

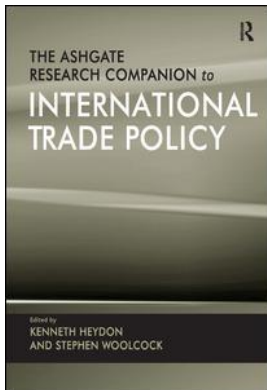
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## **The Ashgate Research Companion To International Trade Policy**

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### **Trade in Services**

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# Trade in Services

Christopher Roberts and Kenneth Heydon

Services make a major contribution to the economy and employment in all countries, whatever their stage of development. Yet they contribute a significantly smaller share of international trade than goods. Part of the reason for this is that only modest progress has so far been made to guarantee open markets for trade in services. This chapter sets out the importance of services in international trade, and assesses the gains that can be made from liberalization. It describes the structure and impact of the key international agreement on trade in services – the General Agreement on Trade in Services (GATS). It explains how far governments have committed themselves, both multilaterally in the World Trade Organization (WTO) and through preferential agreements, to keeping their markets open to foreign suppliers of services.

## Some Definitions

Just what is meant by services and international trade in services? This is best illustrated by distinguishing goods and services. Unlike goods, services are not physical objects which you can touch or see, or drop on your toe. Yet goods and services are often closely interlinked: you cannot run a railway service without trains, or sell shirts around the world without the help of marketing and distribution services. Services include some of the oldest activities in the world, like teaching and construction, and some of the newest, like software design and satellite communications.

International trade in goods is relatively straightforward in that the producers are in one country and the goods travel across an international border to another. For services the position is more complex. While some services can be supplied across national boundaries, and digital transmissions are making this easier, others require the supplier and customer to be in the same location. This is why, for the purposes of negotiations under the GATS Agreement in the WTO, services are divided into four modes of supply. These four modes are *cross-border supply* (as with goods), *consumption abroad* where the consumer, such as a tourist, crosses the

border, *commercial presence*, for example where a bank sets up an office overseas to handle local customers, and *movement of natural persons* where the supplier of the service such as a consultant goes abroad to work (Sampson and Snape 1985; Wunsch-Vincent 2005).

For negotiating purposes the WTO Secretariat, drawing on UN statistical work, has divided services into 12 sectors and some 150 sub-sectors (WTO 1991). These include all the well-known areas, like banking, insurance, telecommunications, transport and construction, as well as less traditional services like electronic data interchange or trading in futures and options. Services provided directly by government are excluded: these are defined as services 'supplied in the exercise of governmental authority' and 'supplied neither on a commercial basis, nor in competition with one or more service suppliers' (Adlung 2006; Chanda 2003; Krajewski 2003). There are other comparatively minor exclusions, of which the most significant is air traffic and landing rights. Outside these exclusions any WTO government is free to ask another to commit itself to allowing foreign providers to compete in any service sector; and the other government is free to agree or refuse.

## The Economic Importance of Services

The economic importance of services can be clearly illustrated from European experience. Services account for over 77 per cent of European GDP and employment. In the UK the services share of employment is now as high as 81 per cent. In the late twentieth and early twenty-first centuries millions of European jobs were lost in agriculture and manufacturing, and were created in services. Germany and Italy are the only big European economies where a quarter of the working population are still in the business of making things. In the UK, financial and business services contribute more than twice as much to the British economy as the whole of manufacturing. In external trade Europe runs a current account deficit in trade in goods, and a surplus in trade in services.

Thus Europe depends increasingly on services for exports. Europe will continue to have an important capability for manufacturing exports, especially at the high technology, specialist end of the market – aerospace is an obvious example. But products like textiles, footwear, steel and other basic manufacturing, where the technology is relatively simple and labour is a substantial component of production, are already largely sourced from developing countries. Given the competitive advantage of these countries in labour costs, that is inevitable and right.

The position in the United States and other developed countries is broadly similar to that in Europe. In their World Development Indicators Online the World Bank give figures showing that the services share of GDP in high income countries (effectively developed countries) is 72 per cent, in middle income countries 53 per cent, and in low income countries 52 per cent. In all three cases the trend is progressively upwards. So while, as you would expect, services are more prominent

in the economies of richer countries, they also represent at least half the wealth of the developing world, and as much as agriculture and industry together.

