

**NEGOTIATIONS ON TELECOMMUNICATION,
FINANCIAL SERVICES SECTOR AND MOVEMENT OF
NATURAL PERSONS IN WTO: ISSUES AND
STRATEGIES FOR INDIA**

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CERTIFICATE

The dissertation entitled, "NEGOTIATIONS ON TELECOMMUNICATION, FINANCIAL SERVICES SECTOR AND MOVEMENT OF NATURAL PERSONS IN WTO: ISSUES AND STRATEGIES FOR INDIA", submitted by JAYANT NARLIKAR, in partial fulfilment of the requirements for the award of the degree of **MASTER OF PHILOSOPHY**, is his own work and has not been submitted so far, in part or full, for any other degree or diploma of any university.

We recommend that the dissertation be placed before the examiners for evaluation.

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(Chairperson)

Prof. K.D. Kapoor
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J. Narlikar
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PREFACE

There has been considerable expansion of trade in services in recent years. This growth has been spurred by many factors; including rapid advances in information technology, rising demand for services in both developed and developing countries, the growing importance of multinational firms, and increased outsourcing of many service activities by the firms. Although trade in services has grown at a rate of 10% per annum, there remains numerous regulations that constrain further expansion of trade. While some of these regulations are there to address public policy concerns and can't be termed barriers *per se*, some other regulations are discriminatory and protectionist in nature.

Given this, Uruguay Round brought the services sector, for the first time, into the fold of multilateral trade negotiations. According to the General Agreement on Trade in Services (GATS), the Most Favoured Nation (MFN) and "transparency" (*viz.* publication of all laws and regulations) are the two obligations that apply to all services. The commitments, *viz.*, market access and national treatment apply to services that are to be opened up according to specific negotiated commitments only, subject to conditions incorporated in the schedule of commitments. The Agreement covered all the four modes of delivery of a service, including "cross-border supplies", "commercial presence" and "movement of natural persons". The General Agreement on Trade in Services has come up for review in the year 2000. The ongoing negotiations would involve deciding the market access that India can give and the market

access that our services would like to have in other countries. This involves filing of schedules in respect of 12 major sectors and 161 sub-sectors. Movement of Natural Persons, especially professionals, is of special importance to us as India enjoys a distinct comparative advantage in this area covering a whole range of services from computer and related services to hotel, health, engineering, construction and other professional services. The process of economic liberalisation involving opening up of capital intensive services such as banking, telecommunications etc., must be matched by increased access for the temporary movement of our professional people in services of export interest to us. However hardly any commitments have been made by developed countries in regard to the fourth mode for delivery of services under GATS i.e. movement of natural persons.

It is against this background that India approaches the mandated GATS 2000 negotiations. It calls upon the developed WTO members to approach these negotiations, conscious of their responsibilities and obligations towards the developing countries enshrined in the GATS.

This dissertation proposes to bring together the issue and strategies that are relevant to the GATS-2000 negotiations specific to telecommunication services, financial services and the movement of natural persons from an Indian perspective. The whole schematic presentation has been divided into five chapters.

The **first** chapter introduces the importance of theme and the brief historical background of negotiations on trade on services.

The **second** chapter deals with issues and strategies for India in WTO negotiations on telecommunication services. The objective is to focus on the opportunities and challenges in the multilateral trade of telecom services against the backdrop of the rapidly changing domestic and international telecom scene.

The **third** chapter throws the light on how India's negotiating strategy in WTO is linked with internal (domestic) reforms in financial services sectors.

The **fourth** chapter analyses the some suggestions about how India could seek to liberalize temporary movement of labour under the GATS in WTO service negotiations, with respect to specific countries and sectors of interests .

The **concluding** chapter summarizing the whole discussion, highlights the lacunas in developing countries' (specially India's) negotiation strategy and makes recommendations to correct them.

Dedicated to...

My Parents

CONTENTS

Chapter I	Introduction	1-21
Chapter II	Issues and Strategies for India in WTO	
	Telecommunication Services Negotiations	22-57
Chapter III	Issues and Strategies for India in WTO	
	Financial Services Negotiations	58-93
Chapter IV	India and The Issue of Movement of Natural	
	Persons in WTO Negotiations	94-127
Chapter V	Conclusion	128-149
	Bibliography	150-154

CHAPTER I

INTRODUCTION

Negotiation is the continuation of policy by other means. The means chosen have costs and implications, however, which impinge on the unaltered continuation of policy. A party's policy preferences are essentially unilateral creations, designed to further aims and handle problems, and are frequently in conflict with other parties' unilateral policies. Negotiation is joint decision making in which unilateral positions in conflict are turned into multilateral decisions that are deemed preferable by the parties on the combined basis of cost, goals and effectiveness.

The most important characteristic of negotiation is that it is a 'creative process' aimed at providing the parties with a preferred outcome.¹

Secondly, negotiation is an alternative means to a policy end. Negotiation takes place when there are not agreed terms of trade and the main purpose is to establish such terms of trade.

Thirdly, negotiation also is a reflection of power and a register of power changes. Parties in the negotiation often trade off present against the future positions. Negotiation frequently takes place when a dominant power is slipping and a weaker party is rising in power, and the former negotiates to maintain some of its privileges before it loses everything while the latter

¹ Muchkund Dubey, "A third world perspective" in Jagdish N. Bhagwati & Ruggie (edt.), *Power, Passion & Purpose: Prospects for North South negotiations* (Cambridge: MIT Press, 1984), p. 85.

negotiates to consolidate its gains rather than holding out over the long run for additional but costly advantages.²

Fourthly, negotiation is persuasion. It involves changing the views of suspicious, resistant individuals and transmitting such changes through institutional groups and networks structured to resist change. Negotiators come to negotiations with different and uncertain evaluations of various items, events and outcomes under discussion, rather than with fixed positions. Even the scope of discussion is fluid, enabling negotiators to set aside items too intractable to be the subject of agreement and to bring in items strictly extraneous to the problem but useful as side payments for other concessions. Negotiators deal with uncertainty; not only are values flexible, but information about them can be manipulated tactically and even misleadingly, or, in other instances, can be sought expanded cooperatively and creatively to expand the terrain of possible agreement. Furthermore, positions can be altered by bringing out their future implications by attaching contingent deprivations and gratifications. Such contingencies can depend on the action of the persuading party, through his use of threat and promises, or they can be non-volitional and inherent in the position itself, indicated through the use of warnings and predictions.

Finally, in terms of the immediate encounter and also of the broader evolutionary context in which it fits, negotiation is a problem of timing. Time has its costs and so parties negotiate their cost-resistances against each other.

² *ibid*, p. 98.

This means that it is in each party's interest to make an offer the other can't refuse just before the negotiation is about to end for a procedural reason- just before an external deadline is lowered, or just before the other party is about to break off and go home. Unless there is a sense of a clear rise in time costs – an external or internal deadline – negotiations can go on forever. But time costs rest on three analytically discernable elements that are hard to separate in reality: the procedural rhythm of the negotiation (the concession rates), the substantive discount rates of the items under discussion (the rotting rate), and the long-range evolution of the relative power and fortunes of the parties (the historical rate of change). It is an unusual encounter that benefits from a coincidence of all three.

Thus, negotiation can be analyzed as six different problems – a creation problem, a defense problem, a bargaining problem, a power problem, a persuasion problem and a timing problem – each to be solved according to its own theoretical components.³ All can be applied to the analysis of a common negotiating process that runs through three phases: Diagnosis, formulation, Elaboration.

On the basis of this understanding of the negotiation process and its various natures, an attempt is made in the Research Paper to recommend some strategies in WTO negotiations on Telecom Sector, Financial services sector, and Movement of Natural persons for India.

³ *ibid*, p.99.

‘What is a service’?

A service is an activity that adds values to something, either a good belonging to another person (such as car repairs) or another person himself/herself (such as a hair cut or an education). When a service is being performed, the ownership of a good to which values are being added doesn't change during the process, unlike the process of producing goods for sale for some one else. The increment in value added is a measure of the output of the service producer. It has been argued that for an activity to be a service, a transaction must take place between separate economic organisations. Exchanges within households such as work done in the home by a family member or within firms such as management hiring labour to work on production lines are not service transactions.⁴

The General Agreement on Trade in Services (GATS) definition of services includes any service in any sector. The one exception is services supplied “in the exercise of government authority”, but this exception doesn't include services provided by governments on a commercial basis or in competition with one or more other service suppliers.

‘Special characteristics of service’

The services sector has a unique position in the domain of global political economy. This uniqueness arises from various characteristics of the services sectors. The important ones are:

⁴ ESCAP – *Implication of the Uruguay Round agreements for the ASEAN & Pacific Region*, (New York: UN Publication, 1995), p.48.

- Services are not storable, and they are produced and consumed simultaneously, which means that producers of services don't store output. Instead, they maintain the capacity to produce the service while waiting for customers to arrive. This is referred to as the '*lumpiness of services*'. Lumpiness has implications for the pricing of services and the nature of competition in the market.
- The simultaneity of consumption and production has additional implications. It means that there will be direct interaction between consumers and producers of services, because they must meet in some way in order for the transaction to take place. This personal contact makes cultural differences and communication barriers such as language even more important as potential impediments to trade in services.
- New technology and declining costs for transport and communications have increased the scope for those providing and demanding services to make contact across national boundaries, thus promoting the growth of services transactions relative to merchandise trade.
- Services sector has a strong forward and backward linkages with other sectors of the economy, both under institutionalised as well as decentralised perspectives.

Mode of services Delivery:

The GATS defines four modes of delivery of services:

- (1) transactions with no movement of providers or demanders (e.g., International Telephone calls) i.e. *cross border movement of service products*.
- (2) movement of provider only, (e.g. Banking), i.e. *commercial presence*
- (3) movement of demanders only (e.g., tourism) i.e. *movement of consumers to the country of importation*
- (4) *movement of natural persons* (e.g., consultants)⁵ i.e. services provided by individuals of one member in the territory of any other.

Why is services trade important?

The significance of the services sector to the global economy continues to grow: more than 60% of world production is derived from services, and while services trade (on a balance-of-payments basis) amounts to one-fifth of total world trade, it is growing more rapidly than merchandise trade. The World Bank has reported that the services share of world GDP during the period 1980 to 1998 rose by 5%. In developing countries, this increase has been estimated at 9%. The GATT Secretariat estimates that services account for about 50% of foreign direct investment (FDI) flows.⁶

The volume of trade in services doubled between 1960-70 and again between 1970-75. Services account for the largest share of GDP in most

⁵ 'Focus on Services', *INDIA & the WTO* (A monthly newsletter of the ministry of commerce), vol. 1, no.6, June 1999, p.3.

⁶ ESCAP, n.4, p.50.

countries ranging from around (in year 1980) 40% in the least developed countries (LDCs) to almost 67% in the developed countries (DCs).⁷ Services trade as estimated from balanced of payments statistics was greater than \$1.3 million in 1999 representing over 1/5th of world trade in goods & services.⁸

This growth in trade in services has following reasons:

- a. technological progress, especially in telecommunications and information technology.
- b. broad trend towards liberalization /regulatory reform in key service industries: starting with the Thatcherite revolution in the UK in the late 1970s, pursued in the US (air, rail, break up of telecom monopolies);
- c. embracing of privatization and competition around the world in key infrastructural service sectors (telecom, transport, finance).

Clearly, the service sector is a leader in the global high tech economy. This makes the ongoing negotiations on services extremely important. Specifically, they represent a chance to bring forward liberalization in key sectors such as telecommunications, financial, energy, environmental, tourism and distribution services.

Furthermore, services create a win-win situation for both developed and developing countries. Unlike some North-South issues which were divisive in

⁷ JJ Schott, "Protectionist threat to trade and Investment in Services", *The World Economy*, vol. 6, no.2, p.198.

⁸ This value is widely viewed as understated, because much 'trade in services' takes place though on established presence, i.e., via. FDI, and hence generates local activity and value added that do not appear as exports in balance of payments statistics.

Seattle, the services issues was then and continues to be a relatively unifying force.

Barriers to trade in Services-

These barriers include:-

- i) Subsidies that are both direct and implicit in the operation of government owned firms .
- ii) Rationing of foreign exchange funds .
- iii) Local content rules .
- iv) Barriers to entry into the market or the local infrastructure required to service the market .
- v) Rules on the establishment of local operations.⁹

Tariffs are not included among barriers to trade in services, as it would be hard to impose tariffs on services. The tariff would have to apply to a resident or the good belonging to a resident moving across the national border and consuming the services of a foreign provider.

The definition of trade in services includes the categories where demanders and providers move. The barriers to trade involving demanders' movement are probably less significant than when providers move. Important barriers to demanders movements would be restrictions on travel (visa restrictions) or restrictions on the use of foreign exchange imposed by the home country. A provider of services may also be taxed on service exports, thus

⁹ ESCAP, n.4, p.51.

reducing the export volume perhaps by asking visitors to make transactions at a relatively high value of the local currency.

Why are services the subject of international agreements?

Global business interests are seeking binding, global and irreversible rules on services. It should come as no surprise that multinational corporations, as they expand and extend their global reach, increasingly have a strong interest in reducing the cost of complying with the regulations they face in different countries. They also benefit by reducing competition from domestic, sometimes publicly owned firms and from the privatization and commercialization of public enterprise that allows them to expand their market share. Adopting global rules to reduce or eliminate constraints placed by governments on their international commercial activity is understandably a key priority of many global corporations operating in the service sectors.

“The General Agreement on Trade in services” (GATS) Negotiations

GATS is a multilateral framework agreement that restricts government actions affecting services through legally enforceable constraints backed up by trade sanctions. The GATS is one of the numerous agreements that were adopted in 1994 as part of the newly established WTO and that apply to all WTO members.

What is most striking about services liberalization is that no broad based political challenge from developing states emerged. The resistance by less developed states to a liberal international institutional order is sometimes portrayed as a ‘*counter hegemonic challenge*’. Rather than coalescing around a

set of policies which would reflect a state led planned development approach, opposition by developing state to services liberalization slowly evaporated; moving from full opposition to discussing services in GATT prior to 1986, to acceptance of parallel discussion on services outside of GATT among contracting parties, to negotiations undertaken in good faith with the purpose of supporting multilateral trading institutions (and with the goal of linking trade in professional services to movement of labour services across borders).

The services issue was not on the GATT agenda at the beginning of 1980s. At the 25th–26th March 1982 meeting of the committee which was preparing for the November 1982 Ministerial meeting, the first mention of services took place.¹⁰

Initial Indian response for GATS:-

The initial response of developing countries specially India was then to postpone the liberalisation debate to provide more time to understand services

- a) Indian analysts argued that effectiveness of free international trade in ensuring the development of a national services sector had not been proven.
- b) Even Developed nations–Which now have large International service transactions–built service economies with the use of massive state spending on public services and physical infrastructure, and by regulatory intervention in finance and communications, rather than by the use of the markets alone.

¹⁰ Stephen D. McDowell, *A Political Economy of India's communications sector*, (London: McMillan Press Ltd., 1997), p. 93.

- c) Indian analysts also made the point that integration with world markets will make the economy more vulnerable to shifts in International economy and reduce the role of national control over domestic service activities. Deregulation and privatisation had just begun in Organisation for Economic Cooperation and Development (OECD) and led to costly mistakes over the 1980s; market shakedowns and bankruptcies. These were the policy errors which developing countries could not afford to make.
- d) The group of five (India, Brazil, Yugoslavia, Argentina, Egypt,) feared that industrialised countries could use 'trade in services' as a means to obtain concessions in the merchandise sector.

At the November 1984 annual meeting of GATT, US called for a fresh round of trade negotiations which would include services. The efforts for the new round have to be seen against the background of present state of the world economy and the situation of the US, which now feels that its power and hegemony is threatened and challenged from diverse sources. The US which still is the dominant home of the TNCs and the leading country in outward FDI is hence directing its efforts to limit national space of others, through demands for 'liberalisation' and 'deregulation'.¹¹

With OECD nations focusing on services sector, Indian Ambassador SP Shukla's proposal that there be significant enlargement of access to developing countries' exports to the markets of developed countries had little chance of

¹¹ C.Raghavan, *Recolonization: GATT, The Uruguay Round and the third world*, (Penang :Third World Network,1991), p. 68.

being accepted. It was also reported that current atmosphere of western nations was of indifference towards third world troubles. US delegation threatened to block debate on the GATT budget, if services were not included, leading to a compromise accord on services. Indian negotiators had been deserted by other developing countries at this meeting.¹²

Why US was so keen to include 'services' in GATT?

Three main reasons can be cited for this :

- a) US is the world's largest exporter of services.
- b) It has the highest percentage of it's population engaged in services.
- c) US was the earliest and furthest in it's data collection regarding services.

Many countries (India, Brazil etc.) were told that if they did not agree to the US positions, they might be deprived of concession granted by US under the Generalised System of Preferences (GSP). US representative C. Yeutter said:-

"US would not participate in the new round if the services were not included".¹³

Secondly, India also realised that if trading blocs arose accompanied by the protectionist policies of dominant trading nations and GATT lost its 'free – trade teeth', weaker nations would have no recourse. As visiting Japanese commerce officials led by Michio Mizoguchi to India tried to convince developing countries (Specially India) to participate in new round of trade

¹² Mario A.Kakabadse, "Trade in service and the Uruguay Round", *Georgia Journal of International and Comparative Law*, vol. 19, no.2, 1989, p.387.

¹³ Editorial, *The Economic Times* (New Delhi), 25th November, 1985.

negotiations. “*Not to participate*” he argued “*would leave the whole issue of protectionism and free trade to the US, which is determined to go ahead and seek bilateral arrangements*”.¹⁴

Finally, the developing countries coalition was disintegrating, due in part to their poor economic fortunes and bilateral US actions.

So, Group of five (India, Brazil, Argentina, Yugoslavia, Egypt) had decided that they would rather accept the formation of a preparatory committee rather than force a vote on the issue.¹⁵ In a last minute compromise at Punta Del Este meeting (Sept 1986) it was agreed that services would be discussed in the new round of trade negotiation, but on a parallel track among GATT contracting parties outside of GATT.

1987–88: Parallel Negotiations and Increasing Agreement

Five major issues to be addressed in 1987, consistent with the negotiating objectives of Groups of Negotiations on Services (GNS) were:

- (1) Definitional issues
- (2) Broad concepts on which principles and rules for Trade in Services, including possible disciplines for individual sectors, might be based.
- (3) Coverage of the multilateral framework for Trade in Services.
- (4) Existing International disciplines and arrangements.
- (5) Measures and practice contributing to or limiting the expansion of Trade in Services.

¹⁴ McDowell, n.10, p. 97.

¹⁵ It was the time when Brazil had a debt problem and Egypt was closely tied to the US in security arrangements.

In the course of negotiations, the developed contracting parties were laying more emphasis on transparency and progressive liberalisation in ‘Trade in Services’ by dismantling various barriers and providing non discriminatory National Treatment. Developing contracting parties, on the other hand, have emphasised that the negotiation framework in this area has to give due weightage to their developmental needs.¹⁶

Montreal Meeting: Retrieving India’s Image

In the text agreed by Ministers at Montreal, regarding progressive liberalisation of Trade in services, it was agreed that there should be “appropriate flexibility for individual developing countries in line with their development objectives.” Regarding the regulatory situation, the right of countries, particularly developing ones, to introduce new regulations is recognised. But one obvious omission in text has been of the segment relating to ‘growth and development’, which in GNS report to Montreal conference was duly incorporated specifying that the main objective of promoting growth and development should permeate through all matters to be addressed for the elaboration of the multilateral framework. Similarly, Montreal text excluded GNS report item about ‘special and differential (s&dt) treatment’ to be granted by developed countries to the developing ones. The wording was seen as limiting s&dt only to least developed countries.¹⁷

¹⁶ John Croome, *Reshaping the world Trading System: A history of the Uruguay Round*, (Geneva: WTO Publication, 1995), p.123.

¹⁷ Sec United Nations, *Trade and Development Report*, (Geneva, 1989), p.28.

Still, Montreal meeting certainly retrieved India's image as a contracting party to be reckoned with. Both EEC and USA now recognise the effective role India can play in the course of negotiations.

1989–90: Unilateral US trade complaints and Multilateral Trade negotiations

After 1988, India's strategy was to bargain as effectively as possible to protect the national interest.¹⁸ But in line with earlier patterns efforts were also made to reconstruct a common position among developing countries.

In May 1989, US listed Japan, Brazil, India as priority countries for bilateral trade consultations'.

Finally, NAM and G-77 coalitions could not be held together given threatened (and implemented) economic coercion; for e.g. US had doubled the duties on some Brazilian imports and India was the only country which was named for a second year (1990) under section 301 of US Omnibus Trade and Competitiveness Act, 1988.

Bringing the Round to a Close

In early 1991, extensive negotiations on trade liberalisation in specific services sectors had taken place (labour, finance, telecom, maritime).¹⁹ There was a shift in the negotiation process on the GATS from the negative list (which would list only activities where countries won't be allowing free trade, leaving all else open) to a positive list approach (listing areas which will be

¹⁸ It was also because of domestic shifts in India. The services sector had gone from 24% of Indian net domestic increase in 1951 to the 40% in 1987. India also realized that it could be competitive in international services markets by exploiting their particular comparative advantages in many services for e.g., construction, health, software, consultancy services. See Andre Sapir, "North South Issue in Trade in services", *World Economy*, vol. 8, no.1, March 1985.

