Domestic Regulation and Service Trade Liberalisation  
A South Asian Perspective

Introduction

General Agreement on Trade in Services (GATS) does not provide a concrete definition of the concept ‘domestic regulation’ in Article VI, albeit it explains some legally binding provisions of procedural nature, mandating for the development of multilateral disciplines associated with licensing, qualifications and technical standards, and a mechanism for the provisional application of the main principles underlying the future disciplines.1

Also, there is no universally agreed definition of the term “regulation”: the term ‘regulation’ is used both to refer to different acts of governance covering a wide variety of forms of state intervention in the economy and other means of influencing behaviour of firms and individuals in society, not essentially limited to the economic realm only. The concept of domestic regulation (as mentioned in GATS) seems to be closest to the narrowest meaning of the term referring, in general, to the state directly prescribing and proscribing what private agents have to do and what they can and cannot do.

Having defined in such a way, regulation is apparently distinct from other forms of state intervention in the economy, such as the provision of public goods or essential services and also from intervention that intends to affect the behaviour of private agents by modifying price signals, for example, through taxes or subsidies.

Domestic regulations are important as they have a profound effect on services trade. On the one hand, effective regulation is often considered to be a precondition for successful liberalisation; it can sometimes become an impediment to trade, on the other. This is so because it is extremely difficult and usually very expensive to control the flow of services at the national borders, and hence, governments prefer to regulate the services through domestic regulatory process. In other words, in the absence of border measures, protectionism in services trade takes almost exclusively the form of internal regulatory interventions. Protectionism in the services sector typically has its origin in domestic regulations. Consequently, any attempt to liberalise services is a bit more difficult in comparison to liberalisation in goods.

Furthermore, since domestic regulation is heterogeneous in nature and takes several forms – ranging from protectionist device to attaining economic or social objective – the overall aim of the regulation remains to preserve the latter. But developing a multilateral framework to deal with different modalities of regulation is a difficult task. Stringent requirements on domestic regulation has been an impediment in the free flow of services, and therefore development of disciplines on the qualification and licensing requirements and procedures are relevant in South Asian context. This paper examines why domestic regulation is an important issue for South Asian countries in order to benefit from further services trade liberalisation in these economies.

Domestic Regulation in GATS Framework

GATS in its preamble, ‘wish to establish a multilateral framework of principles and rules for trade in services with a view to the expansion of such trade under conditions of transparency and progressive liberalisation and as a means of promoting the economic growth of all trading partners and the development of developing countries’2. GATS framework seems to combine the doctrine of laissez faire with the principles of most favoured nation (MFN), transparency, market access and national treatment. At the same time, it also recognises continued right of members to enforce domestic policy objectives through regulation in order to meet the domestic requirements vis-à-vis international trade in services.

GATS provides exactly the desired framework by distinguishing between trade restrictions and domestic regulation. Hence, it can be said that market access and national treatment are explicit forms of protection of national service industry while domestic regulation is more implicit form of barriers to access. This means, in GATS framework of principles, market access and national treatment are the trade restrictions targeted by liberalisation negotiations and commitments while domestic regulation covers all other regulations that are neither market access limitation nor covered by national treatment (de jure or de facto) violations. Therefore, in
GATS jargon, domestic regulation is only a subset of what is covered by the actual ‘regulation’ of any sector in the economy and vice versa, the liberalisation endeavours of the GATS (i.e. specific commitments on market access and national treatment) focuses only on a specific subset of measures applied to regulate service activities. In order to facilitate international trade and investment in services, the WTO agreement on trade in services contains several provisions that deal specifically with regulatory measures that may have restrictive effect on trade in services as contained in Article VI. Precisely, the provision of Article VI: 4 on domestic regulation is one of the major provisions, which mandates the development of any necessary disciplines to ensure that measures relating to qualification requirements, qualification procedures, licensing requirements, licensing procedures, and technical standards do not become unnecessary barriers to trade and is a part of ongoing negotiation in the Working Party on Domestic Regulation (WPDR) in the WTO. Article VI: 4 requires that disciplines aim to ensure that such requirements are, inter alia:

- based on objective and transparent criteria, such as competence and the ability to supply the service;
- no more burdensome than necessary to ensure the quality of the service; and
- in the case of licensing procedures, not in themselves a restriction on the supply of the service.

