ICRIER-SRTT Quarterly WTO Newsletter

WTO News & Views

April - June, 2007 Vol. 3, No. 2

FROM THE DIRECTOR

The failure of the new G-4 countries - the U.S., the EU, India and Brazil - at Potsdam to break the deadlock in certain critical areas of the Doha development round was not unexpected. The negotiations have now moved back to Geneva, to be driven by the Chairs of the negotiating groups. Prospects look dim as the fast track authority of the US president has also not been extended. The new G-4 has yet to build mutual trust and credibility with the other members to be able to play the role of a catalyst in furthering the Doha Round.

That said, and regardless of if and when DDR is successfully concluded, the reform effort in India must continue. The policymakers, for example, would do well to focus urgent attention on domestic constraints for export growth especially in the context of a rising Rupee. India's reform experience in the past 16 years has proved that unilateral reforms not only yield welfare gains but also create enabling conditions for sustaining the present high rate of domestic economic activity and growth. This edition of the Newsletter, therefore, focuses on reforms and policy changes that need careful consideration in the two important areas of Agriculture and Financial Services.

Dr Rajiv Kumar
Director & Chief Executive, ICRIER

LEAD ARTICLE

Subsidies on Biofuel Crops: Farm Support or Industrial Subsidy

Wide concern over global warming and climate change has suddenly transformed into a central theme for debate and discussion at all international fora. With carbon emissions identified as one of the main culprits for global warming, in conjunction with the dramatic rise in energy prices in the past few years, countries are focussing strongly on the reduction of their dependence on hydro carbons as a source of transportation fuel and energy.

More on page 2

SCHOOL BRIEF

The Trade Policy Review of India – A Bird's Eye View

The Trade Policy Review (TPR) is an exercise undertaken by the WTO Secretariat, to examine and evaluate a member country's trade and economic policies and practices with the wider objective of enhancing transparency and gauging their impact on the world trading system.India's economic performance is reviewed by the TPR Body once every four years, as is the norm for developing country members. The fourth TPR of India was completed in May 2007. The three earlier reviews were conducted in 1993–4, 1998, and 2002.

More on page 5

IN THIS ISSUE

- **Lead Article: Subsidies on Biofuel Crops: Farm Support or Industrial Subsidy**
  by Suparna Karmakar
- **School Brief: The Trade Policy Review of India - A Bird's Eye View**
  by Sumitra Ganguli
- **Liberalization of Financial Services under GATS: The Indian Experience**
  by Abhijit Sen Gupta
- **Recent Developments in WTO**
  by Shravani Prakash

We welcome any suggestions, inputs and feedback from our readers.
You may send your comments to info@icrier.res.in or write to the Managing Editor at suparna@icrier.res.in

Subsidies on Biofuel Crops: Farm Support or Industrial Subsidy

*by Suparna Karmakar**

Introduction

Wide concern over global warming and climate change has suddenly transformed into a central theme for debate and discussion at all international fora. With carbon emissions identified as one of the main culprits for global warming, in conjunction with the dramatic rise in energy prices in the past few years, countries are focussing strongly on the reduction of their dependence on hydro carbons as a source of transportation fuel and energy.

A panacea seems to have been found in the biofuels (bioethanol and biodiesel), and US is leading this particular charge. The main (stated) drivers for the switch are predictably: energy security, support for farm incomes and environmental concerns. Food crops like corn, sugarcane, sugar beet, soybeans, rapeseed and palm oil are presently being used as feedstock for biofuels. And the support-incentive schemes adopted usually combine generous subsidies for domestic generation (via tax credits on energy crops) and tariff protection against imports.

Industrialized Country Subsidies on Biofuel Crops

While U.S. commodity programmes (under the Farm Bill) cover 20 differ-ent crops, eight major crops—corn, soybeans, wheat, sorghum, barley, oat, cotton and rice—account for 74 per-cent of total cropland in the U.S. These very same primary programme crops receive 70 to 80 percent of all government payments.[1] In the case of corn, a small group of very big grain companies have reaped tremendous riches over the last few decades. (U.S.) Taxpayers now pay (corn) farmers between USD 15-20 billion a year to make up for low market prices. In 2005, when corn prices were low, U.S farm subsidies skyrocketed to USD 24 billion. But in 2006, as the strong demand for ethanol took effect, subsidies dropped to around USD 16 billion.[2] In 2004, subsidies to corn alone amounted to USD 8.3 billion, of which 36 percent of support was given through loan deficiency payments, 22 percent through countercyclical payments and 20 percent as fixed payments under historical entitlements. In addition, local (state) authorities provide biofuel plants subsidies in the form of tax exemptions, operating capital grants, low rate loans for small plants, etc. Another report from Global Subsidies Initiative[3] found that biofuel subsidies in the US alone currently amount between USD 5.5 billion to USD 7.3 billion per year. Not surprisingly therefore, corn-based ethanol production in the U.S. doubled between 2001 and 2005, and is likely to double again the next few years. The U.S. already has 100 active ethanol plants, and more are coming up.