¹⁹ See more on these controversial issues/services, Croome, n.16, pp. 314-315.

opened). The level of development of a particular country was recognised as a factor in Draft Final Agreement of December 1991.

Later on, Interests of US and France Clashed on opening up of Audio–Visual sectors. In financial services, US declared that it would give Most Favoured Nation (mfn) treatment only to countries which offered equivalent benefits to US financial institutions. US was not yet among the 25 declared potential participants and was known to be reluctant to offer access to shipping services. Conflict between US & EU on agricultural issues was the main hindrance to the conclusion of a huge and complex trade round.

In sudden developments, changes occurred in rigid attitudes of member states. India introduced with the support of US, a proposal for a post round examination of how qualification and licensing requirements for professional services might be prevented from blocking trade unnecessarily. This proposal got approved.

EC dropped its conditions for the maritime service negotiation. But on Audiovisuals EC making no offer, the whole Audiovisuals annex was lost from services agreement.

In financial service sector, a formula was adopted; which would allow countries not satisfied by results of further negotiations to withdraw offers, without giving compensation, up to six months after Uruguay round results came into the effect.

Thus, an overall trade agreement was finally concluded in Marrakesh on 15th April 1994.

Obligations Under The GATS

The GATS is divided into a set of general obligations and obligations related to specific commitments that are entered into by members.

A. General Obligations

1. ***Most favoured Nation (MFN)***:- This clause applies to all measures and all sectors whether or not specific commitments have been made. Some exemptions to MFN rule are allowed, but members must claim that by listing measures when the GATS comes into force. If an exemption is not claimed at that time, member loses an opportunity to discriminate among other member countries. All exemptions are to be removed over a five to ten year period and must be reviewed after five years.
2. ***Economic Integration***:- GATS will accept regional arrangements in service trade, but any regional agreement should have 'substantial sectoral coverage' which applies to the numbers of sectors affected as well as modes of supply. GATS rule required the elimination of existing discriminatory measures and/or the prohibition of new measures. GATS text can be interpreted as referring to the average level of barriers to trade in services that applies to countries outside the regional agreement.
3. ***Recognition***:- Art. VII of GATS refers to selective recognition of other people's standards, such as educational requirements in various professions. The countries ought to use criteria, which are

transparent when deciding whether or not to recognize other people's standards. The members should not discriminate in the application of those criteria. The article asserts that countries which are not party to an agreement should have the opportunity to demonstrate that their standards are equivalent to those of the parties to the agreement.

4. **Transparency:-** Members are to publish details of 'all relevant measures of general application which pertain to or affect the operation of the GATS'. However, members have to notify a newly created Council for Trade in Services of any changes to those measures that will affect their specific commitments under the GATS.

B. Specific Commitments

Market access, national treatment and other such elements of the liberalization process are subject to specific commitments made by each member country. Members list sector for which they are willing to make commitments, and these commitment don't apply to sectors not listed. For those sectors listed, members make explicit limitations on market access and limitations on national treatment. In each category, reference must be made to four modes of delivery:

- (1) Cross border supply (mode I)
- (2) Consumption abroad (mode II)
- (3) Commercial presence (mode III) and
- (4) The presence of natural persons (mode IV)

'National treatment' in the GATS means that a member country treats suppliers from other member countries 'no less favourably' than its own suppliers, apart from the measures for which specific commitments are made in the agreement: *'Market Access'* is defined as the absence of various quantitative barriers to trade (for e.g., the number of suppliers, the value of the transactions or assets, the quantity of output or the number of natural persons involved).

Hoekman argues that specificity in GATS will make it more difficult for governments to point to external pressures for internal reform. Instead, domestic lobbies will mobilise to argue that why their sector should receive the special treatment which is possible under GATS. So, there is concern about endorsing 'appropriate flexibility for developing countries'.

The *transparency* provisions of the Agreements are significant in addressing the concerns about the contribution of the GATS to the political economy liberalizing trade in services. Reports on the extent of liberalization across sectors in each member country's economy can contribute to the process in other member countries.²⁰

The GATS 2000 Agenda

The GATS 2000 negotiations are now well underway. In late May 2000, the WTO Council on Trade in Services adopted an ambitious agenda for future work, calling for members to submit initial market access proposals by December 2000, followed by a 'stock-taking exercise' in March 2001. While the real trade-offs and arm-twisting may only take place in the latter stages of

²⁰ <http://www.services2000.ic.gc.ca>

negotiations, the collective decisions made by negotiators in this early 'rule-making' phase of the talks could profoundly affect the scope and coverage of any revised GATS package that emerges from this negotiating round.

The program to broaden and deepen the GATS can be grouped into the three main areas:-

1. ***Expanding market access commitments:-*** This will include the push to expand the number and extent of specific commitments in national schedules, to remove existing limitations within already committed sectors, and to bind more new and existing commitments so that future governments can't reverse them.
2. ***Negotiating new and expanded horizontal, "across the board" commitments:-*** This refers to the negotiation of crosscutting commitments that apply across members, sector and/or modes of supply.
3. ***Placing new constraints on domestic regulation:-*** Art. VI:4 calls for the development of any 'necessary disciplines' to ensure that 'measures relating to qualification requirements and producers, technical standards and licensing requirements don't constitute unnecessary barriers to trade'. The working party on Domestic Regulation was formed to fulfill this mandate and negotiations are well under way in Geneva.

Besides these, negotiations are on to develop new GATS rules and restrictions; for e.g., emergency safeguards to provide temporary protection to domestic service suppliers, further constraints on subsidies, and covering government procurement of services.

GATS' contribution in the longer run will depend on:

- (1) the outcome of on-going negotiations in financial services, telecommunications and movement of labour.
- (2) development of a body of case materials that clarify provision of the agreement and their interpretation.

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CHAPTER II

ISSUES AND STRATEGIES FOR INDIA IN WTO

TELECOMMUNICATION SERVICES NEGOTIATIONS

Telecommunication is both the architect and the architecture of globalisation, and a facilitator of beneficial interdependence of economies. Telecommunications has spurred innovations that have led to tremendous growth, among other services, in international financial services. Other service markets such as IT-enabled services and “remote service” depend crucially on telecom infrastructure. In the information age, India’s ability to take advantage of its massive pool of skilled technical persons to export software and IT-enabled services would depend a great deal on the status of the domestic telecom infrastructure.¹

Estimates of International Telecommunications Union (ITU) show that global telecom revenue in 1998 stood at US\$722.5 billion, a figure which represented 2.4% of global GDP (The revenue estimate does not include revenues from cellular mobile, radio paging, or data services if these services are not provided by the main fixed line operator). The rate of growth of this revenue is relatively high, with telecom being one of the dynamic sectors in the world economy. Soon, telecom revenue is expected to cross the US\$1 trillion mark. Dynamic opportunities in telecom arise to a large extent on account of the rapid growth of the newer services. For example the average growth of the

¹ Macro CEJ Bronckers and Pierre Larouche, “Telecommunication Services and the World Trade Organization”, *Journal of World Trade*, vol. 31, 1997, p.5.

number of cellular mobile subscribers has been about 50 per cent since 1990. likewise, due to increasing importance of data traffic in total traffic, the proportion of voice in total traffic will become less than 5 percent within the first decade of this century.

A notable feature of the telecom service industry is that a large portion (i.e. about three-fourths) of the telecom revenue is accounted for by only the top twenty Public Telecommunication Operators (PTOs). Nine of the top twenty PTOs are from the United States (like AT&T, Bell Atlantic, SBC, GTE) showing the basis for United States' major interest in seeking market access opportunities abroad. A somewhat wider list of countries emerges when we consider the list of top international carriers (see table 1 below). With this coverage, the countries with a major interest in access to the telecom market would include not only the major players in OECD, China, Brazil and Republic of Korea, but also Singapore and India.

Table 1
Top International Carriers, Ranked by International
Telecommunications Revenues, 1997

Company	International Revenue (\$m)	Total Revenues (\$m 1997)
AT&T (USA)	8,200	51,319
MCI (USA)	3,400	19,653
China Telecom (China)	2,355	15,821
Sprint (USA)	1,636	14,873
Telmex (Mexico)	1,432	7,534
Singapore Telecom (Singapore)	1,263	3,051
VSNL (India)	778	1,630
Telkom	585	4,024

Source: WTO Document S/C/W/74, dated 8 December, 1998 from <http://www.wto.org>

The importance of external markets becomes apparent if we look at the picture on investment in telecom in various parts of the world. For example Table 2 (below) shows that while the major portion of telecom revenues is earned in the Americas and Europe, a large portion of the investment in telecom is taking place in Asia.

Table 2
Telecommunications Investment in India and Other Selected Areas

	Telecommunications Investment, 1998 (Billion US\$)	Proportion of Gross Fixed Capital Formation (%)	Teledensity, 1998 (Main telephone lines per 100 inhabitants) (%)
India	2.4	2.4	2.2
World	175.6	2.4	14.2
Africa	4.6	4.2	2.2
Americas	41.9	1.4	32.3
Asia	78.0	3.2	7.3
Europe	47.8	2.8	37.2
Oceania	3.2	4.3	40.2

Note: The ITU statistics for teledensity include payphones for most countries, and the estimates the populations are for mid-year. Therefore, the ITU's teledensity estimate may vary slightly from the teledensity estimates calculated with year-end population and telephone lines excluding payphones.

Source: ITU (www.itu.int).

Therefore, while Asia is a region that is already attracting substantial investment in telecom, there will continue to be focus on telecom investment in Africa too (there being very low teledensity), even if the volumes are substantially lower. This has implications for investment opportunities that may open up, inter alia, in the process of divestment of Public Telecom Utilities that is taking place in a number of countries, including in Africa.

Telecom activity and investment in NICs and developing countries are likely to continue to grow rapidly in the next few years since the teledensity in these countries is much less than the global average (or in many cases less than the average for their region). This tendency will receive an additional impetus due to technological changes, which is bringing down the costs and increasing the affordability and availability of a large number of telecom services. Further, there is also a widespread view that the dynamic opportunities in the early part of the 21st century will depend on access to telecom. Thus, telecom markets and investment in these countries would tend to grow even than would be expected with the pattern of investment reflecting current technologies.

Telecommunication Services in the Indian Economy

India operates one of the largest telecom networks in the world, with about 25 million telephone lines. India's Telecom Sector grew at a rate of 22.8% during 1994-95.² A noteworthy feature is that during the 1990s, India registered very rapid growth in telephone lines (also referred to as DELs or "Direct Exchange Lines"). At about 20 per cent annum, this growth rate is much faster than in most countries of the world, and implies a doubling of the network size in less than every five years. However, there is still a considerable waiting list in several parts of the country, and a large number of villages are

² Neela Mukherjee, *World Trade Organization and India's Trade Policy in Services*, (New Delhi: Vikas Publication House, 2000), p.147

yet to be provided telecom access. By the end of September 1999, 3.43 lakh villages out of 6.07 lakh had been provided with public telephones.³

Further, along with managing the large investment to cater to the potential demand, there is also a need to ensure that new and efficient technology is installed in the network. This is imperative for a sector such as telecom where technology is changing rapidly, resulting in cost decline as well as convergence of technologies and products.

Though the cellular subscriber base is not an adequate measure for teledensity⁴, its (cellular services) scope for expansion together with the scope in related services is an indicator of a very large potential market, making India an attractive market. This high growth of the telecom sector activity, especially for the new and value-added segments of the market, suggests that if the sector's growth is allowed to progress (in particular through competition, especially in the provision of a fibre optic backbone), the current size of the domestic telecom market of about US\$ 5 billion a year could increase to even US\$ 100 billion in about ten years. India has a Long Distance Transmission Network of about 1,65,000 route kilometers of terrestrial Microwave Radio Relay and co-axial cables and about 96,261 route kilometers of Optical Fibre Cables. The total number of stations connected to National Subscriber Dialing (NSD) is over 16,019 and this number is increasing fast.

³ R.Kathuria, S.K. Nair and H.V. Singh, "Telecommunications" A Paper Prepared for the NCAER-ADB study on Indian Infrastructure, New Delhi, 2000.

⁴ For most subscribers to Cellular Mobile, the Cellular Phone is an addition to their basic telephone. Therefore, only a small proportion of the cellular mobile subscriber may be considered as being those who aren't already covered by the teledensity estimates given for basic service.

Certain Other Features of the Indian Telecom Scenario that are Important

for Policy Formulation: One is the fact that a minor proportion of total subscribers provide a large share of the total call revenue. For example, about 5 percent DELs provide about 55 per cent of the call revenues, and about 14 per cent DELs provide about 70 per cent of the call revenues (and a much larger share of surplus). Any competitor to Bharat Sanchar Nigam Limited (BSNL) and Mahanagar Telephone Nigam Limited (MTNL) in the market will focus mainly on these high revenue subscribers. Loss of such subscribers through competition would result in a reduction of BSNL's available surplus unless there is an increase in certain tariffs that are at present below cost. This reform will become even more necessary when the long distance sector is opened up to competition.

Another is the High Tariffs for long Distance Calls in India, especially for distances above 200 kms. This makes investment in long distance telephony attractive, unless interconnection chargers (which are yet to be fully worked out) significantly reduce the perceived surplus. The BSNL has announced that it will be providing relatively cheaper long distance calls on the basis of packet-switching. With new service providers entering the long distance market, and the availability of frontier technologies, which will drastically reduce the costs of long distance transmission, there will be great downward pressure on tariffs for this service. These lower tariffs will greatly benefit subscribers, while putting downward pressure in the near term on the revenues for BSNL.

In addition, various policy initiatives that are mentioned in New Telecom Policy 1999 will have a bearing on the negotiating position of India in the WTO.

Impact of Liberalization on the Sector

The national monopolies which have dominated the industry in almost all countries until very recently are now facing competition and in many countries are being privatized. As of July 1998, over 1000 facilities-based international carrier were operational worldwide, compared with less than 500 just two years earlier.⁵

Competitors are prompting sharp reductions in prices of international and national long distance services. In emerging economies where commitments on wire-based infrastructure and public voice services are often to be phased in later, new providers of liberalized wireless services are increasing the pace of entry into local service markets, supplying service to consumers who have been waiting for fixed lines to be installed.

The clear prospect of competition has also further accelerated the pace of innovation, leading to new services that may have been difficult to foresee less than five years ago when WTO negotiations concluded. New equipment technologies and deregulation are contributing to a rapid breakdown of service segmentation. Suppliers are now seeking to combine, for eg. fixed and mobile services into an integrated service. New and traditional operators are hastening to integrate internet-style backbones into their network infrastructure. With

⁵ *Telecommunication Services: Background note by the Secretariat*, (Geneva: World Trade Organization, 1998), www.wto.org.

new satellite services such as Global Mobile Personal Communications by Satellite (GMPCS) just beginning to come on line, still further advances in satellite based services with full multimedia capabilities—the so-called third generation technologies—are expected to become operational well with in four to five years.

Definition Of The Sector

‘Telecommunications’ as defined in the Annex on Telecommunication in GATS implies “the transmission and reception of signals by any electric-magnetic means, which enjoys both economies of scale and scope.”⁶

The GATS sectoral classification list (MTN-GNS/W/120) breaks down telecom into 14 sub sectors (a-n) and an “other” category (o) (spelled out in Annex). For the purposes of the negotiations on basic telecom, sub-sectors (a) through (g) of this list, as well as a variety of “other” services, including mobile telecommunications, providing real-time transmission of customer supplied information (usually listed under sub-sector o.), were generally considered *basic telecom services*. Subsectors (h) through (n) and any other services, not supplied on a real time basis or which transform the form or content of customer’s information were considered *value-added telecom services*.⁷

It is recognized, however, that this breakdown doesn’t necessarily reflect and does not need to correspond to any particular governments national practice with respect to classifying services as basic or value added, for e.g. it

⁶ Neel Mukherjee, n.4, p.140.

⁷ *WTO focus Newsletter*, (Geneva, October-November 1997), p.19.

is not uncommon for mobile telephony, paging or data transmission (whether or not real time) to be designated as value added services in national regimes.

A difficulty with GATS list of telecom services is that the distinction between many of its subsectors has blurred with the adoption of new transmission technologies, the enhanced ability to integrate different technologies and the advent of service suppliers who distinguish themselves not by specializing in particular telecom services, but rather by the marketing segments they seek to serve.

Relevant Provisions of GATS and Other Rules and Disciplines for Telecommunications

While the result of the WTO negotiations on market access for basic telecommunications services formally entered into force on 5 February 1998, the WTO rules relevant to telecom are also contained in the GATS and the Annex on Telecom, which entered into force in January 1995.

a) The Schedules Of Commitments

Article XX of the GATS provides that WTO Members should specify their specific commitments in their Schedules of commitment. Not all the WTO Members have undertaken disciplines in the area of telecom through their Schedules of commitment. 93 WTO Member Governments included commitments on telecommunications in their Schedules (there were 82 Schedules, because the European Union provided a combined Schedule of commitment for its Member countries). The markets of these participants account for more than 90 per cent of global telecommunications revenues.

The Schedules of commitments specify both the telecommunications service sector in which commitments have been undertaken by a WTO member, and the nature of these commitments with respect to market access and national treatment. These commitments are made separately for each mode of service supply. In certain cases, Members have undertaken additional commitments (on licensing and regulatory principles) in their Schedules of commitments. While one Schedule specifies the conditions and qualifications attached to Market Access and National Treatment by Members, another Schedule contains the MFN exemptions specified by countries.

Based on an interpretative note issued by the Chairman of the Negotiating Group (on Basic Telecom), an understanding was developed that unless specified, the scheduled commitments would cover all the relevant dimensions of basic telecom services in terms of:

- local, long distance and international services;
- public and non-public services;
- supply on a facilities basis or through resale;
- technology-neutrality with respect to supply by cable, radio, satellites, stationary and non-stationary means.

b) The Annex On Telecommunications

The Annex on Telecom comprises seven sections, with the core obligations contained in the section on access to and use of “public telecommunications transport network and services” (or PTTNS). These require WTO members to ensure that access to and use of the PTTNS are

allowed on reasonable and non-discriminatory terms for the supply of services included in its schedules. Further, since this discipline covers “access to and use of” telecom services publicly made available, Members must ensure that their obligations under the GATS framework are fulfilled for access to any entity that is providing PTTNS. This would be true even when no basic telecom service commitments have been made by the government in its schedule, and whether or not such PTTNS is supplied by a monopoly or through competition. In, as, much as a Commitment in a Member’s schedule on basic telecom services is for the supply of that services, access to and use of PTTNS on reasonable and non discriminatory terms is a mandatory requirement under the provisions of this Annex. This would imply non-discriminatory treatment in the matter of interconnection between privately and publicly owned networks.⁸

In terms of the provisions of this Annex, on Telecom WTO Members have to ensure that relevant information on conditions affecting access to and use of public telecom transport networks and services are publicly available. Examples of such measures include tariffs and other terms and conditions of services, specifications of technical interfaces with such networks and services, information on bodies responsible for standards affecting access and use, conditions applying to attachment of terminal or other equipment, and notifications, registration or licensing requirements

⁸ Arun Goyal (ed.), *WTO in the New Millennium* (New Delhi: Academy of Business Studies, January 2000), fourth edn., pp.509-510.

c) *The Reference Paper*

A Reference Paper was prepared to lay down regulatory disciplines that were necessary to promote competition in this sector. Adherence to these principles, however, was voluntary and subject to whether or not WTO Members inscribed them into their schedules as additional commitments.⁹

The Reference Paper includes commitments to:

- adopt safeguards to protect against anti-competitive behaviour including use of cross-subsidy, or misuse of information;
- establish terms and conditions for non-discriminatory interconnection to be provided by major suppliers, under conditions, rates, and quality no less favourable than that provided to all other suppliers of like services;
- provide interconnection in a timely manner, on transparent and reasonable terms and conditions, and at cost-oriented rates;
- utilize transparent (i.e. publicly available) criteria in licensing;
- establish an impartial regulator, independent of any service supplier;
- utilize objective, timely, transparent and non-discriminatory procedures for allocation of scarce resources such as radio frequencies, numbers and rights of way.

Liberalization in Telecommunication Services Under the GATS

As of January 2000, 93 WTO Members had included telecommunications services in their Schedules of Commitments. Basic telecommunications is included in the schedule of commitments of 83 WTO

⁹ *ibid.* pp. 506-507.

Members and value added services have been committed on by 72 Member governments. Even though more commonly subject to competition, they are listed in fewer schedules than basic services because the extended negotiations concentrated on the latter. In addition, 72 Members have committed on some or all aspects of the Reference Paper. Of these 66 have accepted the Reference Paper in its entirety or with minor modifications. All industrialized countries have taken commitments on basic telecommunications, most value-added sectors, and the Reference Paper.

The Nature of Commitments Made in the Schedules, Including the Types of Limitations on Nations Treatment and Market Access

Most of the WTO Members have made partial commitments. Such partial commitments are made much more for the mode of supply “commercial presence”, than for other modes of supply.

Another noteworthy feature is that the mode of supply “commercial presence” is also subject to the highest number of limitations. Most limitations relate to “nationality requirement”, followed by limitations relating to residency requirement, authorizations requirements, and ownership of property land.

The number of limitations for “market access” are much more than those for “national treatment”. These related mainly to limitations on number of suppliers, types of legal entities, and participation of foreign capital.

