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Domestic Preparedness for Services Trade Liberalisation

Are South Asian countries prepared for further liberalisation?*

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Abstract

During the last three decades or so there has been significant growth of services sector in all five South Asian countries (Bangladesh, India, Nepal, Pakistan and Sri Lanka) studied here. Along with this growth, liberalisation of services trade has become a critical economic agenda of these economies. Under the General Agreement on Trade in Services (GATS) these countries have liberalised many of their services sectors. Apart from the GATS commitment, they have also made significant unilateral liberalisation in a number of services sectors. However, there are arguments that weak domestic preparedness before opening up is likely to be associated with unsatisfactory and undesirable outcomes of liberalisation. This paper makes an overview of the experiences from five South Asian countries on domestic preparedness for services trade liberalisation, and analyse the associated concerns.

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I. Introduction

In the present day world services sector is the fastest growing sector of the global economy and it accounts for two thirds of global output, 30 percent of global employment and 20 percent of global trade .Between 1990 and 2002, the growth in world services trade was 155 percent while those for manufacturing and agriculture were 97 percent and 40 percent respectively (Kumar, 2005). Services activities in low- and middle-income countries have been expanding faster than GDP (gross domestic product) for the last two decades. An implication of this continuous shift toward services sector is that the overall growth of productivity in the economy is becoming increasingly determined by what is happening in the services sector (Sorsa, 1997).

Even though services sector is the major contributor to GDP in most of the countries, trade in services is relatively a new phenomenon, and it has a low share in the total world trade. 'Intangibility' and 'no storability' characteristics of services were considered as main impediments to services trade. Services sector was not included in the multilateral trading system till the inception of the Uruguay Round of General Agreement on Tariffs and Trade. Following the conclusion of the Uruguay Round, the General Agreement on Trade in Services is the first initiative with the aim of progressive liberalisation of trade in services. Since January 1995 the World Trade Organisation (WTO) is administering this Agreement. After the inception of GATS, services trade is getting the necessary importance in the multilateral trading system.

During the last three decades or so there has been significant growth of service sector in all five South Asian countries studied here: namely Bangladesh, India, Nepal, Pakistan and Sri Lanka. Along with the growth of the services sector, liberalisation of services trade has become a critical economic agenda for these economies. Under GATS these countries have liberalised some of their services sectors. Apart from the GATS commitment, they have also made unilateral liberalisation of a number of their services sectors. However, under the request-offer process of GATS, there have been a large number of requests from other developing and developed countries to these South Asian countries to open up a significant number of their services sectors. It has been argued that liberalisation of services trade in these countries, by opening up a number of sectors to international competition, would bring large economic benefit to them. However, there are growing concerns with regard to domestic preparedness for opening up of these sectors to international competition. There are arguments that weak domestic preparation before opening up is likely to be associated with unsatisfactory and undesirable outcomes of liberalisation.

This paper makes an overview of the cross country experience on domestic preparedness of five South Asian countries for services trade liberalisation, and analyse the associated concerns. It examines their experience in terms of importance of service sectors, their experiences in GATS negotiations, and their domestic preparedness for further trade liberalisation. Two of these five South Asian countries, namely Bangladesh and Nepal, are categorised as Least Developed Countries (LDCs), whereas the rest are developing countries. Therefore, the choice of these countries facilitates generating useful insights by differentiating country experiences in terms of their level of development, degree of openness in their services sectors, and institutional and regulatory capacity.

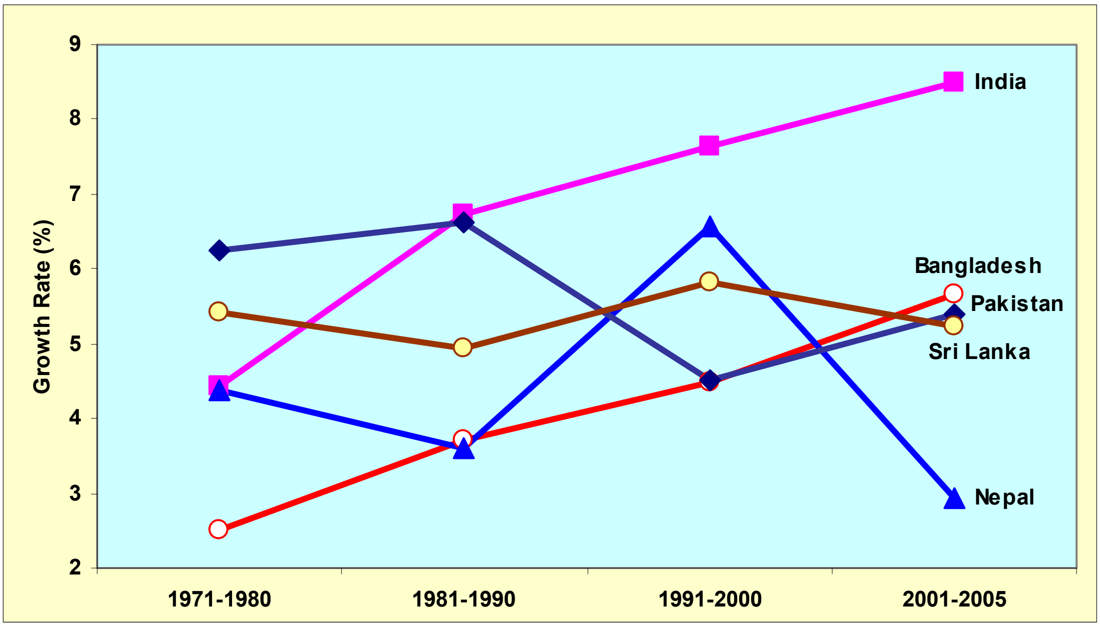
The structure of the paper is as follows. Section II provides an overview of the service sector in these five countries, highlighting the growth of the sector and its contribution to the economy in terms of output, employment, trade, and investment flows. Section III emphasises on the experiences of these countries in terms of multilateral commitments and offers made and in this regard the issues and concerns of domestic preparedness for further opening up of the services sector. Section IV analyses the current state of art of domestic preparedness in different services sub-sectors in terms of their competitiveness and the likely positive and negative outcomes of liberalisation. Finally, Section V concludes by summarising the major findings.

