CHAPTER 7

TRADE IN SERVICES

SERVICES—which include activities as disparate as transport of goods and people, financial intermediation, communications, distribution, hotels and restaurants, education, healthcare, construction and accounting—are vital to the functioning of any economy. Even in the lowest income countries, services generate at least 40 per cent of GDP. Services account for 70 per cent or more of economic activity in high-income countries. Common explanations for the rise in the share of services in output and employment as countries become richer include increasing specialization and exchange of services through the market ('outsourcing'), with an associated increase in variety and quality that may raise productivity of firms and welfare of final consumers, in turn increasing demand for purchased services and the fact that the scope for (labour) productivity improvements in the provision of many services is less than in agriculture and manufacturing. The latter implies that over time the (real) costs of these services will rise relative to merchandise, as will their share of employment (Baumol, 1967; Fuchs, 1968).

Services are essential inputs into the production of all industries. Service sector policies therefore can have a major effect on economic performance. Starting in the 1980s, many countries began to undertake regulatory reforms to increase the contestability of service markets. In part these reforms were driven by changes in technologies that allowed competition to emerge in markets that were traditionally regarded as natural monopolies. Service sector reforms were also supported by manufacturing and agricultural interests. In order to benefit from the process of globalization with its attendant 'splintering' or 'fragmentation' of the production chain (see Chapter 1), enterprises must have access to efficient service inputs. As nations reduce tariffs and other barriers to trade, effective rates of protection for manufacturing industries may become negative if they continue to be confronted

with input prices that are higher than they would be if services markets were contestable. It is therefore not surprising that liberalization and regulatory reform of service markets began to emerge as a high-profile policy issue in the 1980s. Nor is it surprising that governments started to focus on policies affecting trade and investment in services, as service suppliers started to recognize the existence of a rapidly growing international market.

The initiative to consider rules for trade in services was launched by the US in the early 1980s. The US perceived it had a comparative advantage in services, and sought to link further liberalization of 'old trade' to progress in liberalizing trade in services. An initial attempt to put services on the GATT negotiating agenda was made by the US during the 1982 GATT ministerial meeting. This attempt met with vigorous resistance on the part of many contracting parties and agreement could not be reached to negotiate in this area. However, the meeting did result in establishing a GATT work programme on services, with the major countries agreeing to undertake national studies of their services sectors with a view to documenting status quo policies and better understanding the potential implications of applying GATT-type rules to trade in services. This helped to generate a spate of research on an issue that had been virtually ignored by trade economists.

A major result of the Uruguay Round was the creation of the General Agreement on Trade in Services (GATS). By establishing rules and disciplines on policies affecting access to service markets, the GATS greatly extended the coverage of the multilateral trading system. This chapter starts with brief overviews of global trade flows in services, the barriers that restrict such trade and the economics of service sector protection and liberalization. This is followed by a summary of the main elements of the GATS and its operation to date, as well as efforts during the Doha Round to expand the coverage of the agreement. The chapter ends with a brief assessment of the usefulness of the GATS as an instrument for the pursuit of service sector reform and suggestions for further reading.

7.1. Conceptual and Empirical Questions

Liberalizing trade in services was long thought to be an oxymoron, as historically many services have been nontradable. If trade occurred, the services tended to be embodied in goods, information flows or in people. Although trade in some services such as transportation has always been significant, technological changes have made an increasing number of services and tasks more tradable, resulting in a rapid expansion in trade.

Trade in services differs from trade in goods because services tend to be intangible and nonstorable (Box 7.1). Proximity between providers and demanders is often required for exchange to be feasible (Bhagwati, 1984; Sampson and Snape, 1985). Although more and more transactions may occur across borders (using telecommunications media), permitting provider and demander to be in different geographic locations, many services continue to require that provider and consumer be in the same place at the same time. This constraint can be satisfied through physical movement of consumers to the location of service providers (an example is tourism), or via the entry of service providers into the territory of a consumer (for example, management consulting). In a statistical sense all the above transactions comprise trade and are registered as such in the balance of payments as long as the movements of consumers and providers are short term, generally defined as lasting less than one year. They all involve exchanges between the resident of one country and that of another.

Establishment of a commercial presence in a country—engaging in foreign direct investment (FDI)—is another way of contesting services markets. If cross-border, long-distance exchange or temporary physical movement of either provider or consumer does not suffice for an exchange to be feasible, firms can only sell their services in foreign markets by establishing a long-term physical presence. In national accounts statistics the sales of the foreign affiliates or branches do not

Box 7.1. Services are different

Services have unique characteristics that differentiate them from manufactured products in international trade. The characteristics most frequently noted include:

- Intangibility—services are difficult to touch. To paraphrase the newspaper *The Economist*, services are products you cannot drop on your foot. Consequently, international transactions in services are often difficult to monitor, measure and tax.
- Nonstorability—it is often impossible to store services in inventory; services are typically produced and consumed at the same time. This implies that not only is it more difficult to trade services across space, but it is also difficult to trade across time.
- Heterogeneity—services are often nonstandardized and highly tailored to the needs of customers. There is therefore a considerable degree of variation in what is effectively supplied across international borders. The extent of product differentiation is very great.
- Joint production—services are typically produced with some input by the demander. That is, customers participate in the production process, providing critical information or feedback to providers that partly determines the latter's efficiency and productivity (in business school parlance, services are often a high-touch industry).

These characteristics help explain why a different approach was taken towards the design of multilateral disciplines for trade in services as compared to goods.

represent trade. However, as discussed below, in the WTO it does. As of the early 1990s, some 50 per cent of the global stock of FDI involved services activities, up from only 25 per cent in 1970. It rose to 60 per cent as of 2005, with the global stock of FDI exceeding the US$10 trillion mark (UNCTAD, 2007).

Available data on trade in services are very weak compared to those on merchandise. Only a limited number of industrialized countries collect and report statistics on trade in services at a relatively disaggregated level (ten categories or more). Most non-OECD countries only report data on trade in so-called commercial services, broken down into transport (largely freight and passenger transport by sea and air), travel (expenditures by nonresidents—mostly tourists—while staying in a foreign country) and other services. The last category includes items such as brokerage, insurance, communications, leasing and rental of equipment, technical and professional services, and income generated by the temporary movement of labour, as well as property income (royalties).