The overall intent of Article VI is that provision of domestic regulation under GATS has been Members’ intention to establish a process that would allow the identification of trade-restrictive measures. Such trade restrictive measures are not essential for the achievement of the domestic regulatory objectives that Members have unilaterally defined in their jurisdiction.

To deal with the definition of restrictive nature of domestic regulation, it was left for further negotiations among the WTO Members as part of a work programme under Article VI: 4 of GATS, which has been implemented since the inception of the WTO in 1995. However, a major challenge for the GATS is how to design rules that prevent the protectionist use of domestic regulations without depriving the regulators of the freedom they need to pursue legitimate objectives.

In principle, GATS recognises the right of Members to regulate and introduce new regulation within its territory to meet national policy objectives. It further provides that the process of progressive liberalisation regarding trade in services has to take place with due respect to the national policy objectives and the Members’ right to regulate the supply of services within its own territory. Nevertheless, the possible impact of GATS on the regulatory autonomy of the individual state is an issue, which has generated interest amongst the negotiators, national policy makers and civil societies in South Asian countries, viz. Bangladesh, India, Nepal, Pakistan and Sri Lanka.

Though this group of countries is comprised of heterogeneous mix of developing and least development countries (LDCs), domestic regulation is equally important for all of them, whether it is an advanced developing country like India, developing countries like Pakistan and Sri Lanka or LDCs like Bangladesh and Nepal.

**Negotiations in Domestic Regulation**

On the basis of the Marrakesh Ministerial Decision on Professional Services of April 15, 1994, negotiations in domestic regulation of services were initiated in the WTO in 1995. The mandate to develop future disciplines is clearly provided in Article VI.4 of GATS. The work programme on the development of disciplines on domestic regulation was initially implemented in March 1995 with a decision by the Services Council to have Members begin work in professional services. Priority was accorded to the accountancy sector and work was undertaken by the Working Party on Professional Services (WPPS). As a first step, the Council for Trade in Services (CTS) adopted the multilaterally agreed to Disciplines in Domestic Regulation in the Accountancy Services in 1998.

Thereafter the CTS constituted a WPPS with a mandate ‘to develop generally applicable disciplines and to develop disciplines as appropriate for individual sectors or groups thereof’. The WPPS completed its work in April 1999 following the elaboration of two documents: Guidelines for Mutual Recognition Agreements for the Accountancy Sector (May 1997) and Disciplines on Domestic Regulation in the Accountancy Sector (December 1998). With the completion of the WPPS work, the WPDR was established in April 1999 to continue the work of the WPPS to develop generally applicable disciplines.

For many years, after the establishment of WPDR, members have indulged in extensive discussions on the development of disciplines on domestic regulation, in pursuance of Article VI: 4 of GATS. There was discussion on developing disciplines, which culminated in the form of tabling and further specific proposals pursuant to Article VI: 4. WPDR focused its effort on developing disciplines before the end of the Doha Round of negotiations, as mandated in Annexure C of the Hong Kong WTO Ministerial Declaration.

It can be inferred from the evolution of the work programme on domestic regulation in the WTO that there has been a significant shift from the original task aiming at developing disciplines exclusively for professional services to the current attempts to device disciplines governing domestic regulation affecting all services sectors. One would wonder if the original intention of the GATS drafters and what was their main concern, when they incorporated Article VI: 4 into the agreement, was only to deal with trade restrictive domestic regulation that affected professional services. The content of Article VI: 4 are quite suitable to the case of accredited professions than to all the existing or future services.

Negotiations in the WPDR, after more than 10 years, have not achieved substantial progress. Still there are many basic issues to be resolved and consensus seems to be obscure. However, in the last few years the negotiations seem to have reached a different level such as: on horizontal disciplines on transparency, technical
Another area of discussion in the WTDR negotiations was the context of the disciplines on domestic regulation. Transparency: The reach of transparency obligations in the context of the disciplines on domestic regulation is another area of discussion in the WTDR negotiations. The said countries contended that qualification requirements mean the substantive requirements including education and examinations, practical training, experience or language requirements and registration requirements, where relevant, that a services supplier supplying a service is required to fulfill in order to obtain authorisation to supply a service. Members should ensure that the measures relating to qualification requirements and procedures are:

- based on objective and transparent criteria, such as competence and the ability to supply the service;
- not more burdensome than necessary to meet national policy objectives; and
- in the case of qualification procedures, not in themselves a restriction on the supply of the service.

