India China Services Trade: Promise or Predicament?

Suparna Karmakar
Nipika Walia Sharma
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Abstract

India-China bilateral trade has witnessed a huge spurt over the years, and China is now one of India’s largest trading partners. Amid growing trade relations between the two nations, however, increasing trade deficit with China has become a major concern for India. In order to reverse this trend, Indian government is looking at possible solutions, one of which is exploring the bilateral trade prospects in tradable services, a sector in which the country has demonstrated competitive advantage. This paper explores the prospects and challenges for India in garnering a higher market access into the large and nascent domestic services market in China.

It argues that the authoritarian nature of governance in China poses unique challenges yet unencountered by the Indian service economy in its external market forays. India’s service sector prowess has actually manifested in market economies with minimal overt government control. However, in a tightly monitored regime like China’s, where operational freedom is limited even in the few sectors that have been opened up, Indian service sector companies may face the problem where its comparative advantage is negated because of the existence of favoured domestic incumbents. Optimistic projections of potential market access for Indian firms in China’s huge domestic market and government initiatives to increase bilateral service trade therefore should factor in this chasm.
1. Introduction

Amidst a global slowdown and a softening of growth in the BRICs\(^2\), Asia’s two emerging economy giants seem to be forging a new economic relationship. Despite being trillion dollar plus neighbouring economies (with China’s GDP at USD 5.7 trillion as opposed to India’s 1.7 trillion, 2010 data) dealings between India and China have been stunted in many ways. Traditionally having limited economic interface and in modern times competing for access to foreign natural resources despite sharing the podium in several regional groups, it’s only recently that the two countries have agreed to cooperate and jointly bid for foreign energy resources in times to come. And yet a huge shift has taken place in the direction of Indian trade flows. China is now India’s third-largest trading partner in goods, and the biggest if Hong Kong is included.

**Table 1: India-China Bilateral Trade trends**

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>India’s Export to China</strong></td>
<td>13.70</td>
<td>20.86</td>
<td>23.41</td>
</tr>
<tr>
<td><strong>Growth (%)</strong></td>
<td>-32.63</td>
<td>52.19</td>
<td>12.26</td>
</tr>
<tr>
<td><strong>China’s Export to India</strong></td>
<td>29.57</td>
<td>40.88</td>
<td>50.49</td>
</tr>
<tr>
<td><strong>Growth (%)</strong></td>
<td>-6.17</td>
<td>38.25</td>
<td>23.50</td>
</tr>
<tr>
<td><strong>Total India-China Trade</strong></td>
<td>43.28</td>
<td>61.74</td>
<td>73.90</td>
</tr>
<tr>
<td><strong>Growth (%)</strong></td>
<td>-16.55</td>
<td>42.66</td>
<td>19.71</td>
</tr>
<tr>
<td><strong>Trade Balance for India</strong></td>
<td>-15.87</td>
<td>-20.02</td>
<td>-27.08</td>
</tr>
</tbody>
</table>

Source: Trade statistics from the Ministry of Commerce and Industry, Government of India

Rising trade and economic cooperation with China has been good for India, insofar as it is importing cheap Chinese capital goods\(^3\). However, India does not produce much of what China wants to buy\(^4\); India’s main merchandise exports to China are the lesser ‘other raw materials’, mainly minerals and cotton, while manufactured/processed items of export include refined petroleum products, gems and jewellery, transport equipment and machinery account for a smaller share. Thus, for every dollar worth of exports to China, India imports three, leading to a rising trade deficit that reached (an estimated) USD 40 billion in the year to March 2012, or about 2 percent of GDP\(^5\); in 2011, the trade deficit for India had stood at USD 27.08 billion, increasing by 35.26 percent from year 2010 (Table 1). China today accounts for a fifth of India’s overall trade deficit with the world, and over half if oil is excluded.

Chart 1: Bilateral Trade balance (CEIC database)

As can be seen from Chart 1, the spurt of India’s trade with China is less than a decade old\(^6\) and has so far been growing without any formal preferential trade agreement between the two governments. No bilateral free-trade agreement exists; the 2005 report of the Joint Study

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\(^2\) The acronym indicates the 4 high growth emerging market economies, namely Brazil, Russia, India and China.

\(^3\) India’s heavy industries significantly rely on intermediate-raw materials and finished goods imports from China. The top five items of import from China are electrical machinery and equipment (USD 11.9 billion), mechanical machinery and appliances (USD 7.7 billion), project goods (USD 3.2 billion), organic chemicals (USD 3.85 billion) and iron and steel (USD 2 billion). In the last couple of years, import of power and telecommunication equipment has seen a huge rise. In 2010-11, import of mobile phones and other kinds of wireless phones reached USD 4.1 billion, up 60 percent year-on-year from 2009-10. Similarly, import of project goods topped USD 3.2 billion in the last financial year, up 54 percent from 2009-10.

\(^4\) This has historically been the status, a problem that the British colonial empire tried to resolve by forced exports of Indian opium, leading to disastrous consequences that continue to influence China’s foreign policy.

\(^5\) The Economist (2012), ‘India and China: Friend, enemy, rival, investor’, June 30; http://www.economist.com/node/21557764?scode=3d26b0b17065c2cf29c06c010184c684. Recent media reports indicate that analysts are expecting the deficit to soar to USD 60 billion the current financial year.

\(^6\) India and China resumed trade in 1978 and signed the Most Favoured Nation Agreement in 1984. Interestingly however, the spurt in bilateral trade begins shortly after China’s accession to the WTO, and the trend follows China’s explosive trade integration with the rest of the world. At the same time, bilateral merchandise trade between Indian and China grew from USD 2.92 billion in year 2000 to USD 61.7 billion in year 2010; in 2011, the bilateral merchandise trade between the two countries reached a new height of USD 74 billion.
Group of the two countries evaluating the prospects and potential of a FTA has not yet transcended into concrete trade negotiations though the leaders agreed to establish an India-China Strategic and Cooperative Partnership for Peace and Prosperity7. However, the two countries signed memorandums of understanding and a number of cooperative agreements on various trade and non-trade issues8, viz. customs cooperation, finance, civil aviation9, SPS issues, education, human resource, auditing, consulting, tourism, marine transportation, environment, science and technology, films, and an agreement on mutual recognition of academic certificates and degrees10. Furthermore, India is currently evaluating its potential gains from a preferential trade deal with the customs territory of Chinese Taipei, which could act as a stepping stone for closer trade relations with the Chinese mainland.

 Amid growing trade and investment relations between the two nations, on the other hand the increasing trade deficit with China has become a major concern for India. In order to reverse this trend, the Indian government is exploring a range of possible solutions11, including enhancing bilateral trade in commercial services, a sector in which India has demonstrated competitive advantage. Currently, the service trade between India and China exists only on a minimal scale. A contributing factor has been that China has so far opened its market very selectively, notwithstanding the apparently liberal GATS12 commitments, as evidenced by the "2011 investment guidance catalogue"; as a result, neither the software industry nor pharmaceutical firms from India have done well in their Chinese ventures. It is in this context that this paper explores the prospects and challenges for India in garnering greater market access into the large and growing domestic services market in China. The focus of this paper is to analyse the state of play in services market access and related domestic concerns in India and China, and to evaluate the prevalent barriers in the form of restrictions on entry, sector regulations as well as competition from China’s other trade partners in the region in order to realistically assess India’s ability to gain additional market access in China.

Furthermore, in undertaking this analysis, we should remember that in the present global economic scenario two facts stand out. First, overall demand for goods and services is much weaker, both in the partner countries as well as the rest of the world13, than it was in the go-go years before the recession, which has an impact on a country’s ability to increase net exports. According to preliminary estimates by the WTO and UNCTAD, in the first quarter of 2012, world exports of commercial services rose by 3 percent year-on-year (on balance-of-payments basis, current price, not seasonally adjusted), similar to what was recorded in the fourth quarter of 2011 (annualised); the corresponding figures for India and China respectively are 6 percent and -4 percent14.

