

## Trade in Services & Developing Countries *The Market Access Barriers*

The services sector has emerged as the largest and most dynamic component of both developed and developing country economies. In the developing countries, average share of services in gross domestic product (GDP) has increased from around 40 percent in 1965 to around 50 percent in 1999; and in the OECD (Organisation for Economic Cooperation and Development) countries, this share has increased from 54 to over 60 percent, over the same period. However, world trade in services gives a contrasting picture. Its share in total world trade (goods and commercial services together) is only one-fifth, not commensurate with its strong presence in national economies.

When it comes to participation of developing countries in services trade, they have a diminutive share. Their share has not improved significantly, over the last decade. For example, according to the WTO's (World Trade Organisation) International Trade Statistics 2004 Report, Latin America in 1993 made up 3.9 percent of world exports in commercial services, which fell to 3.4 percent in 2003. The African region made up 2.3 percent of exports in 1993, which fell to 2.2 percent in 2003. The Asian region increased its share of world exports, albeit marginally, from 12.9 percent in 1993 to 14 percent in 2003. All these regions were net importers of services in 2003.

These figures clearly indicate that the General Agreement on Trade in Services (GATS) signed as a part of the Uruguay Round has had limited impact on services trade liberalisation. It has, so far, failed to provide developing countries increased opportunity to exploit their natural comparative advantage in services trade. One reason is that developed countries have put many restrictions on temporary movement of natural persons, which is seen as developing countries' main export interest in services. At present, Mode 4 (temporary movement of workers) accounts for a meagre 1-2 percent of total trade in services.

The reluctance to make significant commitments in this area is common to both developed and developing countries. Further, commitments made so far provide privilege to high-skilled personnel and especially service providers associated with the establishment of foreign offices. These intra-corporate transferees are the group covered by about 43 percent of all current horizontal commitments. Another 27 percent of commitments relate to executives, managers, and specialists (not specifically related to intra-corporate transferees); 13 percent to business visitors in charge of setting up a commercial presence; and 10 percent to other business visitors. Independent professionals account for only 1 percent of all commitments under Mode 4.<sup>1</sup>

Not only temporary movement of natural persons, some of the developing countries from Asia and Latin America are showing interests to other Modes of services supply as well. The revolution in information technology has made cross-border trade possible in a number of services that were previously only tradable through the movement of providers. Developing countries, such as India and Philippines, are fast emerging as major exporters of these IT-enabled services. The offshoring of jobs to low cost locations creates a more efficient global division of labour and brings significant welfare gains

for all countries. But developed countries, especially USA whose businesses have been major beneficiaries of these developments, are trying to bring legislation to check outsourcing of jobs. It is, therefore, desirable on the part of developing countries to take preemptive measures for locking-in the current state of openness.

Besides outsourcing, medical tourism, which comes under Mode 2 (consumption abroad), offers tremendous potential for some developing countries because of their low-cost advantage. India, Thailand, Malaysia, Singapore, South Africa, Chile, Cuba, and Peru have been emerging as key destinations for medical tourism. The size of this market is estimated to be US\$40bn based on a Saudi Report prepared in 2000. During the past four years, the market grew at a whopping rate of 20-30 percent and is expected to grow further. Considering this growth, the current market size is estimated to be US\$100bn.<sup>2</sup> For promoting health tourism, domestic health infrastructure plays a major role, but at the same time, some of the health-related insurance policies in developed countries are preventing patients to move abroad for cheaper treatment.

Contrary to the general impression, tourism is also an important source of foreign exchange earner for majority of least developed countries (LDCs) that are members of the WTO. It could well be a

starting point for achieving their prosperity through trade-led economic development. It is, therefore, important for LDCs to recognise both the potentials of this sector and accordingly take measures to develop a sustainable

tourism industry. LDCs can also make use of special provisions provided to them under GATS. As mandated by Article XIX of GATS, WTO members adopted modalities for the special treatment for LDC members. These include, *inter alia*, special priority to LDCs in providing effective market access in sectors and modes of supply of export interest to them, flexibility for opening fewer sectors, liberalising fewer types of transactions, and progressively extending market access in line with their development situation.