Members shall ensure that qualification requirements are pre-established, publicly available and objective. They shall establish mechanisms for the verification and assessment of qualifications of services suppliers of any other member. Such mechanisms shall lay down the qualifications required for the supply of the service and shall apply equivalent criteria to the recognition of home and overseas qualifications. Where qualifications are found to be equivalent to those required for the supply of the service, members shall recognise such qualifications.

The members should in general allow service suppliers to fulfill such additional requirements in home country or in any third country. Residency or work experience in host country should not be a condition for eligibility for such examination unless necessary for meeting national policy objectives.

**Applicability of Future Disciplines:** If these disciplines should apply regardless of whether specific commitments had been undertaken, or they should only apply to sectors in which a Member has undertaken specific commitments.

**Horizontal vs Sectoral discipline:** An issue under discussion in WPDR is whether a set of common disciplines on domestic regulation should be developed for all services, or if it would be more appropriate to device disciplines for particular services sector, i.e. discussion on the appropriate nature of those disciplines, i.e. horizontal vs. sectoral disciplines, and in this context if the disciplines on accountancy can be extended to other sectors is underway.

**The Necessity Test:** Article VI:4 contemplates action by the CTS to ensure that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services. The assessment of the trade effect of domestic regulatory measures, i.e. the necessity test. Domestic regulations should not be more trade restrictive or burdensome than necessary to achieve a specific, legitimate objective. Without a clear statement of purpose, it would be difficult to measure the effectiveness of a regulation after implementation.

**Transparency:** The reach of transparency obligations in the context of the disciplines on domestic regulation is another area of discussion in the WTDR negotiations. Information on regulatory principles and process should be accessible to all parties concerned. Relevant criteria include:

- reasonable advance notice before implementation;
- public availability to service suppliers – easy to find, easy to read;
- specification of reasonable time periods for responding to applications;
- information provided as to why an application was declined; and
- information provided on procedures for review of administrative decisions.

Other principles that have been raised for discussion includes impartial application, proportionality (any penalties for non-performance should bear a reasonable relationship to the risks involved) regular review process, minimisation of the administrative burden involved and objective criteria linked to international standards.

**Status of Domestic Regulation in South Asia**

The service sector constitutes a significant share of gross domestic product (GDP) in many developing and LDCs of South Asia, namely, Bangladesh, India, Nepal, Pakistan and Sri Lanka. With growing global trade and investment flows in services driven by liberalisation and deregulation of economies, technological advances, as well as cost and other imperatives, the service sector presents many developing countries with opportunities to diversify their economies, their export baskets and markets, to tap emerging segments that leverage their inherent and acquired sources of comparative advantage, and to address domestic concerns of service quality, accessibility, and economic efficiency (see Table 1).

Among many issues, “domestic regulation” has become very important for these countries while undertaking liberalisation of the service sectors. Domestic regulation has its importance in protecting national policy and ambition.
The problems or challenges relate to issues of consumer protection, universal service provision, equity-efficiency trade-offs the need for institutional and regulatory reforms and measures to support service sector liberalisation and to ensure that the potential benefits are realised and risks mitigated. There is also a challenge of achieving an overall balance of rights and obligations for all WTO Members”.

Moreover, the imbalance was further perpetuated since Pakistan undertook autonomous liberalisation (and in the case of telecommunication, liberalisation was WTO plus) under structural adjustment programmes (UNCTAD, 1998).

Nepal also undertook liberalisation of certain services such as banking, insurance, telecom etc. Under the WTO, though Nepal has committed to allow 67 percent foreign equity in the sector, it already allows 100 percent equity. As Nepal has already liberalised beyond WTO commitments in the Insurance services sector, its WTO commitments may not result in further liberalisation in this sector. However, the need for a sound regulatory and supervisory system is still necessary to maintain an efficient, safe, fair and stable insurance market and promote growth and competition in the sector.

Further, Nepal's telecommunication services sector also faces various challenges that need to be resolved before new licences can be granted, especially in basic telecommunication and mobile telecommunication sectors. In particular there is a need to enhance Nepal Telecommunication Authority’s (NTA’s) regulatory capacity to ensure fair competition among the incumbent and new service providers given the fact that Nepal Tea Development Corporation (NTDC), still a government owned enterprise, has a huge share in the market.

Although the liberalisation of services trade is a low key affair in Sri Lanka, it is much rigorous in India that underwent not only the policy changes in 1990s, but also liberalised its services sector in the last few years. There has been wide exchange of request and offers in case of India, it has adopted a cautious approach in making specific commitments. One important point that comes out from the above discussion is that in spite of growth in trade and investment flows in services due to liberalisation and deregulation of trade in all the five South Asian countries, the problems, in general, regarding domestic regulation and framework still persists.