Second, most of the economic gains in China, and particularly in recent years, have gone to the upper echelons of society while the middle class has fallen behind in relative terms. This development will have an impact on the type and value of goods and services that can be traded, and the trade partner’s relative competitive advantage in those sub-sectors matter more than the general state of competitiveness. Concerns about domestic income inequality, though muted, are also seen in the angst

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7 The partnership is based on the principles of Panchsheel, mutual respect and sensitivity for each other’s concerns and aspirations, and equality; provides a sound framework for an all-round and comprehensive development of bilateral relations based on mutual and equal security, development and prosperity of the two peoples; and contributes to jointly addressing global challenges and threats. The two sides also reiterated their intention to promote regular ministerial-level exchanges and make full use of the India-China strategic dialogue and other bilateral dialogue mechanisms.


9 To boost bilateral trade, the 2005 MoU on Civil Aviation liberalised the major air links between India and China with multiple designation of carriers and an ‘Open Skies’ policy for cargo, increased capacity entitlements and code-sharing, points of call and the number of intermediary and beyond points. The MoU also provides for simplification of the visa procedures for operating and cabin crew, employment of foreign pilots by designated airlines of either party, use of dry leased aircraft for both combination services and cargo services.


11 Basu, Nayanima, 2012, ‘Govt looks for ways to cover trade gap with China’, July 16, Business Standard. “The commerce and industry ministry is in a damage-control mode, looking for ways to narrow its soaring trade deficit with China. With costs of products rising in China, the government is leaving no stone unturned to grab the opportunity of entering the Chinese market in full force, by organising buyer-seller meets and aggressively pushing China to buy more value-added products from India, instead of merely importing raw materials.”

12 The WTO General Agreement on Trade in Services.

13 In a periodic update of its economic forecast, the IMF maintained its forecast of 2012 global economic growth at 3.5 percent, but cut its forecast of growth for 2013 to 3.9 percent, down from the 4.1 percent estimated in April. Not surprisingly, however, the IMF has lowered India’s growth forecast by 0.7 percent to (a still optimistic) 6.1 percent for 2012, the steepest cut for any nation, and by a similar margin for 2013 to 6.5 percent.

about inequality between regions, as the coastal regions are roaring ahead while the central and western regions stalls, despite the recent government interventions. China is ramping up state spending to counter its sharpest decline in growth and employment since the financial crisis, and although policies to stabilise growth "include stimulating consumption and diversifying exports, currently the main task is to promote reasonable investment growth"\(^{15}\). Projections and assessment of effective market access therefore will need to reflect the reality of this moderation in growth prospects and the uniqueness of current investment and consumer demand in China.

The rest of the paper is structured as follows. Section 2 gives a brief outline of the status of services sectors in the two partner countries, and the trends and direction of their service trade flows, multilateral as well as bilateral. Section 3 follows with a discussion of state of liberalisation in selected service sub-sectors in China (effective domestic opening, in light of multilateral and FTA commitments) and identifies the sectoral market access challenges for India. The final section 4 concludes with an assessment of India’s service market access prospects in China, in view of the latter’s domestic conditions.

2. Services in India and China: Significance in the Domestic Economy and External Trade

While world trade in services is still dominated by the developed countries, emerging economies like India and China are now playing an increasingly important role; in 2010 India accounted for 4.4 percent of global commercial service (excluding intra-EU) exports and China’s share was 6.1 percent. Services are also an important source of export revenue for both. Further services trade liberalisation has the strong characteristics of a ‘win-win’ proposition for both governments and the private sector, in particular in the developing country markets like India and China where for operational as well as economic reasons public provisioning of services are sub-par when compared to the developed world. It is easy to see how governments can enact regulatory reforms and reduce discrimination against foreign service firms without incurring revenue losses, and still deliver enhanced efficiency to their underserved economies. Domestic firms can also gain through lower regulatory costs and greater market expansion, and foreign suppliers can gain through greater export opportunities. But before going onto to discuss the potential opportunities and concerns from further liberalisation, we will analyse the relevance and performance of services in the domestic economies of the two trade partners.

For over two decades, the service sector has served as an important engine of growth of the Indian economy. With a share in GDP at about 57 percent and much ahead of the contribution of agriculture and industries, services today account for a fourth of the total employment in the country. The service sector growth rate at constant prices has always been above the overall GDP growth rate since mid 1990s except for 2003-4 when the two converged; in 2011-12, the growth rate of services is estimated to be at 9.4 percent. In 2010, India ranked 11th in services Gross Domestic Product (GDP) among top 12 economies of the world\(^{16}\). Furthermore, the share of services in India’s overall trade performance has also been on the rise. India’s services exports grew at a compound annual growth rate (CAGR) of 20.6 percent in the period 2004-05 to 2010-11 while the imports grew at the CAGR of 20.2 percent for the same period\(^{17}\). Within the services sector, CAGRs of financial services (52.8 percent) and business services (29.2 percent) were higher, while that of software (at 21 percent) was low; in terms of size, however, software is a major services export category, accounting for 41.7 percent of total services exports in 2010-11. The overall openness of the economy reflected by total trade (including services) as a percentage of GDP showed a higher degree of openness at 50.3 percent in 2010-11. The service sector has also been a major contributor in FDI inflows with the cumulative share of 41.9 percent during the period of April 2000 to December 2011; the FDI equity inflows into the financial and non-financial service sector, computer software and hardware, and the telecommunications services account

15 Davis, Bob, 2012, ‘China Lifts Spending as Growth Weakens’, 10 July, The Wall Street Journal. To arrest the slowdown, the Chinese central bank cut interest rates twice in June and July, and officials have also accelerated approvals of investment projects, which are expected to provide a boost to the economy in the second half of 2012. Fixed asset investment as a proportion of output has also risen this year; such investment by state-owned enterprises expanded one-quarter in June.


17 Balance of Payments data, Reserve Bank of India.
for the bulk of this inflow. It must also be noted that in comparison with the manufacturing sector, India’s service sector continues to operate relatively unencumbered by policy and administrative intrusions.

### Table 2: Performance of the Service sectors in India and China’s economies

<table>
<thead>
<tr>
<th>Rank (Services GDP)</th>
<th>GDP (USD billion-current price)</th>
<th>Share of Services (% of GDP)</th>
<th>Services Growth Rate (%)</th>
<th>CAGR (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>11</td>
<td>1722.3</td>
<td>56.5</td>
<td>9.6</td>
</tr>
<tr>
<td>China</td>
<td>3</td>
<td>5739.4</td>
<td>42.1</td>
<td>10.1</td>
</tr>
</tbody>
</table>

Source: Chapter 10, Economic Survey, 2011-12

The share of services in China’s domestic GDP on the other hand falls behind the contribution of its manufacturing sector, though its services GDP is the third in the world. Domestically, there are also large regional disparities; the service sector accounts for 70 percent of the economy in Beijing, but only 20 to 30 percent in coastal areas. However in the aftermath of the ongoing global slowdown, the service sector is being promoted as a source of new opportunities for domestic economic growth. The importance accorded to the service sector can also be surmised from the fact that China’s 12th Five-Year Plan for National Economic and Social Development (2011-2015) has identified some services sectors for extensive promotion through creating favourable policy and institutional environment, promoting the new business formats, cultivating a larger range of services, business internet usage, cultivating new tourism hot spots etc. In particular, health-care and new age IT services are considered the new Strategic Emerging Industries (SEIs) and are expected to witness a major boost in terms of significant investment from the public and private sources. Moreover, the education sector has been identified for major reforms, including in science and technology, as increasing investment in human capital is an important agenda now.

Though China’s service sector accounts for only 41.8 percent of its GDP, its CAGR for the period 2001-10 is about 11.3 percent (as compared to that of India’s at 9.4 percent; Table 2). Data from the WTO indicate that while India is still considered the global commercial services powerhouse, China overtook India in the second half of the last decade and now accounts for 6.1 percent of global commercial service (excluding intra-EU) exports, with China’s exports of commercial services expanding by 32 percent in 2010. China has decided to further open its service and trade sectors, facilitating market access for its competitive service industries including transportation, construction and travel in the global service market. This is to complement China’s General Agreement on Trade in Services (GATS) commitments, which is seen as one of the most radical services liberalisation in history of World Trade Organization (WTO) negotiations. It is expected that by 2015, China’s service trade will reach USD 600 billion and the industry will account for 47 percent of the national GDP. Therefore, it can be safely concluded that both the trade partners are increasing their reliance on the service sector for greater domestic growth opportunities, with India also seeking a haven in this sector to deal with its trade deficits woes.

