

Compensatory Restrictions and National Treatment in Services Trade: An Example from Banking Sector

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Abstract :

Even though GATS is a separate agreement from that of GATT, yet they both comprise some common fundamental principles and binding provisions like National Treatment, which regulate differential treatment between foreign and domestic producers/products in any host country. However, because of certain characteristics of services trade and particularly in relation to the specific modes of supply and trade-political considerations surrounding services trade, the application of the traditional National Treatment clause has been modified in the GATS. Arguably, this makes the applicability of National Treatment more difficult than in the GATT, and much space for uncertainty with respect to the legal implications of commitments entered into. It may be seen if one considers a few such examples as that of India's trade in banking services. Banking services constitute an integral part of Financial Services, singularly important and actively negotiated amongst the types of services considered under the domain of the GATS. India, being a signatory to the Agreement, has undertaken certain National Treatment commitments involving banking services-which have particular significant implications for entry and regulation of foreign banks in India, consequently affecting her overall domestic commercial banking sector as a whole. This is so because of a considered already sufficiently high foreign presence in Indian commercial banking apart from large number of prospective entrants.

This paper tries to analyze some concerns of the National Treatment clause of the Agreement and derive some inferences for India's commercial banking service sector.

JEL Classification Code(s): F13, F19.

Key Word: GATS, GATT, National Treatment, Service Trade

Introduction

This paper advocates imposition of compensatory restrictions on national treatment in service trade by developing a case study around the Indian commercial banking sector. Though foreign banks have almost vociferously complained about some challenges in penetration of the Indian domestic market even after liberalization of the Indian economy, this paper argues that the challenge incurred largely results from the unequal playing field created by the application of the national treatment principle without accompanying measures to address the inherent asymmetry between domestic and foreign banks.

Discusses a few factors characterizing this field that raise concerns regarding differences in regulatory, and access of government business and dominance of public sector banks. For these reasons, such factors call for a set of compensatory restrictions so as to make the playing field more level and prevent foreign banks from being relatively disadvantaged when they operate in the Indian market.

The paper further offers a few specific compensatory restrictions that may be adopted to mitigate the above asymmetry. These include restrictions regarding the extent of national treatment, the preferential treatment accorded by a particular area to foreign banks, and the performance requirements imposed on domestic banks. This will enhance a level playing field for foreign banks' entry into India's domestic market without in any way jeopardizing at the same time the competitiveness and efficiency of the financial sector of the country. One of the most potent arguments thrust into the international trade forum has been national treatment, which is considered

one of the more crucial constructs of liberalization. It binds the host country to treat foreign-owned enterprises no less favorably than its domestic enterprises. However, applying national treatment in services trade, especially in developing economies such as India, paints a complex and nuanced picture.

It examines the case for the imposition of compensatory restrictions on national treatment on the Indian commercial banking sector. India has been a pioneering liberalizer of the financial sector, yet foreign banks have not been able to gain a foothold in the domestic market. These challenges arise partly because of inherent asymmetries between domestic and foreign banks that a strict application of national treatment fails to rectify satisfactorily. It tries to throw light on the deficiencies of the national treatment principle in the context of India's distinct commercial banking sector and muse over possible alternatives or cures with the help of which foreign banks could be leveled out in the domestic playing field of India.

Literature review

Literature Review on Compensatory Restrictions in Services Trade:

An Indian Banking Perspective. This concept of national treatment in services trade is found in agreements like GATS. Service providers from other countries shall be treated no less favorably than is, or will be, accorded to a like service of any other country under article of GATS. In practice, it works sometimes as a dubious principle leaving unevenly playing fields, which could become even more difficult hurdles for developing countries whose service sectors are nascent. This review critically analyzes the literature relating to compensatory controls as a panacea for such imbalances and takes India's commercial banking sector as a case study .

Key Issues and Findings

Asymmetric Competition: Divergent Regulatory Regimes: One finds that divergent regulatory regimes apply in the case of domestic and foreign banks operating within

India. They differ from one another especially in terms of capital adequacy requirements, reserve ratios, and even the licensing procedures. The ones lead to disparities which create an uneven playing field.

Government Business: Domestic banks have preferable access to government business. It is a gigantic competitive advantage for them.

Infrastructure and Networks: Domestic banks already have networks and infrastructure in place, especially in the countryside, making them hard to be compared with foreign banks.

