities all across India. Housing sales in Bangalore, Ahmedabad, and Hyderabad all fell by at least 40%. The cities of Pune, Chennai, and Kolkata experienced a milder fall with housing sales falling by 35%, 31% and 20%, respectively.⁵⁵

Foreign Investment

If India has to build its infrastructure (both physical and energy setups), boost manufacturing, improve agricultural yields, increase R&D (research and development) spending and provide jobs to 1 million Indians who enter the labor force every month it needs massive foreign investment.

Attracting foreign investment has been a key part of the Modi administration's strategy to boost India's economic growth. According to the World Bank, India saw \$78.5 billion of FDI net inflows between 2014 and 2015 or an increase by 27%, while according to government data, India witnessed \$95.2 billion in FDI inflows since Prime Minister Modi took over, to September 2016.^{56,57} However, when it comes to Foreign Institutional Investment (FII), India is on the verge of a \$2.8 billion

⁵¹ “The high economic costs of India's demonetization,” *The Economist*, January 07, 2017, accessed January 10, 2017, <http://www.economist.com/news/finance-and-economics/21713842-benefits-withdrawing-86-rupees-circulation-remain-elusive>.

⁵² Renu Kohli, “Demonetization: The Impact on Agriculture,” *LiveMint*, November 22, 2016, accessed January 10, 2017, <http://www.livemint.com/Opinion/B1vFTOgwgqHjdM5nkmg2CxJ/Demonetization-The-impact-on-agriculture.html>.

⁵³ PTI, “Luxury home rate may fall by 25-30% after demonetisation,” *The Economic Times*, November 15, 2016, accessed January 10, 2017, <http://economictimes.indiatimes.com/wealth/real-estate/luxury-home-rate-may-fall-by-25-30-after-demonetisation/articleshow/55440301.cms>.

⁵⁴ Dhaval Kulkarni, “Demonetisation hits real estate hard,” *Daily News and Analysis (DNA)*, December 02, 2016, accessed January 10, 2017, <http://www.dnaindia.com/mumbai/report-demonetization-hits-real-estate-hard-2278879>.

⁵⁵ PTI, “Demonetization Effect: Realty hit hard,” *Daily News and Analysis*, January 15, 2017, accessed January 19, 2017, <http://www.dnaindia.com/money/report-demonetization-effect-realty-hit-hard-developers-wait-for-buyers-with-white-money-2292663>.

⁵⁶ World Bank Open Data, “Foreign direct investment, net inflows (BoP, current US\$),” *World Bank*, accessed December 30, 2016, <http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD?locations=IN>

⁵⁷ Department of Industrial Policy and Promotion, “Multiple Fact Sheets on FDI from May 2014 to September 2016,” *Ministry of Commerce and Industry*, September 2016

outflow, owing to a decline in Indian bond yields after the demonetization drive by Prime Minister Modi.⁵⁸

The 'Make in India' campaign, promoting the set of reforms that the Modi administration undertook that targeted the Indian economy, was launched in September 2014.⁵⁹ It is the Modi administration's flagship program to attract both foreign and domestic investment. To attract investment more than twenty industries saw the removal, or relaxation of FDI limits.⁶⁰ Sectors such as e-commerce and the previously untouched by FDI railways were opened up to 100% FDI.⁶¹ The launch of the campaign was attended by many foreign and domestic CEOs such as Lockheed Martin's Phil Shaw and Reliance head Mukesh Ambani, signaling the positivity the business community had for the campaign, but red tape and infrastructure remained concerns.⁶²

A major sector in which foreign investment has traditionally been barred, the defense sectors, will now allow for between 49%-100% of FDI. However, 100% FDI is only allowed under certain conditions such as "wherever it is likely to result in access to modern and 'state-of-art' technology in the country". FDI in the Indian defense sector above 49% would still require government approval.⁶³ While the government has continued making defense purchases, such as the Rafale deal, in the calendar year 2016, there has been almost no increase in FDI in the defense sector, with FDI equity inflows in defense only increasing from \$5.02 million to \$5.12 million as of September 2016.^{64, 65}