### 2.1 Global Services Trade and Competitiveness of India and China – A Comparative Status

Data from the WTO show that both India and China are major players in the global commercial service trade flows. India is ranked 7th in both imports and exports of trade in commercial services while China ranks 4th in exports and 3rd in imports of commercial services. Therefore, 19

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18 Detailed breakup of the inflows can be found in Table 10.3, Chapter 10, Economic Survey, 2011-12.

19 Bao Chang, 2012, ‘Nation to open service sector wider, says official’, 15 June, China Daily. "The ongoing cross-border transfer of the service industry has brought China unprecedented opportunities for the service trade and China will open the industry wider," said Lu Jijian, deputy director-general of the ministry’s department of trade in services and commercial services. Service industries including finance, logistics, education, healthcare and sports will be gradually opened, Lu said. According to the ministry, China will promote the proportion of trade in modern high value added services in its total services exports to 45 percent by 2015.
both the economies have emerged as big suppliers as well as consumers for these services. It is true that the composition of service export baskets of the two countries are vastly different, with India largely specialising in business service exports (reflected in the high share of ‘other commercial services’ in its total service trade), while Chinese exports are focused more on lower-value transport and travel services; the latter two together accounted for nearly 50 percent of China’s commercial service exports in 2010 as compared to less than a quarter for India. In 2010, commercial services exports of India and China were USD 123 billion and USD 170 billion respectively, whereas the corresponding figures for ‘other commercial services’ exports were respectively USD 96 billion and USD 90 billion (details in Table 3 below). Though at the moment India maintains clear lead (both in demonstrated competitiveness and absolute trade value), the fact remains that while China is a net importer of commercial services, for a few years now it has been a net exporter of ‘other commercial services’. In 2010, China’s net surplus of ‘other commercial services’ trade was USD 16.19 billion, a little less than half of India’s surplus of USD 36.78 billion, presumably supported by the impressive growth in China in the infrastructure (viz. construction services) and trade-related business and financial services.

Chart 2: Revealed Comparative Advantage, India and China (Balassa Index)

The revealed comparative advantage indices (RCA, Balassa Index20) of the two countries (Chart 2) clearly help to explain this emerging trade trend. The striking feature of the 2 charts above is that while India’s RCA in ‘other commercial services’ has remained flat in the decade reported, China has steadily improved it’s performance, especially since 2006, and in 2011 has become competitive in the sub-sector. Our calculations show that India’s RCA in ‘other commercial services’ is nearly 0.4 index points higher than that of China’s at present; however, it is the underlying trend that is proof of China’s increasing focus and competitiveness in commercial services exports. Comparing the change in shares of exports and imports in ‘other commercial services’ further supports our argument. Between 2005-2010, the growth in China’s ‘other commercial exports’ to the world averaged 25 percent to the 18 percent growth in its ‘other commercial imports’. The corresponding export and import shares for India are a mirror opposite at 20 and 24 percent respectively. The picture becomes a little more stark if we consider the 2010 data; the growth rates of ‘other commercial services’ exports and imports in China was 38 and 9 percent, as compared to India’s 36 and 66 percent respectively. The

20 The Revealed Comparative Advantage (RCA) indices in three broad service sectors, i.e. transportation, travel and ‘other commercial services’ of the two countries have been computed based on the formula: $RCA_{ij} = \frac{X_{ij}}{X_i} / \frac{X_{wj}}{X_w}$, where $RCA_{ij} =$ Revealed Comparative Advantage for country i of service j; $X_{ij} =$ ith country’s export of service j; $X_i =$ total service exports of country i; $X_{wj} =$ world exports of service j; and $X_w =$ total service exports of world. The index of value greater than unity indicates strong comparative advantage while a lower value would mean that the specified sector/commodity is not particularly competitive in the world market. The advantage of using the RCA index is that it considers the intrinsic advantage of a particular export sector/commodity and is consistent with changes in an economy’s relative factor endowment and productivity. The disadvantage, however, is that it cannot distinguish improvements in factor endowments and pursuit of appropriate trade policies by a country.
direction of gaps in export and import growth rates is an important point of consideration here, the especially notable fact being that growth rates of imports of ‘other commercial service’ by India were nearly double that of its exports in 2010, most likely indicating a high import content of its ‘other commercial service’ exports.

At the sub-sectoral level, data from WTO’s International Trade Statistics indicate that India and China have been major contributors in recovery of the commercial service trade in key sub-sectors. Specifically, China helped the transportation sector to bounce back to its pre-crisis levels by increasing its exports by 45 percent for the year 2010. Similarly, China became fifth largest exporter of travel services by virtue of a 53 percent increase in exports. Yet, China’s most commendable contribution has been in the construction sector which reported increase in exports by 53 percent when all other major exporters of the sector reported negative growth during the period. On the other hand, India helped the otherwise struggling financial sector by reporting an increase of 64 percent in its exports and an increase of 17 percent in insurance services (see Table 3). In 2010, India also increased its imports financial services and insurance services by 81 and 24 percent respectively.

The takeaway from the above analysis for Indian policymakers is that these developments in recent trade performances and competitiveness indices of the two countries may well reflect the relative openness of the respective country’s service sector at the WTO (or GATS commitments) in key trade and business service sectors; China has taken market access commitments in 10 sectors and 97 service sub-sectors listed in the Service Sectoral Classification List (W/120) as compared to India’s 37 sub-sectoral commitments. China’s liberal commitments with GATS seem to indicate its interest in joining the world

| Table 3: Global Commercial Service Trade Performance – India and China |
| (All figures are USD billions and percentages) |

<table>
<thead>
<tr>
<th></th>
<th>Exports</th>
<th></th>
<th>Imports</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Value</td>
<td>Annual Percentage Change</td>
<td>Value</td>
</tr>
<tr>
<td>Transportation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>India</td>
<td>13.2</td>
<td>28</td>
<td>-5</td>
</tr>
<tr>
<td>China</td>
<td>34.2</td>
<td>23</td>
<td>-39</td>
</tr>
<tr>
<td>Travel</td>
<td></td>
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<td></td>
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<tr>
<td>India</td>
<td>14.2</td>
<td>10</td>
<td>-6</td>
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<tr>
<td>China</td>
<td>45.8</td>
<td>10</td>
<td>-3</td>
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<tr>
<td>Other Commercial Services</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>India</td>
<td>95.9</td>
<td>25</td>
<td>-15</td>
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<tr>
<td>China</td>
<td>90.2</td>
<td>27</td>
<td>-3</td>
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<tr>
<td>Construction</td>
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<tr>
<td>India</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>China</td>
<td>14.5</td>
<td>92</td>
<td>-8</td>
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<td>Insurance Services</td>
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<td>India</td>
<td>1.8</td>
<td>4</td>
<td>-2</td>
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<tr>
<td>China</td>
<td>1.7</td>
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<td>27</td>
<td>-15</td>
</tr>
<tr>
<td>China</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<td>Computer and Information Services</td>
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<tr>
<td>India</td>
<td>33.9</td>
<td>-</td>
<td>-</td>
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<tr>
<td>China</td>
<td>6.5</td>
<td>44</td>
<td>4</td>
</tr>
<tr>
<td>Of which: Computer Services</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>India</td>
<td>33.4</td>
<td>-</td>
<td>-</td>
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<tr>
<td>China</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Other Business Services</td>
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<tr>
<td>India</td>
<td>28.5</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>China</td>
<td>45.6</td>
<td>15</td>
<td>-2</td>
</tr>
</tbody>
</table>

Source: Compiled from WTO International Trade Statistics, 2011
services economy by opening wide the gates for trade. However, there appear operative barriers in accessing the Chinese service market, as has been reported by many a trade partner in the recent WTO Trade Policy Review of the country. India’s experience in entering the Chinese market has also been unspectacular, the details of which we discuss in the following section.