The problems or challenges relate to issues of consumer protection, universal service provision, equity-efficiency trade-offs the need for institutional and regulatory reforms and measures to support service sector liberalisation and to ensure that the potential benefits are realised and risks mitigated. There is also a challenge of

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Source: World Development Indicators, 2006
deciding the right balance between public and private delivery of services, the right degree of regulation so as to ensure competition and efficiency without compromising on various public policy objectives, the kind of institutional structures required to balance commercial, social and other concerns, and issues of institutional capacity.

**Concerns of South Asian Countries**

In the case of Bangladesh, India, Nepal, Pakistan and Sri Lanka, the main concern regarding the domestic regulation is attached to issues of ongoing negotiations on licensing requirements and procedures, qualification requirements and procedures and technical standards. The issues on domestic regulation aforementioned coupled with the greater potential of the South Asian countries in Mode 4 makes a significant case for why domestic regulation is important for these countries. The heterogeneous level of development across five south Asian countries when combined with the barriers in the guise of evaluation process of quality and skills of workers in the developing countries and LDCs is considerably underscores.

Domestic constraints like lack of uniformity in training and standards within the country upgraded the recognition requirements for the developing and LDCs. To assess qualification and skills, some countries apply Mutual Recognition Agreements (MRAs), which is mostly used for certified and licensed professionals who already have internationally established standards. There are different testing procedures like United States Medical Licensing Examination (USMLE) for medical professionals and Commission on Graduates of Foreign Nursing Schools (CGFNS) for nursing in the developed countries like US prior to providing licence for job to foreigners.

Thus stringent qualification norms in a variety of professional services do act as an impediment in the movement of services providers from developing and LDCs of South Asia. Hence, South Asian members should ensure that qualification requirements are pre-established, publicly available and objective and may add that members may acknowledge and agree to consider professional experience as a substitute for educational requirements.

It is suggested by the South Asian developing countries that all measures be based on objective and transparent criteria such as competence and the ability to supply the service and may not be cumbersome in order to meet the national policy objectives. Further, where the qualification of service providers found to be equivalent to those required for the supply of service, Members should recognise such qualifications. When the verification reveals any deficiencies in the qualifications, Members should identify those additional requirements relating to course work and training or work experience service providers must fulfill to meet the qualification required to supply the service. Members may provide the opportunity to service suppliers to fulfill such additional requirements through examinations, course work, practical training and professional experience, depending on the circumstances of each case.

The members should in general allow service suppliers to fulfill such additional requirements in home country or in any third country. Residency or work experience in host country should not be a condition for eligibility for such examination unless necessary for meeting national policy objectives. Although most of the elements have their origin from accountancy disciplines, yet it is good that emphasis has been laid on domestic regulation.

**Benefits from Service Liberalisation**

It is established fact that liberalisation and regulatory reform in the service sector has had an impact on growth, trade, and investment flows in services, albeit to different degrees in all the selected countries. The discussion on the nature of the liberalisation and regulatory reform experience of the six countries is closely linked to how domestic regulation has shaped liberalisation, how liberalisation has in turn given rise to certain regulatory issues and challenges, and how the countries have in turn responded to these challenges through their domestic regulations. This discussion on the interplay between liberalisation and domestic regulation largely follows from the sectoral case studies prepared for each of the countries under the study.

A common feature that emerges from the experience of the South Asian countries is that although there have been benefits from liberalising trade and investment flows in such services, there have also been unforeseen outcomes mainly due to lack of adequate preparedness and institutional capacity on the regulatory front. The benefit reaped by Pakistan in liberalising communication sector is well understood in this regard. The communication sector in Pakistan, particularly telecom has witnessed comprehensive reforms and robust growth in recent years, contributing to a large share of services in the country’s total GDP. As a result, it is often touted as one the most successful service sectors to have gained substantial benefits from liberalisation.

The analysis also reveals that the challenges associated with liberalisation vary across infrastructural and social services and that different groups or classes of services throw up different regulatory issues and concerns, which may thus require different approaches. The major concern in some of these South Asian countries is the lack of regulatory framework, which essentially underlines the importance of issue of domestic regulation and is significant whether or not a country should continue its policy of further liberalisation. For example, in Sri Lanka the biggest concern in terms of the liberalisation of services is the weakness in domestic regulatory frameworks – legislative weakness and capacity gaps in professional services associations. This applies to many of the professional services which has made the liberalisation of Mode 4 particularly difficult.