Although there was general appreciation among Members that the accounting rate regimes in place would not be able to withstand the pressures

brought about by competitive markets, it was decided to secure a shared understanding that Members would not challenge each other's accounting rates under the WTO's dispute settlement regime.

Exemptions to MFN Treatment

Exemptions to MFN treatment for telecommunications were taken by: Antigua and Barbuda (relating to Government extending to nationals of other Caricom-member countries treatment equal to its own nationals); Argentina (supply of fixed satellite services by geostationary satellites); Brazil (relating to distribution of radio or television programming directly to consumers); Bangladesh, India, Pakistan, Sri Lanka (the possibility of permitting Government or Government-run operator to apply differential measures, such as accounting rates, in bilateral agreements with other operators or countries); United States (for one-way satellite transmission of DTH and DBS television programming directly to consumers).¹⁰

Table 3 shows the telecom. Sectors for which different WTO members have made commitments.

¹⁰ Willam I. Drake and Eli M. Noam, "Assessing the WTO Agreement on Basic Telecommunications" in Gary C. Hufbauer and Erika wada (ed.) *Unfinished Business, Telecommunications after the Uruguay Round*, (Washington D.C.: Institute for International Economics, December 1997), pp.40-44.

Table 3

Number of Telecommunication Service Sectors Covered by Various
WTO Members in their Schedules Commitments¹¹

Number of Service Sectors Covered	Countries
17	Antigua and Barbuda, Barbados, Belize, Czech Republic, Dominica, Georgia, Hungary, Jamaica, Jordan, Kenya, Kyrgyz Rep., Latvia, Slovak Rep., Switzerland, Turkey, United States of America.
16	Argentina, Brazil, Canada, Estonia, Grenada, Korea Rep., New Zealand, Romania
15	Austria, Colombia, Hong Kong, Malaysia, Mexico, Peru, Poland, South Africa
14	Australia, European Community, Finland, Iceland, Japan, Norway, Sweden, Trinidad and Tobago
13	Bulgaria, Israel, Nicaragua
12	Chile, Morocco, Pakistan
11	Gambia, Indonesia, Philippines, Senegal, Singapore, Zimbabwe
10	Bangladesh, Cote d' Ivoire, Djibouti, Dominican Republic, Ghana, India, Mauritius, Nigeria, Uganda
9	Bolivia, Ecuador, El Salvador, Guatemala, Liechtenstein, Papua New Guinea, Suriname
8	Brunei Darussalam, Panama, Thailand
7	Cuba, Mongolia, Venezuela
6	Lesotho, Sri Lanka, Tunisia
5	Slovenia
4	No Countries
3	St. Kitts and Nevis
2	No Countries
1	Congo RP, Guyana

¹¹ Dr. Harshvardhan Singh Report on *Trade in Telecommunication Services Opportunities and Constraints*, Project Study Sponsored by Ministry of Commerce, Government of India (New Delhi: ICRIER, 2000), p.33.

A comparison of commitments made by the US Australia, Argentina, Switzerland, Japan with that made by India would indicate the limited nature of India's commitments. These were as follow:

(a) **For voice telephony** (limited to local/long distance, for public use over a public telecommunication transport network, wire based, i.e. for fixed network of subscribers):

- provision of the service through commercial presence only after the operator gets the requisite license;
- induction of one operator other than DOT/MTNL in each service area for a period of 10 years after which the position will be reviewed;
- the private operator should be a company registered in India in which total foreign equity must not exceed 25%;
- the service operator will be permitted to provide long distance service within the licensed service area only;
- resale of voice telephony will not be permitted, but licensees can grant franchises for providing public call offices service.

(b) **For circuit switched data transmission services:**

- licensed voice telephone service operators will be permitted for transmission of data on the PSTN network in its licensed service area.

(c) **For Facsimile services:**

- licensed voice telephone service operators will be permitted for transmission of facsimile on the PSTN network in its licensed service area;

- franchisees of service operators can provide commercial facsimile services.
- (d) **For private leased circuit services:**
- licensed voice telephone service operators will be permitted to provide leased circuits to their customers, for their own use within their licensed service area;
 - resale of such leased circuits will not be permitted.
- (e) **For Cellular mobile telephony:**
- the requisite license has to be obtained by the operator;
 - only digital (GSM) technology will be permitted and this will only be terrestrial based;
 - there will be two cellular operators in each service area;
 - the position will be reviewed after 10 years;
 - the right of DOT/MTNL to enter into each service area is reserved;
 - the private operator should be a company registered in India in which total foreign equity must not exceed 25%.
- (f) has **MFN exemptions** with regard to accounting rates.
- (g) **Additional commitments** taken are as follows:
- opening up of national long distance service beyond the service area to competition will be reviewed in 1999;
 - opening up of international service to competition will be reviewed in 2004;

- commitment to a revised text (i.e. revised by India for its purpose) of the Reference Paper for regulatory framework. This revised text either deletes some provisions from the References Paper or alters it to clarify India's commitment.

If one compares the relevant text of the Reference Paper and the commitment made with respect to those provisions by India, India's commitments relating to Reference Paper do not include the following disciplines:

- should not engage in anti-competitive cross-subsidization;
- provision of interconnection in a timely fashion on terms and conditions and cost-oriented rates that are transparent, reasonable, and sufficiently unbundled;
- provide interconnection at any technically feasible point in the network;
- make publicly available the period of time normally required to reach a decision concerning an application for a license;
- make known to the applicant for a license, upon request, the reasons for the denial of a license;
- procedures for allocation and use of scarce resources (including frequencies, numbers and rights of way) being carried out in a transparent and non-discriminatory manner;
- make publicly available the current state of allocated frequency bands, without there being a need to provide a detailed identification of frequencies allocated for specific government uses.

Comparison of WTO Commitments made by India with the actual policy implemented/under consideration

India has made commitments only under mode 3 (i.e. commercial presence). Mode 4 for this sector is covered by its horizontal commitments which are limited to the entry of and temporary stay of business visitors, intra-corporate transferees like managers, executives and specialists and professionals.

Comparison of the applicable policy regime with India's commitment reflects the fact that the applicable regime is far more liberal than the commitments made by India. The value of a binding at below status quo is attenuated by the scope it gives a government to worsen existing conditions of market access without violating a GATS commitment.¹² Moreover, the process of telecom liberalization is continuing and this will further augment the telecom market available to investors from India and abroad. (*see table 4 & table 5*)

¹² Patrick Low and Aditya Matto, "Reform on Basic Telecommunication and the WTO Negotiations: The Asian Experience" Paper Presented at the Asian Development Bank conference on *The impact of the Uruguay Round on Asia*, (Manilla, 25 November, 1997).

Table 4

Market Structure for Selected Telecommunication Sector in India:
Next Few Years Following NTP 1999

Segment	Market Structure	No. of Operators Per Service Area	Service Areas	Period of License
Fixed Telephone Services	Duopoly	2 (Eventually multipoly)	Delhi and Circles	20 years
Domestic Long Distance	Multipoly	Market determined	All India	20 years
International	Monopoly (VSNL)	1 (till 2004)	All India	No Limit
Cellular	Oligopoly	3 (others on recommendation of TRAI)	Metros and Circles	20 years
Radio Paging	Limited Competition	4 (others on recommendation of TRAI)	Cities and Circles	20 years
GMPCS*	Full Competition	1 at present (free entry allowed)	All India	20 years

(GMPCS* = Global Mobile Personal Communication System by Satellite)

Source: TRAI (1999), Consultation Paper on Liberalization of Domestic Long Distance Service, and NTP 1999.

Table 5
Chronology of Significant Events in the Process of India's Telecom De-Regulation¹³

Date	Event
June, 1992	Bids invited for radio paging services in 27 cities
July, 1992	Bids invited for cellular mobile services in four metro cities
May, 1994	National Telecom Policy announced
July, 1994	Radio paging, V-SAT data services, electronic mail services, voice-mail and video-text services opened to private providers
September, 1994	DoT guidelines for private sector entry into basic telecom services in the country
October, 1994	Eight cellular licensees for four metros finalized
January, 1995	DoT calls for proposal to operate basic, cellular telecom services and public mobile radio trunked services (PMRTS)
August, 1995	DoT receives bids for basic, cellular and PMRT services
December, 1995	Most cellular operators in circles sign license agreements
December, 1995	DoT announces cap on the number of circles basic operators can roll out services in Licenses selected for five circles.
January, 1996	After setting reserve prices for circles, DoT invites fresh bids for basic services in 13 circles
March, 1996	Five successful bidders short-listed for providing basic services
January, 1997	Telecom Regulatory Authority of India (TRAI) formed.
February, 1997	First basic telecom service company signs license and interconnect agreements with DoT for Madhya Pradesh
March, 1997	TRAI becomes operational with the induction of a chairperson, vice-chairperson and a Member Second basic service provider signs basic telecom license agreement for Gujarat
September, 1997	Internet Policy cleared; License agreement for basic services in Maharashtra also becomes operational
November, 1997	Basic service licensees for Andhra Pradesh and Punjab sign basic telecom agreements with DoT.
March, 1999	TRAI Issues First Tariff Order.
March, 1999	New Telecom Policy approved; License period extended to 20 years, renewable.
May, 1999	TRAI Issues First Regulation on Interconnection and Usage Charge
September, 1999	Cellular operators allowed the use of any digital technology; MTNL given a license to provide cellular mobile service under these flexible technology conditions.
October, 1999	Cabinet approves switch-over from bid amounts for license fee to revenue share license fee for basic services and cellular mobile
2000	Government has allowed the setting up of eight international gateways to private internet operators; Government is considering the conditions under which domestic long distance sector will be liberalized; DoT announces that it will provide (on an experimental basis) long distance calls services using packet-switching technology; DoT to enter the cellular mobile market in Assam, Bihar, West Bengal and Tamil Nadu by mid-2000; All district headquarters to be connected by internet nodes in 2000; Mergers/acquisitions of certain cellular mobile firms in India has started, which is likely to give rise to entities with substantial network, subscriber and resource base; Corporatization of DTS and DoT and new corporation Bharat Sanchar Nigam Limited (BSNL) came into existence.

¹³ Dr. Harshvardhan Singh, n.11, pp.40-41.

Similarly, certain regulatory disciplines committed by India (in terms of the Reference Paper), are less onerous than the disciplines actually applied in practice. For example, under the WTO, India has not agreed to apply a non-discriminatory interconnection regime, but non-discrimination is one of the principles of the interconnection regime that has been specified by the regulator, i.e. by Telecom Regulatory Authority of India.

Further, India is embarking on liberalization in a number of telecom sectors, and the actual extent of liberalization is likely to be increased even more in the future, bearing in mind that the negotiations at WTO will take a few years to be concluded. These changes may occur even with respect to internet telephony and international call market, given the recent policy initiative for providing long-distance calls through packet-switching, and the permissions granted to establish private international gateways. One implication of these various policy initiatives would be that India could improve its commitments under the WTO without any need for altering its policy as a consequence of making such an offer. Another is that the unilateral policy changes made by India would provide a basis for others to seek even greater access from India than they may have without such policy changes.

Therefore two important questions for India during the negotiations will be:

- Which of the policy initiatives that it has taken (or will take in the near future) could be included in the list of commitments that may be made under the WTO process;

- What are the likely demands of other nations that would extend beyond the unilateral policy initiatives taken by India, and to what extent should such demands be considered for India's possible commitments under the WTO.

External Constraints on India's Exports of Telecom Services

India's main objectives in the area of telecom include provision of world class telecom services at affordable prices, and achieving the Universal Access objectives. At present there doesn't seem to be any major external constraints on India's exports of telecom services under "commercial presence", "cross border" and "consumption abroad" modes of supply. In general, Indian telecom companies are not planning investment in telecom ventures in large markets; in any event, there is considerable flexibility provided in these market in case Indian firms contemplate operations there.

Under cross border supply of Indian telecom services through International calls/internet, there doesn't seem to be any significant demand from India regarding liberalized policies of other countries. Rather, India has to make efforts to improve its capacity and environment for increasing the supply of such exports.

Same is the case with the export of telecom services through the mode of supply "consumption abroad" involving sales of telecom services in India to foreign consumers. "Movement of natural persons" is not a common mode for supply of telecom services, therefore there is unlikely to be any specific negotiating demand from India with respect to this mode.

There is however a likelihood that other countries will demand commitments from India regarding its telecom policies. Before considering the likely demands that other countries will make regarding Indian policies, it would be useful to take a look at Indian telecom policy initiatives, including the various priority areas for policy action.

Telecom Policy Developments in Indian Telecom Sector

Although some policies to liberalize telecom came forth before the announcement of 1994, National Telecom Policy (NTP), a major policy reorientation was established only with the announcement of NTP, 1994.

NTP 1994 recognized that the public sector entities were not adequate to increase the capacity to meet the anticipated demand. DoT's perspective plan for the years 1997-2007 estimated that for the next seven years, financing an addition of 60 million new phone connections would involve an outlay of about Rs. 1.8 trillion at current prices; where as the total ninth plan public sector outlay for communications including of information technology and posts is Rs. 476 billion.

The government recognizes that the result of the privatization has so far not been entirely satisfactory. The main reason, according to the cellular and basic operators, has been the fact that the actual revenues realized by these projects have been far short of the projections and the operators are unable to arrange financing for their projects and therefore complete their projects.¹⁴

¹⁴ 'New Telecom Policy, 1999', Department of Telecom, Ministry of Communication, New Delhi, p.2.

Besides this, there have also been far reaching developments in the recent past leading to convergence of technologies and services. This convergence now allows operators to use their facilities to deliver some services reserved for other operators; necessitating a relook into the existing policy framework.

The new telecom policy framework was also required to facilitate India's vision of becoming an IT super power and develop a world class telecom infrastructure in the country.

NTP, 1999 balances the provision of 'Universal Service' (including unconnected and rural areas, re-targeted for year 2002) with the provision of high-level services capable of meeting needs of the country's economy. The latter objective is further amplified to include 'Internet' access to all District head quarters by 2000, and providing high speed data and multimedia capabilities to all towns of population of 200,000 and above by 2002.

Whereas NTP 94 only acknowledged the need to induct private participation in a big way into value added as well as basic services, and to "ensure fair competition", NTP 99 goes further in targeting a greater competitive environment and a level playing field between private and public sector operators. NTP 1999 sets a target average penetration of 7 per hundred by year 2005 (and 15 per cent by 2010), and targets for rural 'tele-density' to increase from the current of 0.4 per cent to 4 per cent during the same period.

To meet the tele-density targets, it is estimated that a capital expenditure of Rs. 4000 billion for installing about 130 million lines will be required.

Recognizing the role of private investment, NTP 1999 envisages multiple operators in the market for various services. The Policy allows DoT/MTNL to enter as third cellular mobile operators in any service area, if they wish to provide these services. To ensure a level playing field, DoT and MTNL will have to pay license fee but DoT's license fee will be refunded on the ground that it has to meet the Universal Service Obligations.

Another major change has been a shift from the existing license fee system to one based on one time entry fee combined with revenue share payments as license fee. (percentage to be decided by the government in consultation with the TRAI)

Following are some of the other notable steps envisaged under the 1999 Policy

- Speeding up competition in domestic long distance, including usage of existing backbone network of public and private entities in Rail transport, Power and Energy sectors for data (immediately) and for domestic long distance voice communication when latter is opened to competition from January 2000. This opens up the scope for entry of a new category of 'infrastructure providers' or 'carrier's carrier';
- The Fixed Service Providers (FSP) to be freely permitted to establish 'last mile' linkages to provide fixed services and carry long distance traffic within their service area without seeking an additional license;
- Achieving efficiency and transparency in spectrum management;

- Long term policy will be to have uniform 20-year licenses for both Basic services and Cellular Mobile. Extensions of license periods initially by five years and subsequent ten year extensions are also envisaged;
- Commitment to restructure DoT;
- Interconnect between private service providers in same Circle and between service provider and VSNL along with introduction of competition in Domestic Long Distance;
- The number of players in each circle for Basic Services and their mode of selection would be decided on the basis of recommendations from TRAI;
- Liberalization in other telecom service sectors such as GMPCS, V-SAT, Public Mobile Radio Trunking Service, radio paging.
- Permission for 'resale' of domestic telephony;
- Clarity regarding number of license that each operator may be granted;

This is a very wide canvas for policy initiatives, and would result in fundamental changes in the access provided to others in the Indian telecom market.¹⁵

Important Issues For India in WTO Negotiations

The telecom policy regime in India is evolving, as it should, for domestic policy reasons. However, some of these policies will become the

¹⁵ *ibid*, pp.4-9.

subject matter for negotiations in the WTO services negotiations, which have technically started from January 2000.

i) Competition in Domestic Long Distance

Policy considerations regarding liberalization of domestic long distance involve a number of decisions regarding:

- *Type of Competition*, that is whether the entities will compete on facilities or service or both.
- *Areas of operation*, which means geographical boundaries within which these entities will be allowed to operate.
- *Degree of Competition*, free entry or limited number of entities to be licensed in the segment.
- *Time Frame* for policy implementation and transition through different stages of competition.

At present, BSNL is the only provider of Domestic Long Distance (DLD) services in the country. According to NTP 1999, DLD beyond the service area will be opened up for private operators from 2000. All access service providers will have to provide interconnection to the Domestic Long Distance Operator (DLDO) so that the subscriber can exercise choice with respect to the DLDO.

However, certain complications may arise in the context of DLD service provision because:

- There would be a possibility of by-pass of DLD traffic due to cheaper leased circuits and use of voice over internet;

- There would be a need to move to some cost-based interconnection/usage charge regime. This may create transition problems with regard to the charging (or revenue share) regime that is in place for the existing service providers of basic and cellular mobile services.

Policy considerations regarding liberalization of domestic long distance involve a number of decisions regarding following issues.

Tariff and bypass issues; though immensely important for the domestic policy situation, are not likely to be the subject of negotiations.

Internet Telephony; though internet telephony is still prohibited in India, this situation is unlikely to continue for long. This is indicated, for example, by the fact that DTS has now decided to provide long distance call service based on packet switching. Further, there are now technologies available that drastically reduce the cost of long distance carriage. And these technologies are likely to be applied in the liberalized long distance market of India. Therefore, the cost advantage of internet telephony will be substantially reduced, and it would be possible to consider its authorization in due time.

Internet telephony will be an issue for negotiations and commitments in the WTO.

Cost based interconnection charges; though India has not committed in the WTO to cost based interconnection charges, this principle has been adopted by TRAI in its Regulation (Dated 28th May, 1999) on interconnection charges. This also prepares the grounds for non-discriminatory treatment of various

operators providing any particular telecom service, a criteria that is essential if a multi-operator system has to become effective and fully functional.

Therefore, cost-based interconnection charge is another policy initiative that could be part of India's offer list, and this would be of interest to the other countries too.

Type of competition (facilities-based or other); in the initial period, countries generally have facilities based competition. In the Indian situation, the possibility of leasing facilities of non-telecom companies has been envisaged for domestic long distance segment. Nonetheless, the basic thrust is towards a facilities based competition, though NTP 1999 does consider the possibility of resale. In the near future, there is unlikely to be any major demand seeking non-facilities-based competition in India.

Area of operation; this policy area could be subject of focus by countries with interest in India's long distance market (e.g., United States, United Kingdom). The issue will become relevant especially in the context where the existing operators in contiguous circles combine together to become national long distance service providers, thus having access to both intra-and inter-circle traffic.

Degree of competition and time frame for introducing competition; this will be the subject of demand by other countries, which will seek a commitment from India for not limiting the number of service providers. At present, the view of the Government seems to be that the number of service providers in domestic long distance should be limited to three or four.

As NTP 1999 provides that the TRAI will recommend the increase in the number of service providers that should take place after certain years. A two pronged approach in negotiations may be used with respect to this issue.

- To the extent that the Government decides that there should be free entry, India could consider whether to convert the actual policy into a WTO commitment. If free entry has been provided, there should not be a major problem in giving the policy as a commitment.
- If a limited entry is provided at present, the Government may still consider a commitment that it will review after a specified number of years (e.g., three or five years), the possibility of increasing the number of operators providing the service.

Extent of foreign ownership; in several areas of major interest, up to 49 per cent ownership is provided for foreign investors in telecom. With indirect investment, this becomes about 70 per cent. While one view may be that this is a reasonably flexible policy regarding foreign ownership, it is likely that some demand will be made for relaxing this limit (e.g., from the United States).

This will have to be seen in the context of the overall policy of foreign direct investment. The minimum demand in this regard will be to bind the applicable policy i.e. at 49%.

ii) International Long Distance

In accordance with the commitment to WTO, the question of opening up International Long Distance to competition will be reviewed by year 2004. this

position is re-stated in NTP 1999. Opening up of the International Long Distance to competition will be major demand on India.

We have already mentioned the possibility of internet telephony being permitted in India sometime sooner than later. Further, the Government has provided permission to certain private Internet Service Providers to set up their own Gateways. This, combined with the Wireless Access Protocol (WAP) technology, will bring down the costs of international telecommunications and also make it difficult to monitor and curb the provision of services by ISPs. Moreover, the pressure to revise accounting rates downwards will become even stronger with decrease in costs (and the consequent likely increase in call back).

