Module On

International Trade in Services: Importance and Potential for States

Dr. Pralok Gupta
Assistant Professor
Centre for WTO Studies
New Delhi

SLIDE 3: INCOME GENERATION, EMPLOYMENT AND EXPORT POTENTIAL OF SERVICES

Services account for a large share of the economy at all levels of development. The majority of both production and employment in most economies around the world depend on services. Services play a vital role in facilitating all aspects of economic activity. Transportation, communications and financial services provide the support necessary for any type of business. Educational, health, and recreational services influence the quality of labor available to firms. Professional services provide specialized expertise to increase firms' competitiveness. Increasingly, the major portion of value-added (up to 70 percent) comes from services inputs: upstream (such as feasibility studies and research and development activities); on stream (such as accounting, engineering, and administrative services); and downstream (such as advertising, warehousing, and distribution).

SLIDE 4:

Three distinctions can usually be made between goods and services: Intangibility of services; Simultaneity of production and consumption of services; and Non-storability or Perishability of services.

Intangibility: Services are intangible and insubstantial which implies that they cannot be touched, gripped, smelled, tasted or heard. It also implies that there is neither potential nor need for transport, storage or stocking of services.

Simultaneity: Services has to be consumed at the same point of time at which it is generated. Thus, the service provider and service consumer, both are indispensable for service delivery. The service provider is required to generate and render the service and the service consumer is required to consume the rendered service.

Non-storability or Perishability: If the service is not consumed at its assigned time and place, it will be lost forever. The alternative may be the next version of service but that specific service cannot be used. If there is an empty seat on a plane, it can never be utilized and charged after departure.

Given these special characteristics, the initial belief was that services cannot be traded internationally and hence economists did not pay attention to international trade in services. However, these beliefs are contrary to the existing pattern of global trade, as reflected by the services export data.

Some services sectors, in particular international finance and maritime transport, have been largely open for centuries - as the natural complements to merchandise trade. Other large sectors have undergone fundamental technical and regulatory changes in recent decades, opening them to private commercial participation and reducing, even eliminating, existing barriers to entry. The emergence of the internet has helped to create a range of internationally tradable product variants - from e-banking to tele-health and distance learning - that were unknown only two decades ago, and has removed distance-related barriers to trade that had disadvantaged suppliers and users in remote locations (relevant areas include professional services such as software development, consultancy and advisory services, etc.). A growing number of governments has gradually exposed previous monopoly domains to competition; telecommunication is a case in point.

SLIDE 5: SOME DATA ON SERVICES

According to the data available at UNCTAD, services were estimated to account for 64% of the world GDP in 2010. For developed countries the share of services in total GDP was 71% whereas for developing countries, it was around 50%. Even within developing countries, the share was 54%, 49% and 45% respectively for High income, Middle income and Low income developing countries. This kind of pattern is obvious given the fact that as an economy progresses, the share of tertiary sector (services) increases whereas primary sector share (agriculture and allied activities) decreases.

If we talk about India, services sector has shown remarkable growth over past two decades. The contribution of services in India’s GDP is continuously increasing and it has risen from 43% (1990-91) to 64% (2010-11) (Economic Survey, 2012). India’s performance in terms of services share in GDP is not only above that of other emerging developing economies, but also very close to that of the top developed countries. Among the top 12 countries with highest overall GDP in 2010, India ranks 8 and 11 in overall GDP and services GDP respectively.

SLIDE 7: TRADE IN SERVICES

While world trade in services is dominated by the developed countries, emerging economies like China and India are now playing an increasing role. India is the most dynamic exporter of services and ranked seventh in the world in both exports and imports of services in 2010.

The contribution of services in India’s exports is also continuously increasing. Its share in total exports grown from 20% (1990-91) to 35% (2009-10) (UNCTAD Handbook of Statistics, 2011). The share of services in India's total exports is expected to rise to about 50.4%, likely to surpass merchandise exports by 2012 (FICCI Survey, 2007).

SLIDE 8: SERVICES AND EMPLOYMENT

In spite of a significant jump in services contribution to GDP, services contribution to employment increased marginally in India over the past two decades. Due to this phenomenon, some people criticize India's growth story as 'jobless growth', i.e., there is high growth in Indian economy but jobs are not being created.