II. Overview of the Services Sector in South Asia

2.1 Growth in the Service Sector

Figure 1 compares the growth rates in the services sector across five South Asian countries for different time periods. It appears that Bangladesh is experiencing a persistent rise in the growth of the services sector over the last three and half decades. During 1970s the average growth rate in the services sector in Bangladesh was only 2.5 percent. The average growth rate in the services sector in Bangladesh during 2001-2005 was 5.67 percent which was higher than the growth rate of gross domestic product (GDP) during that period. Among the South Asian countries, India experienced the highest growth in the services sector. In fact, during the 1990s India had the highest growth in the services exports amongst the major economies of the world. India started with an average growth rate of 4.4 percent during the 1970s which became almost doubled during 2001-2005. In contrast Nepal experienced a rather fluctuating trend in the growth rate of their services sector, which was highest during 1990s (6.6 percent) and reduced to only 2.9 percent during 2001-2005 (the lowest average during the entire period under consideration). Like Nepal, Pakistan also encountered fluctuations in their growth rate and during 2001-2005, it was 5.4 percent; lower than the averages in 1970s (6.3 percent) and in 1980s (6.6 percent). On the other hand, Sri Lanka, though experienced some fluctuations, were able to maintain a growth rate of around 5.5 percent.

Figure 1: Average Annual Growth in Services in South Asian Countries



Data Source: World Development Indicators 2007, The World Bank

2.2 Contribution to GDP

Over the last three decades these South Asian countries witnessed significant shift in the structure of their economy towards dominance of the services sector (from the traditional sectors of agriculture and industry) in national production and employment. Table 1 suggests that, with the exception of Nepal, the contribution of the services sector to GDP is above 50 percent in South Asian countries.

Table 1: Sectoral Composition of GDP: South Asian Perspective

Countries	Services			Industry			Agriculture		
	1990	2000	2005	1990	2000	2005	1990	2000	2005
Bangladesh	48	51	52.6	22	24.7	27.3	30	24.3	20.1
India	41	48.9	54.4	28	27.1	27.3	31	24	18.3
Nepal	32	--	40.8	16	--	20.9	52	--	38.2
Pakistan	49	48.9	53.3	25	24.9	25.1	26	26.2	21.6
Sri Lanka	48	52.1	57.2	26	27.3	26.1	26	20.6	16.8

Source: World Development Indicators 2007, The World Bank

2.3. Contribution to Trade

The contribution of the services trade in total trade of South Asian countries is increasing over time; more than doubling in actual amount during 1995-2003 (from $26bn to $51bn). Considering individual country performance, as reflected in Table 2, there is an increasing contribution of services in a country's total trade. For India, Sri Lanka and Nepal, the figures are quite impressive. Workers remittances are gaining importance for all the countries of the region, especially for the low-income countries, reflecting the significance of labour-based services exports (Table 3).

South Asian countries' large labour endowment, including low-skilled, semi-skilled, high skilled categories, results in a regional comparative advantage in exporting labour based services under the Mode 4 of GATS – that is, temporary movement of workers.

Table 2: Significance of Services in Total Trade (% of country's total trade)

Country		2000	2001	2002	2003	2004	2005
Bangladesh	Services exports	11	11	12	13	12	12
	Services imports	17	16	15	15	16	15
India	Services exports	28	28	28	28	29	-
	Services imports	26	28	28	27	25	-
Nepal	Services exports	39	36	33	35	-	30
	Services imports	11	13	14	14	-	16
Pakistan	Services exports	14	14	20	20	17	19
	Services imports	19	19	18	22	24	26
Sri Lanka	Services exports	15	22	21	22	-	20
	Services imports	20	25	22	22	-	21

Note: Services exports do not include remittance.
Source: World Development Indicators 2007, The World Bank

Table 3: Importance of Workers Remittances (% of GDP)

Country	2000	2001	2002	2003	2004	2005
Bangladesh	4.2	4.5	6	6.1	6.8	7.1
India	2.6	2.3	2.7	2.9	3.0	2.9
Nepal	2.0	2.0	11.0	13.0	-	16.4
Pakistan	1.5	2.0	5.0	4.8	4.0	3.8
Sri Lanka	9.0	9.0	9.0	10.0	-	8.9

Source: World Development Indicators 2007, The World Bank

In the case of Bangladesh, remittance earnings appear to constitute a significant portion of the country's GDP. Going beyond the underestimated official statistics, about 3.2 million Bangladeshi people are working abroad (Blanchet *et al* 2005) with major occupations being construction labour, domestic maid, engineers, health workers and nurse. Raihan and Ahmed (2008) show that very few services sectors in Bangladesh have positive trade balances, while others have secular negative trend. Among the services sub-sectors, Bangladesh faces huge trade deficit in transportation, especially in freight, insurance services and travel, while positive balance has been found in case government services, computer and information services, communication, and construction services.