With a downward revision of accounting rates, there will be pressure for decline in international tariffs, which in turn will reduce the surplus available in India from this service. New revenue sources will have to be found by the existing service provider, and the Government may recognize within the next couple of years that the international segment needs to be opened up.

iii) Liberalization in the existing service areas

The existing policy of a duopoly for basic and cellular mobile in each service area is already under review in the wake of allowing existing operators to migrate to a revenue sharing regime. It is likely that India will be asked to commit for liberalizing this policy. NTP 1999 has provided for a time-bound review of the number of service providers within a specified time period. The same could be given as a commitment during the negotiations.

iv) Regulatory principles

In general those investing in telecom lay particular emphasis on regulatory principles, because these principles provide the basis for successfully operating in a market which is normally dominated by a large service provider who has strong links with the policy maker. In these negotiations, countries will focus much more on the disciplines contained in the Reference Paper than they did previously.

a) Reference paper

As mentioned above, a number of disciplines of the Reference Paper have not been incorporated by India in its commitments, but the actual application of disciplines in India incorporates these elements. Thus, these could be considered for commitments.

The most important conditions are related to *interconnection terms and conditions*. It is noteworthy that the conditions relating to interconnection specified in the Reference Paper are also emphasized by TRAI in its Regulations pertaining to interconnection. This includes provision of interconnection in a timely fashion on terms and conditions and cost-oriented rates that are transparent, reasonable, non-discriminatory and sufficiently unbundled.

Similarly, *transparency* could be enhanced with respect to decision-making, including publicly making available the period of time normally required to reach a decision concerning an application for a license, and make

known to the applicant for a license, upon request, the reasons for the denial of a license.

With greater use of cellular technology, conditions regarding *allocation and use of scarce resources* such as frequencies becomes as important as interconnection. Once again, proper conduct with respect to use and allocation of various resources requires that the regulatory procedures be transparent and be carried out in non-discriminatory manner, subject to any specific national interest objectives.

It suggests that it is possible for India to agree to the provisions of transparency and non-discrimination on above mentioned issues.

b) ***Restructuring of DTS***

One important regulatory principle is that the policy maker and service provider should not be the same entity. In India, this requires complete de-linking of the DTS from the DoT. As government has already moved forward in corporatizing DTS/DoT by making BSNL, it can make commitments in WTO negotiations regarding this with a transition phase.

v) **Other policies which are important in the domestic context but are unlikely to be emphasized by other countries during negotiations**

These policies are important to bear in mind so that any commitments made during negotiations should not be such that the objectives of these policies get compromised. These policies include, for example, license fee regime, rural connectivity, and research and development.¹⁶

¹⁶ Dr. Harshvardhan Singh, n.13, pp.71-72.

Strategy For The Forthcoming Telecom Negotiation

The negotiations on telecom services will involve India not as a demander, but one on whom demands will be made regarding a number of telecom service.

Thus, the first issue to consider is that if India has to make any commitments in telecom, for which other services could it obtain concessions from those whom it provides concessions in the area of telecom.

India has embarked on a reform process in telecom, and would have implemented a number of policies that are likely to be of interest to other countries. Knowing that these policies are to be implemented in any event, and would be difficult to roll-back once implemented, the other countries are likely not to emphasise some of these policies in their list of demands. Nonetheless, India may like to look at these issues in the following order.

- a) Liberalization policies for which a commitment may be made on the basis of currently applicable policies or for those which may be in place during the early phase of negotiations (e.g., foreign equity participation, number of operators in domestic long distance communications and for existing service areas, and various regulatory principles that are not yet included by India in its commitments).
- b) Liberalization commitments to be considered in the interim phase of the negotiations, based on domestic developments (e.g., liberalization of international call segment, corporatization of DTS, area of operation for domestic long distance operators).

- c) Liberalization policies for which review commitments may be made (e.g., increase in the number of operators for basic services and cellular mobile services, increase in the number of operators providing domestic long distance service and for existing service area, non-facilities-based competition).
- d) Future commitments in terms of a phase-in time period (e.g., internet telephony, corporatization of DTS, foreign equity participation).

One feature of the above list is that some liberalization policies are mentioned under more than one category. This is to provide an example of how more than one type of strategy for commitments may be considered for certain policies (e.g., foreign equity participation, corporatization of DTS).

While the negotiations are going on, there should also be an attempt to develop a policy framework for certain issues, such as allocation and use of frequency, or number policy. This would help in being clearer on the nature of commitment that could be considered for these issues.

CHAPTER III

**ISSUES AND STRATEGIES FOR INDIA IN WTO FINANCIAL
SERVICES NEGOTIATIONS**

The Importance of Financial Services Industry for India:

Within service sector, which comprises a large number of services, financial services constitute the part of the basic infrastructure of an economy. Three features tend to distinguish the financial services sector from other sectors:

Firstly, there is the existence of an international market, quite distinct from the point of view of regulation from various national markets.

Secondly, these services are highly mobile.

Thirdly, financial services markets are complex. They consist of a large number of sub-markets with different product characteristics, types of consumers, institutional supply features and territorial boundaries.¹

The structure of Indian financial system primarily comprises the banking sector, the financial institutions encompassing term-lending institutions, investment institutions, specialized financial institutions, the state-level development banks, non-banking financial companies (NBFCs) and capital market intermediaries, co-operative credit societies, life and non-life insurance activities and other economic activities like ownership of dwellings, real estate services and business services.

¹ Urvashi Zutshi, "Aspects of the final outcome of the negotiations financial services of Uruguay- round" in H. Singer, N. Hatti and R. Tandon (ed.) *Trade In Services*, vol.14, (New Delhi: B.R. Publishing Corp., 1999), p.263.

A close look at the experience of the last two decades shows that from the early 1980s to 1993-94, the relative importance of the component 'financial and business services' has steadily increased within the services sector [for instance, 24.7% in 1980-86; 25.6% in 1986-91; and 27.8% in 1991-94]. (See **table 1**) However, its share in total services sector has somewhat slowed down to 24.8 per cent during 1994-98. Also within this segment, the 'financial services' component comprising 'banking and insurance' is the only category which has consistently improved its growth performance over the period 1980-81 through 1993-94 [for instance, 9.5% in 1980-86, 14.0% in 1986-91, 14.3 % in 1991-94]. Its growth performance, however, slowed down to 12.1 percent during 1994-98. The overall growth performance of this segment may be explained in terms of the growing monetisation and financial intermediation in the economy.

Table 1
Relative Contribution to the Value Added of the Services Sector (%):
1980-98

Period	Trade Hotels & Restaurants	Transport, Storage & Communication	Financial & Business Services	Community & Personal Services	Total
1980-86	33.4	13.1	24.7	28.8	100.0
1986-91	32.3	13.5	25.6	28.7	100.0
1991-94	31.1	13.4	27.8	27.6	100.0
1994-98	33.6	16.6	24.8	25.0	100.0

Source: Central Statistical Organisation, 1998 National Accounts Statistics: 1998, Ministry of Planning, Government of India, New Delhi.
** At 1993-94 prices.*

Among the 'services sector', the 'financial services' segment attracted the largest share of FDI during 1992-98 [9.78 % for financial services while 6.95% for other services]. The buoyant growth of financial services industry during the 1990s is also reflected in the amount raised by it from the capital market during 1992-99. It may be noted that the amount raised by the services sector as a whole has been steadily increasing with its largest share going to the financial services industry [for instance, in 1998-99, in the total amount raised from the capital market, the share of the services sector was 65.9%, of which 62.7% went to the financial services industry].² Though the financial services industry has considerably grown in size and importance within the domestic economy during the last two decades, its share in world trade is still very negligible. The latest information on the world trade in commercial services (WTO Annual Report, 1998) shows that India has one of the lowest ranks (31st, to be precise) in terms of its share in the world exports and imports of commercial services.

How more liberalized financial sector will benefit India?

Liberalization commitments would help in disciplining future macro economic, structural and prudential policies within the country. The commitments in the multilateral context not only yield benefits from more liberal domestic trade, but may also yield additional benefits from more open markets in other countries. The benefit of better financial services are illustrated in the cost savings and quality improvements that can be realized by

² Data collected from <http://www.rbi.org.in>

the households, businesses and governments that are the main users of these services. As financial institutions face stiffer competition from domestic competitors and foreign entrants, they learn to exploit economies of scale and scope, reduce managerial inefficiencies and make better use of advanced technology. Savers and investors earn higher rate of returns and they have more savings instruments to choose from and more opportunities to diversify risk, as well as easier access to financial products. Those seeking funds benefit from better risk appraisal, reduced waiting times, a wider range of lending instruments and maturities and expanded access to funds.³

India stands to gain by joining the global financial markets as benefits far outweigh the risks. The major advantages are as follows:

1. This will secure for India larger inflows of foreign capital that are needed to sustain a 7 to 8 per cent GDP growth;
2. Globalisation will discipline future macroeconomic, structural and prudential policies;
3. Foreign competition in insurance sector and reforms in the provident & pension funds will enhance the savings rate and availability of long-term funds for infrastructure development; and
4. Globalisation will provide improved opportunities for markets abroad.⁴

³ Wendy Dobson and Pierre Jacquet, *Financial Services liberalization in the WTO*, (Washington: Institute for International Economics, June 1998), pp.5-6.

⁴ H.A.C. Prasad, "India's Invisibles: Trade and Development Issues" in Seminar on *Trade In Invisibles*, (New Delhi: IIFT, 1st June 1995).

A Brief History of Negotiations

The final agreement of the Uruguay round was completed in December 1993 and signed in Marrakesh on April 15, 1994 by more than 100 countries. However the involved governments were unable to reach full agreement on a package of market opening commitments in financial services. So the involved parties sought an extension till July 1, 1995 for the negotiations. But the negotiations on financial services could not be concluded by the new deadline; instead interim agreement was signed to consolidate existing offers till November 1st, 1997. After that period, offers could be withdrawn, or maintained or improved during a limited period of 60 days.⁵ Eventually, the negotiation on 'Financial Services Agreement' (FSA) under the WTO was Completed on 13 December 1997, which included market-opening commitments by 102 WTO members. But the FSA, save for actual advances in the field of insurance services, barely goes beyond binding the status quo. (see table 2)

⁵ *Background note by Secretariat, Downloaded from <http://www.wto.org>*

Table 2
Market Access in Financial Services: Status quo Versus WTO
Commitments, 1997⁶

Economy	Status quo^a	WTO financial services agreement (1997)
Argentina	Allows 100 percent ownership in all sectors.	Guarantees 100 percent ownership in banking and securities.
Brazil	Allows up to 100 percent ownership of existing banks, on case-by-case basis. Allows 49 percent ownership of investment banks. Allows 50 percent ownership in insurance, but on new branches or subsidiaries are permitted.	Guarantees 100 percent ownership in banking and securities, subject to authorization on a case-by-case basis. Commits to 100 percent-owned insurance subsidiaries, subject to authorization on a case-by-case basis, but no entry through branches.
Chile	Allows 100 percent ownership in all sectors	Guarantees 100 percent ownership in banking. Commits to 100 percent-owned insurance subsidiaries, but no entry through branches.
India	Allows 8 licenses per year for foreign bank branches. Allows up to 100 percent ownership of nonbank financial institutions, depending on amount invested.	Commits to a limit of 12 new foreign bank branch licenses per year. Commits to 49 percent ownership for stock brokering and 51 percent ownership in other financial services.
Indonesia	Allows 85 percent ownership in banks, but new foreign equity capped at 49 percent. Allows 80 percent ownership in insurance. Allows 85 percent ownership of securities firms.	Commits to 49 percent ownership in banks. ^b Commits to 100 percent-owned insurance subsidiaries. Commits 100 percent ownership of nonbank financial institutions and securities firms.
Japan	Market access requires national reciprocity	Binds 1996 US-Japan bilateral insurance deal in the WTO.
South Korea	49 percent ownership in banking and life insurance. 50 percent ownership in securities.	Standstill for market access. ^b
Malaysia	Allows 30 percent ownership in domestic banks. Allows 49 percent ownership in insurance, by law, but existing practice is higher.	Commits to 51 percent equity in domestic banks. Commits to 51 percent ownership in insurance, existing investments not grandfathered.
Mexico	Allows 100 percent ownership for bank subsidiaries for NAFTA and 41 percent for non-NAFTA. Allows 100 percent ownership of insurance for NAFTA and 49 percent for non-NAFTA.	Binds NAFTA commitments on insurance; commits to 100 percent ownership of insurance subsidiaries and branches.

^a: "Status quo" refers to markets access when the WTO financial services negotiations concluded on 13 December 1997.

^b: Indonesia and South Korea subsequently removed numerous restrictions on foreign participation in the financial services sector in the context of their IMF economic programs.

⁶ Dobson and Jacquet, n.3, pp.91-92.

Still the FSA is considered a milestone for the WTO as it extended the GATS to financial services, adding to existing agreements in the telecommunications and information technology industries. Three broad conjectures may be offered as possible explanations of this success; in spite of many unsettled issues:

- 1) After the 1995 interim agreement on financial services entered into force, the United States and Europe cooperated to provide a joint leadership in the negotiations. In particular, the United States and European Union made clear that developing countries would be denied any opportunity to postpone liberalization while watching a transatlantic conflict on the issue and waiting for its resolution. This signaled an encouraging willingness to achieve results through cooperation rather than unilateral action. The European Union's active diplomacy, seeking an agreement on the basis of substantially improved offers from different developing countries, also supported U.S. demands and facilitated transatlantic cooperation, irrespective of the final decision that would be taken on any agreement.
- 2) The private firms in the United States and in the European Union set up effective cooperation through the creation of the Financial Leaders' Group (FLG) in 1996, between European and American financial service firms. This promoted a dialogue conducive to more effective and balanced lobbying, and provided a useful framework for intermediating

dissensions and differences of interests among firms of different sizes and from different countries.

- 3) The eruption of the Asian financial crisis and its severity and the reversal in market sentiment toward Asia helped to some extent, to make demands for financial reforms acceptable. It also highlighted in terms of credibility, the benefits of binding in a multilateral agreement. To the extent that a multilateral agreement could help to restore credibility and contain the damage from this crisis, this also shifted the balance of judgements in industrial countries toward accepting an agreement that they might otherwise have been felt to be still insufficient.⁷

Originally, India ratified the Agreement establishing the WTO on 30th December 1994.⁸ At that time, its schedule in the Financial Services made the following commitments:

1. In the field of *banking* it allowed only a branch presence and five licenses per year. It denied the entry to foreign banks if the market share of assets of foreign banks exceeds 15 per cent of the total assets of the banking system;
2. In the field of *non-banking financial services* (i.e., merchant banking, factoring, financial leasing, venture capital, and financial consultancy), it allowed the local incorporation with a maximum equity of 51 per cent by foreign financial services suppliers including banks;

⁷ *ibid*, pp. 83-85.

⁸ See annex 1: "*Financial Services in the GATS*"

3. In the field of *insurance*, no commitments were made in life insurance area. In the case of non-life insurance, it committed to continue the old restrictive practices (except in the case of insurance of freight, where there is no requirement that goods in transit to and from India should be insured with Indian insurance companies only). Further, a minimum of 10 per cent of the premium of the overall market was committed to be reinsured abroad.

India's offers were criticised on many counts by the other countries. The major points of criticism were -- limitations on the number of new branches; ATM restrictions outside branch premises; denial of new branch licenses when assets of foreign banks exceed 15 per cent of the total assets of the banking system; limitations on foreign bank investments (i.e., no national treatment and denial of permission to foreign banks already operating in India to invest more than 10 % of owned funds in other financial services companies or 30 % of the investee company's capital); limitation of entry form by NBFCs to local incorporation and ceiling of 51 per cent on the foreign equity; incomplete sectoral coverage and the state monopoly on insurance.

India offered to improve upon some of its commitments provided that its major trading partners were also prepared to make substantial improvements in their stance on the movement of natural persons. India's improved negotiating brief included a liberalised policy on ATMs (i.e., an ATM will not be treated as a separate branch), increasing the number of new bank branches to an inclusion of stock broking in India's schedule, with a maximum foreign equity of 49 per

cent. Based on India's enhanced offer, the European Union, Norway, Switzerland, and Australia for the first time tabled an offer on the movement of natural persons, which did not insist on the economic needs test.⁹

In June 1995, the USA had invoked a MFN exemption on the ground that the offers of certain commercially important markets had remained inadequate in terms of market access and national treatment. In order to protect Indian interests and to meet the requirements of the Banking Regulation Act, 1970, India also filed MFN exemptions in banking, non-banking, and insurance sectors based on the principle of reciprocity. India's trading partners took strong objection to this and urged India to reconsider the decision. In the next round of negotiations (that took place during June 4-6, 1997), India's major trading partners, i.e., the U.S., the European Union, Canada, Australia, and Switzerland submitted their request lists and the common elements of their requests were as follows:

General

- India should lift its MFN exemptions from all areas, if other members do the same.

Insurance

- India should make some commitment in health insurance (may be a 'staged liberalisation') given that it had earlier made an announcement to that effect in its annual Budget.

⁹ Economic needs tests assess the impact of new market entrants on the indigenous industry. Such assessments may result in a negative determination if market entry is considered likely to have a detrimental impact on market structure, profitability, population density, geographical distribution and job creation.

- India should commit for the cross border reinsurance to the extent of 15 per cent (which is the actual practice) as against its commitment for 10 per cent of the market
- Brokers and other intermediaries should be allowed to operate in the markets and provide direct access to foreign insurance companies
- Representative offices should be permitted to receive income in India.

Banking

- India should increase the number of licenses and provide a gradual increase in the market share on assets of the foreign banks. The more liberal practice of granting licenses must be bound in the schedule.
- Sectors like 'trading on customers account,' trading in derivatives products etc. should be covered under banking.
- Subsidiaries and joint ventures should be allowed in banking.
- Discrimination against foreign banks in terms of higher rate of taxation, and in placement of surplus funds by public sector units should be removed.

Non-banking Financial Services

- Increase coverage in this sector by binding additional services which have been actually allowed in the revised foreign investment policy.
- In actual practice, the government has allowed higher level of foreign equity and India should bind actual practice, which is more liberal than the commitments made.

- In those cases where higher level of foreign equity has been permitted, the acquired rights should be permitted. For example, in most of the non-bank financial services, India has allowed 75 per cent or even more foreign equity subject to the approval of Foreign Investment Promotion Board (FIPB). If a foreign investor has already obtained approval for higher than 51 percent foreign equity, he should not be asked to reduce this holding to the level bound, i.e., 51 per cent at any time. This is a major issue for the U.S. and EU that there will be no roll back for the existing investors.
- Securities companies should be allowed to set up branches.

Against these considerations, in the last round of negotiations that was held during 9-11 December 1997, India made the following main improvements over its 1995 commitments:

- It deleted a MFN exemption based on reciprocity in insurance, banking, and other financial services. This was justified by saying that MFN exemption taken by small countries will not have any adverse effect on India's position. The Banking Regulation Act refers to only non-discrimination and not reciprocity. Therefore, if our major trading partners are willing to take MFN obligation, it should also be possible for India to take MFN obligation and withdraw its MFN exemptions.
- India increased the limit on the number of bank licenses granted per year from eight to twelve. This was considered as a practical solution, as (otherwise also) the market share is kept unchanged at 15 percent for the

foreign banks. However, licenses issued for ATMs installed by foreign banks will not be included in the ceiling of 12 licenses.

- India introduced more flexibility in reinsurance allowed to be taken abroad. Now it has allowed foreign reinsurers to take reinsurance to the extent of the residual uncovered risk after obligatory or statutory placements domestically with Indian insurance companies. The earlier commitment had allowed reinsurance abroad after meeting statutory or obligatory domestic retention requirements and additionally gives at least 10 per cent of the market to overseas re-insurers. It was felt that the latter was not required in the case of public sector insurance companies (because of the overall Government control) and would be difficult to implement in the case of private insurance companies in the future. The percentage of re-insurance ceded abroad is therefore best left to the commercial judgement of the insurance companies, subject to statutory/obligatory requirements for domestic retention.

Major Foreign Demands in the Next Round

It is readily apparent from the above set of commitments that India has not gone much beyond the status quo in the last round of negotiations. There could be two reasons for this outcome:

1. In general, the Indian reluctance to liberalise emerged from the likely impact of further opening up on domestic financial stability;

2. At present, very few of India's financial firms have reached the size and efficiency that could make them adequately competitive in developed nations' financial markets.

It now has to make concrete decision as to what type of additional commitments it should undertake in the next round to send appropriate signals to the international community regarding its commitment to the reform process, taking all relevant factors into consideration.

In the next round, the developed countries, particularly EU, US, Canada, Switzerland etc., are likely to put considerable pressures on India with respect to the following financial services sectors.

Banking and Other Financial Services

1. to increase the number of licenses in banking and also gradually eliminate the cap on foreign banks' share in total banking assets (15%);
2. to allow wholly-owned banking subsidiaries;
3. to remove restrictions on foreign bank investment in other financial companies (10% of owned funds or 30% of the other company capital whichever is lower);
4. to allow more segments of financial services for foreign entry such as the pension fund management;
5. to remove discriminatory corporate tax rate on foreign companies;
6. to allow cross-border supply and transfer of financial information, financial data processing, and related hardware and software;

7. to confirm that public sector enterprises can freely make deposits and do business with foreign-owned banks;
8. to guarantee existing foreign ownership or control of financial companies;
9. to progressively raise the level of foreign equity holding in non-bank financial companies based on a time-table; and
10. to increase the coverage of non-banking services to include securities trading and asset management and to bind majority participation in stock-broking companies.