The Modi government, however, has yet to open multi-brand retail entirely to FDI. As of now, foreign companies are only allowed to invest up to 51% in multi-brand retail. This is due to fears that entry of foreign multi-brand companies will wipe out

⁵⁸ Nickey, Mirchandani, "India Set To Witness Biggest Foreign Fund Outflow Since 2008," *Bloomberg Quint*, December 23, 2016, accessed December 26, 2016, <http://www.bloombergquint.com/charts/2016/12/23/india-set-to-witness-biggest-foreign-fund-outflow-since-2008>

⁵⁹ Make in India, "About Us," *Government of India*, accessed December 23, 2016, <http://www.makeinindia.com/about>

⁶⁰ Make in India, "Foreign Direct Investment," *Government of India*, accessed December 23, 2016, <http://www.makeinindia.com/policy/foreign-direct-investment>

⁶¹ Department of Industrial Policy and Promotion, "Consolidated FDI Policy," *Ministry of Commerce and Industry*, India, June 7, 2016, accessed December 23, 2016, http://dipp.nic.in/English/policies/FDI_Circular_2016.pdf

⁶² Knowledge @ Wharton, "How Modi Can Deliver on the Promise of 'Make in India'," *Wharton School at University of Pennsylvania*, October 21, 2014, accessed January 2, 2016, <http://knowledge.wharton.upenn.edu/article/how-modi-can-deliver-on-make-in-india/>

⁶³ Department of Industrial Policy and Promotion, "FDI Policy: Sectors where Government Approval is required," *Ministry of Commerce and Industry*, July 8, 2016, http://dipp.nic.in/English/Policies/Sectors_Where_Government_Approval_Is_Required.pdf

⁶⁴ "India, France ink €7.87 billion agreement for 36 Rafales," *The Hindu*, September 23, 2016, <http://www.thehindu.com/news/national/India-France-ink-%E2%82%AC7.87-billion-agreement-for-36-Rafales/article14995775.ece>

⁶⁵ Department of Industrial Policy and Promotion, "Fact Sheets on Foreign Direct Investment, January - September 2016," *Ministry of Commerce and Industry*, January 2017

the small 'mom and pop' unorganized stores.⁶⁶ As of 2010, the unorganized retail sector saw 95% of the retail sales in India, according to a report by FICCI, so the government is wary of policies that may cause any adverse effect on unorganized retail.⁶⁷

⁶⁶ ET Bureau, "'Not yet', says Nirmala Sitharaman on FDI in multi-brand retail," *Economic Times*, September 8, 2016, accessed December 24, 2016, <http://economictimes.indiatimes.com/industry/services/retail/not-yet-says-nirmala-sitharaman-on-fdi-in-multi-brand-retail/articleshow/54048468.cms>

⁶⁷ "Retail Sector Profile," Federation of Indian Chambers of Commerce & Industry, accessed December 27, 2016, http://ficci.in/sector/33/Project_docs/Sector-prof.pdf

Global Perspectives

Global investors and foreign governments placed a lot of hope on Mr. Modi and his administration which has been demonstrated in the upward trajectory of FDI into India and India still retaining a slot as one of the most attractive markets. According to the United Nations Conference on Trade and Development (UNCTAD) World Investment Report 2016, India ranked 10th globally in terms of FDI inflows, up two ranks from the 2014 rankings.⁶⁸ The 2016 report also saw India placed at 6th in UNCTAD's survey of investment promotion agencies on the most appealing economies, up one spot from last year, while it held 3rd position in a survey of Multinational Enterprises on the most appealing economies.⁶⁹

The World Bank, in a report on India's economy on June 2016, stated that despite the flat lining of private investments, India's economy has been growing owing to public investments and urban household demand. The same report also stated that it would be important to see an uptick in private investment nonetheless, in order to sustain the current level of economic growth and that reforms such as the Bankruptcy Code passed last year, should help businesses in picking up steam. The report also stated that a lot of the reforms process was being passed onto the shoulders of the states.⁷⁰ The IMF meanwhile, revised India's forecasted growth to 7.6% in October, after forecasting a growth rate of 7.4% in July. The IMF also praised the Goods and Service Tax, but called for more reforms in the labor market in order for India to further boost its economic growth.⁷¹