India is also a large receiver of remittance income. Indian export of IT (information technology) professionals has been driven by IT boom in the US market during early 1990s with a shortage of skilled labour force. Gradually, there has been an increased demand for Indian IT professionals in markets like Japan, Germany, Austria and Singapore. At present, there is a common trend among the professional migrants from India to developed countries, especially US, in seeking entrance to the permanent labour market. India's services trade is also much more diversified compared to any other country in the region with business services, including software exports, finance, communication, management and consultancy services growing rapidly.

Apart from Mode 4, Mode 1 (that is, cross-border supply of services) is important for India because of rapid growth in business process outsourcing (BPO) and other IT enabled services (ITES), in which the country has a great comparative advantage. Mode 2 (that is, consumption abroad) is also becoming increasingly important for India. In fact, India is an attractive place for temporary movement of people for medical treatment (health tourism) and for academic pursuit. India is considered as the most competitive in providing BPO services in terms of its volume and firm level capabilities. The annual growth rate of this sector in India is 50 to 60 percent and forecasts indicate that this will continue to increase India's share of the global BPO market from 2 percent in 2003 to 4.8 percent in 2008 (Chanda, 2005).

During the last two decades, the contribution of services sector in trade increased significantly for Nepal. In 1989-90 services (tourism, remittances and interest earnings) contributed to about 17 percent of the total foreign exchange earnings, which doubled in a decade and reached nearly 35 percent in 2003-04. In 2005, remittance income constituted more than 16 percent of GDP in Nepal. Within services, travel and tourism constitutes the most important source of foreign exchange earnings; private remittances (the earnings of workers employed abroad) is another major source of income (Bhatt, 2005).

A large number of Pakistanis are working abroad and remittance income is an important source of foreign exchange earnings. Paracha (2008) observes that despite the fact that the services sector is the fastest growing sector in Pakistan's economy, the balance of trade in services is also widening very fast.

About 1.2 million Sri Lankan workers are working abroad of which 70 percent is employed in the Middle East countries (CUTS, 2004). A specialty of Sri Lankan human resources export among the South Asian countries is the dominance of female migrants. In 2001, 68 percent of the 183,888 migrants were female workers (Chanda, 2005). Remittances by migrant workers continue to play a critical role in the Sri Lankan economy. Deshal and Wijayasiri (2008) report that during both 2005 and 2006, apart from 'other business services' (in which case there is a negative trade balance), in all other services sectors, Sri Lanka experienced positive trade balance. In 2006, remittances, along with some surplus in trade in other services, have enabled Sri Lanka to mitigate large deficit in trade in goods.

2.4 Contribution to Employment

In all the South Asian countries though service sector employment has shown a rising trend but its contribution to total employment is much lower than its contribution to country's GDP. In the case of Bangladesh, Raihan and Ahmed (2008) highlighted that because of liberalisation in some key services sectors, such as telecommunications and financial services, the share of services sector in total employment had increased substantially over the last few years and reached around 35 percent of GDP by 2002-03. It, thus, appears that liberalisation has helped employment growth with the most dynamic sub-sectors exhibiting the highest rates of employment growth. However, the employment elasticity of services is lower than that for manufacturing and agriculture in Bangladesh.

In India, the services sector accounts for less than 30 percent of total employment, which is much lower than its share in GDP. Also it has much lower employment elasticity than other sectors of the economy, which indicates that service sector growth in India has primarily been driven by growth in skill-intensive services such as IT and ITES rather than employment-intensive services such as tourism (Banerjee *et al* 2008).

In the case of Nepal, there is no updated data on service sector employment. However, the data for 1990-95 suggests that the share of the services sector in total employment averaged 17.12 percent during that period (WDI 2007), which was much lower than the share of services in GDP.

In Pakistan, despite the fact that there has been reduction in the share of agriculture sector in job creation since 1990, agriculture remained the dominant source of employment with its share of 43.37 percent in 2005-06. The services sector, on the other hand, is contributing 36 percent employment. However, like the other South Asian countries, the employment share of the services sector is much lower than its contribution to GDP.

In Sri Lanka the services sector accounted for 41.2 percent of employment in 2006, which was greater than the shares of industry and agriculture. The fact that 41.2 percent of the total employed yielded 54.6 percent of GDP is testimony to the earning potential and economic significance of the services sector (Deshal and Wijayasiri, 2008). The major sources of employment within the services sector are tourism and personal services. Financial services and telecommunications provide less employment but generate greater earnings.

Chanda (2008), however, observes that official statistics on service sector employment in the developing countries when juxtaposed with the dynamic nature of sub-sectors such as trade and distribution services or construction services may also suggest that part of the employment growth in services has been informal in nature. Therefore, the official estimates of the service sectors' contribution to overall employment may, to some extent, understate the actual contribution of this sector to total employment due to their failure to capture informal employment.

2.5 Service Sector and FDI

In several South Asian countries, increased foreign direct investment (FDI) in the services sectors has been associated with increased liberalisation in those sectors. Raihan and Ahmed (2008) point out that in the case of Bangladesh, since 2003-04 the services sector has been able to attract large inflow of FDI and as a result by 2005-06 the FDI inflow in the services sector accounted for 81 percent of total FDI inflows in the country. The services sub-sectors, which received highest shares of FDI in recent years, are telecommunication, energy and financial sectors. In 2005-06, the telecommunications sector alone received 36 percent of total FDI, followed by the banking sector (17 percent). Increased investment into such sectors is associated with deregulation of government monopoly.

The experience of India suggests a similar trend as India has experienced a large inflow of FDI in the services sector. It was higher than that in the manufacturing sector. Among the services sub-sectors, financial, IT and telecommunication services appear to be the most important recipients of FDI. During 2003-06, software services and finance, insurance, real estate, telecom, and various business services accounted for over 30 percent of India's inward FDI flows.