Global cross-border trade in services stood at US$2.7 trillion in 2006, of which 50 per cent was in the nontravel (tourism) and nontransport categories. Excluding intra-EU cross-border trade, the total is some US$2 trillion. As total trade in merchandise was some US$12.5 trillion in 2006, cross-border trade in services reported in balance-of-payments statistics is a bit over 20 per cent of world trade as measured by the balance of payments. Despite the often expressed view that services trade has been expanding rapidly as a result of services outsourcing and offshoring, the share of services receipts in total trade has remained relatively constant since the 1980s. In part this is because of the dynamic growth that has occurred in merchandise trade—driven by fragmentation and global production sharing intra-industry trade—and in part it reflects the fact that many services remain less or nontradable. The relatively constant share of total services in world trade hides large changes in the composition of trade. Much of the growth in cross-border services trade since 1990 has been in so-called business process outsourcing (BPO) services, which is captured in the balance-of-payments category 'other commercial services'. The rapid growth in trade in such activities has led to a significant decline in the shares of more traditional services—transport and travel (Figure 7.1). Relative to the size of domestic services activities, to date the extent of internationalization of services is still quite limited (Bhagwati, Panagariya and Srinivasan, 2004; Amiti and Wei, 2005).

The relative importance of trade in services (as registered in the balance of payments of a country) as opposed to sales of services by affiliates is not known for the world as a whole. This is because comprehensive data on the latter do not exist given that, once established, foreign firms are considered to be residents of the host country. Data reported by a number of OECD members indicate that 'foreign affiliate trade in services' (FATS)—the value of sales of services by affiliates of multinationals—is roughly 50 per cent greater than cross-border exports of services. In the case of the US, the value of outward FATS is significantly greater than

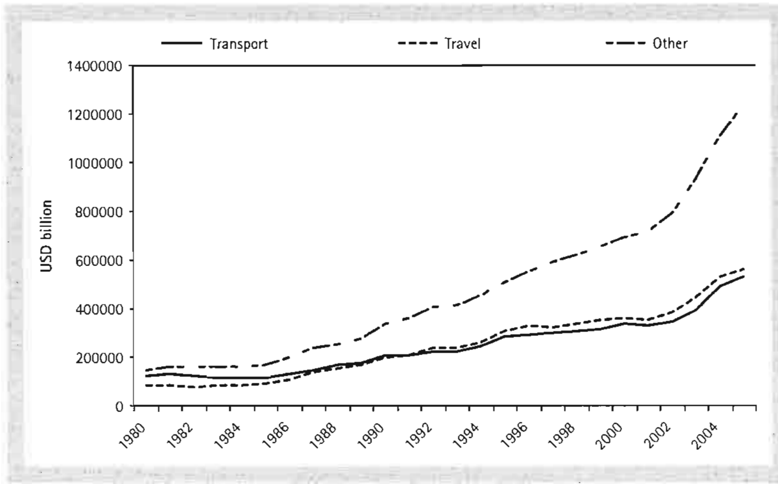

Fig. 7.1. Global cross-border trade in services, 1980–2006

Source: IMF balance of payment statistics.

cross-border trade, a pattern that has held since the mid-1990s (Figure 7.2). It may well be that increased services outsourcing will result in cross-border trade in services coming to dominate the value of FATS at some point in the future, but this is not the case today.

Extrapolating from the fact that FATS is 50 per cent greater than cross-border trade for the countries reporting such data, applying the factor 1.5 to other

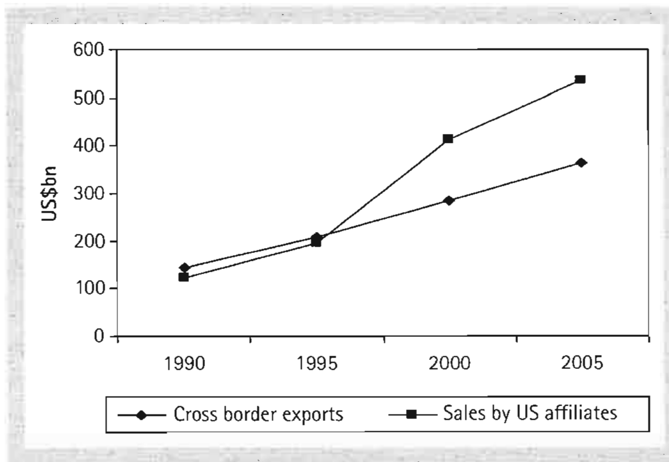

Fig. 7.2. US exports of services and sales of services by US foreign affiliates

Source: US Department of Commerce, Bureau of Economic Analysis.

Table 7.1. Trade in services by mode of supply, 2006

Mode of supply	Category	Value (US$ billion)	Share (%)
Cross-border	Transport and other commercial services	2,000	41.2
Consumer movement	Travel	750	15.5
Commercial presence	Sales by foreign affiliates	2,000	41.2
Temporary entry	Compensation of employees	100	2.1
Total		4,850	100.0

Source: Author's estimates, based on WTO (2007).

commercial services trade of about US$1.4 trillion gives a 'guesstimate' of the total value of FATS of some US$2 trillion.[1] That in turn suggests that aggregate international transactions in services are almost US$5 trillion (Table 7.1). Note that payments associated with the temporary entry of service providers is of trivial quantitative importance. Although probably an underestimate, the low figure reflects the stringent barriers that affect this mode of supply—the potential for greater trade in services through temporary movement of natural persons is very large.

Although in aggregate value terms global trade in services is dominated by OECD countries—which account for about 80 per cent of the total—many developing countries are relatively specialized in exporting services. Small developing countries in particular (defined as those with less than one million people) often derive a large proportion of total foreign exchange revenues from the sale of services. In many cases this reflects mostly tourism. However, a number of developing countries have also become large exporters of transactions processing and related back-office services and information and software development services. The best known example is India, which has become increasingly specialized in services. But many other countries have also registered double-digit export growth rates (Figure 7.3). The high business service export growth rates for developing countries increased their share of global trade to 22 per cent in 2006. Most of this increase reflects expanding exports of Asian countries, which doubled their global market share to 15 per cent.

[1] An alternative way of guestimating the total value of FATS is to use the information on global stocks of FDI. For the US, the stock of outward FDI in 2003 was some US$1.8 trillion, of which US$1.3 trillion was in services (UNCTAD 2005). Given FATS of US$477 billion in 2003, this gives a sales/stock ratio of 0.35 for the US. Assuming this applies more generally, given that the total stock of FDI in services was some US$6 trillion in 2006, this generates a global FATS guesstimate of US$2 trillion.