This kind of growth may be due to the fact that our focus after liberalization has remained on those services which are less labor intensive such as IT services. However, services do have high potential to absorb semi-skilled and skilled workforce as reflected in employment data of other countries. This is due to the labor-intensive nature of many traditional services, including distribution, construction, education, health and social services.

SLIDE 9: SERVICES AND STATES

A reflected in the gross state domestic product (GSDP) data of different states and union territories (UTs) in 2009-10, services sector is the dominant sector in most states of India. States and UTs such as Tripura, Nagaland, West Bengal, Mizoram, Maharashtra, Bihar, Tamil Nadu, Kerala, Delhi, and Chandigarh have higher than all-India shares. Chandigarh with an 86 per cent share and Delhi with 81.8 per cent top the list (Economic Survey 2012).

Other than a few states, services in all other states contribute more than 40 per cent in their individual GSDP. Therefore it could be understood that the services revolution in India is becoming more broad-based, with many backward states piggy-backing on the good performance of this sector to go up the escalator of progress.

SLIDE 14: STATES AND SERVICES TRADE

Foreign trade is in 'Central' List of the Indian Constitution. The GoI is empowered to frame all rules and regulations for foreign trade. Such rules are applicable to the whole country. The role of the state governments is complimentary in the sense of providing special and additional measures for promoting foreign trade. For instance: in the case of foreign investment, national policy framework is to maximize inflow of foreign investment in India and accordingly the GoI has framed various rules and regulations. The investors have the ultimate choice of where to locate their investment in India. Hence, policies and programs of state governments become very important in deciding location of such foreign investment.

SLIDE 15:

Over the years, many states have developed themselves as services export hub for specialized services such as Karnataka and Andhra Pradesh for IT services but many states have not so far performed well from the perspective of services exports. The World Bank Investment Climate Survey, 2009 of 16 Indian states ranked Karnataka at the top position in terms of conducive investment climate followed by Kerala, Gujarat and Andhra Pradesh.

Some states have natural advantage with respect to specific services such as Goa has for tourism services, whereas other has to develop the competitive advantage. A case in point is Karnataka. It has emerged as IT hub because of the government's efforts, such as single window clearance committee, special focus on skill development etc. that helped in creating appropriate environment conducive to IT services.

SLIDE 16: LEGAL/REGULATORY FRAMEWORK FOR SERVICES AT DIFFERENT LEVELS OF GOVERNMENT

Indian Constitution provides for three layers of the government: Center, State and Local. The responsibility of providing various services is also distributed at these three levels. There are many services which require involvement of the state governments either on a stand-alone basis or with the central government. Therefore, the states need to understand the importance of services in general as well as for international trade.

SLIDE 17: EDUCATION SERVICES

The regulatory framework concerning India's higher education sector is complicated, with the rresponsibility for higher education being shared between the central government and the state governments. The central government has the responsibility of coordinating and determining standards in higher education, through an apex regulatory body, the University Grants Commission (UGC) and professional councils for different disciplines at the national level. The state governments, as the main financiers of the higher education system are responsible for all administrative and operational matters. Some states also have a council for higher education and councils in different professional areas. In addition, there are three agencies (the National Assessment and Accreditation Council-NAAC, the National Board of Accreditation- NBA, and the All India Council of Technical Education-AICTE) which are responsible for evaluating the quality of institutions or programmes through an external quality assurance process.

Hence, the regulatory framework is quite complex, with an overlap in regulation at the federal and state levels and a plethora of institutions and councils involved in standard setting and implementation. Such complexities have resulted in regulatory failures and problems of implementation. Many institutions do not meet the minimum norms prescribed by the regulatory bodies and provide substandard higher education.

SLIDE 18: TRADE IN EDUCATION SERVICES-CENTRAL LAWS OR STATE LAWS?

If the foreign educational institutes will be allowed through 'deemed university' status, the central laws will be more applicable whereas if they will be established as private state universities, the state laws will be applicable. In the latter case, the involvement of states in the international trade in education services will be more.

SLIDE 19: RETAIL DISTRIBUTION SERVICES

The role of state government is very important in efficient supply of retail distribution services as most of the services incidental to retail services are in the hands of state government. Expansion of organized retailing/franchising is dependent on the availability of approach roads, parking facilities, public transport facilities, electricity and communication systems, and real estate. In India, the lack of quality urban public transport discourages the development of shopping malls/hypermarkets in the outskirts of cities. Electricity charges are high and the supply is unpredictable. Shortage of electricity and frequent power cuts hampers efficient operation of the existing outlets and impose with restriction on shop opening timings. In order to overcome the accessibility problems, many organized retailers are forced to open their outlets close to residential areas. However, they are faced with a variety of barriers which make real estate acquisition very costly.

