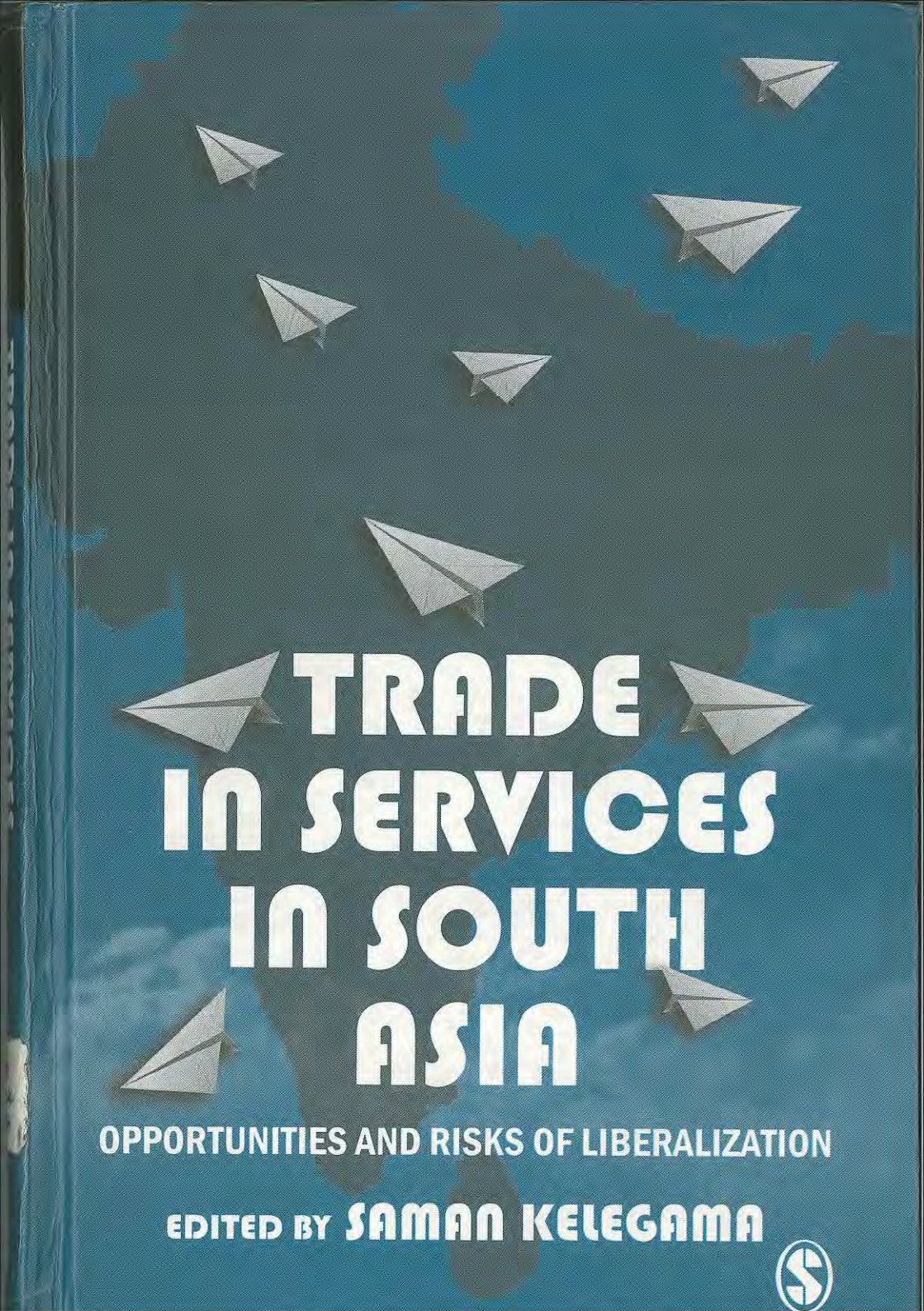

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ASIA
OPPORTUNITIES AND RISKS OF LIBERALIZATION
EDITED BY SAMAN KELEGAMA

# Trade in Services in South Asia

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## Opportunities and Risks of Liberalization




Edited by
SAMAN KELEGAMA

IPS
Institute of Policy Studies of Sri Lanka

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# List of Abbreviations

| | |
|---|---|
| BBS | Bangladesh Bureau of Statistics |
| BIMSTEC | Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation |
| BIS | Bank for International Settlements |
| BML | Bank of Maldives Plc |
| BoP | Balance of Payments |
| BP | Bearing Point |
| BPO | Business Process Outsourcing |
| CDs | Certificate of Deposits |
| CECA | Comprehensive Economic Cooperation Agreement |
| CEPA | Comprehensive Economic Partnership Agreement |
| CMD | Capital Market Division |
| COE | Committee of Experts |
| CSO | Committee of Senior Officials |
| CSS | Contractual Service Suppliers |
| CTS | Council for Trade in Services |
| DDR | Doha Development Round |
| DOC | Department of Commerce |
| DOI | Department of Industry |
| DR | Domestic Regulation |
| DTAA | Double Taxation Avoidance Agreement |
| ENTs | Economic Needs Tests |
| FDI | Foreign Direct Investment |
| FISB | Foreign Investment Services Bureau |
| FITT | Foreign Investment and Technology Act |
| FTA | Free Trade Agreement |
| GATS | General Agreement on Trade in Services |
| GDP | Gross Domestic Product |

| | |
|---|---|
| GFCF | Gross Fixed Capital Formation |
| GMPCS | Global Mobile Personal Communications by Satellite |
| GNIE | Government Not Included Elsewhere |
| HDFC | Housing Development Finance Corporation Ltd |
| HSBC | Hong Kong and Shanghai Banking Corporation Ltd |
| ICAI | Institute of Chartered Accountants of India |
| IFIs | International Financial Institutions |
| IP | Independent Professionals |
| ISIC | International Standard Industrial Classification |
| IT | Information Technology |
| ITES | IT-Enabled Services |
| LDCs | Least Developed Countries |
| MA | Market Access |
| MACL | Maldives Airports Company Ltd |
| MATI | Maldives Association of Tourism Industry |
| MCST | Ministry of Communication, Science and Technology |
| MMA | Maldives Monetary Authority |
| MNSL | Maldives National Shipping Limited |
| MOICS | Ministry of Industry, Commerce and Supplies |
| MRAs | Mutual Recognition Agreements |
| MSEs | Micro and Small Enterprises |
| MTCA | Ministry of Tourism and Civil Aviations |
| MTCC | Maldives Transport and Contracting Company |
| NASSCOM | National Association of Software and Services Companies |
| NRB | Nepal Rastra Bank |
| NT | National Treatment |
| NTA | Nepal Telecommunication Authority |
| NTC | Nepal Telecommunication Corporation |
| PSEB | Pakistan Software Export Board |
| RBI | Reserve Bank of India |
| RCA | Revealed Comparative Advantage |
| RRDBs | Regional Rural Development Banks |
| SAFTA | South Asian Free Trade Area |

| | |
|---|---|
| SAPTA | SAARC Preferential Trading Agreement |
| SMEs | Small and Medium Enterprises |
| SNA | System of National Accounts |
| SOEs | State Owned Enterprises |
| STELCO | State Electricity Company |
| STO | State Trading Organization |
| TAM | Telecommunications Authority of Maldives |
| TIS | Trade in Services |
| TMNP | Temporary Movement of Natural Persons |
| USOs | Universal Service Obligations |
| WAIPA | World Association of Investment Promotion Agencies |
| WIPO | World Intellectual Property Organization |
| WTO | World Trade Organization |

# Foreword

Despite the striking growth in services exports from some parts of India and the remarkable dynamism of the liberalized telecommunications sector in South Asia, the gains for the South Asian region from international integration are small so far, compared to the unexploited opportunities. But there are also significant challenges. Exposing previously "non-tradable" sectors to international competition could imply changes in income distribution and adjustment costs, fears of which could lead to the persistence of protection at home and abroad. Also, some of the smaller and poorer countries and regions within countries may be no better equipped to engage in services trade than they were in merchandise trade and hence there is a danger of further marginalization. Thus, a vital question for the policy makers and the development community is: *How can South Asian countries secure the benefits from the internationalization of services without painful disruption and widening inequalities?*

To a large extent, South Asian countries can liberalize their markets and strengthen their regulatory institutions unilaterally. But, international cooperation has a role, though not necessarily along the traditional lines. Most countries in the region are participants in multilateral services negotiations in the context of the WTO's General Agreement on Trade in Services (GATS). These negotiations have so far produced disappointing results, both in terms of improved access for the regions' services exports and in terms of encouraging reform within the region beyond levels undertaken unilaterally by each country.

At the same time, South Asia remains the least integrated region in the world, both in goods as well as in services trade. Barriers to intra-regional trade are even more restrictive in services than in goods,

resulting in missed opportunities for mutually beneficial trade. Most regional agreements now have a services dimension, and negotiations have focused on simulating goods-like preferential liberalization, mostly unsuccessfully. Experiences in other regions of the world suggest that the elimination of explicit barriers to trade in services may be legislatively simpler and economically more desirable on a "Most Favored Nation" (MFN) or non-preferential basis. However, cooperation on services infrastructure and regulation may be more easily accomplished in the regional context with proximate countries at a similar level of development and with a similar institutional inheritance.

While international negotiations can be harnessed to deliver much needed reform, there is also a danger that premature liberalization or putting policy in the straightjacket of international commitments could produce outcomes that are antithetical to development. South Asian policy makers and trade negotiators need to be fully informed about the opportunities for expanding trade in services (unilaterally, regionally, and multilaterally) as well as the domestic pre-conditions for successful services liberalization.

Unfortunately, policy reform in services has not been informed by serious economic analysis, which is itself constrained by a paucity of data on the evolution of policy, market structures, and sector performance. The reliance on anecdotal evidence and casual policy analysis has led to demonstrably poor policy choices. One aspect of poor policy choice is the segmentation of regional services markets, which has inhibited investment and curtailed competition. Another is the failure to ensure in some cases that reforms in services, including liberalization, improve not just overall economic performance but also improve access to services for the poor and remote.

The need for country ownership of policy research is perhaps greatest in the sensitive area of trade policy reform where the pontifications of international organizations are often greeted with skepticism. The Institute of Policy Studies of Sri Lanka has for many years played an outstanding role in galvanizing regional expertise to produce better and more credible research. It shares with the Friedrich-Ebert-Stiftung a tradition of stimulating socio-political dialog among different

stakeholders, which is indispensable to creating broad-based support for reform.

This volume, the result of a collaboration between these two remarkable institutions, is an important contribution to the limited literature of services reform in South Asia. The mosaic of perspectives on the opportunities and risks of liberalization from each country in the region is bound together by an insightful introduction. These contributions will deepen the discussion on services reform in each country. The juxtaposition of country studies offers each an opportunity to learn from the experience of others. The volume should also provoke much-needed debate on the political feasibility and economic desirability of a more integrated regional market for services.

May 2008

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I am grateful to FES-Colombo for providing financial support to organize this conference. Particular mention should be made of Astrid Becker, Resident Director, FES-Colombo for the keen interest taken to support the IPS in this endeavor.

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**Saman Kelegama**

International trade in services is, however, low, compared to the output in services and amounts to about 24 percent of global trade.[1] Trade in services is dominated by developed countries but the share of developing countries is on the increase. However, many developing countries remain outside the modern services economy and most have deficits in trade in services. Developing country services trade is predominant in traditional areas such as tourism, transport, retail trade, and movement of natural persons. More sophisticated trade in services such as those linked to science and technology are still dominated by developed countries. Services suppliers from developing countries face difficulties due to limited resources, weak supply side, and inadequate capacity to establish in other countries. Nevertheless, developing countries have important services sector export interests and some are global/regional players in sectors such as business process outsourcing, ports and shipping, construction, health services, etc., but these services are concentrated in a limited number of developing countries.

## General Agreement on Trade in Services (GATS)

The liberalization of trade in services among countries is a relatively new phenomenon. While multilateral liberalization of trade in goods has taken place for the last half century, liberalization of trade in services began only in 1994 with the end of the Uruguay Round. Coupled with the novelty of liberalization of trade in services is the complexity involved in this process, thus leading to considerable attention to trade in services in recent times.

The General Agreement on Trade in Services (GATS) is the first and the only set of multilateral rules covering international trade in services, concluded at the Uruguay Round (1986–93), which sought to progressively liberalize and expand trade in the service sector. The GATS came into force in January 1995 and contained a "built-in agenda" mandating members to initiate progressive liberalization negotiation on services from January 2000. The Guidelines and Procedures for Negotiations were adopted by the Council for Trade in Services on March 2001 as provided in the GATS Article XIX: 3. Under these

Guidelines, a request–offer approach is adopted as the main method of negotiation with specific commitments made on market access and national treatment, and additional commitments made if required. The Guidelines also mandate members to continue negotiations in the Most Favored Nation (MFN) exemptions and the GATS rules, which include disciplines on domestic regulations, and on government procurement and subsidies (Mattoo and Sauve, 2003).

So far, though liberalization under the GATS has progressed, it has albeit been slow and little. This is not surprising given the fact that the "positive list" approach was adopted in the negotiations which enabled countries to accede to the Agreement with minimal commitments. Three-quarters of the WTO Membership have participated in the process to date and have submitted, at least, the initial offers of new or improved commitments. One-third of the members have made commitments on less than 20 sectors (mainly very poor countries), one-third between 20 and 80, and the rest between 80 and 145 (out of about 160 existing sectors). Tourism is the sector with the highest number of bindings, while health and education have the lowest number of commitments. Of course, there are also variations about the type of commitments, as commitments can be accompanied by a large number of limitations/qualifications.

Clearly, the implementation of the GATS is characterized by the same dynamics which pervaded the Uruguay Round talks. Although there has been significant unilateral liberalization, most countries have so far been wary of engaging in multilateral talks in services. The scope for reciprocity within services sectors has been drastically curtailed by the unwillingness of developed countries to consider greater openness where developing countries have comparative advantage, notably, in the supply of services through the movement of natural persons, which is Mode 4.[2]

In this context, policy makers, academics, civil society analysts, and advocacy organizations in developing countries have expressed serious reservations about making deep legislative and regulatory changes to provide greater market access to developed countries for their services. This concern is aggravated by the lack of appropriate safety nets in the GATS to guard against unexpected negative consequences of binding liberalization.[3] For instance, Emergency Safeguard Measures

is currently absent in the GATS and is under negotiation. Further, the extent of disciplining under domestic regulation (Article VI) is unclear. Limiting approaches such as "necessity test" to validate whether domestic regulations are objective and not too burdensome on foreign suppliers have become debatable.[4]

Many developing countries have not undertaken an assessment of the impact of liberalization in services trade, and are still evolving the regulatory frameworks and institutions to govern the services sectors in their domestic economies. The unresolved issues have hampered further advancement of negotiations and have been key contributory factors in the widely-shared perception that the GATS negotiations, under the current Doha Round, have left much room for improvement in terms of liberalization commitments (RIS, 2007; Raihan and Razzaque, 2007).

Although the progress is slow, it is now widely accepted that exposing the services sector to the "fresh winds of international competition" has the potential to unleash significant economy-wide gains. Many services have great underlying importance for the performance of the economy as a whole. Increased efficiency in sectors such as telecommunication, transport, and finance will resonate throughout the economy, improving performance in the agricultural and industrial sectors. The WTO Director General emphasized this when he said that services liberalization and the completion of the Doha Round are needed "...to help realize the economy-wide gains from trade and to amplify whatever market access might be achieved in agriculture and industrial products" (Lamy, 2007: 2). Liberalization of trade in services can also improve both access and efficiency of many service sectors, reducing their cost and increasing their quality. Human development can also be positively affected through services such as health and education. Though these sectors are usually in the realm of state supply, there are avenues for liberalization as well. Therefore, there is potentially a significant poverty impact of services liberalization.

While the liberalization of trade in goods involves predominantly "at the border" measures of tariff reduction, barriers to trade in services involve "behind the border" measures of government policy and regulation. The latter is, therefore, far more complex both in implementation and in understanding the multiple effects that

result from liberalization. Liberalization of trade in services is also an information intensive process, and in most developing countries, data and information is a constraint at the best of times. Given this backdrop, the implications of liberalizing trade in services for developing countries have been poorly understood. However, with economic development, services play an increasingly important role in the economy, and therefore depriving this sector of the benefits of liberalization comes with an escalating opportunity cost. Hence, it is essential that developing countries consider the liberalization of services in a serious manner. A thorough examination is needed of both the offensive opportunities that arise and the challenges that will be faced, domestically, as a result of liberalization.

## South Asia

Services have taken on an increasingly important role in the South Asian economies, overtaking industries and agriculture as the largest contributor to the GDP in most of them. For instance, in Sri Lanka, services contribute 57.1 percent of the GDP and the figures for India, Pakistan, and Bangladesh are 58.1 percent, 52.3 percent, and 49.1 percent respectively. The sector has grown at an average of 6 percent since 2000. Growth in services has been accompanied by an increase in trade in services, particularly since the early 1990s, when most South Asian countries adopted domestic reforms and pursued liberalization. Both exports and imports of services have increased since then: exports growing at 3.9 percent and imports at 5.7 percent.[5]

Although the services sector is considered increasingly important for economic development, both in terms of its contribution to growth and export expansion, deep and justified concerns regarding unemployment, poverty alleviation, and universal access to basic services have led some South Asian countries to adopt a cautious approach to the progressive liberalization of the key services under the GATS. The opportunities and risks of liberalizing trade in services in South Asia are thus delicately balanced. This is particularly so in an environment in which regulatory and competition authorities have only been recently established, and the restructuring of state assets is still far from complete.

The submission of initial requests in services to the South Asian nations by a number of WTO members in all the major services sectors has underscored the importance of developing a coherent and coordinated approach to liberalizing services in South Asia. Any well-designed strategy for services liberalization must maximize the gains and minimize the associated adjustment costs. In this respect, there have been considerable general improvements of the institutional foundations for services liberalization, notably the establishment of (largely independent) regulatory authorities committed to transparent and non-discriminatory rule-making procedures. Nevertheless, South Asia still does not have a coherent and well-designed strategy for services liberalization and efforts to formulate one are constrained by a trade negotiating apparatus operating sub-optimally on a number of levels.

The South Asian countries have already liberalized their services sectors to a certain extent through unilateral, multilateral, and regional initiatives. Under the GATS, most South Asian countries (other than Bhutan) have made commitments. Further commitments are forthcoming under regional and bilateral arrangements such as Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC)—including Bangladesh, India, Bhutan, Nepal, and Sri Lanka—and the Comprehensive Economic Partnership Agreement (CEPA) between India and Sri Lanka.

Trade in services is also expected to find its way into the South Asian Free Trade Area (SAFTA) framework. The idea seems to broaden SAFTA so that trade liberalization in goods gets a stimulus from services. There also seems to be a perception that the services in South Asia have more complementarities than the trade in goods (Raihan, 2007). The South Asian Association for Regional Cooperation (SAARC) Heads of States at the 13th SAARC Summit (Dhaka, November 12–13, 2005) recognized the potential for trade in services, which has expanded rapidly at an informal level. They called for a study to see how services could be integrated into the SAFTA process. At the 14th Summit (New Delhi, April 3–4, 2007) also, the leaders stressed that to realize the full potential, SAFTA should integrate trade in services. They also called for finalization of an agreement in the service sector at the earliest.

Services liberalization in each of these forums (multilateral, bilateral, and regional) necessitates a different approach and brings with it different challenges and opportunities. Despite the temporary glitch in the Doha Round of the WTO, South Asia will certainly have to face the prospects of service liberalization in other forums.

## Key Issues and the Objective of the Book

There are a number of key issues which have to be considered in embarking on a process of service liberalization. Prior to embarking on negotiations, it is essential that a country has a strong grasp over its own offensive and defensive interests. This responsibility lies not just with the state: research inputs from the private sector, academics, and civil society play a critical role in helping state negotiators get a deeper and broader understanding of their own country's interests. Multi-sectoral dialog and debate with key stakeholders is essential in identifying these interests.

It is important to identify the interests of consumers, exporters, and domestic producers, and to balance these interests so that a positive impact is felt overall. Being developing countries and Least Developed Countries (LDCs), South Asia needs to be wary of the impact of liberalization on the poor. Given the fact that factor markets are imperfect, liberalization can result in medium to long term unemployment in certain uncompetitive sectors. It is, therefore, important to strike a compromise between the medium term hazards of increased unemployment and the longer term benefits of increased competitiveness.

Domestic regulation, as highlighted earlier, is another critical issue for developing countries. South Asia has historically been plagued by over-regulation; however, what is required is effective regulation. This is particularly important in the services sector where the "good" cannot be inspected prior to consumption. Regulation is even more important in services like health and education, which have important social impacts, and services like telecommunication and finance, which have important economic impacts. An effective but un-cumbersome regulatory regime is an essential prerequisite for liberalization, and is therefore, a key research area.

Another issue is that of reliable data. Data on services is problematic. First, services are traded differently from goods, thus creating problems of tracking trade in a reliable manner. Second, certain services are handled in goods and it becomes difficult to differentiate their share in the total value of trade (Hoekman, 2006). In other words, large parts of services trade are intangible. It is, therefore, important to highlight these data issues. Negotiations in services liberalization are data intensive exercises, and in South Asia, data shortage is a significant constraint on effective liberalization. Research is required to identify the scope for collaboration and cooperation in this regard within South Asia.

Trade in services has been seen largely as an offensive interest of developed countries, attempting to break into regulated developing country markets. However, the status quo is shifting with developing countries such as India harnessing significant offensive interests in services, particularly in Mode 4. It is important to identify particular sectors where strong offensive interests exist, and to identify the direct and indirect benefits these can bring. When considering domestic liberalization, defensive interests need to be considered along with the benefits of liberalization. Defensive interests include sectors where the poor are affected, emerging sectors, vulnerable to intense competition, and sectors requiring independence from reliance on foreign supply. These should be balanced against the benefits for consumers of increased competition, including lower prices, higher quality, and greater choice. Multiplier effects and the underlying impact on the rest of the economy of improved service delivery are also needed to be examined.

It is, therefore, clear that the liberalization of services has profound impacts, both positive and negative. A country will be successful if it is able to reap the benefits of liberalization while controlling and suppressing the harmful effects that could result from them. This is not an easy task, and a great deal of research, thought, dialog, and debate needs to go into this process. Indeed, a comprehensive policy analysis of the implications of trade in services for sustainable development, and of the policy spaces available for implementing public policies, is still missing in South Asia. This book fills this gap.

## Overview of the Chapters

### India

In Chapter 2, Rupa Chanda presents the Indian case of liberalization of trade in services. She shows that the services sector has played an important role in India's recent growth process and in its integration with world markets. The sector is also integral to India's structural reform and deregulation process. The significance of services is also evident from India's proactive stand in the WTO under the GATS, where the country has actively pushed for enhanced market access and greater transparency, and predictability of such access in key modes of supply and in key sectors that are of interest to developing countries. Increasingly, India is also looking at regional and bilateral agreements which can advance its interests in the services sector.

Despite the high growth recorded by the services sector, the performance within the sector varies with sub-sectors such as IT, communication, and financial services which have liberalized in recent years witnessing more rapid growth compared to the closed and restricted sub-sectors. Moreover, the growth in the services sector is not matched by a corresponding growth in employment and has failed to generate substantial employment opportunities. Nevertheless, the growth in the services sector has been accompanied by a rapid growth in India's trade and investment flows in services. Consequently, India has managed to increase its share in world services exports from merely 0.5 percent in 1995 to 2.3 percent by 2005. It is observed that the composition of exported services has shifted from traditional services such as transport and travel toward miscellaneous services, in particular, business services like IT and IT-enabled services. Foreign Direct Investment (FDI) in services too has grown over the past decade, reflecting the liberalization of many erstwhile government monopoly services in India during the 1990s.

Liberalization of the services sector in India is driven by the overall reform process launched in 1991. While key services such as telecom, banking, and insurance were gradually opened up to FDI with the relaxation of foreign equity ceilings and the institution of more

transparent and streamlined regulations, the extent of liberalization undertaken by the country has varied considerably across sectors. The chapter also examines India's multilateral commitments under the GATS and notes that sectors in which India faced considerable pressure to open up, it has offered to commit them to reflect the autonomous liberalization it has undertaken to date. Nevertheless, it still has not fully bound most sectors and, thereby, has tried to retain some policy space in order to address its own interests in the GATS negotiations as well as to provide itself with the flexibility to go back to the liberalization undertaken, on a future date.

India has also not made substantive changes in its offers relative to the Uruguay Round (UR) commitments and, thus, has also not responded fully to the requests for increased transparency and fairness in the application of regulations to foreign services providers, despite instituting significant regulatory reforms in some services sectors. Even in areas which are not high demand sectors, India has improved upon its UR commitment, reflecting unilateral liberalization undertaken in these areas in recent years, and possibly recognition of the potential gains to be realized from the entry of foreign players in this sector.

However, India has attached conditions to its revised offers in such cases so as to retain policy space for addressing social and consumer protection concerns. In other services, India has moved from not scheduling the sector at all to making an initial and revised offer. This revised stance reflects its willingness to meet, at least partially, requests by key partners. It may also be part of a negotiating tactic to elicit improved offers in India's own sectors and modes of interest from key players by signaling a willingness to negotiate while maintaining some room to improve further in subsequent negotiations, and come closer to the requests placed by key trading partners. In highly sensitive sectors, India's multilateral approach remains conservative, indicating that there is, as yet, no domestic consensus and there is stiff opposition from key stakeholders in the country. This section also discusses India's recent bilateral initiatives covering services and examines the state of commitments made and received under the Indo-Singapore Comprehensive Economic Cooperation Agreement (CECA) and the possible learning for negotiation of other agreements.

Limited progress has been made under the GATS in terms of opening markets in areas and modes of interest to India. The GATS has played little or no role in determining market access opportunities in services trade. It has neither provided new market opportunities nor prevented the emergence of protectionist legislation in key markets. But business dynamics, technology, and demographic imperatives have continued to drive India's services trade.

Chapter 2 also discusses the scope for services sector liberalization in other countries of South Asia which would be beneficial for India and likewise, areas in India where services sector liberalization could be beneficial for other South Asian countries. These include IT and IT-enabled services, social services such as health and education, tourism and recreational services, infrastructure services such as transport and energy, and trade in labor services (Mode 4). Given the commonalities in interest among South Asian countries, there is scope for the region to cooperate more closely to strengthen their bargaining position in the GATS negotiations, develop statistics on trade in services, build regulatory capacity, and learn from one another's experience in liberalization.

The concluding section of the chapter discusses the extent to which domestic institutions and stakeholders in India are involved in the services negotiations and to what extent this process has helped in institution and capacity building. Based on India's experience, it calls for a consensus-based approach in each country to build domestic research capacity and an information base on services, and greater industry-academic-and-government exchange of information and views.

## Pakistan

In Chapter 3, Fasih Uddin presents the Pakistani case of liberalization of trade in services. The chapter shows that the liberalization of services initiated in Pakistan since early 1990s impacted the economy in many ways. The contribution of services in the GDP and employment is on the rise. Growth in services trade is ahead of merchandise trade, with imports registering faster growth due to the liberal policy, resulting in widening of the trade gap. Competition to domestic services has increased due to liberalization. Development of services remains

domestic demand oriented and linked with the behavior of other sectors, especially in agriculture and manufacturing. Government policies continue to focus on merchandise trade and awareness of export potential among stakeholders is growing slowly.

The earlier commitments under the GATS reflected the autonomous character of liberalization in Pakistan rather than the result of reciprocal negotiations under the WTO. The same approach is followed in formulating initial offers under the Doha Round and they are mainly based on responses to requests rather than on the proper assessment of competitive position of domestic services. The requests for concessions from trading partners are also not based on impact assessment of the respective sectors.

Evaluation of the liberalization services undertaken autonomously or under the GATS in Pakistan is yet to be undertaken. Such an exercise is constrained by inadequacy of information and data about domestic production and trade. The chapter argues that the experience of other nations in making such assessment can be fruitfully used to undertake similar work in Pakistan. Mechanisms should be devised to improve the services statistics. Services trade should also be viewed as a vehicle to sustain economic and social development, quality of life improvement, human resource up-gradation, and institution building. The chapter argues that the concerns of the civil society in Pakistan should also be kept in view while formulating strategy for services trade and development.

Notwithstanding data limitations, some broad conclusions are drawn in Chapter 3 with respect to services in Pakistan. First, the technology driven services, like telecommunications, computer, and information technology have progressed. Liberalization and privatization in Pakistan have attracted foreign capital and technology resulting in expansion, up-gradation, and cost-effectiveness of facilities. It has also helped in the export of these services. However, availability of qualified and trained manpower is a major bottleneck. Second, it will take time and determined efforts for most services in Pakistan to shift from domestic demand orientation and become competitive internationally. Third, the autonomous liberalization in Pakistan, under the compulsion of international financial institutions,

without seeking reciprocal access in other markets under the GATS negotiations, has put domestic service under external competition, adding to payment liabilities and putting pressure on the balance of payments. Fourth, exporters of services to Pakistan have benefited through Modes 3 and 1. Commercial presence in many areas like telecommunications, travel, advertisement, banking, insurance, retail and wholesale, and fast-food in Pakistan have expanded, causing increased competition to domestic services and higher payment liabilities of royalties, fees, and profits. The increased use of external services, in areas such as transport and insurance under Mode 1, has enlarged the trade deficit. Fifth, so far, Pakistan has gained little from Mode 4 arrangement as commitment by trading partners mainly cover transferees and senior executives and are subject to strict visa and other restrictions. The rise in home remittances (which also include earnings from services provided by natural persons under Mode 4) seems to have no relation to Mode 4 commitments by trading partners.

At the end of the chapter it is argued that the scope for cooperation among the South Asian nations in services is multi-dimensional, and thus, the SAARC, bilateral, and other institutional arrangements (both public and private) should be used to foster these relations.

## Sri Lanka

Deshal de Mel presents the Sri Lankan case of liberalization of trade in services in Chapter 4. Sri Lanka has one of the more liberal services sectors in the region, and is in the process of further liberalization at the multilateral and regional levels. The chapter provides background data and information on the services sector in Sri Lanka, outlining the fact that despite contributing 56.2 percent of the GDP, trade in services remains relatively insignificant when compared to trade in goods, and confined to very traditional sectors such as international transport and tourism. The chapter also includes details of Sri Lanka's efforts in the liberalization of trade at the unilateral level, commitments at the multilateral level, and forthcoming agreements at bilateral levels. Key sectors of the services economy that have been exposed to foreign competition (mainly through Mode 3) are focused upon, touching on the impacts of liberalization on the economy.

Future scenarios in services liberalization are discussed in Chapter 4; particularly the potential for exports of services through Mode 4 and Mode 1, detailing present barriers in the international system, and Sri Lanka's interests in the removal of these barriers, given the country's comparative advantages in labor intensive service provision. Specific sectors with export potential are also explored, including tourism, maritime transport services, air services, and retail. Besides exportable services, the chapter also looks at possible benefits through the liberalization of certain sectors which have wide ranging impacts on the rest of the economy. Health services, maritime services, and computer and related services are identified as sectors which can be liberalized with this in mind.

The possible risks in the liberalization of services are discussed in detail in the chapter. Sri Lanka faces many problems common to other developing nations in this regard. The lack of proper data and analysis on trade in services, weak regulatory capacity, particularly in professional services and the vulnerability to the competition of emerging services sectors are highlighted as areas of concern. Many structural changes must take place before Sri Lanka can take advantage of the opportunities offered by a more liberal trading environment in the services sector. Infrastructure (particularly, communications technology), English language, and IT capabilities must be improved in order to achieve success in dynamic service sectors such as Business Process Outsourcing (BPO). The chapter concludes by recommending the urgent upgrading of regulatory and legal frameworks in order to deal with the complexities put forward by the import of services, and the parallel importance of building strong negotiating capacity among trade negotiators and other stakeholders involved in negotiating agreements on trade in services.

## Bangladesh

Chapter 5 presents the case study of Bangladesh and is authored by Ananya Raihan. This chapter shows that the services sector in Bangladesh has grown rapidly in importance over the last three decades. The contribution of services to the GDP has increased to 49.1 percent in 2006 and the sector continues to grow faster than the

overall GDP in the past decade. Despite a large contribution to the GDP, only 26.8 percent of employment is in services, implying a less labor-intensive service expansion. The role of services related to FDI is also very significant in Bangladesh, particularly in telecommunications, energy, and power. Like many other developing nations, Bangladesh's trade in services is relatively low compared to its contribution to the GDP; furthermore, there has been a negative trade balance in terms of services in the country. The chapter outlines the fact that Bangladesh's intra-regional trade in services is an even smaller component of overall trade in services—just 3 percent of Bangladesh's total trade in services is with South Asia, and 72 percent of this was with India.

Chapter 5 highlights Bangladesh's present interests in the GATS, including details of the requests made by other members for liberalization of Bangladesh's services sector. The chapter identifies several sectors that are of export and import interest and sectors that ought to be protected. This is done by assessing the growth potential, global demand, regulatory environment, and balance of payment situation of the different sectors. The chapter identifies financial services, telecommunications, health, tourism, and education as sectors that can be liberalized to a certain extent. Like many South Asian countries, Bangladesh has significant interests in increased market access through Mode 4. The chapter concludes that making services work for the poor should incorporate increased market access for the less skilled service providers. Given the low number of skilled service providers available, it suggests that there is greater potential for increasing remittances by focusing on the export of less skilled labor. At the same time, it is important to keep in mind the adverse impacts of temporary migration such as the potential for increased brain drain.

The chapter also argues that despite being an LDC, Bangladesh should consider liberalizing certain sectors given the potential benefits of international services delivery in sectors such as telecommunications and education. However, liberalization needs to be carefully studied and implications need to be well understood prior to going ahead. A strong regulatory environment, supply side capabilities, infrastructure, and standards harmonization (through Mutual Recognition Agreements [MRAs]) are mentioned as priority pre-conditions for liberalization. The chapter refers to the need for collaboration among country

groups, particularly SAARC, and the need for incorporation of trade in services in the SAFTA, including the possibility of introducing the concept of a GATS visa within the SAFTA. The chapter concludes with references to the importance of capacity building and investment in both human and physical capital and infrastructure to take best advantage of increased market access in services.

## Nepal

Liberalization of trade in services in Nepal is the theme of Chapter 6 written by Navin Dahal. The chapter shows that the services sector plays an important role in the Nepalese economy both in terms of its share in the GDP and trade. The services sector is also important from an employment perspective. Historically, the services sector in Nepal has been highly protected, not only against foreign investment but also in terms of the participation of the private sector. However, in line with the liberal economic policies adopted after the restoration of multi-party democracy in 1991, the services sector has also witnessed a gradual liberalization.

In addition to the unilateral liberalization measures, Nepal has also made commitments at the WTO in many services sectors in all modes of supply. As a late entrant to the WTO, Nepal had to undertake significant liberalization commitments in services under the GATS during its accession in 2003. This happened despite the flexibilities in terms of market opening that the LDCs are entitled to enjoy as per the special LDC-modalities for the services trade negotiations. Today, the services sector is much more liberal with active participation of the private sector, including foreign sector, as compared to the period prior to the WTO entry.

The chapter shows that Nepal has the potential to become competitive in many services sectors due to its location, climate, and low labor cost. In particular, it has potential in tourism, higher education, and health services. It is argued that Nepal could also benefit from the emergence of India as a global player in IT outsourcing business. Nepal also has a major interest to liberalize Mode 4. In addition, the chapter argues that enhanced cooperation among countries in the

South Asian region can play an important role in the growth of the services industry in Nepal.

A country needs a strong institutional foundation and competitive service providers to benefit from services liberalization, both of which are lacking in Nepal. Thus, development of supportive institutional, physical, and human infrastructure on the one hand, and addressing the supply side constraints on the other, are prerequisites for this. The timing and sequencing of reforms also determine whether or not the country benefits from services liberalization. The government also needs to address anti-competitive practices that are prevalent in the Nepalese economy to help efficient firms enhance their competitiveness.

## Maldives

The Maldivian case study on trade in services is discussed in Chapter 7, authored by Janaka Wijayasiri and Jagath Dissanayake. The chapter shows that the services sector plays a major role in the Maldives, with the tourist sector playing a dominant role in the economy.

The Maldives has undertaken autonomous liberalization of the services sector since the late 1980s with the opening up of the economy to Foreign Direct Investment. Though the role of the government remains extensive in the economy, including the provision of services through state-owned enterprises, the country has opened up the services sector across all modes of delivery, including Mode 4 by maintaining a liberal labor policy with regard to foreigners. In fact, about one-third of the labor force in the country comprises of foreigners from South Asia, largely due to the lack of workers, both skilled and unskilled in the economy.

The chapter shows that Maldives has an export interest in the tourism sector which is the leading sector in the country while its import interest covers all four modes of trade in services and a number of sectors including health and education. The chapter gives an overview of the services sector and discusses the current status of services liberalization in the country, including the commitments made at the

multilateral level. The Maldives's competitiveness in key areas of trade in services (tourism, financial, transport, and telecommunications) is also examined in addition to highlighting some of the opportunities available for cooperation in the region. The chapter also shows that despite the unilateral liberalization initiatives undertaken, the Maldives have so far committed to very few sectors in services under the GATS, limited to business services, and thereby, have maintained policy space with regard to the liberalization of the sector.

## Bhutan

Chapter 8 documents trade in services in Bhutan. This chapter is authored by Pema R. Rinchen. The chapter explores trade in services from the perspective of a country that is in the process of acceding to the WTO. Given the very early stages of services liberalization in Bhutan, the level of data and information available is limited, but valuable insights are provided with regard to opportunities and challenges associated with accession to the WTO and the GATS in particular.

The chapter begins with an overview of the structure of the Bhutanese services economy, including major sectors and highlighting the importance of tourism and electricity as major service exports. There is, however, potential for improvements in both sectors, with capacity far from filled. It points out the importance of cooperation within South Asia, in areas such as tourism where there is scope for mutual benefit, by exploiting the diversity that South Asia offers to visitors.

Other areas of potential Bhutanese export growth are also identified, including sectors such as financial services, business services, and Information and Communication Technology (ICT). The chapter highlights the importance of services in fueling the growth and dynamism of the rest of the economy, in particular, in tourism and infrastructure development. The chapter offers useful insights into the development of prerequisite structures surrounding the liberalization of trade in services. It also touches on the importance of public–private consultations to identify country interests, the necessity of improving and recognizing standards in services delivery to facilitate trade

in services and the need for legislative and regulatory practices to keep up with the rapid evolution of the dynamic market for trade in services.

## South Asia

Rashmi Banga takes an overall South Asian perspective on liberalization of trade in services in Chapter 9. The chapter shows that the services growth has been an important driver of economic growth of the region. Given the dynamics provided by the services sector, the chapter analyzes the opportunities arising due to the growing tradability of services for the region. However, with imports of services growing at an average rate of 5.7 percent since 1997, and exports growing at a rate of 3.9 percent, there is also a need to assess the risks involved in liberalizing services at the existing pace.

