Testimony Before the United States International Trade Commission

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The Information Technology and Innovation Foundation appreciates the ITC's invitation to provide testimony regarding the impact of India's trade, investment, and industrial policies on the U.S. economy. The hearings come at an opportune time. In the early 1990s, Indian policymakers made a brave decision to abandon the restrictive trade and economic policies that characterized the country's post-independence import-substitution industrialization strategy and instead embrace core tenets of competitive markets, non-discriminatory trade, and greater openness to flows of goods, people, technology, and capital. That decision contributed directly to the Indian economic miracle of the past two decades—as Indian GDP grew 40 percent faster per year than it had over the preceding two decades.

Unfortunately, over the past several years, India has begun to increasingly embrace a wide slate of "innovation mercantilist" policies—including forced localization policies such as local content requirements (LCRs), compulsory licensing of foreign intellectual property, price preferences and subsidies for domestic manufacturers, market access restrictions, and barriers to foreign direct investment. Collectively, these policies constitute a coherent Indian industrial policy which seeks to bolster Indian economic and employment growth by distorting global trade and forcing investment and production to occur in India. India has erected these policies across a diverse range of sectors from information and communications technology (ICT) and life sciences to renewable energy, manufacturing, retail, and financial services.

For example, in February 2012, the Indian government announced a Preferential Market Access (PMA) policy, an LCR mandating phased increases in the domestic value

addition of ICT goods, initially applied to both public and private sector ICT procurements. India has moved to exclude foreign ICT vendors from participating in the country's $4 billion national fiber optic network rollout. India's LCRs on solar photovoltaic cells compelled USTR to request a WTO investigation just this week. Meanwhile, foreign intellectual property rights holders in the life sciences sector have encountered significant difficulty in protecting their IP rights in India, particularly with regard to issuance of compulsory licenses, patent denials, and patent revocations. For instance, in March 2012, the Indian Patent Controller General granted a compulsory license to the Indian pharmaceutical company Natco, enabling it to produce a patented cancer drug, Nexavar, developed by Bayer. The United States Trade Representative's Office *2013 Special 301* report noted that he Controller based this ruling, in part "on the innovator's decision to import its products rather than manufacture them in India"—thus establishing a troubling precedent.

Yet, as ITIF articulates in a forthcoming March 2014 report entitled *The Indian Economy at a Crossroads*, while India's "innovation mercantilist" policies appear to offer India short-term benefits, in the long run they will prove self-defeating, damaging not just India's economy—including its producers and consumers—but also harming enterprises and workers in India's trading partner countries, including the United States, and even the global innovation economy.

In fact, India's mercantilist policies strike at the very heart of the United States' innovative industries and enterprises. The success of such innovative industries—such as biotechnology or semiconductors—depends not on making a particular drug or semiconductor cheaper, but on inventing the next-generation one. Such innovative industries have three distinct characteristics: 1) the need for constant innovation; 2) high fixed costs of initial R&D and design relative to low marginal costs of production, and; 3) a dependence on intangible capital, particularly intellectual property. Internationally, maximizing innovation by innovation industries depends upon three key conditions: 1) ensuring the largest possible markets—which better enables innovative firms to cover fixed costs, so that unit costs can be lower, and revenues for reinvestment in innovation higher; 2) limiting non-market-based competition; and 3) ensuring strong IP protection.

Unfortunately, India's innovation mercantilist policies threaten each of these key conditions American innovators depend on to succeed in global markets. First, they introduce market balkanization. A biopharmaceutical firm may only need one manufacturing plant to produce a drug for global sales, but if nations require a firm to manufacture locally in order to sell locally, then it will need multiple plants—potentially one in every country—thus increasing the firm's costs and reducing the resources available for reinvesting in innovation—and also lowering rates of new drug discovery. Second, LCRs, such as India's PMA, introduce damaging excess competition by providing at least an implicit price or quality preference that enables domestic firms to compete which otherwise could not on a market-determined, best-value basis.

Third, these policies compromise IP-dependent American industries. As USTR's *2013 Special 301* report notes, "large-scale copyright piracy" persists in India, "especially in the optical media, publishing, and software industries"—where the piracy rate reached 63 percent in 2011, with the commercial value of PC software theft in India totaling $2.9 billion. The music industry estimates a total loss of over $431 million in 2012 and upwards of 90 percent music piracy online. This rampant digital piracy distorts global trade, threatens the production of digital content in the future, and costs U.S. jobs. Likewise, India's use of compulsory licenses in the life sciences industry both induces excess competition and compromises the ability of biopharmaceutical innovators to capture gains from their successful innovations—profits that constitute the industry's lifeblood as they are indispensable for reinvestment to create the next-generation of innovative biopharmaceutical products.

