

**Sri Lanka's telecommunications commitments under GATS: Assessment and issues
for the future**

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Introduction

The objective of this paper is to review the current commitments made by the Government of Sri Lanka (GoSL) under the Fourth Protocol of the General Agreement on Trade in Services (GATS), which deals with telecommunication services, and to identify the key issues for consideration in making further commitments. To provide the necessary context, the paper also includes a discussion on the rationale for Sri Lanka making telecom services commitments under GATS.

GoSL participated in the request-offer process of Doha Round with regard to services, including telecommunications services, in 2002-03 and possibly after that too.¹ However, the Doha process is becalmed if not worse at this time. In addition, political circumstances in Sri Lanka have changed and the commitment to reform in infrastructure sectors including telecom has weakened, if not disappeared. It is unlikely that the offers made in 2003 will still be relevant. Therefore, the paper will not include a discussion of the requests and offers under the Doha Round (which are not in the public domain in any case), but will simply lay out the key issues that need consideration in the event GoSL needs to make multilateral (e.g., Doha Round), plurilateral (e.g. South Asian Free Trade Agreement (SAFTA)) or bilateral (e.g., India Sri Lanka Comprehensive Economic Partnership Agreement (ISLCEPA)) commitments.

Why make GATS commitments in telecom services?

An international regime in telecom services has existed since 17 May 1865 when the first international telegraph regulations were adopted to govern the transmission of telegraphs across European borders. A regime, in this instance, is not a “government we don’t like,” but a set of arrangements (that may or may not include enforcement mechanisms) to govern a set of actions that involve more than one country. An international regime includes both rights and obligations.

¹ The author was Chair of the GATS advisory committee of the Department of Commerce GoSL in 2002-04.

The GATT [General Agreement on Trade and Tariffs] is a regime governing trade in goods. If countries that have entered into the regime violate its terms, they can be subject to financial penalties following arbitration. The GATS [General Agreement on Trade in Services] is a related regime that came into effect in 1999 which governs trade in services. Services are intangible, examples being insurance and telecommunications services. Purchase of termination services to complete an international call is trade in services; the operator who purchased the termination services does something equivalent to the import of goods. These transactions are subject to the GATS, as are the establishment of commercial operations in Sri Lanka by foreign-owned firms to supply telecom services, including, but not limited to, international telecom services as described above.

The GATS regime with regard to telecommunications services embodied in the Fourth Protocol to the GATS (adopted 30 April 1996; entered into force 5 February 1998) differs from the previous regime centered on the International Telecommunication Union (ITU) in two ways:

1. Violation of the terms of agreement can attract financial penalties. A few years ago, Mexico was taken to arbitration by the US for violating the commitments it had made under the Fourth Protocol of the GATS (Hauser, 2004; Wellenius, Tohen & Guermazi, 2005).
2. The GATS regime with regard to telecommunications services sets out detailed principles on how regulation of all telecom services will be conducted. This kind of specification of domestic regulation is not found in the GATT and even in other service sectors governed by the GATS.

In April 1997, in the last stage of the negotiations on Basic Telecommunications, GoSL made a set of commitments that were accepted. It is unlikely that the level of commitments made by the GoSL would be accepted by the parties to the GATS today.²

² See, for example, what was finally agreed as acceptable from the Peoples Republic of China when it joined the WTO (Zhang, 2002). In 1997, priority was given to increasing the number of countries acceding to the agreement

But they were accepted, and there is no specific overt pressure on GoSL to improve its commitments at this time. Such pressure may arise either when the Doha Process gets restarted or within the context of bilateral or plurilateral trade negotiations, especially if with countries that have significantly liberalized their telecom sectors and are home to regional investors. The on-again-off-again bilateral trade negotiation with Singapore is likely to generate such pressure, especially because SingTel and Temasek are major regional investors and SingTel already has a Mode 3 presence in Sri Lanka through Lanka Communications. India, a major trade partner does have companies seeking to invest and who engage in trade in telecom services with Sri Lanka, but its telecom market is not fully liberalized.

One reason GOSL would consider making concessions in telecom services is to gain concessions in a different sector such apparel exports. This was the primary objective of GoSL in the inchoate negotiations with the USA on an FTA in 2003. What the US negotiators wanted in that instance, however, was commitment to TRIPs [Trade Related Intellectual Property] rather than telecom.

In this context, the question posed at the top of this section has to be answered other than by citing external pressure. It has to be a reason internal to GoSL. In short, GoSL should improve the GATS Protocol 4 offer unilaterally, because it wishes to, and sees benefits from doing so.

Economic theory says that trade liberalization is good, and that even unilateral liberalization under some conditions can be good. The actual practice of GoSL with regard to telecom services supports this.