The retail services segment is also constrained by different Indian states having their own policy with respect to production, distribution and taxation. The sector is subject to multi-level administrative control. There are restrictions on interstate movement of goods. Multi-point taxation makes it difficult to set up a centralized sourcing infrastructure causing most retailers in India tend to source their products locally and affecting their economies of scale in sourcing. Inter-state difference in taxes encourages infiltration of products from states with lower taxes to states with higher taxes, resulting in black marketing. The distribution sector is also subject to a plethora of laws at the central, state and local/municipal levels.

SLIDE 21: TRADE IN RETAIL SERVICES- FDI IN MULTI BRAND RETAIL?

In November 2011, the cabinet decided to allow up to 51 per cent FDI in multi-brand retail, but had to stall the move due to political opposition. With political parties in the ruling UPA and outside resisting the retail FDI move, the Centre is of the view that states which want to allow foreign investment in the sector can do so, while others can wait. In such a scenario, states role become very important because foreign retailers will be interested in establishing their retail chains in India only if sufficient no. of states opt for it. Many foreign retail chains such as Walmart, Carrefour and Tesco have been waiting for the government to permit FDI in multi-brand retail.

Thus, it is evident that role of the states is very important in international trade in services. Though the decision for allowing such trade may be taken at the centre, the states cannot take it for granted. They need to understand the modalities of such trade and need to create an appropriate investment climate in order to realize their exports potential.

SLIDE 22: UNDERSTANDING THE GATS

The General Agreement on Trade in Services (GATS) is the first multilateral trade agreement to cover trade in services. All Members of the World Trade Organization are signatories to the GATS and have to assume the resulting obligations. So, regardless of their countries' policy stances, trade officials need to be familiar with this Agreement and its implications for trade and development.

SLIDE 23:

The GATS' contribution to world services trade rests on two main pillars: (a) ensuring increased transparency and predictability of relevant rules and regulations, and (b) promoting progressive liberalization through successive rounds of negotiations. Within the framework of the Agreement, the latter concept is tantamount to improving market access and extending national treatment to foreign services and service suppliers across an increasing range of sectors.

It does not, however, entail deregulation. Rather, the Agreement explicitly recognizes governments' right to regulate, and introduce new regulations, to meet national policy objectives and the particular need of developing countries to exercise this right.

SLIDE 24: BUILDING BLOCKS OF THE AGREEMENT

The GATS consists of two main parts: (i) the text of the Agreement (a Preamble, 29 articles arranged in six Parts and various Annexes); (ii) and a schedule of specific commitments for each WTO Member. The text provides a framework of disciplines and obligations that apply to all Members, while a schedule contains Member-specific commitments on individual sectors (together with a list of any MFN exemptions).

The main body of the Agreement outlines Members' obligations concerning their use of measures (i.e. which may be in the form of laws, rules, regulations, procedures, decisions or administrative actions) affecting trade in services. These obligations essentially fall into two main groups: (i)"unconditional obligations" that must be adhered to by all Members in all sectors covered by the GATS; and (ii)"conditional obligations" whose scope is confined to those sectors and modes for which a Member has undertaken specific commitments.

SLIDE 25: SERVICES TRADE AND MODES OF SUPPLY

Mode 1: Cross-border - A user in a country receives services from abroad through its telecommunications or postal infrastructure. Such supplies may include consultancy or market research reports, tele-medical advice, distance training, or architectural drawings.

Mode 2: Consumption abroad - Nationals of home country go abroad as tourists, students, or patients to consume the respective services.

Mode 3: Commercial presence - The service is provided within home country by a locally-established affiliate, subsidiary, or representative office of a foreign-owned and – controlled company (bank, hotel group, construction company, etc.)

Mode 4: Movement of natural persons - A foreign national temporarily moves to other country to provide his service as an independent supplier (e.g., consultant, health worker) or employee of a service supplier (e.g. IT firm, consultancy firm, hospital, construction company).

SLIDE 26: GATS - SCOPE AND APPLICATION

Article I:1 stipulates that the GATS applies to measures by Members affecting trade in services. It does not matter in this context whether a measure is taken at central, regional or local government level, or by non-governmental bodies exercising delegated powers.