There is nevertheless room for improvement. U.S. Trade Representative Michael Froman, on a visit to India for the Trade Policy Forum in 2016, stated that more transparent rules and regulations and sustained action on strengthening intellectual property rights (IPR) would help attract investment from the United

⁶⁸ "World Investment Report 2014: Overview," *United Nations Conference on Trade and Development*, June 24, 2014, http://unctad.org/en/PublicationsLibrary/wir2014_overview_en.pdf

⁶⁹ Chapter 1: Global Investment Trends, "World Investment Report 2016," *United Nations Conference on Trade and Development*, World Investment Report 2016, June 22, 2016, http://unctad.org/en/PublicationChapters/wir2014ch1_en.pdf

⁷⁰ Volker Treichel; Federico Gil Sander, "India Development Update: Financing Double-Digit Growth," *World Bank*, June 2016, <http://documents.worldbank.org/curated/en/543111468194942579/pdf/106456-P156828-PUBLIC-MAKE-PUBLIC-8PM-DC-JUNE-19-IDU-Jun16-vweb.pdf>

⁷¹ Asit Ranjan Mishra, "IMF revises India's GDP forecast to 7.6% on robust growth momentum," *Livemint*, October 5, 2016, accessed December 28, 2016, <http://www.livemint.com/Politics/UIDlyxwzncrZFdBiChFrwL/IMF-revises-Indias-GDP-forecast-to-76-on-robust-growth-mo.html>

States.⁷² The report “Overseas Business Risk - India” by the United Kingdom’s Department for International Trade (DFID) similarly outline concerns over IPR, along with corruption as issues in conducting business in India.⁷³

During Prime Minister Shinzo Abe’s 2015 visit to India, India and Japan signed major trade deals that were to result in Japanese investments in infrastructure projects in India. Amidst all the enthusiasm a Japanese official expressed these words of caution: “The money will be disbursed only when Japanese investors are assured that their money will be properly channelized and utilized. If the promises made by PM Modi are not kept, not a portion of the \$35 billion can be expected to enter India.”⁷⁴

One key concern of companies is the lack of consistency in government regulations and policies especially taxation policies. As early as March 2015, Japanese financial firm Nomura stated that issues such as retrospective taxes give foreign investors second thoughts when it comes to investing in India.⁷⁵ The Tata-Docomo issue also has the potential to hurt future Japanese - and foreign - investment in India akin to the Vodafone retroactive taxation issue.⁷⁶ Incidents such as these make foreign investors think twice before committing any investments into India.

International investors, whether Japanese or American, are also wary of India’s bureaucratic red tape and regulations. JETRO (Japan External Trade Organization) has consistently stated that bureaucratic regulations hurt Japanese investment in India and the head of U.S. software giant, CISCO, has sought the removal of hurdles and reduction in regulations.^{77,78} One suggestion from JETRO

⁷² Nayanima, Basu; Amity, Sen, “India still has impediments to FDI in some retail, finance areas, rues USTR,” *The Hindu Business Line*, October 19, 2016, accessed December 29, 2016, <http://www.thehindubusinessline.com/economy/india-still-has-impediments-to-fdi-in-some-retail-finance-areas-rues-ustr/article9240945.ece>

⁷³ Department for International Trade, “Overseas Business Risk - India,” *Govt. of the United Kingdom*, April 23, 2015, accessed December 27, 2016, <https://www.gov.uk/government/publications/overseas-business-risk-india/overseas-business-risk-india>

⁷⁴ Nayanima Basu, “Abe’s \$35-bn promise to Modi has riders,” *Business Standard*, September 16, 2014, http://www.business-standard.com/article/economy-policy/abe-s-35-bn-investment-promise-to-modi-is-not-without-conditions-114091400479_1.html

