



# ISSUE BRIEF

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## 2+2 Summit Meeting and Beyond



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### Introduction

US Secretary of Defence, James Mattis and Secretary of State, Mike Pompeo, accompanied by Chairman, Joint Chiefs of Staff, Gen. Joseph Dunford, met with India's Foreign Minister, Sushma Swaraj and Defence Minister, Nirmala Sitharaman, at New Delhi on September 6, 2018, in what was dubbed the "two plus two" summit. Three months have passed since that meeting. The ongoing trade war between the USA and China and recent development in Quad have critical bearing on the Indo-USA relations. A number of important events have taken place since the first two plus two summit meeting. A review of the present state of Indo-US relations is undertaken keeping in view the ongoing US-China trade war and recent happening in Quad.

### Iran

**Oil.** On November 5, 2018, in the first Significant Reduction Exception (SRE) grants available under reimposed US sanctions, the eight countries that received the SRE are: China, India, Italy, Greece, Japan, South Korea, Taiwan, and Turkey.

### Key Points

1. Number of important events have taken place since the first two plus two summit meeting on 6th September 2018.
2. Eight countries including India were granted Significant Reduction Exception (SRE) by US. India will pay for the oil in rupees. The rupees can be used to purchase Indian goods largely of Indian rice and pharmaceuticals by Iran.
3. USA exempted India from sanctions regarding the development of the strategically located Chabahar port in Iran.
4. India signed a \$5 billion deal to purchase S-400 Triumf air defence system from Russia despite threat of CAATSA.
5. The United States and India are carrying out intensive negotiations to address key trade issues, such as on the U.S. steel and aluminum tariffs and India's GSP status.

The Centre for Land Warfare Studies (CLAWS), New Delhi, is an independent think-tank dealing with national security and conceptual aspects of land warfare, including conventional and sub-conventional conflict and terrorism. CLAWS conducts research that is futuristic in outlook and policy-oriented in approach.

## 2+2 Summit Meeting ...

US Secretary of State Pompeo called it a “temporary” arrangement. He said, “We expect to issue some temporary allotments to eight jurisdictions, but only because they have demonstrated significant reductions in crude oil and cooperation on many other fronts and have made important moves toward getting to zero crude oil importation.”

The Trump administration made it very clear that while oil imports might not go to zero by November 4, revenues from oil for the Iranian regime will certainly go down to zero through the sanctions. Pompeo said, “Starting today, Iran will have zero oil revenue to spend on any of these things. Let me say that again, zero. One hundred percent of the revenue that Iran gets from the sale of crude oil would be kept in foreign accounts and will be used by Iran only for humanitarian trade or bilateral trade in non-sanctioned goods and services.”

With this waiver, India will be back to dealing with Iran in much the same way it did before the Iran nuclear deal. This is important for India since it must import some 80 percent of its oil and Iran has historically been its third largest supplier. Under the US-India waiver agreement, India will limit its imports to 1.25 million metric tons per month through March 2019. This is about 70 percent of what India had been importing from Iran prior to US withdrawal from the Iran nuclear deal. India’s purchases of Iranian oil fell from July to October 2018, totalling about 350,000 barrels per day in October – still substantial but enough of a reduction to earn India an SRE sanctions exception on November 5.

India will use a payment mechanism that will show to the United States that Iran is unable to use the proceeds from the oil sales to India for terrorist purposes. Transactions will be in rupees deposited in an escrow account at an Indian state-owned bank. The rupees can be used to purchase Indian goods largely of Indian rice and pharmaceuticals.

Secretary of the Treasury Steve Mnuchin has resisted calls to cut India and others off from the mechanism that allows banks to clear large dollar transactions,

the Society for Worldwide Interbank Financial Transactions (SWIFT). Barring India from SWIFT would create havoc for India and severely damage the US-India relationship.

One of the major advantages of buying Iran crude is the additional credit period of 90 days that the country gives to India, compared to 30 days by other countries. Iran also gives India the option to import crude oil on cost, insurance and freight (CIF) basis, as against a free-on-board (FOB) model followed by other countries. Under the CIF model, the seller pays freight and insurance charges. Under the FOB model, the buyer has to charter its own vessel and manage the cost of shipping.