Insurance and Insurance-related Services

1. to provide phased-in commitments for market access and national treatment on a cross border, consumption abroad and commercial presence basis in all the sub-sectors such as life, non-life, reinsurance, retrocession and services auxiliary to insurance such as broking and agency services; and
2. to allow all expenses of insurance resident representatives and representative offices to be met with income generated in India.¹⁰

Strategy for Indian Response

Major Goals for India

The real issue before India is how to negotiate the best deal for itself in the next round. It must be remembered that India is in somewhat advantageous position, as it is starting from a small base. As it broadens its base to offer

¹⁰ Downloaded from <http://www.wto.org/wto/services/financia.html>

greater market access to countries such as the UK and the US, it can also negotiate for openings to gain in terms of export niches for itself.

The response strategy has two parts: (i) internal, i.e., to practically undertake reforms; and (ii) external, i.e., to negotiate as outlined following. It is important for us to accept that reforming our financial sector is an integral part of the response strategy, besides being in our own interests. Any opening has to be done cautiously to avoid the East-Asian type crisis. This indicates the need for strengthening the financial sector particularly through institutional capacity building. In order to avoid the crisis and smoothen the globalisation process, reforms have to be undertaken.

Our strategy is based on “*reciprocity*” and “*convergence of interests*”. *Reciprocity* means that we will give in to foreign demands to the extent that we receive concessions. *Convergence* indicates that the concessions we offer are also in our own interests. The primary objective of policy-makers is to develop a negotiating strategy within an organising framework that comprises several following goals:

1. One such goal could be to obtain major specific benefits such as, freer movement of natural persons. While developed countries will ask for greater commercial presence in India, India will ask for better terms and conditions for the movement of natural persons.
2. Indian negotiators could also forge links between software and financial services and focus on exporting financial data processing services & related software as well as providing other e-services from India such as

back-office work, share transfers and accounts and also customer services. India is fast becoming a hub for many data processing activities related to financial services like credit cards and insurance, sourced by a plethora of foreign and multinational companies. The main advantage we possess in the area of remote processing services is the availability of a large pool of trained, english speaking and relatively cheap labor force. The Foreign Investment Promotion Board (FIPB) too has taken a liberal approach in this regard and cleared several proposals for up to 100% foreign equity investment in remote processing ventures. An example of the same is GE Capital International Services (GECIS) that is currently developing processing infrastructure for various financial services, including general ledger handling, financial statement analysis, bank reconciliation, payment research and insurance claims examination.

However, the exports of Indian data processing companies might be seriously affected in the future, given the recent EU Data Protection Directive, which subjects the transfer of personal data to countries outside the European Economic Area (EEA) to stringent data protection requirements.¹¹ Indian negotiators should highlight such restrictions on cross border trade in the WTO and ask for these barriers to be removed, or at least temporarily suspended to give the Indian data processing units sufficient time to comply with the data protection requirements.

¹¹ *The Economic Times*, October 9, 1999.

3. Indian negotiators should aim at safeguarding certain critical aspects of the economy. For instance, unrestricted access to debt instruments of residents by foreign entities (i.e., free external borrowing) can lead to massive demand for foreign currency putting pressure on exchange rates, in times of stress. As such, continued ceiling on the amounts of domestic debt that can be held by foreign entities may be appropriate. Simultaneously, trading partners could be asked to work for improving the governance of global finance, so that the volatility of short-term flows can be reduced.
4. The negotiators should also attempt to secure an appropriate "adjustment time" for domestic players to smoothen the process of transition to a more competitive environment. This necessarily means speedier liberalization after providing for necessary time for initial gearing up.
5. The primary focus of the negotiating strategy should be on mode 3 (i.e., commercial presence) rather than the other modes of trade such as cross-border trade, movement of natural persons and consumption abroad. With the advent of new technology and the resulting possibilities of remote transactions, one would expect that mode 1 (cross border) trade would become more and more common in the supply of financial services, as compared to mode 3 (commercial presence).

A. Internal Strategy : Concrete Domestic Reform Proposals

Given below are some the concrete reform proposals for the domestic financial sector, which are necessary to make it strong enough to withstand the strains of opening up.

i. *The problem of weak banks is to be tackled expeditiously*

Tougher options, like allowing banks to fail, are not always available to the Government in a politically sensitive electoral democracy like India. In these circumstances, the regulatory authorities need to consider other alternatives that are more politically acceptable and act to moderate the stress on the weak banks but also impose market discipline on the latter.¹² On such proposal, floated initially by the Committee on Financial System (1991) but formalised only recently by the Verma Working Group on restructuring weak public sector banks (1999), is that of an Asset Reconstruction Fund (ARF). The idea of an ARF is of a specialist agency that buys the chronic non-performing assets (NPAs) of weak banks at a discount, and sells them after reconstruction, or in an 'as is where is' condition. This is meant to help the troubled banks clean up their balance sheets, allowing them to concentrate on productive lending and strengthening their overall performance, while the ARF deploys specialist resources to effect a speedier and more successful recovery of the bank debts. The ARF is to have a two-tier structure whereby ownership of the assets lies with the government and the management thereof with an

¹² V. L. Rao, "Out put and productivity in India's financial sector" in V.L. Rao and Janter Wengel (ed.) *Financial and consultancy services: Issues in International Trade*, (New Delhi: Sage publications, 2000), p.127.

independent private (with majority non-governmental shareholding) Asset Management Company (AMC) equipped with the necessary professional and organisational expertise. The Verma Working Group has identified three public sector banks – Indian Bank, UCO Bank and United Bank of India – as weak banks and proposed a comprehensive strategy of operational and financial restructuring for the same.

ii. There is a *need to drastically reduce the government / RBI equity holding in the banking sector* to 33 per cent (as recommended by the Narasimham Committee II Report) and even below, and remove the civil service nature of employees so that they are brought fully under RBI's supervision.

iii. Debt recovery mechanism to be strengthened considerably

One of the major structural weaknesses of the Indian financial sector is the lack of an effective and robust legal framework for the recovery of debt due to banks and other financial service providers. This has been instrumental to a great degree in the build up of non-performing assets on the balance sheets of these institutions, some of the specific proposals for the strengthening of the debt adjudication and recovery machinery, and imparting legal teeth to the process are as follows:

➤ There is an urgent need to establish more Debt Recovery Tribunals (DRTs) and Appellate Tribunals throughout the country to improve the geographical spread of the loan recovery mechanism, and to reduce the excessive workload on individual tribunals.

- The Government needs to ensure that the DRTs get full operational support in terms of infrastructural and staffing facilities, to enable them to speed up the adjudication process.
- The automatic nature of the blanket immunity granted to the borrower by the present scheme of Sick Industrial Companies (Special Provisions) Act. 1985 needs to be suitably rectified to remove the incentives for promoters to get their companies declared as sick fraudulently, to perpetuate default or negotiate more favourable terms.

iv. A need to reduce the regulatory burden on banks in the form of CRR and SLR

Further reduction is needed in the resource pre-emption levels to bring them in line with the best international practices (for instance 3% for CRR and reduction of SLR below 25% -- i.e., its statutory minimum level to say, 10 %), to enable banks to deploy these funds in investments earning more competitive returns. While Austria and Iceland use SLR for prudential purposes; Canada, Italy, New Zealand, Spain, and United States do not use liquid asset requirements at all even for prudential purposes.

v. Further tightening of NPA norms

The current norms for classification of bank assets as non-performing need to be further tightened to conform to the international practice of restricting the period of non-payment to one quarter. This would help evaluate and project the true health of balance sheets for domestic banking institutions aiming to set up operations outside India.

vi. Progressive Strengthening of Capital Adequacy Norms

We should avoid adopting international benchmarks like the Basle norms for capital adequacy as mechanical rules for prudential regulation of the banking sector. These requirements need to be progressively strengthened (as per the Narasimham Committee II recommendations) to reflect the true level of riskiness and structural weaknesses of the Indian financial system. Moreover, these norms need to be complemented with strict enforcement of appropriate standards of asset classification, income recognition and provisioning, since the latter determine the true levels of core and complementary capital available with the institutions to comply with the same.

vii. Deficit Reduction

Besides reducing Central government fiscal deficits, State government deficits need to be tackled through progressively raising user charges for water, transport, electricity and higher education.

viii. Reforms in Pension and Provident Funds Management

Reforms are urgently needed in the pension and provident funds through extension of coverage, and improved allocation and management by allowing private participation. A minority foreign participation would help in a big way in developing proper systems, as the domestic private sector lacks experience in this field.

ix. Universal Banking Issues

In the changed context of today, the major challenge before the Indian policy makers is to allow the development of appropriate institutional

structures that will respond to the challenges posed by an open and liberalized financial regime.

Furthermore, the on-going liberalization process with its focus on international integration necessitates the emergence of not just domestically strong players but also globally competitive ones. It is necessary to allow the emergence of three to four globally competitive financial services companies in India by removing the plethora of restrictions on organisational forms and resource raising and deployment by intermediaries. There is a need to equalise regulatory burden on a system-wide basis by bringing into its gamut not just banks and FIs but also mutual funds and insurance companies. There is also a need to remove distortions in the domestic tax and interest rates structures, which have given rise to a number of imperfections in the market and created advantages for certain FSPs at the expense of others.

x. Insurance Sector Reforms

There is an urgent need to open up the insurance drastically to private participation including foreign companies. The cross-country evidence clearly shows that countries with liberalised insurance sector have witnessed a rapid growth in premium volumes that has further enhanced their domestic savings rate. This is more strikingly witnessed by China, Malaysia and Singapore.

xi. Gearing up for the advancement in information and communications technology

In the time to come, competitiveness in the financial sector will be clearly driven by the use of technology to improve efficiency of operations as

well as to provide newer customer friendly financial products and services at low cost and not by considerations of branch network or personnel strength. The nationalised banks need to adopt a tightly focussed strategy for development of information technology that provides them with the technical capability and flexibility required to reorient their service operations according to the imperatives of technology banking and compete with the foreign banks that are looking to enter (or expand their operations within) the Indian market. As part of this strategy, public sector banks need to establish a system of inter-branch networking so as to allow the customer freedom of geographical movement and full time convenient access via electronic modes like telephones, Automated Teller Machines (ATMs), PCs, internet or point of sale terminals.

The funds transfer mechanism in the Indian banking sector is also inordinately slow paced and inefficient due to lack of a planned and standardised intra-bank and inter-bank electronic payment clearing and settlement systems backbone. It is important that the Reserve Bank of India undertake immediate steps to develop a reliable communications backbone for the banking and financial sector.

B. External Strategy: Negotiations

The negotiators can classify the demands on India into the following three Categories.

- § Demands that can be agreed to straight away on a reciprocal basis;
- § Demand that can be considered by linking with the progress of reforms;
- § Demands that cannot be considered during this Round.

The recommended Indian response strategy is detailed below under these three heads.

a. Demands that can be agreed to straight away on a reciprocal basis:

1. According to India's Schedule of Commitments, licenses for new branches of foreign banks may be denied when the maximum share of assets in India (both on and off-balance sheet) of foreign banks to total assets (both on and off-balance sheet) of the banking system exceeds 15%.¹³

As of 1997-98, the total assets (on-balance sheet) of foreign banks operating in India were Rs.65,288 crore, as against Rs.795,535 crore for all the 103 scheduled commercial banks (including the foreign banks), which works out to a share of 8.2% for the former. In addition, the off balance sheet exposure of foreign banks amounted to Rs.238,420 crore (365.2% of their on-balance sheet assets) while for the commercial banking sector as a whole, the

¹³ Urvashi Zutshi, n.1, p. 275.

figure was Rs.467,045 crore (58.7% of the total on balance sheet assets of the sector).¹⁴

The foreign banks operating in India clearly have a comparative advantage in undertaking off-balance sheet activities like forward exchange contracts and guarantees due to their foreign exchange positions and relevant expertise (as is evident from the much higher proportion of off-balance sheet exposure in their operations as compared to the industry as a whole). To that extent, it would be useful to remove the restrictions on their business activities relating to off-balance sheet operations as the latter only helps develop more sophisticated derivative markets and instruments in the economy. In fact, restrictions on the asset share of foreign banks can be done away with entirely. The experiences of other countries too have shown that even unrestricted opening to foreign banks does not lead to excessive penetration by foreign banks, given the comparative advantage which the domestic players enjoy in their own markets.

2. Entry of foreign banks through branches rather than subsidiaries is a hangover of the past based on earlier reciprocal arrangements. It was felt at that time that branches were easier to administer than subsidiaries. At a time when our regulatory and supervisory capability was limited, it was also appropriate to entrust that responsibility to home country supervisors through letting in only branches. With an improved

¹⁴ All Figures are from Reserve Bank of India *Report on Trend and Progress of Banking in India, 1997-98*, RBI, (Mumbai, November 1998).

regulatory and supervisory set up as India has now, allowing wholly owned subsidiaries or joint ventures also seems all right. This idea also finds support in both the Reports of Narasimham Committee (1991 and 1998). Two points of interest to be noted in the context of allowing foreign banks into India as subsidiaries are:

- . As per the current foreign direct investment guidelines by the FIPB, investment is already permitted upto 20% in private sector banks in India by foreign banking companies or finance companies, including multilateral financial institutions as technical collaborators or co-promoters. This limit is increased to 40% including investment by non-resident Indians (NRIs). However, we have not made this an binding commitment in the WTO.
- . Giving subsidiary status to foreign banks will also imply their coming fully under the priority sector lending requirements of 40% (with further sub-targets of 18% for agricultural advances and 10% for advances to weaker sections) plus 12% (export credit), as against 32% for foreign bank branches currently. In addition, they will also be bound by the rural branching stipulations now applicable to new private banks (one rural to three urban branches).

As regards foreign bank branches, we can negotiate a sustainable increase in number.¹⁵

¹⁵ N. Vaghul, *Report on Trade in Financial Services*, Project Study Sponsored by Ministry of Commerce, Government of India, (New Delhi: ICRIER, 1999), p.30.

3. Giving permission to locally incorporated subsidiaries would remove constraints in providing national treatment to foreign banks in accepting surplus funds of public sector enterprises (which are allowed by their statutes to place such funds with any scheduled commercial bank incorporated in India) in the form of term deposits and also the same rate of corporate tax (as locally incorporated entities are treated as domestic companies).
4. We may also expand coverage of non-banking financial services for participation by foreign financial service providers in addition to the non-banking financial services covered in India's Schedule of Commitments to WTO (including merchant banking, underwriting, stock broking, financial consultancy, factoring, venture capital, leasing etc.), the FIPB guidelines for FDI in non-banking financial services also include asset management, forex broking, credit card business and money changing business in the list of services. The guidelines for foreign equity participation (including minimum capitalisation norms) under FIPB norms in these areas are applicable as in other services. We can consider opening up the above mentioned non-banking financial services to minority participation by foreign service providers.
5. We could raise the limit for investment by branches of foreign banks (in India) in finance companies from 30% to 49% of the investee company's capital, while retaining the ceiling at 10% of owned funds.

6. India's commitments in the last WTO financial services negotiations actually bind market access for foreign firms below current practice. We can allow for "grandfathering" of existing foreign financial firms, including broking companies, i.e., to guarantee the level of foreign equity participation already given to existing FSPs although the binding level is lesser.

b. Demands that can be considered by linking them with the progress of reforms:

1. More commitments on insurance (life and non-life) and pension fund management with respect to commercial presence can be made with reforms to be carried out in stages.
2. India can open up for derivative products including futures and options simultaneously with the introduction of these products for domestic players.
3. We can increase foreign participation in broking beyond the minority holding level.
4. India can allow for progressive rise in foreign holdings in other non-banking finance companies.

It should be noted that we are already allowing up to as much as 100% (on a case-by-case basis) foreign equity holding in non-banking financial services as per the foreign direct investment guidelines by the FIPB. Under the FDI norms for non-banking financial services:

- . Up to 51% foreign equity, no special conditions are attached except those requiring approval of SEBI, RBI etc.
- . For foreign equity beyond 51% but upto 75%, it is necessary that foreign investment of minimum US\$ 5 mn be brought upfront
- . For foreign equity beyond 75%, minimum foreign investment must be US\$ 50 mn, of which US\$ 7.5 mn needs to be brought upfront, while the balance needs to be brought in over 24 months.

Given that the FIPB is already considering applications for upto 100% foreign holdings in non-banking finance companies, we can bind our commitments in the WTO forum to these FDI norms at a suitable stage in our reform process.¹⁶

c. Demands that cannot be considered during this Round:

1. In the life-insurance business, 100 per cent foreign equity participation cannot be allowed.
2. Cross-border supply of insurance (except for freight, which is already permitted) cannot be allowed.
3. Foreign-owned insurance companies in India should not be allowed to invest funds abroad.
4. Indian residents should be prohibited from having unrestricted access to banking and other bank-related services from banks abroad.
5. Foreigners should not be given unrestricted access to debt instruments of Indian residents.

¹⁶ *ibid*, p.31.

6. Differential corporate tax treatment for foreign bank branches as it involves a wider tax statement.

Multilateral negotiations fulfill two functions:

- 1) They bind opening measures, however undertaken, in a multilateral framework, creating a kind of international constitution for trade and market access which is based on effective dispute settlement and prevent backlashes from occurring too frequently.
- 2) It feeds the dynamics of liberalisation by pressuring each country to open its trade with foreign countries and broaden access to its markets.¹⁷

Certainly, WTO financial services negotiations have contributed greatly in this way. Financial reform is a process, not a one shot policy decision, and like any gradual process it needs constant ongoing commitment. In it, gradualism allows opposing interest groups to organize and oppose liberalization. So commitments to reform must be bound if they are to have lasting credibility. The role of WTO is crucial in this respect.

But to improve the prospect of multilateral negotiations in financial services, two important limitations of the current framework need to be addressed.

The **first** lies with weaknesses in the framework of the GATS (specially positive list approach, the difficulty of making cross-sectoral bargains). Positive lists identify sectors on which commitments are made rather than

¹⁷ Dobson and Jacquet, n.3, p.95.

those on which they are not. This approach not only leaves important sectors untouched by liberalization, but also implies that as new sectors emerge they will automatically stand outside the market opening framework until explicitly brought into it.

Moreover, the division of the WTO negotiations along sectoral lines separating both services from goods and individual services from each other makes reciprocity less credible and less effective, as any reciprocal arrangements must stay within sectors. The potential for linkage and trade-offs is minimal .

The fact that financial services talks are negotiated by finance ministers rather than trade ministers makes linkages with other trade negotiations even more difficult .The potential for linkage often helps in concluding negotiations, sometimes in unexpected ways.

The **second** limitation has to do with the traditional way that multilateral trade negotiations are conducted, namely the give-and -take process that is called the '*reciprocity approach to negotiation*'. Financial services are sector in which developing countries feel that they alone make concessions. For most of them, access to the financial markets of industrial countries is not an immediate priority; and thus the threat of reduced access to the U.S. market is of little importance. In addition, although the U.S. market for financial services is indeed very open, it is also segmented geographically and by industry, and the policies and regulations of the fifty states may interfere with general commitments made at the federal level. This makes the U.S. market less

attractive to potential foreign entrants than its vast size and openness might suggest.

Finally, resorting to reciprocity even somewhat weakens the credibility of the case for liberalisation because opening is in the self interest of all countries. If that is the case, denying MFN is to shoot oneself in the foot.

One believes that multilateral negotiations can help, provided the pressure is directed not towards immediate results, but towards a sustainable process of gradual opening. Negotiators from developed countries should keep in mind that deadlines matter less than does the ability to sustain a dynamic process. From this stand point the FSA, which essentially binds the status quo, should be interpreted as a first step. It provides an opportunity for a promising agenda, yet to emerge, on financial opening.

Annex 1

Financial Services in the GATS

As regards the financial services, the GATS negotiations covered all financial services, including banking, securities, and insurance.

What are financial services?

During the Uruguay Round, participants listed the following activities as financial services:

Insurance and related services - life and non-life insurance services; reinsurance and retrocession; insurance intermediation, such as broking and agency services; services auxiliary to insurance. Banking and other financial services (excluding insurance) – acceptance of deposits; lending of all types including consumer credit, mortgage credit, factoring and financing of commercial transactions; financial leasing, all payment and money transmission services; guarantees and commitments; trading in money market instruments, foreign exchange, derivatives, exchange rate and interest rate instruments such as swaps and forward rate agreements, securities, other negotiable instruments and other assets such as gold; participation in issues of new securities; money broking; asset management such as portfolio management or pension fund management settlement and clearing services for financial assets; provision and transfer of financial information and financial data processing; advisory and other auxiliary financial services. Trade in financial services, like in other services, is defined in terms of four modes of supply:

1) *Cross-border supply*, whereby, for example, domestic consumers take a loan, purchase securities, or take insurance cover from a financial institution located abroad;

- 2) *Consumption abroad*, whereby consumers purchase financial services while travelling abroad;
- 3) *Commercial presence*, whereby a foreign bank or any other financial institution establishes a branch or subsidiary in the territory of a country and supplies financial services; and,
- 4) *Movement of natural persons*, whereby natural persons supply a financial service in the territory of a foreign member country.