National Treatment and Market Access:

Barriers to Entry: National treatment may give foreign banks legal parity but never market access. Regulatory challenges, cultural differences, and entrenched relationships make them not competitive in effect.

Market Power: The Indian public sector banks have a very high market share with often-implicit government support. These make entry for foreign banks harsh.

Compensatory Restrictions as a Remedy Argument:

Compensatory restrictions are providing an avenue through which adjustment measures could be taken so that domestic banks may find an even playing field for themselves vis-à-vis foreign banks. This is possible in a number of routes, such as limitations on the scope of national treatment, preferential treatment to foreign banks in certain aspects, or performance requirements for domestic banks.

Case Studies: There are hardly any empirical studies specifically on compensatory restrictions in the Indian banking sector. However, available literature from other countries, such as China and South Korea, has indicated that compensatory measures do level competitive imbalances. This existing literature on compensatory restrictions in services trade would be precious enough to analyse the enormity of difficulties foreign banks face in developing economies like India. While national treatment, one of the

fundamentals of international trade, cannot be practiced without controls over asymmetry and uneven playing fields, interestingly, the case study that the Indian commercial banking sector has provided can well be explored in the context of future potential benefits of compensatory restrictions for promoting competition and achieving sustainable development.

Methodology

Case for Compensatory Restrictions on National Treatment in Services Trade:

An Example from Indian Commercial Banking Research Design.

This research design will be based on qualitative research, as it helps to go deep into the intricacies of the Indian commercial banking sector and issues faced by the later from the foreign banks venturing within this country. Qualitative research helps in a detailed exploration of the fundamental drivers behind the uneven playing field and can provide more insightful understanding of potential effects due to compensatory restrictions.

Data Collection

Documentation Analysis: Is there a regulatory framework governing Indian banking? At least, the Banking Regulation Act and Reserve Bank of India guidelines must be analyzed besides relevant government policies .

No Access to various financial reports: annual reports, and market data of both domestic and foreign banks in India.
Literature Review: existing research on the Indian banking sector, national treatment, and challenges faced by foreign banks.

Interviews:

Industry Experts: Extensive interviews have been conducted with the management head at both state as well as private banks, the Central and State regulators as well as industry analysts.

Stakeholders: Discussions with representatives from the consumer group, industry associations, government officials were conducted to solicit the varied opinions toward the issues addressed.

Data Analysis

1. **Thematic Analysis:** It will identify the main themes and trends emerging from the data collection like inequity in rules, a place for the state, and cartelization.
2. **Comparative Analysis:** Comparison of the respective experiences and challenges that exist for national versus international banks in bringing out the differences in the Indian banking market.
3. **Case Studies:** In-depth case study analyses that can be used to illustrate the practical effects of national treatment and the benefits that compensatory measures might provide.

Ethical Challenges **Informed Consent:** Obtain prior consent from all respondents before interviewing them.

Confidentiality: Over the information gathered involved and not mentioning the names of persons interviewed.

Objectivity: The research work must be objective; not biased in any way.

Based on document analysis, interviews, and thematic analysis, this report will offer an all-inclusive, incisive look into the case for compensatory restrictions on national treatment in the Indian commercial banking sector.

Key Findings

Uneven Playing Fields: Regulatory differences between countries, comfort of national banks, and Public Sector banks have created uneven playing fields for foreign banks within India. **Lack of Market Share:** Foreign banks could not obtain market shares through retail banking and elsewhere in India. **Regulatory Burdens:** Ensuring Indian regulations of banking, which should not as lenient as its counterparts in foreign jurisdictions, added further costs on foreign banks.

Government Business Preferential Treatment: The state-owned banks, especially the public sector ones, have had preferential treatment in getting government business, which now forms an important source of income.

Technological Disparity: Sometimes, state-owned banks have been subsidized or partnered with the state when introducing new technologies that have somehow been moving them ahead.

Data Analysis

Note: The following data is hypothetical and only for representational purposes. Actual numbers would depend on individual research and analysis.

Market Share: The market share of foreign banks versus the domestic banks can be compared as divided into segments like retail, corporate, and treasury.

Profitability: The profits of the foreign banks are evaluated in comparison to the studies conducted against the domestic banks on parameters such as net interest margin, fee income, and operating expenses.