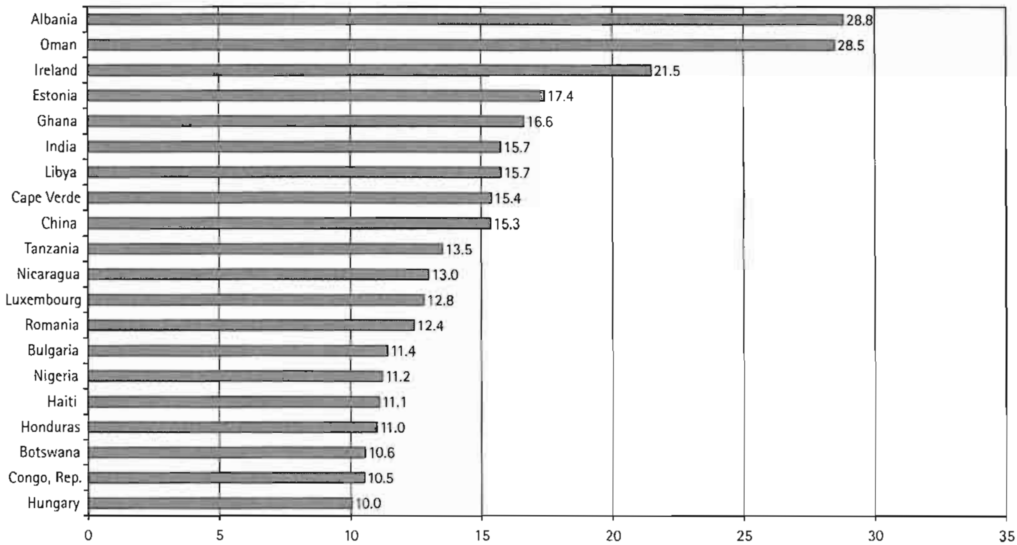

Fig. 7.3. Average growth rate of commercial service exports, 1990–2005

7.2. Barriers and Potential Gains from Policy Reforms

Cross-country data on the magnitude of barriers to trade in services do not exist. Because services are generally intangible and nonstorable, barriers to trade do not take the form of import tariffs. Instead, trade barriers take the form of prohibitions, QRs and government regulation. Quantitative restrictions may limit the quantity or value of imports of specific products for a given time period, or restrict the number or market share of foreign providers of services that are allowed to establish. Such discriminatory QRs are often complemented by nondiscriminatory measures applying equally to foreign and domestic providers. These may consist of limitations on the number of firms allowed to contest a market, or on the nature of their operations. Frequently, this involves either a monopoly (telecommunications) or an oligopolistic market structure (insurance). Considerations relating to consumer protection, prudential supervision and regulatory oversight often induce governments to require establishment by foreign providers or to reserve activities for government-owned or controlled entities.

A distinction needs to be made between policies that discriminate on the basis of nationality of ownership of factors of production, and whether policies affect entry into a market—through whatever mode of supply, including

establishment/FDI—and/or the operation of firms (see, e.g. Deardorff and Stern, 2008). This can alternatively be thought about in terms of whether policies affect fixed or variable costs, and whether they create rents for incumbent (domestic) firms. Table 7.2 illustrates the various possibilities.

Two different approaches have been taken to assess the magnitude and impact of policy barriers to trade. The first involves collection of information on applied policies, converting these into coverage/frequency indicators and using the resulting indices as explanatory variables in a statistical analysis to explain observed measures of prices or costs. The second approach is to rely on indirect methods such as calculation of price–cost margins by sector across countries or gravity regressions to estimate what trade flows 'should be' and back out an estimate of the tariff equivalent of policies from the difference between estimated and observed flows. A well-known problem with indirect approaches is that it is not possible to attribute price–cost margins or differences in trade volumes to specific policies—other factors such as the business cycle and natural barriers to trade/contestability will also play a role. Most of the literature has therefore pursued the first approach.

Efforts to directly measure the extent of policy barriers on a sectoral and cross-country basis employ a policy index of some kind that is used to estimate the price, cost or quantity effects of policies. The policy indices are constructed by identifying existing policies towards entry/establishment and seeking to determine if policies differentiate between domestic and foreign firms. For example, in the case of distribution services, a country may have restrictions on nationality of workers, limits on operating hours, restrictions on size and location, rules that prevent advertising through specific types of product promotions, product carve outs for state monopolies and limits on the temporary entry of workers (engineers, executives, etc.). What is needed is to identify the set of potentially pertinent policies and to assign relative weights to them, something which requires sectoral expertise and is inherently subjective.

Table 7.2. A typology of policies affecting trade in services

	Impact on Entry/Establishment	Impact on Operations
Nondiscriminatory	For example, a limit of two mobile phone providers permitted to operate in the country	For example, all retail banks must have personnel on call to monitor and service ATMs
Discriminatory	For example, nationality requirements for senior managers of affiliates; maximum equity ownership limit for foreign investors	For example, car and fire insurance subject to additional capital requirements; cross-border provision of insurance services subject to price regulation

Once indices of policy have been constructed, these can be used to estimate their price and/or cost effects, controlling for standard determinants of performance for the sector concerned. A problem in doing this is to distinguish the effects of nondiscriminatory regulation from discriminatory policies. Regulations generally will increase fixed and/or variable costs of production for firms, and may result in a *de facto* or *de jure* exclusion of new entry, thereby increasing prices. Insofar as regulation is motivated by market failures created by the characteristics of specific service industries—e.g. network externalities, asymmetric information—such price impacts may be social-welfare-enhancing. A number of the price and cost estimates of the impacts of the restrictiveness indices generated by researchers are reported in Table 7.3. These suggest there is significant variation in the extent of discrimination against foreign providers.

The consensus view is that the tariff equivalents of prevailing restrictions are a multiple of those that restrict merchandise trade (Hoekman, 2007). A recent survey undertaken by the World Bank of the extent of discriminatory policies restricting entry by foreign firms in specific services markets in 56 developing countries found significant heterogeneity (Gootiz and Mattoo, 2008). Many sectors are open, especially for FDI. However, in many sectors various restrictions continue to be imposed, and some sectors remain completely closed. 'Sensitive' sectors vary by country reflecting differences in comparative advantage and the legacy of past policies. Many countries maintain foreign equity or entry restrictions for certain services markets. In India, for example, a number of key 'backbone' services sectors were liberalized in the last decade. Barriers to entry by new private firms have been eliminated in telecommunications and freight transport, and are being phased out in insurance and banking. However, restrictions on foreign ownership remain. Professional services like accountancy and legal, retail distribution, postal and rail transport services are formally closed to foreign participation. Moreover, barriers to entry in a number of services sectors, ranging from telecommunications to professional services, are maintained not only against foreign suppliers but also against new domestic suppliers.

Overall, the literature suggests business services such as consultancy are among the least protected sectors. Barriers to competition are higher in transportation, professional services, finance and fixed-line telecommunications. Policies are generally more restrictive in developing countries (Figure 7.4).

