Chapter 2

Barriers to services trade between EU and India and areas of interest in a possible FTA[61]

Although services trade is an important trading sector for the EU and India and bilateral trade between them is relatively strong, there are significant barriers to services trade between the two. Hence an FTA offering substantial coverage of services *à la* GATS Article V could help deliver significant improvements in access to both markets. Our judgement, given the political economy of reforms in India (for instance, see World Bank, 2004), is that it would also allow a more rapid liberalisation of India's services than can be accomplished unilaterally.

Imports of services to India suffer from a range of horizontal barriers such as archaic laws, multiplicity of rules and regulations, inconsistent practices across states and multiplicity of contact points at different levels of bureaucracy, regulatory gaps, public sector bias, and limits on foreign investment and ownership. In general, India's services suffer from simultaneously excessive and inadequate regulation. Many explicit and implicit restrictions – tax incentives, labour laws, for instance – favour small scale units and discriminate against larger firms. Weaknesses in the institutional and regulatory regimes have resulted in disparities in the quality of services and the abilities of professionals. Legitimate universal access goals are pursued not based on the most efficient means but through elaborate restrictions involving efficiency losses without any commensurate gain in equity and access. These policies result in domestic firms that are sub-optimal in size, operate in a weakened regulatory environment, and are burdened with the legacy of pursuing equity goals (For instance, see World Bank, 2004).

In addition to these horizontal problems, Table III.6 below provides a list of sector-specific policy barriers in Indian services.

Considering the recent history of EU–India bilateral trade relations in services, the EU has raised specific market access/national treatment issues and regulatory impediments with India in the case of satellite services (lack of national treatment), telecom (lack of national treatment and burdensome domestic regulation), private security agencies (limits on FDI), courier (proposed legislation on taxation) and air transport services (tax on business/first class tickets for passengers embarking in India). These would seem likely to be key EU demands in an FTA. In terms of specific sector interests, Brussels as well as EU Member state delegations in New Delhi point to key strategic interests in the Indian market in banking, finance and insurance; retail; accountancy; legal; telecom and maritime services. Sectors like IT and telecom are already significantly liberalised in India while

Table III.6. India's autonomous policy on services

Service sector	Issues
Accountancy	FDI not allowed; FSP not allowed to undertake statutory audit of companies. Only partnership firms allowed with number of partners limited to 20.
Architecture	No cap on FDI. Foreign architects need to be registered by the Council of Architecture as individuals. Appointment of foreign architects as consultants to Indian architects subject to case-by-case approval by GoI.
Legal	FDI not allowed. International law firms not allowed presence. Indian advocates cannot enter into profit-sharing arrangements with non-Indian advocates.
Computer-related or Software Services	No cap on FDI. No explicit barriers on commercial presence of foreign firms. Intellectual property laws are not effectively enforced. Tax structure discourages movement along the value chain.
Management and Consultancy	No cap on FDI. Foreign firms must be incorporated in India.
Postal	FDI not allowed. Price preferences to state postal operators. No functional demarcation between regulator and service provider. Imprecise definition of USO.
Courier	No cap on FDI but subject to FIPB approval.
Telecommunications	Fully owned foreign firms allowed in some segments, though voice telephone services continue to have 49 per cent FDI limit. Policy uncertainty on tariff, inter-connect regimes, USOs remain.
Audio-visual Services	No cap on FDI in motion picture but FDI not allowed in radio and television services. Up-linking restrictions.
Construction and Related Engineering	No cap on FDI. Price preference to PSUs, as well as a large number of barriers that are external to the sector: land ceiling; unclear land titles; minimum area restrictions; minimum capitalisation norm; restriction on repatriation.
Distribution	No cap on non-retail segments and 51 per cent limit on FDI in single brand product retail. Lack of clear responsibilities within the government. Large unorganised sector with low tax compliance. Land market distortions.
Education	FDI permitted without cap through the automatic route.
Environmental	FDI permitted without cap through the automatic route.
Financial services (Insurance)	Foreign equity limit of 26 per cent in most segments. Minimum capitalisation norms; Funds of policy-holders to be retained within the country. Compulsory exposure to rural and social sectors and backward classes.
Financial Services (Banking)	Private domestic equity limited to 49 per cent and foreign equity limited to 74 per cent with 10 per cent voting rights. FDI and portfolio investment in nationalised banks subject to overall statutory limits of 20 per cent. Mandatory priority sector lending and rural branch requirements for domestic banks.
Health and Social Services	No cap on FDI. Movement of FSP subject to registration by the Medical/Dental/Nursing Council of India. FSP cannot provide services for profit. Responsibilities divided between the Centre and states. Absence of a standardised accreditation system.
Tourism	No cap on FDI. Land market distortions.
Recreational, Cultural and Sporting	FDI is permitted in entertainment services (including theatre, live bands and cultural services), libraries, archives and museums. FDI is restricted to 26 per cent through the Government route in print media. FDI is not allowed in News Agency Services. Lottery, betting and gambling is not allowed.
Transport	100 per cent FDI in maritime and road transport but significant restrictions in air and rail transport. Restrictions on inter-state movement of goods. Overlapping responsibilities and coordination issues between government departments (e.g. multi-modal transport).