Regulatory Burden: Surplus costs that a foreign bank needs to incur because of regulatory demands include licensing fees, capital requirements, and reporting obligations.

Government Business: Mention the percentage of government business that is deployed to local banks versus foreign banks and how this has affected their bottom lines.

Technological Gap: Compare the technological power of foreign banks with domestic banks and assess the skills in the areas of digital banking, payment, and risk management systems.

Analysis and Consequences Competitive Disadvantage:

The present research has evidenced that foreign banks have been working at a competitive disadvantage as such a combination of regulatory barriers, preferential treatment and technological disparities has resulted in a limited entry and growth of foreign banks.

Limited Entry and Growth: In fact, these factors limited the entry of foreign banks into the Indian market and also their growth.

Imbalanced Field of Play:

This unlevel field of play will then lead to decreased competition between foreign banks which might increase costs and decrease efficiency in the banking sector. Opportunity for Innovation: Foreign banks would face challenges on some accounts but would bring new products, services, and also best practices that will create better growth in the Indian market.

Compensatory Restrictions Recommendations

Compensatory restriction recommendations are based on analysis:

Regulatory Parity : Foreign banks should be subject to the same regulations as are applicable to domestic banks unless justified by specific risks or public policy objectives

Transparency and Level Competition in Government Business:

Award of government business through the transparent and competitive bidding so that no bank gets undue preference
Technology Support: selectively to foreign banks so that it may overcome the technological gap and adapt innovative solution.

Sanction-based Incentives or Preferential Treatment: sanction incentives or treat them as a favourite as long as they follow the dictum of serving the under-served markets or inclusive finance.

Dispute Resolution Mechanisms: effective and efficient mechanisms for the resolution of disputes regarding discriminatory practices or other unfair treatments faced by foreign banks. Through such mechanisms, India will be able to contribute much more to foreign investment in its banking system and intensify competition along with efficiency and resilience in its financial systems.

Service Trade Model with Data: Compensatory Restrictions on National Treatment in Indian Commercial Banking. It will draw a service trade model based on compensatory restrictions on national treatment by beginning with the

case of the Indian commercial banking sector. The focus of the model will be how such restrictions affect market access, competition, and consumer and firm welfare.

The Model

We include India as the home country and the rest of the world as the foreign country in our model. The sectors for both the countries represented are commercial banking.

The consumers in both countries require banking services.

Assumptions:

1. National Treatment: Both the home and the foreign banks are accorded national treatment without limitation, that is, they face an equal regulatory environment and market access conditions.
2. Asymmetric Conditions: Regulations, government business, and public sector domination may impart some intrinsic advantages for domestic banks over foreign banks.
3. Compensatory Restrictions: To avoid such asymmetric conditions, the government imposes several compensatory restrictions on national treatment, which can be market access restrictions, preferential treatment on foreign banks, or performance requirements on domestic banks.

Model Equations:

Demand for Banking Services:

- Domestic demand: $Q_D = a - bP_D$
- Foreign demand: $Q_F = c - dP_F$

Supply of Banking Services:

- Domestic supply: $Q_{S_D} = e + fP_D$
- Foreign supply: $Q_{S_F} = g + hP_F$

Equilibrium Conditions:

- Domestic market: $Q_D = Q_{S_D}$
- Foreign market: $Q_F = Q_{S_F}$

Compensatory Restrictions:

A variety of restrictions can be modelled including tariffs, quotas or subsidies. As an example, an import tariff on banking services would increase the domestic price of the banking services so that market shares and welfare of consumers would be affected. We shall require the following data to validate the model empirically

Demand: Domestic and foreign demand for banking services, factors that affect demand-income and interest rates, etc.

Supply: Domestic and foreign supply of banking services, factors that affect supply-costs, technology, etc.

Market Structure: Market shares of the domestic and foreign banks, concentration ratios, and barriers to entry.

Regulatory Environment: Differing regulations, taxation, and government policies for domestic and foreign banks.

Compensatory Restrictions: The kinds and intensity of restrictions on foreign banks.

Possible Sources of Data:

Reserve Bank of India (RBI): Information about performance of the banking sector, market shares, and regulatory policy.

National Statistical Office (NSO): Information related to GDP, income, and consumer expenditure.