The chapter assesses the extent of the significance of trade in services to South Asia. The contribution of services to trade and the composition of trade in services in South Asia are examined. To assess the opportunities arising from liberalization of trade in services for the South Asian countries, the extent of competitiveness of different countries in services is estimated using the Revealed Comparative Advantage (RCA) analysis. The analysis is undertaken for disaggregated services like transport services, communication services, construction services, computer and information services, other business services, other commercial services, travel services, and financial services. Further, mode-wise competitiveness of different countries in South Asia is examined. In order to examine the risks involved in liberalization of services, issues with respect to liberalization of trade in services under Mode 3 are discussed. A comparative analysis of the South Asian countries is undertaken to assess the extent of liberalization of trade in services under Mode 3. Further, the chapter highlights the barriers to the FDI in services in different South Asian countries.

The role of services in the SAFTA is examined and the way forward in services negotiations for South Asia, and the possibility of a common position in multilateral negotiations are discussed. The chapter concludes by suggesting that, if the momentum of growth

in services trade of the region is to be maintained, there is a need to make conscious efforts to improve the competitive advantages of the region as a whole, and inclusion of services in the SAFTA can provide the necessary impetus to growth in trade of services.

The final chapter by Parashar Kulkarni provides a brief overview of the scope and nature of the GATS Domestic Regulation (DR) disciplines. It is suggested that there are clear links between the disciplines and the commonly used indicators of good regulation, implying that the implementation of the GATS may require the South Asian countries to improve their regulatory structures. The chapter proceeds to discuss DR in the context of South Asia. The analysis reveals that the region is far behind in the state of regulatory institutions as well as the quality of regulations. With reference to institutions such as rule of law indicators, corruption indicators, and institutional coordination problems, there is a need for improvement. With regard to the quality of regulation like regulatory quality indicators, heterogeneity indicators, e-governance indicators, and ease of doing business indicators, these provide evidence that the South Asian countries have not been able to effectively overhaul their domestic regulatory framework.

In the concluding section, the chapter provides a note of caution on implementing the GATS blindfolded. Loss of policy space, capacity constraints, cost of implementation, and risk of discrimination against domestic suppliers are some of the critical issues that need to be adequately understood and factored in the GATS commitments.

Nevertheless, in terms of overall positioning, Chapter 10 suggests that in spite of its inability to serve as an ideal instrument of policy reform, the GATS provides a better platform in comparison to policy lock-in instruments such as bilateral investment treaties and regional trade agreements.

## Concluding Remarks

The services sector is the largest and fastest growing sector of the world economy and it is the same in South Asia. Gains from more liberalization in trade in services are greater than those from trade in

goods because the level of protection in services trade is higher than that for goods and the sector occupies a large share of the South Asian economies. However, it has been a difficult task to bring about significant liberalization in trade in services at the global level as well as in South Asia to reap the benefits.

Services liberalization is an important component of the now stalled Doha Round of multilateral trade talks. The slow progress to global liberalization of trade in services, as governed by the GATS framework, is highlighted in this chapter. The challenge that the policy makers of South Asia face is how to calibrate liberalization so that a balance is maintained between the increased competitions resulting from improved market access for foreign suppliers and preserving national sovereignty to regulate services for the attainment of social welfare. Liberalization of services without proper regulatory support can be costly and has to be avoided.

This book covers trade in services in each of the seven South Asian countries and provides an overview of the entire region on market access issues and regulatory constraints. It also highlights the offensive and defensive interests in trade in services, institutions and regulations governing services, and opportunities and risks in further liberalization of trade in services in individual South Asian countries and the region as a whole. It is hoped that the contents of the book will empower policy makers and other stakeholders in the region to comprehend the problems of liberalization of trade in services better and overcome them more effectively in the near future.

## Notes

1. Based on World Trade Organization (WTO) estimates (www.wto.org ).
2. The United States (US) and European Union (EU) trade representatives have specifically stated in the WTO discussions that they do not have a mandate to negotiate immigration matters. Migration from South Asia to the rest of the world is on the increase and the region is the second largest recipient of remittances in the world after the Caribbean and accounts for 20 percent of the annual global international remittances (Kumar, 2005).
3. The US gambling dispute reveals that resourceful members like the USA have also been unable to take into account all concerns when preparing their GATS schedules.

4. The telecom dispute between the US and Mexico clearly suggests that countries that have scheduled commitments without incorporating flexibilities may be unable to introduce development-oriented policies at a later date.
5. Exports of commercial services from South Asia increased from USD 7.9 billion in 1993 to USD 29 billion in 2003 (Kumar, 2005). Services trade in South Asia almost doubled during 1995–2003, from USD 26 billion to USD 51 billion (Raihan and Razzaque, 2007).

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# 2

# India

Rupa Chanda

## Introduction

The services sector has played an important role in India's recent growth process and in its integration with world markets. Services such as Information Technology (IT) and Business Process Outsourcing (BPO) have placed India on the world map. The services sector has also been integral to India's structural reform and deregulation process as erstwhile government monopoly sectors such as insurance and telecommunication services, which have been opened up to domestic private sector participation and Foreign Direct Investment (FDI) inflows. The significance of services is also evident from India's proactive stand in the World Trade Organization (WTO) under the General Agreement on Trade in Services (GATS), where India has actively pushed for enhanced market access and greater transparency, and predictability of such access in key modes of supply and in key sectors that are of interest to developing countries. Increasingly, India is also looking at regional and bilateral agreements, which can advance its interests in the services sector.

The growing significance of India's services sector in the country's overall economy and its trade and investment flows has also given rise to new issues and concerns that have to be addressed domestically,

in consultation with relevant stakeholders, as well as externally, in consultation with key trade and investment partners. Numerous domestic and external constraints have to be addressed if India is to realize its true export and investment potential in services, make growth in this sector sustainable, and remain a contributor to larger socio-economic and development goals. For example, India's exports of professional services remain affected by stringent restrictions on the movement of its services providers and there remain concerns about possible protectionist legislation, which could affect India's outsourcing exports. Within India, certain services still remain closed to the presence of foreign establishments. In some services, liberalization has been slow, halting, and mired in controversy due to domestic stakeholder sensitivities and concerns about the possible adverse effects of liberalization on employment, poverty alleviation, and equity. Hence, in several services, there is clearly a need to build domestic consensus on liberalization and to shape the process of opening up and of regulatory reforms in such a manner that growth is aligned with the country's long term economic and social objectives.

This chapter discusses the opportunities and risks associated with liberalizing trade in services in India. It is divided into six parts. The first section outlines recent trends and characteristics in India's services sector. It provides an overview of the growth of India's services sector, its contribution to the overall economy and employment, the sub-sectoral profile of services including the leading and lagging segments within this sector, and the share of services in India's overall trade as well as investment flows. The second section discusses the nature of India's services liberalization, highlighting the extent to which unilateral liberalization has been undertaken and how this relates to India's multilateral and bilateral/regional initiatives. This section outlines India's commitments under the GATS, including its initial and revised offers. The third section discusses India's competitiveness in key areas and modes of trade in services and areas where it has defensive interests and concerns about liberalization. It also outlines the requests submitted by India to its trading partners and those received by India from key trading partners. The fourth section discusses the scope for services sector liberalization in the other countries of South Asia which would be beneficial for India and likewise, areas where services sector

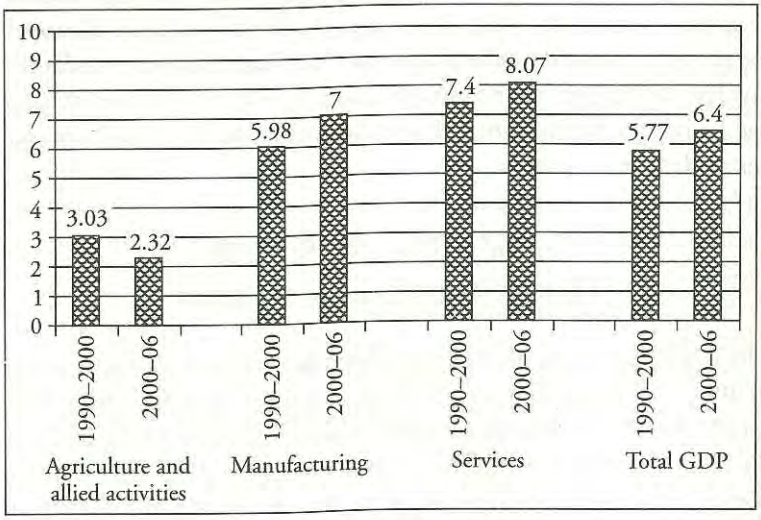
liberalization in India could be beneficial for the other South Asian countries. This section also highlights potential areas for cooperation in services within the South Asian region. The fifth section discusses the extent to which domestic institutions and stakeholders in India are involved in the services negotiations and to what extent this process has helped in institution and capacity building. The sixth section concludes the chapter.

## India's Services Sector: Trends and Characteristics

The Indian economy has registered high growth rates in recent years: in 2005–06, it was the second fastest growing economy. The overall GDP growth per annum accelerated to 5.8 percent on an average during the 1990s, and further to 6.4 percent in the 2000–06 period, compared to 3–4 percent on an average or the Hindu rate of growth in previous decades. While agriculture's performance has been erratic, both industry and services have contributed to this improved growth performance. The average annual growth of industry rose from 6 percent in the 1990s to 7 percent during the 2000–06 period, while that of services rose from 7.4 percent in the 1990s to over 8 percent during the 2000–06 period. Thus, services have been an important driving force of growth in the Indian economy during the post-reform period and has registered superior performance compared to the other two sectors of the economy. Figure 2.1 shows the average sectoral growth rates of the Indian economy as well as the average overall GDP growth for the 1990s and the 2000–06 periods.

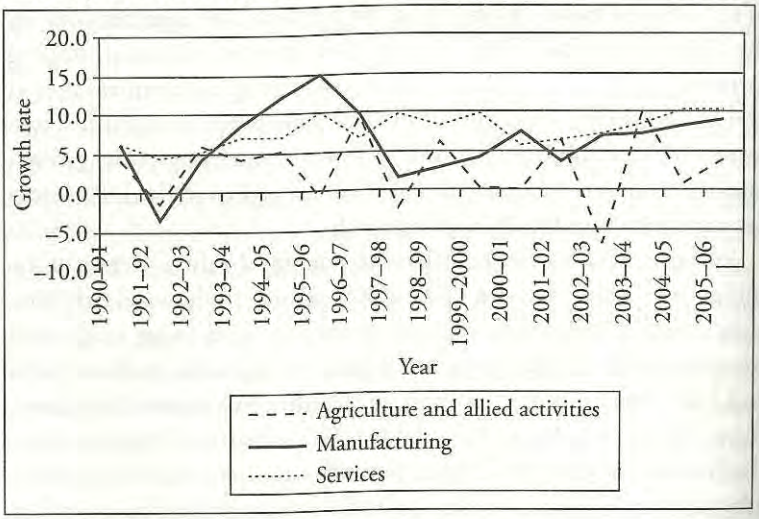
Figure 2.2 shows the yearly growth rates for the three sectors of the Indian economy over the 1990–2006 period. It shows clearly that agricultural growth has been very volatile, witnessing peaks and troughs, while services growth has been on a general upward trend and has surpassed yearly growth in the other two sectors for almost the entire period. Again, it is evident that services has helped pull up the Indian economy to a higher growth trajectory of over 6 percent, a fact commonly acknowledged in Indian policy circles and by Indian academicians.

**Figure 2.1**
**Average Sectoral Growth Rates, 1990–2000 and 2000–06**




*Source:* Compiled from Central Statistical Organization.

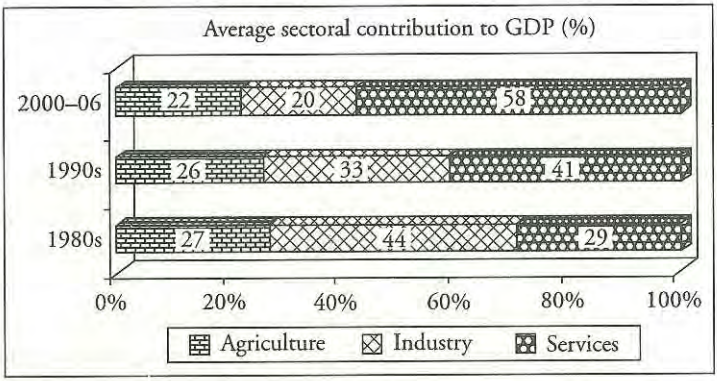
**Figure 2.2**
**Yearly Growth Rates for the Sectors of the Indian Economy (%)**




*Source:* Compiled from Central Statistical Organization.

Given the superior and consistent performance of India's services sector, it has become increasingly important in the country's overall GDP. Its share in India's GDP has risen from 29 percent in the 1980s to 41 percent in the 1990s, and to 58 percent during the 2000–06 period. Meanwhile, the shares of agriculture and industry have declined from 27 percent and 44 percent respectively in the 1980s to 22 percent and 20 percent respectively during the 2000–06 period. Thus, services constitute more than half of India's GDP and have crossed 60 percent of the GDP in the most recent year for which data are available. Figure 2.3 shows the changing sectoral composition of India's GDP over the past two decades.

**Figure 2.3**
**Changing Sectoral Composition of India's GDP (1980s, 1990s, 2000–06)**




***Source:*** Compiled from Central Statistical Organization.

Thus, the Indian economy has become increasingly dependent on the services sector for its growth performance. These numbers are likely to understate the overall importance of services for the economy as many services provide inputs to the production process and to other sectors of the economy and thus, their growth has wider productivity and efficiency ramifications for activities outside the services sector.

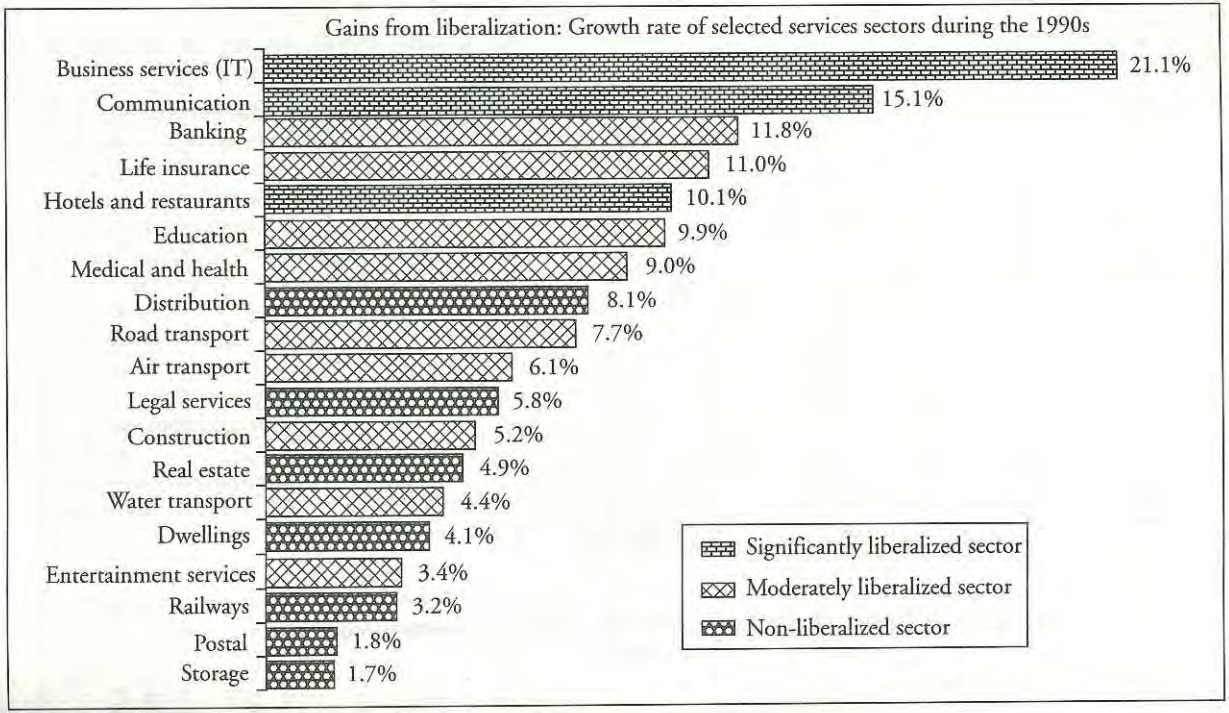
The growth performance in services has, however, varied across subsectors. Communication services have registered the highest growth rates during this period, with an average growth rate of 24 percent

**Table 2.1**
**Annual Growth Rates in Service Sub-sectors in India (2000–01 to 2005–06)**

| | *2000–01* | *2001–02* | *2002–03* | *2003–04* | *2004–05* | *2005–06* | *Average 2000–06* |
|---|---|---|---|---|---|---|---|
| 1. Construction | 6.2 | 4 | 7.9 | 12 | 14.1 | 14.2 | 9.7 |
| 2. Trade, hotels, and restaurants | 5.2 | 9.6 | 6.9 | 10.3 | 8.4 | 8.2 | 8.1 |
| 2.1 Trade | 5 | 9.8 | 7 | 10.5 | 8.3 | 8.1 | 8.1 |
| 2.2 Hotels and restaurants | 7 | 7.9 | 5.7 | 8.5 | 8.7 | 9.4 | 7.9 |
| 3. Transport, storage, and communication | 11.2 | 8.2 | 13.6 | 15.1 | 15.2 | 13.9 | 12.9 |
| 3.1 Railways | 4.1 | 7 | 5.6 | 6.5 | 5.7 | 7.7 | 6.1 |
| 3.2 Transport by other means | 7.7 | 4 | 10.3 | 11.9 | 12.8 | 8.9 | 9.3 |
| 3.3 Storage | 6.1 | 0.7 | –6.8 | 5.1 | 14.1 | 4.1 | 3.9 |
| 3.4 Communication | 26.9 | 19.5 | 25.6 | 25.4 | 22.8 | 23.9 | 24.0 |
| 4. Financing, insurance, real estate, and business services | 4.1 | 7.3 | 8 | 5.6 | 8.7 | 10.9 | 7.4 |
| 4.1 Banking and insurance | –2 | 9.1 | 11.3 | 2.2 | 8.8 | 14 | 7.2 |
| 4.2 Real estate, ownership of dwellings, business, and legal services | 9.1 | 5.9 | 5.4 | 8.3 | 8.6 | 8.6 | 7.7 |
| 5. Community, social, and personal services | 4.8 | 4.1 | 3.9 | 5.4 | 7.9 | 7.7 | 5.6 |
| 5.1 Public administration and defense | 2.1 | 2.9 | 1.6 | 2.6 | 9 | 5.4 | 3.9 |
| 5.2 Other services | 7.1 | 5.1 | 5.8 | 7.6 | 7.2 | 9.4 | 7.0 |

***Source:*** Compiled from Central Statistical Organization.

**Figure 2.4**
**Growth Rate of Selected Services during the 1990s**




***Source:*** Compiled from Central Statistical Organization.

**Table 2.2**
**Sub-sectoral Profile of India's Services Sector**
**(% of the Overall GDP)**

| *Sector* | *1994–95* | *2005–06* |
|---|---|---|
| 1. Construction | 5.5 | 14.2 |
| 2. Trade, hotels, and restaurants | 10.7 | 8.2 |
| 2.1 Trade | 10.9 | 8.1 |
| 2.2 Hotels and restaurants | 7.4 | 9.4 |
| 3. Transport, storage, and communication | 9.8 | 13.9 |
| 3.1 Railways | 2.1 | 7.7 |
| 3.2 Transport by other means | 10.3 | 8.9 |
| 3.3 Storage | 2.4 | 4.1 |
| 3.4 Communication | 16.8 | 23.9 |
| 4. Financing, insurance, real estate, and business services | 5.6 | 10.9 |
| 4.1 Banking and insurance | 8.5 | 14 |
| 4.2 Real estate, ownership of dwellings, business, and legal services | 3 | 8.6 |
| 5. Community, social, and personal services | 3.2 | 7.7 |
| 5.1 Public administration and defense | 1.3 | 5.4 |
| 5.2 Other services | 5 | 9.4 |

***Source:*** Compiled from Central Statistical Organization.

Thus, the services sector in India has also undergone a shift in terms of its overall composition.

Growth in the share of India's services sector in the GDP has, however, not been accompanied by a significant growth in employment in this sector (Banga, 2006: 29–31). Employment creation in services has not been as rapid as that witnessed in other developing economies. According to the 2001 Indian census statistics, the services sector's share in employment rose from 20.8 percent to 25.1 percent between 1991 and 2001 while during the same period, its share in the GDP increased by over 10 percent, thus implying low employment elasticity in this sector. The shares of sub-sectors such as trade and distribution, construction, transport, communication, financial, and business services in total employment grew during the 1991–2001 period, again reflecting the much higher growth rates and liberalization of some of these services while the employment share in segments such as community, social, and personal services, which also witnessed lower growth rates, declined. But overall, the employment growth

even in the fast growing segments was not commensurate to the rapid growth of these segments and there was a fall in employment elasticity even in these areas. Thus, the services-led growth paradigm witnessed in India has not been accompanied by job creation, reflecting the fact that some of the high growth segments may not be highly employment-intensive and that there has been high labor productivity growth in some of these areas, thus enabling their expansion without concomitant employment growth. The services sector has overall not been an employment driver in the economy. This is an issue of concern in view of the need to create job opportunities for India's growing young productive workforce, the declining share of agriculture, and yet the continued high dependence on agriculture for a living.

The services sector has contributed significantly to India's integration with world markets, through both the trade and FDI flows. India's services exports have increased from a mere USD 11.1 billion in 1998 to USD 56 billion in 2005 and have grown more rapidly than its services output, indicating the strong outward orientation of this sector. Over the same period, imports of its services have grown from USD 14 billion to USD 52 billion. India's services exports have grown more rapidly than world services exports. As a result, India's share in world services exports has grown considerably from around 0.5 percent in 1995 to 2.3 percent in 2005, with an average share of 1.6 percent in world services exports during the 2000–05 period. Table 2.3 shows the trends in India's share of world services exports over the 1998–2005 period.

Figure 2.5 shows the trend in the share of India's services exports over the 1995–2005 period.

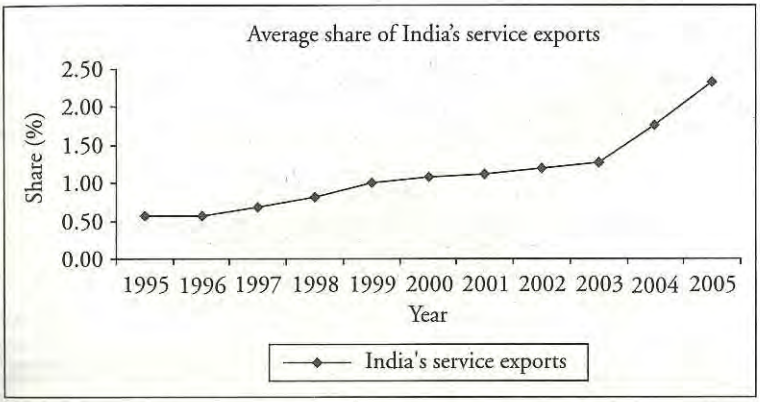
India's services exports grew at an average annual rate of 25 percent during the 1995–2005 period, with export growth accelerating from 17 percent in the 1995–2000 period to 37 percent during the 2001–05 period (higher than that of China), clearly indicating an upward marked movement in the services export growth trajectory in recent years. Services export growth has far exceeds that of merchandise exports, which grew at an average annual rate of 9 percent during the 2000–05 period. Hence, the share of services in India's total trade has grown from only 7 percent in 1999–2000 to 31 percent in 2005–06,

**Table 2.3**
**India's Services Trade and Share in World Services Exports (USD Billion and % Shares)**

| *Year* | *Exports of India's Services (in USD bn)* | *Imports of India's Services (in USD bn)* | *India's Share in World Exports of Services* |
|---|---|---|---|
| 1998 | 11.1 | 14.2 | 0.8 |
| 1999 | 13.9 | 17.2 | 1.0 |
| 2000 | 17.6 | 19.9 | 1.2 |
| 2001 | 20.4 | 23.4 | 1.4 |
| 2002 | 23.5 | 21.8 | 1.5 |
| 2003 | 25 | 21.6 | 1.4 |
| 2004 | 39.6 | 40.9 | 1.9 |
| 2005 | 56.1 | 52.2 | 2.3 |

*Source:* Compiled from International Trade Statistics (WTO, 2005).

**Figure 2.5**
**Trends in India's Services Exports in World Services Exports, 1995–2005 (% Shares)**

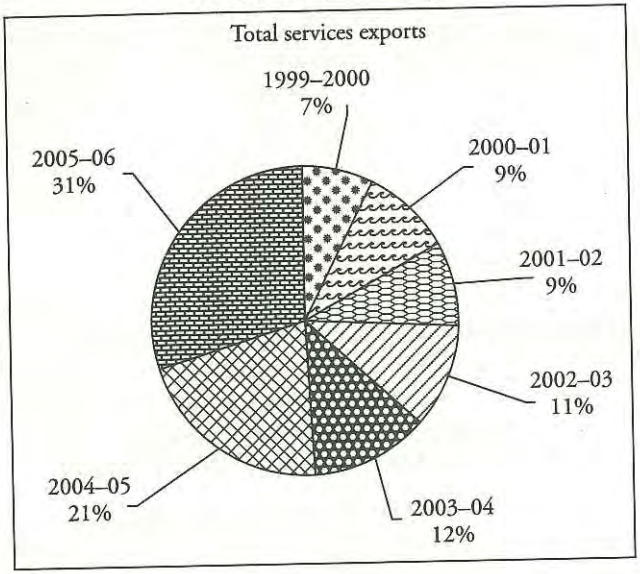



*Source:* Compiled from International Trade Statistics (WTO, 2005).

indicating its growing importance in India's current account. The growing importance of services in India's overall trade basket is shown in Figure 2.6.

The composition of India's services exports has undergone significant change, away from traditional services such as transport and travel toward miscellaneous services, in particular, business services, the main item being software services. Table 2.4 shows the shift in

**Figure 2.6**
**India's Services Exports in Total Exports, 1999–2000 to 2005–06 (% Shares)**




*Source:* RBI, 2006.

**Table 2.4**
**Trends in the Composition of India's Services Exports (1970–71 to 2005–06)**

| | *Amount (USD mn)* | *Share in Total Services Exports (%)* | | | | | |
|---|---|---|---|---|---|---|---|
| | | *Travel* | *Transport* | *Insurance* | *GNIE* | *Software* | *Miscellaneous** |
| 1970–71 | 292 | 16.8 | 49.7 | 5.5 | 13.7 | | 14.4 |
| 1980–81 | 2,804 | 43.5 | 16.3 | 2.3 | 4.0 | | 33.9 |
| 1990–91 | 4,551 | 32.0 | 21.6 | 2.4 | 0.3 | | 43.6 |
| 2000-01 | 16,268 | 21.5 | 12.6 | 1.7 | 4.0 | 39.0 | 21.3 |
| 2003–04 | 26,868 | 18.7 | 11.9 | 1.6 | 0.9 | 47.6 | 19.2 |
| 2004–05 | 46,031 | 14.1 | 10.4 | 2.0 | 0.7 | 37.4 | 35.4 |
| 2005–06 | 60,610 | 12.9 | 10.4 | 1.7 | 0.5 | 38.9 | 35.6 |

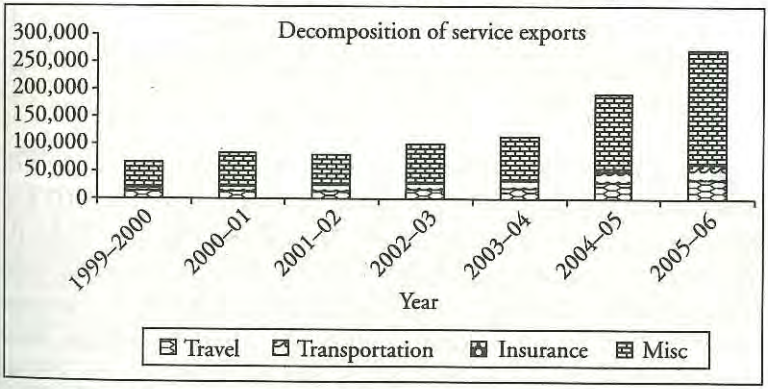
*Source:* RBI, 2006.
*Note:* * Excluding software services.
Government Not Included Elsewhere (GNIE).

the structure of India's services exports over the past three decades and in recent years toward non-traditional services.

As shown in Table 2.4, the share of miscellaneous services has increased from a mere 14 percent in 1970–71 to 60 percent (which includes software services not separately accounted for in earlier years) in 2000–01 to over 70 percent in 2005–06. Software services alone have contributed close to 40 percent of total services exports indicating the growing importance of this segment and India's growing competitiveness in the Information Technology (IT) and IT-enabled services sector. But as the data reveal, other miscellaneous services, mainly business services for which further disaggregation is not available, have also become very important in India's services exports. As shown in a 2004 World Bank study, the revealed comparative advantage of India's services, and in particular its other business services, increased sharply in the 1990s (World Bank, 2004: 11, Figure 3).

Figure 2.7 shows the changing structure of India's services exports over the 1999–2005 period with the miscellaneous services segment (including software services) growing significantly while all other segments have shown only modest growth over this period.

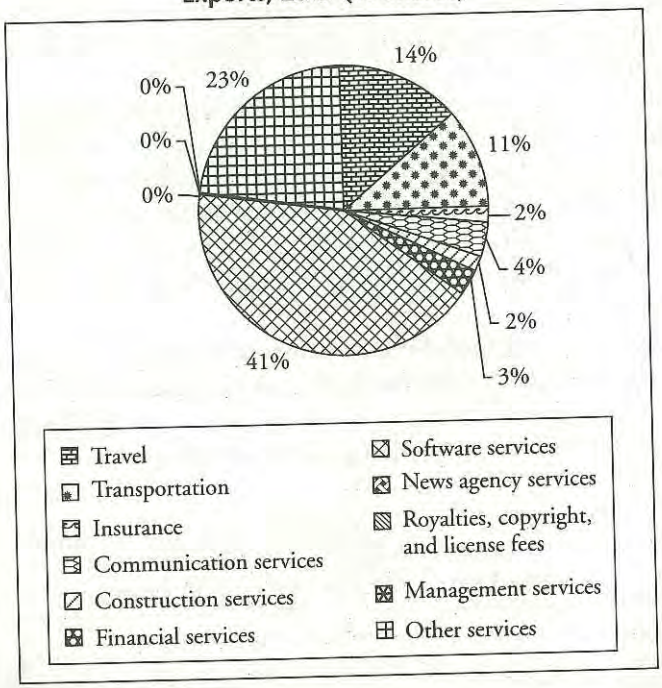
**Figure 2.7**
**Trends in India's Services Exports, 1999–2000 to 2005–06 (Value in Rs Crore)**




*Source:* RBI, 2006.

Figure 2.8 depicts the overwhelming share of total services exports which is accounted for by software and other miscellaneous services in 2005–06.

**Figure 2.8**
**Composition of India's Services Exports, 2005 (% Shares)**



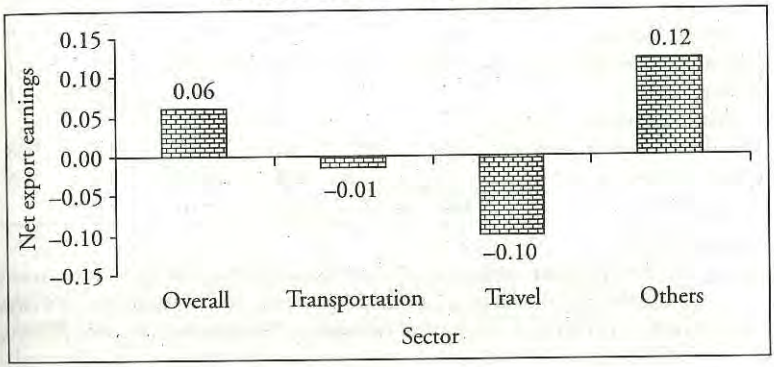

*Source:* RBI, 2006.

IT and IT-enabled services have been the most dynamic growth areas in India's services trade. The Indian IT–IT-enabled services (ITES) industry has grown at a Compound Annual Growth Rate (CAGR) of over 28 percent since 1999–2000 and the industry's national contribution to the GDP over this period has increased from 1.2 percent in 1999–2000 to 4.8 percent in 2005–06. IT–ITES services have registered growth rates of over 50 percent in exports in the 1990s. Software and services exports (excluding hardware) grew by over 30 percent in 2005–06. India's combined exports of IT and ITES

have grown from USD 4 billion in 2000 to around USD 24 billion in 2006 (NASSCOM sources and India Brand Equity Foundation [IBEF], 2006). India's share in the world market for IT software and services (including BPO) has increased from around 1.7 percent in 2003–04 to 2.3 percent in 2004–05 and an estimated 2.8 percent in 2005–06 (World Bank, 2004: 9, Figure 1). India has also emerged as the most attractive offshore destination for services outsourcing in the world today. It has accounted for 65 percent of the global market in off-shore IT services and 46 percent of the global BPO market in 2004–05.

The other services segment, inclusive of software services, also emerges as the most important net foreign exchange earner within the service sector. Figure 2.9 shows the net export earnings from various services segments over the 1995–2005 period.

**Figure 2.9**
**Net Export Earnings from Different Services, 1995–2005 (Rs Crore)**




*Source:* RBI, 2006.

Thus, the data presented in Figure 2.9 clearly indicates India's emerging competitiveness in certain services segments. This has not only boosted the overall growth in India's services exports but has also raised India's share in world services exports.

FDI in services has also grown over the past decade, in part reflecting the liberalization of many erstwhile government monopoly services such as telecommunications, banking, and insurance during the 1990s.

Services today account for around 50 percent of India's total FDI flows. A 2004 World Bank study finds that the FDI in services has grown more rapidly than the FDI in manufacturing in India (World Bank, 2004: 9, Figure 1).

Table 2.5 shows the FDI flows to India over the 2003–06 period and the shares of various service segments in the FDI flows.

**Table 2.5**
**FDI to India: Industry-wise***

| | *USD Million* | | | *% Shares* | | |
|---|---|---|---|---|---|---|
| *Industry* | *2003–04* | *2004–05* | *2005–06*[P] | *2003–04* | *2004–05* | *2005–06* |
| Construction | 172 | 209 | 191 | 11.8 | 9.0 | 5.7 |
| Trade, hotels, and restaurants | 67 | 22 | 95 | 4.6 | 0.9 | 2.8 |
| Transport | 20 | 70 | 66 | 1.4 | 3.0 | 2.0 |
| Financing, insurance, real estate, and business services | 206 | 363 | 452 | 14.1 | 15.6 | 13.5 |
| Computer services | 166 | 372 | 770 | 11.4 | 16.0 | 22.9 |
| Educational services | 0 | 2 | 4 | 0.0 | 0.1 | 0.1 |
| Research and scientific services | 1 | 5 | 5 | 0.1 | 0.2 | 0.1 |
| Health and medical services | 15 | 25 | 61 | 1.0 | 1.1 | 1.8 |
| Other services | 2 | 10 | 49 | 0.1 | 0.4 | 1.5 |
| Total FDI flows | 1,462 | 2,320 | 3,358 | | | |

*Source:* RBI, 2006.

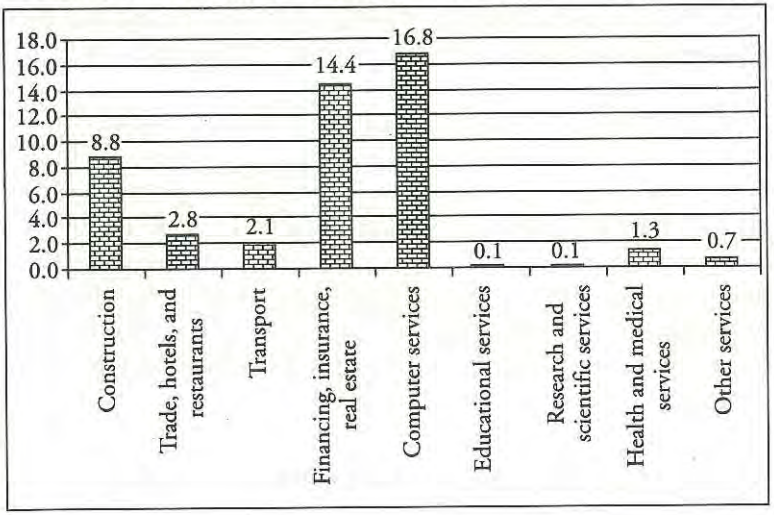
*Notes:** Data in this table exclude the FDI inflows under the NRI direct investment route through the Reserve Bank and inflows due to the acquisition of shares under Section 6 of the Federal Emergency Management Agency (FEMA), 1999.

P = Provisional.

The average share of various services segments in India's inward FDI flows is shown in Figure 2.10. It indicates that software services and finance, insurance, real estate, telecom, and various business services (here, all aggregated) have accounted for over 30 percent of India's inward FDI flows.

Thus, clearly, if one considers both the trade and FDI data, it is the new economy services that have facilitated India's penetration of

**Figure 2.10**
**Services Share in Inward FDI Flows in India, 2003–06 (% Shares)**




*Source:* RBI, 2006.

world markets as well as the opening up of the Indian economy to world markets.

## Services Liberalization in India

The services sector has been an integral part of India's overall reform process. Key services such as telecom, banking, and insurance have been gradually opened up to the FDI, with relaxation of foreign equity ceilings and institution of more transparent and streamlined the FDI regulations. In the multilateral context, there has been growing pressure on India by key member countries to lock in, at a minimum, its unilateral liberalization in the services sector through binding commitments under the GATS and, where possible, to extend this liberalization with commitments that go beyond the status quo. India's commitment and offer strategy has varied across services depending on the stakeholder sensitivities and concerns involved. The services sector is also becoming an important part of India's bilateral and regional initiatives, as there is growing recognition of the role such agreements

can play in enhancing India's export interests in the services sector while also inducing the much needed FDI and technology transfer in key services such as telecom, transport, logistics, and construction, among others, with clear efficiency and productivity spillovers for the economy.

The following discussion highlights the state of unilateral liberalization undertaken in key services by India. It highlights India's multilateral commitments and offers in the GATS negotiations for the same services and discusses the relationship between the multilateral liberalization strategy and India's autonomous liberalization. The discussion also highlights the commitments made in the context of other agreements such as the Indo-Singapore Comprehensive Economic Cooperation Agreement (CECA) and how these relate to India's autonomous and multilateral liberalization.

## Autonomous Liberalization in Selected Services[1]

Since the initiation of reforms in 1991, there has been considerable opening up of the services sector to private participation, both domestic and foreign. Many services, including, construction, tourism, health, and computer-related services, for instance, have been put on automatic approval route for FDI. Government monopoly in many critical services has been eliminated, with further liberalization planned or already announced.

Telecommunication services have experienced the greatest amount of liberalization. Today, fully-owned foreign firms are allowed in several segments of the telecom sector, government monopoly in long distance telephony and internet has been eliminated, and there is no restriction on the number of providers. In February 2005, the government increased the foreign holding limit for services such as fixed line basic services, cellular services, unified access services, national and international long distance telephony, and value added services such as data and message transmission services to 74 per cent, up from an earlier ceiling of 49 percent.