Currently, negotiations on services trade liberalisation are ongoing under the Doha Round. Services trade liberalisation, in general, has generated less tension and friction than any other comparable area within the remit of the WTO. However, the situation is not going to remain the same. WTO members who have significant interests in services trade liberalisation want to see progress on services at par with agriculture and non-agricultural market access. Amongst developing countries, India has shown proactive interest in pushing for ambitious trade liberalisation in services. Other developing country members would also become proactive as it holds an immense potential in terms of further expansion of world trade. It is expected that by 2050, the world services exports would exceed merchandise export.

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### Conclusions

Multilateral trade liberalisation, under the aegis of the WTO has thrown open opportunities for its members to exploit the vast potential of trade in services. Developing countries recognise the potential benefits of liberalisation in trade in services. However, gains from services liberalisation have not been realised much because of limited access in modes and sectors of export interest to developing countries and/or supply-side constraints. Often they are difficult to identify as most of these barriers do not occur 'at the border' but emanates from regulatory framework of national governments. These are specifically designed to exclude foreign competition.

Due to the lack of meaningful market access, developing countries' share of world services exports has increased by a small percentage. In the period from the adoption of the GATS to 1999, this increase had only been of 6 percent, mostly due to the export competitiveness of Asian developing countries. On the other hand, developed countries account for three-quarters of

the world exports of services and represent most of the 20 top exporters in different services sectors.

Them figures establish a fact that benefit from privatisation and liberalisation is not automatic. Liberalisation of services entails adjustment costs. Adjustment has to be made by both developed and developing countries. Developed countries need to show more flexibility by providing better market access to service providers from developing countries. Developing countries, on their part, besides trying to overcome external barriers, need to bring necessary policy changes at the domestic level to harness their natural competitive advantage. An effective regulatory framework is required to channelise the gains from services trade expansion to a desired direction.

Furthermore, developing countries need to give priority to the provision of universal access with regard to essential services and public goods. This can only be met if they are provided with institutional and capacity building support to maintain adequate flanking policies.

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### Endnotes

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## Select Issues of Services Negotiations