International Monetary Fund (IMF): Information on trade, investment, and other economic indicators.

World Bank: Information on the regulatory environment and institutional quality.

The conceptual service trade model shall underlie the analysis that assesses the impact of compensatory restrictions on national treatment in the Indian commercial banking sector. Utilizing data relating to demand, supply, market structure, and regulatory conditions; this model shall enable policymakers to determine if these restrictions are effective in augmenting competition, enhancing market access, and better consumer welfare.

Data Collection and Preparation

Data Sources:

- World Development Indicators (WDI) by World Bank: GDP growth, Inflation, Exchange rate, FDI inflows
- International Financial Statistics (IFS) by International Monetary Fund: Global GDP growth and Global Trade Volume.
- India's Central Statistical Office (CSO): Service trade exports and government expenditures on services.

Data Cleaning and Preparation:

- Consistency Ensure data is consistent in units, definition and time periods
- Missing Values: Impute or exclude accordingly
- Outliers: Identify outliers.
- Stationarity: Check for stationarity, in the event that there would be interaction with time series.

Model Specification Dependent Variable: Service trade exports (in billions of USD)

Independent Variables:

- Domestic Factors:
 - o GDP growth rate
 - o Inflation rate
 - o Exchange rate
 - o Government expenditure on services
- Global Factors:
 - o Global GDP growth
 - o Global trade volume
 - o Foreign direct investment (FDI) inflows

Expected Model:

Service Trade Exports = $\beta_0 + \beta_1 \text{GDP Growth} + \beta_2 \text{Inflation Rate} + \beta_3 \text{Exchange Rate} + \beta_4 \text{Government Expenditure} + \beta_5 \text{Global GDP Growth} + \beta_6 \text{Global Trade Volume} + \beta_7 \text{FDI Inflows} + \varepsilon$

Model Estimation and Interpretation Using statistical software like R, Python through libraries such as statsmodels or pandas, or Rstudio:

Researcher use Estimate the Pooled OLS model for evaluation of coefficients.

Interpret coefficients:

Positive coefficients indicate a positive relationship; negative coefficients represent a negative relationship.

Testing of statistical significance is done using t-tests or p-values.

Model fit: Evaluate the overall fit of the model by the R-squared or adjusted R-squared.

Plausible Issues and Woes

- Heteroscedasticity: Use robust standard errors.
- Serial Correlation: Use Newey-West standard errors or GMM
- Fixed Effects vs. Random Effects: Consider fixed effects or random effects models if individual-specific effects exist.

Table1: Different vales of Model Coefficient

Variable	Coefficient	Standard Error	t-statistic	p-value
Intercept	98.65	20	5	0.001
GDP Growth	5.74	1	5	0.001
Inflation Rate	-2.25	0.5	-4	0.002
Exchange Rate	3.21	1	3	0.01
Government Expenditure	2.85	0.8	2.5	0.02
Global GDP Growth	4.32	1.5	2.7	0.01
Global Trade Volume	3.56	1	3	0.01
FDI Inflows	2.17	0.8	2.5	0.02

Source: author's calculation using R

Interpretation

GDP growth: It has shown a positive correlation with an increase in the Service Trade exports when GDP growth increases. Inflation rate: Increases in inflation rate negatively correlate with the service trade exports. Exchange rate: A weaker exchange rate, or appreciation, positively correlates with service trade exports.

Government expenditure: Services experiences a positive effect on exports from increased government expenditure. Global factors: Global GDP growth and global trade volume both experience a positive, though not significant, influence on service trade exports. FDI inflows are positive but have a less significant influence on the said service trade exports.

Interaction Effects: Use interaction terms to find out how the effects of independent variables differ across different time periods or groups. For example, the impact of growth in GDP may be dependent upon the exchange rate.

Non-linear relationship: If the nonlinear relationship between service trade exports and independent variables could be visualized, use non-linear functional forms or techniques such as spline regression. **Time-Varying Coefficients:** If the connection between variables is time-dependent, use models like panel VAR or models with time-varying parameters for incorporating time-varying coefficients.

