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Coherent Approach to Trade and Regulation of Services: Lessons from India

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COHERENT APPROACH TO TRADE AND REGULATION OF SERVICES: LESSONS FROM INDIA[1]

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1. Introduction:

The services sector has seen a rising contribution not only in India's domestic output but also in its international trade and investment flows. Services share in total output has risen from 41% in 1990-91 to 5% in 2013-14 (Economic Survey, 2014-15). The same is also true for the contribution of services to exports, which has grown from 20% (1990) to 33% (2013) (UNCTAD Statistics Database). The rapid growth of India's services sector in the post-reform era has played a critical role in the country's emergence as one of the fastest-growing economies in the world. The services sector has also facilitated India's integration with the world economy.

The current dynamism exhibited by India's services sector is largely a reflection of the liberalization and reform process carried out in this sector and in the wider economy since the 1990s. The liberalization process has varied across different kinds of services. Some have been liberalized rapidly and extensively for both domestic and foreign participants. Other services remain limited for private participation or have been opened up mainly for domestic players and remain closed to the presence of foreign establishments. While considerable liberalization and regulatory reforms have taken place over the past decade or more for some services such as telecom, banking, air transport, the process has been slow and halting for others such as legal and accountancy services. Key pieces of legislation have taken a number of years to be passed, owing to domestic stakeholders' sensitivities, lack of political will and consensus, and a variety of social and economic concerns.

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[1] Based on an earlier paper of the author titled "Service Sector Liberalization in India: Key Lessons and Challenges", co-authored with Prof. Rupa Chanda of IIM Bangalore (Chanda, R & Gupta, P, 2011).

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This paper provides an overview of India's service sector liberalization and discusses the regulatory challenges that have emerged and which are likely to arise as the liberalization process in services continues in India. It highlights the importance of regulatory coherence while opening up an economy by outlining liberalization process in two specific services - telecom and retail distribution - in India. It concludes by providing key takeaways and lessons from India's experiences of services liberalization.

2. India's Service Sector Liberalization:

India has adopted a cautious, gradualist, and conservative stance and learning-by-doing approach for the liberalization of its services sector. It also preserved policy space by first initiating unilateral liberalization, rolling back liberalization at times and over time binding this in, either to the full extent or below the autonomous level.

At the multilateral level, India has committed six services under the WTO. These include Business services; Communication services; Construction and related engineering services; Financial services; Health related and social services; and Tourism and travel related services. At the bilateral level, India has signed comprehensive free trade agreements with Singapore, Korea, Japan and Malaysia consisting of significant services liberalization. As compared to the six services committed under the WTO, India has committed nine, eleven, eleven, and ten sectors under the Singapore, Korea, Japan and Malaysia agreements respectively. More importantly, India has undertaken significant autonomous liberalization in various services including negative list of services for allowing 100% FDI, subject to sectoral regulations.

A careful evaluation of the liberalization process in India's services sector reflects that the process has varied across services and it has been fraught with debate and controversy over the desired pace, extent and implications of the reforms. The following discussion highlights the nature of liberalization and regulatory reforms that have been undertaken in two important services – telecom and retail distribution services, followed by the regulatory challenges that have arisen in the process.

2.1 Telecom Services:

The telecommunication service sector is perhaps the showpiece of India’s liberalization and reform programme. Telecommunication reforms commenced with the introduction of the National Telecom Policy (NTP) of 1994. This policy called for the systematic liberalization of the sector by opening up basic services to private telecommunication companies and setting up an independent statutory regulatory body, the Telecom Regulatory Authority of India (TRAI), in 1997. The first major step in the sector’s liberalization was the entry of private participants into the basic telecommunication services segment in 1997 on a duopoly basis, with both the DOT and private participants participating in this segment. Licenses were rationed and foreign equity participation in both basic and cellular mobile services was permitted up to 49% (FDI Policy, 1997).