⁷⁵ PTI, “India can attract significant FDI if it sorts out tax issues,” *The Hindu*, March 28, 2015, accessed December 28, 2016, <http://www.thehindu.com/business/markets/india-can-attract-significant-fdi-if-it-sorts-out-tax-issues/article7043611.ece>

⁷⁶ Siddharth Vikram; Philip Grace Huang, “Soured Tata-Docomo Deal Tests India Investment Appeal,” *Bloomberg News*, September 14, 2016, accessed December 28, 2016, <https://www.bloomberg.com/news/articles/2016-09-14/caveat-emptor-soured-docomo-deal-tests-india-investment-appeal>

⁷⁷ “Challenges for India-Japan Investment Promotion and Proposals to Both Governments,” *Japan External Trade Organization*, September 2013, https://www.jetro.go.jp/ext_images/jetro/topics/pdf/1309.topics1_annexion2.pdf

⁷⁸ PTI, “Cisco to government: Remove hurdles, reduce regulations,” *Gadgets Now*, September 27, 2015, <http://www.gadgetsnow.com/tech-news/Cisco-to-government-Remove-hurdles-reduce-regulations/articleshow/49127208.cms>

has been to implement a more streamlined approach of communicating the necessary laws for Japanese investors online.⁷⁹ Further, relevant information for foreign investors is spread across a plethora of websites of the Department of Industrial Policy & Promotion,⁸⁰ the Foreign Investment Promotion Board,⁸¹ the Reserve Bank of India,⁸² the Securities and Exchange Board of India⁸³ and Make in India. Some analysts argue that either the Make in India website or a new website would be a good place for a central repository that provides streamlined legal information to foreign investors.

Companies only invest in those countries where they believe intellectual property rights (IPR) are valued and protected. The new IPR policy launched in May 2016 is seen by many as an attempt to answer foreign critics while at the same time protect domestic interests.⁸⁴ When it comes to foreign investors, the policy provides a legal framework to engender an environment that would address international complaints.⁸⁵ The reaction to this new IPR policy have been mixed. For instance, the Alliance for Fair Trade with India acknowledged that the “policy recognizes some benefits of a robust IPR system to India,” but also criticized the policy for lacking “concrete changes” on IPR rules related to trade secrets and patents.⁸⁶

Turning to the defense sector in 2016 the government now allows for 100% FDI in this sector but investments exceeding 49% still need to meet the condition of “wherever it is likely to result in access to modern and ‘state-of-art’ technology in the country.”⁸⁷ There are many who argue that all the government has done is do what was easy and visible. What is required, however, is to deal with the underlying problems. According to, Lieutenant General (Ret.) Prakash Katoch, a leading defense analyst, lack of strong intellectual property rights and a sluggish bureaucracy are the key reasons that despite changes FDI in the defense sector has

⁷⁹ “Challenges for India-Japan Investment Promotion and Proposals to Both Governments,” *Japan External Trade Organization*, September 2013,

https://www.jetro.go.jp/ext_images/jetro/topics/pdf/1309_topics1_annexion2.pdf

⁸⁰ “Homepage,” Department of Industrial Policy and Promotion, *Ministry of Commerce and Industry*, <http://dipp.nic.in/English/Default.aspx>

⁸¹ “Homepage,” *Foreign Investment Promotion Board*, <http://fipb.gov.in/Default.aspx>

⁸² “A.P. (DIR Series) Circulars for Year 2016-2017,” *Reserve Bank of India*, https://www.rbi.org.in/scripts/bs_apcirculardisplay.aspx

⁸³ “Homepage,” Make in India, *Government of India*, <http://www.makeinindia.com/home>

⁸⁴ Department of Industrial Policy and Promotion, “National Intellectual Property Rights Policy,” *Ministry of Commerce and Industry*, May 12, 2016,

http://dipp.nic.in/English/Schemes/Intellectual_Property_Rights/National_IPR_Policy_o8.o8.2016.pdf

⁸⁵ Aparna Pande, Husain Haqqani, “Modi: Two Years On,” *Hudson Institute*, September 2016,

<https://s3.amazonaws.com/media.hudson.org/files/publications/20160912ModiTwoYearsOn.pdf>