In 2006 major contribution of FDI to Pakistan appears to be the telecommunication and financial services – 37 percent and 18 percent respectively. Also, the wholesale and retail sectors are growing very rapidly, especially through investment in large multinational chain stores.

In Sri Lanka in 2006, more than 50 percent of FDI went to the services and infrastructure sector. Within the services sub-sectors, telecommunication was dominating.

III. Experiences of South Asian Countries in GATS Negotiations

Article IV of GATS stresses that in order to increase the participation of the developing countries in global services trade there is a need to:

- strengthen domestic services capacity of these countries and its efficiency and competitiveness, *inter alia* through access to technology on a commercial basis;
- improve these countries' access to distribution channels and information networks; and
- liberalise market access in sectors and modes of supply of export interest to them.

Such calls were re-emphasised in the Doha Ministerial Declaration of 2001 by the WTO Members as well as in the July 2004 Framework of the Doha Round of negotiations. In the Hong Kong Ministerial Declaration of 2005 by the WTO Members, particular attention to sectors and modes of supply of export interest to developing countries was highlighted again.

It is, however, important to note that a large number of developing countries have been facing difficulties in identifying the sectors of their specific interests. Also, registering any meaningful liberalisation commitments in the negotiations has achieved little progress. There is a serious concern about the developing countries' lack of capacity to evaluate the requests received from other member countries and regarding the development of their own requests. A major challenge is regarding determination of their national policy objectives and the competitiveness of each sector or sub-sector. In case of liberalisation of Mode 4 services, in the categories and skill levels of interest to developing countries, no real progress has been achieved so far. Even, no progress has been achieved with respect to streamlining or increasing the efficiency of processing mechanisms for visa and work permits.

One of the most important developments at the Hong Kong Ministerial was the decision to pursue full and effective implementation of the modalities for special treatment of LDCs in trade in services. It means developing methods for effective implementation of the LDC modalities, including assisting LDCs to enable them to identify sectors and modes of supply that represent development priorities. The Hong Kong Ministerial Declaration set out specific timeline for developing appropriate mechanisms regarding this, but there has not been any attempt to meet the deadline of July 31, 2006.

GATS also provides a general framework for negotiations on further liberalisation in services trade. The negotiations take place under the request-offer process model, whereby WTO Members submit requests to their other Members to open up some specific service sectors. On the other hand, they make offers to others indicating how much they are willing to open up their specific service sectors. Once a country agrees, through negotiations in the WTO, to liberalise a sector it must be listed in a schedule of specific commitments. By committing a particular service sector to liberalise a country is legally bound by GATS to provide national treatment and MFN (most favoured nation) treatment to other WTO Members.

Negotiations under GATS are important for the South Asian countries, as they are facing constraints in economic development due to poor infrastructure, poor institutional settings and governance deficits. Service sector is the dominant sector in these economies. Also, there is a huge growth potential of the domestic service market in these economies. These countries should be very strategic in the request-offer process under GATS settings, as they are lucrative targets for developed countries. Without necessary precautions and adequate readiness, these developing countries in South Asia (including two LDCs: Bangladesh and Nepal) will be lucrative targets for strong market players which might jeopardise the growth potential of the domestic service market (Raihan, 2005). Among the major supply constraints that prevent the building of a competitive services sector in the South Asian countries are the lack of the following factors: human resources and technology to ensure that professional and quality standards are met; telecommunications infrastructure; a national strategy for export of services; government support to help service firms, especially small and medium enterprises; financial capacity of firms; presence in major markets; and the ability to offer a package of services (UNCTAD, 1998).

The outcomes of ongoing GATS negotiations will have a significant implication on the national development initiative. The South Asian countries should have clearly defined negotiation strategies, based on a clear conceptual framework and understanding that might be done in order to make GATS negotiations conducive for the economic development of a country. Every strategy should have a fallback position, if it becomes necessary. Most of the relevant literature put emphasis on Mode 4 as these countries have comparative advantage on the movement of temporary workers. But there are other areas in services sector that also have huge growth potentials.

Bangladesh has made certain specific horizontal commitments on Market Access and National Treatment with some limitations relating to commercial presence (Mode 3) and movement of natural persons (Mode 4) in case of communications and tourism sectors. GATS classified tourism sector into four sub-sectors and Bangladesh made commitments in one sub-sector namely Five Star Hotels. After the inception of GATS, nine countries, including European Commission, USA, Japan and Malaysia, have submitted their request to Bangladesh to liberalise a number of services sectors. The requests to Bangladesh have covered a wide range of sectors except education and health. Singapore requested for opening up transport services and EC's requests include undertaking or improving commitments in business service, telecommunication service, construction and related engineering services, environmental services, financial services, and transport services. In terms of coverage of sectors and sub-sectors, it is observed that the requests to Bangladesh cover 10 sectors out of 12, and 127 sub-sectors out of 161. The requests were limited to market access under Modes 1, 2, and 3, except in case of telecoms, while there were national treatment requests on all sub-sectors. Under 'Horizontal Commitment', requests were made for Mode 4 and on the removal of certain MFN exemptions in telecoms.

In the ongoing services trade negotiations, India is very offensive in seeking market access in developed countries, particularly under Mode 1 (cross border trade) covering business process outsourcing and Mode 4, which deals with movement of temporary workers. Of late, India has realised its strength under other two Modes as well. India has been receiving requests from all the major developed countries as well as several developing countries in a wide range of services.

Most of the requests are to enter the Indian market through commercial presence (Mode 3) of foreign establishments with stress being on the sectors of financial and telecommunication services, though offers in the field of education and environmental services has also been made.