Similarly, in financial services, there has been considerable liberalization since 1991 (Chanda, 2005a).[2] From an earlier limit of 20 percent minority participation for foreign banking companies or financial

companies in private Indian banks, through technical collaboration or through the Foreign Investment Promotion Board (FIPB) route, the limit on foreign ownership has been raised to 74 percent in 2004, under automatic route. Earlier, foreign banks were allowed to operate only through branches but they have now been allowed to operate through other forms as well, including wholly-owned subsidiaries, although conditions remain on foreign investment in the banking sector. The insurance sector has been gradually liberalized starting in the 1990s. In 2000, the Insurance Regulatory Bill was ratified permitting foreign equity participation of up to 26 percent in the insurance sector through only joint ventures and partnerships. Since then, this limit has been risen further to 49 percent and an independent regulator, the Insurance Regulatory and Development Authority (IRDA) has been set up to review the functioning of insurance companies and to regulate the insurance and re-insurance business. Various other segments of the financial services sector, including the mutual funds and the capital market have also been opened up to foreign participation, supplemented with strengthening and institution of regulatory bodies in this sector.

While India has been under pressure from its major trading partners to further liberalize sectors such as telecom and financial services, there are other areas such as health services, and construction and engineering services where India has autonomously liberalized fully. For instance, since 2000, the hospitals segment has been opened to 100 percent FDI participation on automatic route. There are around 20 international players already present in India's health care sector, through various kinds of arrangement, including subsidiaries, technology and training collaborations, and joint ventures. Likewise, in the construction services sector, the government has permitted 100 percent FDI through automatic route in construction for civil works and attached conditions on foreign players have been relaxed. Thus, where there are clear benefits to be realized from liberalization, either in terms of the direct benefits within the sector as in health services, or for the economy at large as in construction services, and where there are no major stakeholder sensitivities, the government has pushed ahead with unilateral liberalization relaxing FDI ceilings fully.

Autonomous liberalization has, however, been mired in controversy and internal debates in certain services, including education, retail, accountancy, and legal services. As a result, the opening up of such areas has either been limited and very halting, or not yet undertaken at all.

In the higher education services sector, there has been considerable domestic debate about the desirability of liberalization and the regulatory preconditions that would be needed to support this liberalization (Agarwal, 2006: 299–359). Foreign equity participation has been permitted up to 100 percent under the automatic route since 2000 for entry through franchises, twinning arrangements, study centers, and program collaboration. There is a 49 percent cap for research and teaching activities. The sector, however, remains closed to the establishment of foreign university campuses and to education testing and training services. Recently, a foreign education provider bill has been introduced to permit the setting up of foreign university campuses, although there are numerous concerns about possible negative implications for domestic higher education providers and for equity and consumer protection. The main concern that has characterized the opening up of India's higher education services has centered around inadequate regulatory capacity and the need to balance measures aimed at attaining legitimate public policy objectives such as quality and equity with provision of sufficient regulatory autonomy for Indian and foreign higher education providers.

In the distribution services sector, unilateral liberalization has varied across segments (Mukherjee, 2006: 146–76). While non-retail segments such as wholesale trading, export trading, cash and carry, and franchising are permitted up to 100 percent (earlier, 51 percent) through the automatic route, the retail segment is only partially open. In 2006, the government allowed 51 percent FDI in single brand retailing subject to FIPB approval and subject to certain conditions.[3] There remains a restriction on multi-brand retailing although this restriction can be bypassed through other channels such as local sourcing, manufacturing, and franchising, and hence even this segment is not completely closed. The opening up of the retail sector, and specifically the multi-brand retail segment, has been subject to a lot of political and social debate, mainly about the impact

of entry by foreign players such as Walmart and Carrefour, as well as the entry of large organized domestic players such as Reliance in the unorganized retail businesses (the *kirana* stores) and associated employment. Recently, following the announcement of a proposal to open up selected products such as electronics, furniture, stationery, and sports goods to multi-brand retail, there has been a rethink in the government's position resulting in the initiation of a study to assess the desirability of and approach to further liberalization of retail services in India. Contrary to expectations, the 2007–08 budget did not propose liberalization of the multi-brand retail segment or further liberalization of the single brand retail segment. A recent tie-up between Walmart and an Indian company, Bharti, where the former would act as the back end in terms of logistics and sourcing support, and the latter would act as the front end, has aroused controversy over intent and legality. Thus, there are strong political and domestic stakeholder interests against further liberalization of retail services, notwithstanding recognized benefits due to increased sourcing and export opportunities, improved supply chain management, and standardization and efficiency spillovers.

Another service sector where there is strong domestic stakeholder sensitivity is accountancy services (Pal, 2006: 177–206). Major players such as the US and the EU have been pushing for the removal of all barriers to the establishment of foreign professional accountancy firms in India. However, the sector remains closed to FDI and foreign services providers are not allowed to undertake statutory audit of companies in India. The Institute of Chartered Accountants of India (ICAI) has resisted the opening up of the sector to foreign accountancy firms unless a level playing field is created for domestic firms, with amendments in domestic legislation permitting domestic firms to enter into limited liability partnerships, multi-disciplinary work and the removal of restrictions on the number of partners, and solicitation of business by Indian accountants. In addition, the organization has also petitioned the government to seek reciprocal arrangements for domestic accountants and Indian firms in other countries, thus linking FDI liberalization in the sector to greater market access and recognition of Indian accountancy professionals in other countries.

The real issue affecting India's autonomous liberalization of accountancy services is the need for reciprocity and domestic regulatory reforms. As with retail services, the FDI restrictions are being bypassed as foreign accountancy firms are already present in the country for providing services such as management consulting and also offering statutory audit services through surrogate firms.

In the legal services sector, there is domestic opposition to the opening up to foreign commercial presence as well as cross-border delivery of legal services (Rangan and Dasgupta, 2006: 207–48). The Bar Council of India has maintained that it is neither interested in accessing international markets nor in liberalization to foreign law firms. Its main concerns are similar to those expressed in the accountancy services sector regarding an uneven playing field, given the existing domestic regulations which prevent Indian firms from having more than 20 partners, multi-disciplinary practice, limited liability partnerships, and restrictions on advertising by Indian lawyers. The Bar Council has also raised the issue of recognition of Indian qualifications and reciprocal treatment of Indian legal professionals. There is considerable concern that the entry of foreign law firms will make it difficult for small Indian law firms to survive and the market segmentation and price effects of such entry.

Thus, the approach to autonomous liberalization is varied considerably across sectors. The determining factors have been domestic lobbies and stakeholder sensitivities against liberalization on the one hand, and efficiency, competitiveness, and technology considerations and the overall economic and structural reform program initiated in 1991 on the other.

## India's Multilateral Commitments under the GATS[4]

India has been among the main developing countries involved in the GATS negotiations. In the Uruguay Round, India made very limited commitments. It did not schedule many sectors such as energy, distribution, education, and environmental services, to name a few, and even when it did table important sectors such as financial and telecom services, key sub-sectors and activities such as insurance or international long distance telephony were not committed. Moreover, the

commitments typically bound less than the status quo creating a gap between existing market access conditions and the level committed under the WTO. For the most part, Mode 1 (cross-border delivery) and Mode 2 (consumption abroad) was also unbound, Mode 3 (commercial presence) was subject to an FDI ceiling of 49 percent or lower even where existing FDI regulations permitted a higher ceiling, and Mode 4 (movement of natural persons) was unbound except for a few categories of service providers (as also committed by other member countries). Thus, India's multilateral commitments in services reflected a conservative approach and no additional market access opportunities for trading partners.

In the ensuing Doha Round services negotiations, which were based on bilateral requests and offers, India received requests in almost all services sectors from all the major WTO member countries. These requests centered on the expansion of India's commitments to include more services sectors and activities within already scheduled sectors and to liberalize its commitments across all modes, especially in Mode 3. The sectors where India received the bulk of requests and the most extensive pressure for tabling new sub-sectors and activities, as well as deepening existing liberalization, commitments include financial, telecom, retail, legal, and accountancy services, among others. In most cases, major players such as the US and the EU requested binding in of the existing FDI regime in areas like financial and telecom services, further removal of all existing barriers to foreign commercial presence, and greater transparency in regulations.

In response to these requests, India submitted its initial offer in January 2004. This offer, however, did not substantially improve upon its earlier Uruguay Round commitment mainly because there was little progress in the commitments by other member countries in the modes and sectors of interest to India. However, in its August 2005 revised offer, India significantly improved upon its Uruguay Round commitment by tabling several new services sectors and sub-sectors and signaling that it was willing to remove commercial presence restrictions in key areas which it had autonomously liberalized since the Uruguay Round. Its revised offer covered 11 sectors and 94 sub-sectors as opposed to 7 sectors and 47 sub-sectors in its initial conditional offer. Some new areas included education, distribution, accountancy, and

environmental services. The change in stance reflected a change in India's negotiating approach, of offering to bind in its autonomous liberalization, especially in areas where it was a recipient of many requests, in the hope of receiving improved revised offers in Modes 1 and 4, where there had been little progress.

Again, the commitment strategy and how this relates to unilateral liberalization have varied across different services. In sectors such as telecom and financial services, where India has faced considerable pressure to open up, India's revised offer clearly indicates that it is willing to move its multilateral commitment closer to its autonomously liberalized regime and thus, is bound in its policy environment. For instance, the unilateral liberalization that has been undertaken in basic, cellular, and data and message transmission services since 1994 has been followed by progressive improvements in the offers placed in telecom services, either at the existing levels or at higher levels but still less than the status quo (such as 49 percent committed multilaterally for voice telephony and cellular mobile services compared to the existing policy regime of 74 percent FDI, while in data and message transmission services the multilateral offer is at the same level of 74 percent).

Similarly, in financial services, India has moved from unbound entries in life and non-life insurance services to allowing FDI participation of up to 26 percent, raising the ceiling on the number of foreign bank branches from 12 to 20, and relaxed restrictions on the form of foreign commercial presence permitted in the banking sector. Thus, there has again been an expansion in the scope of India's potential commitments in this sector and a furthering of its liberalization offer but as with telecom services, the multilateral position generally falls short of the existing policy environment (26 percent FDI in life insurance compared to 49 percent prevailing currently and 49 percent proposed in the revised offer for banking services compared to 74 percent permitted currently).

Thus, India has reduced the wedge that has existed between its autonomous and multilateral liberalization but has still retained some policy space for locking in the current policy regime if its own interests are addressed in the GATS negotiations or for reversing its autonomous liberalization in future. So, India has not fully acceded to the

requests it has received in such high demand sectors by holding back on full offers in Modes 1, 2, and 3. It has also not made substantive changes in its offers on national treatment relative to the UR commitments and thus has also not responded fully to the requests for increased transparency and fairness in application of regulations to foreign service providers, despite instituting significant unilaterally initiated regulatory reforms in some of these services.

Even in some other areas such as health services, which are not high demand sectors, India has improved upon its UR commitment. It has replaced its unbound UR entries with offers of full commitment in Modes 1 and 2, and has raised the FDI ceiling to 74 percent in Mode 3. This improvement reflects the unilateral liberalization undertaken in this sector since 2000, as noted earlier, and possibly, also a recognition of the potential gains to be realized from the entry of foreign players in this sector. However, India has also attached conditions pertaining to appropriate technology, consumer protection, quality and reliability of health care providers to its revised offer so as to retain policy space for addressing social concerns. Likewise, in construction and engineering services, India has moved from an unbound entry for Mode 3 to full liberalization, binding in the current policy regime in this sector and meeting the request received in this area.

India's negotiating strategy in sectors such as higher education and distribution services has undergone a huge change. From not scheduling these services in the UR and not tabling these services in its initial conditional offer, India has changed its stance by tabling these services in its revised offer, indicating a willingness to at least partially meet requests by key partners. In higher education services, India's revised offer proposes full opening up of Modes 1, 2, and 3, the last being subject to certain regulatory conditions on standards and fees. In distribution services, India's revised offer includes two segments, namely, commission agents' services and wholesale trade services and is in line with existing policies, with some regulatory approval related conditions. However, retail services have not been included in the revised offer, although as noted earlier, this segment has recently been opened up partially to single brand products. In both education and distribution services, the offering of these sectors appears to be part of a negotiating tactic to elicit improved offers in

India's own sectors and modes of interest from key players like the US by signaling a willingness to negotiate while maintaining some room to improve further in subsequent negotiations and to come closer to the requests placed by key trading partners.

Thus, certain services appear to be part of a quid pro quo negotiating strategy, where improvements in Mode 3 commitments in particular are traded off against improved offers by major players like the US and EU. But it is interesting to note that in both these services, the revised offer still does not include the more sensitive and controversial areas, where the implications of liberalization are still under debate, where there is no clear consensus on the right approach for liberalization and there are continued concerns about the lack of regulatory frameworks. Such exclusion has two possible explanations: *(a)* that the government wants to keep some negotiating space for future improvement in its revised offer, depending on the progress of the negotiations, and *(b)* that the government is not in a position to offer it yet given domestic sensitivities and political realities.

Finally, in highly sensitive sectors such as accountancy and legal services, the multilateral approach remains conservative. While accountancy services have been tabled in the revised offer, only the less contentious modes, Modes 1 and 2 have been offered, but the key mode, Mode 3, remains unbound, also reflecting the closed existing policy regime. Legal services remain un-tabled. Thus, where there is no domestic consensus and stiff opposition from key stakeholders, offers have not been made by India.

Following the launching of plurilateral negotiations in 2006, India received plurilateral requests in 14 sectors, including all major services and cross cutting issues, and involving all major developed countries. It is difficult to say at this time how India will respond to these requests given uncertainties about the progress of the Doha Round negotiations.

## India's Bilateral and Regional Initiatives in Services[5]

India has always been a proponent of multilateralism. However, it too has now entered into bilateral and regional negotiations: it is a late entrant on the bilateral and regional scene. Till date, India has signed

only one bilateral/regional agreement, which has a chapter on services, namely, the India-Singapore Comprehensive Economic Cooperation Agreement (CECA) that came into force in August 2005. India is also engaged in/likely to enter into negotiations with several other countries and regions, which will incorporate services chapters. It is also in the process of including services chapters in already negotiated agreements, such as with Sri Lanka, Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC), and Thailand. There is a clear recognition of the market access opportunities that such agreements, with select trading partners, can yield for India while enhancing India's attractiveness as a destination for FDI and for technology transfer in key services sectors.

The CECA has architecture similar to that of the GATS. It has a positive list approach. It has general obligations pertaining to recognition, domestic regulation, and transparency, as well as sector specific obligations with regard to market access and national treatment commitments with similar aims and objectives as those of the GATS. The CECA illustrates well the interests India has in the services sector. The coverage of the services chapter is wide. There is a chapter on movement of natural persons, covering disciplines for movement of skilled labor and mutual recognition for 126 professions. The air transport services chapter aims at liberalizing air transport between the two countries and to re-negotiate an earlier bilateral agreement in this sector. There is also an e-commerce chapter providing national treatment for trade in digital products. The two countries have also signed a Double Taxation Avoidance Agreement (DTAA) and there is also a chapter on investment, both of which are expected to benefit services trade and investment flows between the two countries.

Liberalization commitments under the CECA have gone beyond those under the GATS. Both India and Singapore have bound their autonomous levels of liberalization in most service sectors under the CECA while their commitments fall short of the existing regime under the GATS. For instance, in the medical and dental services sector, and in hospital services, India has completely opened up Mode 3, which is its autonomous liberalization level in this sector, but under the GATS, it has made a revised offer of 74 percent, which is less than

the status quo. There are other areas such as technical testing, biotechnology testing, and advertising services, which are not listed in India's GATS schedules but have been liberalized under the CECA. However, there remain sectors such as legal services where the approach remains protectionist, both under the CECA and under the GATS, and others such as computer and related services where given India's highly competitive position in this sector, there is full commitment to full opening under Modes 1, 2, and 3 under both the GATS and the CECA. Thus, while there has generally been a greater willingness to schedule sectors and to commit more within the scheduled sectors under the CECA relative to the GATS, factors such as the degree of competitiveness and stakeholder sensitivities, have again, influence the extent of liberalization under the CECA.

There are specific parts of the agreement, which could help enhance Mode 3 flows from Singapore into India. There are several investment protection clauses in the CECA for investors from both countries. For instance, India has added new areas in its investment schedule, including housing, construction, and infrastructure, areas where it needs FDI, skills, technology, and management expertise. The DTAA provides incentives for registering investments through Singapore, such as by giving capital gains tax exemptions for Singapore tax residents, lowering the withholding tax on royalties and fees for technical services, and reducing the withholding tax on interest for loans by financial institutions based in Singapore as well as for Singapore residents. To the extent that India also has outward Mode 3 interests in selected services, it has benefited as Singapore has made a negative list schedule for investment by listing horizontal and sectoral reservations, and has overall bound its liberal FDI regime with very few restrictions. Disciplines concerning transparency, domestic regulation, and provisions similar to those under the GATS further enforce the value of these investment-related provisions for both parties. Overall, it is expected that the CECA will result in more routing of investments via Singapore (as opposed to Mauritius currently), more Indian companies setting up foreign holding companies in Singapore, and the possible use of Singaporean market as a means to access third countries with which Singapore has Free Trade Agreements (FTAs). There is

also a financial sector carve-out in the CECA. Both countries have accorded national treatment to three banks from the other country. Several financial services such as asset management and mutual funds have been given more liberal treatment for Singaporean investments compared to investments from other countries. Also, the extent of investment permitted to Temasek and Singapore Government Investment Corporation in India exceeds that allowed for other foreign institutional investors.

India has also achieved more under the CECA than under the GATS with regard to its Mode 4 interests. The agreement provides a framework for Mutual Recognition Agreements (MRAs) and discussions are underway for mutual recognition agreements in select professional services such as for doctors, architects, accountants, dentists, and nurses. In other regulated sectors, the CECA calls for discussions among professional bodies in both countries for MRAs if there are written requests. Entry has also been liberalized for skilled service providers, including business visitors, 127 selected professional service provider categories, intra-corporate transferees, and short-term service suppliers. Preferential treatment has also been accorded to selected skilled service providers, including entry and stay for up to one year for the selected occupations, removal of the economic needs test and labor market tests requirements, exemption from social security contributions, and faster handling and greater transparency in the visa application process.

Thus, clearly, in both Modes 3 and 4, India has gained more under CECA than in the GATS. In Mode 3, the CECA has given India an opportunity to make GATS plus commitments to address its investment interests in key services, which in turn can provide it with a benchmark for other Regional Trade Agreements (RTAs) and for improving upon its GATS commitments. In Mode 4, India has been able to achieve progress in critical areas like mutual recognition, necessity tests, and social security taxes, areas where there has been little or no movement under the GATS. The CECA has liberalized movement of skilled service providers along the lines of the GATS' service provider visa proposal, and can again serve as a benchmark for India's negotiations in other RTAs.

## India's Competitiveness in Key Areas and Modes in Services

As shown earlier, there has been a considerable shift in the composition of India's services exports toward software and other business services. This shift reflects India's comparative advantage in labor-based services, both skill and knowledge-intensive services such as IT and health care, but also semi and low skilled labor-intensive services such as construction work and transport operators. Increased tradability of many services with the aid of information and communication technologies is enhancing India's competitiveness in skilled labor-based services. Thus, India's main areas of interest in services are in Mode 4 and Mode 1 and in sectors where it has the potential to supply services through both these modes.

### Significance of Mode 4[6]

India's strength in Mode 4-based exports is well recognized. Mode 4 has been an important driver of India's software services exports in the past decade. Exports of IT–ITES have grown from USD 4 billion in 2000 to around USD 24 billion in 2006, within which software services exports, have risen from a mere USD 754 million in 1995–96 to USD 8.6 billion in 2003–04 and USD 24 billion in 2006. Until recently, around 50 percent of software services exports were through on-site delivery. Although there has been a shift toward off-shore provision of software services in recent years, Mode 4 still remains important, accounting for around 40 percent of India's software services exports (NASSCOM, various years). India's global competitiveness in Mode 4-based software services exports is evident from the fact that Indian professionals accounted for 70 percent of all specialty occupation (H1B) visas granted by the US in computer services in the late 1990s (USINS statistics, 2002; Commander et al., 2002). The rise in India's exports of skilled IT professionals resulted in the IT boom in the US during the late 1990s. India benefited from the American Competitiveness and Workforce Improvement Act passed by the United States in 1999, which increased the H1B quota from

65,000 to 115,000 in 1999 and further to 195,000 in 2000, to meet the growing demand in the US market for IT workers.

In addition to software services, India has also been very competitive in exports of a wide variety of other professional and business services, including health, engineering, accountancy, and management services, through movement of natural persons. Indian professionals across services as diverse as accountancy, engineering, consulting, medical, and management accounted for nearly half of all H1B visas granted to foreigners in the US in 1999, out of a total of 116,695 such visas granted that year. This was far more than the share of the second leading developing country recipient, China, with merely 5 percent of all such visas (USINS statistics, 2002).

**Table 2.6**
**H1B Beneficiaries in the Top 10 Industries, United States, Fiscal Year 2002**

| *Industry (NAICS Code)* | *Total Number of Beneficiaries* | *Leading Country of Birth (%)* |
|---|---|---|
| All industries | 197,537 | India (34) |
| Computer systems design and related services (5,415) | 50,776 | India (68) |
| Colleges, universities, and professional schools (6,113) | 18,401 | PRC (26) |
| Architectural, engineering, and related services (5,413) | 8,963 | India (21) |
| Management, scientific, and technical consulting services (5,416) | 7,458 | India (39) |
| Scientific research and development services (5,417) | 6,695 | PRC (24) |
| Telecommunications (5,133) | 4,357 | India (38) |
| Elementary and secondary schools (6,111) | 3,983 | India (18) |
| Accounting, tax preparation, bookkeeping, and payroll services (5,412) | 3,507 | India (16) |
| General medical and surgical hospitals (6,221) | 3,442 | India (24) |
| Securities and commodity contracts intermediation, and brokerage (5,231) | 2,917 | India (21) |

*Source:* USINS, 2002.

*Notes:* 1. Industry data is collected using the North American Industry Classification System (NAICS).
2. Total number of beneficiaries is the sum of initial and continuing beneficiaries.

Tables 2.6 to 2.8 clearly highlight India's dominant position in Mode 4-based service exports in software as well as other professional services. Table 2.6 illustrates India's significance as a leading supplier of manpower in many professional and technical services to the US market, particularly in computer-related services. Table 2.7 illustrates India's presence among the top five source countries for skilled manpower to the US and its leading position in services like software, architecture, engineering, health, and other miscellaneous services. Table 2.8 highlights India's share in total temporary immigration as well as temporary immigration from the Asian countries to the US. It confirms India's significance not only in computer-related services but also in other occupational categories such as scientists, engineers, teachers, health practitioners, and managers.

**Table 2.7**
**H1B Beneficiaries in the Top Five H1B Receiving Countries, 2002**

| *Category* | *India* | *China* | *Canada* | *Philippines* | *United Kingdom* |
|---|---|---|---|---|---|
| Computer related | 47,477 | 5,357 | 2,770 | 1,561 | 1,250 |
| Fashion models | 5 | 4 | 92 | 1 | 50 |
| Managers and officials | 1,212 | 388 | 1,204 | 315 | 908 |
| Miscellaneous, professional, technical, and managerial | 690 | 349 | 379 | 115 | 283 |
| Administrative specialization | 2,689 | 1,660 | 1,342 | 2,186 | 795 |
| Architecture, engineering, and surveying | 5,780 | 2,633 | 1,629 | 993 | 1,235 |
| Art | 113 | 76 | 133 | 65 | 245 |
| Education | 1,908 | 3,593 | 1,507 | 957 | 893 |
| Entertainment and recreation | 69 | 28 | 77 | 9 | 89 |
| Law and jurisprudence | 72 | 93 | 165 | 34 | 99 |
| Life sciences | 727 | 1,965 | 415 | 63 | 360 |
| Mathematics and physical sciences | 693 | 1,401 | 446 | 76 | 272 |
| Medical and health | 2,530 | 674 | 949 | 2,524 | 297 |
| Museum, library, and archival sciences | 11 | 30 | 56 | 5 | 31 |
| Religion and theology | 7 | 2 | 14 | 6 | 7 |
| Social sciences | 738 | 413 | 365 | 257 | 206 |
| Writing | 77 | 91 | 133 | 44 | 83 |
| Unknown | 182 | 84 | 84 | 84 | 68 |
| Total | 64,980 | 18,841 | 11,760 | 9,295 | 7,171 |

*Source:* USINS, 2002.

**Table 2.8**
**India's Share in H1B Visas, Asia and World, 2000–02**

| Category | 2000 | | 2001 | | 2002 | |
|---|---|---|---|---|---|---|
| | *India's Share in Asia (%)* | *India's Share in World (%)* | *India's Share in Asia (%)* | *India's Share in World (%)* | *India's Share in Asia (%)* | *India's Share in World (%)* |
| Computer-related | 79.62 | 68.18 | 81.53 | 71.39 | 76.43 | 63.21 |
| Fashion models | 10.53 | 0.33 | 2.00 | 0.11 | 11.63 | 0.67 |
| Managers and officials | 32.45 | 12.28 | 37.16 | 13.92 | 31.79 | 11.42 |
| Miscellaneous, professional, technical, and managerial | 27.62 | 11.49 | 33.63 | 15.98 | 30.82 | 13.97 |
| Administrative specialization | 23.69 | 13.88 | 28.98 | 17.14 | 22.26 | 12.74 |
| Architecture, engineering, and surveying | 39.47 | 26.01 | 42.36 | 27.87 | 38.10 | 22.94 |
| Art | 6.09 | 3.36 | 8.81 | 4.64 | 7.62 | 3.90 |
| Education | 17.26 | 8.36 | 19.99 | 9.45 | 18.64 | 9.26 |
| Entertainment and recreation | 38.42 | 17.37 | 19.26 | 6.74 | 23.08 | 8.89 |
| Law and jurisprudence | 12.90 | 4.77 | 15.31 | 5.02 | 14.40 | 5.01 |
| Life sciences | 19.76 | 11.06 | 19.03 | 10.52 | 18.85 | 10.52 |
| Mathematics and physical sciences | 18.40 | 10.03 | 21.95 | 12.21 | 22.33 | 12.73 |
| Medical and health | 27.86 | 18.00 | 31.86 | 20.34 | 30.50 | 19.58 |
| Museum, library, and archival sciences | 18.99 | 8.06 | 14.18 | 5.65 | 9.48 | 3.49 |
| Religion and theology | 10.34 | 4.41 | 14.71 | 6.02 | 15.56 | 5.93 |
| Social sciences | 29.64 | 16.37 | 26.01 | 13.46 | 25.47 | 13.30 |
| Writing | 12.12 | 6.18 | 15.38 | 7.73 | 10.24 | 5.23 |
| Unknown | 38.93 | 18.88 | 50.00 | 23.66 | 31.71 | 13.22 |
| Total | 61.64 | 44.42 | 65.82 | 48.78 | 50.91 | 32.89 |

***Source:*** USINS, various years.

India has been an important supplier of skilled manpower in IT, health, and engineering to markets other than the US. It ranked second among source countries for foreign skilled workers for Canada, with a share of 10–12 percent overall as well as skilled inflows into Canada for the years 2000, 2001, and 2002.[7] In recent years, Germany, Austria, Singapore, and Japan have introduced special work permit and visa schemes to attract Indian IT professionals and meet shortages of such workers in those markets. Likewise, India has the largest stock of overseas doctors among all countries and exports nurses to several developed countries like the UK and Australia.

India is also an important source country for low and semi-skilled service providers, mainly to the Middle East and increasingly to South East Asia. There is an estimated stock of 700,000 contract service workers in Saudi Arabia, 500,000 in the United Arab Emirates (UAE), and close to 300,000 in Oman, mainly engaged in low and semi-skilled occupations and trades. About one in three of Indian migrants to the Middle East are engaged in construction work. According to the International Labor Organization (ILO) sources, there were an estimated 425,000 construction workers of Indian origin working in the Gulf in 1996 (D'Sami, 2001). In addition, Indian workers in the Middle East are also engaged in other low and semi-skilled occupations, as production workers, transport equipment operators, domestic help, nurse's aids, craftsmen, and technicians, although there is also some movement of professionals such as engineers and accountants. It is estimated that in the year 2000, out of a stock of 285,000 Indian workers in Kuwait, around 100,000 were engaged as domestic help (Wickramasekara, 2002).

## Significance of Mode 1[8]

The second mode, where India has comparative advantage, is cross-border supply or Mode 1, which refers to the physical movement of the service as embodied in data, information, and voice flows across borders. The most striking example of India's service exports through cross-border supply has in BPO where information and communication technology have enabled cross-border trade in labor-intensive

activities as wide ranging as medical and legal transcription, customer support, human resource management and administration, financial and accounting processes, technical support, logistics, sales, and research and development, to name a few. India's BPO exports have risen from a mere USD 665 million in 1999–2000 to USD 3.6 billion in 2002–03, and further, to over USD 6 billion by 2006. They are projected to grow to USD 12 billion by 2008. Off-shore projects have grown by nearly 67 percent compared to a growth rate of 7.8 percent for on-site projects in 2002–03 and the contribution of off-shore projects has increased to 57 percent from less than 50 percent a few years ago. It is projected that the Indian BPO industry will continue to grow at the rate of 50 percent per year in India over the next four to five years, raising India's share of the global BPO business from 2 percent at present to 4.8 percent by 2008 (NASSCOM, various years).

India is by far the leading outsourcing destination today, in terms of the volume and range of services delivered, as well as its firm level capabilities. According to the *Financial Times*, half of the world's 500 largest companies and many government agencies contract out IT and business process work to India. About 60 percent of the Fortune 500 companies are already outsourcing work to India (A.T. Kearney, 2004: 2, Figure 1). A 2004 A.T. Kearney report ranks India as the most attractive destination for off-shore outsourcing, mainly on account of its labor cost advantage, which overrides other factors such as business environment.

## India's Market Access Interests and Negotiating Strategies

India's thrust areas for negotiation under the GATS reflect its modal and sectoral competitiveness. India made seven submissions on services between 1997 and 2001 and between 2002 and 2005, following the Doha Ministerial, it made 18 submissions on services. Its communication proposals and submissions have mainly focused on Mode 1 and Mode 4. India has initiated the friends group of Mode 1 and Mode 4 and has played a critical role in the developing country proposals seeking greater market access in these two modes.

Between 2002 and 2003, India had submitted initial requests for sector specific commitments to 62 member countries, including all the major developed countries, in various services sectors. Its requests are centered on the removal of sectoral and cross-sectoral restrictions in Modes 1 and 4.

In Mode 4, India has sought improvements in the horizontal commitments on Mode 4, by de-linking it from requirements of commercial presence; expanding the coverage of service provider categories to include Independent Professionals (IP) and Contractual Service Suppliers (CSS) to address categories of export interest to developing countries; instituting alternate administrative mechanisms such as a GATS or Service Provider Visa to facilitate Mode 4; reducing discretionary scope in the application of various measures affecting Mode 4 and improving transparency in these commitments; and introducing multilateral norms on recognition, among other demands. In the Mode 1 negotiations, India's interest has been to pre-empt potential protectionist legislation on outsourcing and to ensure predictable market environment. The proposal has been to expand the coverage of Mode 1 commitments and to bind in the existing fully open regimes for cross-border supply, barring a small negative list of services such as financial services where there are concerns about possible adverse implications of full liberalization. In the plurilateral negotiations, which commenced in 2006 after the Hong Kong Ministerial, India was a primary sponsor of the plurilateral requests in Modes 1 and 2, Mode 4, and architecture and integrated engineering services, and a co-sponsor of the plurilateral request in computer and related services. In Mode 1, the plurilateral request reflects a modified stand by India as it provides an extensive list of service sectors where cross-border supply is important and where unrestricted access is being sought rather than asking for an across-the-board full commitment in Mode 1.

An examination of the initial and revised offers made in these two modes of interest to India reveals that there has been little progress under the GATS. The sectoral offers in Mode 4 continue to be unbound except as indicated in the horizontal offer and there is no change in the case of a major trading partner like the US. In the case of the EU,

there is only a slight improvement in that the categories of contractual service suppliers and independent professionals have been included for certain services and there is limited relaxation of restrictions like economic needs tests. But conditions such as requirement of commercial presence for access through Mode 4, or lack of uniformity in definitions of categories, lack of clarity on the criteria for applying certain measures, continue in the initial and revised offers of key players. Although India has submitted a plurilateral request along with eleven other developing countries in this mode, which seeks new and improved commitments on CSS and IP categories and transparency in Mode 4 commitments, it is unlikely that this request will be met, as the US has already indicated.

There is some improvement in the Mode 1 initial and revised offers with more countries offering full commitments in this mode and extending the coverage of their Mode 1 offers to a wider range of professional and business services. But these offers still fall short of the requests made by India and other developing countries in this mode for making full binding commitments with only a small negative list. There is also no change in the scope of Mode 1 commitments by the US and virtually no change in the nature of Mode 1 commitments made by the European Community (EC). Hence, India has not succeeded in securing predictable and significantly enhanced market access in developed country markets under Mode 1.

It is worth noting that despite the limited progress under the GATS, India's significance as an exporter has continued to grow in both Modes 1 and 4. Business dynamics, technology, and demographic imperatives have driven services trade in both these modes. The GATS has also not been able to prevent a rise in protectionist legislation against outsourcing since 2003. Many domestic regulatory barriers are emerging in Mode 1 trade in the form of data protection, liability, and consumer protection related regulations, which are likely to become increasingly important in the near future. Thus, the GATS has played little or no role in determining market access opportunities in services trade. It has neither provided new market opportunities nor prevented the emergence of protectionist legislation in key markets.

## Possibilities for Liberalization and Cooperation in South Asia

There has been little analysis of the potential for services trade and investment among the South Asian economies. The South Asian Free Trade Area (SAFTA) agreement does not cover services or include an investment chapter. Given the significant contribution of services within all South Asian economies and also commonalities in sectoral and modal interests, there could be considerable scope for collaboration, increased bilateral and regional flows, and greater coordination in negotiating strategies for the multilateral services discussions.

There are five broad clusters of services where there is potential for greater bilateral and regional cooperation and economic relations. One or more modes are relevant in most of these clusters of services.

An area where there is considerable scope is IT and IT-enabled services. Many Indian IT companies have become global in their operations and have set up overseas subsidiaries. Given rising wages in India and the available skilled and English-speaking manpower and similar time zone advantage in other South Asian economies, there is scope for Indian IT companies to establish regional subsidiaries to diversify their risk and resource base for undertaking off-shoring operations. Such regional diversification is already being done by a few multinationals, which are retaining India as the main hub for off-shoring but using other cities such as Colombo for backup and disaster recovery. Thus, further liberalization by the other South Asian countries in cross-border supply and in supporting telecom services and investment regimes could expand trade through Modes 1 and 3 in IT and ITES in the region, with possible boost to intra-regional movement of software professionals (Mode 4) as well.

Another cluster of services where trade and investment ties could expand is in the social services, in particular, health and education services. At present, India exports education and health services through Mode 2 to the other countries in South Asia. In health services, Indian companies like Apollo have set up subsidiaries in other South Asian countries. Patients from Bangladesh come to hospitals in Kolkata for

treatment in specialized areas. Indian hospitals also provide tele-diagnostic, tele-radiology, and tele-pathology services to hospitals in Nepal and Bangladesh. Students from Nepal and Bangladesh come to some Indian higher education institutions for professional courses. The trade balance is in favor of India in such sectors. As with IT and ITES, liberalization of the investment regimes in these service sectors would enhance overseas regional investments by Indian health and education providers. Cooperation with regard to regulatory frameworks, visa arrangements, financial arrangements, and recognition issues could enhance trade and investment flows through all four modes in these services within the region.

The third area where economies in the region could cooperate is tourism, recreational, and sporting services. Given commonalities in cultural and historical heritage, the diversity as well as commonality in landscape and topography especially among neighboring regions, and common sports and recreational interests (such as cricket and hockey), there are possibilities for jointly developing tourism infrastructure and tourism packages, which are specifically targeted to different groups and interests (for example, pilgrimage, wildlife, mountain, spas and resorts, ecotourism, etc.). Tour operators could provide cross-country tourism packages. Such initiatives would require greater coordination on visas, cross-border payments, and standards, related transport links in terms of improved air, land, and water connectivity which would also need to be strengthened to support such initiatives. Hence, liberalization initiatives in air transport and other transport services and investments in border infrastructure would also be required (though there would be many security dimensions that could deter such investments). In addition, joint marketing and some form of tourism branding for sub-regions within South Asia would be required.

There are also several infrastructure services where the South Asian economies have complementary interests. For example, there is scope for increased energy services trade between India and countries like Nepal and Bangladesh (for hydropower and natural gas respectively). Barring various political sensitivities in harnessing such possibilities, a coordinated regional/bilateral approach would enable large Indian companies which are seeking energy resources in various parts of

the world today, to invest in some of these South Asian economies to explore energy sources or to create and upgrade energy transport and distribution infrastructure, thus benefiting both India and these economies. The same holds true for transport infrastructure and investments in ports and land transport systems, where there is scope for joint ventures between Indian and other companies in the region. Thus, liberalization commitments on Mode 3 for infrastructure services could be mutually beneficial for countries in the region.

A final but perhaps most important and sensitive area for improving bilateral and regional service sector ties is Mode 4. All countries in this region have an interest in exporting of manpower at all skill levels. Their destination markets are also common, namely, the Middle East, the Gulf countries, and the English speaking developed countries. The sectors are also similar, namely, health, engineering, education, and other professional services among the skilled services and construction work, domestics, transport operators, and artisans among the low and semi-skilled services. Given such commonality of interest, all the South Asian countries need to have a common approach to the Mode 4 negotiations, for market access as well as domestic regulatory issues such as mutual recognition, taxes, and worker security and welfare. Moreover, there is a need to arrive at some managed migration strategy for labor flows within the region, much of which are unrecorded and illegal today. There is certainly scope to incorporate under SAFTA, a mechanism that promotes temporary flow of skilled services providers among the countries in this region, which would also facilitate intra-regional business and investment flows in both services and manufacturing. This visa regime could be in line with the proposals endorsed by some of these countries under the Service Provider Visa scheme in the GATS. A regional visa for skilled service providers, along the lines of the Asia-Pacific Economic Cooperation (APEC) business visitor visa or other regional arrangements covering labor, could be explored. For low and semi-skilled service providers, a managed migration strategy would involve more political sensitivities. But greater regulatory cooperation among the countries in terms of screening, monitoring of these flows, and ensuring return would be an important step. The bilateral and regional labor agreements between developed and developing countries and also between developing

countries for low and semi-skilled movement could be examined and the best practices adopted from those agreements as part of an overall labor framework under SAFTA.

Hence, both the labor and investment chapters need to be introduced under SAFTA. The South Asian countries need to remove administrative and regulatory constraints on investment flows among themselves, exchange information on investment possibilities, and where there are complementary interests, extend investment preferences to each other and fragment the services value chain across the countries in the region.

Given common sectors and modes of export interest, the South Asian countries could cooperate more closely in the context of the GATS' plurilateral negotiations to strengthen their bargaining position and the development of the various GATS disciplines such as on subsidies and emergency safeguard measures. There is also scope for the South Asian countries to collaborate in developing service sector trade and output statistics, in building regulatory capacity, and for cross-country learning with regard to autonomous liberalization and regulatory strengthening processes. There remain issues of political feasibility and uncertainties about relations between some of the countries in the region, which could affect the realization of such synergies, and complementarities. There may also be a case for looking beyond South Asia toward countries in South East Asia and Central and West Asia to reap the full benefits of services trade and investment liberalization.