If however we look at services' share of exports the figures are less impressive. International trade in services is currently only about 20 per cent of global trade. The figure for European exports of services – 26 per cent of total exports – is a bit higher, but still low in relation to services' share of GDP. Of course many services are and will continue to be bought locally: most of us buy our groceries from a local supplier, and most journeys are within national boundaries. But retailers like Tesco, Carrefour and Walmart have developed substantial overseas business, and many of us travel by train or air services which are in foreign ownership. While it is probably unrealistic to expect services to be traded internationally to the extent that goods are, there is considerable scope for expansion.

## The Economic Case for Liberalization

### Developed Countries

There are clear economic advantages from liberalizing services, although individual interests may lose out (Jones and Kierzkowski 1990; OECD 2002, 2010). For Europe, North America and other OECD countries, the argument is fairly straightforward. Here services are much the largest sector of the economy, as they are in smaller, sophisticated economies like Hong Kong and Singapore. As jobs at the more labour-intensive end of manufacturing (and to some degree also of services) continue to move offshore to emerging markets, workers and managers need to find new jobs in services for which rich country wage levels remain competitive.

Significant numbers of internationally competitive manufacturing jobs will remain in developed countries, but many of them will be in capital intensive niche sectors where quality and skill matter more than price. Fashion textiles, certain advanced electronics, pharmaceuticals and whisky are four diverse examples. Nor will the developed countries have it all their own way in services. The strength of Indian competition in IT and business services is already evident, and over time more back office work in areas like financial, legal and accountancy services will move offshore, especially to countries where English and other European languages are well understood. But across the board it is to services, and to the new service products which are constantly being developed and extended, that the developed world must look for many of the jobs needed in the future. This is their area of greatest competitive advantage.

A further argument for opening up and developing the service sector is that it tends to be less prone to economic cycles than is manufacturing (Borchert and Mattoo 2009).

## **Developing Countries**

Less obvious, perhaps, but no less valid, is the case for open markets for services in developing countries, whatever their stage of development. The economic arguments for liberalizing trade in services include the familiar arguments of comparative advantage which apply to trade generally, and which have been demonstrated by the contribution which more open trade in goods has made to world prosperity over the past 60 years. Over time, developing countries will become more significant producers and exporters of services, drawing on their cost advantages. They will develop new strengths to add to their existing success in IT and business services, construction and tourism (Cattaneo et al. 2010; Nielson and Taglioni 2004). But the case can probably best be made in terms of developing countries as importers and consumers of services. Access to modern, efficient services is as important to business consumers as it is to households and individuals: preventing or delaying such access is often tantamount to a covert tax on economic development. Developing countries cannot grow their economies and overseas sales without the support of efficient services, which will not be available in the necessary quality and quantity from domestic sources.

There will of course be some losers from this process. Any opening up of markets is likely to mean that, even when total demand increases, some of the less competitive local players lose market share or go out of business. However, there is one very good reason why indigenous service providers benefit from overseas companies coming into the market. It is often difficult or impossible to market services in a foreign country without some kind of local presence. Such an investment is usually best made in cooperation with a local partner who understands local conditions and customs, and involves the transfer of skills and technology to local people. A foreign insurance company, for example, can hardly sell policies which are unfamiliar to local customers without a local office and local representatives, familiar with local risks, engaged in marketing and selling on the spot.

So services liberalization opens the way for foreign investment, and the jobs which flow from that. In turn this provides vital support for exports, not least in some of the poorest countries. Countries in West Africa like Benin and Mali produce some of the finest cotton in the world, and pressed for the reduction of US subsidies so that they can compete on more even terms. But another necessary condition for making West African cotton competitive is access to banking finance, insurance, transport (roads and shipping), distribution services in overseas markets and so on. Some of these services may be available, or partially available, from local sources. Many of them will not be. Successful exports from developing countries rely on access to foreign services.

It is sometimes argued that developing countries should be free to take advantage of foreign services when they wish, but should not commit themselves indefinitely to granting access to such services, thus depriving themselves of the opportunity to protect domestic interests in the future. But one of the great strengths of the WTO system is that member countries give confidence to their trading partners, and to

global trade in general, by guaranteeing a certain level of market access, whether by tariff bindings under GATT or market access commitments under GATS. They do so in return for broadly similar commitments undertaken by their partners. They compete for inward investment by the range of commitments they offer. If those commitments could be withdrawn overnight, confidence in future trading stability would be lessened, with damaging effects on trade. Moreover, because much international trade in services is linked to a presence and an investment in another country, companies would be reluctant to expend the effort and sunk costs required for a successful investment if the conditions on which that success depended could be changed overnight. For this reason, although many service sectors in key markets are at present relatively open, the long-term guarantee provided by GATS commitments to market opening is reassuring to both buyers and sellers.