⁸⁶ “AFTI Comments on Release of India’s National IPR Policy,” *Alliance for Fair Trade with India*, May 16, 2016, <http://aftindia.org/wp-content/uploads/2016/05/AFTI-Statement-on-National-IPR-Policy-5-16-16.pdf>

⁸⁷ Department of Industrial Policy and Promotion, “FDI Policy: Sectors where Government Approval is required,” *Ministry of Commerce and Industry*, July 8, 2016,

http://dipp.nic.in/English/Policies/Sectors_Where_Government_Approval_Is_Required.pdf

only increased from \$5.02 million in January 2016 to \$5.12 million by September 2016.⁸⁸

If India seeks investment it needs to know what investors seek. A 2015 Ernst & Young survey of 505 business executives across both India and the world revealed that the reduction of corporate taxes, the GST, public investment in infrastructure and land acquisition legislation were the main reforms that executives cited when asked about reforms that raised investors hopes. In the same survey, in the eyes of these executives the main priorities for the government should be continuing the growth of Indian infrastructure, reducing corruption, increasing transparency and a general need to ease doing business in India and a need to improve labor laws so that there were simpler norms for hiring and exits.⁸⁹

In April 2015, Moody's, an international credit rating agency, assigned a long-term debt rating of Baa3 to India. In November 2016 Moody's reaffirmed that India's economic status is trending in a positive direction, but this was still not enough to achieve a Baa2 rating.⁹⁰ According to Moody's scale, a Baa3 rating is issued when they believe the country to be at a moderate credit risk. It is the lowest rating in Moody's investment grade scale but above the non-investment grade scale.⁹¹ Moody's rationale for maintaining the lower rating is that the economic reforms enacted by the Modi administration have not yet resulted in attracting enough private investment that would lead to increased growth.⁹²

Similarly, S&P (Standard & Poor), another international credit rating agency, has assigned India their lowest investment grade of BBB.⁹³ Like Moody's, S&P too praised reforms such as simplifying regulations for businesses as well as major reforms such as the Goods and Service Tax but said more was required.⁹⁴

⁸⁸ Prakash Katoch, "Disappointing figures for FDI in defence indicate that a greater push is needed," *Firstpost*, May 5, 2016, accessed January 2, 2017, <http://www.firstpost.com/business/defence-ministry-fdi-make-in-india-foreign-direct-investment-2766168.html>; Department of Industrial Policy and Promotion, "Fact Sheets on Foreign Direct Investment, January - September 2016," *Ministry of Commerce and Industry*, January 2017

⁸⁹ "EY's Attractiveness Survey: India 2015," *Ernst & Young*, 2015, [http://www.ey.com/Publication/vwLUAssets/ey-2015-india-attractiveness-survey-ready-set-grow/\\$FILE/ey-2015-india-attractiveness-survey-ready-set-grow.pdf](http://www.ey.com/Publication/vwLUAssets/ey-2015-india-attractiveness-survey-ready-set-grow/$FILE/ey-2015-india-attractiveness-survey-ready-set-grow.pdf)

⁹⁰ "Moody's Affirms India's Baa3 Rating; Maintains Positive Outlook," *Moody's*, November 16, 2015, accessed December 28, 2016, https://www.moody's.com/research/Moodys-Affirms-Indias-Baa3-Rating-Maintains-Positive-Outlook--PR_356437

⁹¹ "Rating Scale and Definitions," *Moody's*, accessed December 28, 2016, https://www.moody's.com/sites/products/ProductAttachments/AP075378_1_1408_KI.pdf

⁹² "Moody's Affirms India's Baa3 Rating; Maintains Positive Outlook," *Moody's*, November 16, 2015, accessed December 28, 2016, https://www.moody's.com/research/Moodys-Affirms-Indias-Baa3-Rating-Maintains-Positive-Outlook--PR_356437

⁹³ Asit Ranjan Mishra, "S&P's credit rating for India unchanged, outlook stable," *Livemint*, November 3, 2016, <http://www.livemint.com/Politics/eAg9P9FVGY22gcpV4paYcl/SPs-credit-rating-for-India-unchanged-outlook-stable.html>

⁹⁴ FP Staff, "S&P's decision to hold India rating for 2 yrs hits Modi govt where it hurts the most," *Firstpost*, November 3, 2016, <http://www.firstpost.com/business/sps-decision-to-hold-india-rating-for-2-yrs-hits-modi-govt-where-it-hurts-the-most-3085880.html>

Going Forward

The Modi administration has instituted several reforms in 2016 but there is still a long way to go. The long-term effects of some of these reforms will take time to take effect.