- In the past 5-10 years, the GoSL has acted unilaterally to reduce the termination rates to Sri Lanka or unilaterally allowed operators to do so. This has been as part of a phenomenon that has occurred throughout the world, because of the US Federal Communication Commission (FCC) actions in the late 1990s and even more because of bypass made possible by technological and market changes. This affects Mode 1 provision of telecom services.³

³ Mode 1 is the mode of trade wherein the trade occurs while the seller stays in country A and the buyer stays in country B. This mode of services trade is identical to trade in goods.

- On its own volition, GoSL has allowed a significant number of foreign telecom service suppliers to establish operations in Sri Lanka over the past two decades, from prior to making commitments to GATS in 1997 (Samarajiva, 1997; 2000). This was not done because of treaty obligations or in return for Sri Lanka firms being allowed to set up operations in other countries, but simply because GoSL decided that the investment and expertise that would be brought in to Sri Lanka by these foreign entities was needed for the development of the Sri Lankan telecom sector. The rapid growth of the sector and improved performance in terms of price and quality are testimony to the wisdom of this unilateral liberalization under Mode 3 of services trade.⁴
- GoSL has also allowed the foreign entities who have invested in Sri Lanka to bring in senior management personnel and experts to reside and work in Sri Lanka. This is something that could have been done under Mode 4 commitments to the GATS Protocol 4, but was done unilaterally, again, because GoSL saw the benefits of the action rather than as part of a bilateral or multilateral negotiating process.⁵

The question then is what benefits GoSL may gain from liberalizing in an explicit form, where deviations from stated commitments may lead to arbitration and the levying of penalties, versus ad hoc liberalizations that would be completely under the control of the GoSL and would leave open the possibility of reversal in the future.

Investors deal with different kinds of risks in different ways. As evidenced by the foreign investments made in the telecom sectors of countries with the most inhospitable government structures such as Somalia and the Democratic Republic of Congo, poor governance or lack of explicit rules and guarantees does not preclude foreign investments per se. The investments tend to get made in areas that yield rapid returns (e.g., mobile over fixed; access networks over backbone), and the costs of capital are high (or higher than normal returns are expected). Investors factor in the higher risk, charging a higher risk premium and making sure they can get their

⁴ Mode 3 is the mode of trade wherein the seller from Country A, establishes a commercial presence in Country B in order to trade with a buyer located in Country B.

⁵ Mode 4 is the mode of trade wherein natural persons (as opposed the artificial or legal persons in Mode 3) move from Country A to Country B to supply services to buyers from Country B, in the context of Mode 3 trade or otherwise.

capital and the returns out of the country quickly. The end result from the host country's perspective is mixed. It gets infrastructure and services that it would not have had, if not for the entry of the foreign investor. But the services cost more to end-users (because of the risk premium on the capital and the other additional expenses that have to be incurred), the government may have to offer various kinds of exclusivities and guarantees that prevent the working of competitive dynamics and further increase the costs to end-users, and sector development gets skewed with areas that require long-term investments getting starved of resources. The terms of the privatization of Sri Lanka Telecom Limited (SLTL) in 1997, which included exclusivities and various safeguards for the strategic investor, must be seen in the context of the poor investment climate of a country in the throes of a major internal conflict, including massive terrorist attacks on commercial targets.

What a government does by improving its domestic telecom regulatory framework through adoption of new laws, policies and regulations and by systematic implementation, is to make the conditions more hospitable for investment, thereby changing the perceptions that lead to higher cost of capital and the related "bad" outcomes described above. What a government that willingly reduces its discretion through the creation of independent regulatory agencies, the issuance of licenses that include constraints on government or regulatory actions, and so on, does is create the conditions for more investment on better terms for the sector (Samarajiva & Dokeniya, 2005).

For the desired outcomes to be achieved, the improvements in the domestic regulatory regime must be well communicated to the desired audience of potential investors and the opinion leaders who affect their perceptions. This can be done by advertising and marketing of the type undertaken by Boards of Investment (BoIs), but the GATS Protocol 4 is an even more effective method, one that will directly communicate to the desired audience, but will also enhance the efficacy of BoI type campaigns.

- What the potential investor wants to see is commitment, preferably irreversible. The problem with a commitment given by a warlord in Somalia is that it is only as good as the length of his life or power in the best case, and only as good as his mood and inclination in the worst case. At the other extreme is an international treaty commitment made by a duly constituted government that will require

complicated procedures for reversal including compensation (in the case of the GATS). Here, the investor gets as strong as possible an assurance that the government will keep its commitments for the duration of his investment. In the case of GATS, it also sets out a path for obtaining relief if the government reneges on its commitments.

- The membership of countries in the GATS, and their commitments under Protocol 4 are public information that is routinely accessed by investors in the course of their decision making. Should GoSL decide to improve its commitments under GATS Protocol 4 that will be a powerful signal to current and potential investors that GoSL is truly committed to reducing regulatory risks and making the regulatory reforms irreversible.
- Such a commitment will also be very useful for the BoI and the foreign missions of the GoSL in their campaigns to attract foreign investment on favorable terms.