Source: World Bank (2004); India's FDI Policy (2006); Gasiorek et al. (2007).

others such as construction, health, banking and insurance, education and courier are moderately liberalised. Legal, accountancy, postal and distribution services, on the other hand, are completely closed at present. We presume, however, that the EU would still have objectives in all of them – to consolidate market access in India in IT and telecom services; to significantly improve market access in the moderately liberalised services; and to open up the closed sectors.

The important issues for India are market access for cross-border services (Mode 1[62]) and service professionals (Mode 4 both contractual service providers and service professionals related to Mode 3) and increasingly foreign investment in services abroad (Mode 3). The Indian Ministry of Commerce and Industry maintains that the focus sub-sectors are likely to include computer and related services, financial services and energy services. In Mode 1, India would be looking at increasing the coverage of sub-sectors to research and development, dental and health related sectors and telephone-based services. In Mode 3, issues for negotiation relate to the need for huge minimum capital requirements imposed by the EU, residency requirements, restrictions on legal entity and the absence of national treatment. In Mode 4, India would like to press for the mutual recognition of qualifications to make effective market access possible. Other issues relate to the avoidance of double taxation on social security benefits of Indian services professionals abroad; visa issues and labour market and economic need tests for Indian services providers abroad; and the fact that EU domestic regulation is more burdensome than necessary. In addition to specific modal interests, general issues of priority for India are transparency in EU policies and their implementation and the need for harmonisation of EU policies across Member States. As an illustration from the financial services sector, India will argue that banking sector licences granted by any one EU Member be acceptable across the EU as the need to apply for separate licences in each EU Member state has been pointed to as one of the cumbersome elements of trade in banking services with the EU by Indian government officials.

From India's perspective, it may be easier to negotiate provisions on Modes 1 and 3 into a possible EU–India FTA on services and also examine regulatory issues vis-à-vis Mode 4. It would, however, be more difficult to negotiate mutual recognition agreements across services between these two trading partners. From a European perspective, it may be much easier to consolidate market access in India's liberal sectors and increase access in the moderately liberalised ones. Opening up completely closed sectors would, however, appear to be the most difficult from a negotiating standpoint as far as a potential services agreement between the EU and India is concerned.

Notes

61 Recall from Part I that the information in this section is based on detailed discussions with officials, summarised in Gasiorek et al. (2007) and a number of recent press reports.

62 The GATS classifies four 'modes' of services delivery (these are the different ways in which services can be traded across borders): **Mode One**, which is the cross-border supply of services. An illustration of this is business process outsourcing units in India doing online medical transcriptions. **Mode Two** is consumption of services abroad, e.g. Indian tourists going to the

EU. **Mode Three** is commercial presence, such as Deutsche Bank setting up operations in Mumbai. Finally, **Mode Four** is the movement of natural persons across borders to deliver services, such as Indian software workers delivering and testing a system in the UK.