## Institutional and Regulatory Capacity

Services sector liberalization in India as well as the negotiating stance adopted across different services by India in multilateral as well as regional negotiations has been driven by stakeholders, as highlighted earlier. Regulatory and institutional capacity have played important roles. For example, the complete opening up of the software services sector reflects its highly competitive nature and its strong offensive interests. It also reflects the presence of a strong industry association such as National Association of Software and Services Companies (NASSCOM) which has served as a discussion forum for IT companies

and has helped the Indian IT industry to arrive at a common stand on Market Access and National Treatment issues in services negotiations as well as a set of issues that need to be addressed domestically to enhance the sector's competitiveness. In the legal and accountancy services, regulatory capacity has been present and it is the protectionist mindset of the concerned regulatory bodies that is responsible for the slow progress in liberalizing these sectors.

In either case, the presence of an active industry association or a regulatory body with well-entrenched interests has either spurred or deterred liberalization. On the other hand, there are sectors such as retail services, where the lack of institutional capacity including the absence of a nodal ministry or a nodal regulatory body, has created a lot of confusion and politicization of the debate regarding the liberalization process, as there are divergent views across different interest groups. Hence, it has proved difficult to forge a consensus on the approach to liberalization and on the desired degree and sequencing of liberalization.

The Indian government has consulted with concerned interest groups, regulatory bodies, consumer associations, and academics/researchers in deciding on its approach to liberalization in different services sectors. It has also initiated sectoral studies to take stock of the existing policy environment, the strengths and weaknesses, the barriers faced in overseas markets and the domestic constraints faced by the Indian services providers across different services sectors so as to frame its negotiating position as well as its domestic reform strategy in services. This consultative process has also been facilitated by various bilateral and multilateral agencies, industry associations and chambers of commerce, and several trusts and research foundations, which have provided funding support, helped in information collection, analysis, and dissemination, and platforms for discussion and advocacy, thus helping in formulating domestic policies and India's negotiating stance in the services sector.

This consensus-based approach has helped build domestic research capacity and an information base on various services sectors, which never existed before. It has enabled much greater industry-academic and government exchange of information and views and heightened awareness about the likely benefits as well as potential negative effects

of opening up the services sector. Thus, services negotiations have provided a means to strengthen institutional and regulatory capacity in services and develop a better understanding of the Indian services sector, its needs and interests, and also its linkages with the rest of the economy.

## Conclusion

It is undisputed that the services sector has played, and will continue to play, a very important role in India's growth and reform process and in its integration with world markets through all forms of delivery, including investment flows, human resource flows, data and information flows, and through the commoditization of services embodied in goods. While the policy framework and approach have varied across different services sub-sectors, the general direction is toward greater opening up of all kinds of services. Notwithstanding stakeholder sensitivities and political debates surrounding particular services such as retail, insurance, and legal services, it is widely felt that even in these areas where there is stiff resistance, eventual opening up and gradual consolidation, albeit more gradually, is inevitable with the emergence of organized players and demonstrated positive effects in terms of employment creation, productivity improvements, and higher standards and quality of services delivery.

At the multilateral level, India has pushed its agenda strongly in the GATS negotiations, but with little effect, which has in part contributed to its recent shift in focus toward comprehensive regional and bilateral agreements encompassing services and investment issues. It is perceived that India could achieve a win-win situation from regional and bilateral frameworks covering services, as it can attain progress on difficult issues such as movement of natural persons, recognition, and labor market tests, while also facilitating investment flows into India in important services to further its own growth and efficiency objectives. In this regard, the trade and investment potential in services remains largely untapped within the South Asian region. There are several clusters of services where the South Asian countries have similarities as well as complementarities which could serve as a basis for strengthening economic, cultural, and political relations. While some of these areas

for regional cooperation in services are sensitive, some thought could be given to devising frameworks for discussing such issues. To start with, there is a need to bring in investment and services as explicit areas for bilateral and regional discussions in the South Asian region. The spin-off benefits in terms of regulatory and institutional capacity building can also be significant for all countries.

## Notes

1. Information on FDI for the various services discussed in this section is based on government policy documents.
2. In addition to government policy documents, some of the discussion on financial services is also based on Chanda (2005a).
3. In addition to government policy documents, some of the discussion on financial services is also based on Chanda (2005a).
4. The discussion on multilateral commitments is largely based on an analysis of India's Uruguay Round schedules of commitments and its initial conditional and revised offers under the Doha Round services negotiations.
5. Much of the discussion in this section is based on Kulkarni and Choudhary (2006: 359–403).
6. This section is largely based on Chanda (2005b: 21–74).
7. http://www.cic.gc.ca/english/pub/facts2002/immigration/immigration_5.html
8. The discussion in this section is based on Chanda (2005b).

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# 3

# Pakistan

Fasih Uddin

## Introduction

The liberalization of services in Pakistan began in the early 1990s as a part of the policy package covering deregulation, privatization, liberalization, and structural reforms. The liberalization of services has been basically autonomous, notwithstanding commitments made under the GATS during 1994–98. Practically, all sub-sectors of services are being deregulated and liberalized. This liberalization policy also forms a part of arrangements and programs agreed with the International Financial Institutions (IFIs).[1] This chapter focuses on liberalization of services in Pakistan and opportunities and challenges for trade and development. It also discusses the potential areas of cooperation in South Asia.

## Overview of Services in Pakistan

### Services: Growth and Output

The services sector has emerged as the lead component of Pakistan's economy. Its share in the GDP has risen from 47 percent in 1981 to over 52 percent in 2006.[2] In the past five years (2001–06) it has grown

at a faster pace than the commodity producing sectors of agriculture and manufacturing as seen in Table 3.1. It has accounted for over 43 percent of the employed labor force and has emerged as a promising area of investment in recent years. Services have strong backward and forward linkages with commodity producing sectors as well.

**Table 3.1**
**Growth in the GDP, Services, and Commodity Producing Sectors (%)**

| *Fiscal Year (July–June)* | *GDP* | *Services* | *Commodity Producing* | *Services Share in the GDP (%)* |
|---|---|---|---|---|
| 2001 | 2.0 | 3.1 | 0.8 | 51.3 |
| 2002 | 3.1 | 4.8 | 1.4 | 52.1 |
| 2003 | 4.7 | 5.2 | 4.3 | 52.3 |
| 2004 | 7.5 | 5.9 | 9.2 | 51.6 |
| 2005 | 8.6 | 8.0 | 9.2 | 51.3 |
| 2006 | 6.6 | 8.8 | 4.3 | 52.3 |
| 2001–06 (average) | 5.4 | 6.0 | 4.9 | 51.8 |

***Source:*** Ministry of Finance, Government of Pakistan, 2006.

The services sector is dominated by wholesale and retail trade which in 2006 accounted for 36 percent of services value-addition, followed by transport and communications 21 percent, public administration 13 percent, ownership and dwelling 6 percent, banking and finance 6 percent, household services 5 percent, and education 4 percent (Ministry of Finance, Government of Pakistan, 2006). The balance is shared by other services like hotels and restaurants, health care, real estate, and social and cultural services. The growth rates in major services during 2001–06 are shown in Table 3.2.

A notable feature of recent years is the substantial rise in investment in services—from 37 percent of the total real investment in 2003 to 53 percent in 2006. This increase is mainly shared by transport and communications, banking, insurance, and wholesale and retail trade (State Bank of Pakistan, 2006).

The services sector is expected to maintain the high growth path in future as well. The Medium Term Development Framework, 2005–10 (Planning Commission, 2005), prepared by the Planning

**Table 3.2**
**Growth Rate in Services (%)**

| *Sector* | *2001* | *2002* | *2003* | *2004* | *2005* | *2006* |
|---|---|---|---|---|---|---|
| Transport, storage, communications | 5.3 | 1.2 | 4.3 | 3.5 | 3.6 | 7.2 |
| Wholesale and retail trade | 4.5 | 2.8 | 5.9 | 8.4 | 11.1 | 9.9 |
| Finance and insurance | –15.1 | 17.2 | –1.3 | 9.0 | 29.7 | 23.0 |
| Ownership and dwelling | 3.8 | 3.5 | 3.3 | 3.5 | 3.5 | 3.5 |
| Public administration | 2.2 | 6.9 | 7.7 | 3.2 | 0.6 | 4.7 |
| Others | 5.6 | 7.9 | 6.1 | 5.6 | 5.9 | 6.5 |
| Services (total) | 3.1 | 4.8 | 5.2 | 5.9 | 8.0 | 8.8 |

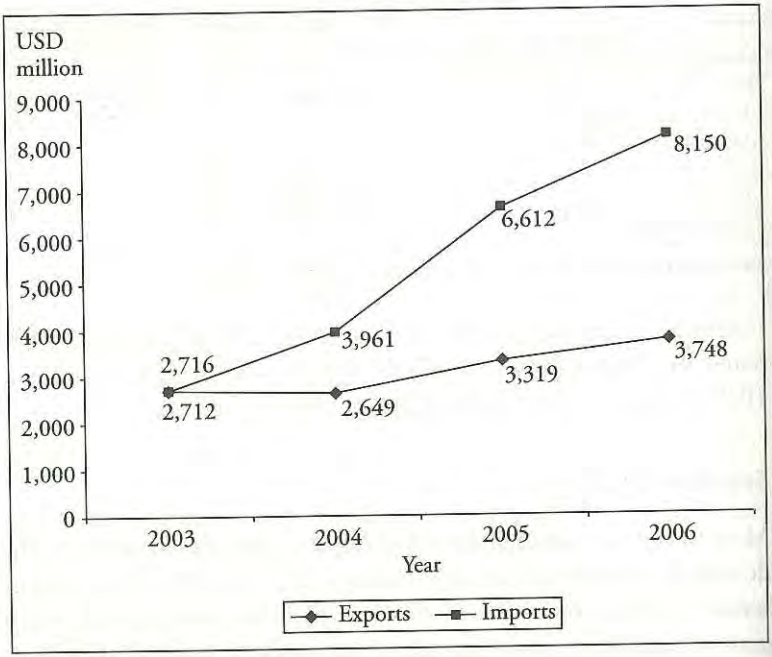
***Source:*** Ministry of Finance, Government of Pakistan, 2006.

Commission, projects 7.3 percent annual growth in services as compared to 7.0 percent in the GDP, 5.2 percent in agriculture, and 10.2 percent in manufacturing during 2005–10.

## Services Trade

Most of the services included in national output are oriented to the domestic activities and are non-tradable internationally. The level of services trade is low and is on the rise in the recent years. The total commercial services trade (that is, credits and debits) of USD 12 billion in 2006 was equal to 27 percent of merchandise trade of USD 45 billion. Exports (credits) of commercial services have increased from USD 2,712 million in 2003 to USD 3,748 million in 2006, while imports (debits) have jumped from USD 2,716 million to USD 8,150 million in the same period. The faster growth of imports has led to a widening of the services trade deficit—from USD 4 million to USD 4,402 million during the said period. The phenomenal increase in imports is attributed to "other business services" (particularly payments by newly established foreign exchange companies). Transportation and other business services have accounted for 69 percent of imports of commercial services in 2006, while transportation and "Government Service N.I.E" (mainly receipts of foreign missions and agencies in Pakistan) have accounted for 73 percent of total services exports in that year.[3] The details of commercial trade during 2003–06 are given in Annex 3.1 and the overall position is reflected in Figure 3.1.

**Figure 3.1**
**Pakistan—Trade in Commercial Services**




*Source:* State Bank of Pakistan, 2006.

The share of various sub-sectors in exports of commercial services during 2003–06 is shown in Table 3.3. It may be noted that the major share of exports (that is, between 40 and 44 percent) is contributed by government services not indicated elsewhere (including remittances received by foreign missions and international agencies). Technically, these receipts should not be considered as commercial exports. If items of non-commercial nature are excluded, the proportion of services to mercantile exports will drop from 22.7 percent to 14.5 percent. The other main items of export earnings are transportation, communications, other business services, and travel.

A major source of foreign exchange earnings are remittances by Pakistanis residing abroad: these remittances are growing and have reached USD 4.6 billion in 2006. A major part of remittances consists of money sent by Pakistanis permanently residing abroad. Since Mode 4 of the GATS considers only earnings by workers on

**Table 3.3**
**Export of Commercial Services (% Share)**

| *Sector* | *2003* | *2004* | *2005* | *2006*[P] |
|---|---|---|---|---|
| Transportation | 29.8 | 32.7 | 33.1 | 28.4 |
| Travel | 3.4 | 6.2 | 5.3 | 5.8 |
| Communications | 10.2 | 7.7 | 10.1 | 5.3 |
| Insurance | 0.8 | 0.7 | 0.8 | 0.6 |
| Finance | 0.6 | 0.8 | 1.2 | 1.9 |
| Computer/information technology | 0.8 | 1.5 | 1.4 | 2.0 |
| Other business | 10.4 | 7.6 | 8.8 | 10.5 |
| Government n.e.i. | 43.8 | 41.8 | 40.0 | 44.2 |
| Others | 0.2 | 1.0 | 1.1 | 1.3 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 |

***Source:*** State Bank of Pakistan, 2006.
***Note:*** P = Provisional.

temporary stay and employment abroad as services transactions, the total remittances cannot be considered as services exports. No separate data is maintained on the basis of residential status and nature of employment. It is, however, presumed that a large portion of this amount is composed of money sent by workers residing in other countries on a temporary basis.

### Services Statistics

Data on trade in commercial services is being compiled by the State Bank of Pakistan since 2003 on the basis of the revised International Monetary Fund (IMF) manual on Balance of Payments. Statistics on services trade other than commercial transactions are not available. Data on the value addition of services is compiled in the old United Nations (UN) System of National Accounts (SNA) as Pakistan has not yet adopted the revised (1993) version of this System. This revised system is based on reclassification and improved methodology of compiling services data. This is a potential area of cooperation among South Asian countries.

## Liberalization of Services

Pakistan initiated the policy of deregulation, privatization, and liberalization of the economy in the early 1990s (Uddin and Akram, 2006).

The liberalization of services was an integral part of the policy. This autonomous liberalization of services was complemented by obligations and commitments under the GATS in 1994–98. Some free trade arrangements negotiated by Pakistan also contain provisions on trade in services. These are now briefly discussed.

## Autonomous Liberalization

In the initial period of liberalization in the early 1990s, the thrust was on denationalization of enterprises (including industries, trading corporations, banks, insurance, shipping companies, airlines, and educational institutions) which were nationalized in the early 1970s. This was followed by the opening up of public sector entities (like telecommunications, post, and energy) for private investment and transfer. The general and sector-specific liberalization measures are briefly discussed.

### *General Measures*

- Liberalization of payments for services associated with merchandise trade (like transportation, insurance, commission, and fees).
- Removal of restrictions on payments for services obtained from other countries (like on education, health, tourism, advertising, professional and institutional membership fees, travel, etc.).
- Reconstitution of Investment Board to facilitate FDI and opening up services (wholesale and retail trade, transport, telecommunications, hotel, and travel) for FDI.
- Equal treatment of local and foreign investors.
- Allowing foreign investment in stocks.
- Elimination of restrictions on remittance of capital, dividend, profit, royalty, franchise, and technical fees.
- Allowing branches and liaison offices for foreign companies with permission of the Investment Board.
- Permitting 100 percent foreign equity holding in services enterprises.
- Full protection to foreign investment.

## *Sectoral Measures*

### Telecommunications

- Conversion of the Telecommunications Department of government into a public limited company and thereafter transferring it to foreign investor.
- Permitting private investment in mobile and other telecommunication services.
- Establishment of the Pakistan Telecommunication Authority to regulate and promote telecommunication services.

### Post

- Allowing foreign-based courier services to operate in the country.
- Corporation of post department.

### Ports and shipping

- Opening the sector for foreign investment and collaboration.

### Airlines

- Reconstituting Civil Aviation Authority to regulate air traffic.
- Permitting private airlines to operate domestic and international services.
- Liberalization of operations of foreign airlines in passenger and cargo traffic.

### Banking and insurance

- Privatization of nationalized banks.
- Permitting private investment in banking and insurance.
- Liberalization of rules and regulations relating to operation of foreign banks and opening their branches in Pakistan.
- Strengthening State Bank's regulatory and supervisory functions and establishing the Securities and Exchange Commission to regulate the stock market and corporate sector.

#### Education

- Introduction of education reforms.
- Reconstitution of Universities Grants Commission into Higher Education Commission.
- Denationalization of some education institutions.
- Allowing new educational institutions and universities in the private sector.
- Permission to educational institutions to affiliate with foreign universities.
- Easing foreign exchange restrictions on educational expenses abroad.

#### Electronic media (TV)

- Permitting private television (TV) channels.
- Establishing Pakistan Electronic Media Regulatory Authority.

### *Regulatory Arrangements*

The liberalization and privatization entail transfer of ownership and economic power from the public to the private sector. It may also lead to conversion of public monopolies into private monopolies and formation of cartels. With a view to ensuring orderly functioning of these privatized entities and safeguarding the interests of all stakeholders, new regulatory authorities in various areas have been created and the existing ones restructured. Regulatory authorities active in the services sector include the State Bank of Pakistan (for banking), Securities and Exchange Commission (for finance and stock market), Pakistan Telecommunications Authority (for telecom), Civil Aviation Authority (for air transportation), Higher Education Commission (for education), Pakistan Electronic Media Regulatory Authority (for TV), Pakistan Environment Authority (for environment), and Pakistan Medical and Dental Association (for health). Some of these regulatory authorities are in a nascent stage, lacking in requisite expertise and operating as controllers rather than facilitators. Their operational transparency and interaction with all stakeholders also need to be improved.

## Commitments under the GATS

Pakistan has assumed obligations under the GATS and is currently involved in the Doha Round Negotiations. Following are the obligations and commitment made by Pakistan in 1994–98 under the Uruguay Round (WTO, 1999):[4]

### *Commitments under the Uruguay Round*

Pakistan has assumed the general obligation of Most Favored Nation (MFN) treatment to services of other members with seven Article II exemptions in the following two sectors:

1. Banking and financial services (four exemptions), and
2. Telecommunication services (three exemptions).

Pakistan has made specific commitments relating to Market Access and National Treatment in the following six sectors (covering 42 sub-sectors):

1. Business services (11 sub-sectors).
2. Communication services (one sub-sector).
3. Construction and related engineering services (two sub-sectors).
4. Financial services (nine sub-sectors).
5. Health and related social services.
6. Tourism and travel.

### *Negotiations under the Doha Round*

#### Initial offer by Pakistan

Pakistan has made its initial offer in May 2005 taking into consideration the requests of trading partners for market access and national treatment. The offer prepared by the Ministry of Commerce in consultation with respective stakeholders is conditional on the market access that Pakistan will receive in other areas under Doha Negotiations, retaining the power to add, remove, or modify any element of it until a final agreement is reached that meets Pakistan's objectives. The offer is summarized as:[5]

1. Exemption from MFN
   - Exemption on telecom and financial services retained.

2. Horizontal commitments
   - Mode 3—commercial presence
     *(a)* Acquisition of real estate: restrictions on non-Pakistani entities removed.
     *(b)* Equity limit: limit increased from 51 to 60 percent unless otherwise specified.
   - Mode 4—movement of natural persons: categories for "intra corporate transferees" and "business visitors" defined to facilitate entry and stay.
3. Sector specific commitments
   - *Engineering services:* equity limit increased from 40 to 50 percent.
   - *Integrated engineering:* equity limit rose to 51 percent and partnership restriction on companies registered with the Security and Exchange Commission removed.
   - *Telecommunications:* all restrictions removed and mobile service added.
   - *Construction and related services:* limitation in Modes 1 and 2 removed.
   - *Financial services:* Market Access improved considerably.
   - *Tourism:* Market Access improved.
   - *Business services:* new sub-sectors added—legal services, accounting and bookkeeping, architecture, veterinary, services provided by midwives, nurses, physiotherapists and paramedics, computer-related services, rental and leasing services, printing and publishing, agricultural storage facilities, and land services.
   - *Communications:* courier services
   - *New areas:* addition in distribution, education, and environment services.

#### Pakistan's request to trading partners

Pakistan has also submitted its request list to 17 trading partners in 2002.[6] The list contains areas in which Pakistan has export interest

(including legal, accounting, auditing, taxation, architecture, engineering, finance, construction, medical, consultancy, and education services).

In addition, Pakistan has joined other countries in making following plurilateral requests:[7]

1. Mode 4 plurilateral request by 15 countries coordinated by India in 2006.
2. Mode 1 plurilateral request by 10 countries coordinated by India in 2006.
3. Plurilateral request for computer-related services by 15 countries coordinated by Chile in 2006, and
4. Plurilateral request for removal of remaining MFN exemptions to 17 countries (groups) by a group of countries coordinated by Hong Kong, China in 2006.

These collective requests are intended to complement, and not supersede, the bilateral request/offer negotiations in accordance with the Hong Kong Ministerial Declaration of December 2005 (that is, paragraph 7 Annex C). In all plurilateral requests, a common chapeau has been agreed that "all GATS flexibilities available to developing countries are recognized by requesting members and allow recipient developing countries to keep from making commitments in their sensitive sectors."

### *Free Trade Areas*

Pakistan is negotiating free trade area arrangements with a number of countries including China, Sri Lanka, Malaysia, European Union, Canada, and USA. These agreements mainly relate to trade in goods. However, in some signed agreements there are general provisions on services trade as well. For instance, Article 83 of the Pak-China Free Trade Agreement signed on November 24, 2006 states that negotiations on services will take place after conclusion of this Agreement. Similarly, the preamble of the Pak-Sri Lanka Free Trade Agreement signed on August 1, 2002 stipulates trade in goods and services, but does not contain any operative provisions for services trade. So far, no concessions have been extended by Pakistan on services trade under free trade arrangements.

## Pakistan's Competitiveness in Services

Services produced in Pakistan are primarily oriented to domestic demand. Their performance and growth is intimately related to other sectors, in particular, agriculture, manufacturing and infrastructure. Little attention is paid to their quality, efficiency, and cost. Consequently their competitive position is weak. Most services lack strength to withstand the onslaught of foreign services in domestic market and are also not fully geared to exploit the external markets. The exploitation of export potential in services is conditioned by many factors, such as, an effective services trade policy and sectors-specific strategies, improved infrastructure and institutions, effective regulatory and promotional framework, and, more importantly, availability of high quality human resource (Uddin, 2007). Without developing appropriate, qualified, and skilled human resource supported by efficient infrastructure, Pakistan will not be able to offer competitive and high quality services within and outside the country. This needs persistent efforts on many fronts, and in particular requires rethinking and reorientation of the present human resource development strategy and plans to focus on the expanding services trade potential. Institution building efforts should include reorientation of the Board of Investment from trade perspective, setting up a services export authority, property rights, standardization codes of conduct and quality control, dispute settlement mechanism, consumers' protection, and good governance. The improvement and simplification of domestic regulations and alignment with international standards and practices will help in facilitating and promoting services trade.

The issue of competitiveness may be examined in the context of modes of supply and sectors of services.

### Modes of Supply

The four modes recognized under the GATS envisage movement of service, consumer or supplier. Each mode has its own peculiarity needing distinct approaches for improving competitiveness.

- *Mode 4: movement of natural persons.* This mode is considered as an area of substantial promise for labor surplus countries

like Pakistan. Market access under this mode is, however, restrained by exogenous and endogenous factors. First, the commitments made under the GATS are focused on inter-corporate transferees, high skilled workers, and senior executives. The offers made under the Doha Round show no marked change in this position. Second, the commitments are subject to such conditions as qualifications, recognition, accreditation, and other requirements besides visa and migration restrictions. The available human resource in Pakistan is mostly unskilled and semi-skilled and even professionals lack qualifications and experience required by the host country. Action is required on both the fronts—improving the quality of manpower to meet market demand and negotiating concessions with trading partners in export potential areas.

- *Mode 2: consumer movement.* This mode envisages movement of the consumer to the place of production of service, like a tourist traveling from the place of his residence to avail tourist facilities in another territory. In this case, in addition to the quality of service and cost, such factors as security, reputation and recognition, social and physical infrastructure, ease of entry and exit also count. Pakistan has undertaken plans for the development of human and physical infrastructure and improvement in services and institutions which contribute in the utilization of services by other nationals. However, the consumers are attracted by the quality, qualifications and experience of persons manning the services. On the other hand, liberal balance of the payments policy has enabled Pakistani consumers to increasing avail of health, education, travel, and other facilities in many countries. This has caused substantial rise in payments for services availed by Pakistanis abroad as shown in Annex 3.1.
- *Mode 3: commercial presence.* This mode involves commercial presence of an entity in another territory. Pakistan is encouraging foreign investment and collaboration which is also coming in the shape of agencies/branches/agents of foreign-based service firms (banks, insurance companies, hotels, traveling agencies, couriers, etc.). This has three major implications—bringing foreign

personnel to run them instead of employing local persons, repatriation of income earned in Pakistan, and competition to domestic suppliers. Except for few areas like banking, Pakistan is not in a strong position to avail opening in other markets through commercial presence.

- *Mode 1: cross-border movement.* In this mode, involving movement of services from one territory to the other, the important elements seem to be the cost, quality, speed of delivery, predictability, and transparency. Some of these elements are within the domain of the producer/supplier (like price and quality) while for others (like timely delivery) one is dependent on other sources. The Pakistani producers and suppliers of services should work individually and collectively for improving human resource, systems, and institutions that should ensure efficiency, quality, cost-effectiveness, and timely delivery of service. Due to the liberal policy, the use of external service facilities is growing rapidly resulting in the rise in payments (refer Annex 3.1) and competition to domestic suppliers.

## Services Trade Potential

Taking into account the production, exports and development plans, as well as global trends, the main areas of export potential from Pakistan are identified as:

### *Communication Services*

Communications, in particular telecommunications, is one of the rapidly growing and expanding areas globally. The telecommunications sector has also progressed in Pakistan rapidly. Teledensity (that is, proportion of population with telephone facilities) in Pakistan has risen from 2.3 percent in 2000 to 23.1 percent in 2006, with expanded and competitive availability of telecom and telecom-related services. The sector is also one of the major areas of Foreign Direct Investment and trade. Its export potential can be gauged by the fact that in the Fiscal Year 2005, Pakistan earned USD 331 million through exports of communications services as against only a payment of USD 59 million.

(This data relate to cross-border transactions only as information on other modes are not available.)

Pakistan has the potential to substantially enhance cross-border (Mode 1) exports of communication services as well as temporary employment abroad (Mode 4). The exploitation of this potential is conditioned on forward-looking policies and regulations, expansion of facilities, induction of latest technology and enhancement of competitiveness. In this context, training, skill development, and continuous up-gradation of quality and knowledge of manpower will play a critical role.

### *Transportation Services*

This sector is closely linked with the domestic, industrial, and agricultural output, and merchandise trade. It accounts for over one-fourth of trade in commercial services. With the annual GDP and trade growth rates of 7.6 percent and 14 percent respectively, envisaged in the Medium Term Development Framework of Pakistan 2005–10, this sector is expected to play an important role in the future as well. Pakistan is having a trade deficit in this area (USD 1,790 million in Fiscal Year 2006) as a substantial portion of its merchandise trade is using external transportation. This deficit should be reduced by expanding domestic transport services, especially in Mode 1 (cross-border) and Mode 4 (temporary movement of natural persons). Emphasis should be given to the quality of services as well as on expanding the national transportation fleet (ships and aircrafts), improving ports and terminal facilities, cost, and time effective handling of cargo.

### *Business Services, Computer and Information Services (Professional, Legal and Accountancy, IT-related)*

The international demand for labor is shifting from unskilled to skilled and professional workers. Pakistan has been a major exporter of semi-skilled and unskilled labor to the Middle East and other countries since the late 1970s. As the demand for such labor is shrinking, it should adapt to this changing trend and focus on the development of skilled and professional manpower in line with the changing global market.

Business services are promising areas with scope in all the four modes. While Mode 4 (movement of natural persons) remains the main area of interest, Pakistan should explore exporting business services by other modes of cross-border, consumer movement and commercial presence as well. Sustained efforts are, however, required to improve the quality of business services, obtaining international recognition and accreditation of professional degrees and qualifications, and undertaking promotion and marketing campaigns by domestic professional associations, individually as well as in association with multinationals.

### *Financial Services*

Financial services have emerged as one of the leading areas of trade in services in recent years. This growth has been spurred by substantial rise in global financial liquidity, policies of liberalization and deregulation undertaken in many countries, mergers and acquisitions of financial institutions and technological advancements. The financial sector reforms introduced in Pakistan since the 1990s have improved the quality of service and opened up avenues of foreign collaboration. It is emerging as a promising area for Pakistan; many Pakistanis are rendering services in banks and financial institutions in the Middle East and the West since the 1970s. In addition to Mode 4 (movement of natural persons), Pakistan can explore export potential in Mode 1 (cross-border) and Mode 3 (commercial presence). Financial sector reforms should continue to promote best practices, along with modernization of the facilities and introduction of high quality and internationally recognized business practices. The sector should also organize itself to exploit the vast opportunities arising in this area due to global liberalization.

### *Tourism Services*

International tourism continues to expand and diversify. Many developing countries have been able to substantially expand their earnings from tourism by improving their facilities and environment and undertaking aggressive promotional campaigns. So far, Pakistan has not been able to benefit from the expanding tourist market and,

it is estimated, that only 800,000 tourists visit Pakistan annually. Though Pakistan is not able to offer "pleasure-tourism" (like casinos, night clubs, bars, etc.), it is rich in historical and natural sites. Many factors, such as law and order situation, country-image, and poor and inadequate infrastructure, hotel and transport facilities, need to be addressed fully. In addition, training in tourism and hotel-related fields should be encouraged to meet the domestic requirements and for exporting manpower. Effective promotional campaigns should also be undertaken in association with tour operators, airlines and hotels. Special attention should be given to group-tourism which has substantial scope for expansion.

### *Health Services (Medical Services, Doctors)*

A large number of Pakistani medical doctors and other professionals are working in the Middle East, USA, and UK. The scope for further increase is conditioned on their meeting the improved qualifications and competition from other countries. The critical elements in this respect are improvement in teaching and training, and global recognition of degrees and qualifications in line with the requirement of importing countries. In addition to exporting manpower (Mode 4), potential for exports under Mode 1 (cross-border) and Mode 2 (movement of consumer) also exists. For this purpose, it is essential that hospitals, laboratories, and related facilities are upgraded and brought up to high international standards and modern diagnostic and treatment practices are promoted.

## Improving Competitiveness

A nation's competitive position in services trade, however, basically depends on the capacity of firms and enterprises to innovate and upgrade their services, processes, and organizations continuously. Competitiveness depends on productivity (that is, high quality, low cost, client satisfaction) which in turn is dependent on *(i)* innovation, *(ii)* investment in skills and knowledge, *(iii)* improved physical assets, and *(iv)* business reputation. It needs continuous improvement, even making its own existing advantage obsolete by moving to other levels

before another competitor does it. Actions at firm and enterprise level may include:

1. Devising mechanisms for innovation (changes in service, processes, and organization structure).
2. Evolving systems of continuous improvement.
3. Promoting best practices approach.
4. Introducing mechanism for inflow of updated information and knowledge.
5. Promoting client and customer orientation and customization.
6. Ensuring quality and certification (example, International Organization for Standardization [ISO] 9000).
7. Initiating continuous up-gradation of skills and knowledge.
8. Developing staff motivation, dedication, commitment, and job satisfaction.
9. Evaluating regularly own and competitors' performance.
10. Developing business reputation.
11. Encouraging research and development.

## Potential Areas of Liberalization and Cooperation in South Asia

The identifiable mutuality of interest among the South Asian nations in current negotiations on services trade under the World Trade Organization (WTO) provides a basis for collaboration among them in various areas. In this context the following areas are suggested:

### Plurilateral Request/Offer

Negotiations on services trade are primarily based on bilateral request and offer processes which are slow and lack tangible results. This process has recently been complemented by plurilateral offers and requests. Pakistan and India have joined other countries in making plurilateral requests as stated earlier. Since the South Asian nations have common export interest in many areas (particularly in Mode 4), they can conveniently adopt this approach and submit a common request list to their trading partners. The same mechanism can be

adopted for offers also. This will help in negotiations and strengthen the bargaining position.

## Statistical Issues

Statistics on services trade and domestic output is weak. The Balance of Payments statistics only cover commercial services trade (mainly Mode 1) and there is no reliable mechanism to compile statistics on other transactions, in particular, under Modes 4 and 3. For instance, data in Mode 4 is not available as statistics on home remittances, which are the main source of foreign earnings of South Asian nations, and are not compiled on temporary and permanent residence basis. The methodology and classification used for computing value addition by various services in many regional countries is weak and they have not adopted the revised UN System of National Accounts (1993). The South Asian nations can collaborate in devising mechanisms to remove these data limitations. They can also collaborate in international forums set up by the UN and the WTO to improve and standardize services statistics.

## GATS Legal and Institutional Issues

Being the first of its kind, the GATS is not perfect and there are a number of legal and institutional issues that need to be addressed for strengthening the framework. Some of these issues like safeguard, subsidies, and domestic regulations, have been identified in the GATS for further negotiations and improvement. The negotiations on services are focusing on liberalization and concessions by members and no serious attempt is being made to address these issues. The South Asian nations may collaborate to expedite consideration of these issues and develop a common stand on them. Domestic regulations in particular is an area in which the regional countries can collaborate among themselves as well as under the WTO.

## Regional Collaboration in Services Trade

South Asian Free Trade Area (SAFTA) agreement is primarily concerned with trade in goods. In accordance with the decision of the South Asian

Association for Regional Cooperation (SAARC) Ministerial Meeting in Dhaka in April 2006, the feasibility of extending the arrangement to trade in services is being examined. The Committee of Experts set up for the purpose should expedite its recommendations.

In addition to the SAARC, private sector institutions, professional associations and bodies can cooperate in different forms like setting up regional associations, harmonization of systems and procedures, and developing common regional standards.

## Collaboration in Third Countries

South Asian nations can collaborate among themselves for providing such services as tourism, construction, consultancy, and software development for supply to third countries. Firms and business associations should explore the possibility of forming consortia or joint projects to provide services to third countries.

## Regulatory Mechanism

South Asian nations have established regulatory institutions in various services sectors. They can learn from each others' experience. A program of cooperation among them may be devised under the SAARC.

## Domestic Capacity Building

Services are labor intensive and over 70 percent of value-addition is contributed by it. South Asian nations can assist each other in upgradation of skills and training of personnel. Training and education institutions should explore the feasibility of organizing regional training and professional development programs.

## Impact Assessment

Despite the lapse of over 13 years since the conclusion of the GATS, no serious attempt has been made to study the impact of services liberalization on the regional economy. This task may be undertaken within the SAARC framework.

### Research Collaboration

Research institutions in South Asia may promote comparative research in the services sector and arrange regional seminars and conferences to develop greater understanding of the subject. The initiative of the Institute of Policy Studies of Sri Lanka in organizing the International Conference on Liberalization on Services Trade in South Asia on April 4 and 5, 2007, sets a good example for promotion of such cooperation.

## Domestic Institutions Supporting Services Negotiations

The Ministry of Commerce is responsible for all matters relating to trade. The WTO wing of the ministry coordinates the WTO matters and keeps close liaison with the ministries/agencies concerned and the Pakistan Permanent Mission to the WTO in Geneva. The policy matters relating to various services are dealt with by respective ministries (that is, transport and communications, education, finance, health, tourism, etc.). In addition to regular consultations with respective ministries as laid down in the rules of business, the Ministry of Commerce has constituted inter-agency consultation groups comprising of respective ministries, public, agencies, and other stakeholders on major services (such as telecommunications, transportation, finance, and tourism). The groups can also be consulted in preparing offers in response to requests from trading partners as well as formulating Pakistan's request lists. The ministry has undertaken training and awareness programs on the WTO which also include the United Nations Development Porgram (UNDP) assisted "Trade Initiatives from a Human Development Perspective". Non-governmental organizations like, the Institute of Policy Studies of Pakistan and Sustainable Development Policy Institute are playing active roles in promoting debate on the WTO issues, including trade in services through seminars, workshops, and publications. The Government of Punjab, Federation of Chambers of Commerce and Industry and other trade bodies have established special cells to deal with the WTO matters.

These institutional arrangements are, however, not yet fully geared to the challenges of negotiations in a complex sector. The stakeholders are not well-conversant with the complexities of the GATS and their focus remains on the domestic market. The issues are not analyzed in depth, partly due to lack of information and non-availability of expertise with the government. The consultation mechanism also needs to be improved, particularly, among government agencies, business, research institutions, and academics. The consultative process should be strengthened and broadened to include such areas as negotiations, impact assessment, awareness development, export promotion, and facilitation.

## Conclusions

The liberalization of services initiated in Pakistan since the early 1990s impacted the economy in many ways. The contribution of services in the GDP and employment is on the rise. Growth in services trade is ahead of merchandise trade; with imports registering faster growth due to liberal policy, there is a widening of the trade gap. Competition to domestic services has increased due to liberalization. Development of services remains domestic demand oriented and linked with the behavior of other sectors, especially in agriculture and manufacturing. Government policies continue to focus on merchandise trade and awareness of export potential among stakeholders is growing slowly.

The earlier commitments under the GATS reflected the autonomous character of liberalization rather than the result of reciprocal negotiations under the WTO. The same approach has been followed in formulating initial offers under the Doha Round and they are mainly based on response to requests rather than on the proper assessment of competitive position of domestic services. The requests for concessions from trading partners are also not based on impact assessment of the respective sectors.

Evaluation of the liberalization of services undertaken autonomously or under the GATS is yet to be undertaken. Such an exercise is constrained by the inadequacy of information and data about domestic production and trade. Experience of other nations in making such assessment can be fruitfully used to undertake similar work in Pakistan.

Mechanisms should be devised to improve the services statistics. Services trade should also be viewed as a vehicle to sustain economic and social development, quality of life improvement, human resource up-gradation, and institution building. The concerns of the civil society should also be kept in view while formulating strategy for services trade and development.

Notwithstanding data limitations, some broad conclusions can be drawn in respect to services in Pakistan. First, technology driven services, like telecommunications, computer, and Information Technology have progressed. Liberalization and privatization have attracted foreign capital and technology resulting in expansion, up-gradation, and cost-effectiveness of facilities. It has also helped in the export of these services. However, availability of qualified and trained manpower is a major bottleneck. Second, it will take time and determined efforts for most services to shift from domestic demand orientation and become competitive internationally. Third, the autonomous liberalization under the IFIs compulsion, without seeking reciprocal access in other markets under the GATS negotiations, has put domestic services under external competition, adding to payment liabilities and putting pressure on the balance of payments. Fourth, exporters of services to Pakistan have benefited through Modes 1 and 3. Commercial presence in many areas like telecommunications, travel, advertisement, banking, insurance, retail and wholesale, and fast-food have expanded causing increased competition to domestic services and higher payment liabilities of royalties, fees, and profits. The increased use of external services, in such areas as transport and insurance under Mode 1, has enlarged the trade deficit. Fifth, so far Pakistan has gained little from Mode 4 arrangement as commitment by trading partners mainly cover transferees and senior executives and are subject to strict visa and other restrictions. The rise in home remittances (which also include earnings from services provided by natural persons under Mode 4 seems to have no relation to Mode 4 commitments by trading partners.