In sum, the GoSL should consider improving the commitments under GATS Protocol 4 because such an action will improve the regulatory environment of the telecom sector in Sri Lanka and create the conditions for foreign investment on terms more favorable to Sri Lanka and its people. This action should be taken in the context of an overall program of reform that includes a clear focus on mobilizing capital and expertise (both domestic and foreign) under conditions that give competition pride of place. This is what international as well as Sri Lanka experience shows is effective. The decision should be taken because GoSL believes it to be in the interests of the people of Sri Lanka, not because of any external compulsion.

Review of the current commitments under GATS Protocol 4

The commitments made in 1997 by GoSL are extremely weak and do not even reflect the existing reality of the Sri Lanka telecom sector. They were merely restating the conditions of 1997, without making any additional commitments or reducing the levels of discretion exercised by GoSL officials. The documents that are commented on are “Sri Lanka Schedule of Specific Commitments,” GATS/SC/79/suppl.1

[Commitments], and “Sri Lanka List of Article II (MFN) Exemptions,” GATS/EL/79 [Exemptions].⁶

A potential investor seeking assurance about getting senior managers in place without difficulty or inducements or whether he will face a playing field with regard to subsidies and tax treatment will get none from the Commitments. Is there anything wrong with giving them?

- If a foreign investor has gone to the trouble of obtaining all the necessary approvals to invest his capital in order to supply telecom services in Sri Lanka, is it likely that he will not want to have senior managers and experts from abroad? What will be lost by giving this assurance in an enforceable form, other than the opportunity to extract rents?
- If the GoSL has adopted a policy of competitive provision of telecom services, is it not reasonable to expect that a level playing field be provided in terms of basics such as subsidies and tax benefits? Even if this were not the case, and GoSL wished to reserve the right to give subsidies and tax benefits differentially to Sri Lanka owned firms, would it not be useful to define the subsidies, the benefits, the beneficiaries and the terms and conditions of the differential treatment in the legal text?

The provisions in the second row of the Commitments (international basic voice telecommunications services) are obsolete. The reforms of 2002-03 fully liberalized the international gateway. At least for purposes of accuracy, these provisions should be revised. There are multiple other rows, such as those for data services and mobile cellular services, which should be revised to bring them up to the level of present liberalization implemented by GoSL.

The Exemptions from the Most Favor Nation (MFN) rule are time bound, expiring in ten years (on 5 February 2008; just six months from the time of this writing).

The above paragraphs illustrate the variety of problems with the legal text. In some cases they say nothing; in others they are obsolete; in no case does it contribute to

⁶ http://www.wto.org/english/tratop_e/serv_e/telecom_e/telecom_commit_exempt_list_e.htm

making Sri Lanka a more attractive destination for telecom investment. The one exception is the commitment to the regulatory disciplines, in the form of the regulatory Reference Paper, given as part of the commitments.

However, detailed analysis the actual state of Sri Lanka's adherence to the Reference Paper takes the wind out of that balloon too. In provision after provision, GoSL has failed to meet its commitments, as shown below. The Reference Paper states:

Public availability of licensing criteria

Where a licence is required, the following will be made publicly available:

- (a) all the licensing criteria and the period of time normally required to reach a decision concerning an application for a licence and
- (b) the terms and conditions of individual licences.

The reasons for the denial of a licence will be made known to the applicant upon request.

Except for the licensing of External Gateway Operators in March 2003 (Samarajiva, 2004), GoSL has failed to meet this commitment. The most recent example is the issuance of the fifth mobile license to Bharti Airtel for USD 4 million in fees in 2007.

Provisions related to interconnection to major suppliers (in the Sri Lankan context, SLTL and possible Dialog Telekom) take up a full one-third of the document. While the Gazetted Interconnection Rules of March 2003 (Dharmawardena 2004) did meet the standards set out in the Reference Paper, the failure of the Telecommunication Regulatory Commission of Sri Lanka, and thereby the GoSL, to implement them places Sri Lanka in jeopardy of arbitration under the GATS.

In sum, Sri Lanka has made almost meaningless commitments regarding telecommunications services under the GATS. The one meaningful commitment is with regard to regulatory disciplines as embodied in the Reference Paper. However, the actual practice of regulation in Sri Lanka thus far, fall short of even the weak commitments that have been made and leaves GoSL open to complaints of violating its treaty commitments.