2.2 Bilateral Trade and Investment in Services - Performance and Prospects

Currently, the bilateral trade in services exists only on a minimal scale and the domain has remained largely yet unexplored. The growing trade in services between India and China so far represent their complementary strengths in the sector. According to GOI (2005 data), in the year 2003, the total trade in services between the two countries was USD 75 million, and given the low base, the bilateral service trade grew at a rate higher than the individual growth rates of trade in services of either China or India. Several MoUs and cooperation agreements have been signed since then to further boost the bilateral services trade, but with limited success so far. As mentioned earlier, a contributing factor has been that China has opened its market very selectively, despite its apparently liberal GATS commitments, as evidenced by the "investment catalogue"; on the other hand, Indian investments in China in the service sector (via commercial presence or Mode 3 trade in GATS classification) have been less aggressive and merely exploratory, despite business services being a major component of India’s outward FDI flows (in overseas greenfield projects). As a result, neither India’s software industry nor the healthcare firms have been able to market their products well in China, barring the limited presence as suppliers to the MNC clients or for procurement purposes. However, with the share of India and China in world trade in services increasing continuously, it is conceivable that India and China not only has potential in increasing bilateral services trade but also that enhanced bilateral trade would be mutually beneficial.

As per information received from the Indian Embassy in Beijing, companies related to software solutions and IT-enabled services, trading, banking and education (IT training) mainly dominate Indian presence in China. Some of the major Indian companies in China are NIIT, APTECH, Infosys, Wipro, Mahindra Satyam, Essel Packaging, Reliance Industries etc, and while in the field of banking, ten Indian Banks have set up their operations in China. Some of them are State Bank of India (Shanghai), Bank of India (Shenzhen), Canara Bank (Shanghai), Bank of Baroda (Guangzhou) have branch offices while Punjab National Bank, Allahabad Bank, Indian Overseas Bank have representative offices. So far as Chinese companies in India are concerned, they mainly dominate the sub-sectors of machinery and construction infrastructure, and related R&D. There are about 100 companies that have established their operations in India. In addition, there are a few IT and hardware manufacturing companies that are spreading their operations in India, viz. Huawei Technologies, ZTE, TCL, Haier etc. At present, the scale of mutual investments in the service sector is not very large. However, China is hoping that trade in services will play an increasingly bigger part as the growth engine of a cooling Chinese economy as its shifts domestic growth from being overly trade and investment led to consumption led, as well as a driver for its depressed product trade amid sluggish global demand. "China's domestic market (for service providers) still has huge potential, even amid global uncertainties ... and development of the service sector is the new opportunity for the Chinese economy," Qiu Hong, China’s assistant commerce minister said at a news conference on the First China International Fair for Trade in Services.

In the most recent Foreign Investment Industrial Guidance Catalogue (2011 Revision) or the 2011 Catalogue issued by the China National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM), and which went into effect in China on January 30, 2012, new strategic service sectors have been added to the "Encouraged" category. The 2011 Catalogue

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21 UNCTAD's World Investment Report 2012: FDI Outflows from India increased to USD 14.8 billion in 2011. Though cross-border M&As slid across all three sectors – extractive industries, manufacturing and services – the drop was compensated largely by a rise in overseas greenfield projects.


23 The 2011 Catalogue broadly expands the "Encouraged" category in various service industries in line with China’s policy of encouraging foreign investment to develop a modern service industry in China. Nine industrial projects have been added to this category, including rural distribution chains, electric
is an update to the Foreign Investment Industrial Guidance Catalogue (last issued in 2007), a long-standing tool used by the Chinese government to guide foreign investment in China. The 2011 Catalogue reflects changes in China's macro-economic and industrial policy outlined in the consumption-focused 12th Five-Year Plan adopted by the National People's Congress in March 2011. Specifically, the 2011 Catalogue reflects the Chinese government's emphasis on developing certain selected industry sectors, such as information technology, clean technology, value-added manufacturing and services. The proposal is to both promote domestic investment and liberalise (encourage foreign investment) in these sectors. Also, the government plans to deepen the ‘opening up’ of the special economic areas of Shenzhen and other cities, Shanghai Pudong New Area and Tianjin Binhai New Area. In light of the proposed liberalisation of new service sectors in the 2011 Catalogue, India should take fresh initiatives to implement the existing cooperative agreements and benefit from an early mover advantage in this underserved and newly liberalising economy in its areas of competitive advantage.

3. State of Play in select Services sub-sectors in China and Trade Liberalisation

This section will provide a brief discussion of the state of liberalisation in selected service sub-sectors in China (effective domestic opening given the 2011 Catalogue, and market openness in light of China’s multilateral and FTA commitments) and identify the potential sectoral market access challenges for India. It must be reiterated here that a large portion of Chinese economy remains in the hands of its state-owned companies or those working closely with provincial governments, and these companies tend to follow very closely the policy guidance issued by the national government, which allows the government to easily carry out its economic decisions. Thus competition from the incumbent government monopolies is always a significant barrier to overcome in China, even in the case of sectors that are liberalised. Likewise, the likelihood of the 12th Plan proposals to domestically promote select services (viz. finance; logistics and distribution services; healthcare services; high-tech extension services including information services and professional services related to support technology innovation and R&D; business services including accounting, auditing, taxation, engineering consulting, certification and accreditation, credit evaluation, brokerage, management consulting, market research and other professional services) being carried out expeditiously is certain, which will add to the challenges of the foreign firms operating in the country.

We must also remember that China’s multilateral (GATS) market access commitments are all subject to domestic laws and regulations, as in any other country, and accessing the Chinese services market through either its multilateral commitments or any bilateral agreement will depend on domestic policies and priorities in China; at present, China is still in the process of implementing its access commitments in services. Through the combined impact of different policy and regulatory measures, or limiting entry through joint ventures, equity caps, limits on the number of establishments etc., China steers its economic development, in particular by favouring local companies through technology and "know-how" transfer. Thus, understanding the domestic policies and meeting (often discriminatory)

vehicle charging stations, venture capital businesses, intellectual property services, household services and vocational skills training. In addition, foreign-invested medical institutions, sales of pharmaceutical products and automobiles, commercial product auctions, commercial franchises, agencies, business management and financial leasing are removed from the "Restricted" category. Distribution of audio-visual products (excluding movies) remains in the "Restricted" category and businesses with foreign investment in these types of industrial projects still need to be conducted through a joint venture with a Chinese partner; however, the Chinese partner no longer has to hold a controlling interest in the joint venture.

24 In China, the National People’s Congress and its Standing Committee exercise the legislative power of the State. The State Council, that is, the Central People's Government of the People's Republic of China enacts administrative rules and regulations and issues decisions and orders in accordance with the Constitution and the law. Local people’s congresses at various levels ensure the observance and implementation of the law and the administrative rules and regulations in their respective administrative areas. The people's congresses of provinces and municipalities directly under the Central Government and their standing committees may adopt local regulations, which must not contravene the Constitution and the law and administrative rules and regulations, and they shall report such local regulations to the Standing Committee of the National People's Congress for the record.

25 The five largest Chinese banks, all state-owned, account for about 44 percent of the nation's financial assets and listen closely to the central government’s "window guidance"— ignore-at-your-peril advice about lending doled out by bank regulators and the central bank. State-owned firms dominate other key sectors of the economy.

26 The 12th Plan proposed to open up these services to further reform in these sectors by enhancing competition, thereby furthering development. Therefore, the plan objectives are: service systems innovation will be promoted, the service policy system will be improved, and the developmental environment for services will be optimised.
regulatory requirements is key to realising the market access ceded in the WTO, something that Indian companies have also come to appreciate through experience.

Given India’s demonstrated competitive advantage and current investment forays in China, we will evaluate the policy state of play and effective market access potential in the service sectors of: Computer and IT services; Business and Professional services; Healthcare services; Education services and R&D services. Our selection of the sectors was also influenced by the Chinese government focus in the 12th Plan to promote and liberalise (encourage competition) in new service sectors considered as SEIs. The Plan proposal is to “establish fair, standardized and transparent market access standards, remedy sector fragmentation, regional blockades and industrial monopoly, expand the opening of the services sector, encourage and guide various types of capital investment in the services industry, vigorously develop a range of forms of service enterprise ownership, and establish an integrated, open, competitive and orderly services market... will explore market managing methods suitable for new types of services format development”. Here we evaluate how open the individual service sub-sectors are at present.