The scope for cooperation among South Asian nations in services is multidimensional as identified in the earlier section. SAARC, bilateral, and other institutional arrangements (both public and private) should be used to foster these relations.

# ANNEXURE

## Annex 3A.1
## Pakistan: Trade in Commercial Services (FY 2003–06)

(USD million)

| | *Sector* | *2003* | *2004* | *2005* | *2006*[P] |
|---|---|---|---|---|---|
| 1 | Transportation (net) | –710.7 | –890.1 | –1,218 | –1,790 |
| | Credit | 808.3 | 863.9 | 1,062 | 1,066 |
| | Debit | 1,519.0 | 1,754.0 | 2,280 | 2,856 |
| 2 | Travel (net) | –401.9 | –1,034.0 | –995 | –1,185 |
| | Credit | 92.1 | 164.4 | 177 | 216 |
| | Debit | 494.0 | 1,198.3 | 1,172 | 1,401 |
| 3 | Communications (net) | 230.4 | 165.6 | 272 | 97 |
| | Credit | 275.4 | 204.0 | 331 | 198 |
| | Debit | 45.0 | 38.4 | 59 | 101 |
| 4 | Construction (net) | 0.0 | 6.0 | 18 | –127 |
| | Credit | 0.0 | 12.4 | 24 | 16 |
| | Debit | 0.0 | 18.4 | 6 | 143 |
| 5 | Insurance (net) | –51.4 | –69.7 | –76 | –98 |
| | Credit | 21.0 | 19.0 | 25 | 29 |
| | Debit | 72.4 | 80.7 | 101 | 127 |
| 6 | Finance (net) | –48.7 | –55.9 | –38 | –63 |
| | Credit | 16.4 | 21.4 | 39 | 70 |
| | Debit | 65.1 | 77.4 | 77 | 133 |
| 7 | Computer and information (net) | 21.6 | 29.7 | 20 | 29 |
| | Credit | 22.5 | 40.8 | 47 | 71 |
| | Debit | 0.9 | 11.1 | 27 | 42 |
| 8 | Royalty and license fee (net) | –15.5 | –37.2 | –94 | –67 |
| | Credit | 7.6 | 10.1 | 13 | 33 |
| | Debit | 23.1 | 47.3 | 107 | 100 |
| 9 | Other business services (net) | –42.0 | –331.6 | –2,217 | –2,552 |
| | Credit | 281.0 | 202.1 | 285 | 391 |
| | Debit | 323.0 | 533.7 | 2,502 | 2,943 |
| 10 | Personal, cultural, and recreational (net) | 0.3 | 1.1 | –6 | –5 |
| | Credit | 0.3 | 2.1 | 1 | 1 |
| | Debit | 0.0 | 1.0 | 7 | 6 |
| 11 | Government services, n.i.e (net) | 1,013.7 | 905.1 | 1,041 | 1,359 |
| | Credit | 1,187.0 | 1,105.7 | 1,315 | 1,657 |
| | Debit | 173.3 | 200.6 | 274 | 298 |
| Total (net) | | –4.2 | –1,316.0 | –3,293 | –4,402 |
| | Credit | 2,711.6 | 2,644.9 | 3,319 | 3,748 |
| | Debit | 2,715.8 | 3,960.9 | 6,612 | 8,150 |

***Source:*** State Bank of Pakistan, 2006.

***Note:*** P = Provisional.

## Notes

1. Pakistan remained under the IMF Structural Adjustment Arrangements in 1988–2004.
2. Pakistan Fiscal Year: July–June.
3. This data relate to trade in commercial services (mainly cross-border) as information on all modes, in particular, under Modes 3, commercial presence, and Mode 4, movement of natural persons, of services transaction is not available.
4. Pakistan's commitments are listed in the WTO documents GATS/SC/67 April 15, 1994, supplements 1/Rev.1 (October 4, 1995), 2 (February 11, 1997), 2 Rev.1 (February 16, 1998), and 3 (February 26, 1998).
5. Ministry of Commerce, Government of Pakistan, and the WTO document no. WTO S/DCS/W/PAK.
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# 4

# Sri Lanka

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## Introduction

The services sector has been the most dynamic sector in the economies of most countries and those of South Asia are no different. For instance, in Sri Lanka, services have grown at 8.1 percent in the first nine months of 2006 and contributed 56.4 percent of the Gross Domestic Product (GDP) (Central Bank of Sril Lanka [CBSL], 2007). At the same time, trade in services has been a relatively unexploited avenue of growth in most countries of South Asia, India being the only standout country to have broken this trend in the region. This is unfortunate for several reasons. First, services contribute 49 percent of South Asia's GDP and not exposing such a large sector of the economy to the benefits of trade is an unfortunate omission. Second, trade in services has been the fastest growing form of trade in the world. Between 1990 and 2002, global trade in services grew by 155 percent, compared to a growth of 97 percent in manufacturing and 40 percent in agriculture (Chanda, 2005). Whilst the total trade in services in South Asia increased from USD 26 billion in 1995 to USD 51 billion in 2003 (Chanda, 2005), a large share of that was due to Indian trade (Indian services exports accounted for USD 25 billion out of a total of USD 29 billion worth of commercial services exports by South Asia in 2003) (Kumar, 2005). The rest of South Asia has lagged behind

and missed out on this potential. While part of the explanation for this sluggish trade in services lies in failing to perceive and latch on to market opportunities, the extent of regulation in trade in services is also to blame. Hence, there are strong arguments in favor of mutually liberalizing trade in services for the benefit of all.

The General Agreement on Trade in Services (GATS) of the World Trade Organization (WTO) is the multilateral arm of liberalization of trade in services, but slow progress in the GATS has seen countries look toward regional and bilateral arrangements to liberalize services. Whilst there are great opportunities and potential in the liberalization of services, there are also substantial risks to the domestic economy if this process is not properly managed. Furthermore, from the perspective of developing countries, there is a great deal of groundwork that needs to be completed before liberalization will be of benefit to the country. These include development of regulatory frameworks, infrastructural changes to take advantage of technologically sophisticated opportunities, and, importantly, improving information and analysis on the real impacts of liberalization of services.

The aim of this chapter is to examine some of the opportunities and risks in liberalization of trade in services from a Sri Lankan perspective. The next section provides a background to the role of services in the Sri Lanka's economy. The following section examines the present extent of services liberalization in Sri Lanka. The fourth section examines the key areas in which Sri Lanka can benefit through the liberalization of services and examines some of the risks in doing so. The fifth section looks at domestic institutions supporting trade negotiations and other issues that need to be addressed in order to maximize benefits from liberalization. The sixth section concludes the chapter.

## Role of Services in the Sri Lankan Economy

The services sector has played an increasingly important role in Sri Lanka's economy. Sectors such as telecommunications at 20.2 percent growth (CBSL, 2007), finance, construction, and transport have been growing rapidly. A lot of this growth is attributed to liberalization in some of these sub-sectors, particularly telecommunications and finance.

As is evident in Table 4.1 services make up 56.4 percent of the GDP and have grown at 8.1 percent, and made a significant contribution to overall economic growth. The major services sectors in Sri Lanka are tourism, retail, transport, communication, and financial services. Services have also taken over as the largest contributor to employment generation in the country.

**Table 4.1**
**Role of Services in the Economy (2006)***

| *Item* | *Growth (%)* | *Contribution to Total Services (%)* |
|---|---|---|
| Wholesale and retail trade, hotels, and restaurants | 7.2 | 38.38 |
| Transport, storage, and communication | 12.0 | 28.70 |
| Financial, services, real estate, and business services | 8.1 | 21.03 |
| Government services, personal, and social services | 2.3 | 11.88 |
| Total services | 8.1 | Services as a share of the GDP 56.39 |

***Source:*** CBSL, 2007.
***Note:*** *Project based on information available up to September 2006.

Tourism accounted for 60,500 direct employment opportunities and 85,000 indirect job opportunities in 2007,[1] making up 2 percent of total employment in Sri Lanka. This figure is, if anything, underestimated, given the extent of informal employment in this sector.

The importance of many of these services sectors is manifold due to the spillover benefits enjoyed in other sectors. This is particularly true in telecommunications and finance, where liberalization and privatization have seen increased foreign participation in these markets, and simultaneous rapid growth in the sectors. Liberalization in telecom, for instance, has also seen the emergence of the Business Process Outsourcing (BPO) sector in Sri Lanka since the turn of the century. The export of services through temporary migration also has a major impact on the economy, particularly in terms of reducing unemployment in Sri Lanka. It is estimated by the Sri Lanka Bureau of Foreign Employment that 1.6 Million Sri Lankans worked abroad on a temporary basis in 2007 (Sri Lanka's total employment in 2007 was 7.2 million, excluding migrant workers). A large proportion of temporary migrants work in the service sector as domestic aides and

in construction services. This fact is missed in the share of services in the total employment figure given in Table 4.2.

**Table 4.2**
**Share of Services in Employment ('000 Persons)**

| *Item* | *2004* | *2005* |
|---|---|---|
| Trade and hotels | 1,039 | 1,043 |
| Transport, storage, and communication | 422 | 485 |
| Finance, insurance, and real estate | 1,580 | 234 |
| Personal services and others | 177 | 1,607 |
| Total employment in services | 3,219 | 3,368 |
| Share of services in total employment | 43.71% | 44.80% |

*Source:* CBSL, 2007.

Despite the significant share of services in the GDP, they contribute little to trade and exports. In the year 2005, out of a total trade of USD 7.9 billion, only USD 1.5 billion was contributed by trade in services. The surplus in trade in services declined between the years 2004 and 2005. Nonetheless, the surplus contributed to mitigating the deficit in trade in goods (this mitigation is enhanced by the addition of private remittances from migrants).

As indicated by Table 4.3, Sri Lanka's major services export is temporary migrants. The other exports of any significance are

**Table 4.3**
**Sri Lanka's Trade in Services, 2004–05 (USD Million)**

| | *2004* | | | *2005* | | |
|---|---|---|---|---|---|---|
| *Item* | *Credit* | *Debit* | *Net* | *Credit* | *Debit* | *Net* |
| Transportation | 624 | 415 | 209 | 673 | 470 | 204 |
| Travel | 513 | 296 | 217 | 429 | 314 | 115 |
| Telecommunication services | 43 | 10 | 33 | 44 | 19 | 25 |
| Computer and information services | 72 | 0 | 72 | 82 | 0 | 82 |
| Construction services | 26 | 6 | 20 | 29 | 5 | 24 |
| Insurance services | 50 | 30 | 20 | 73 | 34 | 39 |
| Other business services | 178 | 315 | –137 | 188 | 322 | –134 |
| Total services | 1,527 | 1,108 | 419 | 1,540 | 1,202 | 338 |
| Private remittances | 1,564 | 214 | 1,350 | 1,968 | 233 | 1,736 |

*Source:* CBSL, various years.

transport, tourism, and computer and related services. It is evident that Sri Lanka relies on traditional services exports, but the improvement in computer and related services exports, while most other sectors saw declining net exports, is an encouraging sign.

In the first half of 2006, the surplus in trade in services increased by 12 percent to USD 178 million. This was driven by recovery in tourism, transportation sector receipts, and the Information Technology (IT) sector. In the first nine months of 2006, tourist arrivals increased by 9.5 percent. At the same time, increased receipts from the transportation sector were led by a 33 percent growth in trans-shipment volumes in the first half of 2006. This is an improvement from 2005 when the surplus in the services account declined by 19.3 percent due to lower tourist arrivals following the tsunami of December 2004 (CBSL, 2007). The remittances received from temporary migrants play a critical role in the economy. With increasing oil prices and further increases in imports due to military expenditure, there has been significant pressure on the balance of payments in Sri Lanka. Remittances have gone a long way toward easing this pressure on the balance of payments. Sri Lanka at present is undergoing a significant wave of infrastructure building and in this context, construction and engineering services play a major role in the economy, both in the short and long run. Therefore, the role of services in the Sri Lankan economy is extensive, both as a driver of the economy and in terms of supporting other sectors. Nonetheless, as is evident in Table 4.4, trade in services has lagged behind trade in goods despite the importance of services in the economy. It is in this context that the rest of the paper examines the potential for services liberalization and the pitfalls that may arise in doing so.

**Table 4.4**
**Share of Services in Overall Trade (USD Million)**

| | *2004* | | | *2005* | | |
|---|---|---|---|---|---|---|
| *Item* | *Credit* | *Debit* | *Net* | *Credit* | *Debit* | *Net* |
| Goods | 5,757 | 8,000 | –2,243 | 6,347 | 8,863 | –2,516 |
| Services* | 1,527 | 1,108 | 419 | 1,540 | 1,202 | 338 |
| Total trade (goods and services) | 7,284 | 9,108 | –1,824 | 7,887 | 10,065 | –2,178 |

***Source:*** CBSL, various years.
***Note:*** *This does not take into account remittances from abroad.

## Services Liberalization in Sri Lanka

### Unilateral Liberalization

Sri Lanka has one of the most open trade regimes in the region, and the same applies to services. According to Sri Lanka's latest trade policy review with the WTO, foreign investment is allowed in almost all sectors in the economy. "Foreign investment is allowed with automatic approval up to 100 per cent of equity in all business activities other than sections such as fishing, supply of water, mass transportation, freight forwarding, professional services, travel agencies and shipping agencies" (*Sri Lanka Trade Policy Review*, 2003). Hundred percent foreign equity is allowed in exports, tourism, infrastructure, services, agriculture, dairy and livestock development, and electronics. Other sectors require some form of joint ventures with Sri Lankan firms. Shipping, for instance, requires 40 percent domestic asset ownership. However, the following sectors, namely money lending, pawn broking, retail trade with capital of less that USD 1 million and coastal fishing, are reserved entirely for Sri Lankan service providers. The sectors that allow 40 percent equity or more given limits by the Board of Investment are:

1. Production of goods where Sri Lanka's exports are subject to internationally determined quota restrictions.
2. Growing and primary processing of tea, rubber, coconut, rice, sugar, and spices.
3. Mining and primary processing of non-renewable national resources.
4. Timber-based industries using local timber.
5. Fishing (deep sea fishing).
6. Mass communication.
7. Education.
8. Freight forwarding.
9. Travel agencies.
10. Shipping agencies.

Key services sectors in the economy have also seen substantial liberalization.

*Finance*: Foreign equity limits in banking were eliminated in May 2002. There are no restrictions in foreign competition in banking, including overseas unincorporated branches. National Treatment (NT) is provided for foreign investors. Foreign investment limits in insurance were removed in 2002 and in licensed stock broking in 2000.

*Tourism*: Visa on arrival was accorded to the South Asian Association for Regional Cooperation (SAARC) countries in 2003, and this facility is now extended to over 70 countries in Sri Lanka. The Ceylon Tourist Board approves investment in hotels and allows up to 100 percent foreign equity. Foreign tour guides can work in the country if they pass the same tests and accreditation as required for local tour guides.

*Telecommunication*: Up to 100 percent equity is allowed in investments in telecommunication that are not classified as mass communication.

## Sri Lankan Commitments in the GATS

Sri Lanka's initial commitment in the GATS was limited to tourism in 1994. This was expanded in 1998 to include the following:

1. *Telecommunications*: Commitments were made in National Treatment (NT) and Market Access (MA) in international basic voice telecommunication services, domestic local and long distance basic telephone services, mobile cellular services, wireless local loop services, public payphone services, radio paging services, and data communication services, and Global Mobile Personal Communications by Satellite (GMPCS) services were provided through own gateways.
2. *Financial services*: Commitments were made in MA and NT in direct life insurance, non-life insurance, reinsurance, and retrocession.
3. *Banking*: Acceptance of deposits and other repayable funds from the public, lending, financial leasing, all payment and money transmission services, guarantees and commitments, trading for own account or of customers, participating in issues of all kinds of securities, money broking, asset management, settlement

and clearing services for financial management, provision and transfer of financial services, and advisory services in all of the above cases.

4. *Tourism*: Commitments were made in hotel and lodging services, and travel agency and tour operators, characterized by full commitments in Mode 3 in both MA and NT.

It is evident that Sri Lanka has made substantially low commitments in the GATS compared to the extent of unilateral liberalization that has been undertaken in Sri Lanka. Furthermore, the level of commitment in the listed sectors is lower than the actual level of liberalization evident in the country. This allows for a greater deal of policy space for the state to shift within the committed level of liberalization and the unilaterally provided level. At the same time it should be noted that the low levels of the GATS commitments gives an incorrect signal to potential investors since it gives the impression that Sri Lanka's service sector is relatively closed, whereas, in reality, it is relatively open. The GATS commitments are among the most visible and transparent indicators of openness. Therefore, low commitments can be detrimental to a country seeking to raise foreign investment in the services sector.

Sri Lanka has submitted its request list to 18 countries in the GATS. The requests have been in the sectors of professional services, computer-related services, communication services, health-related and social services, transport services, and services auxiliary to all modes of transport. Requests are for full commitments in all modes of services supply.[2]

## Bilateral and Regional Initiatives in Liberalization of Services

Sri Lanka is in the process of negotiating a Comprehensive Economic Partnership Agreement (CEPA) with India which includes the liberalization of services. This process began in 2002 and following the release of the report by the Joint Study Group to examine the CEPA, the first round of technical negotiations began in February 2005. Since then, progress has been staggered and following a breakdown in services negotiations during the *Vanaspathi* crisis, negotiations have resumed

in January 2007 and the agreement is expected to be completed by mid-2007. There are indications that the Sri Lanka–Pakistan Free Trade Agreement (FTA) may also be deepened into a CEPA in the near future. Other regional agreements have been slow to acknowledge the importance of liberalizing services. South Asian Free Trade Area (SAFTA) and Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) are two agreements where the liberalization of services has been mooted. Recently, a study was commissioned by the SAARC secretariat to examine the possibilities of incorporating services into the SAFTA.

## Potential Benefits from the Liberalization of Services for Sri Lanka

### Sri Lanka's Offensive Interests

#### *Mode 4*

In the multilateral sector, it is clear that Sri Lanka's main area of interest is the liberalization of Mode 4. This holds true for most of the other South Asian countries as well, given the region's comparative advantage in low skilled labor. Remittances from migrants contributed an estimated USD 2.1 billion to the Balance of Payments in 2006 (CBSL, 2007). This has been particularly important in recent times as it has helped mitigate a weakening balance of payments position given increasing import bills due to oil price hikes, defense expenditure, and construction-related imports. Receipts from migrant workers are twice the value of foreign aid receipts—foreign aid disbursement in 2006 was USD 1,052 million (Galle Development Forum Sri Lanka, 2007). Furthermore, given the conflict situation and frequent political instability in the country, remittances play an important role in compensating for limitations in Foreign Direct Investment (FDI) (Kelegama, 2006). Therefore, the importance of Mode 4 cannot be overstated in a Sri Lankan context.

Unfortunately, in today's global trading environment, Mode 4 is the least liberal of all the modes of service delivery. During the Uruguay Round, none of the countries made sector specific commitments in

Mode 4 while 50 percent, 30 percent, and 20 percent of the WTO members undertook full commitments in Mode 2, Mode 1, and Mode 3, respectively (Rajapakse and Tennekoon, 2007). Only six WTO members have improved upon the GATS obligations and made partial liberalization in Mode 4. These are the European Union (EU), Australia, India, Canada, Norway, and Switzerland (Kelegama, 2006). Therefore, there is considerable scope for further liberalization of Mode 4, which would be of great benefit to Sri Lanka and to the rest of South Asia. Restrictions on lower skilled workers are more stringent, which is of further disadvantage to Sri Lanka and the South Asian countries since their comparative advantage lies in these areas. Furthermore, the commitments in the GATS are mainly for temporary migration of higher skill workers such as intra-corporate transferees, speciality workers and for setting up commercial presence. "Only 17 percent of all horizontal entries cover low skilled personnel and only 10 countries have allowed some form of entry to 'other personnel'. Very few schedules (some 15 percent) refer to the category of contractual service suppliers (CSS)" (Chanda, 2005).

The major barriers imposed on Mode 4 include economic needs testing, quotas on the number of foreign employees, difficulties in renewing working visas, wage parity requirements, lack of recognition of qualifications, and long waiting periods due to security cross-checking among others. With regard to conditions such as economic needs testing, it could be argued that while such processes are often necessary, particularly in developing countries, it is important that they are transparent and clearly defined. As Rupa Chanda explains, "The main problem with ENTs (Economic Needs Tests) is their lack of clearly established criteria and procedures for application, making them unpredictable, non-transparent, and arbitrary barriers to Mode 4" (Chanda, 2005). Lack of recognition of qualifications is a significant problem given the fact that Sri Lanka has a comparative advantage in exporting the services of professionals. The Mutual Recognition Agreements (MRAs) have been used as a way to mitigate this, but there remain great transaction costs in obtaining recognition, such as having to sit for fresh examinations and stringent administrative requirements, which are often multiplied due to sub-national regulatory requirements (Chanda, 2005).[3] These can be simplified by holding relevant exams

in the exporting country and by streamlining administrative processes. Another barrier to make the MRAs effective is the quality of training institutes. For instance, Sri Lanka has not been able to sign an MRA with India for recognition of seafarers' qualification. One explanation of this is that Indian training institutes are opposed to an MRA, given the possibility of Indians going to Sri Lanka to receive training and then returning to work in India, thereby undermining the interests of the training institutions.

Security-related delays are expected in the aftermath of September 2001; however, such clearances do need to be streamlined since many of the professions requiring temporary migration need rapid turnover and delays result in the loss of other opportunities. There are other issues such as taxation laws which adversely effect temporary migrants. For instance, social security contributions are not always met with equivalent benefits. South Asian professionals need to contribute to the medicare and social security of the US Government, but are often not in the country for the period required until benefits can be availed (10 years in the US) (Chanda, 2005).[4]

Sri Lanka has a clear interest in having such barriers to Mode 4 reduced. At present, Sri Lanka's temporary migrants are dominated by low skill workers, particularly housemaids, as is clearly shown in Table 4.5.

**Table 4.5**
**Temporary Migration of Labor by Skill Level**

| *Type of Job* | *Average Number of Departures Per Year in 2003–05* |
|---|---|
| Professional | 2,015 (0.9%) |
| Middle level | 7,369 (3.3%) |
| Clerical and related | 7,063 (3.2%) |
| Skilled | 46,420 (21.2%) |
| Unskilled | 43,112 (19.7%) |
| Housemaids | 112,525 (51.5%) |
| Total | 218,505 |

***Source:*** Sri Lanka Bureau of Foreign Employment, 2005.

If further liberalization in Mode 4 can be secured, it would be possible for Sri Lanka to move up in the value chain and export labor in higher skill categories. Sri Lanka, for instance, exports several permanent

migrants in the professional and middle level categories, indicating the ability of the country to produce skilled individuals capable of working in an international environment. However, if Mode 4 can be liberalized to the extent that contractual service suppliers in particular have more liberal access to markets, there is great potential in benefits for Sri Lanka. This is true of professional services such as medicine, nursing, accountancy, engineering, and architecture. Given the wage differentials between Sri Lankan professionals and those in developed nations, there is great potential for mutual benefit in the liberalization of certain sectors. For this to be a success, steps would need to be taken to ensure simplified mutual recognition agreements that limit transaction costs. It is in the interest of the exporting country to initiate these with their major markets so that the full benefits of liberalization can be enjoyed.

### *Mode 1*

The BPO sector is in its infancy in Sri Lanka. Nonetheless, it remains a sector which has tremendous potential. At present, there are 25 BPOs in Sri Lanka and an additional six are awaiting Board of Investment (BoI) approval. Total employment in these firms is estimated at slightly over 4,000 with a total investment of over USD13.2 million. Around 43 percent of these firms engage in accounting services, 19 percent operate as call centers, and 14 percent as medical insurance processors (De Silva et al., 2006). A highly educated labor force (both in terms of skills and in the ability to communicate in English) with relatively low wages makes Sri Lanka an excellent option as an outsourcing hub. Though telecommunications infrastructure remains a constraint, this sector is one of the fastest growing sectors in Sri Lanka and technological improvements are occurring at a rapid rate. Specific areas where Sri Lanka can benefit include accountancy, hospital services (such as laboratory testing), architectural services, and computer and related services.

Most of the trade that occurs under Mode 1 is unregulated at this point of time, possibly because this remains a relatively new phenomenon the adverse impacts of which have not been felt significantly in labor markets of developed countries. However, laws have been passed of late that are impediments to free flows of

services in this mode. For instance, laws relating to privacy, data protection, liability, and consumer protection have had an adverse impact on outsourcing. An example is the EU law that data protection legislation in the providing country must match legislation in the EU for services like health care and financial services. The State of New Jersey has banned government contracts being outsourced to foreign countries. A new law has been passed in the US that allows consumers the right to know which country a specific call center service originates from (Chanda, 2005). As outsourcing continues to expand, it is likely that such legislation will increase sooner than it declines. There is already a significant level of agitation in developed countries regarding outsourcing of work to low wage countries. In this context, it is important from Sri Lanka's perspective that Mode 1 is not unnecessarily regulated any further.

## Specific Sectors

Apart from general strengths in Mode 1 and Mode 4, there are also certain sectors where Sri Lanka can benefit if there is increased market access available. Sri Lanka would benefit a great deal if the South Asian countries consider liberalizing these sectors at the multilateral or unilateral levels.

*Tourism and travel-related services Mode 3 and Mode 4:* Sri Lanka has a highly developed hotel industry and there has already been an FDI by Sri Lankan firms in South Asian nations like Maldives and India. The South Asian countries could benefit by opening up Mode 3 for investment from Sri Lankan firms since improved hotel infrastructure could boost tourism in the recipient country. Furthermore, travel agency and tour operator services can be supplied by Sri Lankan firms in Mode 3 in particular. There are also opportunities for Mode 4 liberalization in this sector. For instance, Sri Lankan tour guides could be allowed to operate in areas that are frequented by Sri Lankan tourists, for example, pilgrim spots in India (Buddha Gaya), Pakistan (Taxila), and Nepal (Lumbini).

*Maritime services:* Sri Lanka has a well developed maritime sector and has interest in exporting these services under several modes. Colombo has one of the best ports in South Asia, offering a range of

services through Mode 2. These include maintenance and repair of ships, supporting services for maritime transport (CPC 745), cargo handling (CPC 741),[5] and warehousing services. Often, tariff and non-tariff barriers exist which undermine competitiveness of Sri Lankan service providers, such as price preferences for vessels which receive services from domestic rather than international service providers. If such barriers are liberalized it would greatly benefit the Sri Lankan maritime sector. Furthermore, Sri Lanka also has expertise in Mode 4 for passenger and freight transportation. This refers to the removal of barriers for the Sri Lankan seafarers for working on foreign vessels in the sectors of passenger and freight transportation. Given the importance of maritime transport and increasing global trade, South Asia stands to gain from liberalizing this sector since Sri Lanka's competitive prices will certainly improve competitiveness of South Asian transport and indirectly that of exports passing through Colombo.

*Retailing services:* Sri Lanka has many competitive retailing firms along with retailing arms of production firms. This applies to both food retail (CPC 631) and non-food retail (CPC 632) sectors and Sri Lanka would benefit from liberalization in Modes 1, 3, and 4.

*Computer and related services:* This is an ever expanding sector in Sri Lanka and therefore, there is much scope for benefiting from the mutual liberalization of this sector. Sri Lanka has competitive interests in all four modes in this area, particularly in Modes 1 and 4. While India has taken giant strides in the outsourcing arena, there is scope for improved competitiveness by sharing some of the burden with Sri Lanka according to comparative advantages.

*Air transport services:* Whilst air services are out of the GATS at the moment, this is one area where Sri Lanka can provide competitive services. As it stands, most liberalization in this sector occurs through bilateral air service agreements. Sri Lanka has aggressively been pursuing greater market access in neighboring countries such as India and China. Greater liberalization in air services will be of benefit to all parties and will complement increased economic integration and liberalization of other services since it will facilitate efficient mobility of resources between trading countries.

## Sectors that Sri Lanka Could Liberalize

While Sri Lanka has export interests in services, it stands to benefit a great deal from liberalization of services within the country as well. The major services which have impact on the rest of the economy, such as telecommunications and finance, are very liberal. Telecom, for instance, is a standout example of the benefits of services liberalization. This sector has attracted foreign investment from several countries, and with it came technology and knowledge transfer. The increased competition has resulted in vast improvements in service delivery in this sector, and a further encouraging sign was the adaptation of the FDI to the local market. Today SMS is available in the local languages of Sinhalese and Tamil; service packages have adapted to feed the rural market by incorporating very cheap minimum top-up values and the provision of low-cost handsets. Given this experience, there is scope for liberalization in other sectors such as transport, construction (though regulatory practices in this field are not as yet suitable for liberalization to take place on a large scale), which would have positive spillover benefits throughout the rest of the economy.

*Maritime services:* In the maritime sector there would be benefits from foreign investment in dry ports, liberalization of maintenance and repair of ships, and from temporary migration of certain specialist seafarers such as navigating officers and marine engineers. Investment in the port and in maritime transport, in general, could further boost Sri Lanka's attempts at making Colombo a trans-shipment hub. However, in order to achieve this, there needs to be further investment in the expansion of the port so as to allow opportunities for foreign investment. Maritime transport services are a strength in many South Asian countries, given the major ports in Karachi, Chittagong, and in many locations around India. Therefore, there is much scope for benefits throughout South Asia if Sri Lanka liberalizes this sector.

*Computer and related services:* Along with maritime transport, there is scope for liberalization of the computer and related services sector. As mentioned earlier, the BPO sector is still in its infancy in Sri Lanka, and infusion of foreign investment through Mode 3 could be encouraged. This, however, needs to incorporate modalities to ensure technology transfer. This is a good example of how the

liberalization of services can be used to encourage the development of a particular sector in a country. For instance, in the BPO experience in Sri Lanka, many local workers started off in foreign-owned BPO firms, but with experience broke off to form competing ventures of their own. Sri Lanka could also benefit from temporary migration of qualified trainers to work with local workers in IT-enabled services. This liberalization would be of benefit to South Asian countries like India, Pakistan, and Bangladesh which have varying levels of expertise in this sector.

*Health services:* Whilst most professional services lack effective regulatory mechanisms, the medical sector has a relatively well defined system of regulation. There is scope, therefore, for temporary migration of certain specialists where there are shortages in the Sri Lankan market. This includes specialists such as neuro-surgeons, plastic surgeons and thoracic surgeons, and certain other shortages such as microbiologists, pathologists, and laboratory consultants. Furthermore, given the present security situation in the country, there are shortages of nurses and midwives in the north and east of the country. In this case as well, there is a case for temporary migration of workers from abroad. There is also scope for foreign investment in the health sector in Sri Lanka, particularly outside the major metropolitan areas of the western province. Given the cultural and geographic ties amongst the South Asian countries, it would be feasible for the South Asian specialists to fill in the gaps for specialists mentioned above. Countries like India and Pakistan have sophisticated health sectors and would benefit from any such liberalization by Sri Lanka.

There are certainly many benefits that Sri Lanka can gain by liberalizing individual sectors. Another overall benefit of making commitments, particularly at the GATS level, is the signal that it sends to investors. As it stands, Sri Lanka has made very limited commitments in the GATS, and this gives the incorrect impression that Sri Lanka has a highly protected service sector. If Sri Lanka makes further commitments (and this does not mean increased liberalization, but a level of liberalization even lower than the present level of liberalization provided unilaterally), it will act as a signal to investors that the country is open to investment. This is a far more useful way of attracting investment than spending large amounts on investment

promotion fairs and making wonton concessions that are detrimental to government tax revenue collection.

## Risks in the Liberalization of Services

It is clear from the last section that there are only few sectors which Sri Lanka would be comfortable liberalizing. This is a reflection of the risks inherent in service liberalization, both perceived risk and real.

*Gaps in data:* One of the major problems in Sri Lanka, and in developing countries in general, is the lack of data on services, and trade in services. For instance, even within some professional bodies, there is a lack of consensus on the disaggregated numbers of service providers in the profession. As a result, it is difficult to identify sectors where liberalization would have positive impact, and to predict the results of liberalization at all. Furthermore, there is limited public understanding of what is entailed in liberalization of services. Many stakeholders feel that liberalization is tantamount to flooding of domestic markets by foreign service suppliers, and are, therefore, very reluctant to make concessions that would in reality be beneficial for the sector. It is important to increase awareness of the fact that liberalization of services can be moderated through scheduling. However, given limitations in data, it is difficult to produce effective schedules which strike a balance between beneficial liberalization and effective safeguard measures. For instance, it is difficult to determine the most efficient cap on the number of service providers allowed into the country for a particular sector due to lacking data. If a country is under pressure to make commitments, it may well end up using an arbitrary figure which would be detrimental to the country's interest.

*Lack of regulatory capacity:* This is a major problem particularly for regulation of professional services. Many professional bodies in Sri Lanka have limited regulatory capacity, and even if they do have capacity, some of these bodies lack parliamentary authority to control activities of members. For instance, in Sri Lanka, the Construction Industry Act is yet to be implemented and therefore, Sri Lanka is unable to make commitments in this sector. The architectural institutes in the country have regulatory capacity but lack the required

"practice registration" which would allow them to legally regulate the activities of the members. In Sri Lanka, the lack of regulatory capacity is a problem even for domestic service regulation in certain sectors, and therefore, it is not in a state to extend this to foreign service suppliers as well. Services trade is an evolving topic and it is often difficult for regulators to keep up with the changes. For instance, in Sri Lanka, there is almost no regulation in trade through Mode 1. Therefore, there is great reluctance to make any commitments in this mode. If services are liberalized without effective regulation there could be serious problems in terms of ensuring quality of service delivery, health, and safety standards, and in the coordination of rules (for example, ensuring that the foreign supplier understands and complies with national laws and regulations).

A great deal of capacity is required for effective regulation, the task of comprehending the quality of various degrees from around the world (and even within countries there is great variation in the quality of degrees, example in India). Rushing into liberalization would compromise the role of effective regulation, which would undermine the interests of consumers. On the other side of the coin, it is argued that liberalization is often the spur that is required to force regulatory bodies to develop into high quality institutions capable of effective regulation. In Sri Lanka, this was the case in the health sector, where foreign investment brought in foreign doctors to work in hospitals, and the Sri Lanka Medical Council (SLMC) had to get its act together in order to regulate the practice of these new doctors. Today, despite its shortcomings, the SLMC is one of the best developed regulatory bodies of all the professional bodies. The importance of regulation stretches beyond professional bodies. The BoI is the primary coordinating body for investment in the country. It also has regulatory functions in terms of determining the extents of regulation on investment practices in order to ensure technology transfer, local employment levels, and so on. Therefore, it is important that the BoI has the capacity to fine tune investment conditionalities, so as to the result will maximize technology transfer whilst not deterring investment flows.

*Maturity of the services sector:* As mentioned earlier, a frequent misperception is that liberalization is equivalent to "opening the floodgates" which will result in mass unemployment. While this is

not true, given the possibility of tempering liberalization through scheduling, there is a risk that scheduling itself may not be effective, keeping in mind the data shortages and inaccuracies. In this context, it is important that Sri Lanka is cautious in liberalizing services due to the relative immaturity of its services sector. While some sectors are strong, others are very immature, such as the BPO sector. Overexposure to foreign competition could undermine the potential for some of these firms to emerge as strong firms in their own right. Domestic capabilities could also be undermined due to overexposure. For instance, if a certain medical specialty is in short supply in Sri Lanka, and foreign doctors are allowed to work in that sector, it could be dominated by foreign personnel and would discourage Sri Lankans from taking on that specialty due to an inability to break into the market once they reach the level of required maturity. Therefore, it is important to have a proper time period for which foreign workers can work in a specific sector. The difficulties in incorporating safeguards into services liberalization agreements cause another matter of concern. While it is argued that safeguards are not necessary since the country is able to clearly spell out any restriction in their commitment schedules, earlier schedules themselves are prone to error. However, it is difficult to implement safeguards due to complications such as defining and measuring a "surge" in services imports. This problem does not arise in goods trade. In countries like Sri Lanka, safeguards will be important simply in order to sell an agreement to stakeholders who would otherwise be, often irrationally, wary of such surges. In this context, it is in the interest of all countries to devise an effective safeguards text in the GATS.

*Labor market issues:* Another problem is that, in Sri Lanka, factor markets are very rigid, particularly in labor. Therefore, it is unlikely that fluid movements will take place in the labor market once liberalization causes shocks and displacements. Even at present, graduate unemployment is a major problem in Sri Lanka, and liberalization of the services sector could result in further, medium to long term unemployment of educated individuals who would be expecting to find jobs in the services sector.

While liberalization of Mode 4 is a key area of interest for Sri Lanka, it could also have drawbacks. The brain drain has affected

Sri Lanka in an acute manner in the past 25 years in particular, and this may be exacerbated if there is even easier access to foreign labor markets for skilled Sri Lankan workers. It is important to realize that Mode 4 is temporary. However, workers could get contracts renewed or continually find new markets to enter into, given the higher wages and standards of living on offer in developed nations.

## Capacity of Trade Negotiating Bodies and the Role of Stakeholders

Sri Lankan trade policy is formulated primarily by the Ministry of Commerce and Consumer Affairs while the Department of Commerce (DOC) is the main implementing body of trade policy. The DOC handles trade relations at the bilateral, multilateral, and regional levels through development and promotion of relations and engages in negotiations for trade agreements. Under-funding and lack of awareness of negotiating issues is a key constraint for trade negotiating bodies. There is a lack of capacity in terms of officials in Sri Lanka. Negotiating capacity needs to improve through technical assistance and institution building. The latter is particularly important, since often, those trained and experienced in negotiations are sent overseas to represent the country in other international forums resulting in a large amount of turnover at institutional levels. Building capacity requires technical assistance to continue, in the form of capacity building programs conducted by the WTO and other international organizations. Negotiations for trade liberalization are complex at best, and this is exacerbated in negotiations for liberalization of services. Since this is a new area, officials have little ability to "stand on the shoulders of giants" and many of the issues that arise are completely novel. The issues can be highly complex, such as determining the ownership of a firm which has both foreign and local capital, management, and staff. This particular example is important in Sri Lanka because, due to the immaturity of its own services sector, most of the firms that are large enough to take advantage of liberalization have some share of foreign ownership. In bilateral and regional services trade agreements, this is a problem since the "rules of origin" become

a matter of contention. It requires intensive training, knowledge, and experience to handle such issues in the best interest of the country. It is essential at the domestic level that the state recognizes the importance of negotiating capacity and competence as Sri Lanka gets increasingly embedded in the global economy. Sri Lanka will be involved in trade negotiations of growing complexity in the future therefore, effort will be needed to ensure the development of a stock of highly specialized and trained trade negotiators in the department of commerce.

Sri Lanka's negotiating capacity has been further stretched in attempts to move toward bilateral and regional trade agreements in parallel with the GATS negotiations. As mentioned earlier, at present Sri Lanka is negotiating the CEPA with India and has plans in the pipeline to engage in a similar agreement with Pakistan. Trade in services is also likely to be incorporated in the future SAFTA negotiations and in the BIMSTEC. At the best of times, negotiations in services are highly complex and information intensive, and therefore, it requires a great deal of resources in order to negotiate a single services agreement. There are several bodies which act in support of the Department of Commerce in trade negotiations. For instance, negotiations in the CEPA agreement between Sri Lanka and India are joint efforts between officials of the DOC, BoI, Central Bank, Institute of Policy Studies, and the Ministry of Foreign Affairs, and supported by the Ceylon Chamber of Commerce. While usage of a variety of expertise is a valuable asset, coordination of duties is sometimes a problem in this regard.