## How Far Can the Benefits of Services Liberalization be Quantified?

In seeking to quantify the gains from services liberalization there are three reasons to expect the numbers to be large. As we have seen, the service sector has the biggest share of GDP in all country groupings. That large sector tends to be highly protected in all countries. And gains are magnified to the extent that services liberalization acts as a proxy for the improved mobility of factors of production – capital via GATS Mode 3, and labour via Mode 4 (Chanda 2004; Whalley 2003).

It is thus found, in ex post analysis, that NAFTA had a strong positive effect on US service exports to Mexico. Similarly, EU service exports to Chile grew strongly as a result of the EU–Chile free trade agreement (Heydon and Woolcock 2009: 208).

The expectation of high gains is also borne out by computable general equilibrium (CGE) modelling – the only measurement technique that furnishes an economy-wide ex ante assessment of service barriers, and the main focus here. It is thus estimated that services liberalization would account for between 72 per cent (Hertel et al. 1999) and 82 per cent (Chadha et al. 2000) of total gains in welfare (GDP) from full Uruguay Round implementation and a successfully completed Doha Round. Services gains would thus far exceed those in agriculture and manufacturing. The modelling work also points to some important practical implications: that multilateral liberalization yields bigger gains than unilateral opening (Chadha et al. 2000); that gains are greater when barriers to both foreign and domestic service providers are reduced (Market Access in GATS terms) than when only barriers to foreign providers are reduced (National Treatment) (McGuire 2003); and that economies with high initial protection levels tend to gain most from liberalization (Dihel 2003; OECD 2003a).

Another important finding of the modelling work is that developing countries are major beneficiaries of services liberalization. Chadha et al. (2000) thus estimate

that services opening yields a 2.5 per cent increase in GDP in developing countries, compared with a 2.0 per cent increase in developed economies. This is due in large measure to the fact that developing countries tend to have high barriers to trade in services. But it also reflects developing countries' growing competitiveness as services exporters.

Valuable though this modelling work is, it needs to be interpreted with great care. Measuring the gains from services liberalization faces two major challenges. The first results from the fact that national data on trade in services are much less comprehensive than data on trade in goods. The second challenge is methodological and results from the fact that services barriers are essentially domestic regulations that do not lend themselves to quantification in the way that tariffs do. In fact, the CGE modelling work relies on estimates of 'tariff equivalents' of services barriers that unavoidably have a considerable element of subjectivity. The modelling is also highly sensitive to underlying assumptions and scope. Thus while Chadha and Hertel reach broadly comparable results on the *relative* importance of services liberalization, compared with goods opening, they differ greatly on the *absolute* size of total welfare gains – USD 836 billion for Chadha and USD 493 billion for Hertel. The discrepancy arises because Hertel does not seek to estimate gains from increased competition and economies of scale.

But all of these challenges are being addressed. Data deficiencies are being tackled through collaborative work between the IMF, Eurostat, the WTO, OECD and UNCTAD. And the methodological underpinning of modelling work, the trade restrictiveness index, is being refined and developed by the OECD (Conway and Nicoletti 2006; OECD 2009), building on the pioneering work of Bernard Hoekman on tariff equivalents (Hoekman 1995).

Current modelling work is also focussed less on broad estimates of prospective gains in welfare and more on measuring the impact of barriers to trade in services on downstream users. It is thus found that if account is taken of service barriers, the effective rate of protection<sup>1</sup> for some agricultural and manufacturing sectors actually turns negative; in effect as we saw earlier, these sectors are being taxed (Dihel 2005; Dihel and Dee 2006). Put positively, countries will strengthen their comparative advantage in manufacturing following trade liberalization in services (Nordas 2010). Moreover, in the framework of intra-industry trade, which is driven by product differentiation, high trade costs in business services are found to be associated with a low level of product differentiation in downstream industries, particularly in the motor vehicle industry. An important policy implication of this finding is that open markets in business services will help industrial upgrading in developing countries (Nordas 2011).

In short, notwithstanding limitations of data and methodology, modelling work is valuable in demonstrating that the liberalization of trade in services yields

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<sup>1</sup> The effective rate of protection is the measure of net protection given when the cost of restrictions on imported inputs (say banking services) for the production of a particular product (say a motor vehicle) is subtracted from the protection given to that product.

major potential gains in welfare and in economic efficiency, not least for developing countries.