In the EU, on the other hand, since tax policy is not part of the sphere of action of the European Commission, each Member state decides on the level of taxation and relief thereof. But feedstocks for biofuels receive support. The 2003 CAP reform introduced a new payment called ‘Energy Crop Payment’ that amounts to Euro 45 per hectare, with a ceiling of Euro 90 millions. Additionally, agricultural raw materials used for biofuel production also benefit from the substantial support granted to traditional food crops. Oilseed producers received compensatory payments to the tune of Euro 1.3 billion a year in 2004, which since 2005 has been channeled through the ‘single farm payment system’ under the new CAP. Cereals also receive payments through market price support that is equal to Euro 101.31 per ton; in 2004 this amounted to Euro 11.9 billion. Sugarbeet for ethanol has not been granted any additional direct support other than the energy crop aid.[4]

Industrialized Country Policies on Biofuel: Acreage and Targets

President Bush has set a target of replacing 15 percent of domestic gasoline use with biofuels over the next 10 years, which would imply almost a five-fold increase in mandatory biofuel use to about 35 billion gallons. This is easier said than done. Given that available technology mandates that almost all of this ethanol would have to come from corn, achieving the 15 percent goal would require the *entire* current U.S. corn crop, which represents a whopping 40 percent of the world’s corn supply.[5] If all American corn and soybean production were dedicated to biofuels, that fuel would replace only 12 percent of gas demand and 6 percent of diesel demand, says a study published by the National Academy of Sciences.

The EU policy on biofuels is a part of a larger action plan for increasing renewable energy use in the union, enumerated under the directive EC 2003/30. It sets a goal of 5.75 percent of biofuels on their transportation fuel markets by 2010. In the EU, presently, about 40 percent of rapeseed production and approximately 62 percent of the rape oil is diverted into biodiesel. Domestic production (assuming a 50 percent usage of oilseed acreage for biodiesel) will certainly not suffice, and EU will need to import 4.16 million tonnes of vegetable oil to meet the target. EU also uses sugarbeet for production of bioethanol, which is less environment-friendly than cereal-based ethanol. German Marshall Fund researchers reckon that while domestic production of cereals in the EU would suffice for meeting the ethanol targets, it would for example use up quantities of wheat equal to 50 percent of projected exports.[6]

All this would do more than create mere market distortions. The FAO has recently calculated that despite bumper harvests in 2007, the poorest countries will see their cereal import bill increase by one quarter in the current season alone due the biofuels demand.[7] In the US, the pressure to divert corn from food to fuel has already triggered unprecedented turmoil. The recent 'tortilla unrest' in Mexico is but a mere preview of things to come. Already, the prices of corn have doubled (from USD 2 to 4 per bushel) in the past year; and presently only 20 percent of the US corn production is dedicated to ethanol. Other than in Mexico, protests in the US have come from the cattle feedstock and food and beverages companies, who are demanding an end to these subsidies for ethanol after experiencing a 36 percent increase in expenses on cattle feed. In the EU increased use of rape oil for biodiesel has resulted in a 63 percent jump in prices between 2002-03 and 2006-07. Imports of main vegetable oils into EU from Indonesia and Malaysia have gone up by more than 50 percent in the same period; the European agri-food industry of bottled oil, margarine and pastry (those that use rape oil as raw material) are justifiably concerned.

Implications for Multilateral Negotiations in Agriculture

This raises a couple of concerns from the perspective of the currently stalled Doha Round of WTO Negotiations. It needs to be recalled that the current impasse is mainly on account of the stalemate in agriculture, in particular the developed country intransigence on reduction targets for agricultural subsidies.

First, given that new industrial uses of agricultural produce have been found and are being encouraged, ought the developed country subsidies going into these agricultural crops dedicated for biofuel generation continue to be discussed under Agreement on Agriculture (AoA)? If not, what should their treatment ideally be and is there a need for reviewing the caps of agricultural subsidies under AoA, especially the direct transfer payments made under Green Box?

Green Box programmes include seven sorts of general government services (such as research, inspection services and infrastructural services), other spending such as domestic food aid and public stockholding for food security, and a number of direct payments to producers. The latter cover decoupled income support, income insurance and income safety-nets, natural disaster relief, environmental programmes and regional assistance. Also in the category of direct payments are three types of 'structural adjustment assistance': producer and resource retirement programmes, and investment aids. However, this huge component of support that rich country farmers receive from their governments is not on the block in the Doha negotiations: these 'green box' payments (deemed not to affect production and trade) dwarf the amounts of trade-distorting support over which negotiations are currently deadlocked.

It is also notable that while the US is negotiating for the development of stronger WTO rules that will rein in the use of industrial subsidies[8], in the light of the ongoing agriculture negotiations, the proposed new subsidy rules are not intended to apply to the agriculture sector. A question that begs to be answered whether the industrial use of agricultural products should merit different treatment insofar as 'certain particularly trade-distorting subsidies' on these products are concerned.

