GATS and Retail Services: India Perspective

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In the past five years, India has witnessed significant debate, brainstorming sessions and political drama over the issue of liberalizing retail services for foreign investors, particularly in the multi-brand sector. For the most part, the arguments have concerned the fate of local retailers, “kirana shops,” pursuant to permitting foreign direct investment (FDI) in this sector. While one school of experts has expressed apprehension about local retailers being eliminated from the market if such FDI is permitted, the other school has advocated that such FDI will, aside from boosting the economy and foreign exchange reserves, generate employment on a large scale.

Balancing both of the foregoing concerns, the Indian government recently liberalized FDI in this sector up to 100 percent in single-brand retail and up to 51 percent in multi-brand retail services. Although this move has been appreciated by the industry and the investor class, such investments are subject to a significant number of restrictions in terms of minimum capitalization, local sourcing of materials, prior approval and other such requirements.

Needless to say, India, being a sovereign nation, has the authority to impose such investment restrictions at the municipal level. Having said that, given the unification of the world economy through globalization, it would be inadequate and myopic to confine the assessment of such restrictions to the municipal level. The justifiability of such restrictions needs to be assessed at the global level against the country’s international commitments, more specifically commitments under the World Trade Organization (WTO), considering that WTO membership comes as a package of
obligations across different areas, namely trade in goods, trade in services and trade-related investments. While much has been deliberated with regard to the merits and demerits of India’s restrictions on FDI in retail services from the perspectives both of economics and of India’s municipal laws, the question of whether such restrictions are sustainable against the radar of the WTO has been overlooked on most debate platforms.

Therefore, this article attempts to assess India’s FDI norms in the retail trade sector vis-à-vis its commitments, if any, under the General Agreement on Trade in Services (GATS) within the auspices of the WTO. Further, this article reviews the commitments made by a few other countries in retail services and the nature of the limitations imposed by such countries. Also, this article suggests a way forward for India, factoring in the various trade barriers applicable to retail trade services, whereby the country might harmonize its municipal investment restrictions with future commitments under GATS.

Keywords: distribution services, foreign direct investment, GATS, India, retail trade services

I. Introduction

With proliferating cross-border trade and investments, and unification of the world economy, countries can no longer sustain isolated sectors of economy. Therefore, non-exposure to cross-border trade and investment as a protection mechanism to safeguard domestic sectors is redundant in contemporary times; nevertheless, such protectionist efforts were witnessed recently in the context of liberalization of foreign participation in India’s retail services sector. While the advocates favouring such liberalization cited development of the retail infrastructure, inflow of foreign exchange, improved retail services and overall economic growth, the opponents’ arguments rested upon the interests of local retailers (kirana shops) and protection of domestic supplies.

Although the above debate pertains to India’s municipal laws regulating foreign investment, one is also compelled to assess and analyse its relevance and application under the WTO regime, more specifically the General Agreement on Trade in Services (GATS), to which India is a member signatory. Such an examination is important because municipal law regulating investment conditions in the country must operate within the contours of the global trade/investment framework on retail services. The following questions arise:

- Does GATS apply to trade in retail services?
- Has India made any commitments under GATS with respect to such services?
What are the limitations, if any, made by India on such commitments?
Does India’s foreign direct investment (FDI) policy conform to India’s commitments on retail services under GATS?
What are the trade barriers in the Indian context with respect to import of retail services?

This article examines India’s position under GATS vis-à-vis its national laws with respect to trade in retail services and, more specifically, import of such services.

II. Retail Services under GATS

II.1 GATS in General

Prior to the establishment of the World Trade Organization in 1995, trade in services had not found a place on the global platform. Pressure was created by developed economies like the United States during the negotiation rounds of the WTO to expand the multilateral trade regime to include services and investment. Such proposals were vehemently opposed by countries such as India and Brazil, which regarded their service sectors to be under the “public/state domain.” Finally, by the Uruguay round, the WTO endorsed a comprehensive agreement regulating trade in services, i.e., the General Agreement on Trade in Services. Thus, country obligations with respect to trade in services were codified under GATS, which is one of the mandatory agreements under the multilateral trade regime of the WTO. Similar to the General Agreement on Tariffs and Trade (GATT), a multilateral agreement regulating merchandise trade, GATS is guided by the following objectives:

- creating a credible and reliable system of international trade rules;
- ensuring fair and equitable treatment of all participants;
- stimulating economic activity through guaranteed policy bindings;
- promoting trade and development through progressive trade liberalization; and transparency in global trade.