3.1 Computer and Information Services

This sector has led India’s commercial service export performance for several years. The Indian IT industry, which has now grown to a size of nearly USD 60 billion, has been completely liberalised. During the last decade, India has rapidly become a favoured destination for offshore outsourcing for software projects because of its competitive low-cost solutions, well structured tax laws and good IT networking infrastructure. The Indian BPO industry itself is worth almost USD 15 billion. India is the number one outsourcing destination in the world with almost a 50 percent share in the global off-shoring business. However, India’s presence in the Chinese IT offshoring market is disproportionately small. As per the WTO International Trade Statistics, 2011, as far as the imports of the Computer and Information services are concerned, China ranked 4th among the top 10 countries, comprising of 3.7 percent of their total import value of the particular service.

The Chinese software industry, comprising of software products, services and software integration has been supported and encouraged by the China government. The industry is also known to be geographically centralised, with top five provincial areas accounting for 66.5 percent of total revenue in 2011 being Guangdong Province, Beijing, Jiangsu Province, Shanghai and Liaoning Province. In recent years, the sector has grown at unprecedented rates and is believed to have huge potential in coming years. As per the estimates, the Chinese software and IT revenues are likely to experience an annual growth rate of 24.5 percent and reach USD 635 billion by year 2015. The main drivers for the software services in China have been modernisation of the core sectors, large mobile and internet using consumer base, increasing adoption of e-commerce, rising incomes and increasing emphasis on computerisation.

The 12th Plan of China seeks to actively develop and promote its domestic information services industry by strengthening the application of software development, the development of information systems integrated services. The plan also looks at building the next generation national IT infrastructure by building new generation mobile communication networks, the new generation internet and broadband highways, construction of industrial bases of integrated circuits (IC), panel display, software and information services. The country will also witness the socio-economic IT building by developing e-business and e-governance actively.

As per China’s GATS commitments, no limitations are imposed on this sector except for limitation on market access for the sub-sector ‘Software Implementation service’ where a foreign firm can exist only in the form of joint venture with majority stake of the foreign firm permitted and for limitation on national treatment where only certified engineers or personnel with Bachelor’s degree and three years of experience in the field are eligible to enter the market. Looking at the service
schedule of China, it appears that the market for Computer and Information service is both open and strong prospects exist for India. However, there are alleged informal bans on entry, operating requirements and government procurement of software. As per the United States Trade Policy Review, concerns have been raised about the Ministry of Finance, China for putting up the guidelines which mandates the local and central governments (largest purchasers of software in China) to purchase the software only developed by China to the maximum extent possible indicating a negative stance of China on its national treatment commitments, which calls for giving the foreign goods and services the same treatment as one’s own goods and services. Another such instance of non-preferential treatment meted out to foreign operators is the fact that as part of promotion of the domestic software companies, the Chinese software companies do not have to pay taxes for the first two years of operation and receive a 50 percent tax break in third and fourth year. These broad stances have not changed in the 2011 Catalogue guideline.

3.2 Business and Professional Services

This is the second most important service export category for India, in particular in the two critical ‘cross-border trade’ and ‘movement of natural persons’ categories, and as such holds a very important place in the Indian negotiators agenda. Indian professionals in a wide range of services have been in high demand across the world. According to India's balance of payment data, export of other business services (including, inter alia, accounting and auditing services, business management and consulting services, legal services, architectural, engineering and other technical services and advertising) have increased from just USD 0.5 billion in 2001-02 to around USD 17 billion in 2007-08, a compound annual growth rate of almost 80 percent.

On the other hand, realising the need for upgrading domestic professional skills, the 12th five-year Plan of China has identified the development of business services as an important SEI for boosting domestic growth. China is also working towards growing its pool of talent and increasing professional service providers, to support and accelerate the growth of China's service trade, which will add to the challenges faced currently by the Indian professionals, in both the Chinese domestic market as well as the rest of the world. As per the 12th Plan, China will undertake policy and regulatory reforms to push for the development of accounting, auditing, taxation, engineering consulting, certification and accreditation, credit evaluation, brokerage, management consulting, market research and other professional services. It has been stated that they “will actively advance the services of lawyers, notaries, forensics, economic and trade arbitration and other legal services... financial advisory and other business management services. We will regulate the development of personnel agencies, personnel recommendations, personnel training, staffing and other human resources services”. These are all directed at boosting development of domestic service providers in key business services.

On the other hand, in its GATS commitments, China has offered to open the market for foreign service providers in many more business and professional services sub-sectors as compared to India. Generally, there is a preference for JVs, especially given the difficulty in navigating through the complex domestic regulatory systems and licensing requirements in most sectors, though wholly-owned foreign firms are being permitted in all the professional service sectors in which China has take GATS commitments since 2007. As per its Legal Services specific commitments, representative offices of foreign law firms in China can engage in the following business, excluding Chinese law practice, and charge their clients for services provided:

• Clients are provided with legal consultancy services on the legislation of the foreign country/region and on international conventions, commercial laws and practices
• Handling of legal affairs of the country/region is permitted, when entrusted by clients or Chinese law firms
• Entrusting, on behalf of foreign clients, Chinese law firms to deal with Chinese legal affairs
• Entering into contracts to maintain long-term entrustment relations with Chinese law firms for legal affairs
• Provision of information on the impact of the Chinese legal environment

The specific commitments also require that representatives of a foreign law firm in China shall be practitioner lawyers who are members of the bar or law society in

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a WTO member and have practiced for no less than two years outside of China. The chief representative shall be a partner or equivalent (e.g. member of a law firm or a limited liability corporation) of a law firm of a WTO member and have practiced for no less than three years. All representatives shall be resident in China no less than six months each year. The representative office shall not employ Chinese national registered lawyers.

However, although China eliminated quantitative and geographical restrictions on legal services in 2002, the foreign firms are still not permitted to form joint ventures with the local firms. Moreover, the foreign firms cannot directly participate in the Chinese law, they can only work in matters related to their home country or to entrust work on behalf of their clients and to provide information on the impact of Chinese legal environment. Also, the law firms have to annually register with the Ministry of Justice which is bureaucratic and a time consuming process29.

In the accounting and auditing services, partnerships or incorporated accounting firms are limited to Certified Public Accountants (CPAs) licensed by the Chinese authorities. Moreover, the limitation under the national treatment specifies requirements for the foreigners to become CPA with the following conditions: (1) at least two years’ working experience as an auditor in China; (2) a permanent address in China and have stayed in China for at least one year cumulatively; (3) been recommended by the Chinese CPA firms for whom they work30.

The primary administrator of architectural and engineering services in China is the Ministry of Construction. At present, under the GATS specific commitments, the architectural and engineering services providers can establish wholly owned subsidiaries. If they are providing the services under the cross-border supply mode, then cooperation with the Chinese enterprise is required except in case of scheme design. Also, the foreign service supplier in these sectors are required to be registered engineers/architects or the enterprises must be engaged in engineering/architectural/urban planning in their home country.

3.3 Healthcare Services

Another sector that has catapulted India as one of the major players in the global commercial services market is healthcare services, in particular health tourism and IT-based remote/cross-border provisioning of medical and technical expertise31. Though still at a nascent stage, the healthcare industry in India has developed as the sector with immense growth opportunities owing to the India’s competitive edge in offering large quantities of skilled human resources and surgical costs at as low as one-tenth of the costs in US or Western Europe in surgery. The healthcare sector is a USD 35 billion plus industry in India and is expected to reach over USD 75 billion in 2012 and USD 150 billion by 2017. Given India's large pool of highly qualified doctors, nurses, paramedics and technicians, growing innovations, expansions, low cost of treatment, world-class technology and five-star services medical tourism is growing at a phenomenal rate of 30-35 percent per year in India. Health services offered include indigenous systems of holistic care such as Ayurveda, Yoga, Unani, Siddha, naturopathy and homeopathy in addition to western medicine32. Modern healthcare and hospital services in India are also largely market based private provisioned, and has delivered cost-effective solutions at different levels of the consumer pyramid. As such therefore, India could also potentially play a major role as the cost-effective service provider of choice for the rapidly aging Chinese populace.