The estimates in the literature suggest that although services trade barriers can be significant, there is generally much variation. This reflects the fact that in the late 1980s and throughout the 1990s many countries took action to increase competition on services markets by liberalizing FDI, opening access to foreign competition in backbone sectors such as transport and telecommunications, and privatizing state-owned or controlled service providers. These developments helped support the observed increase in trade flows—both services and goods—and led to a marked increase in the magnitude of services FDI flows and changes in their composition. UNCTAD (2005) reports that in 1970 finance and trade (distribution)

Table 7.3. Selected estimates of price/cost impacts of services policies

Sector	Source and period covered	Measure	OECD countries			Developing countries		
			Simple average	σ	N	Simple average	σ	N
Maritime shipping	Clark, Dollar and Micco (2001); 2000	Percentage impact on shipping costs of mandatory use of certain port services	2.0	2.6	21	5.6	3.5	32
Air transport: economy fare	Doove et al. (2001); late 1990s	Estimated increase (%) in fares over an estimated 'free trade' level for a set of bilateral routes	30.6	19.5	23	63.9	19.6	12
Air transport: APEX discount fare	Doove et al. (2001); late 1990s	Estimated increase (%) in fares over an estimated 'free trade' level for a set of bilateral routes	8.9	4.4	23	16.8	3.5	12
Retail food distribution	Kalirajan (2000)	Impact on costs of barriers on foreign establishment	2.7	1.7	12	2.3	3.2	6
Retail banking	Kalirajan et al. (2000); 1996-97	Percentage impact on net interest margins of discriminatory policies	11.8	11.6	7 (a)	31.8	19.0	9
Engineering	Nguyen-Hong (2000); 1996	Impact of barriers to FDI on price cost margins (%)	5.2	4.1	14	8.4	4.3	6
Mobile telecom	Doove et al. (2001); 1997	Price impact (%) of regulatory policies relative to a notional benchmark regime	26	27	24	21	15	18
International telecom	Doove et al. (2001); 1997	Price impact (%) of regulatory policies relative to a notional benchmark regime	73	61	24	34	9	18

Notes: (a), includes the EU-15 as one observation; σ, standard deviation; N, number of observations.

Source: Data compiled in part from tables reported in Deardorff and Stern (2008), drawing on Findlay and Warren (2000) and Dee (2005).

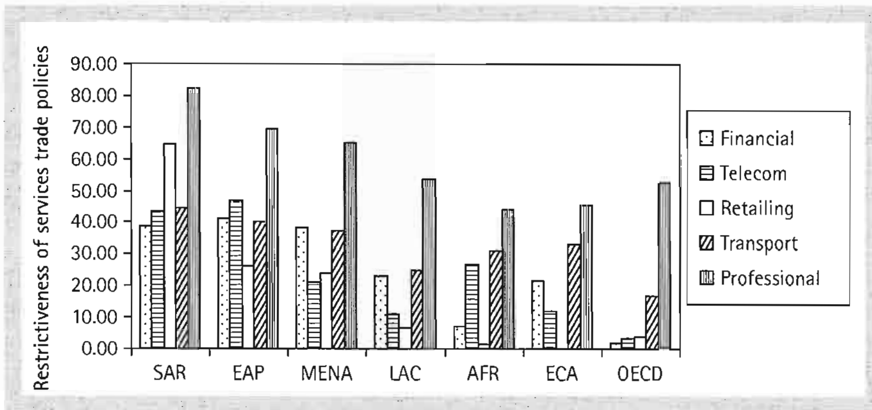

Fig. 7.4. Services trade restrictiveness indices by region and sector

Note: There are in total 76 countries.
Source: Gootiz and Mattoo (2008).

accounted for 65 per cent of the total stock; this dropped to 45 per cent in 2003. Conversely, the share of telecoms, energy, and business services has risen from 17 to 44 per cent. There are significant differences in the composition of FDI inflows into developed and developing countries. Business services accounted for 40 per cent of the total inward FDI stock in developing countries in 2003, compared to only 20 per cent in the OECD.

Gains from policy reform

Services are no different from goods in terms of the economic effects of removing barriers to trade and allowing greater competition from foreign providers. Inefficient firms will be forced to improve their performance or exit the market; more efficient firms will expand and new firms, products and techniques will enter markets. These resource re-allocation effects will improve welfare, although households and communities that were dependent on firms that cannot meet the competition will confront adjustment costs and losses. If there are economies of scale, and greater foreign participation is associated with increased competition, there will be a larger scale of activity, and hence scope for economic growth-enhancing effects as well. There is nothing special about trade here: if greater scale can be achieved merely by eliminating domestic barriers to entry and attracting domestic resources from other sectors this would also generate larger endogenous growth. However, a key difference between trade in goods and services in terms of their growth impact is that 'imports' of services often must be locally produced. If foreign participation merely substitutes for domestic production and the sector does not expand, i.e. the degree of competition remains unchanged, then there may

be no positive growth impacts. More generally, if greater technology and knowledge transfer accompanies services liberalization—either embodied in FDI or disembodied—this will stimulate the potential growth impact of pro-competitive policy reforms. There is substantial empirical evidence demonstrating that technology diffuses through trade in goods and affects total factor productivity growth (see e.g. Hoekman and Javorcik 2006). At least theoretically, the same should hold true for technology that is diffused through flows of services.

Compared to the literature on the effects of liberalization of trade in goods, there is much less research focusing on the impacts of services trade reforms. To a large extent this is due to the weaknesses of the data on both policies and outcomes (performance of firms). Bearing that caveat in mind, there has been a significant amount of research in recent years that documents that the effects of policy reforms in services can be significant. In a cross-section, cross-country regression analysis, Mattoo, Rathindran and Subramanian (2006) find that controlling for other determinants of growth, countries with open financial and telecommunications sectors grew, on average, about one percentage point faster than other countries. Fully liberalizing both the telecommunications and the financial services sectors was associated with an average growth rate 1.5 percentage points above that of other countries. Eschenbach and Hoekman (2006*a*) utilize three indicators of the 'quality' of policy in banking, nonbank financial services and infrastructure, constructed by the European Bank for Reconstruction and Development (EBRD) spanning the period 1990–2004 to investigate the impact of changes in services policy, including liberalization, on economic performance over this period for a sample of 20 transition economies. They find that changes in policies towards financial and infrastructure services, including telecommunications, power and transport, are highly correlated with inward FDI. Services policy reforms are statistically significant explanatory variables for the post-1990 economic performance of the transition economies in their sample.