Current Status	Main Problems	Empirical Facts	Policy Measures
<b>Market Access</b>			
<p><b>Mode 1</b></p> <ul style="list-style-type: none"> <li>Advances in technology have made cross-border trade possible in a number of services that were previously only tradable through the movement of providers. However, members are hesitant to undertake commitments under this mode, out of the uncertainty of legal implications and perceived constraints on their ability to intervene later for regulatory purposes or employment-related and other strategic policy reasons.</li> </ul> <p><b>Mode 2</b></p> <ul style="list-style-type: none"> <li>Overall, commitments on Mode 2, (consumption abroad), tend to be most liberal. Over one-half of the commitments scheduled under Mode 2 are without limitations. However, the relevance of these commitments may be limited so far as Mode 2 transactions are economically important only in few sectors, such as tourism and, increasingly, health and education. Also, governments may have few instruments to prevent their nationals from moving abroad or to influence their consumption habit, once they have left the country.</li> </ul> <p><b>Mode 4</b></p> <ul style="list-style-type: none"> <li>Virtually all commitments on Mode 4, (movement of natural persons), are tightly circumscribed. Full liberalisation is used as a starting point to which limitations are added that are deemed necessary on whatever political, economic or social policy grounds. A horizontal section in the schedules provides for a general 'unbound' commitment across all sectors, subject to narrowly defined exceptions for individual groups of persons (e.g. senior executives or domestically not available specialists), movements (e.g., intra-corporate transfers), and duration of stays (e.g., up to three to four years).</li> </ul>	<p><b>Mode 1</b></p> <ul style="list-style-type: none"> <li>Emergence of developing countries as offshore service providers to the industrialised world has created fears in the North and that may translate into protectionism. In several US states, legislation is pending that will introduce an outsourcing ban with respect to government contracts. In Europe, legal norms designed to protect workers in outsourced deals, known as Transfer of Undertakings and Protection of Employees (TUPE), as well as privacy directives, could have an inhibiting effect on trade.<sup>3</sup></li> </ul> <p><b>Mode 2</b></p> <ul style="list-style-type: none"> <li>A major barrier to "consumption abroad" of medical services is lack of portability of health insurance. For example US federal or state government reimbursement of medical expenses is limited to licensed certified facilities in the US or in a specific US state. In EU countries also, public insurance does not cover elective care received abroad. Canada only makes an exception for cancer treatment in some neighbouring US states. Further, the lack of long-term portability of health coverage for retirees from OECD countries is also one of the major constraints. In the US, for instance, Medicare covers virtually no services delivered abroad. This constraint is significant because it tends to deter some elderly persons from travelling or retiring abroad.<sup>4</sup></li> </ul> <p><b>Mode 4</b></p> <ul style="list-style-type: none"> <li>Movement under Mode 4 faces a range of barriers in all countries. A major problem is that temporary movement of service providers invariably comes under the purview, not of international trade policy, but of immigration legislation and labour market policy. Visa formalities are a significant obstacle, and the conditions attached are used to implement a range of restrictions. These include prohibitions and quotas either explicitly or through a variety of economic needs tests (ENT). Wage parity conditions tend to erode the cost advantage of hiring foreigners and have the same restrictive impact as quotas. Non-recognition of professional qualification poses a particular challenge because of the difficulty in distinguishing between legitimate and protectionist denial of recognition. And above all, linking movement of natural persons to commercial presence is proving more problematic for developing countries, which are interested primarily in the movement of independent professionals.</li> </ul>	<p><b>Mode 1</b></p> <ul style="list-style-type: none"> <li>Given the size and rapid growth of business process outsourcing (BPO), economic implications for developing countries could be enormous. For example, if half of India's 50 million English-speakers are to eventually earn US\$10,000 per year in IT-related services, this would more than double India's current GDP of US\$450 bn.<sup>5</sup></li> <li>Whereas most industries have started to outsource operations because it allows them to significantly cut labour costs, they have also reported considerable productivity gains, ranging from 15-25 percent. As only around 5 percent of US firms with revenues from 100 million to 4 billion have started to outsource, much untapped potential as remains. The size of the outsourcing market will certainly grow small and medium sized enterprises seek similar efficiency gains.<sup>6</sup></li> <li>The offshoring of jobs will not remain confined to IT-sector. A survey by Deloitte Research, for instance, has found that the world's 100 largest financial services firms expect to transfer US\$350bn of their cost bases abroad<sup>7</sup> by 2008.<sup>7</sup> The value of medical transcription outsourcing in America alone is expected to double by 2005 to US\$4bn.<sup>8</sup> The US market for 'contact centers' alone has a turnover of US\$100bn.<sup>9</sup></li> </ul> <p><b>Mode 2</b></p> <ul style="list-style-type: none"> <li>If only 3 percent of the 100 million elderly persons living in OECD countries retired to developing countries, they would bring US\$30-50bn annually in personal consumption and US\$10-50bn in medical expenditures.