In the US, most farm subsidies are crafted under the Green Box, and the 2007 Farm Bill has been drafted so as to maintain the status quo. Spending on 'decoupled income support' is likely to increase substantially following the 2003 CAP reforms. Insofar as the overall trade distorting nature of the Green Box measures are no longer in doubt, the ball seems to be in the court of the developing countries to use all available means to rein in the autonomy of the OECD governments, or at least be informed of the trade implications of domestic policy actions in developed countries. For, in the absence of any multilateral agreement, dispute settlement is likely to become the avenue through which WTO Members will pursue reform of the trade-distorting aspects of Green Box support. Canada has already asked for the establishment of a dispute settlement panel on US agricultural subsidies (vide 12 June Panel request WT/DS357/11), following its January 2007 request for consultations, which challenged US domestic support programmes for corn and export credit programmes available to several agricultural commodities. However, going down this path poses several cost and time-related problems for developing countries, including their inability get decisions implemented in their favour. A more robust solution needs to be found, and which can only come from continued engagement and activism within the multilateral trading regime.

Second, given that increasing demand for biofuels would have the potential of raising agricultural exports from developing countries, how ambitious should their WTO negotiating strategy be? The possibility is high that industrialized countries may turn net agricultural importers in certain food crops and oilseeds, or begin to import larger amounts of biofuel from developing countries like Brazil, Columbia, South Africa, Indonesia, Malaysia, and potentially India, where generation of ethanol is cost efficient given the amenability of local weather conditions for increasing production of biofuel feedstocks.

At the moment, international trade in biofuels is extremely limited, aided to a large extent by the 54 cents a gallon import tariff on imported ethanol in the US and limited demand in the EU countries for biofuel blends in transportation fuel. However, empirical evidence and economic logic indicate that the trade flows could increase considerably in the medium term. Negotiators from developing countries with real comparative advantages in this product should ensure that the final outcome of the DDR does not deny them of this new window of opportunity to improve the lot of the masses dependent on the farm sector. Current trends in national farm policies in industrialized countries (certainly drawn under the influence of demands from the influential agro-business communities in these countries) and their offers in the multilateral trade negotiations, if undeterred, could seriously limit export opportunities for developing countries.

---

[*] Views are personal.

[1] Daryll Ray, Daniel De La Torre Ugarte and Kelly Tiller (2003): *Rethinking U.S. Agricultural Policy: Securing Farmer Livelihoods Worldwide*, University of Tennessee Agricultural Policy Analysis Center. http://www.agpolicy.org/blueprint.html

[2] U.S. Department of Agriculture, Economic Research Service: *U.S. Farm Income and Costs Briefing Room*. Accessed February 22, 2007. http://www.ers.usda.gov/Briefing/FarmIncome/nationalestimates.htm

[3] Doug Koplow (October 2006): *Biofuels: At What Cost? Government Support for Ethanol and Biodiesel in the United States*, GSI.

[4] Marcos J. Jank, Geraldine Kutas, Luiz Fernando do Amaral and Andre M. Nassar (May 2007): *EU and US Policies on Biofuels: Potential Impacts on Developing Countries*, pp 22-23, German Marshall Fund Paper Series.

[5] Colin A. Carter and Henry I. Miller (May 2007): *Drunk on Ethanol*, AEI-Brookings Joint Center Policy Matters 07-18.

[6] Marcos J. Jank et al (May 2007), *op cit*. pg 5.

[7] FAO (May 2007): *Crop Prospects and Food Situation*, Vol. No.3, Rome. Also the FAO *Food Outlook* (June 2007, No. 1) estimates that "global expenditures on imported foodstuffs look set to surpass USD 400 billion in 2007, almost 5 percent above the record of the previous year. The bulk of the increase can be levelled against rising prices of imported coarse grains and vegetable oils – the commodity groups which feature most heavily in bio-fuel production".

[8] Indo-Asian News Service (June 4, 2007): *US seeks WTO ban on Industrial Subsidies;* http://www.hindustantimes.com/StoryPage/StoryPage.aspx?id=0cfb456d-2373-4d74-8802-e6a5a3569fa8&&Headline=US+seeks+WTO+ban+on+industrial+subsidies

School Brief

The Trade Policy Review of India – A Bird's Eye View

by Sumitra Ganguli

Introduction

The Trade Policy Review (TPR) is an exercise undertaken by the WTO Secretariat, to examine and evaluate a member country's trade and economic policies and practices with the wider objective of enhancing transparency and gauging their impact on the world trading system. India's economic performance is reviewed by the TPR Body once every four years, as is the norm for developing country members. The fourth TPR of India was completed in May 2007.[1] The three earlier reviews were conducted in 1993–4, 1998, and 2002.

India's economic performance has continued to be impressive since 2001–02 and growth has been particularly rapid since 2003–04 averaging over 8.5 per cent with over 9 per cent expected for 2006–07. This performance is largely due to unilateral trade and structural reforms, in particular in services. In India, trade policy making and implementation is the responsibility of the central government, and is articulated for a five-year period, with annual updates, through the Foreign Trade Policy (FTP). The FTP while calling for a simplification of import procedures and reduction in import barriers, is also striving to use trade (in particular exports) to generate employment. Measures to attract FDI include an increase in the number of sectors in which it is permitted, reduction in sectoral restrictions, and streamlining of the approval and investment process which had been identified earlier as a potential barrier to investment. Nevertheless, FDI remains far below its potential, at around 1 per cent of GDP, suggesting that policy and infrastructural constraints need to be addressed.