Key issues for consideration

What is required first and foremost is clarity on the objectives that are sought to be achieved; for example, increasing foreign and domestic investment to maintain the growth of connectivity achieved so far and to make new services such as broadband widely available. If this is the objective it will make sense for GoSL to draft a revised offer under the Fourth Protocol to the GATS and unilaterally revise the commitments and exemptions that are currently in force. To the extent that the revision does not take away any previously made commitments (a practically impossible task, given the vapidness of the existing commitments), this is a straightforward action at the level of the WTO. Other countries such as Pakistan, Morocco and Honduras have done this.

Of course, simply making international treaty commitments is not enough. The national legislation must be amended and the regulatory agency empowered and motivated to aggressively implement the commitments. Clearly, implementation of the Reference Paper, a commitment that has already been made, has to be priority one. In addition, a number of actions can be taken to improve the regulatory environment.

The inter-related nature of regulatory problems requires multi-pronged solutions. The optimal regulatory environment is constituted by

- Existence and enforcement of transparent market entry policies;
- Efficient management of scarce resources, primarily frequencies, numbers and rights of way;
- Effective, cost-oriented and non-discriminatory interconnection and access to backbone capacity; and
- Effective enforcement of regulatory and competition rules.

Market entry policy

Even after the monopoly of the government-owned incumbent is broken, governments tend to maintain control over market entry, using various rationales, ranging from national security to spectrum scarcity. The potential to collect rents either in the form

of high auction proceeds to the government or in the form of bribes to key decision makers is a major factor in restrictive market-entry policies.

The market-entry principle that is now accepted as best practice is “licenses where scarce resources are involved; authorizations otherwise.” The latter refers to standard procedures where the discretion has been stripped out or minimized, whereby entities that meet specified, publicly announced criteria will be authorized to provide services without numerical limit. Until the advent of unlicensed wireless services based on IEEE 802.11 standards, there was almost universal agreement that radio frequencies were scarce resources. Indeed, under most current technological standards, most wireless-based services require exclusive or heavily regulated shared use of frequencies, justifying the classification of frequencies as scarce resources.

Management of scarce resources

Supply of telecom services in a rapidly growing market requires both the ability to obtain additional scarce resources needed for increasing supply and the assurance that the assigned resources can be used effectively. These expectations apply to rights of way and towers as well as for spectrum. Given the present focus on wireless, emphasis will be placed on spectrum and towers (Telecommunications Regulatory Authority of India, 2005, October 3).

As subscribers and coverage areas expand, operators require access to additional frequencies. As explained above, the frequencies must be from particular bands that satisfy the technical requirements of operators. The spectrum manager must manage the resource efficiently, anticipating the operators’ requirements as best as possible and refarming the expansion bands. Given the importance and value of these incremental frequencies, it is generally better to assign them through transparent mechanisms such as auctions.

Interconnection and access

Interconnection and access are critical problems in all competitive telecom environments, whether services are provided wirelessly or not. The importance of

ensuring cost-oriented and non-discriminatory interconnection and access to essential facilities including backbone and undersea cable stations cannot be over-emphasized. The effects of unsatisfactory interconnection and access regimes can undo much of the benefits of good regulation in other areas. The best spectrum management in the world will not make an operator offer services in a remote area if the costs of backhaul are too high.

Effective enforcement of competition and regulatory rules

The markets within which suppliers of telecom services operate are highly imperfect and pervaded by market power and government discretion. Therefore, successful operation is not simply about picking the right technologies, keeping the costs down and making the customer happy. In many countries, skills in negotiating with the incumbent and with the regulator overshadow the skills involved in running a telecom business.

If regulatory risk and the consequently higher costs are to be minimized and operators' energies refocused on the provision of services and away from influencing the regulator and negotiating with the incumbent, it is essential that the regulatory agency be effective. A necessary condition for effective regulation is modern, pro-market, discretion-minimizing legislation that also includes provisions for the independence and accountability of the regulatory agency. Requirements for broad consultation and transparency will also contribute.

In cases where competition law is not yet enacted, it is still possible to enforce competition rules through license conditions and the general provisions of telecom regulatory legislation. Examples of anti-competitive practices that can be addressed under formal competition legislation or under the specific provision in licenses are the preferential treatment of a mobile affiliate by an incumbent in terms of interconnection and access to essential facilities, including sharing of antenna towers. Refusal to deal with Internet Service Providers (ISPs) that use wireless in the access network (in terms of not providing leased lines) or discriminatory pricing are very common, though rarely challenged. As the momentum builds toward convergence, anti-competitive practices such as tied sales are likely to increase.

Capitalizing on the commitments

In order to realize the benefits of the above actions it will be necessary to launch a communications campaign, possibly in association with the BoI, addressing all the key telecom fora, such as the ITU, APT [Asia Pacific Telecommunity], CommunicAsia, and the principal trade journals. It would be good to articulate the new commitments with either a new policy or other tangible reforms. If there are opportunities to create a window for investment, either in terms of a new license auction or in terms of the existing operators going public, the benefits will be that much greater.

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