Structurally, GATS may be divided into four parts:

i. General obligations, i.e., mandatory and binding obligations immediately in effect upon becoming a member of WTO, including, *inter alia*, most-favoured-nation treatment, transparency, economic integration and emergency safeguard measures;²

ii. Specific obligations, i.e., commitments made by a member country with respect to specific service sectors in terms of market access, national treatment and others;³

iii. Annex, containing the rules pertaining to certain specific sectors like telecommunication, financial services, etc.; and

iv. Schedule of commitments, i.e., the schedule executed by a member country containing its mode-wise commitments for each sector.
Thus, GATS includes certain obligations which are mandatorily and generally applicable to all member countries as mentioned in (i) above; for instance, members must extend immediately and unconditionally to services or service suppliers of all other members “treatment no less favourable than that accorded to like services and service suppliers of any other country,” which essentially prohibits preferential arrangements among countries in each individual sector.

While they must meet the foregoing mandatory obligations, countries may choose the services and their modes for which they wish to undertake commitments under GATS. Such commitments are made through the schedules. There is no compulsion on a member country to make commitments in any sector; thus, countries are free not to schedule any sector for GATS commitments. Moreover, even where a country schedules a service sector, it may restrict such commitment to only one mode of supply. Further, each member country determines limitations on market access\(^4\) and national treatment\(^5\) for each committed sector. In this context, while market access indicates non-discriminatory quantitative restrictions impeding access to markets, national treatment refers to equitable treatment of foreign and domestic service providers in terms of competitive opportunities. The leverage available to the member countries under GATS is a fundamental deviation from the unqualified and absolute obligations applicable to trade in goods under the GATT.

In other words, subject to adherence to the mandatory obligations, a member country may be in conformity to the GATS mandate through any of the following means:\(^6\)

- A country may decline to make any commitments in a sector whatsoever;
- A country may qualify its commitments made in a particular sector;
- A country may make an absolute commitment in a sector, i.e., open up a sector without any limitations or restrictions;
- A country may apply horizontal limitations applicable across all sectors.

In terms of applicability, GATS applies to measures affecting trade in services, where such service may belong to any of the 12 sectors listed, namely:

i. business services;
ii. communication services;
iii. construction and related engineering services;
iv. distribution services;
v. environmental services;
vi. financial services;
vii. health and social services;
viii. educational services;
ix. tourism and travel-related services;
x. recreational, cultural and sporting services;
xi. transport services; and
xii. other services not included elsewhere.

Considering the extensive scope of the residuary category (xii) above, it is well established that GATS applies to all service sectors found in the WTO Services Sectoral Classification List, subject to (a) the member country’s specific commitment to the sector in the national schedule, (b) the limits to such commitments mentioned by the member country, and (c) the express exceptions under GATS, i.e., (i) services supplied in the exercise of governmental authority, (ii) measures affecting and services directly related to the exercise of air traffic rights and (iii) the general exceptions and security exceptions.

Further, GATS distinguishes the supply of education services under four modes of trade, as described below:

<table>
<thead>
<tr>
<th>Mode of supply</th>
<th>Meaning</th>
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<tbody>
<tr>
<td>Cross-border supply (mode 1)</td>
<td>The provision of a service where the service crosses the border, without physical movement of the consumer.</td>
</tr>
<tr>
<td>Consumption abroad (mode 2)</td>
<td>Provision of the service involving the movement of the consumer to the country of the supplier.</td>
</tr>
<tr>
<td>Commercial presence (mode 3)</td>
<td>The service provider establishes or has presence of commercial facilities in another country in order to render service.</td>
</tr>
<tr>
<td>Movement of natural persons (mode 4)</td>
<td>Persons travel to another country on a temporary basis to provide service, i.e., movement of service supplier being a natural person.</td>
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II.2 Retail Services under GATS

Retail services are covered under the Distribution Services Sector of GATS, which sector also includes commission agents’ services, wholesale trade services and franchising. This sector provides the nexus between manufacturers and consumers across countries. In addition, the sector’s performance contributes directly to the competitiveness of other sectors, such as manufacturing, agriculture and service industries. For example, manufacturers and resource companies seeking to extend their activities overseas are adding value to their products and differentiating them by improving logistics, delivery and after-sales service, and through encompassing other services. The more efficient distribution services are, the more optimal the allocation...
of resources and the matching of supply with demand. From a consumer perspective, these benefits can be considerable, taking the form of reduced risk, lower costs and prices, better quality and wider choice. Thus, inefficient performance of this sector can cause misappropriation of resources and can cripple the entire trade machinery.