Since the previous review in 2002, in addition to its participation in the WTO negotiations, India has also started engaging itself in negotiations for a number of RTAs. It has concluded the Comprehensive Economic Cooperation Agreement with Singapore, an 'Early Harvest Scheme' with Thailand, and a preferential agreement with Afghanistan. In addition, previous arrangements, including the Asia Pacific Trade Agreement (APTA), the South Asia Free Trade Area (SAFTA) and the Bay of Bengal Initiative for Multisectoral Technical and Economic Cooperation (BIMSTEC), have been amended or have come into force.

Trade and Related Reforms

Tariff remains India's chief trade instrument as also an important source of tax revenues, accounting for 16 per cent of central government tax revenue (net of states' share). Applied MFN tariffs, have continued to fall steadily (notes the WTO Secretariat *ibid*) with the average currently at 15.8 per cent. Furthermore, at 12.1 per cent (14.1 per cent including ad valorem equivalents or AVEs), the average for non agricultural products is considerably lower than the average for agricultural products, which is 40.8 per cent; both are however much lower than their respective bound rate averages.

With rapid reduction in the applied industrial tariffs in the country, the gap between agricultural and non-agricultural tariffs has increased the tariff dispersion between the sectors, though brisk tariff de-escalation is being observed between un-processed and semi-processed foods and in some cases between semi processed and final products. These differences between the bound and the applied rates however give the government considerable scope to raise applied tariffs—as has been done for some agricultural products in recent years. The policy regarding tariff rate quotas has remained unchanged since the previous review. Nonetheless, the overall trend in tariff rates continues to fall, with the government announcing a further reduction of the "peak rate" of tariff (on non-agricultural products) from 12.5 per cent to 10 per cent in its 2007–08 budget.

India's tariff preferences, granted under its regional trade agreements are not of significant proportions, with the exception of SAFTA and the agreement with Sri Lanka. Use of import restrictions has also declined. Only 3.5 per cent of tariff lines are being subject to such measures; another 300 sensitive imports are being monitored. Also, policy with regard to state trading enterprises remains essentially unchanged.

India continues to be a major user of anti-dumping measures, with the majority of initiations targeted at chemicals, plastics, rubber products, base metals, and textiles and clothing, and aimed mainly at China, the EC, Chinese Taipei, and Korea. Safeguard measures were instituted against Epichlorohydrin, in addition to the measure against imports of industrial sewing machine needles from China; no countervailing measures were taken during the review period.

Efforts are under way to align national standards with international norms. Some 73 per cent of national standards (for which the corresponding international standards exist) have already been aligned. SPS procedures are also being streamlined, notably with the passage of the Food Safety and Standards Act in 2006 to consolidate 13 separate laws related to SPS issues. In addition, a risk analysis process has been put in place since 2004. India's procurement policies have undergone reform, especially at the central government level, although preferences continue to be extended to certain items from the small-scale industry and state-owned enterprises.

Even as import barriers fall, India's export regime continues to be complex, with prohibitions and restrictions largely intact since its last review. Schemes to reduce the anti-export bias inherent in India's import and indirect tax regime have been initiated, and are targeted primarily at sectors such as electronics (hardware and software), agricultural products and services. Further, EPZ policies offering tax holidays to investors are expected to increase and facilitate exports.

Other Measures Affecting Trade

Internal reforms have concentrated on increasing competition and efficiency in the economy. While industrial policy reforms have concentrated on simplifying and reducing restrictions (number of industries requiring compulsory industrial licensing for safety, environmental, and strategic reasons has been reduced from six to five, while the number of items reserved for production only by the small-scale sector has declined further, from 799 in 2001 to 326 in May 2006), measures to simplify the tax structure have been initiated and have resulted in substantial increases in revenue generation. Tax reforms have been pursued to meet the fiscal deficit targets set by the Fiscal Responsibility and Budget Management Act (FRBMA) and include the introduction of a new value-added tax and an increase in the number of services subject to a service tax. However, limited progress has been achieved on the assistance front (both direct and indirect), with direct subsidies accounting for around 1.4 per cent of GDP in 2005–06. Another element of subsidy is contained in price controls, which are basically unchanged since the previous review, although the removal of the administered price mechanism has reduced the subsidy provided for petroleum products.

Efforts to increase competition include the passage of a new Competition Act (2002), and a Micro, Small and Medium Enterprises Act (2006) to encourage the development of these businesses. The problem of "industrial sickness", especially in the public sector, has been addressed by a bill introduced in Parliament in 2003. Progress has been made in improving corporate governance, notably through improved listing requirements for listed companies and banks. In addition, efforts are under way to amend the Companies Act, 1956, to increase transparency and accountability.

Public sector reform, however, has been delayed by a decision in July 2006 to keep all decisions on disinvestment in state-owned enterprises on hold pending a review; consequently, the privatization programme has effectively stopped.

Changes in the intellectual property rights regime include the passage of new legislation on patents, aimed at bringing Indian legislation in line with the TRIPS Agreement, establishment of a new Geographical Indications Registry in 2003, and steps to improve the enforcement of IPR through increased seizures of infringing materials, and fines.