The positive association between policy reforms in services and inward FDI in services, and between total factor productivity growth performance of firms that use services and this FDI is perhaps the most robust finding to emerge from the limited empirical research on the impacts of services reforms. For example, Arnold, Javorcik and Mattoo (2007) analyse the effects of allowing foreign providers greater access to services industries on the productivity of manufacturing industries relying on services inputs. The results, based on firm-level data from the Czech Republic for the period 1998–2003, show a positive relationship between FDI in services and the performance of domestic firms in manufacturing. In related research focusing on Africa that uses data from over 1,000 firms in ten Sub-Saharan African economies, Arnold, Mattoo and Narciso (2006) find a statistically significant positive relationship between firm performance and the performance of three service input industries for which data were collected through enterprise surveys (access to communications, electricity and financial services). Arnold,

Javorcik, Lipscomb and Mattoo (2008), using panel data for 10,000 Indian firms for the 1990–2005 period, focus on the link between services sector reforms and manufacturing productivity and export propensity. The reforms are associated with a significant increase of FDI into services, outpacing FDI into goods. They find a significant positive relationship between policy reforms in banking, telecommunications and transport and the productivity of Indian firms in manufacturing industries. Enterprises that rely more intensively on services such as banking and telecommunications have higher total factor productivity growth rates. Although services reforms benefit both foreign and locally owned manufacturing firms, the effects on foreign firms tend to be stronger.

The trade literature has devoted much attention to the effects of 'trade costs'—the nontariff-related costs that are incurred in getting goods from point of production to point of consumption. Many of the determinants of trade costs are services-related. The most obvious source of such costs is infrastructure-related services. Limão and Venables (2001) estimate that poor infrastructure accounts for 40 per cent of predicted transport costs for coastal countries and up to 60 per cent for landlocked countries. Francois and Manchin (2007) conclude that infrastructure is a significant determinant not only of export levels, but also of the likelihood exports will take place at all. They find that basic infrastructure (communications and transportation) explains substantially more of the overall sample variation in exports than do the trade barriers faced by developing countries.

Such cost factors reflect the specific role of 'transport' services—they are intermediates that help determine the costs of trade in goods and thus the producer prices received by firms. The impact on trade (and welfare) of lowering transport-related costs may be much larger proportionately than those that can be obtained from merchandise trade liberalization because transport costs generate real resource costs as opposed to rents (Deardorff, 2001). Insofar as policy generates redundant procedures and duplication of fixed costs, the potential gains from liberalization of 'trade services' are likely to be large.

Francois and Wooton (2007) note that trade in goods may depend on the degree of market power exercised by the domestic trade and distribution sectors. An absence of competition in the domestic distribution service sector can serve as an effective import barrier against goods. Their econometric results point to statistically significant linkages between effective market access conditions for goods and the structure of the domestic service sector. An implication is that services liberalization can boost trade in goods. More important, by ignoring the structure of the domestic service sector, the benefits of tariff reductions may be overstated. They also find that competition in distribution and related sectors matters more for poorer and smaller exporting countries than for others. This is intuitive, in that small players will have less, if any, ability to counteract the exercise of market power they confront.

Other research has illustrated the interdependence between the efficiency of available domestic service sectors and trade in goods. For example, Francois and

Reinert (1996) document that the importance of services for export performance rises with per capita incomes—business, distribution and communications services become the most important sectoral elements of overall exports in terms of inter-industry linkages. Fink, Mattoo and Neagu (2005) show that international communication costs are a determinant of export performance for higher value, differentiated products, whereas they matter less for more homogenous, bulk-type commodity trade.

Numerous 'services inputs' therefore affect the volume and composition of trade, whether in goods or services. Many of these input costs will factor into the overall level of trade costs confronting firms. Actions to reduce these excess costs and improve quality will enhance the competitiveness of firms located in the markets concerned, with an aggregate effect that is akin to a depreciation of the real exchange rate. Which factors are more important than others will vary across countries. Wilson, Mann and Otsuki (2005) use a gravity model to estimate the effects of four 'trade cost' variables, two of which are services-related: port efficiency, customs clearance, the regulatory environment more broadly and service sector infrastructure (telecommunications, e-business) across 75 countries for the 2000–1 period. The total potential expansion in trade in manufactures from trade facilitation improvements in all the four areas—raising performance of 'underperformers' to the average in the sample—is estimated to be US$377 billion. On average, their port efficiency variable—which includes both maritime transport and airports—account for more than half of the trade costs imposed by policies in their four areas.

The political economy of services liberalization

Depending on local circumstances and political constellations, governments may face more or less opposition to reforms that aim at increasing competition in service markets. Although often supported by other economic sectors, which have an interest in having access to a wide array of efficiently produced service inputs, final consumers may oppose liberalization because of concerns about a reduction in the frequency, quality or geographical coverage of services (e.g. telecommunications, transport, health, education). Labour unions may be concerned about the potential for large-scale layoffs by incumbent firms, and those in society who have benefitted from subsidized access to services may resist a change in the status quo that is expected to raise prices or restrict supply.

Thus, governments may be constrained in implementing reforms that would benefit society at large because of the opposition of politically powerful vested interests. International trade agreements offer a potential way for breaking domestic deadlocks by mobilizing groups to support reform. The traditional *raison d'être* of the GATT—that groups that would benefit from better access to export markets are induced to throw their weight behind import liberalization—should also apply

in the services context, as long as export interests exist. Often, however, export interests in services are weaker than in manufacturing or agriculture because services are more difficult to trade. In OECD countries, for example, the ratio of exports to output is on average over six times less for services than for goods. In many instances, potentially tradable services are simply not traded at all; the barriers—whether natural or man-made—are prohibitive. As a result, the number and political weight of import-competing sectors may greatly exceed that of export-oriented service sectors interested in obtaining access to foreign markets. If so, there is greater need to mobilize support from exporters of merchandise that require access to competitively priced and high-quality service inputs if they are to be able to contest global markets. This in turn puts a high premium on the availability of information and analysis of the economic impact of status quo services policies. As important, the required cross-issue linkages may greatly complicate negotiations.

Given that FDI is a significant mode of supplying nontradable services, potential direct investors may have a strong 'export' interest and supply the traditional political economy dynamics that have driven negotiations. Moreover, opposition by domestic firms and labour to the prospect of increased competition from foreign firms may not be as strong in services as in goods. As already mentioned, the gross negative impact on labour employed in services is likely to be lower (given that foreign entrants will often use FDI and employ mostly nationals). The net impact on labour is more likely to be perceived to be positive (as total employment opportunities can be expected to expand). And support for reform by businesses that would benefit from higher quality and lower prices services is more likely to be stronger. Indeed, those that liberalize first may have a strategic advantage—creating further incentives to pursue domestic reforms. Narrow reciprocity, in the form of 'equivalent' concessions being offered by trading partners, is therefore likely to be less of a priority for countries than has been the case for merchandise trade liberalization (Hoekman and Messerlin, 2000).

