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WORKING PAPER

U.S.-India Initiative Series

Unleashing U.S.-India Defense Trade

By Kenneth I. Juster and Ajay Kuntamukkala

Center for a
New American
Security

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This paper is one of a series commissioned in conjunction with a major Center for a New American Security (CNAS) study on the future of the U.S.-India relationship. The study, co-chaired by former Deputy Secretary of State Richard L. Armitage and former Under Secretary of State for Political Affairs R. Nicholas Burns, and directed by CNAS Senior Fellow Richard Fontaine, has produced a comprehensive blueprint for the next phase of the U.S.-India strategic relationship. The full text of the final report can be found at www.cnas.org.

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About the Authors

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During the last 10 years, the United States and India have forged closer defense ties based on the recognition that they share fundamental security interests in Asia and beyond. While the two countries have increasingly undertaken joint exercises and improved military-to-military relations, bilateral defense trade has yet to fulfill its potential. The sale of defense-related goods by U.S. companies to India and collaboration on defense technology between U.S. and Indian firms remain areas of significant opportunity for the U.S. government and the U.S. defense industry. President Barack Obama's visit to India in November of this year should serve as a catalyst for further progress on defense trade between the two countries.

Expanding defense trade with India would benefit the United States by enhancing interoperability between the U.S. and Indian militaries and opening a sizable new market for U.S. defense firms, especially at a time of contracting defense budgets in the United States. India's total defense spending over the next six to seven years is expected to be in the range of 280 billion dollars, with a substantial portion of its procurement coming from foreign suppliers. But defense trade and defense technology collaboration continue to be sources of irritation in U.S.-India relations. Despite a steady increase in the licensing of U.S. defense items to India, members of the Indian government and Indian industry argue that the United States needs to further streamline its export control systems relating to "dual-use" and munitions items. They claim that U.S. licensing policy hampers the transfer of high technology from the United States to India and puts U.S. firms at a competitive disadvantage in the Indian market.

There is certainly truth to these arguments, but there also are myths and misunderstandings. In order to suggest practical steps that each government can take to facilitate further defense trade and collaboration, we examine the publicly available facts relating to dual-use, munitions and civil nuclear exports from the United States to India.

I. FACTS ON U.S.-INDIA DEFENSE TRADE

Dual-Use Exports

Dual-use exports involve items that have both commercial and military applications. Given the increasing sophistication of commercial technologies and their application in military systems, dual-use exports are an important element of U.S.-India defense trade.

The U.S. dual-use export control system is managed by the Department of Commerce, with input from the Department of State, the Department of Defense (DOD), the Department of Energy (DOE) and the intelligence community. Since the lifting of sanctions on India in 2001 and the creation in 2002 of the U.S.-India High Technology Cooperation Group (HTCG) – a bilateral government forum that has focused on increasing high-technology trade between the two countries while enhancing controls on sensitive technology – the number of dual-use exports to India requiring licenses has dropped significantly. For example, in calendar year 2000, of the 4.1 billion dollars in U.S. exports to India, 24 percent (approximately 1 billion dollars) required a license from the Department of Commerce. However, by calendar year 2009, with total U.S. exports to India at approximately 16.3 billion dollars, only 0.3 percent (approximately 49 million dollars) required a Commerce Department license. In addition, of the 16.3 billion dollars in total exports, approximately 24 percent (4 billion dollars) were classified by the Commerce Department as high-technology products. Only 0.5 percent of such products required a Commerce Department license.[1]

In terms of dual-use license applications for U.S. exports to India, the Commerce Department processed 1,114 such applications in fiscal year 2009, involving 375 million dollars of goods. The Commerce Department granted 774 licenses for 269 million dollars of goods, returned without action 316 licenses for 102 million dollars of goods[2] and denied 24 licenses worth 4 million dollars. Moreover, the average processing for license applications was 28 days, which is below the 35-day average for the processing of all Commerce Department licenses. Again, these figures can be contrasted with those in fiscal year 2003, when 619 licenses worth 57 million dollars were approved, 229 licenses worth 36 million dollars were returned without action and 72 licenses worth 15 million dollars were denied, with an average processing time of 41 days.[3]

In short, only a fraction of dual-use trade with India now requires a license, and the U.S. licensing process for dual-use technology to India has improved significantly in recent years. In the context of the accelerating bilateral relationship, however, it is critical that the United States and India make further improvements.