Yet not only do India's trade-distortive policies compromise the conditions America's innovative industries need to thrive in global markets, they lower the global production of innovation, in part by igniting a "contagion effect" that encourages other governments to adopt similar policies to close off their own markets to foreign competition. This has a cascading effect on U.S. companies. The effect is real, and we see it when see other governments turn increasingly to similar problematic approaches. For instance, in September 2013, South Africa's Draft National Policy on Intellectual Property proposed using compulsory licensing on innovative medicines, taking a page

from India's playbook. And India's implementation of LCRs only perpetuates their growing global use, which affects 5 percent of global trade, reducing global trade value by almost $100 billion annually.

While India's innovation mercantilist policies affect many U.S. industries, I want to focus the rest of my comments on their impact on the ICT sector—both in the United States and globally—particularly regarding Indian's onerous compulsory registration requirements for ICT products and its PMA. Regarding the first, in 2012, India's Department of Electronics and Information Technology issued a "Compulsory Registration Order" which requires manufacturers of a wide range of ICT products to submit them for India-based testing, regardless of whether the products have already been tested and certified to an identical standard by internationally accredited labs. These requirements were developed with limited industry consultations, are practically unworkable, and veer markedly from global norms. It's estimated they have caused U.S. (and other foreign) ICT enterprises to incur millions of dollars in new compliance and liability costs. More concerning, time-to-market delays and regulatory uncertainty continue to jeopardize billions of dollars of exports and potential sales. Moreover, India is now looking to expand the scope of these requirements, and there is fear that they will become the model for testing and certification for security and other up-and-coming regulations.

As for the PMA, in July 2013, India's government announced it would review and suspend its PMA requirement as applied to private sector procurements. ITIF applauds the Indian government for recognizing the concerns voiced by foreign governments, investors, and the international ICT community and rescinding the PMA's application to private sector procurements.

Nevertheless, the PMA's continuing application to Indian government and SOE procurement activity threatens to significantly distort India's ICT market—the PMA will still impact at least one-quarter of India's ICT market—and harm U.S. ICT enterprises and ICT production. In fact, if India's PMA were to be fully realized—with India achieving the goal expressed by the Telecom Regulatory Authority of India in its 2011 Telecom

Equipment Manufacturing Policy of having 80 percent of India's demand for telecommunications equipment be met through domestically manufactured products by 2020—with at least 50 percent of that production being met by Indian products—then ITIF estimates that foreign imports of ICT products to serve Indian government procurement would decline by up to $6.5 billion in the year 2020. **ITIF further estimates that U.S.-based ICT production would fall by an estimated $1.7 billion, costing the United States 10,500 jobs, annually.**

It's also worth pointing out that the PMA may compromise the ability of many American ICT firms to sell "managed solutions" that depend on proprietary ICT hardware in offering ICT-based systems and solutions. When bidding for Indian government contracts for large deployments of ICT systems and solutions—such as for the deployment of intelligent transportation systems or health IT systems—even though the underlying hardware may constitute only perhaps a tenth of the value, U.S. competitors may be disqualified or prevented from competing for such tenders because of requirements to use domestically sourced ICT hardware. India's PMA thus threatens to engender significant distortive effects not only in India's ICT hardware market, but also its ICT services market.

In conclusion, the U.S.-India economic relationship is one of our most strategically important. A strong, growing, and collaborative trade relationship is surely in both parties' best interests, particularly with India enjoying a $20 billion surplus from two-way trade that totaled $63.7 billion in 2013. In fact, India has run a trade surplus with the United States in every year since at least 1985. But India's recent trade policies are placing that relationship in jeopardy. India needs to re-embrace open markets and get back to using the kinds of market-based incentives that gave rise to India's global leaders in ICT software and services; such policies should set the foundation for India's efforts to build its ICT and broader manufacturing sectors. "Forced localization" policies, such as the PMA, taken to their logical conclusion mean the end of vibrant global supply chains. They cannot stand. They are a real threat to global innovation and to the American economy and jobs.