Blanchard (2007) develops a formal model that provides insights into one possible channel that explains why unilateral reforms have been pursued and that provides an explanation for the lack of strong support by lobbies for the GATS process. She argues that the existence of investment flows (FDI) attenuates the need to use trade agreements to deal with terms of trade externalities. If firms are able to engage in FDI and do so, as more firms originating in any country-pair invest in each other's markets, governments will have less incentive to manipulate tariffs and other policies in an effort to improve their terms of trade. The reason is that doing so, assuming it is feasible and effective, will benefit the foreign firms located in a host market as well as domestic firms. The greater the foreign (FDI) share, the lower the incentive of the government to use border policies, and the less need to use the reciprocity mechanism in trade negotiations. An implication is that the larger are two-way FDI stocks, the more inclined governments are likely to be to

lock these in: there is little, if any, downside to doing so. The GATS schedules are on average most far-reaching and comprehensive for mode 3, consistent with the analytical framework developed by Blanchard—presumably reflecting at least in part the large two-way FDI flows among the OECD countries, complemented by the desire on the part of many developing countries to attract FDI.

International agreements can also be helpful in providing focal points for regulatory reform, providing templates for domestic policy measures that are welfare-enhancing. An example is supporting the implementation of pro-competitive regulatory regimes. This is particularly important in the case of network-type services (such as financial and telecom services), where there is a need to deal with problems of asymmetric information (moral hazard, adverse selection) or to ensure universal service. One of the beneficial 'didactic' outcomes of the negotiations on financial services (discussed below) was that it helped educate decision-makers on the importance of distinguishing between liberalization and (de-) regulation. Liberalization involves the elimination of discrimination in the treatment of foreign and national services providers and removal of market access barriers—to both cross-border provision and establishment. But this does not restrict the government's ability to enforce regulatory regimes, undertake prudential supervision, conduct monetary policy or manage external capital flows (Key, 1997). The same applies to other sectors. In all cases, however, the required regulatory capacity must be there, if needed. In principle, multilateral negotiations can help by identifying good regulatory practices and principles that governments should consider adopting, as well as criteria or necessary conditions that must be met before certain reforms should be undertaken.

Another important potential beneficial role multilateral agreements can play is to enhance the credibility of a government's economic policy stance. This can be very important for countries where there is a history of policy reversal. The WTO offers mechanisms for governments to pre-commit to a reform path and to lock-in reforms that have already been achieved. However, the credibility impact of WTO commitments depends on the probability that export interests will contest violations of an agreement. As discussed in Chapter 3, the credibility payoff for small countries may be limited, as exporters in large nations may have little interest in 'suing' such countries.

Many service activities are highly regulated. The regulatory agencies involved have a vested interest in defending their turf, complicating the needed interagency coordination and cooperation in a negotiating context (Feketekuty, 1988). At the same time, there is frequently a need for appropriate regulation. Regulators may have greater objections to liberalization of cross-border exchange than to FDI, as it is more difficult for them to control industries located in foreign jurisdictions. They may prefer that establishment is required as a mode, as this ensures that they will maintain their control of the activity involved. Whatever their preferences may be, trade negotiators on services must interact and consult with the relevant

regulatory authorities, which makes it more complex to engage in negotiations. Such complexity is made worse in the case of federal states where the central government often does not have the authority to make commitments on behalf of lower level governments.

Another variable that distinguishes services from goods liberalization is that if FDI is the preferred mode of supply, adjustment will be associated with transfers of ownership of industry. Opposition from affected bureaucracies and from groups with noneconomic concerns (such as the impact of 'denationalization' on national culture) may further increase the complexity of liberalization efforts with respect to services. The challenge for policymakers is to enhance foreign competition while ensuring that the need for regulation of service providers is satisfied. This requires that the case for liberalization be distinguished from the need for regulation or regulatory reform. Regulation to achieve fiduciary, public health or cultural objectives should be in place and strengthened where necessary, and should apply equally to domestic and foreign providers.

Although there are substantial potential benefits from liberalizing key services sectors, these gains cannot be realized by a mechanical opening up of services markets. Governments have an important role to play in putting in place the preconditions for an efficient set of service industries, bolstering the case for focusing on key inputs like education and (institutional) infrastructure. Also important is the design of reform programmes. A flawed reform programme can undermine the benefits of liberalization. For example, if privatization of state monopolies is conducted without taking actions to foster greater competition, the result may be merely transfers of monopoly rents to private owners (possibly foreigners). Similarly, if increased entry into financial sectors is not accompanied by adequate prudential supervision, the result may be insider lending and poor investment decisions. Also, if policies to ensure wider access to services are not put in place, liberalization need not improve access to essential services for the poor. Managing reforms of services markets therefore requires integrating trade opening with a careful combination of competition and regulation. Doing so will often be critical to mobilize the political support needed to launch and to sustain efficiency-enhancing policy reforms.

7.3. The GATS

As an integral part of the WTO, the GATS entered into force on 1 January 1995. A major innovation for the global trading system, which until 1995 covered only trade in goods, the GATS was the result of a 15-year discussion that commenced in the

early 1980s. As mentioned in the introduction to this chapter, services were put on the GATT agenda in the early 1980s by the US. Before and during the 1986 ministerial meeting in Punta del Este, Uruguay many developing countries defended the view that new negotiations should not address services. This position was defended most vigorously by the so-called G10—a group of ten developing countries (Argentina, Brazil, Cuba, Egypt, India, Nicaragua, Nigeria, Peru, Tanzania and Yugoslavia)—which rejected launching talks on services, as well as trade-related aspects of intellectual property rights and TRIMs. In the event the majority prevailed, adopting a draft text proposed by Colombia and Switzerland. The main concession to the G10 was agreement that the services negotiations would proceed on a parallel track from talks on goods. Notwithstanding this procedural agreement, it was agreed that the negotiations were to be a 'single undertaking'.

The nonexistence of a common set of border barriers such as tariffs greatly complicated the life of negotiators seeking to agree to incrementally reduce barriers to services trade. As discussed in Chapter 4, negotiators require a focal point—some tangible variable enabling parties to set objectives and assess negotiating progress. Lack of data on trade and the complexities associated with identifying and quantifying barriers to trade made a GATT-type approach—exchanging equivalent 'amounts' of trade liberalization—impossible to emulate. Rather than focusing on the identification, quantification and reduction of barriers, subjective notions of sectoral reciprocity became the focal point of negotiations. This contrasts with the 'first-difference' approach to reciprocity used in tariff negotiations (Bhagwati, 1988).