The Ceylon Chamber of Commerce has acted as the body which coordinates the incorporation of stakeholder views into negotiations. While the chamber takes efforts not only to coordinate but to educate and create awareness about trade agreements that have been signed and are in the pipeline, there remain great gaps in knowledge amongst the stakeholders themselves. This is particularly true with regard to trade in services, where knowledge of the implications of liberalization is often at a very naïve level. This undermines the ability of Sri Lankan stakeholders to make informed judgements and decisions with regard to their own interests in trade negotiations. As mentioned earlier, the chamber does make an effort to create awareness. This needs to continue in a more aggressive manner, but it is more important for the

stakeholders themselves to be aware of trade negotiations and trade agreements so that they can serve their own interests better. Another key issue is the lack of organizations of consumer interest. There are few organized consumer interest lobby groups. Therefore, it is very difficult for negotiators to take into account the interests of consumers in negotiations. Furthermore, the impact of services liberalization on the consumers is highly complex and has different implications in the long and the short run. It will be a while before Sri Lanka has an organized consumer interest lobby group, capable of making such informed judgements. A related problem is the lack of debate and awareness of trade policy issues at the highest political levels. Often, agreements are signed for political and international relations concerns without paying attention to economic agreements. A greater deal of quality debate at the parliamentary level on trade policy matters will contribute to a richer trade policy.

## Conclusion

This chapter has focused on liberalization of trade in services and the risks and opportunities thereof. However, in order to take advantage of opportunities through liberalization, there is a great deal of reform that needs to take place at the domestic level. In terms of taking advantage of liberalization, the supply side is a key issue. For instance, in the BPO sector, the major constraints that were identified for expansion in the sector in the Lirneasia study include the lack of skilled personnel who are fluent in English, 43 percent of the firms expressed dissatisfaction with the supply of skilled personnel, and 38 percent expressed dissatisfaction with the quality of the available individuals. Forty-eight percent of the firms felt that telecommunications services (particularly broadband and leased line facilities) are an obstacle to growth. Thirty-eight percent felt that broadband facilities were unreliable. Only 29 percent considered leased line services as reliable (De Silva et al., 2006). Lokanathan (2005) suggests that Sri Lanka's costs in using leased line facilities are higher than in India and Pakistan.

Sri Lanka's Domestic Private Leased Circuit (DPLC) price for 2 mbit/s is around USD 6,518 for a 2 km distance and around USD 7,901 for a

100 km distance. Seventeen comparative DPLC costs in India are USD 376 and USD 3,899, and in Pakistan, the prices are USD 1,598 and USD 6,948. (Lokanathan, 2005)

A further concern is that leased line facilities have limited penetration outside Colombo where costs such as rent and wages could be lower, and firms are unable to take advantage of these cost differentials. Therefore, a significant investment in telecommunications infrastructure and in education will be required to take greater advantage of liberalization of the BPO sector. While these processes have long term benefits, a short term fix would be for the state to contribute to training processes which are undertaken by firms. Ninety-five percent of firms in the Lirneasia study invested in training for their staff, and it is possible for the state to facilitate, encourage, and regulate standards of private training institutions specialized in the skills required for the BPO sector.

Another more general concern with regard to taking advantage of opportunities of liberalization is the lack of awareness of opportunities. This is particularly true in areas where services trade is technology intensive, and the larger, more traditional firms in Sri Lanka lack the dynamism to grasp these opportunities. The BPO sector is one area where these opportunities have been exploited, but as mentioned earlier, this sector is very much in its infancy. The media could play a role here in publicizing the innovative efforts of certain successful firms.

The second key area to consider when discussing the ability to take advantage of the opportunities of liberalization is the area of hidden costs faced by firms attempting to export services. For instance, if a Sri Lankan firm wishes to set up a commercial presence in another country which has liberalized the sector in question, if there are hidden barriers such as stringent regulatory and bureaucratic processes, hidden taxes, and other delays, these may act as prohibitory barriers to service exports. It is in the interest of the firms in question to make clear their concerns to negotiating bodies when undertaking service liberalization negotiations.

The liberalization of services is a complex and energy consuming task. There are a number of pitfalls that may arise, a number of

fundamental issues that need to be tackled in order to benefit from liberalization, and a number of risks to domestic actors. However, this should not discourage us from pursuing this task. As is now well known, the services sector is increasingly dominating the global economy, and economic liberalization has a great number of benefits, hence there is no reason why the two cannot come together as long as we understand the inherent issues and are able to navigate through the road blocks.

## Notes

1. Sri Lanka Tourist Board, 2007.
2. Government of Sri Lanka report to the WTO secretariat as part of *Trade Policy Review* (2003).
3. For instance, obtaining accountancy qualifications in the US requires for non-nationals costs up to USD 1,300 and requires multiple examinations followed by a work experience requirement which may stretch up to two years.
4. For instance, obtaining accountancy qualifications in the US requires, for non-nationals, costs up to USD 1,300 and requires multiple examinations followed by a work experience requirement which may stretch up to two years.
5. Central Product Classification devised by the United Nations Statistics Division.

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# 5

# Bangladesh

Ananya Raihan

## Background

One of the major driving forces of future global economic growth is the liberalization of services trade which addresses development concerns. In the face of losing competitiveness in trade in goods, developed countries identified a new source of growth in trade in services. Setting up a global regime for trading in services through inclusion of a multilateral agreement under the World Trade Organization (WTO) was the first step in realizing that potential. Less developed countries observed growth of the services sector in their economies with an increased share in their national output. In the national income accounts of almost all developing countries, the contribution of the services sector accounts for more than 50 percent of the national income. Presently, at least 25 developing countries depend on services exports for more than half of their total export earnings. Over 50 percent of the Foreign Direct Investment (FDI) flows were directed to the services sectors by 2000, while the corresponding number for the manufacturing sector was 42 percent (UNCTAD, 2003).

However, growth potential through liberalization of markets was not obvious for less developed countries. It was not clear what services they can sell in the global market for reaping the benefit of liberalization. It was also not clear how the liberalization of trade in services could

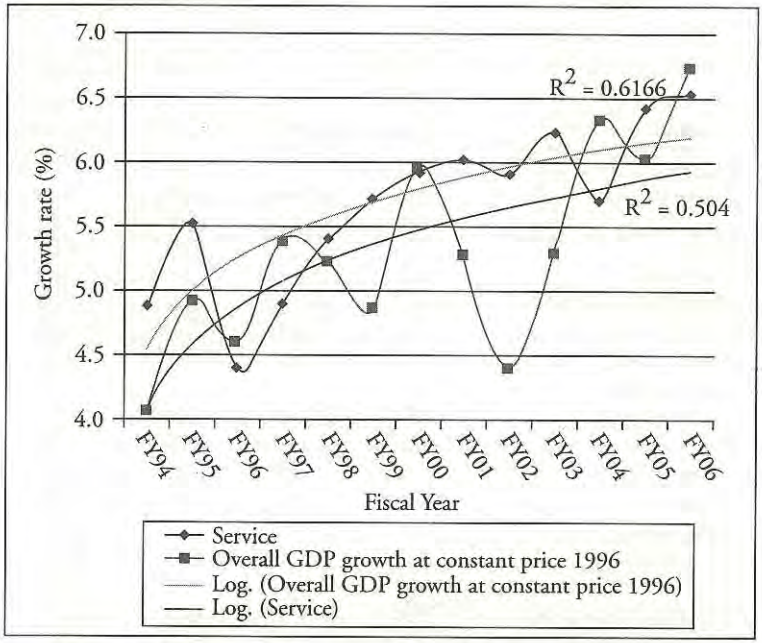
work for development, to be more specific for poverty alleviation. The experience of trade liberalization since the 1990s shows that opportunities for growth through trade liberalization is often theoretical and potential in nature; however, the danger of jeopardizing domestic economy through unplanned liberalization is real. Despite initial disagreement, countries, both developed and less developed, conceived the idea of achieving further economic growth through increased tradability of services. During the last seven years, the multilateral efforts for liberalizing trade in services are faltering and have failed to convince the less developed countries that the outcome of the negotiations at multilateral forums will be benefiting them equally. With that background, the South Asian trading bloc South Asian Free Trade Area (SAFTA) attempted to expand its coverage through inclusion of trade in services into the agreement. Currently, the countries are studying whether the expansion of liberalization horizon by the inclusion of services into SAFTA's portfolio is feasible. This chapter may provide some food for thought from Bangladesh's perspective to all relevant stakeholders of the process.

## Importance of the Services Sector in Bangladesh

The contribution of the services sector in Bangladesh's economy has gained dominance during the last two decades in terms of its share in the national income accounts. The share of the services sector in the Gross Domestic Product (GDP) has increased from 46.5 percent in Fiscal Year (FY)[1] 1983 to 61.3 percent in FY 2006. The services sector GDP in FY 2006 was USD 43.31 billion. The overall trend of growth of the services sector is higher than the overall GDP growth during the FY 1994–2006 (Figure 5.1). The growth of the services sector GDP was 6.5 percent in FY 2006, while the overall GDP growth was 6.7 percent in the same period.

Bangladesh's major services sectors, their respective shares in the GDP and their growth rates are presented in Table 5.1. According to the growth rates recorded in FY 2006, the major services sub-sectors of the Bangladesh economy are construction services (8.37 percent), transport, storage, and communication services (8.25 percent), educational services (7.98 percent), electricity, gas, and water supply (7.72 percent), hotel and restaurants (7.45 percent), wholesale and retail

**Figure 5.1**
**Trend of Growth of Services Sector and Overall Economic Growth**




*Source:* Ministry of Finance, Government of Bangladesh, various years.

trade (7.26 percent), health and social work (7.13 percent), financial intermediations (7.12 percent), and real estate, renting, and business activities (3.69 percent). All these services, except real estate and other rental services, have growth rates higher than the average GDP growth rate of 6.7 percent (Raihan, 2006).

In terms of the share in the GDP, major services sectors are wholesale and retail trade (14.17 percent), transport, storage, and communication services (10.1 percent), construction (9.15 percent), real estate, renting, and business activities (7.88 percent), community, social, and personal services (7.25 percent), public administration and defense (2.71 percent), educational services (2.47 percent), health and social work (2.26 percent), financial intermediations (1.7 percent), electricity, gas, and water supply services (1.65 percent), and hotel and restaurants (0.69 percent). These sectors combine to account for 60.03 percent of the GDP in FY 2006 (Raihan, 2006).

**Table 5.1**
**Sectoral Growth and Share of Services Sectors in the GDP**

| | *2005–06*[P] | | | |
|---|---|---|---|---|
| *Sub-Sectors* | *GDP (USD Million)* | *GDP (Crore Tk)* | *Sectoral Share of GDP (%)* | *Sectoral Growth Rates (%)* |
| Utility services | 735 | 4,515 | 1.65 | 7.72 |
| Electricity | 616 | 3,784 | 1.38 | 7.76 |
| Gas | 82 | 504 | 0.18 | 8.66 |
| Water | 37 | 227 | 0.08 | 5.08 |
| Construction | 4,081 | 25,055 | 9.15 | 8.37 |
| Wholesale and retail trade | 6,317 | 38,781 | 14.17 | 7.26 |
| Hotels and restaurants | 306 | 1,881 | 0.69 | 7.45 |
| Transport, storage, and communication | 4,506 | 27,660 | 10.1 | 8.25 |
| Land transport | 2,983 | 18,312 | 6.69 | 4.37 |
| Water transport | 397 | 2,439 | 0.89 | 1.97 |
| Air transport | 51 | 313 | 0.11 | 1 .37 |
| Support transport services and storage | 133 | 817 | 0.3 | 0.64 |
| Post and telecommunications | 941 | 5,779 | 2.11 | 28.56 |
| Financial intermediations | 757 | 4,647 | 1.7 | 7.12 |
| Monetary interrnediations (Banks) | 566 | 3,474 | 1.27 | 6.85 |
| Insurance | 161 | 991 | 0.36 | 7.46 |
| Other financial intermediations | 30 | 182 | 0.07 | 10.64 |
| Real estate, renting, and business activities | 3,513 | 21,568 | 7.88 | 3.69 |
| Public administration and defense | 1,209 | 7,424 | 2.71 | 8.21 |
| Education | 1,100 | 6,755 | 2.47 | 7.98 |
| Health and social work | 1,007 | 6,179 | 2.26 | 7.13 |
| Community, social, and personal services | 3,235 | 19,860 | 7.25 | 4.08 |

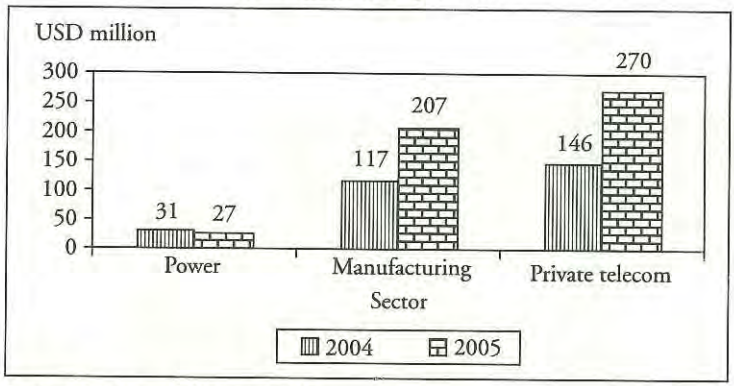
***Source:*** Economic Survey, Ministry of Finance, Bangladesh (2006); Raihan, 2006.
***Notes:*** Tk = Taka (Bangladesh currency); P = Provisional.

The growth of the services sectors has had a positive impact on employment generation. According to the employment statistics of Bangladesh Bureau of Statistics (BBS) 2000, 26.8 percent of the employed population is in the services sector whereas the share

for agriculture is 62.9 percent. Thus, the GDP–employment ratio for the services sector is much higher than that of agriculture. The GDP–employment ratio for the services sector is USD 1312.09 per employee per annum. The corresponding ratios for industry and agriculture are USD 1,944.70 and USD 383.81 respectively. The services sector is dominated by male labor force which is 82 percent of the labor force involved in the services sector. On the other hand, the share for agriculture is only 53.37 percent (Raihan, 2006).

Services sector also dominates the FDI inflow to Bangladesh (Figure 5.2). In 2004, out of the total FDI inflow of USD 660 million, 66.76 per cent came to the services sector, which includes *inter alia*, telecommunications, and energy and power (BOI, 2004, 2005).

**Figure 5.2**
**Investment in Key Sectors**




*Source*: Raihan and Hassan, 2006.

During 2004–05, the telecommunications sector came to be the most attractive sector for the FDI (Figure 5.2 and Table 5.2). This sector attracted foreign investors with an investment of USD 270 million in 2005, which is 33 percent of the total FDI inflow of that year. In 2004, the volume of the FDI inflow to this sector was USD 237.41 million, which was 35.93 percent of the total FDI inflow. In 2001, the private telecom was rather limping with a mere USD 1 million FDI to its credit. The scenario, however, has undergone a change in the following years with USD 49 million in 2002, USD 46 million

**Table 5.2**
**Sectoral Distribution of FDI in Bangladesh for 2004**

| *Sector* | *BOI Registered (in Million USD)* | *BEPZA Registered (in Million USD)* | *Financial Institutions (in Million USD)* | *Total (in Million USD)* | *Sectoral Share (%)* | *Sectoral Rank (Position)* |
|---|---|---|---|---|---|---|
| Service | 374.252 | 0.354 | 66.518 | 441.124 | 66.76 | – |
| Telecommunications | 237.410 | – | – | 237.410 | 35.93 | 1 |
| Energy and power | 133.045 | – | – | 133.045 | 20.13 | 2 |
| Power generation | 15.676 | – | – | 15.676 | 2.37 | – |
| Oil, gas, and coal | 117.369 | – | – | 117.369 | 17.76 | – |
| Other services | 3.797 | 0.354 | 66.518 | 70.669 | 10.69 | 4 |
| Financial institutions | – | – | 66.518 | 66.518 | 10.07 | – |
| Others | 3.797 | 0.354 | – | 4.151 | 0.63 | – |
| Manufacturing | 55.676 | 151.146 | – | 206.822 | 31.30 | – |
| Textile | 14.995 | 101.893 | – | 116.888 | 17.69 | 3 |
| Chemical | 19.681 | 27.642 | – | 47.323 | 7.16 | 5 |
| Leather and rubber | 8.666 | 10.026 | – | 18.692 | 2.83 | 6 |
| Agro-based | 7.284 | 1.752 | – | 9.036 | 1.37 | 9 |
| Food and allied | 3.212 | – | – | 3.212 | 0.49 | 10 |
| Glass and ceramics | 1.280 | – | – | 1.280 | 0.19 | 11 |
| Printing and publications | 0.558 | – | – | 0.558 | 0.08 | 12 |
| Misc/NEC | – | 9.833 | – | 9.833 | 1.49 | 8 |
| Engineering | 0.771 | 12.089 | – | 12.860 | 1.95 | 7 |
| Total | 430.699 | 163.589 | 66.518 | 660.806 | 100 | |

***Source:*** BOI, 2005.

in 2003, followed by a massive USD 146 million and USD 270 million in the next two years. Actually, the investment in this sector during the last five years facilitated to achieve a teledensity of 8.4 percent in April 2006 (Raihan and Habib, 2006).

Construction and real estate has become one of the booming sectors in Bangladesh. In the FY 2004, domestic investment in the construction sector represented more than three-fourth (about 75 percent) of the total Gross Fixed Capital Formation (GFCF) and its share has been steady during FY 1997–2005 (Table 5.3). It is one of the most important growth sectors of the economy today (Figure 5.5). The second highest component of investment is plant and machinery: its contribution is 14 percent. The third category is transport equipment whose share is 11 percent.

**Table 5.3**
**Composition of Gross Fixed Capital Formation (GFCF) at Constant Price (Base: 1995–96 = 100)**

| *Year* | *Construction* | *Plant and Machinery* | *Transport Equipment* | *GFCF* | *GFCF as % of GDP* |
|---|---|---|---|---|---|
| FY97 | 270.4 | 52 | 39.8 | 363.6 | 21.1 |
| FY98 | 292.4 | 58.6 | 45 | 397.2 | 22.4 |
| FY99 | 315.4 | 63.2 | 47.8 | 427.7 | 23.5 |
| FY00 | 350.7 | 66.6 | 51.8 | 470.6 | 23.8 |
| FY01 | 379.4 | 75.8 | 39.2 | 496.1 | 23.9 |
| FY02 | 406 | 77 | 38.5 | 522.6 | 24.8 |
| FY03 | 421.7 | 85 | 46.1 | 553.9 | 25.4 |
| FY04 | 449.2 | 109.8 | 45.8 | 606 | 26.1 |
| FY05 | 483.7 | 116.1 | 46.5 | 647.6 | 27 |

*Source:* BBS, 2005.

Real investment in residential housing and other construction activities has recorded a steady growth of average 8–9 percent per annum during the period FY 1999–2002. However, since FY 2003, the growth rate recorded a fluctuating trend that went down to 3.9 percent in FY 2003. Again in FY 2004, the growth in this sector gained momentum and picked up to 6.5 percent, and it is likely to be somewhat higher in FY 2005 (7.7 percent). The investment boom in this sector is caused by a number of factors of which steady growth

of the GDP, increasing rate of urbanization and increasing share of urban population, and industries expansion are the major factors. The substantial gains in Bangladesh's final domestic demand in the recent years have led to a marked rise in capital spending in this sector (BBS, 2005).

The other important element in construction activities is infrastructure development such as roads and highways, bridges, schools and hospitals, administrative buildings, etc. Construction activities in the industrial sector is also one of the important destinations of investment, for instance, construction of factory buildings in export-oriented ready-made garments. Recent boom of service sector activities, as evident in its share in the GDP (more than 60 percent in the recent years) gave a further spurt on investment in construction work due to the fact that trade and other services-oriented activities, especially in health, education, and recreation industries recorded a phenomenal growth in the last couple of years. The addition of retail space for domestic commercial and foreign trade activities in response to buoyant consumer demand lifted the growth momentum of GFCF by construction activities in the commerce sector. All these developments show evidence of sustained investment growth in the construction sector (Bangladesh Bank, 2005).

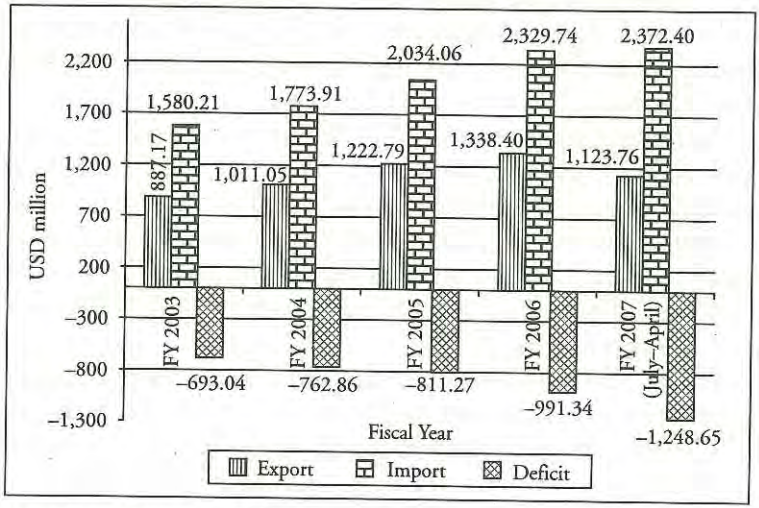
## State of Trade in Services

### Trade in Services

Bangladesh services trade shows a chronic deficit: the deficit is gradually increasing in the recent years (Figure 5.3). There was a trend of higher growth of export more than the growth of services in import. In FY 2004, the growth of service export was 16.01 percent, whereas the growth of import was 14.27 percent. This trend continued in FY 2005 (Bangladesh Bank, 2005); however, since FY 2006, there is a reverse trend (see Figure 5.3).

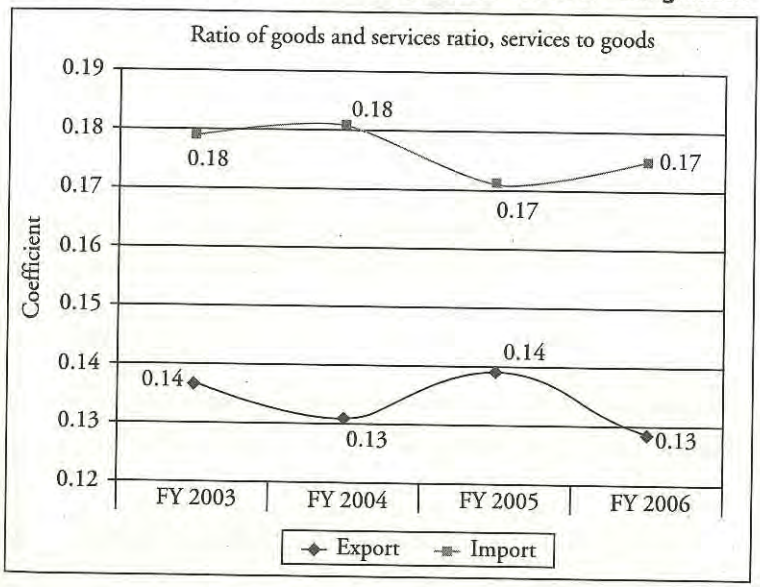
On the other hand, despite having the lion's share in the GDP, the share of trade in services compared to trade in goods is still heavily in favor of goods, which shows that the services industry is still domestic market oriented. Ratio of export of services to export of goods is nearly 1:10 (see Figure 5.4).

**Figure 5.3**
**Bangladesh's Trade in Services and Balance**




*Source:* Bangladesh Bank Data.

**Figure 5.4**
**Ratio of Trade in Services to Merchandise Trade for Bangladesh**

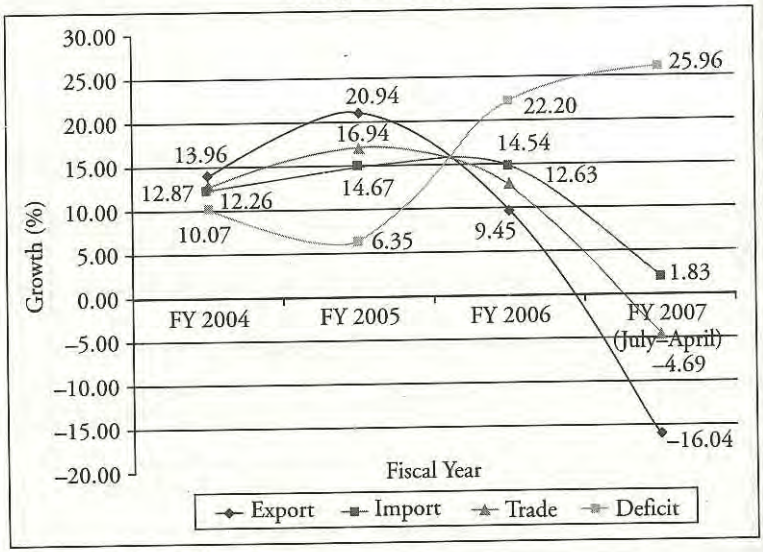



*Source:* Bangladesh Bank Data.

The growth of trade in services has also shown a fluctuating trend. In FY 2000, the overall growth in trade in commercial services was 31.87 percent, however, the growth fell to 2.28 percent in the following year. In FY 2001, the growth turned into recession with a negative growth of 25.35 percent. This trend was largely attributed to global recession and the post-9/11 syndrome. The trade in services recovered in FY 2003 and from a low base of FY 2002, the growth was 20.22 percent. If one compares the trade figure of FY 2003 and FY 2000, one observes a growth in export by 9.66 percent, but a recession of –16.86 percent. As a result, the overall growth of trade in commercial service in FY 2003 in comparison with FY 2000 was –8.21 percent (Raihan, 2006).

Since FY 2004, other than deficit in trade in services, both growth in export and import have slowed down (Figure 5.5). Most of the sectors of the economy in Bangladesh suffer from a negative balance except a few, namely, computer and related services, telecommunications services, distribution services, life insurance, and maritime transport services.

**Figure 5.5**
**Growth Trends of Services Sector: Export, Import, Trade, and Deficit**




*Source:* Bangladesh Bank Data.

# Trade in Services with South Asia

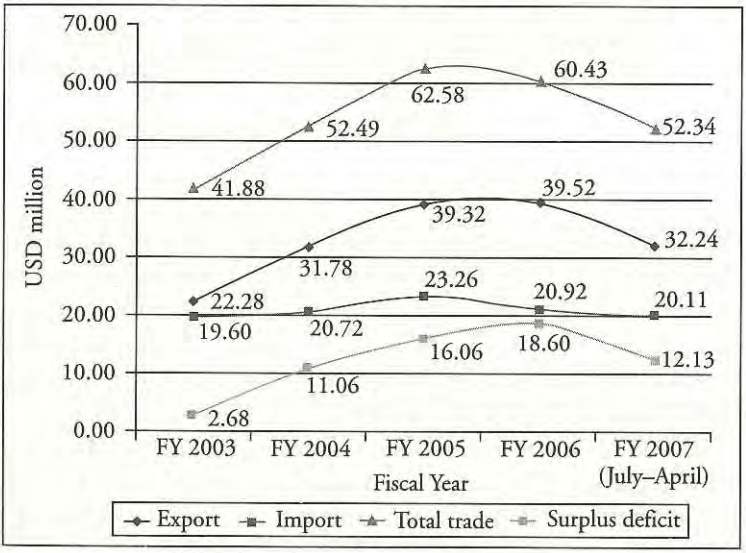
## Trends of Trade in Services

While analyzing the trends of trade in services with South Asia, two important features have been depicted:

1. The overall trade of Bangladesh in services with South Asia is miniscule as compared to the total trade in services of the country.
2. There is a systematic surplus in trade in services with the South Asian nations, which is contrary to common understanding.

While the total trade in services of Bangladesh is only one-tenth of trade in goods, the share of trade in goods with the South Asian nations is only 3 percent of Bangladesh's total trade in services. In FY 2006, the total trade in services with South Asia was only USD 60.43 million (Figure 5.6), of which 71.78 percent occurred with

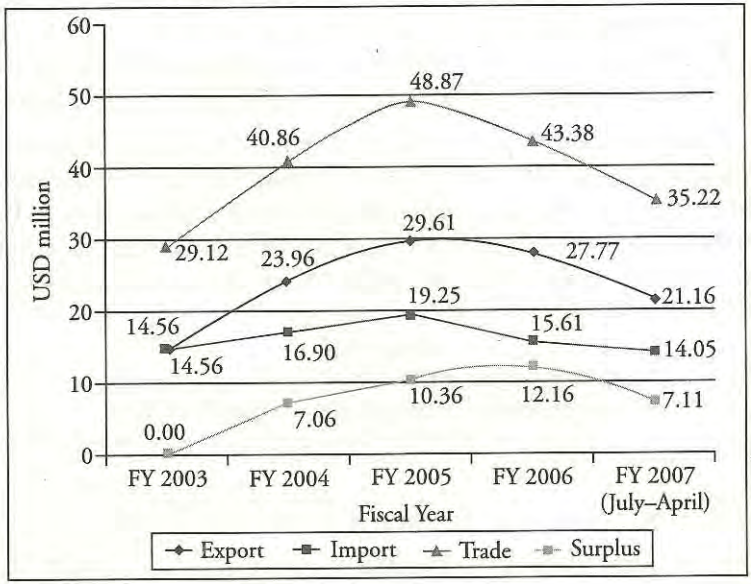
**Figure 5.6**
**Trade in Services with South Asia: Overall Trends: Export, Import, Total Trade, Surplus/Deficit**




*Source:* Bangladesh Bank Data.

India and 17.02 percent with Sri Lanka (Figure 5.7). The share with Pakistan was about 7 percent. The remaining 5 percent of trade took place with four other nations. This low volume of trade in services should be kept in mind while drawing any conclusion regarding the potential of trade in services in South Asia.

**Figure 5.7**
**Trends of Trade in Services with India**




*Source:* Bangladesh Bank Data.

It is interesting to note that while Bangladesh is suffering from a chronic deficit in trade in goods with India, in the case of services Bangladesh is enjoying a systematic surplus. The total trade in services with India was USD 43.38 million in FY 2006. The surplus in that year was USD 12.16 million. Bangladesh's highest export of services to India was in FY 2005 with a volume of USD 29.61 million.

The second largest South Asian trading partner of Bangladesh in the services sector is Sri Lanka with a total trade volume of USD 10.29 million. Here also, Bangladesh is enjoying a trade surplus since FY 2004. In FY 2006, the surplus was USD 6.95 million.

### Liberalization of Services Trade in the South Asian Context

Having limited data on trade in services among the South Asian nations, it is difficult to identify the sectors where Bangladesh has offensive or defensive interest. The services import pattern of neighboring countries would also be helpful in this regard.

The previous analyses on Bangladesh show that, in general, Bangladesh may have both offensive and defensive interest in services trade liberalization (Raihan and Mahmood, 2004). However, in the context of South Asia, the analysis is not adequate.

While explicit trade interest has been identified in the energy, transport, and tourism sectors, interest in computer and related services and telecommunication services is also growing. Furthermore, the liberalization under the Temporary Movement of Natural Persons (TMNP) is going to be a big issue in the coming days. While all the South Asian nations are demanding liberalization of trade in services under Mode 4 in the General Agreement on Trade in Services (GATS) negotiations, it is not clear whether the countries in South Asia are open for such liberalization to each other depending on their needs.

## Bangladesh's Interest in GATS Negotiations

### State of Offer–Request Process

In the Doha Development Round (DDR), nine countries have submitted requests to Bangladesh to open different service sectors. The requests made to Bangladesh are presented in Table 5A.5. The requesting countries are Singapore, the European Commission (EC), Japan, Norway, Korea, Hong Kong (China), Malaysia, Sri Lanka, and the USA. The European Union's requests are most comprehensive, which have called for an opening of computer and related services, construction and related engineering services, environmental services, financial services, transport services, and other business services. Japan's requests were limited to only infrastructure services which include telecommunication services, construction and related engineering services, distribution services, financial services, and

transport services. Norway has requested to open up environmental services and telecommunication services. Singapore's request was only for the liberalization of maritime transport services. Requests for making "horizontal commitments" were common for Mode 4. There was a request to remove the Most Favored Nation (MFN) exemptions on the application of different tariff accounting rates in the telecommunication sector. It is to be mentioned that the MFN exemptions have expired automatically at the end of 2004. In the maritime transport sector, particularly in equipment and international cargo, there are some specific requests under market access. In terms of frequency, requests from more than one country came for maritime transport, financial services, construction and related engineering services, telecommunications, and environmental services. Requests from a single country came for computer and related services, distribution services, other business services, and services auxiliary to all modes of transport. It is important to note that no countries have requested to open education and health sectors.

## Bangladesh's Interests in Offer–Request Negotiations

Bangladesh is participating in the offer–request negotiations process under the Doha Round negotiations of the WTO which theoretically allows her to take care of both her offensive and defensive interests (Raihan, 2003). Thus, from this perspective, Bangladesh's defensive interest is important. In an identification of the services sectors with export interest, import interest, and interest in protection of domestic service suppliers, the factors that have been considered are:

1. Growth potential of demand for particular services in domestic markets.
2. Global demand for particular services sectors.
3. Potential of those services sectors which can meet increased domestic and global demand (available training facilities, capacity building, technology acquisition, etc.).
4. Analysis of balance of payments situation of individual services sectors to understand current trends in export and import of services.

5. Provision of infrastructure and its improvement for meeting the growing demand.
6. Availability of investment and scope for attracting FDI.
7. Regulatory environment facilitating growth of new sectors.
8. Adoption of pro-competitive policies.

## Sectors of Export Interest

A number of sectors have been identified in which Bangladesh has export interests, namely:

1. Computer and related services;
2. Telecommunication services;
3. Distribution services; and
4. Life insurance and maritime transport.

Amongst these listed sub-sectors of export interest, distribution services have the highest share in Bangladesh's GDP (13.91 percent in FY 2003). In this particular sub-sector, there are hardly any foreign service providers in the domestic market. This sub-sector covers a large number of Small and Medium Enterprises (SMEs) which constitute the major source of employment for the economy. Thus, the distribution services have export interests but they need protection to maintain their present level of contribution to the GDP. The share of the transportation sector in Bangladesh's GDP is also high (9.78 percent), while the corresponding share of maritime transport is more than 50 percent. However, the maritime sector is classified separately under the GATS. Therefore, an identification of the export-import interests for this sector requires further analysis.

## Sectors of Import Interest

The sub-sectors in which Bangladesh has import interest are:

1. Rental/leasing services without operators.
2. Construction and related engineering services.
3. Education services.
4. Health and social services.
5. Tourism and travel-related services.

6. News agency services.
7. Research and development services.
8. Air transport services.

Among these sectors, the construction and related engineering sector has 8.63 percent share in Bangladesh's GDP. Technology transfer plays a significant role in the development of this sector. As the sector has a high stake for domestic service providers as well as substantial import, its liberalization should be balanced. The GDP shares of educational services (2.36 percent), health-related and social services (2.21 percent), and tourism and travel-related services (0.67 percent) are comparatively low. Liberalization of these sectors will attract foreign investment which will facilitate their further growth and will play an import substitution role in the long run, particularly in the health and education sectors.

The experience of opening the education sector to foreign competition shows that the opening of off-shore campuses of foreign universities and the growth of private universities with foreign affiliation creates some sort of import substitution effect. The same is true for the health sector. However, the sectoral stakeholders have strong reservations in opening these two sectors under Mode 4.

## Sectors Requiring Protection

The sub-sectors with mixed signs in the Balance of Payments are audio-visual services, financial services (non-life, reinsurance, and banking), personal, cultural and recreational services, and rail transport services. It is to be mentioned that the financial sector in Bangladesh has already been opened up under the aegis of the World Bank and the International Monetary Fund (IMF) since the 1990s. Although the share of this sector is not very high in the GDP (1.7 percent), the sector plays an important role in the macro-economic stability. The increased frequency of financial crisis across the globe provides hints for a cautious approach in further liberalization of the sector. Rail transportation has a long tradition in Bangladesh since the British colonial age. Due to the lack of investment in the sector and politicization, the sector could not flourish despite its huge potential. Bangladesh has import interest as well as export interest in this sector.

However, the balance is more on the side of protectionism. Thus, the policy makers should follow a cautious approach in liberalizing these sectors.

In Table 5.4, the sectors for which Bangladesh received requests from different countries have been compared with the sectors for which Bangladesh has trading interest. Amongst the sectors for which

**Table 5.4**
**Identification of Sectors for Offers and Requests**

| *Sector Requested to Bangladesh* | *Sectors of Export Interest* | *Sectors of Import Interest* | *Mixed Interest* |
|---|---|---|---|
| Maritime transport | Maritime transport services | | |
| | | Education services | |
| | | | Audio-visual services |
| Environmental services | | | |
| | | Health and social services | |
| Financial services (insurance and banking, and other insurance) | | | Financial services (non-life, reinsurance, banking) |
| | | Tourism and travel-related services | |
| Telecommunication services | Telecommunication services | | |
| | | News agency services | |
| | | | Rail transport services |
| Construction and related engineering services | | Construction and related engineering services | |
| | | | Personal, cultural, and recreational services |
| Computer and related services | Computer and related services | | |

(*Table 5.4 continued*)

(*Table 5.4 continued*)

| *Sector Requested to Bangladesh* | *Sectors of Export Interest* | *Sectors of Import Interest* | *Mixed Interest* |
|---|---|---|---|
| | | Research and development services | |
| Other business services | | | |
| | | Rental/leasing services without operators | |
| Distribution services | Distribution services | | |
| | | Air transport services | |
| Services auxiliary to all modes of transport | | | |
| | Life, accident, and health insurance services | | |

***Source:*** Author's own analysis.

Bangladesh received requests, two sectors have been identified for offers and one for request. These are:

1. Financial services (non-life, reinsurance, and banking).
2. Telecommunication services.
3. Computer and related services (requests).

The sectors that have also been selected for offers in which Bangladesh has import interests through Mode 3 are:

1. Health and related services.
2. Tourism and travel-related services.

Education services have been selected for both offers and requests. Apart from the education sector, the other major area for requests is temporary movement of natural persons (Mode 4). The justification of selection of Mode 4 for requests has been elaborated in the previous section.