At the same time, the socialist country of China has identified healthcare service provision as one of the most important social policy target area in the 12th Plan. The sector will witness major public investment and deepening of the reforms in coming years. The government also plans to promote the traditional Chinese medicine and to give it equal priority as the western medicine. The specific areas in healthcare industry that will command attention are basic medical insurance system, public health service

29 http://international.lawsociety.org.uk/files/FinancialServicesChina.pdf
30 Australia-China Free Trade Agreement, Joint Feasibility Study, 2005. The agreement is still under negotiation.
31 The country leads in offshoring and outsourcing the medical processes like medical transcription (conversion of the voice-recorded reports as dictated by the physicians into text formats); medical billing; collection of medical insurance claims; medical coding etc. Recently, India has also witnessed impressive growth in area of telemedicine, supported by information and communications technology (ICT). Telemedicine is basically remote diagnosis, monitoring and treatment of patients via videoconferencing or internet.
system, medical service system, training base for the medical practitioners and pharmaceutical and healthcare informationisation. Though the sector is likely to grow on the shoulders of domestic spending, the government hints at opening the sector for international trade as well with potential in medical insurance services and hospitals. In fulfilling the objective of increasing the share of private consumption in GDP, the Chinese government has already initiated major health reforms in year 2009 aiming at universal, affordable and basic healthcare by 2020. The reforms mainly looked at increasing the government expenditure in this sector. The outcome was that the annual total healthcare expenditure reported a CAGR of 18.72 percent over the years 2006-2010, which is expected to exceed USD 600 billion by 2020 if the present growth trend holds. Presently, the Chinese government has essentially focused on five issues within its ambit: basic level healthcare service, basic healthcare insurance service, essential drug system, equitable public health service and public hospital reform. Today, around 90 percent of the hospitals are publicly owned. Simultaneously, the Chinese also have a strong preference for traditional medicines and processes.

As far as China’s commitments under GATS are concerned, the sector is only partially open. There are market access limitations, whereby foreign suppliers are permitted to establish joint venture hospitals or clinics with Chinese partners with quantitative limitations in line with China’s needs, though foreign majority ownership is permitted. Also, the equity joint venture or cooperative joint medical institutions must meet the following requirements:

- The joint venture must have independent legal person status
- Total investment value should be no less than RMB 20 million (US$2.4 million)
- The proportion of stock or equity of Chinese investors or co-operators should be no less than 30 per cent in the equity of the joint venture or cooperative joint medical institution
- The term of operation of the joint venture should be no longer than 20 years
- The joint venture will be subject to other requirements stipulated by sanitation administrative departments at the provincial level and above

Moreover, foreign doctors with professional certificates issued by their home country shall be permitted to provide short-term medical services in China after they obtain licenses from the Ministry of Public Health. The term of service is usually six months and may extend to one year. Limitation under the National Treatment specifies that the majority of doctors and medical personnel of the joint venture hospital and clinics shall be of Chinese nationality. As per China’s horizontal commitments, the limitations on national treatment are unbound for all the existing subsidies to domestic services suppliers in the sector of medical services, a potentially major market access barrier, especially when competing with the domestic incumbents.

### 3.4 Education Services

In education services, India’s technical education institutes, especially the private IT education sector, have been very outward oriented. Companies like NIIT and APTECH have successfully established foreign footprints. Even in China, it is these firms that have begun initial forays. The entire education sector in China on the other hand is mainly dominated by the public sector. Currently, the government is allocating 13 percent of the total public expenditure towards education taking the total education spending in China at USD 212 billion and still experiencing impressive growth. The government’s main focus of education related reforms has been support for rural and poor population in the form of various allowances. Also, the government has initiated efforts to improve the quality of the primary and secondary teachers by providing them with tuition free education in teachers’ colleges and universities. China’s rapid industrialisation led to surge in demand of the skilled labour which the country’s education system was not able to fulfill. As a result, the economy has seen one of the largest number of students travelling abroad to avail education services. As per the report of Department of Foreign Affairs and Trade, Australia, China is the largest consumer of international education with largest number

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33 Traditional Chinese medicine (TCM) originated in ancient China and has evolved over thousands of years. TCM practitioners use herbal remedies, acupuncture and other methods to treat a wide range of conditions emphasising individualised treatment.


of outbound students, comprising of over 15 percent of world’s total outbound students.

In terms of opening up the sector under the GATS, China has made considerable progress, as also indicated by the UNESCO EduGATS index. However, although foreign majority investment is allowed in joint ventures providing education services, there is certain amount of ambiguity regarding the fact that whether or not the foreign firms will be subjected to national treatment. Also, China is known to have a number of regulatory barriers in provision of the education services through cross-border supply, commercial presence and movement of natural persons. One of the issues faced by the foreign providers of education services is recognition of the overseas qualification which has an adverse impact on the demand of these services by the Chinese students, especially when they aim to take up jobs in China itself. The movement of the natural persons is possible if invited or employed by the Chinese institutions or other institutions, subject to requisite qualification which includes possession of Bachelor’s degree or above and an appropriate professional title or certificate with minimum of two years of work experience.

There is also a host of regulatory requirements in setting up a foreign institute. As per the 2003 regulations, a foreign institute must partner with the Chinese institutes and that the partnership must not seek any profits. Also, no less than half of the members of the institute’s governing body must be Chinese citizen. The post of the president or equivalent must be held by Chinese citizen, residing in China, the basic language of instruction must be Chinese and that the tuition fees cannot be raised without prior approval. While these requirements are not significantly different from requirements in many other developing countries, they still pose significant market access challenges.

### 3.5 R&D Services

Though US, China and Japan have led the market for innovation globally for quite some years now, there is evidence that suggest that R&D industry is gradually shifting its boundaries with India, China and Brazil having greater R&D growth rates than US. The EIU Innovation Index also indicates that while both India and China are improving their performances, China has progressed faster in moving up the innovation index in 2009-13, despite the two countries being at comparable positions in the earlier quinquennium.

Currently, India is consolidating its position as a strong destination for R&D, gaining strength and setting standards for the rest of the world. India has emerged as a global hub for sophisticated areas such as network equipment, medical equipment, medicines, semiconductor design, aerospace and automotives. Significantly, R&D services

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36 China has EduGATS index value of 0.42 (lower than the average for developing countries), where EduGATS index measures the progress in terms of commitments on trade in Education under the WTO. The index depends on number of sub-sectors of education that are committed, limitations on national treatment as well as market access and horizontal commitments; and take the value ranging from 0 (totally closed or zero liberalisation) and 1 (maximum openness).


in India (and patents emerging therefrom) is dominated by the wholly-owned R&D centers of foreign multinationals in India. The sectors where these MNCs have set up their R&D base in India range from IT, pharmaceuticals to telecommunication and biotech. A Zinnov 2012 study "Location Analysis: Emerging cities in India" highlighted that the MNC R&D Talent pool in India for 2011 stood at ~204,196. It also added that talent base is indeed growing at the rate of nearly 9 percent every year and is expected to reach ~250,000 by 2015. There are 93 MNC R&D companies that have operations in the two main R&D centres in India, namely Bangalore and Pune. In terms of outbound R&D investments from India, top software producers and exporters of India including Infosys Technologies and Tata Consultancy Services have set up their offices and R&D centers in China. On the other hand, Chinese investments in India are mainly in trade and IT related R&D. For example, China National Machinery and Equipment Import and Export Corporation, and China Metallurgical Import and Export Corporation have set up their representative offices in India; Huawei Technologies has also established its software R&D center in India.