Many professional services regulatory bodies lack the legislative authority (e.g. The Sri Lanka Institute of Architects lacks the “Practice Registration” authority to
regulate practitioners of architecture working in Sri Lanka) to effectively regulate service provision. Even in professional bodies that have the parliamentary authority to regulate (e.g. Sri Lanka Medical Council), capacity constraints are problems. For instance, Sri Lanka has had bad experiences in terms of unqualified foreign medical practitioners operating in the country due to weak assessment criteria - there is no peer review system to assess qualifications of foreign doctors. An example of regulatory problems is the case of RMP (Apothecaries) qualified abroad receiving the same registration status by the Sri Lanka Medical Council (SLMC0 as doctors in 2006. The SLMC lacks the capacity to monitor the functions of foreign practitioners and at present relies on complaints by consumers in order to take action. Furthermore, loopholes between the regulatory requirements of the Board of Investment and the SLMC have resulted in certain medical practitioners being able to operate in Sri Lanka with minimum assessment of capabilities.

Similarly, India’s trade in accountancy services is at present virtually negligible. However, due to deregulation of the economy, there is significant scope for increased trade via all four modes of supply in future. The accountancy sector in India is already have a advantage given the fact that huge pool of trained and skilled accountancy, auditors and other related professionals, with a good command over English and established reputation amongst foreign companies many of which are active in India. Disciplining on domestic regulations, especially with respect to qualification and licensing requirements and procedures will be important to secure effective market access in this sector.

Further, it is argued that domestic regulations and restrictions on the domestic accountancy firms have restricted the size and spread of these companies. Consequently, India makes a strong case as to the need for concrete disciplines on domestic regulation and may benefit from further liberalisation in this sector. However, it may be noted that in context of MRAs ICAI (regulating body in accounting sector in India) do not recognise any foreign qualifications and it has to be prepared to reciprocate if MRAs are signed.

India’s legal services market provides a serious target to multinational companies (MNCs) for whom the current Bar Council rules and policy prohibiting foreign investment are definite barriers to growth. While there is scope for Indian law firms to take advantage of the expanding global businesses, there is also the danger if the processes are not judiciously planned. In this parlance, the disciplines on domestic regulation are extremely important before India commits to liberalise its legal market.

Thus liberalisation in some countries has necessitated countries to undertake regulatory reforms not only to improve the efficiency of the regulatory framework but also to increase the contestability of certain sectors and thus objectives may be multifaceted. Hence, there cannot be a standard approach to liberalisation across different service sub-sectors though certain issues may be commonly applicable. Thus, the approach to multilateral liberalisation would also need to vary to accommodate the different concerns associated with liberalisation in different services. The benefits of liberalisation in Bangladesh and Nepal can be increased with the operationalisation of LDC Modalities as well as with the help of increased technical assistance (see Box 2).

**Conclusion**

Services trade liberalisation is on the top of the agenda of trade negotiators of South Asian countries both at the multilateral and at the bilateral level. The important point made in the above discussions is the need to amend, strengthen and better enforce domestic regulations so as to mitigate potential adverse effects and maximise the gains from the services liberalisation. It is inferred conveniently that liberalisation needs to be supported by more effective regulatory and institutional frameworks.

In this respect several regulatory and policy inadequacies and structural distortions, which hurt the competitiveness of these countries in overseas market *vis-à-vis* Foreign Service providers in the domestic markets. It is stressed that there is a need to preserve the degree of autonomy to ensure that national interests such as consumer interest, quality of service etc, however regulatory barriers are not impeding service trade in these countries. Hence further liberalisation of services has to be within the safety nets of such domestic regulations, which do not act as barrier thereon.
References


GATS Preamble: http://www.wto.org/English/docs_e/legal_e/legal_e.htm#services


Endnotes


2 Preamble to the General Agreement on Trade in Services, available online at http://www.wto.org/English/docs_e/legal_e/legal_e.htm#services

3 It is precisely this distinction between trade restrictions and domestic regulation that has allowed most observers to conclude that ‘liberalisation’ under the GATS must not be equated to ‘deregulation.’

4 Sectoral commitment, made in sectors which members are willing to table for negotiations, and, horizontal, made across all sectors that have been committed.


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