The GATS aims at negotiating a legally binding set of commitments to enhance predictability and provide transparency under the principle of progressive liberalisation. The most important of the general obligation under the GATS are MFN (most-favoured-nation) (Article II) and transparency (Article III). They apply across the board to all services sectors, although exemptions to the MFN obligation in specific sectors are permitted, provided that the measures are listed in the list of MFN exemptions and that such exemptions, in principle, should not extend beyond 10 years. Specific obligations are related to market access and national treatment (Articles XVI and XVII, respectively). They apply only to services that are inscribed in the Schedules of Commitments of countries where specific commitments on market access and national treatment are listed in the form of limitations or measures applicable. Such limitations may be either horizontal (cross-sectoral) or sector-specific, and are listed for each of the four modes of supply.

Moreover, Article XVIII offers the possibility for countries to inscribe additional commitments not dealt with under the two previous articles. In addition to the provisions of Articles XVI, XVII, and XVIII, specific commitments in financial services are made in accordance with the Annex on Financial Services that complements the basic rules of the GATS. This Annex at some place clearly

recognises that countries may take measures for prudential reasons, including for the protection of investors, depositors, and policyholders and for preserving the integrity and stability of the financial system. Such measures shall not be used as a means of avoiding a country's commitments or obligations under the GATS. These measures do not need to be inscribed in the Schedules of Specific Commitments of countries regardless of whether they are in conformity with any other provisions of the GATS, including Articles XVI and XVII.

Furthermore, Article XII of the GATS allows Members to introduce restrictions of a temporary nature in the event of serious balance-of-payments and external financial difficulties subject to consultations with WTO Members.

CHAPTER IV

**INDIA AND THE ISSUE OF MOVEMENT OF NATURAL
PERSONS IN WTO NEGOTIATIONS**

Although trade in services has expanded considerably, there remain numerous regulations that constrain further expansion. These barriers are particularly severe on the mobility of the factors especially temporary movement of the labour related to the delivery of services in overseas markets. Liberalisation commitments are strikingly limited in the case of movement of natural persons (mode 4 of services delivery).

Since developing countries, including India have a comparative advantage in exporting labour intensive services, the lack of significant liberalisation under the movement of natural persons limits the overall value of GATS for developing countries.

If GATS is to effectively promote trade in services and address the interest of countries such as India, the ongoing WTO negotiations on services must aim at liberalizing the movement of natural persons.

Why liberalizing movement of natural persons?

Several reasons can be cited for this:

Firstly, the enhancement of earnings of developing countries through the economic activities of their labour force in developed countries can be an important component of their foreign exchange resources for further development.

Secondly, it can be an important example of economic partnership between developed and developing countries. It can provide the developed countries with trained work force and at the same time it can be a source of additional income for developing countries and also an opportunities for upgrading the technical awareness and knowledge of their workforce.

Thirdly, a mere free movement of labour across the borders can improve the efficiency of production in manufacturing and services sector in the world, particularly in the developed countries.

Hamilton -Whalley study shows that when barriers to movement of labour are removed, labour reallocates and efficiency gains occurs. Quantitatively, it is estimated that international regime of free movement of labour can double the world GDP.¹

As against these advantages, there could be the apprehension of erosion of sovereignty in matters of immigration; but more free movement of labour will hardly erode the sovereignty any more than that due to more liberalized flow of financial or telecommunication services.²

Definition Of Natural Persons

Natural persons are defined as people who are distinct from juridical persons such as companies and organizations.³ The subject (foreigners entering a country to engage in services business) is one of the four modes supplying commercial services internationally and recognized under the GATS.

¹ B. Hamilton and J. Whalley, "Efficiency and Distributional Implications of global Restrictions On Labour Mobility", *Journal Of Development Economics*, no.14, 1984, pp. 61-75.

² B.L. Das, "Restoring Balance to Services", *Third World Economics*, no.199, 16-31 December 1998, p. 15

³ B. Chatterjee and P.S. Mehta, "Movement Of Natural Persons Under GATS: Problems And Prospects", *CUTS Briefing Paper*, no.9, September 1997, p.4.

One misconception is that movement of natural persons is a stand-alone issue. In other words, it is only one among the four modes of services supply. But the reality is that the movement of natural persons is both a stand alone as well as cross sectoral issue applicable to the services sector, being negotiated under the GATS.⁴

Overview of trade in services and movement of natural persons

It is very difficult to assess the extent of trade in services that occurs via the movement of natural persons (MNP). This difficulty arises from general problems with service sector data as well as problems related to the lack of information on direct measures to quantify the significance of this mode.

Data on labour-related transfers and income flows (proxy measures to assess MNP) suggest the importance of mode 4 for trade in services. Table 1 provides the value and direction of remittances, transfers, and labour income for developed and developing countries. One can infer from **Table 1** that on net, developing countries are recipients of labour income from developed countries. This implies that developing countries tend to have a comparative advantage in exporting labour- intensive goods and services. Hence, they are likely to have a strong interest in promoting temporary labour flows as a source of trade earnings. (see **table 1**)

⁴ Often confused with negotiations on Movement of Natural Persons (MNP), Professional Services is in fact a separate subject with a separate objective. MNP talks were about commitments to open markets so that personal could conduct business in foreign countries. The discussions in WTO's Professional Services Working Party deal with Rules, not specific commitments.

Table 1
Direction of Labour related transfers and income flows (1980-1990)⁵

(US \$ million)	1980	1985	1990
New Workers' remittance			
LDCs	20110	19387	33737
Credit	25336	23444	38599
Debit	5225	4057	4862
DCs	-10607	-10107	-18230
Credit	3760	2941	5213
Debit	14367	13047	23442
Net migrant's transfers			
LDCs	-147	-94	43
Credit	230	131	212
Debit	377	225	168
DCs	1092	804	3326
Credit	1946	1807	5225
Debit	854	1003	1899
Net labour income			
LDCs	1161	1756	2923
Credit	3713	4056	7144
Debit	2551	2300	4220
DCs	-1874	-2686	-10243
Credit	7366	6642	14748
Debit	9240	9328	24992
Net total labour-related flows			
LDCs	21125	21049	36704
DCs	-11389	11988	-25147

India's Service Trade Via The Movement Of Natural Persons

India has significant potential to export many services through the temporary movement of labour. It's potential lies in a wide range of service activities including health services, software services, construction and integrated engineering services, accountancy and legal services, among

⁵ UNCTAD-The World Bank, *Liberalizing International Trade in Services: A Handbook*, (Geneva, 1994), p.19.

others. India not only has potential in exporting labour-based services, it has the capability to provide services at various skill and professional levels. In all these areas India's comparative advantage stems from a combination of low cost and a high quality of skills and training.

At present most of India's trade in services via mode 4 (MNP) is in health and software services sectors. India relies heavily on outward movement of professionals for onsite delivery of software services. For instance, in 1997-98, of total software export earnings of Rs.65.3 billion, on-site services accounted for 60% of total export earnings in this sector of which the bulk was due to professional service export worth Rs.31.6 billion or 48.4% of total software service exports.⁶

In the case of health services, India currently exports skilled doctors, nurses, paramedics, and technicians to countries of Middle East, Africa, and South Asia.

In the construction and integrated engineering sectors, India exports construction workers, consultants in the field of engineering design, and construction management. The main markets are in West Asia, Bangladesh, Nepal, and countries in South East Asia.

In legal and accountancy services, although movement of natural persons is highly limited, there is growing demand for Indian professionals by foreign firms. It is due to increased FDI and the growing presence of foreign corporate in the country requiring skills in activities such as writing and

⁶ www.nic.in/commin (Ministry of Commerce, Udyog Bhawan, New Delhi.)

drafting contracts, intellectual property protection, designing of loan and equity instruments and knowledge of domestic corporate law and accounting practices.

In 1996, top 10 payers and receivers, respectively, accounted for 94% and 74% of total remittances respectively. On the debit side, Saudi Arabia ranks first, followed closely by U.S.; while on the credit side India is far ahead.⁷

Constraints to the movement of natural persons

Restrictions to the movement of natural persons can be broadly grouped into four categories. These relate to:

- 1) immigration related regulations concerning entry and stay of service providers;
- 2) regulations concerning recognition of qualifications, work experience, and training;
- 3) differential treatment of domestic and foreign service personnel; and
- 4) regulations covering other modes of supply, particularly commercial presence which indirectly limit the scope for movement of natural persons.

1) Restrictions on the Entry and Stay of Natural Persons

These restrictions range from strict eligibility conditions for applications of work permits/visas, cumbersome procedures for actual application and processing of these visas and permits, limitations on the length of stay and

⁷ WTO, *World Trade Organization Council For Trade in services: Presence of Natural Persons- An Introduction*, (Geneva, 1998), p.5. <http://www.wto.org>

transferability of employment in the overseas market. For instance, Indian software professionals require work permits/visas to provide on-site software services in overseas markets such as the US and U.K. There may also be additional requirements specifying that the foreign worker must train a local person for replacement within a certain time period or other age and residency based restrictions.⁸

Another restrictive eligibility condition is wage parity i.e. wages paid to foreign service providers be at par with those that would have been paid for a local person in the same position and with similar qualifications. The principle underlying the wage parity requirement is that overseas nationals are to be hired to address the shortage of suitably qualified service providers in the host country and not to save money by hiring cheap labour from abroad. However, the wage parity requirement acts to negate the cost based advantage of many developing countries in exporting labour intensive services and works against the very concept of comparative advantage based on cost differentials

The eligibility conditions are also subject to an inherent bias against middle and lower level service professionals with respect to wages, prior employment, and investment in most developed countries. For instance, under the tiered system of work permit application in the UK, tier 1 applications that are filed for higher level persons such as directors, senior executives are easier to obtain than permits for personnel such as systems analysts and database consultants. This is because it is recognised that higher level managerial staff

⁸ UNCTAD secretariat Report on "General agreement on Trade In Services: Summary Of Positions And Proposals" (As of July 26,1999) UN Geneva, p.12.

raises the competitiveness without significant displacement effects in the local labour market while entry by middle level persons is likelier to displace local labour. Such biases in entry conditions tend to hurt developing countries like India, which have a comparative advantage in middle level professionals rather than managerial and executive level personnel.

There are also barriers in the form of quantitative limits on visas in important service importing markets such as the US. For instance, the US puts a cap on the number of H-1B visas (the most important visa for the movement of natural persons).

Restrictions also apply to natural persons after they enter the foreign market. For instance, there are limitations on the transferability of work permits and mobility of the provider after he enters the host country.

There are also limits on the duration of stay for service providers. Work permits or visas are valid only for the specified duration which in turn depends on the nature of the position, the candidate's skill level, and other criteria. These limits range from three months to five years. Although permits are often extendable, renewals and extensions are subject to stringent conditions and high fees which discourage start up companies from hiring foreign nationals and force them to use local persons who may be in short supply and costlier.⁹

Apart from immigration-related restrictions on entry and stay, there are also entry barriers in the form of additional requirements imposed on foreign service providers. These include economic needs tests, local market tests, and

⁹ To have a view of different countries' regulations on MNP, see *Business Line*, 6/7/97; *The Economic Times*, 16/7/97; *The Wall Street Journal*, 28/8/97; *Business Line*, 30/9/97.

management needs test to ascertain the need for entry as well as the number to be allowed to enter.

2 *Regulations concerning recognition, certification, and licensing*

Movement of natural persons in services is also constrained by requirements on qualifications, work experience, and licensing/certification. Recognition requirements may either prevent market access for the foreign service provider causing a rejection of the work permit or visa application, or may limit his scope for work to specific activities once he enters the overseas market. Such regulations are common in the case of accredited services such as legal, accountancy, and health services where there are licensing norms and procedure. For instance, Indian medical degrees are not recognised in the US and UK. Indian doctors and nurses must recertify in those countries by passing the local medical licensing exams in order to practice.

In some sectors there are no formal certification or licensing procedures to accord recognition. In such sectors, there is some degree of discretion in granting recognition and equivalence between work experience and educational qualifications and/or training.

3. *Differential treatment of Foreign Service providers*

There is differential treatment in the context of social security taxes and benefits. For instance, temporary service providers in the US economy are required to make social security payments like Mediclaim to the US government in the absence of tax treaties between the home country and the US. These contributions are required despite the fact that the service provider is

on deputation abroad for a period which is less than the period of stay required to avail of social security benefits in the future (ten years in the US). The service provider not only pays social security taxes in the US, but also continues to make his contributions back home and does not recover his contributions upon returning to the home country. In effect, there is double taxation of earnings.

There are many policies which although really meant to protect consumers and to reduce the scope for professional misconduct and liability may have a side consequence of restricting the flow of professionals across countries. Such regulations include rules with regard to accounting or advertising practices, restrictions on the use of international and foreign firm names, prior residence, permanent residency, or domicile requirements, establishment requirements, consumer protection laws, restrictions on the areas of practice within the overall sector.

4. Restrictions on commercial presence

Since MNP often complements trade through commercial presence in services, restrictions on foreign direct investment in services may also translate into barriers to temporary labour movement in services. For instance, restrictions on foreign equity participation in services, exclusion of certain service sector activities from foreign commercial presence, conditions relating to staffing and management by local persons, nature of incorporation, and geographic and branching restrictions limit the scope for movement of natural

persons (MNP) as a complement to the movement of capital associated with foreign commercial presence.

GATS and the Movement of Natural Persons: An Assessment

How The Issue Emerged?-

Interest in the movement of natural persons came mainly from developing countries, although many developed countries also wanted to see barriers lowered. Initially, one area of interest for a number of developing countries was the possibility of pushing for entry commitment for less skilled employees, for e.g. construction workers travelling abroad to work with a construction company from their home country.

Services liberalization talks have tended to concentrate on issues such as cross border supplies and commercial presence. But India and other developing countries like Thailand, Egypt and Argentina argued that their service providers did not have capital to establish branches abroad. 'Never the less, individuals could still supply services competitively in foreign countries even without the formal commercial presence of their companies in those countries', the developing countries said.

In the closing stages of the Uruguay Round, this group of developing countries argued that the developed nations- especially Quad (US, EC, Japan and Canada) - expand their offers in this area. In the post Uruguay Round talks, some developing nations adopted the strategy of linking movement of natural persons with financial services liberalization. Negotiating group on movement of natural persons finally completed its work on 28th July 1995.

GATS framework and the movement of natural persons

MNP is defined in Article 1:2 of GATS as “Supply of a service—by a service supplier of a member through presence of natural persons of a member in the territory of any other member”.¹⁰ It thus includes both service providers who are working overseas in an individual capacity and service providers who are part of a home, host, or third country commercial establishment. One of the most important general provisions in GATS with respect to mode 4 is Article 6 on domestic regulation. Article 6 requires members to ensure that in sectors where specific commitments are undertaken ‘*measures of general application affecting trade in services are administered in a reasonable, objective, and impartial manner.*’ It further specifies that ‘*the measures relating to qualification requirements and procedures, technical standards, and licensing requirements do not constitute unnecessary barriers to trade in services— and that such requirements are: (a) based on objective and transparent criteria; (b) not more burdensome than necessary to ensure the quality of the service; and (c) in the case of licensing procedures, not in themselves a restriction on the supply of the service.*’

Article 7 grants members the discretion to recognise the education, experience, and licensing and certification of a Foreign Service provider either in whole or in part, and either autonomously or by mutual agreement or by harmonisation. However, it also obligates members to apply the criteria or standards for authorisation, licensing, or certification equally across all

¹⁰ WTO, n.7, p.3.

countries and not to use the latter as a *'disguised restriction on trade in services.'*

A third important provision under GATS is the obligation of transparency, under Article 3. This article requires members to publish "*all relevant measures of general application which pertain to or affect the operation of this agreement*" including relevant international agreements to which the country is a signatory.

GATS also contains a separate annex on the movement of natural persons. The annex defines the scope of mode 4 to cover *persons who are temporarily working in another member country*. It is *not applicable to individuals who are seeking access to the employment market of another member on a permanent basis or for citizenship or residency purposes*. Two categories of service persons covered are independent and self-employed suppliers who get paid directly by their customers and natural persons who are employed by their service suppliers in the host, home, or a third member country in respect to the supply of a service. The annex states that countries can regulate entry and stay of natural persons provided they do not apply these measures in such a manner as to nullify or impair the benefits granted to members under their specific commitments.

GATS Commitments on the movement of natural persons

While the GATS framework adequately addresses regulatory barriers that concern MNP, the commitments that have been made in this mode are very

limited in nature. There are many problems with the nature of liberalization that has taken place in mode 4.

The **first** problem is the limited sectoral coverage of commitments. High income countries have scheduled 50 percent of service sectors while developing countries have scheduled only 11 percent of all service sectors. In both cases, these commitments remain subject to restrictions on market access and national treatment. Overall, only 28 percent of the universe of services have been scheduled without restrictions by developed countries. But more importantly, it is sectors such as health services, legal and accountancy services where professional movement is important that have not been scheduled by many countries

A **second** major problem with the commitments filed on MNP is that in most cases they do not provide for unconditional liberalisation. Market access and national treatment are subject to the fulfilment of additional conditions which usually relate to functional or hierarchical criteria, length of stay, labour market and economic needs tests, etc. MNP has also been linked to commercial presence and few developing countries are in a position to benefit from it because of high capital requirement for establishment in developed countries, lack of technology and inherent comparative disadvantage.¹¹

Moreover, in many of the schedules, the conditions are not clearly specified in terms of their criteria and procedures creating some scope for non-transparency and subjectivity in their application.

¹¹ *India and The WTO*, vol.1, no.6, June1999, p.5.

The **third** main problem is with the nature of the mode 4 commitments themselves. Market access and national treatment obligations on MNP are mostly unbound in the sectoral schedules and refer to the horizontal commitments. The latter in turn are bound for only a small subset of service personnel, typically at the higher level, and in categories that are related to commercial presence abroad, and subject to the limitations noted above. For instance, horizontal commitments in mode 4 are subject to limitations in the case of 100 countries as opposed to only 4 countries for mode 2 (consumption abroad). Specific commitments in general facilitate entry of higher-level personnel in professional, managerial and technical categories. (see **table 2**)

Table 2

Market Access of Natural Persons – Horizontal Commitments

Entry subject to an economic needs test	Antilles, Barbados, Dominica, El Salvador, Grenada, Jamaica, Malta, Peru, Philippines, Sri Lanka, St. Lucia, St. Vincent and the Grenadines, Trinidad and Tobago
Entry for senior persons as intra-corporate transferees* (ICTs)	
All	Argentina, Aruba, Australia, Brunei Darussalam, Cameroon, Canada, Czech Rep., member states of the European Union, Finland, Hong Kong, Hungary, Iceland, India, Israel, Japan, Kenya, Rep. Of Korea, Kuwait, Mauritius, Mexico, Morocco, Namibia, New Zealand, Nigeria, Norway, Romania, Singapore, South Africa, Sweden, Turkey, United States, Uruguay, Zambia
Subject to an economic needs test	Antigua and Barbuda, Belize, Brazil, Cuba, Cyprus, Guyana, Indonesia, Poland, Suriname, Thailand, Zimbabwe
Subject to a quota	Bolivia, Chile, Colombia, Costa Rica, Egypt, Ghana, Guatemala, Honduras, Liechtenstein, Malaysia, Nicaragua, Pakistan, Switzerland, Tunisia, Venezuela.
Business Visitors	Australia, Austria, Canada, Czech Rep., member State of the European Union, Finland, Hungary, Iceland, India, Japan, Rep. Of Korea, Malaysia, Mexico, Morocco, New Caledonia, New Zealand, Norway, Poland Slovak Rep., South Africa, Sweden, Switzerland, Thailand, Turkey, United States, Venezuela

* Executives, managers, specialists

Source: *Guide to Uruguay Round Agreement*, (Geneva: WTO Secretariat, 1999).

Finally a fundamental problem with commitments is that there is no separation of temporary and permanent labour under the existing framework of commitments, even though GATS is meant to cover only temporary labour flows in services. This is reflected in the fact that most limitations that have been filed fall under the purview of general immigration legislation and labour market regulations which also affect permanent movement of labour. This limits the scope for liberalising movement of natural persons via GATS.

Under the existing commitments on mode 4, the most prevalent market access and national treatment limitations relate to the type of service provider and the reason for his movement (such as negotiating sales, delivery of specialised skills, or commercial presence, etc.) and corollary restrictions on duration of stay, eligibility conditions, and additional requirements that he must satisfy. Pre-employment is the most important criterion and is referred to in over 100 cases. There are some 80 cases where there are limitations in the form of numerical quotas and 50 cases where there is a requirement of an economic needs test. In the case of 46 countries there are horizontal limitations with respect to real estate. Thus, a large number of countries have included in their schedules the more problematic limitations noted above, in particular, those relating to immigration laws (quotas and pre-employment conditions), additional tests, and investment restrictions.¹²

¹² UNCTAD- *Preparing for future multilateral trade negotiations: issues and research from a development perspective*, UNCTAD/ITCD / TSB/ 6, (New York: UN Publications, 1999), pp. 84-85.

In addition, fifty countries have scheduled conditions relating to domestic minimum wage legislation along with additional conditions on work hours and social security. There are also horizontal limitations with respect to geographic and sectoral mobility, mobility across firms, foreign exchange related restrictions, non-eligibility of foreign service providers for subsidies, and other government regulations. Many countries have also indicated that their commitments would be suspended in the case of labour-management disputes.

Further to the existing limitations on commitments, there are also MFN exemptions by countries in selected sectors. Although these exemptions are not mode-related, by their very nature they tend to have a greater impact on the movement of natural persons and on commercial presence. There are 38 such exemptions, mainly of a preferential sort.