Despite the vital significance of this sector, the commitment levels of member countries in this sector remain relatively low. For instance, as of 31 January 2009, only 57 countries had made commitments in distribution services, as shown in table A1 of the technical annex to this article. A few illustrations of specific commitments of the above member countries, and the variations reflected in such commitments, are provided in table A2 of the technical annex.

Distribution services were included in the Doha round of negotiations, commenced in the year 2000. In the initial years of the negotiations, various negotiating proposals were submitted by member countries, both developed and developing, such as the United States, the European Community, Canada, Switzerland, Mercosur, Korea, Colombia and Australia, to name a few. These negotiating proposals emphasized, inter alia, the low commitment level of member countries in this sector. The proposals also deliberated upon some of the hurdles responsible for low commitment, such as the following:

- foreign investment limitations;
- economic needs test;
- limitations on the type of legal entity;
- restrictions on control and management of such legal entity;
- restrictions on the scope of operations;
- discrimination against franchises or direct selling as opposed to other forms of business;
- discriminatory taxes and subsidies;
- discriminatory limitations on the acquisition of assets, such as land and real estate;
- citizenship or residency requirements;
- performance requirements on marketing of domestic goods; and
- product exclusions found in the commitments of members.

Following the Hong Kong Ministerial Declaration of December 2005, a plurilateral request on distribution services was formulated in March 2006, which advocated “no limitations for modes 1 to 3” in this sector. Having said that, the requests accommodated flexibility with respect to (a) transitionary periods, (b) certain non-discriminatory economic needs tests and (c) other exceptions, to be negotiated on an individual basis. With regard to mode 4, the plurilateral request provided for market access and national treatment with no limitations other than those indicated in
the horizontal section. Also, the request required the member countries to comply with the Scheduling Guidelines of 23 March 2001 to ensure clarity, certainty and coherence in their commitments. This plurilateral request was co-sponsored by Chile, the European Community, Japan, Korea, Mexico, Singapore, Taiwan, Penghu, Kinmen and Matsu, and the United States.

Also, in the Special Session of the Council for Trade in Services conducted in June-July 2005, members noted the particular importance of distribution services in the negotiations and the need for greater progress in all four subsectors. Later, in October-November of the same year, the Special Session of the Council for Trade in Services once again reiterated the importance of commitments in the four subsectors, alongside minimization of exclusions for sensitive products and foreign equity limitations, as well as better access in wholesale and retail trade under mode 3.

With regard to India’s stand on retail services under GATS, no specific commitments have been made. This signifies that India has not as yet opened up its retail services sector under GATS. Any trading in retail services undertaken by India originates either from its bilateral and preferential trade agreements with countries outside the GATS ambit, or from standalone transactions subject to national laws and regulations.

III. India and Retail Services

III.1 Retail Services and the Indian Economy
The significance of the services sector to growth of the Indian economy can be explained through the following statistics. Among the 15 countries with the highest overall gross domestic products in 2011, India ranked ninth in overall GDP and tenth in services GDP. A comparison of the services performance of the top 15 countries in the 11-year period from 2001 through 2011 indicates that the increase in the share of services as a percentage of GDP is the highest for India, followed by Spain.

With regard to trade in services, in the 1980s, services trade contributed 20 percent of India’s total trade, a figure that increased to 30.4 percent in 2010, as compared to the global average of 24 percent. Trade in services as a percentage of GDP increased from 3.2 percent in 1980 to 13.9 percent in 2010. The growth in trade in services is illustrated by way of a comparative chart in figure 1.

Further, India’s share in world trade in services increased from less than 1 percent in 1980 to more than 3 percent in 2010. India’s share in world exports of services (see figure 2), which increased from 0.6 percent in 1990 to 1 percent in 2000, and to 3.3 percent in 2011, has been increasing faster than the share of merchandise exports in world exports.
More specifically, the share and growth of trading services (including retail trading) in the Indian services sector, as assessed from the figures shown in table A3 of the technical annex, demonstrate consistent performance and significant contribution to the overall economy, post India’s liberalization move in the past decade. In terms of sales turnover, profits and expenditure as well, the development trend specifically in retail trading has been positive, as illustrated in table A4 of the technical annex.