Thinking on services evolved considerably over the course of the negotiations. Early in the negotiations, many developing countries argued that the lack of data on services trade justified excluding service transactions involving establishment by foreign providers from any agreement. In this they were supported by UNCTAD, which proposed that trade in services be defined to occur only when the majority of value added was produced by nonresidents (UNCTAD, 1985). This definition excluded virtually all transactions through FDI, as foreign factors of production that relocate are generally considered to become residents of the host country for economic accounting purposes. Great emphasis was put on the need for governments to be able to impose conditions on inward FDI and support domestic industries. This implied that a generally applicable national treatment obligation of the type found in the GATT was unacceptable.

The US went into the negotiations with the most liberal proposal: MFN was to apply to all signatories and national treatment was to be a binding, general obligation. Trade was to be defined broadly, including FDI (commercial presence). All measures limiting market access were to be put on the table. The EU also entered into the negotiations with the view that trade in services should be defined so as to include all types of transactions required to achieve effective market access. The EU proposed establishing a committee to determine the 'appropriateness' of

regulations, with inappropriate measures to become the subject of liberalization negotiations and commitments on a sector-by-sector basis for all participating countries. Any framework agreement for trade in services was to involve only limited obligations of a generally binding nature. National treatment was to be negotiated on a sector-by-sector basis.

Thus, both the EU and major developing countries expressed an early preference for an agreement with relatively soft obligations—the EU arguing that national treatment should only apply to specific sectors, major developing countries opposing even that. Only the US and a number of small open economies—both OECD members and newly industrialized countries like Singapore—were in favour of a 'hard' agreement along GATT lines from the start, with generally binding obligations and universal sectoral coverage. At the end of the day, the EU-developing country preference for a relatively soft framework agreement prevailed. In return for acceptance that trade in services be defined to include all four possible modes of supply and that certain nondiscriminatory measures restricting market access were in principle negotiable, national treatment became a sector-specific commitment. It was also agreed that scheduling of specific commitments would be on both a sector-by-sector and mode-of-supply basis.

Throughout the negotiations lobbies played an important role. The inclusion of services on the Uruguay Round agenda was due in no small part to the efforts of a number of large, mostly American, service companies to get the topic on the table. Leading players in this effort included financial institutions such as American Express and American International Group and professional services firms such as Arthur Anderson (Heeter, 1997). As discussed below, a major difference between the Uruguay and Doha Rounds was the visibility and level of lobbying activity by the private sector in support of an ambitious outcome.

The basic rules

The GATS consists of four main elements.[2]

(1) a set of general concepts, principles and rules that apply to all measures affecting trade in services;
(2) specific commitments that apply only to service sectors and subsectors listed in a member's schedule;
(3) an understanding that periodic negotiations will be undertaken to progressively liberalize trade in services; and
(4) a set of attachments, protocols and annexes that set out sector-specific disciplines and ministerial decisions that relate to the implementation of the agreement.

[2] Parts of this section draw on Hoekman and Mattoo (2007).

Instead of attempting to define what a service is—long inconclusive debates had rapidly made clear that this would be an unproductive endeavour—GATS negotiators simply adopted a list of services that is based on the UN Central Product Classification:

1. Business services
2. Communication services
3. Construction services
4. Distribution services
5. Educational services
6. Environmental services
7. Financial services
8. Health-related and social services
9. Tourism and travel-related services
10. Recreational, cultural and sporting services
11. Transport services
12. Other services not elsewhere included.

Each of these sectors is further subdivided into a total of over 150 activities. Trade is defined (in Article I) to include four modes of supply:

- *Mode 1—Cross-border*: services supplied from the territory of one member into the territory of another. An example is software services supplied by a supplier in one country through mail or electronic means to consumers in another country.
- *Mode 2—Consumption abroad*: services supplied in the territory of one member to the consumers of another. Examples are where the consumer moves, e.g. to consume tourism or education services in another country. Also covered are activities such as ship repair abroad, where only the property of the consumer moves.
- *Mode 3—Commercial presence*: services supplied through any type of business or professional establishment of one member in the territory of another. An example is an insurance company owned by citizens of one country establishing a branch in another country.
- *Mode 4—Presence of natural persons*: services supplied by nationals of one member in the territory of another. This mode includes both independent service suppliers, and employees of the services supplier of another member. Examples are a doctor of one country supplying through his physical presence services in another country, or the foreign employees of a foreign bank.

Any measure affecting the supply of services through any of these modes is covered by the GATS. However, the agreement does not apply to services supplied in the exercise of governmental functions, to measures affecting natural persons seeking access to the employment market of a member, or to measures regarding citizenship, residence or employment on a permanent basis. The inclusion of commercial presence as a mode extends the reach of the agreement to measures affecting FDI, and the inclusion of presence of natural persons to measures affecting the entry of foreign nationals, both of which have traditionally been a tightly controlled province of national government.

The dispute regarding the EU regime for the importation, sale and distribution of bananas (the *Bananas* case.[3] clarified that a broad interpretation of the term 'affecting' is implied in the GATS. That is, measures need not affect trade in services as such but could also be measures taken in other areas that affect services—such as measures in respect of the purchase of goods. In *Bananas* the complainants argued that the EU method of distributing import licences violated the GATS because ACP bananas were largely distributed by EU-based entities. The EU argued that a number of non-EU distributors were allocated quotas for these bananas and that there was therefore no violation of national treatment in distribution. The panel decided to focus not on the nationality of providers, but on the question of allocation of licences. It recognized that '[t]he operator category rules apply to service suppliers regardless of their nationality, ownership or control' (para. 7.324), but concluded that the allocation scheme nonetheless affected the conditions of competition. Thus, the focus was on outcomes (the 'market share' held by EU firms), and not on discrimination per se. The Canada *Autopact* panel, brought by the EU and Japan, was asked whether a duty exemption scheme constitutes a measure affecting trade in services. It concluded, based on the *Bananas* panel, that no measures can be excluded a priori, and that the exemption scheme affected wholesale distribution services. The Appellate Body disagreed stating that this should be determined through an investigation of who supplies wholesale services and how such services are applied (DS139/AB/R, 31 May 2000, para. 165).

The major provisions of the GATS are summarized in Table 7.4. The GATS is overseen by the Council for Trade in Services, and a number of subsidiary bodies—including a Committee on Specific Commitments, charged with monitoring implementation of commitments and addressing technical scheduling questions, and a Committee on Trade in Financial Services. In addition, two working parties have been created, one on domestic regulation and another on GATS rules.

General Agreement on Trade in Services rules can be seen as operating at two levels. First, there is a set of general rules that apply across the board to measures affecting trade in services, of which the most important are *transparency* and the *most-favoured nation* (MFN) principle. Then there are sector-specific commitments made by members on *market access* and *national treatment* that are the core of the GATS, and determine the liberalizing impact of the agreement.