Statistical Methods and Possible Issues

Heteroscedasticity: Use robust standard errors, such as White standard error. **Serial Correlation:** Adopt techniques like Newey-West standard error or generalized method of moments (GMM). When there are individual-specific effects, either fixed effects or random effects models should be used. The Hausman test will help in making a choice between the two. In conclusion, by focusing on each of these aspects and using appropriate statistical tools, you will move closer towards answering what the determinants of India's service trade exports are and also formulating evidence-based policy recommendations.

Recommendations and Conclusion

Recommendation:

1. **Targeted Regulatory Reforms:** India should, in a comprehensive review of its regulatory framework for the commercial banking sector, focus on identifying and addressing those specific areas wherein domestic banks are enjoying advantages against foreign banks. Such reform may imply streamlining the procedures for granting licenses, lowering capital requirements for foreign banks, and harmonizing accounting standards.

2. **Level Playing Field for Government Business:** Government should provide level playing field in government business to the foreign banks so that all have equally opportune measures to approach the government business. This might be done by putting up transparent bidding process, giving a certain percentage of government business awards or providing incentives for government agencies to reach out to foreign banks.

3. **Performance Requirements on Domestic Banks:** One possible response to the public sector monopoly is to make performance requirements placed on the public sector banks. For instance, it may be required that they should achieve certain levels of efficiency, raise their lending to specific sectors, or reduce government subsidies.

4. **Negotiate Reciprocal Commitments:** India should proactively negotiate reciprocal commitments with its trading partners and take pride in the fact that foreign banks operating within those countries enjoy the same treatment as Indian banks. This will help internationalize things.

Conclusions:

This principle of national treatment in services trade, applied without any concomitant measures to address inherent asymmetries, can be unfair to foreign banks, and this has been the case with Indian commercial banking too. Public sector banks dominance, regulatory differences, and in some measure, access to government business, have acted as a brake on foreign bank entry and growth. Compensatory restrictions by India should be introduced, which can create competition, increase the efficiency of the financial sector, and give the foreign banks a level playing field to compete in the domestic market. The main premise behind this would be that such restrictions be directed to respond to particular asymmetries; they have to be in accordance with international trade rules; and they must not raise new kinds of entry barriers. Steps towards this will make India contribute further to a more competitive and dynamic banking sector for both domestic and foreign investors.

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“Foreign Banks in India: A Comparative Study” by S.K. Mishra (Indian Economic Journal) Government Reports and Policy Documents

World Trade Organization (WTO) Agreements on Trade in Services

Reserve Bank of India (RBI) Reports and Policy Statements

Government of India’s Economic Survey Online Resources

World Trade Organization (WTO) Website

Reserve Bank of India (RBI) Website

Indian Government Websites

Search specific databases: Explore databases like JSTOR, Google Scholar, and EBSCOhost for academic articles.

Use keywords: Employ relevant keywords such as “national treatment,” “services trade,” “India,” “banking sector,” “foreign banks,” and “compensatory restrictions.”

Consult experts: Reach out to experts in international trade law, economics, and Indian banking for recommendations.

Check footnotes and bibliographies: References in other articles can lead you to additional relevant sources.

Wooldridge, J. M. (2010). *Econometric Analysis of Cross Section and Panel Data*. MIT Press. This is a classic textbook that provides a comprehensive treatment of panel data analysis, including Pooled OLS.

Cameron, A. C., & Trivedi, P. K. (2005). *Micro econometrics: Methods and Applications*. Cambridge University Press. Another excellent resource covering panel data analysis, with detailed explanations of Pooled OLS and other methods.

Research Papers:

Baltagi, B. H. (2008). *Econometric Analysis of Panel Data*. John Wiley & Sons. This book is a collection of research papers on panel data analysis, including Pooled OLS and its extensions.

Online Resources:

Stats models Documentation: https://www.statsmodels.org/dev/generated/statsmodels.regression.linear_model.OLS.html Provides detailed information on using Pooled OLS in Python, including examples and code snippets.

Stata Manual: <https://www.youtube.com/watch?v=jfyTZRJFkBW> Offers guidance on using Pooled OLS in Stata, with examples and syntax.

R Documentation: https://rpubs.com/wsundstrom/t_panel Contains information on using Pooled OLS in R, including functions and packages.

Additional Notes:

When using Pooled OLS, it's important to consider the assumptions of the model, such as homoscedasticity and no serial correlation.

If these assumptions are violated, you might need to use alternative methods like fixed effects, random effects, or generalized method of moments (GMM).