As reported in the A.T. Kearney Global Retail Development Index 2012, India ranked at fifth position as a high-potential market, with accelerated retail market
growth of 15 to 20 percent forecast over the next five years. While the overall retail market contributes 14 percent of India’s GDP, organized retail penetration remains low. Brazil leads the Global Retail Development Index, with retail sales accounting for 70 percent of its consumer spending, followed by Chile, China and Uruguay.

III.2 FDI in Retail Services
From 2006 through 2011, India allowed FDI in single-brand retail up to 51 percent. In January 2012, restrictions on FDI in the single-brand retail sector were removed by allowing 100 percent foreign investment. Later, in September 2012, FDI in multi-brand retail was permitted up to 51 percent under the approval route, subject to certain conditions, described in table A5 of the technical annex. The table shows a comparison of the permissible FDI in the retail sector prior to 2012,16 and pursuant to the major liberalization in 2012.17

The progressive liberalization of FDI in retail services was achieved after much lengthy debate and political conflict, which may be summarized through the following arguments advanced by the two schools, one advocating in favour of such liberalization and the other opposing it:

Arguments in favour of liberalized retail trade services:
- Retailer’s efficiency at supply chain management will eliminate middlemen, resulting in direct procurement of goods from the supplier. Thus, distribution costs will fall, driving down the cost of the product to the end consumer.
- Firms in the organized retail sector will require manpower. For instance, Walmart employs 1.4 million people in the United States alone.18 Pursuant to liberalization of China’s trade services sector to allow foreign investment, employment in China in both retail and wholesale trade increased from 4 percent in 1992 to 7 percent in 2001.19 Thus, liberalization of retail services is expected to boost employment levels in India.
- In view of historic depreciation of the Indian rupee and the country’s need for foreign exchange, inflow of foreign currency through FDI is a must. One of the major sectors which can contribute significantly to such forex earnings is the trade services sector. Also, India may be in a better position to combat its budgetary deficit through taxes collected and added revenue from the global players operating in India. Overall earnings of the economy will increase, helping India to recover from the present fiscal crisis.
- Entry of foreign players will enhance competition in the Indian retail services market. The interplay of multiple players in the market will keep prices in check and thus assist in controlling inflation. For example, the “Walmart effect” has been credited for Canada’s very low inflation rates.20 Also, quality of services will rise to competitive levels, which will benefit consumers and provide them with
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more purchase options. Increased competition will augment market transparency, thereby helping consumers to make informed purchase decisions.

- Any apprehended risks or threats will be adequately taken care of by discretion at the state level to not permit FDI in retail within its jurisdiction unless such investments create favourable conditions. Accordingly, states may impose restrictions such as limits on the number of shops, market share and brands, and in terms of diversity, homogeneity and cultural preferences, safeguards for domestic traders and producers, operating styles, etc.

- The presence of foreign players in the retail sector will also create resource allocation efficiency. Aside from connecting each element of the market, it will facilitate greater access to remote producers and suppliers. For instance, Walmart has successfully initiated the “Direct Farm Project” at Haider Nagar near Malerkotla in Punjab, where a large number of farmers have been reached by Bharti Walmart for sourcing fresh vegetables.

- Foreign investment will further organize the sector and create a regulated market. Until now, local traders have not operated within the cognizance of regulators, resulting in much abuse and escaped illegalities.

Arguments against liberalized retail trade services:

- Due to the closure of small and independent shops, unemployment will rise in India. This problem will be exacerbated by elimination of middlemen, who will be rendered without any means of livelihood.

- The above issue of unemployment will reduce the country’s earnings and, thus, result in further depreciation of India’s economy.

- Foreign players will abuse the Indian market by dumping goods at low prices. Also, such dumped products will be of inferior quality, resulting in poor consumer satisfaction.

- Foreign retailers, by their sophisticated means and reduced costs, may monopolize the market and eliminate competition.

- Repatriation of earnings by foreign investors will result in forex drainage and, thus, cause further harm to the Indian currency. Also, it has been alleged that foreign players will earn at the cost of Indian retailers, producers and consumers.

- Lastly, India is self-sufficient in terms of retail services from its domestic retailers, and foreign services are not required. Not only are they not required, but also entry of foreign traders may bring in risks of political invasion (similar to what happened in the pre-independence era of the East India Company).