Altogether, five sectors have been selected for offers. These are:

1. Financial services.
2. Telecommunication services.

3. Health and related services.
4. Tourism and travel-related services.
5. Education sector.

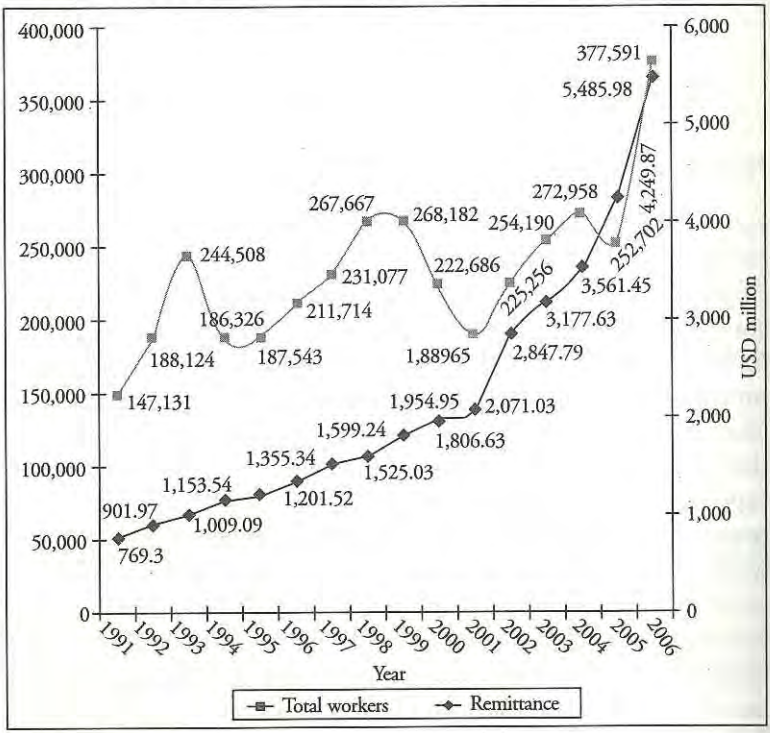
## Potential of Trade in Services in TMNP[2]

### Number of Workers Going Abroad

From 1976 to 2007,[3] 4.82 million Bangladeshis went aboard with temporary work permit for providing services in the Middle East, Asia, Africa, and Europe. In 2006, the total number of workers who went abroad was 377,591. For comparison, in 1976 the number was only 6,087. During the period 1976–93, the growth of export of services providers was steady; however, the trend became volatile from 1994. Since the major destination of the workers is Middle Eastern countries, the fall in the export of manpower between 1994 and 2001 can be explained by the Gulf War and US invasion of Iraq. Data on export of manpower with temporary work permits shows that Bangladesh sent workers only to the Maldives. In 2006, a total of 7,372 people went to the Maldives. This figure was 43 in 2007 [Bureau of Manpower, Employment and Training (BMET), 2007]. The remittance from temporary workers is the second largest source of foreign exchange earnings for Bangladesh. The remittance earnings in 2006 were USD 5,485.98 million (Figure 5.8). Due to the remittance earning, the Balance of Payments of Bangladesh is out of pressure.

There is a common misperception that Bangladesh can send only less-skilled workers abroad. However, the composition of workers going abroad for 2003 was: professionals 6.2 percent, skilled workers 29.3 percent, semi-skilled 11.5 percent, and less-skilled 52.9 percent. The composition shows that Bangladesh's capacity to supply skilled workforce is not only limited to less-skilled categories, although less-skilled categories have significant weight in total export. The trend of exporting services through TMNP (Figure 5.8) proves the fact that if there had been no interruption in exports of manpower, such as war, the export of services through TMNP would have achieved further growth. This trend is valid for all skill categories except semi-skilled workers.

**Figure 5.8**
**Annual Number of Workers Going Abroad and Remittance Earnings**



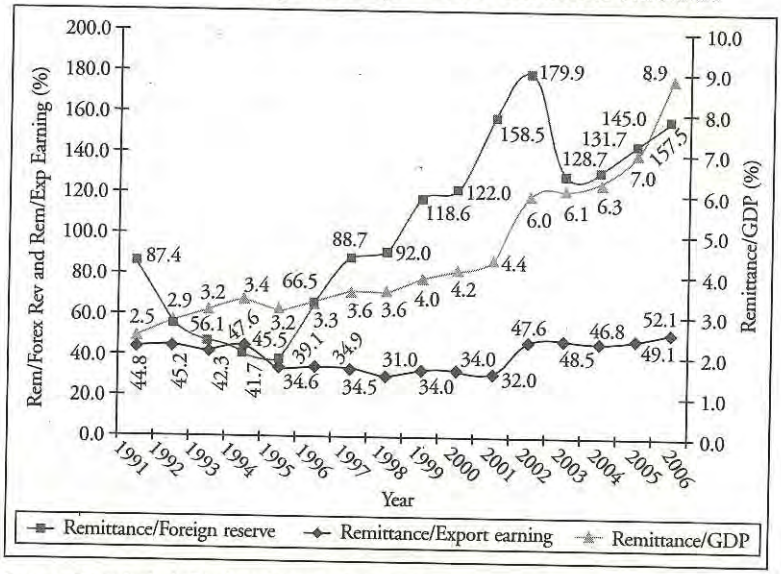

*Source:* BMET, 2007.

## TMNP and Macro-economic Stability

Generally, sources of stability are sought for sustained growth in agriculture and industry. Unfortunately, the role of the export of workers has remained under shadow. In FY 2006, the remittance earning was equivalent to 7.03 percent of the GDP. In FY 2006, the remittance earning from workers was equivalent to 7.03 per cent of GDP. This ratio has shown an increasing trend over the years. The ratio of remittance and export earnings is also increasing steadily and in FY 2006 it was 49.11 percent. The remittance is playing an important role in the stability of foreign exchange reserve and it was 1.45 times higher than the foreign reserve of FY 2006. Remittance earnings are

also playing a positive role in attaining sound Balance of Payments (BoP) (Figure 5.9).

**Figure 5.9**
**Remittance Earning and Major Macro-economic Variables**




*Source*: Bangladesh Bank, Ministry of Finance.

The number of workers going aboard to provide services is around 23 percent of the total number of population entering the labor force.[4] Considering the number of overseas workers between 2000–03, around 25 percent of the labor force goes abroad, reducing the pressure on the unemployment situation of the country.

## TMNP and Poverty Alleviation

The TMNP has a direct poverty alleviation impact. A study (IOM, 2003) shows that the higher the skill and education level of the overseas workers and employees, the lower their ties with the host country and the incidence of sending remittances back home. About 94 percent of the Bangladeshi overseas workers are beyond professional categories, have strong ties with their home, and they tend to send a

significant portion of their remittance back to their home country. The investigation on the pattern of expenditure of the workers shows that the expatriate workers spend 29.8 percent of their income for personal consumption abroad; they send 44.9 percent of their income back home and save 22.8 percent (IOM, 2002).

The remittances sent by the overseas workers are used for various productive, investment, and consumption purposes. A major share of the remittances (36 percent) is used to meet recurrent consumption which includes education, health care, and food (Table 5.5). Another 20 percent is used for investment in land properties. Around 14 percent of the remittances is spent for better housing arrangements (IOM, 2002). Moreover, remittances for the host families play an important role in restructuring their income structure and consumption (Table 5.6).

## Developing Countries are More Open than Developed

The geographical distribution of TMNP from Bangladesh shows the major destination of Bangladeshi workers is the Middle East where

**Table 5.5**
**Annual Expenditure of Overseas Workers' Households**

| | *Expenditure (USD)* | | | *Distribution* | |
|---|---|---|---|---|---|
| *Item* | *Before* | *After* | *Change* | *Before* | *After* |
| Food | 558.6 | 627.3 | 12.3 | 58.71 | 54.23 |
| Footwear/Apparel | 59.1 | 75.4 | 27.6 | 6.21 | 6.52 |
| House maintenance | 11.6 | 12.1 | 4.5 | 1.22 | 1.05 |
| Education | 67.2 | 101.9 | 51.6 | 7.06 | 8.81 |
| Medical expenses | 23.3 | 48.5 | 108.2 | 2.45 | 4.2 |
| Social expenses | 36.4 | 50.8 | 39.7 | 3.82 | 4.39 |
| Electricity | 26.5 | 29.1 | 9.8 | 2.78 | 2.51 |
| Water, gas, fuel | 39.3 | 49.4 | 25.7 | 4.13 | 4.27 |
| Transport | 24.2 | 30.9 | 27.7 | 2.54 | 2.67 |
| Occupation related | 87.3 | 103.6 | 18.7 | 9.17 | 8.96 |
| Cosmetics | 16.4 | 24.0 | 46.9 | 1.72 | 2.08 |
| Others | 1.8 | 3.8 | 111.0 | 0.19 | 0.33 |
| Total | 951.5 | 1,156.8 | 21.6 | 100 | 100.02 |

***Source:*** IOM, 2002.

**Table 5.6**
**Annual Income of Overseas Workers' Families**

| | *Income (USD)* | | | *Distribution* | |
|---|---|---|---|---|---|
| *Source of Income* | *Before* | *After* | *Change* | *Before* | *After* |
| Agriculture | 271.5 | 245.8 | –9.5 | 25.45 | 14.83 |
| Agricultural wages | 13.9 | 6.4 | –53.7 | 1.3 | 0.39 |
| Non-agricultural wages and salary | 439.0 | 133.0 | –69.7 | 41.14 | 8.03 |
| Business | 250.8 | 188.4 | –24.9 | 23.51 | 11.36 |
| Remittances | 75.9 | 1,067.3 | 1,306.0 | 7.11 | 65.39 |
| Other sources | 15.9 | 16.6 | 4.5 | 1.49 | 1 |

***Source:*** IOM, 2002.

94.4 percent of the total TMNP takes place (2003). The shares of Asia, Africa, Europe, and others are 4.0 percent, 1.4 percent, 0.2 percent, and 0.1 percent respectively (Table 5.7). The TMNP to Europe in 1995 was 329 people to Spain. Recently, Ireland, Italy, and UK started to hire Information and Communication Technology (ICT) professionals, total number of which was 397 in 2003. Singapore, Korea and Malaysia are the major destinations for Bangladeshi workers in Asia.

The analysis shows that the movement of natural persons is more liberal in the developing countries than in the developed.

**Table 5.7**
**Geological Distribution of Temporary Workers**

| | *Middle East* | *Africa* | *Others* | *Asia* | *Europe* | *Total* |
|---|---|---|---|---|---|---|
| 1994 | 133,057 | 1,890 | 222 | 51,157 | 0 | 186,326 |
| 1995 | 140,617 | 1,335 | 303 | 44,959 | 329 | 187,543 |
| 1996 | 130,640 | 2,162 | 383 | 78,025 | 504 | 211,714 |
| 1997 | 196,154 | 2,172 | 798 | 31,475 | 478 | 231,077 |
| 1998 | 242,943 | 1,270 | 418 | 23,036 | 0 | 267,667 |
| 1999 | 254,997 | 1,883 | 204 | 11,098 | 0 | 268,182 |
| 2000 | 190,574 | 1,281 | 89 | 30,742 | 0 | 222,686 |
| 2001 | 167,996 | 722 | 1,192 | 19,055 | 0 | 188,965 |
| 2002 | 216,158 | 1,633 | 204 | 7,123 | 138 | 225,256 |
| 2003 | 239,935 | 3,564 | 211 | 10,083 | 397 | 254,190 |
| Share (2003) | 94.4 | 1.4 | 0.1 | 4.0 | 0.2 | 100.1 |

***Source:*** BMET Database, various years.

The temporary movement of the workforce takes place in these countries through bilateral arrangements at the level of governments. However, implementation of the bilateral inter-governmental arrangements takes place through involvement of private sectors. Individuals of Bangladesh can directly contact the agencies in the host countries and go for a short stay.

## Identification of Skill Categories for Bangladesh

To identify the categories of professions in which Bangladesh has specific export interests, the national categories have been matched with the International Standard Classification for Occupation (ISCO-88) classifications. The mapping exercise shows that Bangladesh exports service providers through TMNP in all skill categories according to ISCO-88 classification and also to all continents (Table 5.8).

**Table 5.8**
**Distribution of Service Providers through TMNP by Skill Categories**

| *Code* | *Major Group* | *2-Digit Categories* | *3-Digit Categories* | *Number of Service Providers* | *Share (%)* |
|---|---|---|---|---|---|
| 1 | Legislators, senior officials, and managers | 1 | 1 | 203 | 0.1 |
| 2 | Professionals | 3 | 6 | 1,564 | 0.7 |
| 3 | Technicians and associate professionals | 2 | 3 | 655 | 0.3 |
| 4 | Clerks | 1 | 1 | 1,834 | 0.8 |
| 5 | Service workers and shop and market sales workers | 2 | 5 | 3,812 | 1.7 |
| 6 | Skilled agricultural and fishery workers | 1 | 2 | 1,828 | 0.8 |
| 7 | Craft and related trades workers | 4 | 10 | 92,435 | 41.0 |
| 8 | Plant and machine operators and assemblers | 3 | 6 | 30,004 | 13.3 |
| 9 | Elementary occupations | 3 | 6 | 92,878 | 41.2 |
| | Percentage of total | 71.43 | 21.28 | 225,213* | 100.0 |

*Source:* Center for Policy Dialogue (CPD) Analysis from BMET data.

*Note:* *Although aggregate data was available for 12 months of 2003, the disaggregate data is available for 11 months.

The mapping exercise is a step forward toward requesting "categories of interest by [Least Developed Countries] LDCs"[5] to the members, both in the GATS negotiations and the SAFTA negotiations. The next step is to identify the categories in which there is a demand for workers in the SAFTA countries. Thus, through negotiations a mutually agreed list of services providers could be drawn.

### Potential Gain for Bangladesh

Simulation exercise shows that the potential benefit from the increase of number of skilled services providers is the lowest which may be explained by the low ratio of skilled workers in the total composition of migrant workers. An increase of 200,000 skilled workers would bring USD 381 million. The potential benefit from exporting less-skilled workers is more than that of exporting skilled workers. An increase in the number of less-skilled workers by 200,000 would bring an additional USD 3.5 billion. The benefit from the export of professionals by increased number of professionals going abroad is even higher. The potential benefit from exporting of 200,000 professionals would be USD 11.57 billion (Raihan and Mahmood, 2004).

The simulation shows that for making services trade working for the poor, there is a need for opening the market for temporary less-skilled services providers.

## Future Path of Progress through Trade in Services

It is important to understand whether the aspirations of Bangladesh in the WTO and SAFTA are the same regarding the liberalization of services trade. The analysis in Table 5.8 shows that the sectors needing protection, sector of import and export interest, as well as mixed interest, are not specific to any country. From that perspective, the expectations from the SAFTA is no way different. However, from the perspective of supply capacity of the South Asian nations and availability of market, the set of sectors may differ. However, this needs further investigation. As the common aspirations are the

same, one can conclude that the strategy for reaping benefit may be broadly similar.

## Development Objectives

A number of services sectors have direct development implications. The most important among them is the export interest in Mode 4 as it has direct linkage with poverty alleviation (Raihan, 2004). The telecom sector is also very important for overall economic growth and for linking poor people to global economic opportunities. A major policy objective of the telecom sector in South Asia is to increase access to telecommunication facilities across the countries. The growth of the telecommunications industry will also contribute positively to the growth of the derivative sectors of the economy. A development policy objective of the education sector is to provide universal education to all citizens, specifically education up to the secondary level. On the other hand, for tertiary sectors, the objective is to create an environment of import substitution and enhance the quality of education.

## Addressing Domestic Policy Issues

An orthodox approach adopted by many LDCs including Bangladesh, which propagates that they do not need to open any sector, should be changed. Many sectors would benefit through an open policy regime and a predictable competitive environment. However, proper sectoral study is a prerequisite for opening more sectors. Opportunities through market opening would only be meaningful when an adequate supply of quality services providers exists. Investment in training and education (fiscal resource issues) is a must for ensuring quality supply. It is important to ensure that the strategy should include a plan for improving quality, standards, and the competitiveness of service providers. Establishment of independent regulatory bodies and monitoring mechanisms to ensure standards is another way to create level playing fields. The strategy should include a plan for active negotiations for Mutual Recognition Agreements with key markets. Short-term bilateral agreements with selected countries and

institutions would be useful to understand and streamline the difficulties. These efforts would help to bring transparency in mutual recognition.

Bangladesh and other South Asian LDCs lack policy to regulate skilled labor outflow. The current structure is solely dedicated to dealing with low-skilled services providers. The regulation for inward migration is confined only to the manufacturing sector. These issues also need proper consideration for creating a vibrant services sector in the LDCs. The policy of exporting services providers through TMNP requires a plan for the attraction of returned migrants, the essential element of which is to help them to be effectively absorbed into the domestic labor market.

The strategy of inclusion of trade in services into the SAFTA should also address the issues of brain drain and brain circulation through incentives, improved domestic conditions, and recovery of lost investment. Finally, it is essential to develop bilateral cooperation on visa and recruitment policies with host countries to regulate flows.

## Building Partnership with Country Groups

In the WTO negotiations, the LDCs are weak individually but together they can be a very strong group. It is true that the interests of the Bangladesh and South Asian LDCs differ from those of the African LDCs. While the interest of the South Asian LDCs is in Non-Agricultural Market Access (NAMA) and Mode 4, the African LDCs are more interested in the outcome of negotiations in the agreement on agriculture. Within agriculture negotiations, a few sub-Saharan countries have strong interests in cotton issues. Despite the apparent differences, it is possible to develop a common agenda for negotiations for all LDCs. The situation within the SAFTA is a bit different. There are two groups within the SAFTA—LDCs and DCs. The interests of the LDCs within South Asia are not conflicting but in some cases they are not common. In case of Bhutan and Maldives they do not have any aspiration to capture the labor market of South Asia which is the opposite for Bangladesh and Nepal. Thus, a partnership with Nepal might be useful in developing a common strategy to get benefit out of any SAFTA services arrangement.

## Strategy for Mode 4

It would be very important to deal with issues like the Economic Needs Tests (ENTs) and Mutual Recognitions within South Asia. All WTO members within the SAFTA are very vocal on these issues. The possible inclusion of trade in services would be testimony of the SAFTA countries as to how they would tackle them within the SAFTA context. It can be argued that those unjust mechanisms, against which all South Asian members are fighting in the WTO negotiations, would not be imposed in the case of SAFTA-TIS (trade in services).

India is the promoter of the concept of the GATS visa in the GATS negotiations. This provision can be tested under the SAFTA-TIS and can be showcased in the GATS. Bangladesh can emphasize on this issue.

The current export structure of services providers through the TMNP from Bangladesh shows that the export destinations are Europe, Asia, Africa, and the Middle East. One specific feature of export through the TMNP is that the developing countries are more open to receiving temporary service providers than the developed countries. Thus, the South Asian developing countries would also be open to similar market access. This structure can be an example that regulated market access may be mutually benefiting for SAFTA members.

India is a big promoter of the concept of de-linking commercial presence from Mode 4. It is also important to supplement sectoral commitments, not substitute for them. Bangladesh should highlight that de-linking should be the basis for any future inclusion of trade in services in the SAFTA agreement.

The GATS flexibility should be interpreted rightly and also used within the SAFTA framework so that the SAFTA-TIS allows flexibility to modulate commitments in four ways: by sector, category, skill-level, and period of stay. This explanation resolves the problem of definition of temporary stay.

In terms of identification of priority categories for the SAFTA, the ISCO-88 based classification may also be used which was supported by India in the GATS negotiations. The exercise performed by the author may be used for any future negotiations under the SAFTA on inclusion of all skill categories.

The skill categories of ISCO-88 have been divided into three groups. Group 1 includes the ISCO-88 categories of short-term priorities for which the number of services providers exported from Bangladesh is more than 1,000. It has 23 categories at the 3-digit level and all 1-digit level categories except category 1 (Table 5A.2). The major categories in Group 1 are nursing and midwifery professionals, secretaries, personal services workers, guards, salespersons, farmers, miners, building finishers, painters, machinery mechanics and fitters, metal workers, handicraft workers, printers, food processing workers, machine operators, domestic helpers, cleaners and launderers, drivers, caretakers, agricultural laborers, and construction workers.

Group 2 contains categories of mid-term priorities. It consists of 19 3-digit level categories. The number of services providers exported under this group is less than 1,000. The 1 digit categories under group 2 are 1, 2, 3, 5, 6, 7, 8, and 9 (Table 5A.3). Major categories under the group of mid-term priorities are managers, physicists, chemists and related professionals, architects, engineers and related professionals, life sciences professionals, health professionals (except nursing), college, university and higher education teaching professionals, computer associate professionals, optical and electronic equipment operators, finance and sales associate professionals, protective services workers, fashion and other models, shop salespersons and demonstrators, livestock workers, metal molders, welders, sheet-metal workers, structural-metal preparers and related trades workers, machine operators, textile, fur and leather products machine operators and messengers, porters, doorkeepers, and related workers.

Group 3 includes categories in which Bangladesh is not exporting currently. However, these categories are important for both the countries—the one that exports services (that is, Bangladesh), and the country that imports the services—since both have potential for exports in the future in these categories because of: *(a)* existence of educated unemployed, and *(b)* current protection in importing countries. Under these categories there are 39 3-digit level categories (Table 5A.4).

It is important to keep in mind that the policies for management of returnees are important to argue for TMPN. The strategy should identify domestic policies to facilitate human development benefits and mitigate the costs of temporary movement of services suppliers.

## Capacity Building and Technical Assistance

Investment in human development by the South Asian LDCs is essential to reap potential benefit from market access for TMNP. It is also in the developed and developing countries' interest to provide support in developing a quality workforce which could be quality resources for temporary services supply in their economy.

## Sharing Responsibility

The problem of illegal migration of workforce is harmful both for host and recipient countries. Bangladesh should be ready to share the responsibility for inhibiting illegal stay in the recipient countries after the contract period. One of the remedies of this problem is the capacity of absorption by the host countries of returned workforce after completion of services contract.

## Annexure

**Table 5A.1**
**Bangladesh's Trade with South Asian Nations (USD Million)**

| | *FY 2003* | *FY 2004* | *FY 2005* | *FY 2006* |
|---|---|---|---|---|
| Afghanistan | | | | |
| Export | 0.001727 | 0.00509 | 0.032579 | 0.120751 | 0.289729 |
| Import | 0.013817 | 0.169664 | 0.309497 | 0.253429 | 0.115892 |
| Trade | 0.02 | 0.17 | 0.34 | 0.37 | 0.41 |
| Deficit | –0.01 | –0.16 | –0.28 | –0.13 | 0.17 |
| Bhutan | | | | |
| Export | 0.241796 | 0.084832 | 0.162893 | 0.313059 | 0.434594 |
| Import | 0.172712 | 0.135731 | 0.179182 | 0.298151 | 0.20281 |
| Trade | 0.41 | 0.22 | 0.34 | 0.61 | 0.64 |
| Deficit | 0.07 | –0.05 | –0.02 | 0.01 | 0.23 |
| India | | | | |
| Export | 14.55959 | 23.95657 | 29.61394 | 27.77281 | 21.16471 |
| Import | 14.55959 | 16.89854 | 19.25395 | 15.60823 | 14.05186 |
| Trade | 29.12 | 40.86 | 48.87 | 43.38 | 35.22 |
| Deficit | 0.00 | 7.06 | 10.36 | 12.16 | 7.11 |

(*Table 5A.1 continued*)

(*Table 5A.1 continued*)

| | | *FY 2003* | *FY 2004* | *FY 2005* | *FY 2006* |
|---|---|---|---|---|---|
| Maldives | | | | | |
| Export | 0 | 0.01018 | 0.011403 | 0.011926 | 0.004346 |
| Import | 0.051813 | 0.050899 | 0.065157 | 0.163983 | 0.072432 |
| Trade | 0.05 | 0.06 | 0.08 | 0.18 | 0.08 |
| Deficit | –0.05 | –0.04 | –0.05 | –0.15 | –0.07 |
| Nepal | | | | | |
| Export | 2.867012 | 0.288429 | 0.537547 | 0.730471 | 1.709402 |
| Import | 0.656304 | 0.797421 | 0.814465 | 0.775194 | 0.89816 |
| Trade | 3.52 | 1.09 | 1.35 | 1.51 | 2.61 |
| Deficit | 2.21 | –0.51 | –0.28 | –0.04 | 0.81 |
| Pakistan | | | | | |
| Export | 2.107081 | 2.544961 | 3.111256 | 1.952892 | 1.289295 |
| Import | 3.264249 | 1.900238 | 1.661508 | 2.146691 | 1.723888 |
| Trade | 5.37 | 4.45 | 4.77 | 4.10 | 3.01 |
| Deficit | –1.16 | 0.64 | 1.45 | –0.19 | –0.43 |
| Sri Lanka | | | | | |
| Export | 2.504318 | 4.886325 | 5.847858 | 8.616577 | 7.344633 |
| Import | 0.880829 | 0.763488 | 0.977358 | 1.669648 | 3.042156 |
| Trade | 3.39 | 5.65 | 6.83 | 10.29 | 10.39 |
| Deficit | 1.62 | 4.12 | 4.87 | 6.95 | 4.30 |
| All South Asia | | | | | |
| Export | 22.28 | 31.78 | 39.32 | 39.52 | 32.24 |
| Import | 19.60 | 20.72 | 23.26 | 20.92 | 20.11 |
| Total | 41.88 | 52.49 | 62.58 | 60.43 | 52.34 |
| Deficit | 2.68 | 11.06 | 16.06 | 18.60 | 12.13 |
| Rest of the world | | | | | |
| Export | 864.89 | 979.27 | 1183.47 | 1,298.88 | 1,091.52 |
| Import | 1,560.61 | 1,753.19 | 2,010.80 | 2,308.83 | 2,352.30 |
| Trade | 2,425.49 | 2,732.46 | 3,194.27 | 3,607.71 | 3,443.82 |
| Deficit | –695.72 | –773.92 | –827.33 | –1009.94 | –1,260.78 |
| All countries | | | | | |
| Export | 887.17 | 1011.05 | 1,222.79 | 1,338.40 | 1,123.76 |
| Import | 1,580.21 | 1,773.91 | 2,034.06 | 2,329.74 | 2,372.40 |
| Total | 2,467.37 | 2,784.95 | 3,256.85 | 3,668.14 | 3,496.16 |
| Deficit | –693.04 | –762.86 | –811.27 | –991.34 | –1,248.65 |

***Source:*** Bangladesh Bank Data.

**Table 5A.2**
**Important Categories in the Short Run**

| *Code* | *Major Group* | *Code* | *Sub-Major Group* | *Code* | *Minor Group* |
|---|---|---|---|---|---|
| 2 | Professionals | | | 223 | Nursing and midwifery professionals |
| 4 | Clerks | 41 | Office clerks | 411 | Secretaries and keyboard-operating clerks |
| 5 | Service workers and shop and market sales workers | 51 | Personal and protective services workers | 514 | Other personal services workers |
| | | | | 516 | Protective services workers |
| | | 52 | Models, salespersons, and demonstrators | 523 | Stall and market salespersons |
| 6 | Skilled agricultural and fishery workers | 61 | Market-oriented skilled agricultural and fishery workers | 613 | Market-oriented crop and animal producers |
| 7 | Craft and related trades workers | 71 | Extraction and building trade workers | 711 | Miners, shot-firers, stonecutters, and carvers |
| | | | | 713 | Building finishers and related trades workers |
| | | | | 714 | Painters, building structure cleaners, and related trade workers |
| | | 72 | Metal, machinery, and related trade workers | 723 | Machinery mechanics and fitters |
| | | | | 724 | Electrical and electronic equipment mechanics and fitters |
| | | 73 | Precision, handicraft, printing, and related trades workers | 731 | Precision workers in metal and related materials |
| | | | | 733 | Handicraft workers in wood, textile, leather, and related materials |
| | | | | 734 | Printing and related trades workers |

(*Table 5A.2 continued*)

(*Table 5A.2 continued*)

| *Code* | *Major Group* | *Code* | *Sub-Major Group* | *Code* | *Minor Group* |
|---|---|---|---|---|---|
| | | 74 | Other craft and related trades workers | 741 | Food processing and related trades workers |
| | | | | 742 | Wood treaters, cabinet-makers, and related trades workers |
| 8 | Plant and machine operators and assemblers | 82 | Machine operators and assemblers | 821 | Metal and mineral products machine operators |
| | | 83 | Drivers and mobile plant operators | 832 | Motor vehicle drivers |
| 9 | Elementary occupations | 91 | Sales and services elementary occupations | 913 | Domestic and related helpers, cleaners, and launderers |
| | | | | 914 | Building caretakers, window, and related cleaners |
| | | 92 | Agricultural, fishery, and related laborers | 921 | Agricultural, fishery, and related laborers |
| | | 93 | Laborers in mining, construction, manufacturing, and related occupations | 931 | Mining and construction workers |
| | | ## | Other | 934 | Other |

***Source:*** ISCO-88.

## Table 5A.3
## Important Categories in the Mid-Term

| *Code* | *Sub-Major Group* | *Code* | *Minor Group* |
|---|---|---|---|
| 12 | Corporate managers | 122 | Production and operations department managers |
| 21 | Physical, mathematical, and engineering science professionals | 211 | Physicists, chemists, and related professionals |
| | | 214 | Architects, engineers, and related professionals |

(*Table 5A.3 continued*)

(*Table 5A.3 continued*)

| *Code* | *Sub-Major Group* | *Code* | *Minor Group* |
|---|---|---|---|
| 22 | Life sciences and health professionals | 221 | Life sciences professionals |
| | | 222 | Health professionals (except nursing) |
| 23 | Teaching professionals | 231 | College, university, and higher education teaching professionals |
| 31 | Physical engineering science associate professionals | 312 | Computer associate professionals |
| | | 313 | Optical and electronic equipment operators |
| 34 | Other associate professionals | 341 | Finance and sales associate professionals |
| | | 516 | Protective services workers |
| 52 | Models, salespersons, and demonstrators | 521 | Fashion and other models |
| | | 522 | Shop salespersons and demonstrators |
| 61 | Market-oriented skilled agricultural and fishery workers | 612 | Market-oriented animal producers and related workers |
| 72 | Metal, machinery, and related trades workers | 721 | Metal molders, welders, sheet-metal workers, structural-metal preparers, and related trades workers |
| 81 | Stationary plant and related workers | 812 | Metal-processing plant operators |
| | | 823 | Rubber and plastic products machine operators |
| | | 826 | Textile, fur, and leather products machine operators |
| | | 829 | Other machine operators and assemblers |
| 9 | | 915 | Messengers, porters, doorkeepers, and related workers |

***Source:*** ISCO-88.

## Table 5A.4
## Important Categories in the Long Run

| *Code* | *Major Group* | *Code* | *Sub-Major Group* | *Code* | *Minor Group* |
|---|---|---|---|---|---|
| | | | | 112 | Senior government officials |
| | | 11 | Legislators and senior officials | 113 | Traditional chiefs and heads of villages |
| 1 | Legislators, senior officials, and managers | | | 114 | Senior officials of special interest organizations |
| | | 12 | Corporate managers | 121 | Directors and chief executives |
| | | | | 123 | Other departmental managers |
| | | 13 | General managers | 131 | General managers |
| | | | | 212 | Mathematicians, statisticians, and related professionals |
| | | | | 213 | Computing professionals |
| | | | | 232 | Secondary education teaching professionals |
| | | | | 233 | Primary and pre-primary education teaching professionals |
| | | | | 234 | Special education teaching professionals |
| 2 | | | | 235 | Other teaching professionals |
| | | | | 241 | Business professionals |
| | | | | 242 | Legal professionals |
| | | | | 243 | Archivists, librarians, and related information professionals |
| | | 24 | Other professionals | 244 | Social sciences and related professionals |
| | | | | 245 | Writers and creative or performing artists |
| | | | | 246 | Religious professionals |

(*Table 5A.4 continued*)

(*Table 5A.4 continued*)

| *Code* | *Major Group* | *Code* | *Sub-Major Group* | *Code* | *Minor Group* |
|---|---|---|---|---|---|
| | | 31 | Physical and engineering science associate professionals | 311 | Physical and engineering science technicians |
| | | | | 314 | Ship and aircraft controllers and technicians |
| | | | | 315 | Safety and quality inspectors |
| | | 32 | Life science and health associate professionals | 321 | Life science technicians and related associate professionals |
| | | | | 322 | Modern health associate professionals (except nursing) |
| | | | | 323 | Nursing and midwifery associate professionals |
| | | | | 324 | Traditional medicine practitioners and faith-healers |
| 3 | Technicians and associate professionals | 33 | Teaching associate professionals | 331 | Primary education teaching associate professionals |
| | | | | 332 | Pre-primary education teaching associate professionals |
| | | | | 333 | Special education teaching associate professionals |
| | | | | 334 | Other teaching associate professionals |
| | | | | 342 | Business services agents and trade brokers |
| | | | | 343 | Administrative associate professionals |
| | | | | 344 | Customs, tax and related government associate professionals |
| | | | | 345 | Police inspectors and detectives |
| | | | | 346 | Social work associate professionals |
| | | | | 347 | Artistic, entertainment, and sports associate professionals |
| | | | | 348 | Religious associate professionals |

| | | | | |
|---|---|---|---|---|
| 4 | | | | 412 Numerical clerks |
| | | | | 413 Material-recording and transport clerks |
| | | | | 414 Library, mail, and related clerks |
| | | | | 419 Other office clerks |
| | | 42 | Customer services clerks | 421 Cashiers, tellers, and related clerks |
| | | | | 422 Client information clerks |
| 5 | Service workers and shop and market sales workers | 51 | Personal and protective services workers | 511 Travel attendants and related workers |
| | | | | 512 Housekeeping and restaurant services workers |
| | | | | 513 Personal care and related workers |
| | | | | 515 Astrologers, fortune-tellers, and related workers |
| | | 61 | Market-oriented skilled agricultural and fishery workers | 611 Market gardeners and crop growers |
| 6 | Skilled agricultural and fishery workers | | | 614 Forestry and related workers |
| | | | | 615 Fishery workers, hunters, and trappers |
| | | 62 | Subsistence agricultural and fishery workers | 621 Subsistence agricultural and fishery workers |
| 7 | | | | 712 Building frame and related trades workers |
| | | | | 732 Potters, glass-makers, and related trades workers |
| | | | | 743 Textile, garment, and related trades workers |
| | | | | 744 Felt, leather, and shoemaking trades workers |
| 8 | Plant and machine operators and assemblers | 81 | Stationary plant and related operators | 811 Mining and mineral-processing plant operators |
| | | | | 813 Glass, ceramics, and related plant operators |
| | | | | 814 Wood processing and papermaking plant operators |
| | | | | 815 Chemical processing plant operators |
| | | | | 816 Power production and related plant operators |
| | | | | 817 Automated assembly-line and industrial robot operators |

(*Table 5A.4 continued*)

(*Table 5A.4 continued*)

| *Code* | *Major Group* | *Code* | *Sub-Major Group* | *Code* | *Minor Group* |
|---|---|---|---|---|---|
| | | | | 822 | Chemical products machine operators |
| | | | | 824 | Wood products machine operators |
| | | | | 825 | Printing, binding, and paper products machine operators |
| | | | | 827 | Food and related products machine operators |
| | | | | 828 | Assemblers |
| | | 83 | Drivers and mobile plant operators | 831 | Locomotive engine-drivers and related workers |
| | | | | 833 | Agricultural and other mobile plant operators |
| | | | | 834 | Ship deck crews and related workers |
| | | 91 | Sales and services elementary occupations | 911 | Street vendors and related workers |
| 9 | Elementary occupations | | | 912 | Shoe cleaning and other street services elementary occupations |
| | | | | 916 | Garbage collectors and related laborers |
| | | | | 932 | Manufacturing laborers |
| | | | | 933 | Transport laborers and freight handlers |

***Source:*** ISCO-88.

## Table 5A.5
## Sector Specific Request to Bangladesh

| *Country* | *Services* | *Sector* | *Mode* | *Request* | |
|---|---|---|---|---|---|
| | | | | *Market Access* | *National Treatment* |
| | **Transport services** | | | | |
| | Transport | | | | |
| | | International passenger and freight transport | Modes 1, 2, and 3 | Take full commitments | |
| Singapore | | Maritime agency services | | | |
| | | Ship broking | | | |
| | | International towage | Mode 4 | "Unbound except as indicated in the horizontal section" | Unbound except as indicated in the horizontal section |
| | | Classification societies | | | |
| | **Business services (other than professional services)** | | | | |
| | Computer and related services | | Mode 1, 2, 3 | "none" | none |
| | | | Mode 4 | "Horizontal commitments" | |
| EC | Other business services | Management consulting service (Central Product Classification [CPC] 865) | Mode 1, 2, 3 | "none" | none |

(*Table 5A.5 continued*)

(*Table 5A.5 continued*)

| *Country* | *Services* | *Sector* | *Mode* | *Request* | |
|---|---|---|---|---|---|
| | | | | *Market Access* | *National Treatment* |
| | | Services related to management consulting (CPC 866) | Mode 4 | "Horizontal commitments" | |
| EC | **Construction and related engineering services** | | | | |
| | | General construction work for buildings (CPC 512) | Mode 3 | "none" | "none" |
| | | General construction work for civil engineering (CPC 513) | | | |
| | | Installation and assembly work (CPC 514+516) | Mode 4 | "Horizontal commitments" | |
| | | Building completion and finishing work (CPC 517) | | | |
| | | Other (CPC 511+515+518) | | | |
| | **Environmental services** | | | | |
| | Water for human use and wastewater management | Water collection, purification, and distribution services through mains, except steam and hot water | Mode 3 | Take commitments | Take commitments |

| | | | | |
|---|---|---|---|---|
| | | Wastewater services (CPC 9401) | | |
| | Solid/hazardous waste management | Refuse disposal services (CPC 94020) | Mode 4 | "Horizontal commitments" |
| | | Sanitation and similar services (CPC 94030) | | |
| | Protection of ambient air and climate | Services to reduce exhaust gases and other emissions and improve air quality (CPC 94040) | | |
| EC | Remediation and clean-up of soil and water | Treatment, remediation of contaminated/polluted soil and water (part of CPC 94060) | | |
| | **Financial services** | | | |
| | General | | | Follow the classification of the Annex on financial services |
| | Insurance | | Mode 1 | Take commitments on reinsurance and retrocession |
| | | | Mode 3 | Take commitments on direct insurance (life and non-life) |
| | Banking and other financial services | | Mode 1 | Take commitments |
| | | | Mode 3 | Take commitments |

(*Table 5A.5 continued*)

(*Table 5A.5 continued*)

| | | | | *Request* | |
|---|---|---|---|---|---|
| *Country* | *Services* | *Sector* | *Mode* | *Market Access* | *National Treatment* |
| EC | **Transport services** | | | | |
| | Maritime transport | International transport (CPC 7211 and 7212) | | Take commitment in accordance with the attached model schedule | |
| | | Additional commitments | | | |
| | | Maritime auxiliary services | | | |
| | | Multimodal activities | | | |
| | | Definitions | | | |
| | Equipment | | | * | |
| | International cargo | | | ** | |
| | | Size of the port | | | |
| | | Binding existing ad hoc practices | | To the extent exceptions are already granted for use of foreign flagged vessels. Such practices could be bound to explicitly cover pre- and onward-carriage of international cargo. | |
| | | Geographical limitations | | Transport of international cargo between ports within the same division (or other regional entity) remains excluded. | |

| | | | | | |
|---|---|---|---|---|---|
| EC | Services auxiliary to all modes of transport | Storage and warehouse services (CPC 742) | Mode 2 and 3 | "none" | "none" |
| | | | Mode 4 | "Horizontal commitments" | |
| | | Freight transport agency/freight forwarding services (CPC 748) and pre-shipment inspection (part of CPC 749) | Mode 1, 2, and 3 | "none" | "none" |
| Japan | Infrastructure services | | Mode 4 | "Horizontal commitments" Commitments to be made/ improved in infrastructure services, including telecommunication services, construction and related engineering services, distribution services, financial services, and transport services. | |
| Norway | **MFN exemptions** Telecommunication | | | Remove MFN exemptions on the application of different accounting rates. | |

(*Table 5A.5 continued*)

(*Table 5A.5 continued*)

| *Country* | *Services* | *Sector* | *Mode* | *Request* | |
|---|---|---|---|---|---|
| | | | | *Market Access* | *National Treatment* |
| | **Telecommunication services** | | | | |
| | Specific commitments | | All Modes | Remove limitations and restrictions and make full commitments in all sub-sectors. | Remove limitations and restrictions and make full commitments in all sub-sectors. |
| | Additional commitments | | | Commit fully to the reference paper on regulatory principles of the basic telecommunications negotiations. | |
| Norway | **Environmental services** | | | | |
| | Water for human use and wastewater management | Water collection, purification, and distribution services through mains, except steam and hot water<br>Waste water services (CPC 9401) | Mode 1 (where technically feasible), 2, and 3 | "none" | "none" |
| | Solid/hazardous waste management | Refuse disposal services (CPC 94020)<br>Sanitation and similar services (CPC 94030) | | | |

| | | | | |
|---|---|---|---|---|
| | Protection ambient air and climate | Services to reduce exhaust gases and other emissions and improve air quality (CPC 94040) | | |
| | Remediation and clean-up of soil and water | Treatment and remediation of contaminated/polluted soil and water (part of CPC 94060) | | |
| Norway | Noise and vibration abatement | Noise abatement services (CPC 94050) | Mode 4 | "Horizontal commitments" |
| | Protection of biodiversity and landscape | Nature and landscape protection services (part of CPC 94060) | | |
| | Other environmental and ancillary services | Other environmental protection services not classified elsewhere (CPC 94090) | | |

***Source:*** WTO.

***Notes:*** * Movement of equipment. International maritime transport supplier can move/reposition equipment (that is, empty containers, flatbeds, etc.) on their vessels between ports of Bangladesh.