India's commitments on movement of natural persons

India itself has not offered much horizontally or sectorally on MNP. Its horizontal commitment on mode 4 is unbound excluding categories of business visitors, intracorporate transferees, and professionals. There are the usual conditions on source of remuneration, purpose of visit or employment, job responsibilities, prior employment, and limits on the duration of stay. National treatment under mode 4 is unbound in the horizontal schedule.

As regards sectors where India is a potential destination market for foreign service providers, such as in legal and accountancy services, there is no liberalization. The latter sectors have not been scheduled. The only sectors

scheduled by India where MNP is important are engineering, computer and related services, construction and related engineering, and research and development services. However, for all these scheduled sectors, the sectoral commitments are unbound and refer to the horizontal commitments.

Thus, India has not opened up any of the relevant sectors to inward flows of professional labour. This in turn implies that prospects for technology and skill transfer, raising domestic standards, and raising the quality of services through foreign competition and collaboration are not enhanced by the existing Indian commitments on mode 4.

Thus we find that the specific commitments of GATS regulate only a small part of MNP leaving the rest of labour exports to trade relationship and outside the jurisdiction of WTO. This has set a limit on realising the increased participation of developing countries in multilateral trading which was the much-quoted objective of GATT-Uruguay Round. So Hoekman rightly opines: "GATS is a landmark in terms of creating a multilateral discipline in virgin territory; a failure in terms of generating liberalization." It is because services were new issues for most trade negotiators, and the negotiating process had element of 'learning-by-doing'.¹³

Proposals for improving commitments on the movement of natural persons: An Indian Strategy

If the movement of natural persons is to be liberalised under the GATS, then existing commitments in this mode have to be significantly improved in

¹³ N. Mukherjee, *World Trade Organization And India's Trade Policy in Services*, (New Delhi: Vikas Pub., 2000). p.155.

future rounds of service sector negotiations. This can be realized through country-country negotiations by sector and also through the introduction of multilaterally accepted horizontal formulae on issues such as classification of service providers and the separation of temporary and permanent labour, within the existing framework of GATS. Thus, a two- pronged approach is required for further liberalisation in mode 4: *bilateral and multilateral strategies*.

A. Sector-Specific Demands and Concessions: A Bilateral Strategy

In Health Services, the first objective should be to get more countries to schedule this sector. Countries of interest to India among those which have not filed commitments in health services include Singapore, Thailand, Japan, Bangladesh, Nepal, and Sri Lanka, and some of the East African countries. The second objective should be to seek more liberal and binding commitments in mode 4 from those countries that have already filed/will be filing commitments in the next round of negotiations.

India should negotiate the removal of economic needs and local needs tests with the US and the EU which have included such conditions in their schedules to regulate entry of foreign health professionals. At the least, the negotiations should attempt to get the US and the EU to clearly list the criteria for determining eligibility for entry and the number to be allowed to enter based on these tests and also to make transparent the way in which such tests will be administered.

With regard to recognition the approach should be to negotiate mutual recognition agreements with important destination markets such as the US,

Canada, Australia, and the UK and other member countries in the Middle East, such as Kuwait and Bahrain where current recognition of Indian qualifications may not continue in future.

On its part, India must schedule health services and then make a binding sectoral commitment in mode 4 for health services, including for doctors, nurses, paramedics, and technicians. India stands little to lose from allowing market access to foreign health professionals and is instead likely to gain from an improvement in standards and skills and technology transfer.

In **Accountancy Services**, the issues for discussion include economic needs tests, restrictions on commercial presence, nationality requirements, and recognition requirements. The several members of the EU (France, Denmark, and Italy, England, Greece) have placed citizenship conditions on MNP for both accounting and auditing services. Nationality conditions should be replaced by residency conditions if so required on grounds of public interests. Also, in-state residency requirements for licensure (US) should not be applicable to all accounting, auditing and bookkeeping services. Their application should be limited to certain activities within this sector where protection of consumer and social interests is critical.

Licensing and certification issues must be addressed by negotiating mutual recognition agreements with target countries, including the US, select EU countries (particularly the UK), Canada, and Australia. Finally, as with health services, the negotiations should aim at getting binding *sectoral rather than horizontal commitments* in mode 4.

Once India schedules this sector, it should make a binding commitment on mode 4 at the minimum for foreign accountants who are part of international accounting firms with offices in India, if it is not prepared to make an offer for market access by foreign accountants in an individual capacity. India's offer on mode 3 should also be binding and without restrictions on foreign equity, staffing and management. Recognition and establishment of commercial presence may be restricted to certain activities within the sector and also subject to residency requirements for certain accountancy services, if so justified on public policy grounds. The latter might include areas which require knowledge and expertise of domestic accounting norms and practices.

In Software Services, India must negotiate with US the removal of labour condition for specialty occupations listed in the US horizontal commitments, or negotiate for clearly enunciated criteria for the use and application of such labour conditions. Negotiations with the US and UK should also focus on realizing totalisation agreements to prevent double taxation of India software personnel.¹⁴In the case of Australia, the negotiations should aim at removing the requirements for labour market tests for all specialists and instead aim at obtaining exemptions for specialists who have more than a prescribed level of qualifications and experiences. The negotiations should seek to obtain binding sectoral commitments on mode 4 that are relevant to the needs (personnel classification, recognition) of this particular sector.¹⁵

¹⁵ *Business Line*, (New Delhi), 30 December, 2000.

India's own commitments in this sector, particularly as relevant to mode 4 include removing the foreign equity ceiling in mode 3 (in its horizontal commitments) and making a binding sectoral commitment in mode 4 (and also bind its commitments in modes 1 and 2). The present commitments by India in this sector are more restrictive than the status quo.

In Legal Services, bilateral negotiations should be directed at restrictions on mode 3 arising from commercial presence restrictions, nationality requirements, and residency requirements. Discussions with the US should focus on limiting requirements for in-state office and in-state residency for licensure/practice to selected subsectors within legal services where required on the grounds of consumer protection and national interest. Negotiations should also try to obtain a binding sectoral commitment from the US in mode 4. Mutual recognition agreements would also need to be negotiated with the US for the legal profession. In the case of the EU, the main issues for discussion include the removal of nationality requirements and limiting the scope of residency requirements.

In general, given that several OECD countries maintain nationality requirements, the bilateral negotiations should try to eliminate nationality conditions and instead substitute with residency conditions in these areas.

The bilateral negotiations should also try to remove conditions such as economic needs tests to determine the number of foreign lawyers who can enter

into the country.¹⁶ In all the above cases, India should seek to obtain binding sectoral commitments, at least of a partial nature, on MNP.

On India's part, it must first schedule legal services. Once this sector is scheduled, India could make a partial commitment for legal consultancy services. The main issue to be addressed in India's commitments is the nationality requirement as specified by the Advocates Act. Nationality should not be used as a barrier to practice as long as the age and qualification requirements under the Advocates Act are met. Commercial presence restrictions in legal services should be removed with the view that this would primarily result in the hiring of more local lawyers while also facilitating inward movement of foreign legal consultants and improved quality of legal services and standards within the country.

In Construction and Engineering Services, one primacy objective of the bilateral negotiations will be to get Kuwait, Bahrain and some of the African nations to schedule sectoral commitments.

Negotiations with countries such as Kuwait, Malaysia, Egypt, Sri Lanka, and Thailand should aim at removing/relaxing foreign equity ceilings on commercial establishments, requirements of local management and staffing (Malaysia), and the form of commercial presence (only representative and regional offices as with Malaysia). In the case of countries such as Kuwait where these restrictions are also accompanied by additional conditions of economic needs tests and prior authorization, India should seek more liberal

¹⁶ UNCTAD, n.8, p.13.

terms for commercial presence. Modes 3 and 4 should be de-linked in the sectoral commitments to facilitate outflow of construction personnel from India at middle and lower levels where India has a comparative advantage. Bilateral negotiations should also center on registration and licensing of engineers and architects. Important countries in this regard include Canada, Kuwait and Sri Lanka.

India has scheduled commitments in this sector but it can improve on its offer in the next round. Its sectoral commitment in mode 4 should be bound with recognition-based limitations if so required. The foreign equity ceiling of 51 percent in its mode 3 commitment should be removed to facilitate presence of foreign construction companies in India with resulting benefits in terms of technology, skill transfer, and local employment generation.

It would be useful to identify the significance of different modes of supply in different sectors and focus negotiations in each sector accordingly. It would also be useful to see the extent to which mode 4 is complementary to and substitutable by other modes of supply in formulating India's strategy for the sectoral negotiations. India must also obtain information on all relevant limitations before commencing the negotiations.

It must establish mechanisms to provide information on all associated rules and regulations which would affect the implementation of its commitment and also seek recourse to such information from other members via the enquiry points established under Article 3 to GATS

B. Improving the structure of commitments in mode 4: A Multilateral Strategy

There are two parts to the broader multilateral strategy for liberalizing MNP.

a. Improving sectoral and horizontal commitments in mode 4

It has been noted earlier that most of the commitments in mode 4 are horizontal in nature. The use of horizontal commitments in mode 4 limits the flexibility of the commitments that have been made and also their relevance to the needs and characteristics of individual sectors or subsectors .

Multilateral discussions during the next round should aim at moving away from the reliance on horizontal commitments in mode 4 to *sector-specific commitments* in this mode, especially in sectors such as professional and business services where mode 4 is important. These sectoral commitments must be *detailed and specific*, in terms of the measures that are applicable to individual sectors and in terms of the service personnel categories that are pertinent to each sector. All limitations, conditions, exceptions, etc. should be clearly laid out in the sectoral schedules, both for market access and national treatment, rather than being broadly outlined in the horizontal schedules. Countries must also take the necessary steps to furnish information on these measures as per the provisions of Article 3.

b. Horizontal formula for classification of service providers

Firstly, all members should agree on the coverage of professionals and activities within the personnel categories that are included in the horizontal schedules (ICTs, business visitors, specialists, other personnel). The

multilateral discussions could also focus on expanding the categories of service providers covered by the horizontal commitments to remove the current bias towards higher level personnel. It is important to include middle and low-skill level providers and make the commitments more relevant to the interests of the developing countries with expertise in these categories. The coverage can be expanded in two ways. It can be expanded by explicitly introducing new categories such as technical support personnel, which would for instance include personnel such as systems analysts and programmers in the case of software services. Alternatively, it can be expanded by defining the coverage of categories of “other personal” and “specialists”. This expansion should allow for the inclusion of middle and lower level personnel in these latter categories by specifying relevant criteria and by modifying/removing certain conditions relating to skills, pre-employment and job responsibilities that tends to favour higher level persons.

The main idea underlying the suggested improvements in the sectoral and the horizontal commitments, is that the overall framework of commitments has to be improved for mode 4. *Complementarity rather than substitutability* is required between the sectoral and horizontal schedules. The horizontal commitments should provide the broader umbrella within which the sectoral commitments would fit while the details provided in the sectoral commitments should buttress the horizontal commitments and formulae agreed upon. Thus India should seek a uniform and broader classification of service personnel including professional categories in which India has an interest.

C. **Broadening the GATS framework on movement of natural persons**

In addition to working within the existing framework of commitments, it is also necessary to establish multilateral guidelines on some issues, to strengthen some of the existing GATS provisions, and overall, to broaden the reach of the GATS framework with respect to MNP. The relevant issues to be addressed in this context include:

i) Separating temporary from permanent labour flows - GATS visa

Temporary service providers should be treated separately from permanent migrants. They should ideally fall outside the purview of immigration-related laws and labour market regulations and their entry and stay should be treated under a separate set of regulations. This would reduce the administrative burdens, delays, and costs they face in entering the foreign market. It is proposed that a separate class of visas, a **GATS visa** be established for service professionals temporarily working overseas. The introduction of the GATS visa would require extensive multilateral negotiations. Its main features can be summarised as follows:

- (i) Permission to work overseas on a temporary basis if the service provider is covered by sectoral and horizontal commitments on modes 3 and/or 4;
- (ii) Strict time frame within which visa must be granted (2-4 weeks maximum);
- (iii) Flexibility for visas on shorter notice for select categories of providers and border availability of visa;
- (iv) Transparent and streamlined application process;

- (v) Mechanisms to find status of application, rejection; requirements;
- (vi) Multiple entry visas for senior executives and CEOs;
- (vii) Easier renewal and transfer procedures;
- (viii) Safeguard mechanisms to prevent entering permanent labour Market.¹⁷

ii) *Introducing norms to address social security taxation*

The multilateral framework on social security taxation can only be effective if it is part of a broader agreement on the GATS visa and movement of natural persons (MNP) lies outside the domain of normal immigration and labour market rules and regulations. If the GATS visa proposal is implemented, all foreign service personnel present in the host country under the GATS visa (individual or company- related) should not be required to pay double taxes .

iii) *Introducing norms to address wage parity*

It is difficult to establish multilateral norms on wage parity since one gets into issues of fair wages, welfare and exploitation of cheap foreign labour. However, conditions on wages do affect the comparative advantage of many developing countries in some labour intensive services. To address both the concerns, multilateral talks are required to establish a horizontal formula on wage parity. Again, the distinction between temporary and permanent labour flows as permitted by the GATS visa would be helpful.

The horizontal formula that is developed for wage parity can be used only for those service providers qualifying for a GATS visa.

¹⁷ R. Chanda, *Report on Movement of Natural Persons*, Project Study Sponsored by Ministry of commerce, GOI, (New Delhi: ICRIER, December 1999), p.41.

It is proposed that employees deputed abroad for less than a specified period not be subject to wage conditions that lead to wages in excess of what they receive in their home countries plus costs due to living and other expenses (to be explicitly specified) needed to ensure a fair standard of living for that specified time period in the host country. This time period could be decided mutually by the concerned countries under bilateral wage agreements, given the needs of the sector, the category of the service provider, and the nature of the job.

iv) Strengthening GATS norms on recognition

It would be useful to strengthen the recognition provisions by establishing detailed norms for five issues that concern recognition and to evolve multilateral disciplines and some guidelines to facilitate mutual recognition agreements among member countries.

- *Norms for non-accredited sectors/activities* (for example, software services) are required regarding the criteria to be used in according recognition to professionals, for instance, in terms of minimum professional education as sanctioned by a diploma, formal licensing or certification requirements, and minimum professional experience. These criteria should also be reflected in the sectoral and horizontal commitment schedules.
- *Norms concerning equivalence of work-related and academic qualifications* be established that specify the kinds of jobs/positions and the kinds of academic qualifications that may

be considered equivalent and substitutable for meeting entry requirements and also specify the sectors where such equivalence is difficult to establish. The latter will require the participation of professional bodies and associations in member countries to provide the criteria for equivalence along with names of well recognised training and higher education institutes in the respective countries to better assess the quality of professional qualifications.

- *Norms concerning temporary licensing* should allow for temporary licensing of foreign service professionals when such licensing procedures are absent in the home country of the professional. Countries could bilaterally negotiate areas which could be given priority for temporary licensing. Multilateral discussion on the sectors and procedures concerning temporary licensing is required.
- *Norms concerning broad-based equivalence in recognition* would be useful to establish bridging mechanisms where there is a divergence of requirements and standards between home and host countries. The GATS framework should encourage discussions on a compensatory system of granting recognition, whereby local adaptation periods and aptitude tests for foreign service professionals can be used to offset differences among national systems and standards .

- *Introducing norms for economic needs and other tests* can be done by laying down clear criteria for applying such tests, by establishing norms for the administrative and procedural formalities associated with such tests, and by specifying how the results of such tests are to be used in restricting entry to foreign service providers (e.g., translating the findings to quantitative limits on foreign personnel).

Domestic reforms and measures

The proposed strategies for seeking improved commitments on MNP would also need to be supported by domestic measures and reforms at the individual country level. It is important to highlight some of the main reforms and measures that would be required, especially in developing countries, to benefit from the proposed recommendations.

Recognition is one major area where reforms and measures would be required. Countries would need to evaluate the standard of domestic training and certification systems for individual service sectors and ensure some degree of uniformity in standards within the country. Simultaneously, they may also need to raise their domestic standards to internationally acceptable levels when there is a major divergence. Professional bodies would need to be established in some countries for certain sectors and to be made more proactive so as to constantly monitor and regulate standards within the country and abroad and cooperate with similar bodies abroad.

Other areas for measures and reforms concern policies relating to immigration and taxes. In the case of immigration legislation, countries will need to establish a subset of immigration legislation to deal with temporary migration and the guidelines concerning the GATS visa. In the case of tax policy, countries would need to enter into bilateral totalisation agreements with markets that are important destinations for their professionals. Most importantly, countries would need to be more transparent about their domestic regulations. Without increased transparency on the part of individual countries, most of the proposed recommendations would not be enforceable or effective.

In recent years, the trade in services is undergoing structural changes. There is no doubt that these changes will be further pushed forward by various modalities of services trade, as identified in the GATS. Among the diversified modalities, developing countries have actual as well as potential comparative advantage in movement of natural persons. However, potential comparative advantage may not be translated into the revealed (actual) comparative advantage due to various factors.¹⁸ The two most important ones are:

- the labour market rigidity and associated political economy in the developed world and
- the reactive stance, on the part of the developing world, in opening up of the services sector for trade and global competition.

¹⁸ B. Chatterjee and P.S. Mehta, n.3. p.10.

However, both from the point of view of consumers' welfare and sustainable development, removal of labour market distortions may lead to a global level win-win situation.

Therefore, a pro-active initiative (on the part of both the developed and the developing world) to increase market access regarding the MNP is required. This is particularly true (for global equity in the services trade) for the contractual services requiring semi-skilled workers, and within the framework of cross-border reciprocity.

CHAPTER V

CONCLUSION

The establishment of General Agreement on Trade in service (GATS) was one of the major outcomes of the Uruguay round. The GATS broke new ground in a number of areas. Not only did it cover measures affecting trade in services – a product group that was mostly not subject to the GATT – but also it defined trade in a novel way. Trade under the GATS includes not just cross border exchange but also sales by affiliates of foreign companies that have established a long term commercial presence in a host country, purchases of services made by nonresidents who have moved to the location of their provider, and the sale of services by natural persons made possible by a temporary presence in a host country. The potential reach of GATS therefore extends beyond that of the GATT, which deals only with cross-border trade in merchandise.¹ One consequence of this broader domain was that government insisted on being able to maintain national derogations and limitations on the reach of multilateral disciplines. A rather complicated scheduling technology was adopted: each WTO member may list exceptions to the national treatment principle or market access for individual service sectors for any or all of the four modes of supply through which trade can occur. They may also refrain from making any commitment for specific services.

During the Uruguay round of negotiations on services, most attention centered on conceptual and ‘architectural’ issues-how to define trade, what

¹ Bernward, Hoekman, “Toward a More Balanced and Comprehensive Services Agreement” in Schott Jeffrey J. (ed.) *The WTO after Seattle*, (Washington D.C.: Institute for International Economics, July 2000), p.119.

rules and principles should apply to measures affecting this trade, and devising mechanisms to determine the coverage of the agreement. What was created was a framework under which liberalization could be pursued in the future. Article XIX of the GATS calls on members to engage in the negotiations to liberalize trade in services five years after the entry into force of the agreement and periodically thereafter. New negotiations on services therefore commenced in year 2000.

This dissertation has discussed issues and strategies for India on the Telecom sector, financial services sector and movement of natural persons in WTO negotiations. The premise is that GATS must become more balanced in terms of the magnitude and distribution of the benefits of the agreement for different groups of countries. The services negotiations offer the opportunity for significant market access gains for developing countries, while at the same time improving the regulatory environment of services and the efficiency of domestic industries.²

The major challenge confronting negotiators is to create incentives for developing countries to expand their commitments under the GATS. Given ongoing efforts in many countries to adopt a more pro-market and procompetitive policy stance, the focus of attention can be expected to center on increasing the extent to which both the status quo and future (autonomous) reforms are scheduled in the GATS. This depends importantly on the value that is placed on such scheduling by reforming economies themselves and by the

² *ibid*, p.120.

demandeur countries that want governments to lock in reforms in the GATS. Arguments by economists that the WTO can be used as a valuable credibility bolstering device have proved to be less than compelling to policy makers. In practice, the mercantilist logic of multilateral negotiations is likely to require that industrialized countries improve export market access opportunities for developing countries.

On 15th February 1997, the Group on Basic Telecommunications (GBT), organized under the auspices of the World Trade Organization (WTO), completed negotiations on the world's first multilateral deal liberalizing international trade in basic telecommunications service. The deal that was struck comprises 55 schedules covering 69 governments (the European Commission negotiates on behalf of European union member governments and submitted one schedule for all of them, hence the numerical discrepancy), of legally binding commitments to open some or all of the participating countries' basic telecom markets to foreign competition³.

Most of the industrialized countries have committed to provide market access via the relevant modes of supply for all basic services and market segments (local, long distance, and International). The most common exceptions involve limits on equity ownership (especially in traditional national carriers) that has been retained by some European countries and phased in liberalization schedules for less affluent countries like Spain, Portugal, Greece.

³ William Drake, and ELI M. Noam, "Assessing the WTO Agreement on Basic Telecommunications" in Gary C. Hufbauer and Erika Wada (edt.) *Unfinished Business: Telecommunications after the Uruguay Round*, (Washington D.C.: Institute for International Economics, Dec. 1997) p.27.