Sectoral policies

Agriculture

Given that the sector employs approximately 60 per cent of the working population, the declining share of agriculture and allied activities in India's GDP (from some 23 per cent in 2000–01 to 18 per cent in 2005–06) suggests that the labour productivity is only around one-sixth of the economy average. Food security remains a major concern. Public investment in infrastructure and research has been inadequate, while private investment has grown in recent years, though not sufficiently. Despite efforts to reduce marketing restrictions, the government continues monitoring trade in certain sensitive commodities. Given the shift in demand patterns away from essential commodities, a reorientation of Government's agricultural policy is called for.

Manufacturing

The share of manufacturing in the Indian economy has remained static at 15 per cent to 16 per cent of GDP since 2000–01. On an average, this sector has grown by almost 7 per cent per year since 2000–01. However, this sector continues to be protected by relatively high tariff barriers, especially in textiles and clothing (22.5 per cent, including AVEs), and automobiles (33.6 per cent), despite efforts to bring down the applied MFN rates to align it with the ASEAN levels. Further growth in this sector has been hampered by a lack of infrastructure and labour market rigidities.

Services

Services has been the main engine of growth in recent years with an average annual growth rate of 9.8 per cent over the last four years. India's service exports increased at an even faster rate of around 30 per cent year-on-year in the same period. This can be ascribed to the rapidity with which reforms have been initiated, especially for certain services (notably in banking), as compared with other sectors of the economy.

Infrastructure

Infrastructure, remains a major bottleneck, though in some sectors like telecommunications, there have been significant benefits to consumers. Progress has also been made in improving infrastructure, especially in road transport, where the network of national highways is being expanded. Private–public partnerships are also being encouraged in areas such as freight transport and railway infrastructure development. Liberalization in air transport has resulted in an expansion in the number of airline operators and a decline in prices; foreign investment restrictions have also been relaxed (up to 49 per cent of total equity is permitted), although foreign airlines are forbidden from investing in the sector. In contrast, however, maritime transport and port services continue to suffer from inefficiencies and constitute a major impediment to trade. Another major constraint on economic activity is the energy sector, where there are frequent shortages of supply and little progress appears to have been made in tackling the losses of state electricity boards, and transmission and distribution losses.

Conclusion

From the above, it is clear that the TPR candidly analyses India's current trade regime. It lauds India's achievements, which are acknowledged as the result of India's open-door policies and socio-economic reforms. It also condemns the inefficiency inherent in the system, as also the complex regulations and weak policy implementation, which have hindered the proper allocation of resources needed for a balanced growth of the economy.

[1] http://www.wto.org/english/tratop_e/tpr_e/tp283_e.htm

Liberalization of Financial Services under GATS: The Indian Experience

by Abhijit Sen Gupta

Introduction

The term 'financial services' is broadly used for a set of services provided to ensure efficient mobilization and allocation of funds towards the overall growth of an economy. By directing investment funds to their most productive use, an efficient financial services sector can significantly promote growth and income. As a result, the effective provision of these services is a basic prerequisite for a dynamic and modern economy. Across most developing countries, including India, financial services constitute part of the regulatory system that manages inflow and outflow of foreign capital, reduces exchange rate volatility and provides credit to socially desired sectors.

Countries such as the United States, Japan, as well as some members of European Union have, over the years, been vocal demandeurs of liberalization of different financial services, arguing that barriers to entry hinder economic progress and financial stability. They also have well-developed financial service industries that stand to benefit from access to international markets. However, the rapid flow of money out of developing countries in the aftermath of the Latin American crisis in 1980s and the East Asian crisis in 1997, demonstrated that liberalizing financial markets sans proper planning and management of investment is not a recipe of success. In fact, given their immense importance in overall stability of an economy, there is a broad disagreement among various countries about further liberalization of financial services. These disagreements range from both liberalization in additional financial services sector as well deeper liberalization in a particular sector.

Liberalization of financial services at a multilateral level is largely governed by the General Agreement on Trade in Services (GATS) under the World Trade Organization (WTO). By the time official negotiations under the Uruguay Round were over in 1993, negotiations on financial services remained unfinished. These negotiations continued for two more years and an interim agreement was reached in 1995. The negotiations again reopened in April 1997 and a revised set of commitments in financial services by 70 member countries was agreed on December 1997, and annexed to the GATS as the Fifth Protocol. GATS also required WTO Members to restart negotiations on service liberalization after the fifth year of its implementation. The current round of negotiations has therefore started in 2000, with the objective of further liberalization of trade in all services, including financial services. Under these negotiations, India submitted its revised offers in August 2005.

Current Levels of Liberalization and Ongoing Negotiations under WTO

In the Financial Services Annex to the GATS Agreement, India undertook commitments under various sub-sectors within financial services, mostly in Mode 3.[1] In the banking sector, India committed to allow establishment of branch operations of a foreign bank subject to a license limit of 12 per year. However, India retained the option of restricting entry of foreign banks if their market share exceeded 15 per cent. Apart from this, the foreign banks were also allowed to install ATMs at branches and other places. It also allowed licensed foreign bank branches to invest in other financial services up to a certain limit. The foreign banks were required to constitute a Local Advisory Board, the Chairman and Members of which had to compulsorily be Indian nationals. Finally, public sector banks could invest their surplus funds in term deposits only with scheduled commercial banks in India.