Munitions Exports

The U.S. munitions exports control system is administered by the Department of State, with input from DOD and the intelligence community. This system is more cumbersome and opaque than the dual-use licensing procedure, with less statistical information publicly available. In fiscal year 2008, the State Department approved licenses involving defense articles for India valued at over 233 million dollars. In addition, the State Department authorized defense services for India valued at 677 million dollars through Technical Assistance and Manufacturing Licensing agreements.[4]

In comparing these figures to those of fiscal year 2003, when the State Department approved licenses authorizing the export of defense articles to India valued at 102 million dollars and defense services to India valued at 223.5 million dollars, there is a clear upward trend in munitions sales and a significant degree of technology transfer from the United States to India.[5]

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Recent sales of U.S. defense systems to India include six C-130J Hercules transport aircraft by Lockheed Martin and eight P-8I Orion reconnaissance and antisubmarine aircraft by Boeing. Lockheed Martin and Boeing are now competing in India's 10 billion dollar tender for 126 medium multi-role combat aircraft. While these developments reflect the transformation occurring in U.S.-India relations, the still relatively low total amount of defense exports also demonstrates that the two countries are far from fulfilling their defense cooperation potential.

Civil Nuclear Trade

Trade in civil nuclear commodities, technology and services represent another important aspect of the U.S.-India strategic and economic relationship. Under U.S. export control laws, the DOE, the Nuclear Regulatory Commission (NRC) and the Department of Commerce share jurisdiction over the export of civil nuclear items. The DOE administers controls on the export of nuclear technology and services, the NRC controls the export of nuclear reactors, equipment and materials, and the Department of Commerce controls the export

of dual-use nuclear items. Currently, the export of NRC- and DOE-controlled items to India is in most cases restricted and cannot proceed until the U.S.-India Civil Nuclear Cooperation Agreement is fully implemented. Some important steps toward full implementation have been taken, such as India entering into a safeguards agreement with the International Atomic Energy Agency (IAEA) and the reaching of an accord on reprocessing spent nuclear fuel transferred to India. However, several critical issues remain unresolved. In particular, the government of India will need to resolve issues surrounding its recently-passed nuclear liability legislation, which does not appear to conform to international standards and provide certain non-proliferation assurances to the U.S. government before the DOE can issue specific authorizations for the transfer of civil nuclear technology to India.

II. CONCERNS REGARDING DEFENSE TRADE

The government of India has expressed a series of important concerns regarding the U.S. export control systems that merit serious consideration.

Concerns Regarding Dual-Use Licensing

The government of India has voiced two primary complaints related to the dual-use system: all Indian organizations should be removed from the Entity List (which restricts nearly all exports to those organizations) or the licensing policy for organizations remaining on the Entity List should be revised to have a presumption of approval (rather than the current presumption of denial or case-by-case review); and dual-use licensing requirements for India should generally be eased so that India is treated in the same manner as U.S. allies such as the United Kingdom and Japan.

There are currently 11 Indian organizations on the Entity List. These organizations fall into three categories: Indian Space Research Organization (ISRO) subsidiaries that are involved in activities related to space launch vehicles (four organizations); Department of Atomic Energy subordinates, which are involved in nuclear-related activities (three organizations) and all unsafeguarded nuclear reactors and facilities; and Defense Research and Development Organization (DRDO) subordinates and Bharat Dynamics Limited (four organizations), which are involved in missile technology-related activities.