A review of the above arguments indicates that the arguments opposing foreign participation in retail services lacked commercial logic in the contemporary context and, thus, were mostly politically driven.
IV. Conclusion and Way Forward

In view of India’s non-commitment in the area of distribution services under GATS on one hand, and the jargon of its regulatory back and forth on foreign investment in retail services on the other, it is clear that foreign participants in retail services will be apprehensive about dealing with India until a certain and unambiguous regulatory regime is established. This is the reason why, despite the recent liberalization permitting 51 percent FDI in multi-brand retail, not a single multi-brand retailer has until now opened its shop in India. In fact, such hesitance on the part of foreign players inspired further liberalization moves by the Government of India in August 2013.21

Analyzing India’s FDI norms in retail vis-à-vis GATS, it is certain that India’s foreign investment regulatory norms in retail do not conflict with its obligations under GATS. This is because India has not as yet made any commitments whatsoever in distribution services (in any of the four subsectors) under GATS. Assuming that India wishes to do so in the future, a mode-wise assessment is attempted below. Thus, India’s potential specific schedule of commitment for retail trading services, if crafted now, would encompass the following:

IV. 1 Drafting of India’s Potential Commitments in Retail Trade Services under GATS

• **Mode 1, Cross-border supply:** The form of retail service which may be covered here is e-commerce. Most economies, for example the UK, have sophisticated e-commerce infrastructures, as is apparent from the value of online retail spending statistics for the UK during the period 1999-2010, illustrated in figure A1 of the technical annex. However, considering that globalized retail services are still at a nascent stage in India, such e-commerce infrastructure is yet to be developed. In this regard, India’s FDI policy prohibits e-commerce in retail services, except for B2B e-commerce. Having said that, this restriction applies only in the case of an Indian company having foreign equity. Therefore, e-commerce in retail between an overseas foreign retailer and Indian consumers is not prohibited. Thus, mode 1 will have limited market access to the extent that FDI will be allowed only in B2B e-commerce, and FDI in retail e-commerce will remain prohibited.

• **Mode 2, Consumption abroad:** This mode is not much applicable in the context of retail trade services. Nevertheless, this mode will be committed to without any limitations, as India at present does not impose restrictions on such consumption abroad.

• **Mode 3, Commercial presence:** This mode will trigger maximum debate and uncertainty. FDI in India’s retail sector will fall primarily in this mode. Thus, all
the conditions relating to foreign investment sectoral caps, approval requirements, and conditions relating to “back-end” infrastructure, minimum capital investment, etc., will operate as limitations to market access. Likewise, the condition relating to local sourcing will appear as a limitation to national treatment.

- **Mode 4, Movement of natural persons**: This mode, similar to mode 2, is not much relevant in the context of retail services. Other than the visa requirements, there are not many restrictions in this regard.

Having said the foregoing, India must be cognizant of the likely barriers to trade in retail services if making commitments under GATS, with the major categories being the following:

a) Institutional, cultural and organizational barriers, as illustrated below.

![Figure 3 Institutional, cultural and organizational barriers to trade in retail services.](image)

b) Regulatory barriers

In the Indian context, such barriers are substantial and continue to deter foreign participation in India’s retail sector. Regulatory barriers apply at two levels: firstly, at the central level – to obtain approval or make filings subject to the investment conditions, and, secondly, at the state level – to satisfy the conditions imposed by the state government. Regulatory barriers can also be classified into three major categories, namely (a) foreign investment, (b) property acquisition and (c) residency/visa requirements for natural persons.
Pending commitments by India in the distribution services sector under GATS, India’s position, although not in conflict with its obligations under GATS, needs to be streamlined with clarifications and interpretations by the government for the assurance of foreign participants, who, due to the prevailing regulatory uncertainties, have adopted a wait-and-watch approach. Unless India provides a comfort space for foreign participants, its recent efforts to liberalize retail trading may be rendered ineffective and cosmetic, which India cannot afford during the ongoing depreciation of the rupee and financial distress.
References

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OECD Code on Liberalization of Capital Movements.
Endnotes

1. The author has also worked in the corporate law team of a top tier Indian law firm for more than four years.
2. Articles I to XV of GATS.
3. Articles XVI and VII of GATS.
4. Article VI of GATS.
5. Article VII of GATS.
8. Article I (3) of GATS; point 2 of the Annex on Air Transport Services; and Articles XIV and XIVbis of GATS.
9. Article I of GATS.
15. Supra note 17.
17. Circular 1 of 2013, dated 5 April 2013, issued by Department of Industrial Policy and Promotion, Government of India.
21. Supra notes 22 and 23.