While responding to these requests India made an initial offer in January 2004 that was not very much different from its offer during the Uruguay Round. However, in its revised offer in August 2005, India demonstrated willingness to expand the scope of its Uruguay Round commitments by tabling several new service sectors and sub-sectors for negotiations. It further showed willingness to remove commercial presence restrictions in few important areas, on which it already had made commitments. Eleven sectors and 94 sub-sectors were covered in the revised offer contrary to seven sectors and 47 sub-sectors in the initial offer.

Nepal became the 147th member of the WTO on 23 April, 2003. Under the WTO, Nepal has committed to liberalise 11 services sectors. In the case of financial services and telecommunication services, Nepal has extended market access in Mode 2 with a restriction of providing only US$ 2,000 for Nepalese citizens while going abroad. With respect to commercial presence (Mode 3), no limitation on national treatment has been placed on foreign investments and reinvestments except that both of these requires approval of Department of Industry and incentives and subsidies provided if any will be available to wholly-owned Nepalese enterprises only. However, Nepal’s commitment in Mode 4 is restrictive except in the categories of services sales persons, persons responsible for setting up a commercial presence, and intra-corporate transferees that too for a limited time and not exceeding 15 percent of local employees. Nepal’s commitments under the WTO will remove all limitations on the number of suppliers in all kinds of telecommunication services by January 2009. In addition, Nepal has committed to allow foreign participation of up to 80 percent in the telecommunication sector.

Pakistan has undertaken extensive autonomous liberalisation and it stresses for balanced movement in rules and market access negotiations and progressive liberalisation accompanied by strengthening of domestic regulatory frameworks (Paracha, 2008). Pakistan has received collective requests from 19 WTO Members on energy services, environmental services, financial services, architectural and engineering services, integrated engineering, maritime transport, construction, telecommunication services, air transport services and logistic services. Examining the stance that Pakistan has taken in the May 2005 initial offer, it is clear that Pakistan is ready for expanding the scope of its GATS commitments as well as deepening it. The revised offer has clearly sharpened the existing commitments by embedding safeguards within the text (Paracha, 2008).

In the case of Sri Lanka on Modes 1 and 2 exchange controls for cross border trade and consumption abroad were removed in 1994. FDI is allowed in almost all sectors of the economy. Sri Lanka’s initial commitment in GATS was limited to tourism and travel services. This was expanded in 1997 to include financial services and telecommunications. Sri Lanka has also tabled a revised offer in the Doha Round in 2003 but no new sectors were offered other than to further liberalise the three sectors previously committed, particularly in Mode 3 (Deshal and Wijayasiri, 2008).

IV. Domestic Preparedness for Services Trade Liberalisation in South Asian Countries: Issues and Concerns

The role played by the major services sectors such as telecommunication, banking and transport in the development of an economy is not without risks. There is a possibility of technical, procedural, and financial disorder in these sectors which might have serious economic implications. A large bank collapse might influence the smallest producer in a remote region severely. Disruption of electricity, gas, telecommunication and transport can bring any economy to a stand still within a very short time. Such risks bring forward the necessity of placing regulatory constraints such as capital adequacy and asset quality requirements, technical standards and the like to ensure continued availability of core technical and commercial services.

Before taking steps to liberalise services sector there is a need to identify current state of potentials, weaknesses and constraints, in single word preparedness, of the domestic services sector. There is also the need to explore the linkages within various services sectors and those of services sectors with manufacturing and agricultural sectors in an economy. Prioritisation of sectors for liberalisation should be based on the basis of the sector's link to the poor – that is, by taking into account the impact of trade liberalisation in a sector especially on poor people as producers, consumers and employees and their ability to take advantage of the opportunities from liberalisation. This will provide guidance about critical services sector, where liberalisation may have larger potential to contribute, in terms of technology transfer, human skills development and institutional improvement.

Now the identification of readiness of key services sectors to face international competition after liberalisation is a difficult job due to data unavailability. Whether a sector is prepared for international competition or not, we need to explore the competitiveness of that sector in terms of price competition, technical standard, capacity of the existing firms, etc. Given the fact that there is lack of these types of data in almost all South Asian countries we tried to make a best use of the available data. Using the available data we constructed the Balassa's Index of Revealed Comparative Advantage (RCA) for the services sectors in South Asian countries. Estimates of the RCA for overall services sector for Bangladesh, India, Nepal, Pakistan and Sri Lanka are reported in Table 4. Bangladesh is having the lowest RCA index, which indicates Bangladesh's comparatively disadvantageous position in services trade compared to other South Asian countries. Nepal and India are in strongly advantageous position. The high RCA index for Nepal can be explained by the fact that among the South Asian countries Nepal has the highest share of services exports in her total exports.

Table 4: Revealed Comparative Advantage of Services Sectors in South Asia

Year	1997	1998	1999	2000	2001	2002	2003	2004	2005
Bangladesh	0.62	0.60	0.60	0.57	0.54	0.59	0.62	0.58	0.61
India	1.01	1.23	1.37	1.41	1.37	1.34	1.39		
Nepal	3.38	2.61	2.50	2.00	1.79	1.58	1.70	1.85	1.51
Pakistan	0.81	0.73	0.74	0.69	0.68	0.96	0.98	0.85	0.98
Sri Lanka	0.79	0.77	0.84	0.75	1.08	1.03	1.06	1.04	0.99

Source: Author's calculation based on data from World Development Indicators 2007, The World Bank

Using the GTAP database, it is possible to calculate the RCA for individual services sub-sectors. Table 5 reports the results of such an exercise for Bangladesh, India, Pakistan and Sri Lanka.[1] It appears that for Bangladesh, in 'public administration, defence, health and education' sub-sector, the export of defence services in terms of peace keeping missions of the United Nations, is the major contributor to the high RCA in this sector. Compared to other South Asian countries Bangladesh is in disadvantageous position in all services sub-sectors. In 6 out of 14 sub-sectors India's RCA indices are higher than any other South Asian countries. Whereas, Pakistan and Sri Lanka has higher RCA indices compared to other South Asian countries in 4 out of 14 sub-sectors.