Many in India consider the very fact that these organizations are on the Entity List as an affront, and an indication that the United States is not sincere when it asserts that it wants an enhanced strategic partnership with India. After all, Indians argue, these organizations are not rogue outfits but integral parts of the Indian state apparatus that have strategic and historical significance to India. Indeed, the Indians claim that the statistics on license denials and applications returned without action do not adequately reflect the deterrent effect on exports to India due to the continuing presence of these organizations on the Entity List.

With regard to the ISRO subsidiaries, the view of the U.S. government is that certain technology related to space launch vehicles is also relevant to India's ballistic missile activities, which the United States does not support. The U.S. government needs to have full assurances and complete confidence that U.S. technology exports for use in India's civilian space program are not diverted for use in missile development. Accordingly, while the United States now routinely licenses low-level dual-use items to ISRO subsidiaries on the Entity List, it does not generally grant licenses for highly controlled items to these entities.

While these factors limit U.S. willingness to remove these ISRO subsidiaries from the Entity List, this is certainly an area that demands further scrutiny from both sides. In particular, the Indian government should draw a brighter line between ISRO's legitimate civil space activities and India's ballistic missile programs, and enhance confidence that all

The Commerce Department is considering broader reforms to its regulations that would result in a streamlined process for U.S. dual-use exports to India, including a license exception for intra-company transfers that would permit U.S. companies to transfer commodities, software and technology to their foreign subsidiaries without prior approval.

exported technology is used for the former and not the latter. Such a step would facilitate either the removal of these organizations from the Entity List or a meaningful change in licensing policy. The benefits of such an approach include permitting closer U.S.-India cooperation in civil space activities, contributing to scientific advancements and opening a new market for the U.S. commercial satellite and space industries.

The Indian organizations involved in nuclear-related activities are either entities participating in India's nuclear weapons or sensitive nuclear fuel-cycle activities, or facilities not under IAEA safeguards. For certain entities, such as the Bhabha Atomic Research Center (BARC) or the Indira Gandhi Centre for Atomic Research (IGCAR), it may be possible for the Indian government to separate legitimate activities, such as civil power generation and nuclear medicine, from prohibited activities relating to nuclear weapons, enrichment or reprocessing. For example BARC, a large, multifaceted organization that is involved in a range of legitimate civil nuclear activity, has received U.S.-origin items under Commerce Department licenses. With regard to India's nuclear power reactors and related facilities, Washington has informed New Delhi that, as it places these facilities under international safeguards, they will not be subject to the Entity List.

The DRDO subordinates were added to the Entity List in the wake of India's nuclear weapons tests in 1998. The U.S. government has been unwilling to remove these organizations from the Entity List because they are involved in research related to nuclear weapons delivery systems, including missile technology. However, India has argued that these organizations should be removed because they also engage in non-missile research, including projects to improve the lives of Indian soldiers. As in the case of the ISRO subsidiaries, U.S. and Indian policymakers should explore whether clearer lines can be drawn between DRDO's strategic missile programs and its other defense programs that the U.S. government might be willing to support.

The second dual-use export control issue is India's desire that most licensing requirements be lifted, thus substantially streamlining and simplifying the system. However, a major impediment to such a step is that the government of India has yet to harmonize its export controls with those of two important multilateral regimes – the Wassenaar Arrangement (relating to dual-use goods and technologies and conventional arms) and the Australia Group (relating to items contributing to chemical and biological weapons).[6] There have been reports that the Indian government may be willing to adapt its control lists to conform to these two regimes and even to join them in the future. If so, the United States should encourage this and even assist India both in attaining formal membership in these regimes (which, for the

Wassenaar Arrangement, would require an exception from the policy that membership is confined to parties to the Nuclear Nonproliferation Treaty) and having an effective voice in them. India, for its part, must be willing to accept the full obligations that come with membership in the multilateral export control regimes and play a constructive role in them.