## **The Move for an International Agreement on Services**

By the 1970s and early 1980s there was an increasingly strong view among those active in international trade policy that a General Agreement on Tariffs and Trade, focussing on goods, was not enough. There were other trade issues, notably agriculture, which in the opinion of many should be subject to international rules; and services were prominent among these issues. The switch of more labour-intensive manufacturing from developed to developing countries was becoming more apparent; new and important services, for example in information technology and satellite communications, were coming into being; and business leaders were becoming more aware that they did not have the same guarantees of open markets for services as they had for goods. When the scope of the Uruguay Round was under discussion, business groups in the United States argued for the inclusion of services. Europe was slower to take up the cause, although the City of London, with its strong interest in financial, professional and other services, lobbied actively. Some developing countries, on the other hand, feared that liberalization would swamp their small and not always competitive service industries; and were reassured that their concerns would be respected. When the Uruguay Round was launched in 1986, services were firmly on the agenda.

## **The Negotiation of the General Agreement on Trade in Services**

So negotiation of a services agreement became a major part of the Uruguay Round (Croome 1999; Drake and Nicolaidis 1992; Heydon 2011; OECD 1987; Sampson 2005). Together with the creation of the World Trade Organization and the dispute settlement system it was among the most notable achievements of that Round. The negotiators had to produce a comprehensive new agreement, comparable in scale to the General Agreement on Tariffs and Trade (GATT). This new agreement was in three parts. First, and much the largest part, a framework agreement containing the general rules and disciplines governing trade in services. Second, a number of annexes governing specific sectors. Third, the national schedules which list individual countries' specific commitments on access to their domestic markets by foreign service suppliers.

The GATS agreement has many features in common with the GATT. For example, both have provisions on most-favoured nation treatment, under which governments cannot treat one foreign supplier more favourably than another. Both have (somewhat different) provisions for national treatment, under which governments must treat foreign service suppliers in the same way that they treat their domestic suppliers, for example in relation to tax or regulation. The new



dispute settlement arrangements agreed in the Uruguay Round apply to services as they do to goods.

There is, however, one major difference between GATT and GATS. The former can be described as a top-down agreement, in the sense that the starting point is the existing level of Customs tariffs, which can be negotiated down either individually or (now more usually) by the application of a formula such as a cut of  $x$  per cent, with exceptions to be agreed between the participants. GATS, on the other hand, is a bottom-up system. Each WTO member state lists in its national schedule those services, and only those services, for which it wishes to guarantee access to foreign suppliers. In addition to the services committed, the schedules can either grant completely free access, or limit the degree to which foreign suppliers of a particular service can operate in the market. For example, a country making commitments to allow foreign insurance companies into its market can restrict the number of such companies it allows in, or the number of sales outlets they may operate (Hoekman and Kostecki 2009).

The GATS agreement was not a completely finished product. A number of issues – not the most important, but still significant – were left for further negotiation, and in due course became part of the Doha Round. These included domestic regulation, emergency safeguards, government procurement and subsidies. All have proved difficult to resolve. However, the negotiation of the GATS itself, although requiring a great deal of complex and detailed work in an area hitherto unfamiliar to trade negotiators, was relatively uncontroversial in the context of the Uruguay Round. The work was almost entirely carried out by the GATT secretariat and specialist negotiators from the member states, and rarely engaged ministers. The structure of the GATS agreement made it less controversial, not least by allaying some of the concerns of developing countries. Governments knew that they would only have to include in their schedules those services for which they were content to liberalize or bind the existing regime, and that less extensive commitments would be expected from developing and especially least developed countries.

The inclusion within GATS of provision for negotiation on the movement of natural persons – the fourth of the service modes listed at the beginning of this chapter – was welcomed by developing countries. However, agreement has been difficult to achieve, mainly because of fears in developed countries, notably in the United States but also elsewhere, that workers from the developing world who come to undertake a particular task may stay permanently. Business opinion in developed countries is often sympathetic to measures designed to make it easier for them to move key staff around the world on a temporary basis. The opposition comes from trades unions, concerned about the job opportunities for their members, but particularly from politicians under pressure over levels of immigration. Some agreement on this issue is probably necessary if significant progress is to be made in GATS as a whole. The solution may lie in focussing on skilled workers travelling abroad who return home when their task is complete, and on checks to make sure that they do so (OECD 2004).