<sup>10</sup></li> <li>India is rapidly emerging as major medical tourist destination of the world. An estimated 150,000 foreigners travelled to India in 2003, in search of 'First World Health Care at Third World prices'. A heart transplantation that can cost up to US\$200,000 in the US is available in India for less than US\$10,000. A recent study by McKinsey estimated that the Indian medical tourism industry could yield as much as US\$2.2bn in annual revenue by 2012.<sup>11</sup></li> </ul> <p><b>Mode 4</b></p> <ul style="list-style-type: none"> <li>Studies on economic benefits of liberalisation under Mode 4 suggest that there are huge returns to even relatively small movements of labour. For example, it is estimated that an increase in developed countries' quotas on the inward movements of both skilled and unskilled temporary workers equivalent to 3 percent of their work force would generate an increase in world welfare of over US\$150bn a year. Both developed and developing countries would share in these gains, and it would be largest if both high skilled and low skilled were allowed to move freely.<sup>12</sup></li> </ul>	<p><b>Mode 1</b></p> <ul style="list-style-type: none"> <li>Developing countries must try to pre-empt potential protectionism by locking-in the current international trade regime. The ongoing GATS negotiations is a good opportunity to secure openness in cross-border trade in services.</li> </ul> <p><b>Mode 2</b></p> <ul style="list-style-type: none"> <li>Tourism is one of the most important foreign exchange earners for many developing countries including LDCs. But with the advent of information technology, overseas tour operators offering tourism services keep most of the income generated by tourism in their own country by offering pre-packaged tours, chain hotel bookings, and cruise boat trips. Although tourists are physically in the destination country, substantial revenue and profit is kept in the originating countries. Therefore, to achieve the goal of developing a sustainable economy, 'linkage' of the tourism sector with the development of the local economy is needed. Destination countries need to ensure that tourists consume locally and tourism generates local profits.</li> </ul> <p><b>Mode 4</b></p> <ul style="list-style-type: none"> <li>India made a comprehensive proposal on Mode 4 in which it called for concrete steps to separate temporary service providers under the GATS, from permanent labour movement, so that normal immigration procedures do not hinder the commitments made on temporary mobility. A special GATS visa should be introduced for temporary movement of workers and be exempted from normal immigration procedures.</li> <li>At present, most of the commitments are horizontal in nature, with no specific sectoral offers and most pertain to service providers associated with commercial presence or highly-skilled professionals. Therefore, serious work is required to develop sectoral commitments to complement horizontal commitments.</li> <li>A multilateral norm should be established to facilitate the recognition of academic qualification, as well as the recognition of work-related qualification. Economic Needs Tests should either be codified or abolished.</li> </ul>
<b>GATS Rules – Emergency Safeguards, Government Procurement and Subsidies</b>			
<ul style="list-style-type: none"> <li>GATS Article X provides for negotiations on a possible Emergency Safeguards Measures (ESM). The term 'safeguard' can be used to refer to several 'escape clauses' that can be invoked for various situations. An emergency safeguard is considered as a mechanism that governments can use in specific circumstances where there has been an unforeseen surge of imports, that cause or threaten to cause 'injury to domestic producers of the like or directly competing product'.</li> <li>Negotiations started in 1995 and are continuing on the development of possible disciplines that are not yet included in GATS: rules on emergency safeguard measures, government procurement and subsidies. Work, so far, has concentrated on safeguards.</li> </ul>	<ul style="list-style-type: none"> <li>At present, there seems to be no consensus on this issue. Members continue to disagree on the mandate itself – on what it means, stipulates or intends to do. While some focus on the word 'question' to argue that there was no original intention for a provision, article or discipline on an ESM to be concluded by the agreed time-limit, others focus on the phrase 'results of such negotiations shall enter into effect...' to argue that results that can enter into effect are precisely the ones relating to the application of a provision, article or discipline on ESM.<sup>13</sup></li> <li>Industrialised countries have been extremely unreceptive to the idea of an ESM in the services sector. The US, in particular, argues that the ESM advocates have failed to make a case for these safeguards and that any such rules could scare off investment by foreign service providers since they create legal uncertainty.<sup>14</sup></li> </ul>	<ul style="list-style-type: none"> <li>The Association of Southeast Asian Nations (ASEAN), and other countries like Brazil continue to be demandeurs for an ESM mechanism. They argue that given the largely irrevocable nature of GATS commitments, some form of an ESM helps address the adverse consequences of liberalisation commitments on a temporary and extraordinary basis. In addition, an example cited by developing countries highlighting the need for an ESM is the experience of East Asian financial crisis in the late 1990s.