In addition, the U.S. and Indian governments should renew their commitment to conducting end-use visits on the full range of Indian end-users that receive sensitive dual-use technology. The United States conducts end-use visits for dual-use items throughout the world, and does not target India in particular with such activities. Accordingly, the possible inability to conduct such visits with regard to certain end-users in India raises questions among U.S. government officials about how U.S.-origin items might be used and discourages the U.S. government from further liberalizing controls on exports to India. This issue should be resolved within the context of the end-use visit arrangement for dual-use items that the parties signed in September 2004 as part of the Next Steps in Strategic Partnership initiative.[7]

Finally, the Commerce Department is considering broader reforms to its regulations that would result in a streamlined process for U.S. dual-use exports to India, including a license exception for intra-company transfers that would permit U.S. companies to transfer commodities, software and technology to their foreign subsidiaries without prior approval. The Commerce Department also implemented the Validated End-User (VEU) program for India, which permits entities in India to receive controlled items without a license after the U.S. government has vetted the entities. However, the VEU program has rarely been used by Indian companies, which view the program's requirements as burdensome and time-consuming. The U.S. government should examine whether it can streamline the VEU program to encourage its use by Indian entities while maintaining the U.S. government's ability to properly vet such companies. The Indian government should encourage its companies to take advantage of this program.

Concerns Regarding Munitions Licensing

Under U.S. law relating to munitions sales, arms exports to India would be greatly facilitated if India agreed to several key agreements: an End-Use Monitoring Agreement (which establishes a standard set of procedures governing the proper end-use of U.S.-origin defense items, as well as the on-site inspection of such items); a Communications Interoperability and Security Memorandum of Agreement (which ensures the secrecy and interoperability of U.S. communications and intelligence systems); and a Mutual Logistics Support Agreement (which would give U.S. and Indian military aircraft and vessels access to each country's ports, airfields and other facilities for refueling and refurbishment). While the government of India has agreed to an End-Use Monitoring Agreement, to date it has not seriously negotiated the other two. This is due in part to political concerns that such agreements infringe upon Indian sovereignty and the independence of its foreign policy, and that other governments that transfer munitions to India do not require such agreements. The United States has indicated that these additional agreements would provide tangible benefits to India by permitting better coordination of military-to-military and counter-terrorism activities as well as Indian access to more sophisticated U.S. defense technology, such as advanced communications systems.

Some U.S. companies also have had difficulty concluding Technical Assistance Agreements and Manufacturing Licensing Agreements with Indian governmental agencies. The U.S. government requires these agreements before defense technology and services, including manufacturing know-how, can be exported to non-U.S. organizations or entities. Indian governmental agencies have either refused to sign such agreements or

engaged in lengthy negotiations with their U.S. counterparts, again due to sovereignty-related concerns and various legal reservations.

It is important to note that U.S. munitions controls, and the agreements that would facilitate defense trade, are not specific to India or even to a particular set of countries in which India is being grouped. Rather, by law these requirements apply generally to countries to which the United States sells military items. The rationale for this system is that the United States possesses unique and much sought-after munitions technology that it needs to tightly control, given the broad range of its regional and global concerns as well as its desire to protect its technological edge over current and potential adversaries. That said, it may well be time for the United States to consider changes in its munitions controls that differentiate among allies, friendly nations and other countries, and identify what types of defense technologies will be considered for licensing to each country group.

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In particular, the handling of India under the existing system should be altered so that India is treated as a strategic partner when the U.S. government considers release of certain categories of advanced defense technology items or classified information necessary for defense cooperation. The United States also should consider licensing an entire defense project, rather than each stage of a project. Such changes in the approach to the release of defense technologies to India would create a more predictable and transparent licensing process and would resonate well with India's leadership. It also would clarify to the defense establishments of the United States and India what sales or transactions are worth pursuing and greatly facilitate U.S.-India defense collaboration. These changes would not obviate the need for India to address issues raised by the above agreements that assure the United States that its technology is kept safe, used for proper purposes and guarded against third parties gaining improper access to it. But these steps could be part of the effort to streamline U.S. munitions controls and, in the process, expedite exports to India.