## Sectoral Negotiations on Specific Services

The focus of service negotiations in the Uruguay Round was on the framework agreement. Such specific commitments as were made during the Round were largely to bind existing arrangements, and there were relatively few commitments to new market opening. It was envisaged that major negotiations to liberalize services would take place later. Indeed GATS Article XIX envisages, quite ambitiously, that 'successive rounds of negotiations' would begin not later than 2000 (five years after GATS entered into force in January 1995) 'with a view to achieving a progressively higher level of liberalisation'.

Meanwhile in the late 1990s negotiations took place in the WTO on three specific services sectors, telecommunications, financial services and maritime services. The most successful was the WTO Agreement on Basic Telecommunications, which came into force in 1998 with the support of 69 member countries. The results can now be seen. In almost all regions of the world, countries with WTO telecoms commitments have experienced a more rapid rate of growth in revenue from this sector than countries without such commitments. Access to both fixed line and to mobile services is higher in countries with commitments than in countries without. In Brazil and India, as elsewhere, liberalization has coincided with, and contributed to, dramatic increases in Internet and mobile phone use, and to price reductions.

The other sectoral negotiations were less successful. That on financial services produced little beyond bindings of the existing regime, although the insurance sector in India has grown rapidly since it was partially opened up to foreign suppliers in 1999. A parallel negotiation on maritime services was a failure.

## Service Negotiations in the Doha Round

In accordance with GATS Article XIX fresh negotiations on services were started in 2000, but were soon subsumed into the Doha Round which was launched in the following year. Because the Doha Round is seen as a single undertaking, under which nothing is finally agreed until the Round as a whole is complete, it has been possible for the services negotiations to be held hostage to other parts of the Round, and specifically to the lack of progress on agriculture and on manufactured goods (known in WTO jargon as non-agricultural market access or NAMA). As a result hardly any in-depth negotiations on services were engaged over the first ten years of the Doha Round, and no significant results were secured. However, as long as the Doha Round remains alive, hope must remain that this long drawn out process will eventually yield a positive outcome in terms of improved market access for services.

## Reasons for the Reluctance to Liberalize

A range of different reasons for the slow pace of services liberalization can be identified, some relating to pressure groups outside governments, some to the negotiating mechanics of GATS, and some to policy preferences within government (Gootiiz and Mattoo 2009; Sutherland 2010).

### *Pressure groups outside governments*

A range of different pressure groups exert influence on different governments. There are local business interests, both in developing and developed countries, who fear loss of market share to more competitive outsiders but often present their case in terms of maintaining quality of service to local consumers. Examples are Indian lawyers keen to maintain their dominance of the local market for legal advice; and European audiovisual industries (film, broadcasting) wanting to reserve market share for local productions. Interestingly in both cases the industry is not unanimous. Some Indian lawyers want to team up with foreign firms to offer a global service from offices in India; and much of the European music industry opposes protection for the audiovisual sector.

Another set of pressure groups are trades unions and NGOs, often operating across national boundaries in developed and developing countries. The unions are particularly concerned to protect public ownership of services like health and education, and have persuaded the European Commission to say that they will not make offers in these two sectors. Other campaigning groups are concerned about the control of water supplies, or claim that consumers will suffer from the liberalization of services which ought to remain closely regulated. In the latter case it is important to distinguish between liberalization and deregulation, which are quite different. If there is a case for regulating a service, as for example in financial services or transport, there is a case for doing so whether or not that service is open to foreign providers. There is nothing in GATS which stands in the way of reasonable and impartial regulation (Nordas 2006; OECD 2002; Trachtman 2003; WTO 1999).

A third source of pressure, but on the other side of the account, is the private sector service lobbies. These have been rather less effective than their economic strength might entitle them to be. Indeed it is widely argued that they were more effective in the Uruguay Round than in the Doha Round. What are the reasons for this? Historically, the industries which have put most time and money into lobbying on WTO issues have been those concerned to preserve the status quo – European and Japanese farmers, US cotton producers. Many modern, successful service industries have been reluctant to devote much CEO time or corporate resources to lobbying on GATS, perhaps because, while their businesses are prospering and markets remain relatively open, they do not see the securing of GATS commitments as a major priority. Another factor is the long time scale over which GATS negotiations are conducted: many businesses are reluctant to spend

time and money on a process which will take several years to show any benefit for their bottom line and are more inclined to support bilateral or regional initiatives.