Table 5: Revealed Comparative Advantage of Services Sub-Sectors in South Asia

	Bangladesh	**India**	**Pakistan**	**Sri Lanka**
Electricity	0.00	0.06	0.00	0.00
Gas manufacture, distribution	0.00	0.00	0.01	0.03
Water	0.00	0.08	0.02	0.19
Construction	0.04	0.07	0.04	1.07
Trade services	0.06	1.50	0.24	0.38
Transport services	0.19	1.17	0.23	1.14
Sea transport	1.47	1.26	1.45	2.55
Air transport	0.11	0.31	2.95	1.77
Communication	0.26	0.09	2.94	1.07
Financial services	0.13	0.12	0.12	0.06
Insurance	0.09	0.80	0.24	7.11
Business services	0.26	1.96	0.20	0.54
Recreation and other services	0.12	0.31	0.08	0.22
Public administration, defence, health, education	4.67	0.80	1.05	0.26

Source: Author's calculation from GTAP database version 6.2

4.1 Experiences from Bangladesh[2]

While making commitments on trade in services on market access, national treatment, and MFN treatment, Bangladesh adopted a cautious approach. It was guided by a number of considerations. Bangladesh like many LDCs found that the GATS allows the developed countries greater market access in the developing countries through Mode 3 while market access to unskilled or semi-skilled labour of developing countries through Mode 4 is restricted. The services sector in Bangladesh, like many other LDCs and developing countries, is far less developed compared to that of developed countries, and hence under free trade in services the country is likely to be in a disadvantageous position. Moreover, the existing legal and regulatory infrastructure should undergo minimum structural changes. A number of concerns have been raised with regard to liberalisation in different services sub-sectors.

For example, in the case of *construction* sector, low capacity and capability of local contractors and consultants, due to weak resource base and inadequate skills and experience were considered as the major concerns. Poor working environment, including low standards of safety and occupational hazards at construction sites; weak and non-facilitative policies and regulatory framework; and low productivity and quality of domestic firms due to a low technology base and limited skills and experience are the major constraints in construction services that bring Bangladesh to a disadvantageous position.

[1] GTAP 6.2 database does not have disaggregated data on Nepal.
[2] Based on Raihan and Ahmed (2008)

Moreover, there is a lack of supporting institutional mechanisms to facilitate easier access to key inputs including access to finance and equipment. For instance, introduction of leasing arrangements for heavy construction equipment is the key to increase the capacity of the local construction firms to undertake larger jobs. Lack of regulatory framework, intense competition against well funded and equipped foreign operators and lack of access to finance and equipment as well as inexperienced management are issues that should be addressed to reverse this situation. Now the question is whether these problems could be addressed through further liberalisation or through a more restrictive regime. Citing the experience from emerging economies the analysts in this sector have been arguing that economic opening will lead to the introduction of new financing instruments that can increase local firm's access to critical assets and will expose the labour force to skills and management experience that is critical for the growth and consolidation of the domestic operators. Direct stakeholders in this sector are much confident about facing foreign competition due to liberalisation.

In the *banking* sector in Bangladesh, competition has been enhanced due to the announcement of opening of new markets to new entrants, and as a result interest spreads have been decreased and loan quality (i.e. the share of non-performing loans in banks' balance sheets) has improved. It appears that the activities in the banking sector which was dominated by inefficient nationalised commercial banks (NCB) are being replaced by relatively more efficient and competitive private commercial banks (PCB) and foreign commercial banks (FCB). Foreign investment in the banking sector has brought modern technology like computerisation of banking operations, introduction of ATM services, Smart Card, Credit/Debit Card, and On-Line Banking. These services have quickly been adopted by the PCBs. According to the regulator's perspective the deregulation and liberalisation of the banking sector have been carried out to improve financial intermediation in the economy through enhanced competition, efficiency and profitability and diversification of financial services. However, absence of prudential regulation may result in economic crisis with serious social impact as in the Asian financial crisis of 1997 indicates. So, stakeholders consider that Bangladesh should follow cautious and slow liberalisation instead of wholesale liberalisation in the banking sector.

The regulatory agency of the *insurance* sector in Bangladesh is not equipped with adequate manpower and resources to supervise this growing industry, which limit the agency's role in the development of the sector. Insurance analysts consider that while opening up this sector, apart from introducing efficiency and better regulation, the insurance companies need to be innovative in expanding their business activities which will familiarise their business to the general people.

In the *travel and transport* sector, major weaknesses in the regulatory framework include poor coordination between authorities, poor governance (corruption and poor enforcement). According to analysts, Bangladesh can liberalise this sector with liberalisation on Mode 4 only after setting up a proper regulatory body. Because of unique geographical location, Bangladesh has the potential for becoming a 'transport hub' to serve the entire hinterland comprising Nepal, Bhutan and North-East India.