** International maritime transport suppliers can operate vessels of any flag for the purposes of pre- and onward-carriage of the international cargo between ports of Bangladesh.

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Raihan, A. and S.M.A. Habib. 2006. "Bangladesh", in Shahid Akhtar (ed.), *Digital Review of Asia-Pacific*. Malaysia: Orbicom.

UNCTAD. 2003. *World Investment Report*. United Nations Conference on Trade and Development, Geneva: United Nations.

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# 6

# Nepal

NAVIN DAHAL

## INTRODUCTION

The services sector[1] plays an important role in the Nepalese economy, as indicated in Table 6.1 and in 2005, it accounted for 38 percent of Nepal's Gross Domestic Product (GDP) (The World Bank, 2006). The services sector that grew at an average rate of around 5 percent in the 1990s slowed down after 2003 and grew only by 2 percent in 2005.

**Table 6.1**
**Contribution to the GDP by Sectors (%)**

| *Description* | *1999–2000* | *2000–01* | *2001–02* | *2002–03* | *2003–04* |
|---|---|---|---|---|---|
| Agriculture, fisheries, and forestry | 39.63 | 38.38 | 39.48 | 39.11 | 38.67 |
| Mining and quarrying | 0.50 | 0.49 | 0.51 | 0.50 | 0.50 |
| Manufacturing | 9.16 | 9.02 | 8.09 | 7.85 | 7.73 |
| Services | 50.72 | 52.11 | 51.93 | 52.56 | 53.08 |
| • Electricity, gas, water | 1.62 | 1.78 | 2.04 | 2.49 | 2.39 |
| • Construction | 10.21 | 10.06 | 10.43 | 10.30 | 10.40 |
| • Trade, restaurant, and hotel | 11.71 | 11.33 | 10.05 | 10.06 | 10.32 |
| • Transport, communication, and storage | 8.01 | 8.46 | 8.54 | 8.75 | 9.21 |
| • Finance and real estate | 10.08 | 10.58 | 10.82 | 10.91 | 10.84 |
| • Community and social services | 9.09 | 9.91 | 10.05 | 10.05 | 9.91 |

***Source:*** Nepal Rastra Bank, 2005.

The services sector has also featured prominently in Nepal's external trade, with this sector accounting for 38 percent exports and 17 percent imports in 2004 (Table 6.2).

**Table 6.2**
**Services Share in Trade**

| | *Services Export (% of Total Exports)* | *Services Imports (% of Total Imports)* | *Trade (% of GDP)* | *Services Exports (% of GDP)* | *Services Imports (% of GDP)* | *Trade in Services (% of GDP)* |
|---|---|---|---|---|---|---|
| 1990 | 48 | 20 | 32 | 6 | 5 | 10 |
| 1991 | 47 | 20 | 35 | 6 | 5 | 11 |
| 1992 | 42 | 23 | 42 | 8 | 7 | 15 |
| 1993 | 46 | 23 | 47 | 9 | 7 | 16 |
| 1994 | 61 | 20 | 50 | 14 | 7 | 22 |
| 1995 | 66 | 19 | 59 | 15 | 7 | 23 |
| 1996 | 66 | 14 | 58 | 17 | 5 | 22 |
| 1997 | 68 | 12 | 64 | 18 | 5 | 22 |
| 1998 | 54 | 14 | 57 | 12 | 4 | 16 |
| 1999 | 52 | 12 | 53 | 13 | 4 | 17 |
| 2000 | 39 | 11 | 56 | 9 | 4 | 13 |
| 2001 | 36 | 13 | 54 | 7 | 4 | 11 |
| 2002 | 33 | 14 | 48 | 6 | 4 | 10 |
| 2003 | 35 | 14 | 46 | 6 | 5 | 11 |
| 2004 | 38 | 17 | 48 | 7 | 6 | 12 |

***Source:*** World Bank, 2007.
***Note:*** The values in the table have been rounded to whole numbers.

The services sector is also important from an employment perspective with the share of the services sector in total employment averaging 17.12 percent during 1990–95 (World Bank, 2007).

## Services Liberalization in Nepal

Historically, the services sector in Nepal has been highly protected, not only against foreign investment, but also in terms of the participation of the private sector. However, in line with the liberal economic policies adopted after the restoration of multi-party democracy in 1991, the services sector has witnessed gradual opening up in the last two decades. In addition to the unilateral liberalization measures,

Nepal has also made commitments at the World Trade Organization (WTO) in many services sectors in all modes[2] of supply.

## Horizontal Commitments

Nepal has extended market access in Mode 2 with a restriction of providing only USD 2,000 for the Nepalese citizens going abroad. Nepal has also committed that supply of services by an existing foreign supplier will not be made more restrictive than they existed at the time of Nepal's accession to the WTO. However, commitment of Nepal in Mode 4 (movement of natural persons) is restrictive except in the categories of services sales persons, persons responsible for setting up a commercial presence, and intra-corporate transferees and that too for a limited time and not exceeding 15 percent of local employees.

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 require the approval of the Department of Industry (DOI) and incentives and subsidies provided, if any, will be available only to wholly-owned Nepalese enterprises. The maximum foreign equity is also limited in most services and firms who want to sell their services have to be incorporated in Nepal.

## Specific Commitments

The following sections describe the overall market, regulatory structure, and the WTO commitments of the various services sectors[3] in Nepal:

### *Business Services*

#### Professional Services

1. *Legal services:* The legal service is still highly protected in Nepal. The Foreign Investment and Technology Act (FITT), 1992, did not grant permission for making foreign investment in the legal services. The provision of legal services (consultancy) in Nepal is governed by the Nepal Bar Council Act, 2050 (1993). According to the Act, all legal practitioners must be registered

with the Bar Council to exercise the profession. The Bar Council grants the license to practise law in the country. Only Nepalese citizens who have passed the legal practitioner examination can be registered with the Bar.

As per its commitments in the WTO, Nepal allows advisory and representation services for home country law, third country law, and international law in the first three modes of supply. In terms of Mode 4, the number of foreign nationals cannot exceed 15 percent of the number of local employees and that too at the level of managers, executives, and specialists. Court appearance in Nepalese court will be allowed with the permission of the Supreme Court and membership of the Nepal Bar Association.

2. *Accounting, auditing, and bookkeeping services:* Accounting, auditing, and bookkeeping services in Nepal are ruled by the FITT Act, 1992 and by the Nepal Chartered Accountants Act, 2053 (1997). FITT Act, 1992, restricted the establishment of foreign enterprises, or for foreign investment, in the accounting business. The Nepal Chartered Accountants Act provides for the establishment of the Institute of Chartered Accountants of Nepal, an autonomous body that works as a regulatory body for the accounting and auditing services, as well as for setting the services conditions of the professionals. This Act, enacted for the promotion of auditor services, provides for the establishment of an autonomous body called the Institute of Chartered Accountants of Nepal. The Institute works as a regulatory body for promoting the audit services and service conditions of audit professionals.

Nepal has made commitments in the WTO to open up financial and auditing services, accounting review services, compilation of financial statement services, and bookkeeping services except tax returns in the first three modes of supply. However, services under Mode 3 can be supplied only through incorporation in Nepal and with maximum foreign equity capital of 51 percent.

Foreigners can work as accountants in Nepal, but the number of foreign employees cannot exceed 15 percent of the number of

local employees and that too at the level of managers, executives, and specialists.

3. *Engineering services:* Engineering services, also protected in Nepal as the FITT Act, 1992 (as amended in 1997), restricted the establishment of a foreign company, or for foreign investment, in the engineering consultancy services. However, this service has been opened after Nepal's WTO membership in April 2004. There are now no restrictions in Mode 1 and Mode 2. Upto 66 percent foreign equity capital is allowed in firms incorporated in Nepal to provide these services. There is, however, restriction in Mode 4 as is the case of all other services as per Nepal's horizontal commitments.

#### Computer and related services

Computer and related services constitute a fast growing activity within the service sector in Nepal. There is no up-to-date, specific legislation and regulations regarding the computer and related services in Nepal. As this service is not included in the restricted list of FITT Act, 1992, there were no restrictions in all modes of supply of this service. However, Nepal has restricted foreign equity capital upto 80 percent for companies incorporated in Nepal to provide these services as per its commitments in the WTO.

#### Other business services

1. *Management consulting services:* The FITT Act, 1992, restricted the establishment of foreign companies in the management consulting business. This service has been opened up after Nepal's WTO membership and there are no restrictions in the first two modes of supply. However, foreign companies willing to supply this service in Nepal have to be incorporated in Nepal and are allowed a maximum foreign equity capital of 51 percent.
2. *Placement and supply services of personnel:* There are no specific regulations on placement and supply services of personnel in the domestic market. However, the placement of Nepalese workers in foreign countries is regulated by the Foreign Employment Act, 2042 (1985). This Act aims at controlling and

regulating the business and trade of arranging employment of Nepalese citizens in foreign countries. Nepal has not made any commitment in the WTO regarding this service.

### Communication services

1. *Telecommunications services:* The telecommunications industry is relatively young in Nepal, with the first telephone exchange established in 1960. Since then, the market has consisted of only a single, state-owned monopoly—Nepal Telecommunication Corporation (NTC), which has been dominating the market since its inception in 1975. Following the decision for privatization in 1997, a few more players have been able to enter the industry.

   The first National Communications Policy was adopted in 1992. The objectives of the policy were to liberalize the telecommunications sector, to increase private sector participation in the development, and operation of telecommunications services. In 1997, the Telecommunications Act was passed to involve national and foreign sectors investors in telecommunications services. The telecommunications service in Nepal is governed by the Telecommunications Act, 1997, and Telecommunication Regulation 1997. The Act provides for the establishment of an autonomous regulatory body, Nepal Telecommunication Authority (NTA), to regulate and facilitate healthy competition among the services providers.

   This also led to the privatization of NTC and the establishment of a regulatory body: the Nepal Telecommunications Authority. Besides providing licenses to establish and operate the services, it also approves and regularizes tariffs, prescribes the quality standard of the plant and equipment, and suggests the policies, plans, and programs to be adopted by the Government of Nepal. A major barrier to the entry in this sector is the "safeguard clause" of the 1998 Telecom Act prohibiting more than one operator in a particular service for a period of five years.

   The policy was revised in April 2000 to remove restrictions in investment and accelerate broad market opening. It permits

a liberal environment based on open licensing, widespread competition, specific service obligations for licensed operators, a proposed regime for non-compliance, reference to the WTO obligations, and a sketch of the NTC reforms renamed NT (Nepal Telecom) in April 2004.

During its WTO membership, Nepal had committed to open basic telecommunications services[4] and mobile telecommunications services. It had also committed that no limitation on the number of services providers will exist on January 2009. However, foreign participation is permitted only through a joint venture with upto 80 percent equity participation. Value-added telecommunications services[5] have also been opened up with no restrictions on Modes 1 and 2. Foreign participation, however, is allowed only through joint venture with upto 80 percent equity participation.

Liberalization of the telecommunications sector is fraught with difficulties. Market structure, regulatory framework, and technology are all evolving simultaneously making it difficult to foresee the changes necessary (Wickramasinghe, 2000).

#### Construction and related engineering services

Nepal allows upto 51 percent foreign equity in enterprises incorporated in Nepal for the supply of construction work for civil engineering and has made commitment in the WTO to increase foreign equity participation upto 80 percent after 5 years from the date of accession.

#### Distribution services

Distribution services are governed by the general laws of the country, such as the Company Act, 2021 (1964, and as amended in 1997), the Industrial Enterprises Act, 1992 (amended in 1996), and the FITT Act, 1992. According to the FITT Act, 1992, no permission is granted for the establishment of foreign companies or for foreign investment in retail trade. Nepal has also not made any commitment to open the wholesale and retailing services in the WTO except for the wholesale and retailing services of radio and television equipment, musical

instruments, and records, music scores, and tapes with a maximum foreign equity of 80 percent.

#### Education services[6]

Nepal has a total of 34,634 schools (primary, lower secondary, and secondary), with 6,463,670 students enrolled in them. Out of this, 4,502,697 are enrolled in primary education, 1,374,796 in lower secondary education, and 586,177 in secondary education. Of this, 23,435 schools provide primary education, 7,097 lower secondary education, 4,102 secondary education, and 1,018 higher secondary schools. Nepal has 193 students per school, four teachers per school, 49 students per teacher, and 129 students per trained teacher. Student–teacher ratio is highest in lower secondary, that is, 60. In primary schools, it is better at 49 and in secondary schools, it is the best at 36. In general, student–teacher ratio in Nepal is very high, which reflects the inadequacy of appropriate investment in Nepal.

Within the developed regions, the eastern region has 4,772 primary schools, 1,486 lower secondary schools, 812 secondary schools, and 193 higher secondary schools. Student–teacher ratio is 57 among primary schools, 83 among lower secondary schools, and 59 among secondary schools in this region. Western region has 6,063 primary schools, 1,857 lower secondary schools, 1,151 secondary schools, and 261 higher secondary schools. Student–teacher ratio is 38 in primary schools, 54 in lower secondary schools, and 31 in secondary schools in this region. Mid-western region has 3,251 primary schools, 782 lower secondary schools, 378 secondary schools, and 61 higher secondary schools. Student–teacher ratio is 63 in primary schools, 83 in lower secondary schools and 46 in secondary schools in this region. Far-western region has 2,505 primary schools, 726 lower secondary schools, 373 secondary schools, and 80 higher secondary schools. Student–teacher ratio is 57 among primary schools, 75 among lower secondary schools, and 38 among secondary schools. With 6,844 primary schools, 2,246 lower secondary schools, 1,388 secondary schools, and 423 higher secondary schools, the central region has the most number of schools. The central region also has the best student–teacher ratio in the country: 46 in primary schools, 45 in lower secondary schools, and 28 among secondary schools.

Nepal has over 30,000 public schools, 4,500 private schools, and 3,500 community schools. Of the public schools, 27 percent fall in the central region, 26 percent in the western region, 21 percent in the eastern region, 15 percent in the mid-western region, and 11 percent in the far-western region. Of the private schools, 43 percent fall in the central region, 25 percent in the western region, 20 percent in the eastern region, and 6 percent each in the mid-western and far-western regions. Of the community schools, 31 percent fall in the central region, 23 percent in the western region, 19 percent in the far-western region, 14 percent in the western region, and 13 percent in the mid-western region. The concentration of all schools is in the central region, owing to the fact that the capital, Kathmandu, falls in this region. There is a stark difference in the number of private schools in the central region versus other regions.

In 2004, Nepal had 121,670 students enrolled in higher levels of education. Of these, 132,777 were enrolled in Tribhuvan University, 2,958 in Mahendra Sanskrit University, and 2,476 in Kathmandu University. In 2003, 6,388 students were enrolled in Eastern University and 4,614 in Pokhara University.

As can be seen from the data, a large number of institutions, both government and private, are involved in the delivery of the education services in Nepal. However, the quality of education is still poor as is evident from the high teachers to student, student per school, and low teachers per school ratios in all the regions and levels. In addition to this, there are disparities in the quality of education between the different regions.

Liberalization of the education sector is a big debate, not only in Nepal but also in many other developing countries. Given the generally poor quality of education in Nepal, both due to the lack of human and physical infrastructure, it remains a big question if allowing more foreign investment will help improve the quality of education. However, whether or not a more liberal education services sector is an answer to this remains a big question.

Nepal has made commitments in the WTO to open higher education services,[7] adult education services, and other forms of education except for education services funded from state resources with

upto 51 percent equity capital which will be increased upto 80 percent after five years from the date of accession.

### Financial services

1. *Insurance:* The insurance business in Nepal was dominated by a government undertaking, Nepal Insurance Company, which was established in 1947. After the enactment of the Insurance Rules, 1968, only two new insurance companies came into existence during the period of more than two decades, one in 1974, and another in 1987, with foreign equity of 10 percent. Because of the inward looking and restrictive policies, the insurance sector grew at a very slow pace before the initiation of the reform program. With deregulation in the form of the Insurance Act, 1992, private as well as joint venture insurance companies entered the insurance market. Today, the private sector dominates the insurance market. Out of the 20 insurance companies in the country, 15 are private, three are the branches of foreign insurance companies, three are joint venture companies, and one is predominantly the government-owned company. Within insurance and insurance-related services, Nepal has covered areas such as life, accident and health insurance services, non-life insurance services, re-insurance and retrocession, and services auxiliary to insurance including broking and agency services (Nepal Rastra Bank, 2006).

   The insurance business is regulated by the Insurance Act, 2049 (1992), and the Insurance Rules, 2026 (1969). Although there were no legal restrictions imposed on the entry of privately owned domestic, foreign, and joint venture insurance companies in the insurance market, the Insurance Rules, 1969 granted discretionary authority to the Insurance Board for licensing. After the enactment of the Insurance Act, 1992 and Insurance Regulation, 1993, the insurance sector showed organized growth in the country at an accelerated rate. It is under the Act that an autonomous Insurance Board, *Beema Samiti*, was established to regulate and control the insurance business in Nepal (Nepal Rastra Bank, 2006). The Board is

the governing body for the execution of the Insurance Act. A license is required to operate insurance business. National and foreign companies have to apply to the Board to be registered as insurance companies. The Act also regulates the licensing of insurance agents and surveyors, which apply to both the national and foreign ones. There is no limitation on the total number of licenses in the insurance sector.

The main features of the 1992 Insurance Act are (Khanal et al., 2005):

*(i)* It is mandatory for all insurance companies incorporated in Nepal to offer at least 20 percent of their shares to the general public through public issuance.
*(ii)* Foreign investors are allowed to hold upto 80 percent of the total issued shares.
*(iii)* A single company cannot indulge in both life and non-life insurance.

Also, national and foreign companies have to apply to the Board to be registered as insurance companies. Cross-border supply is not permitted in the insurance services (Khanal et al., 2005).

As per Nepal's commitments to the WTO, branches of insurance services providers will be allowed in Nepal by January 1, 2010.

2. *Banking and other financial services:* In the mid-1980s, the government's liberal economic policy was guided by the Structural Adjustment Program of the Bretton Woods Institutions. In order to import advanced banking know-how, the Commercial Act of 1984 removed most entry and exit barriers in financial services. It allowed foreign banks to enter Nepal as joint venture partners, with a maximum of 50 percent capital share which has been raised to 75 percent through regulation. Additionally, the private sector was allowed to establish banks on their own provided they met criteria laid down by the Nepal Rastra Bank (NRB).

Banking and other financial services are regulated by the NRB as provided by the Nepal Rastra Bank Act, 2002, Central

Bank Act, 2012 (1955), the Commercial Bank Act, 1974, and the Finance Companies Act, 2042 (1985). A bank has to be established as a limited liability company under the Company Act, 1984. Nationals and foreigners can equally apply for the establishment of a commercial bank. Any foreign commercial bank that desires to open a representative branch office or liaison office in Nepal may register it under the Company Act with the approval of the NRB. However, the shares of a commercial bank cannot be sold or transferred to any foreign national without the approval of the Central Bank.

In 2005, Nepal's financial system consisted of 17 commercial banks, 35 development banks, 5 Regional Rural Development Banks (RRDBs), 117 postal savings banks (licensed by the government), 63 finance companies, 19 savings and credit cooperative societies licensed by the NRB involved in limited banking activity, and 47 non-governmental micro-credit financial institutions. Commercial banks, development banks, RRDBs, finance companies, cooperatives, and Non-Governmental Organizations (NGOs) licensed by the NRB are under the supervisory purview of the NRB (Nepal Rastra Bank, 2006).

As per Nepal's commitments in the WTO, branches of wholesale banking will be allowed in Nepal by January 1, 2010. However, the total foreign shareholding in any institution providing financial services is limited to 67 percent of the issued share capital. Nepal has kept Mode 1 and Mode 2 unbound in this services sub-sector.

#### Health-related[8] and social services

There were a number of institutions, both government and private, involved in the delivery of health services in Nepal. In the year 2005/06, Nepal had 4,396 institutions that provided health services. Of these 87 were hospitals, six were health centers, 699 health posts, 293 ayurvedic service centers, 3,131 sub-health posts, and 180 primary health centers. Nepal also had 6,796 hospital beds. In the same year, Nepal had 5,824 doctors, 11,637 nurses, 7,491 health assistants, 3,190 health workers, 3,985 village level health workers, and 62,546 other skilled workers

(this included women health volunteers, etc.). For a population of 26 million, Nepal has 0.2 physicians per 1,000 people. In 2003, Nepal spent USD 12 per capita on health. Nepal spent 5.3 percent of its GDP on health and related services (World Bank, 2006).

The Nepal Medical Council Act provides for the establishment of a medical council for the purpose of regulating health services in the country and registering medical practitioners according to their qualifications.

As per Nepal's commitment to the WTO, direct ownership and management of hospital services is allowed in Nepal through incorporation and with a maximum foreign equity capital of 51 percent. Medical experts are allowed to work in Nepal for a maximum of one year with the permission of the Nepal Medical Council.

The weakness of the regulatory body in the health sector, as described, raises urgent questions regarding the need to strengthen the regulatory body before liberalizing the sector further. Frequent changes in the government led to frequent reshuffling and mis-matched deputation of manpower. As a result, there is a lack of experienced, competent, and visionary leadership in the government machinery (Maskay et al., 2006). Most proposals for reforms and liberalization in the health sector remain undecided due to the lack of competent institutional structure for monitoring quality care, tax system, etc. (Maskay et al., 2006).

In a country like Nepal where inequalities are high, liberalization of the health sector could lead to further aggravation and marginalization of the poor. Liberalization of the private health sector without adequately strengthening the public health sector that has been catering to the needs of the rural population is likely to aggravate the situation (Maskay et al., 2006).

#### Tourism[9] and travel-related services

In the year 2006–07, 516,000 tourists visited Nepal. Nepal's foreign exchange earnings from the tourism sector for the year were USD 205 million. On an average, tourists stayed for 13 days and spent about USD 60 per day. Earnings from tourism make about 3 percent of Nepal's GDP. One hundred thousand people are directly employed

in providing services to tourists while 125,000 are indirectly involved in providing services to tourists.

In 2005, 43.5 percent tourists visited Nepal for pleasure, 15.6 percent for trekking and mountaineering, 12.7 percent for pilgrimage, 5.9 percent came for business, 4.5 percent came for official reasons, and the rest, 17.8 percent, for reasons other than those specified above. In 2005, most tourists to Nepal came from Asia. Of the 61.3 percent Asian tourists, 25.7 percent came from India while 35.6 percent came from the rest of Asia. 26.1 percent came from western Europe, 6.1 percent from North America, 2.2 percent from eastern Europe, 2.2 percent from Australia and the Pacific, 0.9 percent from Central and South America, 0.9 percent from other regions, and 0.3 percent from Africa.

Nepal has 110 star hotels and 896 non-star hotels. Of these, eight are five-star hotels, eight four-star hotels, 17 three-star hotels, 36 two-star hotels, and 41 one-star hotels (MOTCTA, 2007). Kathmandu has seven five-star hotels, seven four-star hotels, 12 three-star hotels, 23 two-star hotels, 20 one-star hotels, and 100 non-star hotels. Pokhara has one five-star hotel, one four-star hotel, two three-star hotels, six two-star hotels, and 12 non-star hotels (HAN, 2007). The star hotels have altogether 10,715 beds and non-star hotels have a total of 28,669 beds. Kathmandu has 954 travel agencies while Pokhara has 30 travel agencies (MOTCTA, 2007).

Tourism services are regulated by laws and Industrial Acts such as the Tourism Act, 2035 (1978) amended in 2053 (1997), the Hotel, Lodges, Restaurants, Bar, and Tourist Guide Rules, 2038 (1981), the Travel and Trekking Agency Rules, 2037 (1980), the Trekking and Rafting Rules, 2044 (1985), and the Mountaineering Rules, 2036 (1979).

As provided by the Foreign Investment and Technology Transfer Act (FITTA), 1992, no permission was granted for the establishment of foreign companies or foreign investment in the travel agencies, trekking agencies, water rafting, pony trekking, horse riding, and tourist lodging. Nepal has opened travel agencies and tour operator services for foreign investment upto 51 percent of foreign equity capital since it became a WTO member in April 2004.

Foreign Direct Investment (FDI) is permitted in the hotel industry for which Government's permission is required, as provided by FITTA 1992. As per Nepal's commitments in the WTO upto 80 percent of foreign equity capital is allowed for hotel, lodging services, and graded restaurants.

## Nepal's Competitiveness in Services Sector

Given the many types of services and different modes of supply of these services, detailed and rigorous studies are required to ascertain Nepal's competitiveness in different services and modes of supply which are beyond the scope of this chapter. However, a general observation, at times also based on the experience of other developing countries, can be made regarding Nepal's potential in different services and modes of supply.

### Mode 1

The trade of services through Mode 1 mainly comprises of transportation, communication, and insurance services (Table 6.3).

**Table 6.3**
**Mode 1 Cross-Border Supply (Rupees in Million)**

| *Fiscal Year* | *1999–2000* | *2000–01* | *2001–02* | *2002–03* | *2003–04* |
|---|---|---|---|---|---|
| Credit | 4,986 | 5,025.7 | 2,513 | 4,148.3 | 4,688.3 |
| Debit | 9,586.2 | 10,433.6 | 10,143.2 | 10,261.6 | 10,965.7 |
| Transportation: credit | 4,466.5 | 4,142.7 | 2,501.7 | 2,880.7 | 2,652.5 |
| Transportation: debit | 8,527.0 | 9,308.7 | 8,854.4 | 8,618.4 | 9,326.2 |
| Communication services: credit | 516.2 | 881.1 | 4.6 | 1,225.2 | 2,024.3 |
| Communication services: debit | 93.1 | 70.5 | 36.1 | 312 | 448.6 |
| Insurance services: credit | 3.3 | 1.9 | 6.7 | 42.4 | 11.5 |
| Insurance services: debit | 966.1 | 1,054.4 | 1,252.7 | 1,331.2 | 1,190.9 |

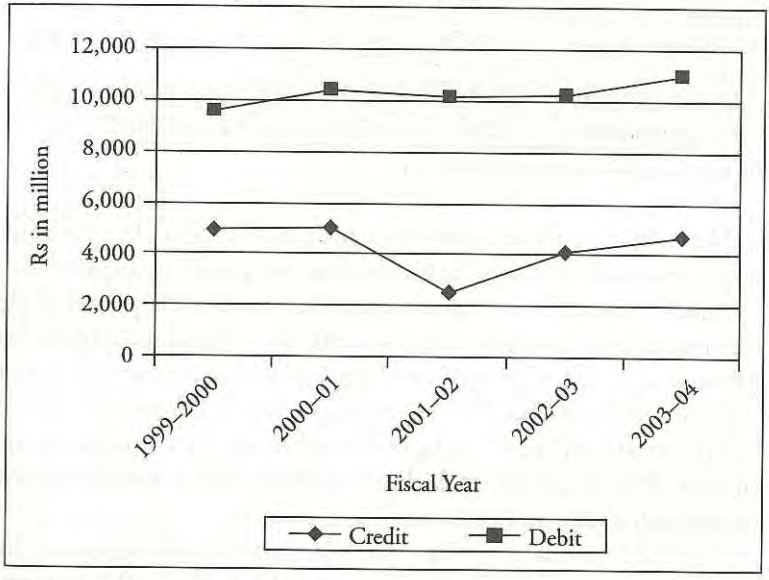
*Source:* Nepal Rastra Bank, 2006.

Both receipts and payments for supply of services through Mode 1 did not change much between 1999–2000 and 2003–04 though

receipts went down in 2001–02. Though this was followed by an increase in receipts in 2002–03 and 2003–04, the level of receipts in 2003–04 was lower than that in 2000–01 (Figure 6.1).

Nepal has the potential to become a part of the global outsourcing business. Outsourcing (also known as off-shoring) takes place when some operations of a firm, such as business processes and back office non-core operations, are outsourced to service provides in other countries and delivered back to the outsourcing firm through the internet, voice, and satellite-based communications (Banga, 2006). India's emergence as the number one outsourcing destination in the world provides Nepal, due to its strong socio-economic ties with India, a good opportunity to dovetail India's success. India is an outsourcing base not only for Information Technology (IT) and IT-enabled services (ITES) but also for high-value specialized services in areas such as research and development, bio-informatics, drug testing and

**Figure 6.1**
**Supply of Services through Mode 1**




*Source:* Nepal Rastra Bank, 2006.

pharmaceutical research, engineering design, and financial analysis (Banga, 2006). As Indian firms move from low value-added to high value-added segments, Nepal has the opportunity to become their outsourcing destination for low value-added products segments.

## Mode 2

The supply and consumption of services through Mode 2 comprising of travel, government, and other services have increased gradually between 1999–2000 and 2003–04 (Table 6.4).

**Table 6.4**
**Supply of Services through Mode 2 (Rupees in Million)**

| *Fiscal Year* | *1999–2000* | *2000–01* | *2001–02* | *2002–03* | *2003–04* |
|---|---|---|---|---|---|
| Credit | 25,833.9 | 24,796.0 | 20,995.2 | 22,370.6 | 29,445.7 |
| Debit | 9,308.8 | 10,085.8 | 9,426.6 | 9,207.6 | 13,839.4 |
| Travel: credit | 12,073.9 | 11,717 | 8,654.3 | 11,747.7 | 18,051.9 |
| Travel: debit | 4,720.2 | 5,520.4 | 5,731.1 | 6,171.5 | 9,790.6 |
| Government services: credit | 8,827.2 | 7,614.2 | 8,894.5 | 6,624.0 | 7,143.9 |
| Government services: debit | 633.8 | 641.0 | 552.3 | 493.4 | 616.8 |
| Other services: credit | 4,932.8 | 5,464.8 | 3,446.4 | 3,998.9 | 4,249.9 |
| Other services: debit | 3,954.8 | 3,924.4 | 3,143.2 | 2,542.7 | 3,432.0 |

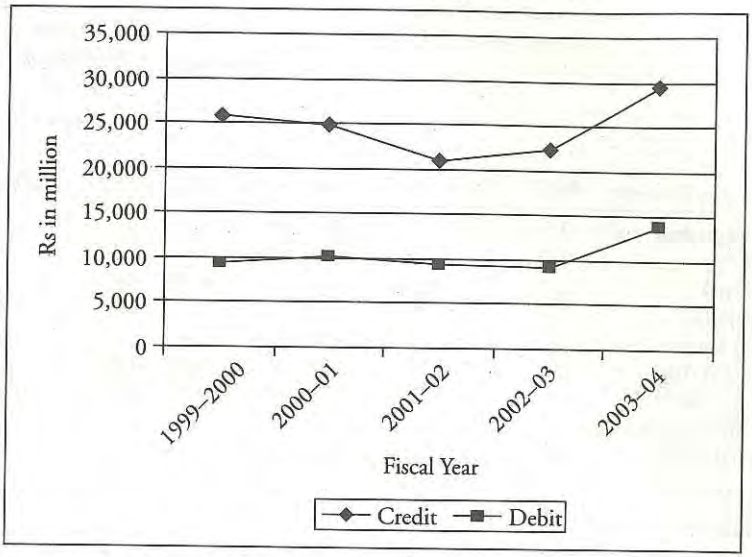
***Source:*** Nepal Rastra Bank, 2006.

Nepal, being a major tourist destination in South Asia, its net receipt under this mode of supply is higher than net payment (Figure 6.2).

Nepal's natural beauty, diversity, and cultural heritage have made Nepal a major tourist destination in South Asia. Revealed Comparative Advantage (RCA) calculations for Nepal and other countries/group of countries in South Asia (Table 6.5) shows that in South Asia, Nepal had the most significant Comparative Advantage in commercial services in 1990. Nepal's RCA declined in 2003, but it is still the highest (along with India) among South Asian countries.

Table 6.6 reveals that Nepal has Comparative Advantage in the travel and tourism sector. This sector accounted for 65.9 percent of Nepal's total service exports in 2003. The relative Comparative

**Figure 6.2**
**Supply of Services through Mode 2**




***Source:*** Nepal Rastra Bank, 2006.

**Table 6.5**
**Revealed Comparative Advantage (RCA) in Commercial Services**

| *Region/Economy* | *Year* | |
|---|---|---|
| | *1990* | *2003* |
| Bangladesh | 0.8 | 0.2 |
| Pakistan | 1.0 | 0.5 |
| Sri Lanka | 1.0 | 1.1 |
| India | 1.1 | 1.6 |
| Nepal | 2.5 | 1.6 |
| South Asia | 1.1 | 1.4 |
| Low and middle income countries | 0.7 | 0.7 |
| High income countries | 1.1 | 1.0 |

***Source:*** Bhatt, 2006.

Advantage in tourism and travel-related activities have increased from 1.8 in year 1990 to 2.1 in the year 2003.

In addition to tourism, the health sector also remains a potential area for Nepal under Mode 2. Given the cost of advantage due to the

**Table 6.6**
**Sector-wise Revealed Comparative Advantage (RCA)**

| | *Transport* | | *Travel* | | *Insurance and Financial Services* | | *Computer Information and Other Communication Services* | |
|---|---|---|---|---|---|---|---|---|
| *Region/Economy* | *1990* | *2003* | *1990* | *2003* | *1990* | *2003* | *1990* | *2003* |
| Bangladesh | 0.5 | 0.8 | 0.2 | 0.4 | 0.01 | 0.9 | 2.5 | 1.5 |
| India | 0.7 | 0.4 | 1.0 | 0.4 | 0.4 | 0.1 | 1.3 | 1.9 |
| Nepal | – | 0.5 | 1.8 | 2.1 | – | 0.02 | 0.9 | 0.5 |
| Pakistan | 2.1 | 2.5 | 0.4 | 0.2 | 0.2 | 0.2 | 0.8 | 0.8 |
| Sri Lanka | 1.4 | 1.8 | 0.9 | 1.0 | 0.6 | 0.4 | 0.8 | 0.6 |
| South Asia | 1.0 | 1.2 | 0.9 | 0.4 | 0.3 | 0.1 | 1.2 | 1.7 |
| Low and middle income countries | 1.0 | 1.0 | 1.2 | 1.5 | 0.4 | 0.2 | 0.8 | 0.6 |
| High income countries | 1.0 | 0.9 | 1.0 | 0.8 | 1.07 | 1.1 | 1.0 | 1.0 |

***Source:*** Bhatt, 2006.

availability of low cost medical practitioners and health professionals, Nepal has the potential to attract foreign nationals for health care services. The area of health education has also been growing in Nepal and students from many South Asian countries are now studying in Nepal. Low cost medical care and lack of quality health services in northern India bordering Nepal has resulted in many Indians coming to Nepal's hospitals for treatment.

## Mode 3

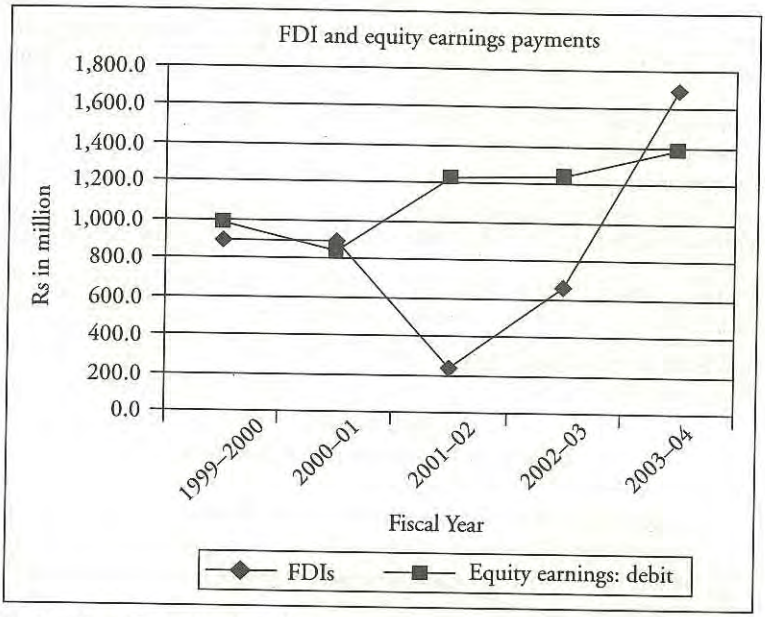
FDI in the services sector declined sharply in 2001–02 after which there was a gradual increase (Table 6.7 and Figure 6.3).

**Table 6.7**
**Commercial Presence (Rupees in Million)**

| *Fiscal Year* | *1999–2000* | *2000–01* | *2001–02* | *2002–03* | *2003–04* |
|---|---|---|---|---|---|
| FDI | 888.7 | 896.8 | 237.2 | 664.0 | 1,690.0 |
| Investment income | 978.7 | 835.5 | 1,232.4 | 1,244.7 | 1,388.1 |

***Source:*** Nepal Rastra Bank, 2006.

**Figure 6.3**
**Foreign Direct Investment in Services**




*Source:* Nepal Rastra Bank, 2006.

Foreign investment in services has always been a very controversial issue partly due to the uncertainty on the developmental and social impact of foreign investment in services. The involvement of the government in the delivery of many services sector is also a reason for the restriction of foreign investment in many services sectors in Nepal.

## Mode 4

It is difficult to get data on supply of services through Mode 4. Workers' remittance, though it includes earnings of workers in both the manufacturing and services sectors, can be used as an indicative trend on flow of services under this mode.

Workers' remittance, which has grown rapidly over the last few years, grew by 62 percent between 1999–2000 and 2003–04 (Table 6.8 and Figure 6.4).