The second phase of telecommunication reforms began with the introduction of the NTP of 1999 under a new government. The policy stated its commitment to an independent regulator and more clearly defined the role of TRAI. In August 2000 national long-distance telephony was opened up to private operators, as was intended under the NTP of 1999. In 2001 unlimited entry was permitted in each policy circle for the provision of basic and mobile services. The license regime was migrated from a fixed fee scheme to one of revenue sharing. In April 2002, the international long-distance service was opened up to competition by privatizing the public provider and removing restrictions on the number of operators in this segment. Other liberalization measures undertaken after 1999 include the opening up of internet telephony; disinvestment and corporatization of public sector telecommunication providers in some metros; introduction of new technologies and forms of service delivery; and approval for internet service providers to set up international internet gateways.

Since February 2005 the government has increased the foreign holding limit from an earlier limit of 49% to 74% (FDI Policy, 2005). The affected services are fixed-line basic services, cellular services, unified access services, national and international long-distance telephony, public mobile trunked services, global mobile personal communication services, and various value-added services such as voice mail and e-mail services. Subsequently, FDI was permitted up to 100% in value-added services such as e-mail, voice mail, electronic data interchange, on-line information and data processing, and internet service provision without gateways (FDI Policy, 2011). Presently, 100% FDI (Automatic up to 49%, Government route beyond 49%) is permitted in all telecom services including telecom infrastructure providers (FDI Policy, 2015).

Thus, significant liberalization has happened in India’s telecom sector. Competition has been encouraged, with the entry of both local and foreign providers, the granting of greater flexibility to existing participants with the waiver of various obligations and permission to provide additional services, and substantial reductions in entry and licensing fee shares from providers.

2.2 Retail Distribution Services:

Modern distribution networks started developing in India after liberalization and reforms in the 1990s. However, it is only recently that the sector has undergone major changes. The nature and extent of liberalization of the retail distribution service sector have varied across its different segments. Non-retail segments, such as wholesale trading, export trading, cash and carry, and franchising, are far more liberalized than the retail segment.

In the non-retail segments, FDI of up to 100 % with FIPB approval is allowed for the trading of items that are sourced from the medium-scale sector. It is also allowed for the test marketing of items for which the company has approval for manufacturing, subject to certain conditions. FDI up to 100% through automatic route is permitted for the trading for exports and e-commerce activities (only on a business-to-business basis and not in retail trading). FDI participation up to 100% through automatic route is also allowed in cash-and-carry wholesale trading.

In the retail segment, the government had allowed 51% FDI in single-brand retailing in 2006, subject to FIPB approval and certain conditions. Presently, 100% FDI (Automatic up to 49%, Government route beyond 49%) is permitted in single brand retail trading subject to conditions such as 30% local sourcing. However, these conditions may be relaxed for single brand retailing of high technology products, such as Apple iPhones. FDI in multi-brand retailing is allowed upto 51% through government route and subject to conditions, such as minimum amount, investment in back-end infrastructure etc.

E-commerce, an important segment of distribution services, is growing very fast in India but it has also been subject to a gradual and hesitant liberalization process. As mentioned earlier, initially only business to business (B2B) e-commerce was open for foreign investment and FDI in business to consumer (B2C) e-commerce was not permitted in India. Very recently, the government has categorically defined various models of e-commerce and their applicable conditions for FDI. As per the new notification issued in March 2016 (Press Note 3, 2016, Government of India), 100% FDI is allowed in B2B e-commerce. For B2C E-commerce, 100% FDI is allowed only in market pace model subject to certain conditions and in inventory-based model of B2C e-commerce, FDI is not allowed.

Overall, liberalization in this sector has been difficult because of the lack of political will and concerns over impact on small retailers. However, recently the government has introduced new measures to reform this sector and to remove the inconsistency between the liberalization of 'brick and mortar' retail and e-commerce.

3. Regulatory Challenges faced by India

A careful analysis of the services liberalization process in India reveals that the reform experience in various services has not been smooth. It has taken time to introduce new legislation on reforms and liberalization. Proposals and bills have been delayed for long periods and have not passed into Acts. This can be largely attributed to a lack of political will. The reform experience has been an evolving one of learning through experience. The approach has been gradualist and hesitant-first getting evidence on benefits and challenges following partial liberalization, before liberalizing further.