### *Negotiating mechanics*

For a number of reasons the complex structure of the GATS, for example by comparison with the GATT, makes it difficult for many governments, especially those with limited resources, to engage with GATS issues. Such governments can find it difficult to decide where their national interest lies in services, and in changing domestic regulation to allow market opening. A variety of ministries will have interests in different services and the rules governing them, and normally these will not be the trade or foreign ministries – the ministries which are familiar with the WTO. Some domestic service providers will not welcome competition, and may have the ear of local politicians. And changes in rules may involve legislation and legislators, who face political pressures: those sectors of an economy which feel threatened by liberalization often exert more influence than those who gain from it (see Chapter 2).

Another source of difficulty reflects the detailed, bottom-up, character of GATS negotiations, as noted earlier. Sector by sector, governments request the market opening measures which they want from their trading partners, and then make offers in response to the requests made of them. This is a slow process, and often difficult for governments to explain to their local constituencies.

Both the 1997 financial services negotiations and the GATS offers so far made in the Doha Round do little more than bind existing regimes. There are some useful offers of liberalization, but not many. This experience suggests that the way negotiations are conducted in GATS may encourage agreements that freeze the status quo, but lead to only very modest new market opening. GATS commitments would thus give countries international blessing for services reforms which they were carrying out anyhow for domestic reasons, but provide little incentive to go beyond this. If this is correct, the institutional structure of GATS may serve to inhibit faster liberalization (OECD 2001).

### *Priority for manufacturing and agriculture*

However, the most immediate cause of delay to the services negotiations in the first ten years of the Doha Round was the preference given by some governments to agriculture and manufacturing (NAMA). Leading agricultural exporters like Brazil and Argentina, supported by India, insisted that, before they engaged seriously in negotiations on services, the basic framework of a deal on agriculture must be settled. When trade ministers came together in substantial face-to-face negotiations, in Geneva in July 2008, they failed to make progress primarily because of an unresolved dispute between the United States and the more prosperous developing countries on the level of commitment by the latter to reductions

in tariffs on manufactures. The United States did not push as strongly for early progress on services as might have been expected. The European Union and some other developed countries who would like to see services treated as one of three big pillars of the Doha Round have been frustrated by the insistence of other major players on settling the framework for agriculture and manufacturing before getting down to serious business on services. At the time of writing (March 2012) this dispute remains unresolved, and seems unlikely to be settled quickly. Meanwhile the growth of preferential trade agreements (PTAs) continues unabated.

## **Services in Preferential Trade Agreements**

Since 1994, some 180 preferential agreements including trade in services rules have come into existence, compared with only 38 in the previous 40 years (Heydon and Woolcock 2009). Over 40 per cent of the cumulative total has come into existence since 2000, involving mainly bilateral agreements between countries increasingly further apart and more diversified in levels of development. The most active countries have been identified as Mexico, Chile, Singapore, the United States, Australia and New Zealand, with the EU, EFTA and ASEAN standing out as the most active regional groupings (Houde et al. 2007).

Three factors help explain the increased attention to trade in services in bilateral and regional trade agreements: the size of the potential liberalization gains on offer, the failure to make progress in the Doha Round, and the opportunity presented to go beyond the WTO in the pursuit of deeper integration.

### **Liberalization Gains**

The broad scope for welfare gains from the liberalization of trade in services has been discussed earlier. As would be expected, gains are also apparent when liberalization is being conducted bilaterally or regionally. It is estimated, for example (Copenhagen Economics and Francois 2007), that in the recently negotiated PTA between the EU and Korea no less than 70 per cent of EU gains are attributable to the liberalization of trade in services and that EU exports will increase by 40 to 60 per cent in the areas of wholesale and retail trade, transport services, communications, financial services and other business services.<sup>2</sup>

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<sup>2</sup> The relative importance of services gains is explained by Korea's growing demand for service inputs to economic growth and the fact that the Korean service sector is highly protected by non-tariff barriers. Also in the modelling, barriers to trade in services are

## Slow Progress in the Doha Round

In recalling the reasons for lack of progress in the DDA, it is possible to see why many countries feel that PTAs offer more hope of progress, albeit with discriminatory elements.

As we have seen, the attainment of services liberalization in the Doha Development Agenda has been held hostage to the lack of progress in other areas, notably agriculture and non-agricultural market access (NAMA). It may be felt that the greater scope in bilateral deals to exclude sensitive products, and in some cases whole sectors, offers less risk of stalemate.