R&D in China on the other hand is again largely public-sector owned and public-sector funded. As per the 12th Plan, China looks forward to the indigenous growth in the research and innovation in science and technology and therefore, aims to further invest in the training and building capabilities of its human resource. The focus is to enhance the core competitiveness of the industrial sector by building its innovation capabilities by building the R&D facilities of sectors like equipment manufacturing units, the ship building industry, the automobile industry, the petrochemical industry, the marine industry etc. At the same time, the plan also talks about encouraging other countries to open the R&D centers in China as well as attracting senior talent in advanced technology from overseas.

In the view of rising challenges in global innovation market place on one hand and unaffordable R&D expenses for developing nations on the other hand, cooperative R&D where the nations agree to share the costs and the results of the R&D before the execution of the project, seems to be a win-win option at least in the socially important sectors like public health and infrastructure services where returns to R&D investment is poor and consequently doesn’t evince private sector interest. Indian R&D firms and research institutes are already collaborating on high-end innovation with intra-governmental organisations (viz. CERN in Europe) and private innovation firms. Most recently, Pratt & Whitney, a United Technologies company, has opened an office at the Indian Institute of Science (IISc) to increase its long term commitment to conduct advanced joint research in gas turbine jet engine technology in India.

3.6 China’s trade Commitments under the FTAs

This last section gives a brief overview of the commitments made by China in its bilateral and regional agreements. China has signed FTAs and closer economic partnerships in Asia-Pacific region with ASEAN, Australia-New Zealand, Hong Kong, Japan, Republic of Korea and Singapore. With most, made commitments in the FTA expand on its commitments in the WTO General Agreement on Trade in Services (GATS). Though the GATS-plus commitments are subject to specific reservations or exemptions listed in China’s schedule, the foreign service suppliers under the FTAs allowed to access the Chinese market without quotas and operate in China on the same footing as domestic Chinese services suppliers in the certainty that the environment in which they are operating cannot be altered adversely. There was, however, little evidence found of actual liberalisation, with significant implementation gaps existing between commitments and practice. Some examples of China’s GATS-plus commitments are in the following sectors:

- Computer and Related Services – including software implementation services, data processing services, and input preparation services;
- Services related to management consulting;
- Hospital Services – Foreign investment is allowed subject to certain limitations mentioned both under the Market Access and National Treatment, viz. service provider cannot exceed the foreign equity share of 70 percent in the joint ventures with Chinese Hospitals, and the majority of the doctors and medical personnel in the joint venture hospitals must be Chinese;
- Education – Removing barriers to the recognition of vocational qualifications and commitment to initiate joint
work on quality assurance criteria for qualifications which include a distance delivery component;
• Environmental services – an improved Mode 3 (investment in environmental services) commitment permitting wholly foreign-owned enterprises;
• Sporting and other recreational services;
• Air transport services – aircraft repair and maintenance services, and air travel computer reservation services;
• Road Transport services – freight transportation by road in trucks or cars; maintenance and repair of motor vehicles; storage and warehousing services; and freight forwarding agency services; and
• Business visitors and intra-corporate transferees are allowed easier entry and longer stay permits, while Contractual Service Provider (mainly providers of Professional Services, Education and Medical and Dental Service) allowed long-term stay permits as stipulated in the terms and of the duration of the contract concerned.

Also, China’s service sector liberalisation with Hong Kong is the deepest under the auspices of CEPA given the latter’s ongoing reintegration with the mainland since 1997, according to which there are 301 liberalisation measures in 47 service sectors. As per the agreement, Hong Kong will gain ‘preferential treatment’ in the specific sub-sectors in the form of wholly-owned operations, relaxing restrictions on equity sharing, reducing registered capital requirements, relaxing restrictions over geographical location and business scope, etc.

4. India’s Service Trade Prospects in China and Way Forward

Analysts now worry that India’s domestic services-based growth spurt may have run much of its course, and given the prolonged weakness in their traditional export markets, Indian service providers are looking at diversifying towards the Asia-Pacific, which has not been a traditional stronghold for India’s service sector. It is thus natural for India to push for liberal service market access in its discussions and negotiations with the trade partners in the region, as seen in the recent FTA negotiations with all the Asia-Pacific countries. Also, in the various FTAs that India is negotiating, it is negotiating for GATS-plus commitments from its partners and hopes to achieve broad based agreements that are both GATS consistent as well as GATS-plus. Even without formal trade agreements, India is working towards increasing commercially meaningful market access with trade partners. But how realistic is the expectation that India will be able to garner a larger part of the service market in China in the years to come?

Prima facie, our analysis in Sections 2 and 3 leave us with little room for comfort; also historical experience suggest that India is not likely to have it easy while entering the Chinese market, much less dominate it. An important concern is the authoritarian nature of governance in China which poses unique challenges yet unencountered by the Indian service economy in its external market forays. India’s service sector prowess has actually followed the well known path of free market principles of comparative and competitive advantage, which assumes a free flow of factors of production and minimal overt government control, despite the sector being governed through extensive regulations. However, in a tightly monitored and closely guided regime like China’s, where such operational freedom exists in a limited fashion even in the select sectors that have been opened up, Indian service sector companies will most likely face the problem where their comparative advantage could be negated because of the existence of favoured domestic incumbents or preferential treatments meted out to Chinese indigenous start-ups. The Indian firms operating in China also face a number of cross-sectoral and sectoral issues such as minimum capital requirements, restrictions on wholly foreign-owned enterprises and other foreign ownership restrictions, licencing requirements and other market access restrictions, intellectual property rights issues, responsibilities and variations in implementing laws between central and state/provincial levels of government, transparency in decision-making processes, limitations on the repatriation of funds and national treatment, recognition of professional qualifications, particularly in the professional services area in educational qualifications, examinations and experience, and inconsistent and opaque visa regulations.

39 Trade and Industry Department, Hong Kong
40 Cowen, T., 2012, ‘Never Mind Europe, Worry About India’, 5 May, The New York Times. India’s IT operations have succeeded by building their own infrastructure and they often function as self-contained, walled minicities, and economically segregated islands of higher productivity.
4.1 Extant Trade Potential and the Way Forward for Indian service industry

The India-China JSG had recommended that the case for a China-India FTA essentially rests on the complementary structures and advantages of the partner economies. However, even when the FTA talks appear to have been shelved, and given the increased focus on services in the 12th Five Year Plan of China to boost domestic productivity and output as well as export revenues, the essential justification for increased bilateral service trade cooperation and liberalisation has not dissipated. There exists numerous ‘win-win’ opportunities to capitalise on for the benefit of both economies. In fact, closer economic cooperation and implementation of the existing MoUs can further increase the international competitiveness of both the trade partners’ services sectors. That said, and as discussed above there exists tremendous regulatory challenges and barriers in entering and accessing the Chinese services market, not only emanating out of the protection that domestic firms are provided by the state by way of existing limitations on foreign participation in key service sectors and domestic support and subsidies in the form of cheap land and capital, and low taxation regimes.41. We discuss the market access potential, challenges and way forward in select service sectors below.

Though the IT service industry in China had a late start compared to India, it has been developing in an orderly fashion for the past decade under government direction and have more or less adhered to the basic rules of development, as evidenced by the rising share of the sector in China’s ‘other commercial services’ exports. However, high-end service capabilities like consulting services, business re-engineering and system solutions are still in short supply, and often do not meet the high standards of MNC requirements. The fragmented nature of the service capabilities provided by Chinese service providers is another major issue. They often do not have solutions for systems integration, design development, testing, deliveries, operation, maintenance and system upgrade. Many of the Chinese companies are also not abreast with the latest technologies like cloud computing. The IT service industry in China also faces an acute shortage of high-end talent as most of the employees in China's IT and ITeS companies have work experience of less than five years.42. On the other hand, twenty years hence, the ratio of China's manufacturing and service industries is expected to reverse from today’s 6:4 to 4:6. The total scale of China's service sector is estimated to reach USD 14 trillion, a net increase of USD 12.5 trillion compared with that of 2010. Pension, health insurance, healthcare, education, housing, employment and other issues will create potential for the vast emerging markets of China's service economy, which will provide a huge market for the IT outsourcing industry. This provides a huge opportunity for Indian companies and IT sector professionals, at least until the domestic Chinese companies catch up with the Indian standards of efficiency and proficiency.