Within the insurance sector, India allowed foreign insurers to insure goods in transit to and from India. Foreign re-insurers were also allowed to take reinsurance but only that part of the risk that was left as residual after statutory placements domestically with Indian insurance companies. This part of the reinsurance could be placed with foreign insurers through overseas brokers. These brokers were also allowed to have resident representatives and representative offices to procure reinsurance business from Indian companies. However, these representatives and offices were not allowed to undertake any other activity in India and their expenses were to be entirely met by remittances from abroad.

Though these commitments signaled some improvement over the original commitments made in 1993, they were well short of the existing regime in 1997. Consequently, in the current round of negotiations India's trading partners made several liberalization requests to India, both under the bilateral request-offer mode as well as under the plurilateral collective requests. In February 2006, India received plurilateral requests for liberalizing trade in financial services from a number of developed and developing countries.[2] Some of the major demands made in the banking sector included: undertaking full market access and national treatment commitments in Modes 1 and 2 for all sub-sectors, removal of restrictions on preferred form of presence, numerical quotas, monopolies, exclusive service suppliers, use of foreign capital and equity ceilings and investment by public sector utilities in foreign banks. Foreign service providers also expressed the desire for removal of the priority sector lending requirement as well as restrictions on land acquisition by foreigners and 'discriminatory' regulations affecting income tax, solvency ratios and borrowing limits.

In the insurance sector, other Members requested India to undertake full market access and national treatment commitments in Mode 1 and 2 for marine, aviation and transport insurance, reinsurance, insurance intermediation and insurance auxiliary services. They have expressed a desire for removal of restrictions on the choice of the form of commercial presence and partner for foreign service providers as well as limitation on equity participation. They asked for greater transparency in the development and application of domestic regulations.

In the current round of talks India has offered to further open up this sector provided other WTO Members make substantive and satisfactory offers in sectors and modes of supply where India has indicated its interests.[3] Within the financial services, India has requested developed countries like Australia, Canada, European Communities and United States to liberalize restrictions on market access and national treatment for data processing of financial services under Mode 2. India has also made several country/member specific requests. For e.g. India has requested Australia to allow bank branches to accept retail deposits and remove the requirement of approval of Australian authorities for setting up of bank branches of parent banks where a single shareholder holds 15 per cent or more share. In the case of European Community, India has requested that a bank subsidiary incorporated in any one of the member states be accepted as incorporated within the EC and be authorized to render financial services in entire EC. In United States, the form of commercial presence, i.e. bank branch or bank subsidiary, depends on individual state regulations and India has requested the removal of such restrictions as they restrict provision of financial services.

India's conditional revised offer for banking services is largely guided by RBI's Roadmap for Presence for Foreign Banks in India.[4] The roadmap has divided further liberalization into two phases. During the first phase, between March 2005 and March 2009, foreign banks will be permitted to establish presence by way of setting up a wholly owned banking subsidiary (WOS) or conversion of the existing branches into a WOS. Consistent with the Roadmap, India has offered to allow foreign banks to enter through branch operations or wholly owned subsidiary of a foreign bank. Given that the number of branches permitted each year has been higher than the WTO commitments, India has agreed to offer up to twenty licenses per year, both for new entrants and existing banks. The minimum start-up capital requirement for these WOS would be Rs 3 billion ($ 73 million) and they have to maintain a capital adequacy of 10 per cent. India has also offered to allow WOS of foreign banks to hold surplus funds of public sector utilities as term deposits, subject to guidelines by RBI.

India has also agreed to allow foreign banks to invest in private sector banks through the FDI route subject to foreign equity ceiling of 49 per cent. However, the combined foreign equity (through FDI, FII and NRI routes) is capped more liberally at 74 per cent.

The resource allocation requirements will be applicable to the foreign banks on a non-discriminatory basis. While public and Indian private sector banks have to ensure that 40 per cent of their net bank credit goes to the priority sector, the limit is only 32 per cent for foreign banks. Finally, India has offered to replace the Local Advisory Board requirement with guidelines on the composition of the board of directors.

In the case of insurance, for both life and non-life insurance as well as reinsurance and retrocession, India has offered to allow foreign equity up to 26 per cent. This is in concordance with the existing regime in India, although an amendment to increase the restriction to 49 per cent is under consideration. In the case of auxiliary services like consultancy, actuarial and risk assessment, foreign equity up to 51 per cent has been allowed. Moreover, India has offered to impose no national treatment limitations on foreign players in life and non-life insurance.

Roadmap for Future

The revised offer on financial services signals a substantial improvement on what was committed in the Uruguay Round. Across most sectors India has offered to bind the existing trade and investment regime. However, India has been shy of making pre-commitments in certain areas where further reforms are in India's own interest. In the insurance sector, increasing the FDI investment limit up to 49 per cent over the next 3 years will allow greater infusion of capital, introduction of new instruments, market expansion and deeper penetration of insurance services. India can also undertake pre-commitments for merger and acquisitions between foreign banks and Indian private sector banks, especially as RBI's Roadmap envisions foreign banks entering into mergers and acquisitions with Indian private sector banks after 2009, subject to the 74 per cent investment limit.

Another area where pre-commitment would send a positive signal to India's trading partners would be regarding provision of national treatment to foreign banks involving solvency ratios, income tax, borrowing limits etc. These would again be consistent with what has been outlined in the Roadmap. Such pre-commitments would signal direction of future reforms and give domestic service providers and regulators time to prepare themselves for competition and put in place the required regulatory regime.