These positive implications from the waiver for the US-India strategic relationship are partially offset by other aspects of the waiver agreement. First, the waiver is only for six months. To many this is a warning that a period of darkness and danger is coming not only for Iran but any who dare not comply with the US Iran sanctions. The possibility of further US demands adversely affecting the relationship in six months is ominous – and apparently Trump intends for it to be.

The reality is that increasing world oil prices were an important factor in US willingness to accept waivers that leave a flow of oil from Iran partially in place. What happens to oil prices over the next six months will affect US insistence on India’s further cutting Iranian oil imports.

It must be noted that the waiver does not apply just to India, but seven other nations as well. It is difficult to see the waiver as reflecting a special relationship when it includes rival China as well as a half-dozen others.

The unstated premise of the US-India waiver agreement is that the United States will act as a chief source for finding the petroleum to make up lost oil imports from Iran. With the advent of fracking and the resumption of the US role as the world’s leading producer of oil and gas, the United States wants to sell oil and gas to India. The US ban on oil exports was lifted in 2016

under President Barack Obama, but oil exports from the US to India have skyrocketed during the Trump administration. Producers and traders in the United States sent more than 15 million barrels of US crude to India this year through July, compared with 8 million barrels in all of 2017.

### Chabahar Port

The US has taken a well-thought-out decision to exempt India from sanctions regarding the development of the strategically-located Chabahar port in Iran. The construction of the railway line connecting Afghanistan with Iran will also remain exempt from Washington's punitive sanctions. This significant decision by the Donald Trump administration is a clear vindication of the role India has been playing in developing Chabahar, and its strategic value for Afghan reconstruction and development. Trump's decision will undeniably go a long way in safeguarding both Indian and American interests in Afghanistan.

According to a US state department spokesman, "The president's South Asia strategy underscores our ongoing support of Afghanistan's economic growth and development as well as our close partnership with India ... This exception relates to reconstruction assistance and economic development for Afghanistan. These activities are vital for the ongoing support of Afghanistan's growth and humanitarian relief." This is certainly welcome news for India that has already committed significant political, financial and diplomatic resources to the Chabahar project.

With terrorists doing all they can to underline the growing vulnerabilities of the Afghan State, the Ashraf Ghani government's capacity is already under siege. If the US had not made the exemption on Chabahar, the impact of sanctions regime on Iran would have been visible on Afghanistan which needs Iran's continued support for the much-needed infrastructure development. Thinking strategically, the Trump administration has been wise in not imposing sanctions on the Chabahar port, as its successful operation would bring Afghanistan and India closer,

theoretically curtailing the influence of Pakistan and China.

### RUSSIA

The 19th annual bilateral summit between India and Russia was held on October 4-5, 2018. India signed a \$5 billion deal to purchase S-400 Triumf air defence system from Russia during the summit despite strong objections from the United States.

India's resistance to US demands over India's defence purchases from Russia is due to the following factors:

- India's strategic autonomy is being challenged.
- Russia's resurgence as a military power in recent times is conducive to India's interests and domestic initiatives such as the Make in India initiative.
- The historical record of US strong regulations about transfer of technology does not encourage India to choose the US as an alternative defence supplier to Russia whose generosity in sharing defence technology with India in the past has been demonstrated several times. The successful development of BrahMos supersonic cruise missile is a case in point.

Defence Minister Nirmala Sitharaman has gone to the US from December 3 to 7 to reaffirm the bilateral strategic partnership in the Indo-Pacific region as well as discuss new defence deals and projects, even though the threat of the Trump administration imposing financial sanctions on India's \$5.43 billion deal for Russian S-400 Triumf air defence missile systems is yet to abate. Sitharaman has held extensive talks with her American counterpart Jim Mattis on December 3.

Though both Mattis and Secretary of State Mike Pompeo have strongly argued India's case for a "national security waiver" under CAATSA (Countering America's Adversaries Through Sanctions Act), which seeks to prevent countries from buying Russian weapons or Iranian oil, the final call is yet to be taken by President Donald Trump. CAATSA is hanging like



a Damocles sword on India's purchase of Russian weapon platforms. India is not the only country.