That said, the IT service sector in China has several inbuilt challenges that need to be overcome and managed. First, information security is often cited as a major drawback for service outsourcing to China. The inefficiency of the information security laws and the weak enforcement of intellectual property rights in China are the two main factors that deter the transfer of critical data and service businesses. Second, language and cultural differences are important constraints, especially for domestic clients like the government and State-owned enterprises. Here, native mandarin speaking neighbours of China like Singapore and IT personnel from territories like Taipei and Hong Kong will have an edge over Indian service providers. Chinese mainland already has healthy trade and investment relations with all three.

Given the new domestic priorities of China, and the above challenges, it is clear that India’s trade prospects in Computer and IT services in China in the near future will clearly be a function of the net investment that Indian firm’s make in the country, either wholly-owned or in

41 12th Plan directives on improving services related policy: “We will implement the regulation that encouraged types of service sectors may purchase electricity, water, gas and heat at the same price as the industrial sector does. We will expand the supplies granted to the services sector and the services sector will have priority in using land which is no longer claimed by industry. Combined with value-added tax reform, the tax system of production services will be reformed. The financing channels for service sector enterprises will be broadened and the public financing and issuing of bonds of eligible enterprises will be supported. We will expand the product range of government procurement services. We will establish and improve services standards systems. We will support service enterprises’ brand and network building”.

Joint Venture firms (or Mode 3 commercial presence). Irrespective of the clear technical and competitive advantage, localisation and language remains major issues and act as a barrier to promoting cross-border trade from India in software and ITeS services in China. Also, as China slowly expands the “opening up” policies and coordinates the opening up of coastal, inland and bordering areas, presence in the country through investments will prove an invaluable first-mover advantage to the Indian firms. The 12th Plan proposal is to deepen the “opening up” first to the special economic areas of Shenzhen and other cities, Shanghai Pudong New Area and Tianjin Binhai New Area in the coastal belt. Among the inland areas, the first drive ahead in the “opening up” is Chongqing’s Liangjiang New Area, which will be encouraged to adapt to the migration of international enterprises and coastal service contracting industries toward inland areas.

The JSG also recommended that the two sides can promote health services trade through exchange of medical care personnel, cross-border diagnosis and mutual investments, and training of personnel of one country in the other. Since China allows the establishment of joint venture hospitals and clinics, India could become an important exporter of medical care services to China, as there will be greater demand for high-quality medical personnel who could provide good services and interact easily with foreigners visiting China for business and tourism. India and China can work together to create health facilities to attract patients from other countries. In the present context, to promote export of services, deepen the “opening up” of outbound service sectors and increase the share of service trade in the total foreign trade, China has proposed to “expand... and in a stable way open up education, medical care and other areas”. Thus, greater trade and investment cooperation in healthcare services and education is likely to become a distinct growth possibility in the medium term. However, expectations of prospective gains in healthcare services may need to be tampered with the fact that China also hopes to promote and export traditional Chinese medicines under the same programme, and which continues to have a significant share in the total healthcare expenditure in the country (and the extended East Asian region) across income groups.

Another important area of cooperation is in co-operative R&D services, especially in sectors such as biotechnology, medicine delivery and healthcare, non-conventional energy services, computer software, etc. Exchange of scientists and technical persons between the two countries would facilitate such co-operation. As per the proposed new R&D and innovation policy, China will bring in senior talent and advanced technology from overseas and encourage foreign enterprises to set up R&D centres in China in order for China to learn advanced international management concepts and systems. There appears to be new opportunities for Indian R&D firms and researchers in this area, as China has decided to actively integrate into the global innovation system. Here India should work to better exploit its existing MoU with China on science and technology.

4.2 The Role of Indian Government

The Indian government is rightly concerned by the rising bilateral trade deficit vis-a-vis China. However, in a misguided sense of doing it right by its domestic SME producers, the Indian government has been using the tried tested method of invoking trade defence measures to subvert many state-sponsored priviledges that Chinese firms benefit from which boost their cost efficiency and competitiveness. The domestic industry is of course highly motivated in actively seeking such protection, as antidumping and countervailing duties reduce competition from direct Chinese exports, while they continue sourcing from China many of the intermediate and final products they finally sell in the domestic market with a mark-up. Such rent seeking actions of the Indian industry and merchant class adversely affect the consumers and producers who are denied access to cheap consumer and capital goods that would have resulted in the absence of such protectionism. Thus, there is clear call for moving away from such politicised tools of arbitrary retaliation and implement regulatory reforms that would help boost the natural competitiveness of the Indian industry vis-a-vis its Chinese counterparts.

This is true even for the service sector, where for example the Indian government can help more by enforcing the education sector reforms and work with the industry to promote rapid skill development in the country, rather than adopting overt retaliatory measures of restricting entry of foreign service providers/ business personnel or regulating...
in requirements of local employment conditionalities in affected sectors as has been the practice in recent years. This would be an important efficiency boosting reform even in the eventuality of an India-China FTA which would have negotiated better market access conditions for services on the key regulations and issues discussed in the second para at the beginning of this section. It is well known that India has serious supply side limitations as a service provider, in spite of the favourable demographics, which some analysts fear will impact even India’s domestic service sector growth prospects in the medium term. The country has developed remarkable strengths in particular in IT and business services, but the bulk of the Indian labor force still lack the skills and education necessary to ramp up supply to the scales that might be demanded. Successful long-term development of the sector’s export performance therefore requires a steady accumulation of human capital and institutional capabilities to meet and sustain the additional demand from higher services-exports. Without sustained investments in human capital and institution-building, which the government needs to implement expeditiously, India’s service trade prospects are condemned to peter out.

The government should further focus on ensuring that the training of Indian service sector personnel follows the global standardised norms, which would boost the prospects of movement of its service sector professionals or GATS Mode 4 trade. For example, in India professionals in several of the service sectors don’t have to receive a practicing license to qualify; merely obtaining the educational degree is deemed sufficient. This practice often leaves them under-qualified and less proficient when compared with the professionals from the developed countries, which lack of harmonisation has in fact also hindered the government’s ability to sign mutual recognition agreements on professional qualification and licensing standards with India’s trade partners. This affects the prospects of Mode 4 trade, especially for the independent professionals from the country. Given the length and complexity of modern global service supply chains, particularly in sectors as finance, healthcare, engineering and architecture, and accounting and auditing, the lack of comparability in qualification and licensing systems in the country with the developed world leaves the majority of the Indian service sector professionals at a serious disadvantage. A proactive government interested in promoting service trade growth should focus on ironing out these regulatory limitations and irregularities. This is an ever more important limitation in India’s service trade with China, where Indian service suppliers will naturally have to face stiff competition from professionals from China’s other FTA partners, and in particular those from Australia, Singapore, Hong Kong and Taipei. The government should address the services market access issue in a more practical problem-solving manner of businesses in addition to adopting a tactical negotiating approach during the bilateral meetings.

4.3 In Conclusion…

Having said all that, what are the additional gains for China from service trade liberalisation and cooperation with India, especially in view of the far superior financial and administrative ability of the former to propose and implement sectoral growth and showcase performance as per policy directions? To the authors, a compulsive justification for increasing service trade openness and liberalisation lies in the fact that despite the far superior ability of the Chinese government to meet the policy targets, the efficiency and frugal competitiveness of the Indian private service providers (with proven models of cheap and effective service delivery) in select areas can be put into effective use by China to rapidly bridge the consumption gaps emerging from income inequality and remoteness of location. Given that necessary reforms to improve efficiency and service delivery of public sector is not easy to achieve, cooperative private provisioning of social services (viz. Chinese public sector collaborating with the Indian private sector entities) can be used as an alternative mode to speed up services like bottom-of-the-pyramid healthcare, medical micro-insurance, private pension systems etc. China’s public redistributive policies so far have demonstrated lack of equality, which can be overcome by participation of innovative technology-using delivery mechanisms of private sector service firms. Why is this important? Recent developments across the world have demonstrated that inequality and being left out of the benefits pie breeds discontent and fetters social unrest. It would be a shame if the world fastest growing economy fails to take its citizens along with it in the wave of development because of lack of imaginative social service delivery mechanisms.