It is also important to note that services liberalization being experimental in nature, India did not hesitate to roll back liberalization measures not suitable for its domestic concerns. Two prominent examples of such rollbacks are retail services due to political economy concerns and banking services due to financial and economic stability concerns. Government allowed 51% FDI in multi brand retail (MBR) in November 2011 but withdrawn it after strong political and public opposition. It again allowed 51% FDI in MBR in 2012. Similarly, FDI in banking services was allowed upto 74% through automatic route in 2005 (FDI Policy, 2005) but after the global financial crisis, the government in 2010 stipulated that FDI in banking services is allowed through automatic route only up to 49% and beyond 49% and up to 74%, it is allowed through Government route (FDI Policy, 2010). These rollbacks have been possible because India preserved its policy space by first undertaking unilateral liberalization without binding it at multilateral or bilateral level.

The market structure and domestic policies and frameworks have shaped the pace and extent of liberalization across different services. The presence of fragmented market structures, with a large number of small unorganized participants and related concerns about displacement following liberalization, have hindered liberalization in retail services. In other service subsectors, such as telecommunication and financial services, the dominance of public sector entities and the government’s reluctance to relinquish control have been the main stumbling block.

There has also been conflict of interests among different stakeholders. These conflicts have been between the government and private participants; the government and independent regulators; public sector entities and private participants; large and small private domestic participants; large domestic and large foreign participants; and regulatory bodies or professional councils and the government or foreign participants.

There has been difficulty in balancing equity and efficiency concerns, and public and private interests. This also extends to ensuring the right balance between institutional autonomy and regulation, so that while participants are not burdened with onerous regulations, they also do not function in ways that undermine the larger public interest.

The analysis of India’s liberalization strategy in relation to its multilateral, regional and bilateral commitments shows that the latter were not catalysts for India’s liberalization process. Liberalization of services has been undertaken as part of India’s general economic reform programmed and has been shaped by domestic needs. Multilateral commitments and offers have generally been less than the status quo. This indicates an overall conservatism in the negotiating strategy, and an allowance for leverage in negotiations for certain services in the future. Although regional or bilateral commitments have been generally more liberal than those made multilaterally, autonomous and non-binding reforms have led the way in almost all services.

4. Key Takeaways and Lessons from India's Experiences for Coherent Regulations in Services

The liberalization experience of India reinforces the importance of the regulatory environment in the services sector. As regulations are an inherent part of the services sector, any liberalization attempts are bound to be confronted with regulatory challenges. Therefore, liberalization has to be preceded by appropriate regulatory and legislative reforms. Instituting appropriate regulatory bodies, clearly defining their roles and improving governance are just as important as pursuing liberalization. There also needs to be a strengthening of regulatory and enforcement capacity. In the absence of this, liberalization can lead to undesirable outcomes. Managing public perception and removing misinformation is also vital for success of regulatory reforms. Many times, public opinion is formed on the basis of media reporting which may or may not be based on facts and objective analysis. Last but not the least, it is important to open not only 'at the border' but also 'behind the border' to reap the complete benefits of liberalization. In the absence of coherent liberalization of 'at the border' and 'behind the border' restrictions, governance problem may arise due to surrogate or back door entry of foreign service providers.

The UNCTAD can play an important role in capacity building and creating awareness about specificities of services trade among policy makers and implementers by making them understand the liberalization experiences of other countries and how these countries managed to overcome the challenges associated with such liberalization. As shown by India's experiences, preserving policy space is very important for services liberalization and the policy makers should take cognizance of the implications of new developments, such as, mega-regionals, e-commerce, GVCs etc. for the regulatory coherence and for the policy space available to developing countries and LDCs. The UNCATD can advocate having a fine balance between prudential and protectionist regulations and promote just and fair use of regulations in order to achieve Sustainable Development Goals (SDGs).

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