4.2 Experiences from India[3]

In India, in case of *legal* services, there is a strong sentiment amongst various members of the profession that permitting foreign law firms even in a limited way would lead to the shrinking of the opportunities available to domestic lawyers. Kumar and Jatkar (2008) argue to look into the immense trade potential of the Indian legal profession without compromising on the interests of Indian legal professionals and local law firms. They argue for developing an appropriate strategy for this sector. Strategy is important because while there is scope for the Indian law firms to take advantage of the expanding global business, there also lays a danger that if the process is not judiciously planned and necessary structural changes are not undertaken, the opening up of this sector may result in a fiasco for the domestic sector. Hence for India the challenge lies in formulating a right strategy at a right time.

India did not schedule *education* services either in the Uruguay Round or in its revised commitments under the ongoing Doha Round. Although India in its revised offer included higher education, many sections such as civil societies have opposed such a move. Whatever liberalisation has occurred in this area, such as allowing 100 percent FDI on automatic route and permitting foreign participation through twinning, collaboration, franchising, and subsidiaries, has been autonomously driven. It is likely that in future GATS negotiations India will come under increasing pressure from certain countries to multilaterally bind the liberalisation undertaken thus far. But it's unlikely that India will agree to such demands.

In the Doha Round of negotiations India has both offensive and defensive interest in *accountancy* sector. In the Uruguay Round India did not make any commitments on accounting. However, in its revised offer for accountancy services, India offered full commitments in accounting and book keeping services under Mode 1 and Mode 2 while kept Mode 4 subject to horizontal commitments. Supply of services under Mode 3 has been 'unbound'. Many considered the revised offer of India as defensive as it was very little. However, this defensive position can be explained by the fact that this is a protectionist measure since its accounting firms are not globally competitive. There are also views among the stakeholders that opening up of the accountancy sector will help Indian accountants in terms of well paid jobs and enhanced employment opportunities although it can endanger some of the accounting firms.

It appears that though there are some significant potential gains from further trade liberalisation India has adopted a cautious approach. Also, there is a need to strengthening up of the domestic regulatory rules in some of the service sectors and in few services sector capacity building seems to be necessary to face global competition.

4.3 Experiences from Nepal[4]

In Nepal, in the case of *insurance* services, since there are already three foreign companies with 100 percent equity and four joint venture companies, liberalisation under the WTO does not expose the country to a completely new scenario. However, the need for a sound regulatory system is still necessary to maintain an efficient, safe, fair and stable insurance market and promote growth and competition in the sector as insurance markets have developed at a much faster pace than the process of insurance supervision.

[3] Based on Kumar and Jatkar (2008)
[4] Based on SAWTEE (2008)

Over the years the *banking* sector of Nepal has slowly transformed from a heavily state owned sector to a vibrant sector dominated by private companies. Under the Financial Sector Reform Programme, Nepal has undertaken various institutional reforms. However, Nepal Rastra Bank (the Central Bank of Nepal) needs to address gaps in its supervisory framework and enhance cross-border supervision mechanisms. In addition, before any further liberalisation of the financial sector, Nepal needs to resolve a few issues such as loan recovery from large, wilful defaulters and improve the financial condition of the two government-owned commercial banks (ADB 2007).

Nepal's commitments under the WTO will remove all limitations on the number of suppliers in all kinds of *telecommunication* services by January 2009. In addition, Nepal has committed to allow foreign participation of up to 80 percent in the sector. These changes seek to make telecommunication services reliable and accessible throughout the country at a reasonable cost. However, the liberalisation process has to be accompanied by the setting up of regulators to ensure that competition is fair and that consumers are not exploited. In addition, as Nepal is moving from a government owned monopolistic market into a liberalised competitive market, a major challenge is to establish an independent regulator with adequate expertise, information, authority and accountability.

4.4 Experiences from Pakistan[5]

The *communication* sector in Pakistan, particularly telecom, has witnessed comprehensive reforms and robust growth in recent years, contributing to a large share to the country's total GDP. As a result, it is often considered as one the most successful service sectors to have gained substantial benefits from liberalisation. Regarding communications, primarily the telecom and IT (information technology) industries, Pakistan has negotiated extensively at the WTO and formulated a comprehensive schedule of commitments, further shaping Pakistan's policy framework concerning trade liberalisation in these sectors. The legislation dealing with licensing in this sector does not distinguish between domestic and foreign service providers, since Pakistan provides National Treatment to all telecommunication service providers.

Another sector that has witnessed strong growth and subsequent liberalisation in recent years is the *financial* sector, particularly banking services. Pakistan's central bank, the State Bank of Pakistan, has pursued reforms aimed at liberalisation and privatisation since the beginning of the 1990s, and has achieved a considerable progress. At present there are no restrictions on the establishment or operations of foreign banks in Pakistan. In order to further strengthen and synchronise domestic legislative framework in relation to multilateral trade negotiations and commitments the Government of Pakistan has established a commission to review Pakistan's financial sector.

There are various regulatory bodies governing the *engineering, construction and architectural* services sector in Pakistan. The regulations governing construction services aim to encourage joint ventures and collaboration with local service providers. Licenses are granted for projects where local firms do not have the requisite technical capacity. In effect, this works as a protection and a safeguard to local construction and engineering firms, who do not face undue competitive pressures.

[5] Based on Paracha (2008)

The *oil and gas* sector in Pakistan is largely state-controlled although there are no restrictions on Market Access through commercial presence of private and/or foreign investors. The Oil and Gas Regulatory Authority (OGRA) of Pakistan grants licenses to companies for oil and gas distribution purposes. The National Electric Power Regulatory Authority (NEPRA) is the principle authority dealing with the regulation of generation, transmission, and distribution of electric power in Pakistan. Both the regulatory authorities do not differentiate between the domestic and foreign service providers, and do not lay separate conditions for granting licenses. The existing regulatory framework suggests that at present there are no Market Access restrictions in Mode 3 (commercial presence) for private or foreign companies.