At the same time, India could enhance the prospects for defense trade with the United States and effective defense cooperation if it provided greater predictability and transparency in its offset policy (which governs investment and local production requirements) as well as its expectations for the transfer of technology. U.S. companies also have made it clear that they would be much more interested in large-scale investments in the Indian defense sector if the Indian government increased the 26-percent cap on foreign direct investment in the defense industry. There have been some reports that the Indian government is considering raising this cap to 49 percent or more, but parts of the Indian government, including the Ministry of Defense and elements of the Indian defense industry, continue to oppose such changes.

Finally, the U.S. government, led by Secretary of Defense Robert Gates, is planning to reform its export-control process by merging the dual-use and

munitions systems so as to create a unified export control regime with a single regulatory agency and a single control list. There are obvious benefits to this approach, including easing the administrative burden for exporters that currently have to deal with multiple government agencies, jurisdictional confusion and multiple legal regimes. However, such an integrated system should be implemented carefully to keep the more restrictive licensing approach to munitions items from tainting the licensing process for dual-use items. Moreover, there is concern that the export control agencies and organizations in the U.S. government already operate somewhat independently of high-level policy direction. Creating a powerful new agency could exacerbate this disconnect between policy and practice. In other words, if the role of government officials who are cautious about strategic trade with India and other countries becomes increasingly pervasive throughout the entire licensing process, these reforms could actually be detrimental to defense trade between the United States and India.

Concerns Regarding Nuclear Licensing

While trade in nuclear items and licensing of nuclear exports does not relate directly to defense cooperation, the government of India views defense, dual-use and nuclear export-control issues as interrelated and collectively important to its strategic and economic interests. Accordingly, the current lack of progress in the nuclear export control area fuels the general perception among Indian policymakers and industrialists that the United States is not a reliable partner and is not sincere when it speaks of an intensified strategic relationship with India. This trust deficit adversely affects progress on munitions and dual-use trade. Completing the nuclear deal and facilitating the export of nuclear technology and items to India would be viewed as a tangible success that could greatly improve the environment for further progress on defense trade.

III. EXPANDING U.S.-INDIA DEFENSE TRADE

The transformation of U.S.-India relations over the past 10 years occasionally has been characterized by tension, within both countries, between political leaders favorably inclined to cooperation and resistance from certain entrenched bureaucracies. Yet, when the two sides have focused their efforts on specific objectives, they have usually achieved tangible results.

With President Obama's upcoming visit to India in November, both countries now need to articulate a concrete vision for a strategic partnership in defense trade. On the U.S. side, this includes examining how the current export control reform process could elevate India to a position of preferred access to both dual-use and munitions items. As a practical matter, this would mean decontrolling many dual-use items that now require a license to India, as well as clarifying and easing licensing policy for munitions so that India could receive more sophisticated defense items and technology. For India's part, willingly undertaking the obligations and responsibilities that other states have accepted as members of the global nonproliferation system would greatly ease its access to sophisticated technology, highlight its role in preventing the spread of weapons of mass destruction and enhance its stature as a global leader. The two countries should each designate a senior official who has the time, energy and authority to work through and resolve the complex policy and regulatory challenges that will enable such a vision to be realized.

Among the initial issues to be considered for further review and discussion are the following:

Create a single bilateral forum for strategic trade. The two governments should consider consolidating the various dialogues regarding export controls and technology transfer into a single forum that

addresses dual-use, munitions and civil nuclear trade. This forum should be led by an appropriate senior official from each side with the authority to resolve the overlapping regulatory and policy issues relating to export controls.