According to the Stockholm International Peace Research Institute, Russia is the world's second-largest arms exporter. From 2013 to 2017, the country accounted for 22 percent of the globe's weapons exports, lagging behind only the United States at 34 percent. Nearly two-thirds of Russia's exports go to Asia, though the Middle East and Africa also receive a significant portion of the country's arms.

Russia's deepest defence relationships are with China, India and Vietnam, which together account for 58 percent of Russian exports. India and Vietnam have been purchasing and using Russian equipment since Soviet times. Russia has signed major arms deals with Indonesia and Turkey, and it is in talks with Saudi Arabia and Qatar over the sale of the S-400 system. The United Arab Emirates and Indonesia are considering the purchase of Su-35 aircraft. Although these countries are some of Russia's biggest customers – or prospective customers – they are not the only ones that could run afoul of CAATSA. States such as Algeria, Myanmar, Malaysia, Kazakhstan and Ethiopia also could soon find themselves in trouble with the United States because of their significant defence relationships with Russia.

Despite its historical links with Moscow, New Delhi has expanded its security and economic relationship with the United States over the past two decades to try to increase its clout in the global system. Their ties are now strong, and India increasingly relies on the United States to balance China's rise in Asia. As a result, Washington has greater leverage over New Delhi. The CAATSA process could rekindle anti-American sentiment in the Indian defence bureaucracy and the political class, two decades after a reset in US-Indian relations consigned such nationalism to the margins.

US is utilising CAATSA process to put Russia's defence industries and its exports in great danger is full of lofty ambitions. If it succeeds, it would alter Russia's

behaviour or curtail its influence in the international system.

India on November 15 had also kicked off the formal process for another mega deal with the US government, the acquisition of 24 naval multirole MH-60 "Romeo" helicopters for around Rs 13,500 crore, as was reported by the media. India and the US are also in talks for 22 armed Predator-B or weaponised Sea Guardian drones, as also the \$1 billion deal for the American National Advanced Surface-to-Air Missile System-II (NASAMS-II) for deployment as a missile shield to protect New Delhi.

The US is also aggressively hawking its F/A-18 or F-16 fighter production line for the IAF's over \$20 billion "Make in India" competition for 114 jets as well as the Navy's quest for 57 carrier-capable fighters. Also, recent reports suggest that the US is trying to "hawk" F-16 aircraft to India in exchange for non-imposition of "sanctions" against India under the CAATSA. India, on the other hand, has been reluctant to buy the forty-year-old F-16, the aircraft which has been in the possession of Pakistan for more than three decades. India has conveyed to the Washington administration on many occasions that its foreign policy decisions are based on its national interests and the growing security challenges are real, especially from China and Pakistan.

The outcome of the CAATSA sanction and India's procurement of S-400 system would have far-reaching consequences globally.

#### **Indo-US Trade**

Indian Americans are the 3rd largest Asian ethnic group in the US following Chinese and Filipinos. Indian immigrants are among the largest foreign populations becoming American citizens, ranking 2nd in US naturalisations in 2015. Indian Americans are among the wealthiest ethnic groups in the US with a median household income of over \$ 100,000. India is the 3rd largest recipient of remittances from the US with an estimated \$ 12 billion sent in 2015. There

are 200,000 Indian citizens studying in the US today. There are approximately 4 million Indian-Americans in the US enhancing this strategic relationship, which extends far beyond trade.

Between 2007 and 2017, bilateral trade between the two countries rose nearly 120 percent to \$ 126 billion, and US foreign direct investment into India jumped nearly 300 percent to \$ 44.5 billion. India's exports to the US in 2017-18 stood at \$ 47.9 billion, while imports were \$ 26.7 billion. The trade balance is in favour of India.

After the Trump administration took over, a number of actions that have been initiated specially regarding China and Pakistan have considerable advantages to India. However, President Trump's utterances about India, especially on trade-related issues, are causing great concern to India.