Progress in the Doha Round has also been impeded by stand-offs within the services negotiations, with some parties, mainly developing countries, reluctant to liberalize commercial presence (GATS Mode 3) until others, predominantly developed countries, show a willingness to liberalize the movement of service providers (Mode 4). Again, bilateral arrangements may be seen as offering better opportunities for breakthrough, such as with the provisions on the movement of nurses contained in the Japan–Philippines and Japan–Indonesia PTAs, and EU commitments under Mode 4 in the EPA with CARIFORUM.

GATS negotiators, mindful of the central GATT principle of non-discrimination, have tended to focus on improved national treatment (which yields benefits only to foreign service providers), whereas most estimates of the gains from liberalization suggest relatively greater opportunities arising from improved market access (which brings benefits to both foreign and domestic service providers). PTAs, by their nature, will be less focussed on the principle of non-discrimination.

Finally, as noted earlier, progress in the GATS has been impeded by concerns (understandable, though largely unfounded) about threats to regulatory sovereignty in sensitive public services. While PTAs offer little beyond the extensive provisions in the GATS for carve out, bilateral agreements have not so far attracted the intense attention of NGOs seeking to put a brake on liberalization.

## WTO-Plus

There is no doubt that many preferential agreements, in the pursuit of deeper integration, have achieved a measure of liberalization of trade in services not so far seen in the GATS. The opportunities to be WTO-plus will be discussed in more detail in the following section, with a particular focus on the agreements to which the United States and the European Union are parties.

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assumed to be real resource costs, compared with tariffs and quotas in other sectors which generate tariff revenue and quota rents.

*Going beyond the WTO*<sup>3</sup>

*United States:* NAFTA, the model for all US PTAs, is based on a negative list (or top-down) approach, whereby everything is liberalized unless explicitly excluded, compared with the predominantly positive list (or bottom-up) approach of the GATS, as described earlier. The negative list approach is generally regarded as being more transparent than positive listing and as affirming an upfront commitment by signatories to an overarching set of general obligations. This approach, pioneered by the United States, Canada and Mexico, has since been spread by these countries in the agreements they have signed in Central and South America.

NAFTA was also a pioneer in providing for the right of non-establishment (i.e. no local presence requirement as a precondition to supply a service) as a means of encouraging greater volumes of cross-border trade in services. This right, for which no GATS equivalent exists, is particularly well suited to promoting electronic commerce (Sauvé 2003).

Moving beyond the NAFTA, all US agreements, apart from the PTA with Jordan, advance on WTO rule making in financial services and telecommunications. In financial services, US PTAs advance on transparency measures, senior management (Mode 4) requirements and dispute settlement procedures. For telecommunication services, US PTAs go beyond the GATS in the treatment of access to public telecommunication transport networks and services, licensing processes, scarce resources, enforcement, dispute settlement issues, and independent regulation and privatization.

The United States' PTAs also tend to be GATS-plus on mutual recognition issues – of particular importance for the (Mode 4) movement of natural persons. Movement of natural persons is furthered beyond the GATS in the agreements with, for example, Chile and Singapore that define minimum education requirements and alternative credentials in several professions. Under these agreements, the United States has committed to accept quotas of 1,400 and 5,400 business entry applications, respectively, from Chile and Singapore.

*European Union:* the desire to match US successes in negotiating significantly GATS-plus commitments in services has been one of the factors behind the EU's more aggressive push for better market access in services since 2006.

The Euro-Med Agreements are WTO-plus in services to the extent that for Mediterranean countries that are not Members of the WTO and therefore not signatories to the GATS, a basic framework agreement similar to that of the GATS is established.

The EU Neighbourhood Policy sets the basis for future PTAs in services with Mediterranean non-Member Partners and will upgrade the current provisions on services found in the Association Agreements. The EU-Moroccan Action Plan calls for opening of negotiations on a PTA in services, as well as exchange of information with a view to regulatory convergence with the EU, capacity building, and e-commerce development. Specific actions in the field of financial services are

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<sup>3</sup> Material in this and the following section draws on Heydon and Woolcock (2009).

aimed at upgrading Morocco's regulatory system in line with that of the EU and with international standards.

The EU has recently negotiated an Economic Partnership Agreement (EPA) with the CARIFORUM, seen by the EU as a model for EPAs with other regions. The EU has made commitments on 90 per cent of sectors and has in particular made more generous commitments in Mode 4 than it was ready to do in the Doha negotiations. The EU's concessions in Mode 4 must of course be seen against other policy areas, such as government procurement where the EU was able to make progress towards its own aims.<sup>4</sup> The EPA with CARIFORUM includes competition provisions in the tourism sector that seek to ensure no abuse of market dominance by large EU investors in the Caribbean. The EPA also follows the EU–Chile model of including significant sections aimed at the promotion of e-commerce.