The long-term impact of demonetization on India's economic growth is expected to strengthen the economy though in the short-term it might impact growth negatively. The Reserve Bank of India has cut its growth forecast from 7.6% to 7.1% while international ratings agency, Fitch, cut India's 2016 GDP growth forecast from 7.4% to 6.9% stating "Indian consumers have not had the cash needed to complete purchases, and there have been reports of supply chains being disrupted and farmers unable to buy seeds and fertilizer."⁹⁵ The Asian Development Bank also revised India's 2016 GDP growth from 7.4% to 7%.⁹⁶ Morgan Stanley has followed suit and revised India's economic growth forecast to 7.4% from 7.7%.⁹⁷

The latest Nikkei report stated that India's Manufacturing, Purchasing Managers' Index (PMI), fell to 49.6 from the previous month's (November) 52.3, signifying a contraction in the sector. "PMI data for December indicated that the rupee demonetization took a toll on manufacturing performance...Companies saw new work and output dip for the first time in 2016. In turn, quantities of purchases were scaled back and employment lowered. Meanwhile, input costs increased at a quicker rate, whereas output charge inflation eased."⁹⁸

2017 will also see the implementation of GST. The success of GST depends entirely on the implementation and simplification of India's complex tax structure. However, the problems faced during the implementation of demonetization have started to reduce the political will needed to execute GST. Many state level leaders have expressed hesitation regarding implementing GST arguing "it would be too difficult on the ground to handle two disruptive policy decisions in the space of less

⁹⁵ Remya Nair & Prerna Kapoor, "Demonetisation: Fitch lowers India's growth outlook for FY 2017 and FY 2018," *Livemint*, November 30, 2016, accessed December 18, 2016, <http://www.livemint.com/Politics/BjJVUxLDwRLo8pGaPOkZmN/Demonetisation-Fitch-cuts-Indias-FY17-growth-forecast-to-6.html>.

⁹⁶ "Asian Development Outlook Supplement: Asia's Economies Steady Despite Global Uncertainty," *Asian Development Bank*, December 2016, accessed January 03, 2016, <https://www.adb.org/sites/default/files/publication/216421/ado-supplement-dec-2016.pdf>.

⁹⁷ Jyotindra Dubey, "Demonetisation: What ratings agencies say about India's growth forecast," *Hindustan Times*, December 08, 2016, accessed January 05, 2017, <http://www.hindustantimes.com/business-news/rbi-and-rating-agencies-slash-india-s-gdp-growth-rate-post-demonetisation/story-x1zq1bLxjsjohzhuCQeWanI.html>.

⁹⁸ "Demonetisation Hits Manufacturing Sector," *The Hindu*, January 02, 2017, accessed January 04, 2017, <http://www.thehindu.com/business/Economy/Demonetisation-hits-manufacturing-sector/article16979062.ece>.

than six months.”⁹⁹ According to S&P, the dual implementation of both demonetization and GST “are likely to have a higher disruptive impact on the informal, rural, and cash-based segments of the economy.”¹⁰⁰

The implementation of these two policies will have a lasting effect as they are expected to increase the tax base, allow for increased levels of participation in the formal economy, and increase the ease of business for companies to conduct business in India. However, the success of these economic reforms depends on their implementation.

Regardless of the short-term pain caused by demonetization, these reforms (GST & demonetization) are a step in the right direction and needed to unify and strengthen the Indian economy. However, the pursuit of a strong and robust economy requires further steps to be taken by the Modi administration to strengthen the transportation and energy infrastructure and easing the business regulatory framework.