An exemption of this scope applies to "services supplied in the exercise of governmental authority”. The relevant definition specifies that these services are “supplied neither on a commercial basis, nor in competition with one or more service suppliers”. Typical examples may include police, fire protection, monetary policy operations, mandatory social security, and tax and customs administration.

SLIDE 30: UNCONDITIONAL GENERAL OBLIGATIONS

Each Member has to respect certain general obligations that apply regardless of the existence of specific commitments. These include:

Most-Favoured-Nation Treatment

The MFN principle applies across all sectors and all Members. However, under the Annex on Article II Exemptions, there is a possibility for Members, at the time of entry into force of the Agreement (or date of accession), to seek exemptions not exceeding a period of ten years in principle.

Transparency

Under Article III, each Member is required to publish promptly "all relevant measures of general application" that affect operation of the Agreement. Members must also notify the Council for Trade in Services of new or changed laws, regulations or administrative guidelines that significantly affect trade in sectors subject to Specific Commitments. Members also have a general obligation to establish an enquiry point to respond to requests from other Members.

Legal Remedies

Under Article VI:2, Members are committed to operating domestic mechanisms (“judicial, arbitral or administrative tribunals or procedures") where individual service suppliers may seek legal redress. At the request of an affected supplier, these mechanisms should provide for the "prompt review of, and where justified, appropriate remedies for, administrative decisions affecting trade in service”.

Monopolies

Article VIII:1 requires Members to ensure that monopolies or exclusive service providers do not act in a manner inconsistent with the MFN obligation and commitments.

Business Practices

Article IX refers to business practices other than those falling under the monopoly-related provisions of Article VIII that restrain competition and thereby restrict trade. The Article requires each Member to consult with any other Member, upon request, with a view to eliminating such practices.

Subsidies

Members that consider themselves adversely affected by subsidies granted by another Member may request consultations under Article XV:2. The latter Member is called upon to give sympathetic consideration to such requests.

SLIDE 31: CONDITIONAL GENERAL OBLIGATIONS

A second type of general obligations applies only to sectors listed in a Member's schedule of commitments.

Domestic Regulation

Pursuant to Article VI:1, measures of general application are to be administered "in a reasonable, objective and impartial manner". If the supply of a scheduled service is subject to authorization, Members are required to decide on applications within a reasonable period of time. Article VI:5 seeks to ensure that specific commitments are not nullified or impaired through regulatory requirements (licensing and qualification requirements, and technical standards) that are not based on objective and transparent criteria or are more burdensome than necessary to ensure quality. Article VI:6 requires Members that have undertaken commitments on professional services to establish procedures to verify the competence of professionals of other Members.

Payments and Transfers

GATS Article XI requires that Members allow international transfers and payments for current transactions relating to specific commitments. It also provides that the rights and obligations of IMF Members, under the Articles of Agreement of the Fund, shall not be affected. This is subject to the proviso that capital transactions are not restricted inconsistently with specific commitments, except under Article XII (see below) or at the request of the Fund. Footnote 8 to Article XVI further circumscribes Members' ability to restrict capital movements in sectors where they have undertaken specific commitments on cross-border trade and commercial presence.

SLIDE 32: OTHER GENERAL PROVISIONS

Economic Integration Agreements

Like GATT in merchandise trade, the GATS also has special provisions to exempt countries participating in integration agreements from the MFN requirement. Article V permits any WTO Member to enter into agreements to further liberalize trade in services on a bilateral or plurilateral basis, provided the agreement has "substantial sectoral coverage" and removes substantially all discrimination between participants. Recognizing that such agreements may form part of a wider process of economic integration well beyond services trade, the Article allows the above conditions to be considered in this perspective. It also provides for their flexible application in the event of developing countries being parties to such agreements.

Recognition

Notwithstanding the MFN requirement, Article VII of the GATS provides scope for Members, when applying standards or granting licenses, certificates, etc., to recognize education and other qualifications a supplier has obtained abroad. This may be done on an autonomous basis or through agreement with the country concerned. However, recognition must not be exclusive, i.e. other Members are to be afforded an opportunity to negotiate their accession to agreements or, in the event of autonomous recognition, to demonstrate that their requirements should be recognized as well. Article VII:3 requires that recognition not be applied as a means of discrimination between trading partners or as a disguised trade restriction.