A common feature of both US and EU PTAs is the extent to which the agreements advance beyond the GATS in financial and telecommunication services. This contrasts with an earlier finding (OECD 2003b) that progress in these infrastructure services was more likely in a multilateral setting, where critical mass is more present. It may in fact be the case that, in a form of reverse engineering, progress in the GATS has provided a stimulus to liberalization at the bilateral and regional level.

### *WTO-minus?*

It may well be that the WTO-plus features outlined above are implemented on a non-discriminatory basis. This will frequently be the case where the measures are achieved through increased transparency or flexibility in domestic regulation. But non-discrimination is by no means guaranteed. Mutual recognition agreements in services (or elsewhere) are inherently discriminatory (Zarrilli 2005).

Moreover, though there is abundant evidence of both US and EU agreements going beyond the GATS, there are important qualifications to the notion that their PTAs are necessarily more ambitious.

For the United States, their ambition is seriously dented by the increasing tendency for US PTAs to contain negative-list reservations that exclude all measures affecting services maintained at the sub-national level.

Moreover, the much-vaunted negative-list feature of US PTAs is not without debate. While negative listing is usually associated with greater liberalization than positive listing, this says nothing about causality. It may simply be that countries that are prepared to open up significantly are more likely to use a negative list. Nor is the balance of advantage always clear. This is nicely illustrated by Japan's

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<sup>4</sup> The Mode 4 commitments by the EU include fairly generous provision for temporary entry of professionals and contract workers from the CARIFORUM states and even include access for Caribbean artists in the cultural industry, where the EU has been especially defensive in the GATS with its insistence on a 'cultural exclusion'. See Chaitoo (2008).



agreements (Fink and Molinuevo 2007). Positive listing (as in Japan-Malaysia) can offer advantages, like status quo bindings, usually ascribed only to negative listing. While negative listing (as in Japan-Mexico) can bring disadvantages, like effectively denying application of the agreement to future service activities, usually ascribed only to positive listing.

In the case of the EU, the Protocol on the Liberalisation of Trade in Services that will provide the basis of services liberalization with Euro-Med partners contains features that will need handling with great care by developing country partners. For example, the provision in the Protocol (Article 13) that in order to achieve National Treatment, treatment of the other Party may be formally different to that afforded nationals needs to be approached with care where this might involve treating foreign entities, say in the area of tax, more favourably than domestic entities. A similar consideration may arise with the GATS, though here the Exceptions provisions in Article XIV appear to grant considerable latitude with respect to tax policy.

It should also be noted that the pursuit of services provisions in PTAs does not necessarily serve the interests of multilateral negotiations to the extent that the motivation for a broad WTO agreement can be undermined by PTAs satisfying the offensive interests of key sectors of the major traders. Moreover, sensitive sectors will remain sensitive – bilaterally as well as multilaterally – and there is likely to be a growing disparity between the treatment of those sectors subject to liberalization commitments and those (such as health, education and audiovisual) that preferential accords, no less than multilateral negotiations, tend to exclude.

Finally, notwithstanding the tendency for EU and US regulatory standards to become the de facto norm in bilateral agreements to which they are a Party, the proliferation of PTAs nevertheless means a proliferation of standards. This has been identified as a particular challenge for developing countries (OECD 2005).<sup>5</sup>

## Conclusions

A powerful case can be made for liberalizing services globally in terms of growth and employment creation. The potential gains in terms of world trade and national welfare from opening up services are greater than in agriculture or manufacturing. Yet progress on services has been disappointingly slow in the GATS negotiations, mostly for reasons not directly arising from the services negotiations themselves. Yet if the Doha Round is eventually concluded, there is reason to hope that, with the support of at least some influential developing countries, it will include a substantial services element. Meanwhile preferential trade agreements can offer pointers to the way to go, though as a second-best to a successfully completed, non-

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<sup>5</sup> Where countries are economically and socially disparate, the conditions for regulatory harmonization may be less than optimal (see work undertaken at the World Bank to establish criteria for 'optimum regional harmonization areas'; Mattoo and Fink 2002).

discriminatory, Doha Round. If this is to happen, however, governments which understand and support the case for services liberalization will have to show greater political will and determination on this front than they did in the first ten years of the Doha Round.

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