4.5 Experiences from Sri Lanka[6]

Considering the *telecom* sector, despite the fact that Sri Lanka has made commitments in GATS and has scheduled conditional offers at the Doha Round of negotiations, the sector is far from perfect in terms of regulatory rigour. This is unfortunate as Sri Lanka stands to gain by locking in reforms in the telecommunications sector. This would provide investors security for much needed investment in this sector. While Sri Lanka has made additional commitment to implement the Telecom Reference Paper, in practice most of the commitments have not been met. This in fact could leave Sri Lanka liable to international arbitration. The level of implementation of the Reference Paper commitments is a good indication of domestic preparedness for further liberalisation. Weak implementation has resulted in many of Sri Lanka's scheduled commitments (for instance the liberalisation of the external gateway) being made redundant. The implication of this is that Sri Lanka should focus on tightening up domestic regulatory frameworks and improve the capacity of the regulatory bodies through increased financial independence. Only then would further commitments in the telecommunications sector be realistic and useful.

There is much work to be done in other sectors to improve domestic preparedness for the liberalisation of services. Many professional service associations lack regulatory and legislative capacity to effectively regulate even local service providers. This is unfortunate given the fact that Sri Lanka stands to gain if there is increased foreign participation in many service sectors. This would provide greater access to foreign expertise and technology whilst triggering competition and investment that would be beneficial to consumers in Sri Lanka. In order to enjoy these potential benefits the regulatory environment needs to be improved first and foremost.

[6] Based on Deshal and Wijayasiri (2008)

V. Concluding Remarks

It is evident from this analysis that competitiveness of the services sectors as well as a well functioning regulatory system are must for ensuring gains from services trade liberalisation in the developing countries. The South Asian countries like India, Pakistan and Sri Lanka have competitive edge in few services sub-sectors, while Bangladesh and Nepal are lagging behind compared to her South Asian counterparts in almost all categories of services trade. It can be argued that development of skill and technologies in the services sub-sectors can improve the competitiveness of these South Asian countries.

There is, however, no denying of the fact that in most instances the South Asian countries under consideration lack established and well functioning regulatory and institutional frameworks when it comes to services trade liberalisation. As for policy stance, there lies common position for these countries to place the need for adequate time to come up with appropriate domestic regulation policies considering the specific economic requirements and at the same time to ensure necessary technical assistance for capacity building. There should also be considerations regarding ensuring adequate regulatory flexibility for these countries to promote liberalisation.

According to GATS Article XIX, the developing countries are allowed with appropriate flexibility on an individual country basis. This implies that the South Asian countries should consider country-specific interests to take appropriate policy stance.

In the GATS Agreement and in the Hong Kong Ministerial Declaration, special emphasis has been given on targeted technical assistance with a view to enabling developing countries and LDCs to participate effectively in the negotiations. The full and effective implementation of the LDC Modalities also calls for providing targeted and effective technical assistance and capacity building for LDCs. It has been clearly stated that amongst others the targeted technical assistance should be provided through the WTO Secretariat. However, there is no such initiative from the developed country members to consider special priority sectors in relation to needs of the LDCs and the developing countries. A more careful reading reveals that the development initiatives relating to market access are either objectives for commitments or, procedural under the request-offer approach. There is a lack of developing country and LDC initiatives to prepare a good negotiating ground and it is quite reasonable that without proper technical assistance many of the developing countries and LDCs will not be able to come out identifying areas most important for negotiation for them. In the case of evaluating or formulating requests and offers, there is a need to look into the kind of capacity available in the government (trade and other ministries, and also regulatory bodies) and needed technical assistance requirements should be formulated accordingly.

Complications relating to services negotiations call for the South Asian countries to know ways to deal with intricate matters associated with specific details of various provisions. It is also important for policy makers to be able to assess the potential implications arising out of certain provisions. Furthermore, taking effective participation in services trade require enacting and implementing the necessary domestic regulations. All these will require technical assistance to these countries, and their effective utilisation.

It is very important to highlight that domestic regulation has its importance in protecting national policy objectives but it should not be applied as a means for undue trade restrictions. Regulation can protect consumers through ensuring quality and appropriateness of services in the midst of a wide range of providers under progressive services trade liberalisation. Regulatory measures can be applied to limit anti-competitive practices that may arise from market penetration by dominant firms. There is a rising concern about repatriation of profits, which may result in serious balance of payments crisis for many LDCs and developing countries. Therefore, these governments can regulate this capital outflow by imposing restrictions like investment in local securities market as a measure against potential balance of payments shocks. The measures of domestic regulation should aim at ensuring a healthy environment for capital inflows in terms of attracting FDI and also offer a friendly mechanism for ensuring better competition between domestic and foreign services providers.

Article VI.4 of GATS is related to domestic regulation, which highlights the right of the WTO Members to regulate and to introduce new regulations, governing the supply of services within their territories in order to meet national policy objectives. Also in the preamble of GATS, given the existing asymmetries with respect to the degree of development of services regulations in different countries, the particular need of developing countries to exercise this right has been recognised. Paragraph 7 of the Doha Ministerial Declaration reaffirms the right to regulate and introduce new regulations governing the supply of services. In Hong Kong Ministerial, WTO Members were asked to develop disciplines on domestic regulation as mandated under Article VI: 4 of the GATS. It can, therefore, be argued that the South Asian countries should take advantage of these provisions in GATS with a view to develop their national policy stance on domestic regulation in the services sectors, which will certainly facilitate their readiness for further trade liberalisation.

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