On October 1, Trump accused India of having a high tariff and described it as a tariff king. In a function at the White House on Diwali eve, President Trump said, referring to India-US trade negotiations, aimed at narrowing a \$30 billion trade deficit, "We're trying very hard to make better trade deals with India. But they're very good traders. They're very good negotiators. You would say right. The best. So we're working. And it's moving along."

PM Narendra Modi met US Vice President Mike Pence in Singapore in November 15. The Modi-Pence meeting took place in Singapore on the sidelines of the Association of Southeast Asian Nations Summit and the East Asia Summit. It was their second meeting. On the agenda were the importance of a free and open Indo-Pacific, defence, trade, restrictions on H-1B visas and counterterrorism cooperation. PM Modi pointed out to Pence that in the past two years, since Trump assumed office, US exports to India had grown by 50 percent and it is perhaps the only country where the deficit is actually reduced.

**Trade Balance.** The Trump administration, which views bilateral trade balances as an indicator of the health of a trading relationship, has taken issue with

the US trade deficit with India (\$ 27 billion deficit in goods and services trade in 2017), and has criticised India for a range of "unfair" trading practices. India favours taking a broader view of their trade ties beyond the trade balance. The consequences of trade deficits are contested.

On June 1, 2018, the United States began applying 25 percent steel and 10 percent aluminium tariffs. The tariff hikes apply to all countries; India did not receive an initial exception like some trading partners, nor negotiate an alternative quota arrangement. India supplied 2.6 percent (\$ 761 million) of US steel and 2.2 percent (\$ 382 million) of US aluminium in 2017. It notified the World Trade Organisation (WTO) of its plans to retaliate against the United States with tariffs on \$ 1.4 billion of US goods (e.g., nuts, apples, steel, and motorcycles), but has deferred applying the tariffs until November 2, 2018, in hopes of a bilateral resolution. India also filed a WTO complaint against the US tariff increases, and joined related complaints lodged by other WTO members. It is not known what has happened to India's action on tariffs on selected US goods.

In September, India announced plans to raise duties on "nonessential" goods (e.g., some precious stones, steel, and consumer electronics) from all countries to curb imports in order to support its depreciating rupee. This follows a pattern of tariff hikes by India in recent years (such as on cellphones and solar panels), as well as long-standing US concerns over India's tariff regime. The US thinks India has relatively high average tariff rates, especially in agriculture, and can raise its applied rates to bound rates without violating its WTO commitments, causing uncertainty for US exporters.

**Generalised System of Preferences (GSP).** In April, the United States launched a review of India's eligibility for GSP, a US programme that gives duty-free tariff treatment to certain US imports from eligible developing countries to support their economic development. As many as 3,500 Indian products from sectors such as chemicals and engineering get duty-free access to the US market under the GSP, introduced in

1976. The review concerns India's compliance with the GSP "market access" criterion and also relates to US medical and dairy industry market access petitions. Continued GSP eligibility is a top priority for India, GSP's top beneficiary. GSP accounted for 12 percent (\$ 5.6 billion) of US goods imports from India in 2017.

**Services.** The United States and India are competitive in certain services industries. Barriers to US firms' market access include India's limits on foreign ownership and local presence requirements. For India, a key issue is US temporary visa policies, which affect Indian nationals working in the United States. India is challenging US fees for worker visas in the WTO, and monitoring potential US action to revise the H-1B (professional worker) visa programme. India also continues to seek a "totalization agreement" to coordinate social security protection for workers who split their careers between the two countries.

**Agriculture.** Sanitary and phytosanitary (SPS) barriers in India limit US agricultural exports. The United States questions the scientific and risk-based justifications of such barriers. An ongoing issue is India's purported compliance with a WTO decision against its ban on US poultry imports and live swine due to avian influenza concerns; the WTO held that India's measures violated WTO SPS rules. Each side also sees the other's agricultural support programmes as market-distorting; India's view of its programmes from a food security lens complicates matters.

**Intellectual Property (IP).** The two sides differ on how to balance IP protection to incentivise innovation and support other policy goals, such as access to medicines. India's IP regime remains a top concern for the United States, which designated India again on its "Special 301" Priority Watch List for 2017, based on such concerns as its treatment of patents, infringement rates, and protection of trade secrets.