</li> <li>For LDCs, with weak financial sector and regulatory mechanism, the fear of a financial crisis might provide one compelling reason to support an ESM. Indeed, as explained in the analysis of the nature of services industries in LDCs, most services industries are still small and struggling to establish domestically. Thus, they require space to grow without the threat of being overwhelmed by more efficient and larger foreign suppliers. An ESM could, therefore, provide the appropriate balance for LDCs, in order for them to make some liberalisation commitments with some level of comfort.</li> </ul>	<ul style="list-style-type: none"> <li>Any measure taken under an ESM must be on the Most-Favoured-Nation (MFN) basis, as there appears no cogent basis for imposing a safeguard measure on a non-MFN basis, when the problem to be addressed presumably arises from an MFN commitment. In any case, this is stipulated under GATS Article X.<sup>15</sup></li> <li>Any injury or threat thereof, which could arise as a result of liberalisation or reform, would presumably manifest within a certain period of time after such a decision is implemented. If so, members could consider a limited window of time during which the ESM could be invoked. Further, an emergency safeguard measure should be applied only for such period of time necessary to remedy or prevent serious injury or threat thereof and to facilitate adjustment of the domestic industry concerned. Based on discussions, it appears that three years is a reasonable length of time for this purpose.<sup>16</sup></li> <li>Some of the developing countries (like India) fear that emergency safeguards will not serve interests of the developing countries, but would be used against them, in particular in the supply of services by natural persons (Mode 4). Therefore, an ESM should have provisions of Special &amp; Differential Treatment (S&amp;DT) to protect the interests of those developing countries, which have identified supply of services through Mode 4 as a particular focus of their interest in services trade.</li> </ul>
<b>Domestic Regulations</b>			
<ul style="list-style-type: none"> <li>GATS Article VI provides that members shall develop the necessary disciplines to ensure that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade.</li> <li>Work started in 1995 to establish disciplines on domestic regulations, i.e., the requirements that foreign service suppliers have to meet in order to operate in a market. By December 1998, members had agreed to disciplines on domestic regulations for the accountancy sector. Since then, members have been engaged in developing general disciplines for all professional services and, where necessary, additional sectoral disciplines. All agreed disciplines will be integrated into GATS and become legally binding by the end of the current services negotiations.</li> </ul>	<ul style="list-style-type: none"> <li>Domestic regulation in services sector is a complex one and one-size-fits-all approach is not feasible. They are often designed to meet 'non-economic' goals, such as environmental or social objectives. Such regulations vary from country to country and also within countries, where local governments and municipalities are often in charge of implementing regulations.</li> <li>Many developing countries and LDCs may not have necessary regulations in place for ensuring the fulfillment of their development objectives while liberalising services sector. Therefore, countries lacking such regulations may find it difficult to attach Article XIX:2 conditions to their liberalisation commitments.<sup>17</sup></li> </ul>	<ul style="list-style-type: none"> <li>As regards domestic regulation, the prevailing situation in developing countries is different from the OECD countries. They often regulate in a less efficient manner. They need to set up standards and regulatory arrangements from scratch but lack enough monetary resources, and competent human resources.</li> <li>A recent World Bank study on business regulation shows that there is a relationship between the level of development and regulatory burden. Rich countries have less burdensome entry regulation as compared to the developing countries.<sup>18</sup> In order to overcome these domestic constraints, developing countries need time and special consideration.</li> </ul>	<ul style="list-style-type: none"> <li>There is a need to ensure that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade.</li> <li>The Services Council must develop necessary disciplines to ensure that national regulatory measures are based on objectives and transparent criteria and are not too burdensome.</li> </ul>
<b>Special Treatment for LDCs</b>			
<ul style="list-style-type: none"> <li>The modalities for S&amp;DT for LDCs were developed under the mandate of GATS Article XIX:3. Through the LDC modalities, LDC members have special provisions that allow for conditions on liberalisations commitments to fulfil developmental goals and objectives.</li> </ul>	<ul style="list-style-type: none"> <li>In the current GATS negotiations, among the offers submitted so far none are from LDCs. This is mainly due to their lack of capacity and limited resources to analyse their domestic economy, assess previous liberalisation, and make initial requests and offers.<sup>19</sup></li> <li>Services exporters from LDCs face both domestic and international challenges. Some of the major challenges are lack of international recognition and a weak profile. Their own governments are not aware of what their capacity is and national websites (such as those targeting potential foreign investors) fail to state what 'international' service exports the country has.</li> <li>Services firms in LDCs also face very high operating costs because of high telecommunications and transport charges, i.e. the networks through which these services are exported. Technological advances and e-commerce have multiplied the number of services that can be traded cost effectively, creating numerous export opportunities.