Revise the Entity List. The U.S. government should consider removing Indian organizations from the list (which would allow them to import most dual-use goods without a specific license) or substantially adjusting licensing policy for these organizations, as appropriate, based on tangible commitments from the government of India that there will be clear and verifiable lines between legitimate and prohibited activities by these organizations.

Harmonize with multilateral control lists. The government of India should begin harmonizing its control lists and adhering to the policies of two important multilateral regimes, the Wassenaar Arrangement and the Australia Group, which would establish greater confidence in India's export control system and open the door to more significant liberalization of U.S. export controls. The United States should be prepared to assist India's efforts in this regard, and should even consider supporting India's formal membership in these regimes if India were willing to accept the full obligations that come with such membership.

Renew end-use visits. The U.S. and Indian governments should renew their commitment to implementing the end-use visit arrangement for the full range of end-users in India permitted, which would provide the impetus for further progress on liberalization of dual-use trade with India.

Modify the Validated End-User (VEU) program. The U.S. Commerce Department should consider modifications to the VEU program that would make the program less burdensome and more appealing to U.S. and Indian industries. The Commerce Department should also implement the intra-company license exception and other initiatives that would facilitate dual-use trade with India. The government of India should actively encourage its companies to take advantage of the VEU program.

Conclude U.S.-India defense agreements. The United States and India should work to conclude a Communications Interoperability and Security Memorandum of Agreement and a Mutual Logistics Support Agreement, which would permit India to access more advanced U.S. defense technology. In addition, the United States and India should discuss how to facilitate the timely conclusion of Technical Assistance Agreements and Manufacturing Licensing Agreements, which are important for technology transfer and manufacturing activities in India.

Examine U.S. licensing policy for defense projects. The U.S. government should examine whether licensing entire defense projects to India, rather than each stage of such projects, could be permitted.

Revise Indian defense procurement policy. The government of India should consider revising its offset policy to make it more transparent and predictable, which would encourage greater defense technology transfers and investment in India. In addition, India should consider raising its limit on foreign direct investment in the defense sector from the current 26 percent limit to 49 percent or more.

Make progress on nuclear trade. Completing the implementation of the U.S.-India Civil Nuclear Agreement and engaging in significant civil nuclear trade would create positive momentum in the bilateral strategic relationship and help to facilitate U.S. defense trade with India.

If the United States and India are truly going to be vital partners as the power balances of the 21st century shift, these important issues of defense trade and export controls must be addressed. Efforts surrounding President Obama's November visit to India should provide the momentum for making substantial progress in this area.

ENDNOTES

1. Kevin Wolf, Assistant Secretary of Commerce for Export Administration, Remarks at the 7th U.S.-India High Technology Cooperation Group Meeting (16 March 2010), http://www.bis.doc.gov/news/2010/2010_k_wolfs_htcg_remarks_final.pdf.

2. Licenses are returned without action for several reasons, including that no license is needed for export, that the applicant provided insufficient supporting information or that the applicant has withdrawn the license application.

3. U.S. Commerce Department, Bureau of Industry and Security.

4. "Report by the Department of State Pursuant to Section 655 of the Foreign Assistance Act of 1961 – Direct Commercial Sales Authorizations for Fiscal Year 2008," U.S. Department of State, http://pmddtc.state.gov/reports/documents/rpt655_FY08.pdf.

5. "Report by the Department of State Pursuant to Section 655 of the Foreign Assistance Act of 1961 – Direct Commercial Sales Authorizations for Fiscal Year 2003," U.S. Department of State, http://pmddtc.state.gov/reports/documents/rpt655_2003.pdf.

6. Pursuant to the terms of the civil nuclear deal between the United States and India, India has taken steps to harmonize its export controls with those of the other two multilateral regimes – the Nuclear Suppliers Group (NSG) and the Missile Technology Control Regime (MTCR).

7. The two countries launched the Next Steps in Strategic Partnership initiative in January 2004 to expand cooperation in civil nuclear activities, civil space programs and high-technology trade, as well as to enhance their dialogue on missile defense.

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