According to the World Bank, for India to continue its growth momentum, “accelerated infrastructure spending and a better investment climate may help increase private investment and exports.”¹⁰¹ India received \$63 billion in FDI in 2015, surpassing China, but many investors remain reluctant because of a “lack of trained labor, stringent land and labor laws and poor infrastructure [that] has been a major deterrent to foreign investment in India.”¹⁰² Major corporations such as Microsoft, GE, and Lockheed Martin have expressed concerns about the unpredictability in taxation rules, such as retrospective taxation, that if cleared would pave the way for greater international investment within India.¹⁰³

India has faced some economic uncertainty as a result of the recent reforms initiated by the Modi administration but is still on track to resume strong economic growth in 2017 and 2018. Morgan Stanley has reduced India’s economic growth slightly in 2017 from 7.8% to 7.6% but India maintains its position as the fastest growing economy surpassing current 2017 Chinese growth estimates of 6.5%.^{104, 105}

⁹⁹ Ibid.

¹⁰⁰ Ibid.

¹⁰¹ Press Release, “South Asia Consolidates Top Growth Spot, Needs to Ignite Private Investment to Stay on Track,” *The World Bank*, October 03, 2016, accessed January 11, 2017, <http://www.worldbank.org/en/news/press-release/2016/10/03/south-asia-growth-potential-realized-through-investment>.

¹⁰² Suparna D’Cunha, “As India Approves Residency For Foreign Investors, Will It Attract Entrepreneurs?,” *Forbes*, September 01, 2016, accessed January 11, 2017, <http://www.forbes.com/sites/suparnadutt/2016/09/01/asia-india-approves-residency-for-foreign-investors-will-it-attract-entrepreneurs/#4e6e3a876e0c>.

¹⁰³ Ibid.

¹⁰⁴ Brenda Goh & Wang Jing, “China should target 6.5 percent economic growth,” *Reuters*, December 11, 2016, accessed January 12, 2017, <http://www.reuters.com/article/us-china-economy-gdp-idUSKBN14101H>.

¹⁰⁵ Jyontindra Dubey, “Demonetisation: What ratings agencies say about India’s growth forecast,” *Hindustan Times*, December 08, 2016, accessed January 05, 2017, <http://www.hindustantimes.com/business-news/rbi-and-rating-agencies-slash-india-s-gdp-growth-rate-post-demonetisation/story-x1zq1bIxjsjhzuCQeWanI.html>.

Morgan Stanley also expects India to resume high levels of growth in 2018 with projections estimating growth at 7.8%.¹⁰⁶ The IMF has forecasted that India's growth rate in 2017 will fall to 6.6% from earlier forecasts of 7.6% as a result of demonetization. The IMF forecast for 2018 has also been revised from earlier estimates of 7.6% to 7.4% but forecasts for 2019 remain unchanged at 7.7%.¹⁰⁷

Current initiatives by the Modi administration with respect to lifting FDI limits, cutting bureaucratic red tape, simplifying the tax code, and offering residency to large investors¹⁰⁸ represents a major improvement on India's previous disincentives for foreign investment. The outlook for the Indian economy remains generally positive but a continued momentum of reforms and change is crucial for India to fully achieve its economic potential.

¹⁰⁶ Ibid.

¹⁰⁷ Economic Times Bureau, "IMF cuts India's growth rate to 6.6%," January 17, 2017, accessed January 19, 2017, <http://economictimes.indiatimes.com/news/economy/indicators/imf-cuts-indias-growth-rate-to-6-6-due-to-note-ban/articleshow/56601116.cms>.

¹⁰⁸ Suparna D'Cunha, "As India Approves Residency For Foreign Investors, Will It Attract Entrepreneurs?," *Forbes*, September 01, 2016, accessed January 11, 2017, <http://www.forbes.com/sites/suparnadutt/2016/09/01/as-india-approves-residency-for-foreign-investors-will-it-attract-entrepreneurs/#4e6e3a876eoc>.

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