</li> <li>Tourism is an important service industry for many LDCs. But major developing countries are the leading exporters in the tourism sector and, therefore, present strong competition to LDCs.</li> </ul>	<ul style="list-style-type: none"> <li>LDCs as a group account for only 0.4 percent of total world exports of commercial services, and their imports are close to 1 percent. However, despite their small global share, services as a share of total trade in individual LDC countries remain of substantial importance. For example, LDCs' commercial services exports, as a share of their total trade is 18 percent on average, which compares favourably with the world average of 20 percent.<sup>20</sup></li> <li>UNCTAD (United Nations Conference on Trade and Development) estimates that a liberalisation package in Mode 4, coupled with a capacity support package in trade in services for LDCs, could generate US\$10-20bn per year.</li> <li>Among the LDC Members of the WTO, 28 made commitments in the tourism sector. Moreover, tourism is the only sector mentioned committed by Bangladesh, Chad, Tanzania and Uganda in their schedules of specific commitments. This high number of commitments suggests that LDCs find the tourism to be one of the more important service industries in their economies.<sup>21</sup></li> </ul>	<ul style="list-style-type: none"> <li>A mechanism should be developed to assist LDCs in identifying the nature and extent of their services trade interests and to translate those interests into GATS requests. LDCs could then judge, as to how far they should go in binding services commitments in light of a fuller assessment of the balance of concessions and economic benefits.</li> <li>LDCs together should work out a liberalisation package in services that would include measures to operationalise their priority areas; in sectors of special interest to them, such as tourism, entertainment and sports and in such other areas as the issuance of visa and work permit.</li> <li>In making requests and offers, non-LDC members should also focus on those sectors, transactions and modes as indicated by LDCs (on the basis of assessment) for services trade liberalisation.</li> </ul>
<b>Systemic Problems</b>			
<ul style="list-style-type: none"> <li>Negotiations proceed through a laborious request-and-offer approach, whereby each WTO member must separately induce other trading partners to make commitments in each sector of export interest.</li> <li>There is a lack of uniform definition of Mode 4. Statistics are also not compiled as per Mode 4 criteria. Further, there is no universally acceptable time period of temporary movement.</li> <li>Security considerations, brought into sharper focus since the attacks of September 11, 2001 have also changed the balance between facilitation and enforcement aspects of immigration controls. Measures to facilitate the entry of foreign workers are increasingly coming under scrutiny by developed country members in order to ensure that they do not become conduits for entry by illegal or undesirable individuals.<sup>22</sup></li> </ul>	<ul style="list-style-type: none"> <li>Negotiations through bilateral request-and-offer approach is a painful task with high costs in terms of negotiating resources; does not necessarily produce efficient or equitable outcomes in a world of unequal bargaining power; is affected by the free-rider problem that arises in negotiations conducted under an MFN-based system; and offers no credible way of granting credit to the unilateral liberalisers.</li> <li>Majority of WTO members are not willing to shift to some alternative way for services trade liberalisation as the exiting bilateral request-and-offer approach allows them considerable freedom to decide on how much to liberalise.</li> <li>No formal classification of services providers separating intra-corporate transferees, business visitors, contractual services providers and independent service providers exists.</li> <li>There are at present no reliable global figures for the size of Mode 4 trade. Available migration statistics are incomplete and not readily comparable between countries. It is also generally not possible to separate Mode 4 workers from broader groups.</li> </ul>	<ul style="list-style-type: none"> <li>The progress on services negotiations is lagging behind. To date only about 50 (74 if the EC's offer is counted as representing 25 member states) of the 148 WTO members have submitted their initial offers on services with deadline ending on May 31, 2005 and many of them are of poor quality.</li> <li>While there is lack of authentic empirical data on Mode 4, it seems that it is not a preferred channel for permanent immigration. The UK work permit system allows people to apply for permanent settlement after four years of continuous employment, but in practice, a relatively small proportion seems to settle permanently. In 1998, 3,160 work permit holders settled in the UK, against approximately 70-80000 work permits approved each year.<sup>23</sup></li> </ul>	<ul style="list-style-type: none"> <li>There has been a demand by some WTO members to shift to a formula approach for services trade liberalisation, as the existing request-offer approach has not yielded any significant outcome. But developing countries would need to consider seriously the impact of such an approach before accepting its application to their commitments.</li> <li>A Special Session of the Council for Trade in Services be convened to consider issues, such as adoption of a classification of services providers: separating intra-corporate transferees, business visitors, contractual service providers and independent service providers.</li> </ul>