**Localisation Trade Barriers.** The United States continues to press India on its "forced" localisation practices. Initiatives to grow India's manufacturing

base and support jobs include requirements for in-country data storage and local content for government procurement in some sectors.

**Investment.** India has made FDI reforms, such as raising foreign equity caps for insurance and defence, but barriers remain in multi-brand retail and other sectors. India's regulatory transparency and judicial infrastructure present challenges for US investors. Two-way US-Indian FDI are associated with US jobs and exports in a range of economic sectors, but US direct investment in India has prompted some concerns about offshoring.

**Defence Trade.** The United States urges more reforms in India's defence offsets policy and higher FDI caps in its defence sector.

### Current Negotiations and Agreements

**Bilateral Engagement.** The United States and India reportedly are in "intensive" negotiations to address key trade issues, such as on the US steel and aluminium tariffs and India's GSP status. These talks may build on the inaugural 2+2 Dialogue in September 2018. Other bilateral dialogues include the government-to-government Strategic and Commercial Dialogue (S&CD) and Trade Policy Forum, and the private sector-based CEO Forum.

The United States and India do not have a bilateral free trade agreement (FTA). In October 2018, President Trump stated that India expressed interest in negotiating an FTA. Some India watchers advocate an FTA, while others question India's willingness to open its markets. Under the Obama administration, the two sides sought a bilateral investment treaty (BIT), but negotiations stalled.

**Regional Integration.** India is party to negotiations on the Regional Comprehensive Economic Partnership (RCEP) with China and 15 other Asia-Pacific nations. Seven RCEP members (but not India) are part of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), concluded by the proposed TPP's 11 remaining parties. President



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Trump, who prefers bilateral negotiations, ceased US participation in TPP, and recently announced plans to negotiate a bilateral trade agreement with Japan.

India has long sought membership in the Asia-Pacific Economic Cooperation (APEC) forum, a grouping of the United States, China, and 19 other economies. The United States previously stated that it welcomes India in APEC, though some have questioned if India is willing to take on economic liberalisation sufficient for APEC membership.

**WTO.** As WTO members, the United States and India negotiate multilaterally to liberalise trade, but their differing views impeded the Doha Round. The recent Trade Facilitation Agreement (TFA) to remove customs barriers (the first multilateral agreement concluded in over 20 years) was initially blocked by India. The TFA entered into force in 2017 after India reversed its position, in light of a US-Indian understanding not to challenge specific food security programmes until a permanent WTO solution is reached – a top priority for India. Presently, however, there is no consensus on a future work plan. There also

are many institutional questions about the WTO's ongoing relevance.

President Donald Trump does not believe in any multilateral mechanism like WTO. He is setting the agenda for all bilateral trades relations. President Trump has stopped appointment of Judges of WTO. After another four months WTO will cease to function without any judges. International trades resolutions would be on completely different path. WTO has to adapt to these norms dictated by the US or perish. India is a non-player in this. Record of Indian FTAs in abysmal.

Questions on US-India trade relations may include:

- How do US and Indian tariff and other trade policies affect their shared goal to expand bilateral trade ties?
- What are prospects for current US-India trade talks to negotiate a resolution to trade frictions? Should the United States look to multilateral or regional options?
- Are bilateral FTA negotiations or a revival of BIT negotiations a possibility in the near term?

### Notes

1. Maj Gen P. K. Mallick, VSM (Retd.), "2+2 Dialogue and Indo-U.S. Relations," VIF, October 2018, Available at: <https://www.vifindia.org/paper/2018/october/11/two-plus-two-dialogue-and-indo-us-relations>
2. Maj Gen P. K. Mallick, VSM (Retd.), "US-China Trade War: Analyses of Deeper Nuances and Wider Implications," VIF, September 2018, Available at: <https://www.vifindia.org/paper/2018/september/us-china-trade-war>
3. "Iran Sanctions," Congressional Research Service Report, November 28, 2018.
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*The contents of this Issue Brief are based on the analysis of material accessed from open sources and are the personal views of the author. It may not be quoted as representing the views or policy of the Government of India or Integrated Headquarters of MoD (Army).*



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