Finally, given the move towards greater capital account convertibility and the advent of e-commerce in financial services, it would be advisable for India to undertake some commitments in Mode 1 and 2 across most financial services. This would also strengthen India's case as it demands that developed countries provide full market access and national treatment commitment in Mode 1 and data processing of financial services under Mode 2

Reforms to Strengthen the Financial Services Sector

While liberalizing the financial services sector undoubtedly provides greater opportunities for mobilization and efficient allocation of resources, it is extremely important to have a proper regulatory structure in place along with opening up of the economy. Perhaps in no other sector can imprudent regulations cause more damage than the financial sector which enjoys strong linkages with the rest of the economy. Financial sector irregularities were a prime cause of several recent crises, like the Tequila Crisis (1994), Asian Crisis (1997) and Argentine Crisis (2001).

As India opens its doors to a large number of global banks, some of which have assets comparable to India's GDP, steps must be taken to strengthen the Indian banks to be able to compete with these banks as well as generate greater international presence. These would include further deregulation of interest rates, reduction in pre-emption of banks' resources through Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR) among others. With greater international presence there will be overlaps and potential conflicts between home country regulators of foreign service providers and host country regulators. A mechanism needs to be set in place to resolve such conflicts.

India must also meet the deadlines it has imposed on itself to conform to the Basel II norms. Currently, foreign banks operating in India and Indian banks having presence outside India are required to migrate to the standardized approach for credit risk and the basic indicator approach for operational risk under Basel II with effect from 31 March 2008. All other scheduled commercial banks are encouraged to migrate to these approaches under Basel II in alignment with them but in any case not later than 31 March 2009.

Public sector dominance in insurance companies also needs to be lowered to allow greater level playing field between all players. Resources of these companies must be freed so that they can undertake investment in long term infrastructure projects with market determined returns. More capital needs to be encouraged into the sector as current rates of insurance penetration in India are well below the international average.

[1]WTO (1998) India's Schedule of Specific Commitment Supplement 4, GATS/SC/42/Suppl.4
[2]India has received Financial Services Collective Request on behalf of Australia, Canada, European Communities, Ecuador, Hong Kong, Japan, Republic of Korea, Norway, Macau and United States
[3]WTO (2005) India's Revised Offer TN/S/O/IND/Rev.1
[4]RBI(2005) Road map for presence of foreign banks in India

Recent Developments in WTO

by Shravani Prakash

WTO Trade Prospects 2007

The year 2006 witnessed robust growth in the world economy and vigorous trade expansion. Global GDP growth accelerated to 3.7 per cent, the second best performance since 2000. Trade expanded in real terms during 2006 at a much faster rate than output. World merchandise exports increased by 8 per cent to USD 11.76 trillion in 2006 (in real terms), while commercial services exports were up by an estimated 11 per cent to reach USD 2.71 trillion. Global FDI inflows surged by one-third to reach USD 1.23 trillion, the second highest level ever.

The global economy could attribute its strength to the recovery in Europe, the overall expansion maintained by the United States, faster economic growth in Japan, and continued high economic and trade growth reported by China and India. Developing countries contributed a whopping 36 per cent to world merchandise exports, while the share of LDCs was also at a record level of 0.9 per cent. Economic growth in the LDCs continued to exceed 6 per cent for the third year in a row.

India's GDP expanded at the rate of 8.6 per cent during 2006. It was the 18th largest merchandise exporter, with exports amounting to USD 120 billion (1 per cent of total world exports). India continued to excel in terms of services trade which was 2.7 per cent of the world total in 2006.

During the year, the growth rate of India's commercial services imports (40 per cent) exceeded that of exports (34 per cent). Total services exports amounted to USD 73 billion while imports were at USD 70 billion.

According to WTO economists, global risks in financial and property markets and large trade imbalances in goods and services meant increased uncertainty in 2007 and raised the prospect of weaker economic and trade expansion in the coming year.

Lamy urges members to reach an agreement soon

Director-General Pascal Lamy, in a report to the General Council in May 2007 said that "a successful outcome to the Round is possible, even in the small amount of time remaining until the end of the year". He warned that failure would mean foregoing the very significant trade package on the table and "breaking the commitment for a more developing-friendly world trading system".

Addressing the G8 Summit in June 2007, DG Lamy said that an interim Doha agreement was now within reach, and urged the G8 leaders not to let this opportunity slip by. He said the reason why he felt an agreement was within reach is that the positions of different members have moved closer to each other. He summarized that in order to achieve a consensus, what is needed is an additional effort from the Americans, and then the Europeans and Japanese should be able to follow without any major trouble. On the opening up of agricultural markets, the Europeans and Japan will have to improve their offer, and the emerging countries will have to accept that the protection to which they are entitled does not mean that no further opening will take place. And on industrial products, the emerging countries, as well, will have to improve the offers they have tabled.