India along with Brazil, Indonesia made more carefully circumscribed (and some times very limited) offers that opened certain market segments while reserving some or all of voice telephony for companies that had already been granted exclusive rights. In some such cases, promises were often made to review the situation after the year 2000 or the passage of new national laws.

The real significance of the GBT deal doesn't rest on how deeply countries have liberalized any given sector or sub-sector in the short term what may matter more for the governance of the global information economy is that the deal signals the beginning of an evolutionary process of mutual adjustment that will unfold according to a clearly defined set of principles, baselines, and mechanisms. The GBT agreement also institutionalizes dialogue among parties and collective examinations of problems, thereby promoting conceptual progress and convergence.⁴ The GBT deal helps to consolidate proliberalization coalitions in member countries.

But EliM. Noam, John Kollar argue that the scope of the GBT agreement is being exaggerated because a total of 73.6% of world telecommunications market is accounted for by US, Japan and EU and these countries had already committed themselves to liberalization and market opening as a result of their own internal evolutions.

Secondly, GBT agreement is not a treaty. It is more in the nature of a series of pledges. Many countries attached conditions to or delayed the date of

⁴ *ibid*, p.47.

their implementation, thereby in effect providing a protective or protectionist cushion.

The deals exemptions and exceptions are not the end of the story. In implementing it, democratic countries will not meekly follow their trade negotiators. Further, exemptions could be claimed in telecommunication for variety of reasons, for e.g. environmental protection or employment.

Still, there is widespread hope that the GBT deal will help to establish a new architecture of global telecom policy that facilitates increasing deep liberalization in the years to come.

The last decade has witnessed a sea change in the telecommunication scenario in India. During this period there has been a very rapid growth of Direct Exchange Line (DELs), though the teledensity in India still remains low. Two policy documents were released during this period reporting a change in the previously held view that telecom was a luxury service to the one where it was seen as an important infrastructure service that should be generally available, with world-class quality at reasonable and affordable prices. Private investment was seen as an important contributor to achievement of national objectives in the area of telecommunications, and a number of policy initiatives were taken in this regard. However, the experience with policy reform has not been entirely satisfactory and a re-orientation of policies has recently taken place to provide greater flexibility of operation. The latest policy framework also recognizes convergence of technologies and services that has thrown up

opportunities for growth in several sectors and takes note of the regulatory and other social challenges.

Access to world-class technologies is possible through procurement of such technologies by the existing services providers and through investment by other service providers.⁵ Both these depend not on policies of other countries but on our own policies, including policies related to provision of bandwidth to service providers. This is particularly because in the telecom market, a number of investors and technology suppliers are seeking markets for their operations, and from India's perspective, these attempts are not restricted by policies of other countries.

Thus, it seems likely that in the area of telecom, India is likely to make little, if any, demand with respect to policies of other countries. There is, however, likelihood that other countries will demand commitments from India regarding its telecom policies. In this situation, Indian negotiators in WTO will have to consider whether, and to what extent, they would like to exchange concessions made by India in telecom with concessions obtained by India in other sectors.

India may like to look at the issues relating to telecom in GATS-2000 negotiations in following order:

1. Policies for which a commitment may be made as they exist at present or will evolve during early phase of negotiations (e.g. foreign equity participation).

⁵ Dr. Harshvardhan Singh, Report on *Trade in Telecommunications Services: Opportunities and constraints*, (New Delhi: ICRIER, 1999), p.46.

2. Policies for which commitments may be introduced in terms of a commitment to review (e.g. increase in the number of operators for basic services and cellular mobile services).
3. Policies, which should be considered in the interim phase of the negotiations, based on domestic developments (e.g. liberalization of international call segment, Corporatisation of DTS).
4. Policies for which commitment could be considered in terms of a phase in time period (e.g. internet telephony).

The WTO Financial Services Agreement (FSA) completed on 13 December 1997, included market-opening commitments by 102 WTO members. The FSA is milestone for the WTO because a significant number of WTO members agreed to a legal framework for cross-border trade and market access in financial services and to a mechanism for dispute settlement.

Yet in an important sense, the FSA is less than meets the eye, as Dobson-Jacquet suggest that there is a significant agenda of market opening measures still to be taken.⁶ For the most part, the FSA simply formalizes the status quo. Commitments made by OECD countries do little to further open the market. US will provide access to its markets on a reciprocal basis, whereas most OECD countries already have such access and developing countries, with less-mature financial institutions, find it of little interest. With a few important exceptions, the significant emerging market economies offer little new access

⁶ Wendy Dobson and Pierre Jacquet, *Financial Services Liberalization in the WTO*, (Washington D.C.: Institute for International Economics, June 1996), p.1.

to their often-underdeveloped banking sectors, while they offer significant new access to their insurance sectors.

There may be good reasons that there was so little movement beyond the status quo. Developing countries must decide how quickly they will integrate their economies with the rest of the world and determine the role that they wish foreign institutions to play in that process and in the domestic economy. However, as the Asian financial crisis of 1997-98 (and the experience of the southern cone countries in Latin America in the 1980s) demonstrates, such integration holds dangers if the process is not planned and managed with great care.

From Indian perspective, GATS may be looked upon as a precious opportunity to re-examine their stance on internationalization of financial services by making the realistic assessment of potential benefits and risks involved in the process. The multilateral commitments don't yield benefits only from more liberal domestic trade, but also from more open markets in other countries. Any postponement of domestic reform measures or multilateral commitments may delay the benefits significantly. There is sufficient empirical evidence to support the argument that the state of financial development and the degree of the openness of a country are important determinants (among others) of global financial inflows—a conclusion too important to be ignored by a capital scarce country like India. Several empirical studies have validated the

strong links between financial liberalization and economic growth.⁷

A stable macroeconomic environment, prudential regulation and supervision of financial institutions and markets have been suggested as the necessary preconditions in order to yield full benefits of internationalization. If macro-economic conditions are unstable then adverse effects of inflation, large budget deficits and unsustainable exchange rates get compounded by large capital inflows, which sows the seeds of macro-economic crisis. If the government of a developing country is not firmly committed to fiscal reform, financial liberalization can lead to an explosion in government debt, economic instability and lower economic growth.

However, it must be noted that internationalization is not a discrete event but a process that has to be carried out in stages. The process of improving domestic financial regulation has to move in tandem with internationalization. Liberalization commitments in the multilateral context, in turn, can help to discipline future macroeconomic structural and prudential policies. This indicates that internally Indian policy makers should strengthen the financial sector particularly through institutional capacity building; and externally our strategy should be based on 'reciprocity' and 'convergence of interests' in WTO. 'Reciprocity' means that we will give in to foreign demands to the extent that we receive concessions. 'Convergence' indicates that the

⁷ For detailed studies, see R King and R. Levine "Finance, Entrepreneurship and Growth: Theory and Evidence", *Journal of Monetary Economics*, 32, 1993, pp.513-542. Also R. Levine "Financial Development and Economic Growth: Views and Agenda", *Journal of Economic Literature*, vol.35, no.2, June 1997, pp.688-726. Also, M.J. Fry, "In Favour of Financial liberalization", *The Economic Journal*, vol.107, no.442, May 1997, pp.754-770.

concessions we offer are also in our interests. Indian response strategy in future WTO negotiations on financial services can be summed up under three heads:

1. Demands of the other countries that can be agreed to straight away on a reciprocal basis; (for e.g. removal of restrictions on the asset sharing of foreign banks, removal of restriction on the entry of foreign banks through subsidiaries or joint ventures, opening up of insurance sector (both life and non-life) pension funds management to foreign sector, allowing grand fathering of existing foreign financial firms).
2. Demands that can be considered by linking them with the progress of reforms; (For e.g. more commitments on insurance (life and non-life) and pension fund management with respect to commercial presence with reforms to be carried out in stages, opening up for derivative products including futures and options simultaneously with the introduction of these products for domestic players, progressive rise in foreign holdings in other non-banking finance companies).
3. Demands that can't be considered during this round; (for e.g. 100% foreign equity participation in life-insurance business, cross-border supply of insurance, allowing foreign-owned insurance companies to invest funds abroad, giving unrestricted access to foreigners to debt instruments of Indian residents).

The Uruguay Round, and even subsequent negotiations, have led to an unbalanced coverage of different modes of supply, with especially unsatisfactory results for the movement of labour. The sector specific

commitments have covered measures (partial or full) regulating commercial presence substantially more than the measures regulating movement of natural persons (MNP) as service suppliers.

Horizontal commitments governing presence of natural persons have been made by 92 WTO member countries. These usually state the elements of the immigration and labour laws and regulations. The present horizontal commitments don't refer to MNP in all categories and occupations. The main categories scheduled are limited to the Intra-corporate transferees (covered in 62 schedules of commitments), Business visitors (included by 32 member countries) and Independent professionals, including those providing services within a service contract (commitments by 12).

This implies that developed countries, who have a greater member of higher level personnel, have largely been in a position to benefit from the GATS commitment on MNP.

In the aftermath of the Uruguay Round, extended negotiations on the MNP continued, and completed on 28th July 1995 but resulted in the modest commitments by six countries, of which four have specified these commitments for selected services.

India enjoys comparative advantage in exporting labour services, similar to other developing countries with surplus labour. While many developing countries cover a relatively narrow range of skilled and semi-skilled workers, India is engaged in exporting a wide range of labour services ranging from semi-skilled and skilled workers to managerial and technical personnel, to the

rest of the world. This, in turn, contributes to India's export earnings from labour services by way of wage-income, fee, honorarium and other remittances. It is in this context that export of labour services holds great significance for India.⁸

India's strategy for seeking to liberalize MNP in the on-going negotiations will have to be two-pronged: Bilateral and Multilateral.

Bilaterally, India must seek and be prepared to offer specific concessions in five selected sectors, namely health, software, legal, accountancy, construction and engineering services from specific countries. There are several items for bilateral discussion that are common to all of the named sectors. Most importantly, these include:

- (a) getting many target countries to schedule these sectors,
- (b) getting binding sectoral as opposed to horizontal commitments in mode 4 (MNP),
- (c) addressing restrictions relating commercial presence, economic needs test (ENT) and local market-tests, recognition and licensing, nationality and residency requirements that are applicable to all of these sectors.

Simultaneously, India itself, must schedule sectors such as legal and accountancy services, health services, educational services and architectural services where it stands to gain from transfer of skills and technology and upgradation of standards through inward movement of foreign service providers.

⁸ Neela Mukherjee, *World Trade Organization and India's Trade Policy in Services*, (New Delhi: Vikas pub. House, 2000), p.37.

Multilaterally, India must try that countries move from horizontal to bound sectoral commitments in mode 4 and fulfil conditions of specificity and detail in the sectoral commitments.

Secondly, there is a need to multilaterally negotiate horizontal formulae on several issues to deepen and broaden the scope of the horizontal commitments. For e.g. multilateral discussions could focus on expanding the categories of service providers (including middle and low skill level-providers) covered by the horizontal commitments to remove the current bias towards higher level personnel. Efforts should be there to make scope and coverage of service personnel uniform in terms of their definitions and coverage across all countries and be correspondingly reflected in the horizontal schedules.

To broaden the GATS framework on MNP following issues have to be plurilaterally negotiated:

- *The separation of temporary from permanent labour.*
- *Introducing norms to address social security taxation and wage parity.*
- *Strengthening GATS norms on recognition.*

The proposed Indian strategy for seeking improved commitments on MNP would also need to be supported by domestic measures and reforms at the individual country level as following.

- a) India would need to raise its domestic standards to internationally acceptable levels when there is a major divergence. Professional bodies would need to be established in some countries for certain sectors and to be made more proactive so as to constantly monitor and regulate

standards within the country and abroad and cooperate with similar bodies around.

- b) India will need to form a mutual recognition agreements with the major developed countries, including the US, the EU nations, Canada and Australia. The agreements should specify some minimum qualifications, for instance in terms of the level of education and work experience, duration and characteristics of the training program, the credentials, and professional license in the field so requires.
- c) India would require changes in immigration and labour market-regulations. For instance, the proposal of a GATS visa would require establishing a separate subset of immigration legislation to deal with temporary migration.

Restoring Balance to Services

The implication of GATS should be viewed in the context of the vast differentials in the supply capacity of the developed countries on the one hand and that of the developing countries on the other. Most of the developing countries have hardly got any supply capacity in the services sector for export to the developed countries. Hence the opportunities have been really opened mainly for the developed countries by the liberalisation of services import in the developing countries.

This imbalance has been further aggravated by special and accelerated negotiations in the financing sector and telecommunication sector. These were the areas of special interest to the developed countries, and were taken up with

priority for special attention. These were particularly the areas in which the developing countries have practically no supply capacity for export to the developed countries.

Then there is an imbalance between the treatment of capital and labour in the GATS. It contains disciplines for unrestricted movement of capital related to the supply of services, but the same treatment has not been given to the movement of labour. Articles XI and XVI of the GATS have included the movement of capital in the obligations. These articles say that (i) restrictions must not be applied on transfers and payments for current transactions related to specific sectoral commitments, (ii) there must not be any restrictions on the capital transactions inconsistent with the specific sectoral commitments, (iii) a country is obliged to allow a cross-border movement of capital, if it is an essential part of the movement of service covered by specific sector of commitments. As it would appear, these obligations are very clear, specific and detailed. There is nothing like it in respect of the movement of labour.⁹

Reasons For the Imbalance

Over the years, the developing countries have been at a disadvantage while participating in international trade negotiations for reasons such as weak bargaining positions, inability to carry out technical homework due to lack of human and pecuniary resources at the domestic level. Infact, one can classify these as *traditional set of reasons*. But there is also another set of reasons i.e. slowly gaining recognition as to why developing countries like India turn out to

⁹ B.L. Das, "Negotiations in agriculture and services in the WTO: suggestion for modalities/guide lines" (downloaded from <http://www.twinside.org.sg>), p.8.

be poor performers in international trade negotiations, even when they do have the clout and also negotiators that are globally respected. An effort must be made to grasp these set of *emerging reasons* using the ‘public policy’ approach under the neo-classical framework. Such an approach proceeds on the basis that there is not one, but many actors (for e.g. sectoral interests, interests of bureaucrats to promote their image) influencing the negotiating approaches that reflect the interest of people at large.¹⁰

What does a negotiator from a developing country generally end up doing with this baggage? He remains confused about the negotiating positions to take, as he is not sure of their precise implications on the economy. Such uncertainty only provides them with a room to adopt strategies to contain the damage that they perceive would result from accepting the language of an instrument/clause of a treaty. Thus, positions that need to be developed on the basis of ‘prism of interest’ remain elusive.

The second important assumption of this approach is that these actors may have differing self-interests, but pursue them rationally to maximise their economic benefits taking into account political and institutional constraints.

Lastly, such an approach accepts that actors are ‘rationally ignorant’; that they are not fully but at least aware of some aspects under discussion. Such a kind of ‘rational ignorance’ is found to be prevalent among negotiators from developed countries who are ‘rationally unaware’ of the political, social and

¹⁰ Vinod Rege, “Developing countries and negotiations in the WTO”, *Third World Economics*, 16-31 August 1998, p.15.

economic constraints that plague developing countries and, hence, fail to grasp the legitimacy of positions taken by the negotiators of the developing countries.

Another important instance of 'rational ignorance' is seen in the very negotiators from developing countries, especially India, dealing with their 'fallback' positions. In any negotiations, a country has a frontline position, a fallback and a position which is a 'dead one' (that is, it prefers to opt out). Successive negotiations on trade issues have shown that India does good homework on 'frontline' positions, but remains 'rationally ignorant' on 'fallback' positions. A country such as India can't afford to only do homework on 'frontline' positions as most of the times it has to settle on different versions of fallback positions.

An important reason for the reflection of 'rational ignorance' in negotiating positions of developing countries is the lack of inter-departmental cooperation. Only after the establishment of the WTO has the Ministry of Commerce and Industry taken up institutional initiatives to set up bodies that involve closer interaction between ministries and departments concerned, academics and civil society. The qualitative difference after such efforts with respect to positions and strategies adopted by India is evident in the form of presentations made by India on 'implementation' concerns before the Seattle Conference.

Another important issue that can't be neglected is the role played by the perception of a negotiator about an issue which may not necessarily be in line with those of the dominant pressure groups at the domestic level. Besides this,

he might fall prey sometimes to circumstantial incentives that would lure them to project themselves at the cost of domestic interests. They are able to do so, as in most cases, the industrial and other interest groups, whose interests may be affected by the newly developed rules, are not vocal and active in expressing their concerns. Given the magnitude of the economic and social problems which most of these developing countries face at domestic level, the political parties and general public have also so far shown little interest in the issues discussed at the international level. This further leads to more freedom and autonomy for negotiators from India and others, finally making them more vulnerable to persuasion by the developed countries delegations.

The analysis of GATS negotiations produce three more features of WTO negotiations that shed light on the factors behind present imbalance in GATS:

- a) Because of the hegemony exercised by the two major players namely, US and EU, the agenda for the negotiations as well as the principles on which the new rules should be based and their content is largely determined by them.
- b) As the subjects for negotiations are brought to organizations like the WTO by these two major players generally after the preparatory work at inter-ministerial level has been completed and after consultations with concerned national interest groups and discussions with other developed countries have been held in such fora as the OECD, they are far more prepared for discussions and negotiations than developing countries like India in participating in multilateral negotiations.

- c) In the current system, the various stages of negotiation on a particular subject are: tabling of the proposal by a country in a formal meeting, discussions and negotiations in small group meetings, brief information on the progress given at formal meetings from time to time by the chairman, and finally when an agreement is reached in the small group negotiations, tabling of the results in the formal meeting for approval. This way, most of the third world countries in general get involved at the initial stage and the final stage, but are almost totally out of the picture on the actual process of the negotiation on small groups. Most of the time, almost all the developed countries are in this small group.¹¹ The selection of countries for small groups is done by chairman with the help of secretariat which works with an agenda and present power matrix in mind. It is well known as '*Green room process*'.

Possible Correctives

In this background, if the new negotiations ask for obligations for liberalizations by both developed and the developing countries, the imbalance is bound to be further aggravated. It calls for a totally new type of approach from India and others. Art. XIX of the GATS says that in course of the negotiations for sectoral liberalisation, the developing countries may take commitments for liberalising fewer sectors. So there can be now an initial modality which will not require developing countries to undertake further commitments and will require only the developed countries to liberalise their

¹¹ B.L. Das, "Full Participation and Efficiency in Negotiations", *SUNS*, 4582, 10 January, 2000, p.1 (downloaded from www.twaside.org.sg).

services imports in the sectors of export interest to the developing countries. This process is fully supported by Art. IV of GATS, which says that increasing participation of developing countries in world trade in services must be facilitated through, *inter alia*, the “liberalisation of market access in sector and modes of supply of export interest to (the developing countries)”.

Simultaneously, the developed countries should agree to take measures for encouraging the import of services from the developing countries into their own.

In the present ‘Green Room Process’, a possible corrective could be to form a representative negotiating group, consisting of a prescribed and small group of negotiators who would be negotiating on behalf a set of countries. They should be selected jointly by the countries that they would be representing. One important pre-condition for such a process is that a set of countries will have nearly common interest on the issues involved in the negotiations. The three groups can be formed: the developed countries, the developing countries and the countries in transition. The groups initially formed should operate for two years on an experimental basis and then there may be changes, if necessary.

There could be many other alternatives for improving the system besides this. What is needed is a deliberate exercise for improvement and change.

In the post Uruguay round trading system, developing countries are faced with serious challenges in exerting influence over the process of setting the international trade agenda, given that there has been a tendency towards

continuous and sectoral negotiations which made it difficult for developing countries to effectively prepare initiatives and counter-proposals. This situation also requires the re-establishment of alliance of the like-minded countries in the form of an informal core group to define a positive agenda in the area of services.

Developing countries will have to establish linkages amongst the sectors and mode of supply of natural persons to obtain reciprocal benefits.

Developing countries must identify common elements in their proposals and use these commonalities to build their negotiating strengths. For e.g. the need for Art 4 and 19 to be operationalised for developing countries; no dilution of the current GATS architecture; identifying sectors and modes of interest to all of them and also obstacles existing in developed countries which impede developing countries.

They must identify and accommodate the concerns of specific countries within the developing country group, so as to maximise the harmony of their positions and enhance their united front in their negotiations.

One of the weaknesses of the Indian negotiations in WTO is the absence of a relatively permanent team of negotiators. Since the diplomats change there is a need for well trained policy researchers to be a part of the negotiating team along with representatives of trade and industry and legal experts to give continuity to the negotiations, arrive at alternative negotiating stands backed by empirical research. Such a semi permanent fast action team can help in delivering the goods, which is the need of the hour.

India needs to look forward to opportunities for enriching and expanding a strong domestic base for service exports. With a large service sector and huge stock of service professionals, a 'big push' in multiple direction is required for exploiting market potential in world trade. As explained earlier, there is much that can be derived from bilateral and multilateral negotiations in selected services. Even modest concessions in this respect can lead to opportunities for quantum jump in services through movement of natural persons as a mode of delivery.

Today, when services have gained legitimacy as an integral part of international economic transactions and are becoming increasingly attractive areas for trade and negotiations, it is time that India undertakes a holistic view of service trade in order to design strategies and measures for growth. On reaching a plateau in goods trade, the door is still left open for India to exploit its potential in service trade. It can hardly afford to watch and wait in an era of global 'service boom'.

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