Exceptions

Part II of the GATS (General Obligations and Disciplines) further contains exception clauses for particular circumstances. Regardless of relevant GATS obligations, Members are allowed in specified circumstances to restrict trade in the event of serious balance-of-payments difficulties (Article XII) or of health and other public policy concerns (Article XIV), or to pursue essential security interests (ArticleXIV*bis*).

SLIDE 33: SPECIFIC COMMITMENTS

In addition to respecting the general obligations referred to above, each Member is required to assume specific commitments relating to market access (Article XVI) and national treatment (Article XVII) in designated sectors. The relevant sectors as well as any departures from the relevant obligations of Articles XVI and XVII are to be specified in the country's Schedule of Commitments. Commitments guarantee minimum levels of treatment, but do not prevent Members from being more open (or less discriminatory) in practice.

SLIDE 35: LIMITATIONS ON MARKET ACCESS (MA): ARTICLE XVI

For a scheduled sector, Article XVI:2 provides an **exhaustive list of six categories of restrictions** that must not be maintained, unless scheduled as a market access limitation. The restrictions relate to:

a. the number of service suppliers;
b. the value of service transactions or assets;
c. the number of operations or quantity of output;
d. the number of natural persons supplying a service;
e. the type of legal entity or joint venture;
f. the participation of foreign capital.

The first four restrictions (a to d) are quantitative as they deal with quota-type limits. It is interesting to note that in Article XVI(a) to (e) no distinction is made between measures that are targeted only at foreign services or service suppliers, and those that are applied to nationals as well. In other words, both discriminatory and non-discriminatory measures are covered. For example, a measure may state that in the banking sector licenses will be issued for a maximum of six banks with no nationality criteria specified. Although this measure is non-discriminatory, it remains a restriction in the sense of Article XVI and would need to be scheduled if it is to be maintained.

The other two restrictions, the second element of (e) and (f), are by their very nature discriminatory. One relates to measures requiring joint ventures, while the other refers to limits on foreign capital participation. Since both restrictions apply only to foreign service suppliers, they are also limitations on national treatment.

It is to be noted that **only measures that fall under these categories are subject to scheduling**. Other measures, although may be deemed to have an economic effect on access, are outside the scope of Article XVI. For instance, a high non-discriminatory tax on a particular service may act as a barrier to entry, but it is not a restriction which falls under any of the categories listed under Article XVI.2.

SLIDE 36: LIMITATIONS ON NATIONAL TREATMENT (NT): ARTICLE XVII

National treatment under the GATS applies only to the sectors committed in a Members' schedule and is subject to the conditions inscribed therein. Unlike Article XVI on market access, **Article XVII does not provide an exhaustive list of discriminatory measures that would be inconsistent with full national treatment**. The Article simply requires a Member to accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment "no less favourable than that it accords to its own like services and service suppliers".

Treatment that is "no less favourable" is defined to mean that treatment which ensures that conditions of competition are not biased in favour of domestic services and service suppliers. Typical examples of discriminatory measures include restrictions on foreign land ownership, tax benefits only for nationals, training requirements imposed only on foreign suppliers, or language requirements that are not directly relevant to the exercise of a profession.

SLIDE 37: ADDITIONAL COMMITMENTS

Members may also undertake additional commitments with respect to measures not falling under the market access and national treatment provisions of the Agreement. Such commitments may relate to the use of standards, qualifications or licenses. Additional commitments are particularly frequent in the telecommunication sector where they have been used by many Members to incorporate into their schedules certain competition-related "self"-disciplines.

SLIDE 38: BILATERAL AND PLURILATERAL NEGOTIATIONS ON SERVICES

As Doha Development Round of the WTO is stalled, more and more countries including India are going for bilateral/plurilateral agreements. Services are becoming an integral part of such agreements. Even those countries having bilateral agreements on goods, are now negotiating agreements on services.

Key demands on India in its services FTAs are with regard to extending concessions on Mode 3, i.e. investment. Whereas, India's key demand on its trade partners in services FTAs are for Mode 1 (cross border services) and Mode 4 (movement of professionals).

India and the European Union are facing "difficulties" relating to the Services sector in signing the Free Trade Agreement (FTA) between the two sides. Under the FTA in the Services sector, India wants the EU to ensure free mobility of professionals without restrictions such as previous experience, whereas the EU wants greater commitment by India to allow foreign investment in services such as retail, legal and postal.