Chairperson of Agriculture Negotiations Group Circulates "Challenges" Papers for Farm Talks

Ambassador Crawford Falconer, chairperson of the agriculture negotiations, circulated a set of "challenges" papers in two installments. The papers contained a set of his ideas on where members' positions might converge. They were designed to provoke comments from members on where consensus might be achieved, leading to a revision or series of revisions of the 2006 draft "modalities" paper. Director-General Pascal Lamy said that the paper by the chair of the agriculture negotiating group was the first of a series of draft papers by chairs of the different negotiating bodies, which could become the basis for agreement. He said "it is important that Members support the chairs by providing constructive inputs and by showing a willingness to negotiate and be flexible".

New Antidumping Investigations Rise, New Final Antidumping Measures Decline

The WTO Secretariat reported that during the second half of 2006, the number of initiations of new anti-dumping investigations showed a modest increase compared with the corresponding period of 2005. However, the number of new measures applied continued to decline.

During July-December 2006, 19 Members reported initiating a total of 103 new investigations, compared with 96 initiations in the corresponding period of 2005. European Communities reported the highest number of new initiations during July-December 2006 (17). The products that were the most frequent subject of the reported new investigations were chemicals (25), pulp and paper (16) and base metals (16).

Under application of new final anti-dumping measures, Turkey reported the largest number (10) for the second half of 2006. Products exported from China remained the most frequent subject of new measures (22). Products in the textiles sector were the most frequent subject of new measures during July-December 2006, accounting for 14 of the 66 total new measures reported.

India reported the second-highest number of new initiations (12) during July-December 2006, which represented a decline in number of initiations in 2005 (14). However, India was subject of fewer than five new initiations during the period. Concerning application of new final anti-dumping measures, India reported the third largest number (8), representing a decline from the corresponding period of 2005. India was also ranked third in terms of exported products being subject of new measures, with six new measures directed at its exports.

RTAs considered under new WTO transparency mechanism

The Committee on Regional Trade Agreements considered four regional trade agreements (RTAs) under the new

Transparency Mechanism. The RTAs considered were Free Trade Agreement between Thailand and Australia; Closer Economic Partnership Agreement between Thailand and New Zealand; Protocol on Trade in the Southern African Development Community; and Free Trade Agreement between Armenia and Moldova.

Under the Transparency Mechanism RTAs notified to the WTO under Article XXIV of the GATT and Article V of the GATS are considered by the CRTA; RTAs notified under the Enabling Clause are considered by the CTD. The consideration is based on a Factual Presentation of each notified RTA, prepared by the Secretariat.

Members set up dispute panel in US–India Wines and Spirits case

The Dispute Settlement Body established a panel to examine the US complaint against India's additional and extra additional import duties on US alcoholic products including wines and spirits. The US said that it believed additional and extra additional duties imposed by India were in excess of those listed in India's WTO Tariff Schedule. The US referred to a similar case involving India and the EC and proposed that both cases be merged. India stated it would consider the appropriateness of the US proposal to merge the two cases into one and would revert on this matter separately. The EC had no objections for the two cases to be merged.

Lamy commends the progress in the Information Technology Agreement

Director-General Pascal Lamy, in opening the WTO Information Technology Symposium on 28 March 2007, commended the Information Technology Agreement on its tenth anniversary as "a major success" — noting that world exports of ITA products have more than doubled during the past ten years in dollar terms, reaching USD 1450 billion in 2005, with an average annual growth of 8.5 percent.

WTO publishes World Tariff Profiles

The WTO, along with UNCTAD and ITC has brought out a publication *World Tariff Profiles*, which provides detailed data on bound and applied tariffs of the 150 WTO Members. It provides a comprehensive picture of tariff profiles from around the world in an abridged format. It is useful to trade specialists as it contains a vast amount of information that is essential for understanding what is at stake in the current round of negotiations in the field of market access.

(http://www.wto.org/english/tratop_e/tariffs_e/tariff_profiles_2006_e/tariff_profiles_2006_e.pdf)

Trade Policy Reviews

In the second quarter of 2007, the WTO released *Trade Policy Reviews* for India, Central African Republic, Costa Rica and Macao. The reports showed that in Central African Republic reconstruction efforts are starting to have a positive impact. Costa Rica has shown unambiguous growth trends but there is need to open key services sectors. In Macao, high gaming-based growth has been reported, although diversification is required.

In the Fourth TPR of India, the Secretariat noted that India's GDP has been growing at high rates led by services and manufacturing sectors. This impressive economic performance is largely the result of unilateral economic reforms, as well as increased involvement in bilateral and regional trade agreements. India has performed particularly well in services exports, with the services trade surplus as a percentage of GDP having increased from 0.7 per cent in 2001/02 to 2.8 per cent in 2005/06. The government has continued to reduce applied MFN tariffs on non-agricultural products to meet its goal of reaching ASEAN tariff levels by 2009. As a result, the overall average applied MFN tariff has fallen from over 32 per cent in 2001/02 to less than 16 per cent in 2006/07, widening the already large gap between the average tariffs for non-agricultural products (12.1 per cent) and agricultural products (almost 41 per cent). The overall average applied tariff based on customs duty collection rates is around 10 per cent, suggesting that the effective rate is considerably lower, in great part due to a number of exemptions.

ICRIER

INDIAN COUNCIL FOR RESEARCH ON INTERNATIONAL ECONOMIC RELATIONS
Core 6A, 4th Floor, India Habitat Centre, Lodhi Road, New Delhi - 110 003, India
www.icrier.org