[3] See European Communities: Regime for the Importation, Sale and Distribution of Bananas, Report of the Panel, WT/DS27/R/USA, 22 May 1997, and European Communities: Regime for the Importation, Sale and Distribution of Bananas, Report of the Appellate Body, WT/DS27/AB/R, 9 September 1997.

Table 7.4. Major provisions of the GATS

Article	Subject Matter
I	Definition. Trade in services covers all four modes of supply.
II	General MFN obligation, subject to possibility of scheduling exemptions on a one-time basis.
III	Notification and publication. Obligation to create an enquiry point.
IV	Increasing participation of developing countries. High-income countries to take measures to facilitate trade of developing nations.
V	Economic integration. Allows for free trade and similar agreements.
VI	Allows for domestic regulation. Requirements concerning the design and implementation of service sector regulation, including in particular qualification requirements.
VII	Recognition of qualifications, standards and certification of suppliers.
VIII	Monopolies and exclusive suppliers. Requires that such entities abide by MFN and specific commitments (Articles XVI and XVII) and do not abuse their dominant position.
IX	Business practices. Recognition that business practices may restrict trade. Call for consultations between members on request.
XIV	General exceptions. Allows measures to achieve noneconomic objectives.
XVI	Market access. Defines a set of policies that may only be used to restrict market access for a scheduled sector if they are listed in a member's specific commitments.
XVII	National treatment. Applies in a sector if a commitment to that effect is made and no limitations or exceptions are listed in a member's schedule.
XVIII	Additional commitments. Allows for any other specific commitment to be made on a sector-by-sector basis. To date these have been limited primarily to telecommunications, through the so-called Reference Paper (discussed below).
XIX	Calls for successive negotiations to expand coverage of specific commitments (Articles XVI and XVII).
XXIX	States that annexes are an integral part of the GATS. There are annexes allowing for one-time MFN exemptions, excluding air transport services, and clarifying the potential coverage of maritime transport commitments. The GATS also has four additional protocols, two on financial services (the Second and Fifth), basic telecommunications services (the Fourth) and the movement of natural persons (the Third). Somewhat confusingly, there is no First Protocol.

MFN and transparency

As in the GATT, the core principle of the GATS is MFN treatment. This constitutes a general obligation that in principle is applicable to all covered measures maintained by members for any services sector. Article II:1 of GATS states:

With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favorable than that it accords to like services and service suppliers of any other country.

Although the MFN obligation under GATT 1994 is concerned with measures affecting products, the GATS also pertains to measures affecting service suppliers (that is, producers, legal persons). It thus has a wider reach. Although MFN is a general obligation (Article II), an annex to the GATS allows members to list MFN exemptions upon entry into force of the agreement. Once a member, further exemptions require a waiver from the ministerial conference of the WTO (which must be approved by three-quarters of the members). Most favoured nation exemptions are in principle to last no longer than ten years (that is, until end 2004) and are subject to negotiation in future MTNs, the first of which was to occur within five years of the entry into force of the agreement—i.e. in 2000 (Article XIX).

The need for an annex on MFN exceptions arose from concerns on the part of some members that an unconditional MFN rule would allow competitors located in countries with relatively restrictive policies to benefit from maintaining sheltered markets while enjoying a free ride in less restrictive export markets. This concern was expressed most vividly in GATS discussions on financial services and telecommunications, prompting industry representatives in relatively open countries to lobby for MFN exemptions as a way to force sectoral reciprocity.

Over 60 WTO members submitted MFN exemptions in 1994, with three sectors dominating: audiovisual services, financial services and transportation (road, air and maritime). Exemptions in the audiovisual area tend to be justified on the basis of cultural objectives, often aiming at safeguarding preferential co-production or distribution arrangements with certain countries. Exemptions for financial services were generally driven by reciprocity concerns: countries sought to retain the ability to discriminate against members that do not offer reciprocal access to financial service markets. The goal of many members in this connection was to maintain some leverage vis-à-vis the US. Exemptions in the transport area by developing countries often were motivated by the UNCTAD Liner Code—under which they may reserve up to 40 per cent of liner shipping routes for national flag vessels.

Apart from services specified in individual MFN exemption lists, the only permitted departure from MFN is for economic integration agreements between subsets of WTO members (Article V). As discussed in Chapter 10, this is similar to the provision found in the GATT. In addition, the GATS makes allowance for agreements on the movement of natural persons (Article V *bis*), which permits members to fully integrate their labour markets. The only such agreement notified so far is the one involving Denmark, Finland, Iceland, Norway and Sweden.

Article III (Transparency) requires all members to establish enquiry points to provide, on request, specific information concerning any laws, regulations and administrative practices affecting services covered by the agreement. In addition, members must establish enquiry points to provide, on request, specific information

concerning any laws, regulations and administrative practices affecting services covered by the GATS.

National treatment and market access

National treatment (Article XVII GATS) is a so-called *specific* commitment. It is defined as treatment no less favourable than that accorded to like domestic services and service providers. Such treatment may or may not be identical to that applying to domestic firms, in recognition of the fact that identical treatment may actually worsen the conditions of competition for foreign-based firms (for example, a requirement for insurance firms that reserves be held locally). National treatment applies only to those services inscribed in a member's schedule, and then only to the extent no qualifications or conditions are listed in the schedule (see below). As is the case in the GATT, Article XVII applies to both *de jure* and *de facto* discrimination.

Consider some examples of limitations on national treatment. If domestic suppliers of audiovisual services are given preference in the allocation of frequencies for transmission within the national territory, such a measure discriminates explicitly on the basis of origin of the service supplier and thus constitutes formal or *de jure* denial of national treatment. Similarly, the WTO Panel in the Autopact dispute between the EU and Canada (*Canada—Certain Measures Affecting the Automotive Industry*) found that a local content requirement that could be fulfilled by the use of certain locally produced services discriminated against cross-border trade in the same services. Alternatively, consider a measure stipulating that prior residency is required for obtaining a licence permitting a provider to supply a service. Although the measure does not formally distinguish between service suppliers on the basis of national origin, it *de facto* offers less favourable treatment for foreign suppliers because they are less likely to be able to meet a prior residency requirement than like service suppliers of national origin.

In addition to national treatment, the GATS introduced a second specific commitment: a market access obligation (Article XVI GATS). Six types of market access restrictions are in principle prohibited for sectors a country chooses to schedule. These comprise limitations on the:

(1) number of service suppliers allowed;
(2) value of transactions or assets;
(3) total quantity of service output;
(4) number of natural persons that may be employed;
(5) type of legal entity through which a service supplier is permitted to supply a service (for example, branches vs. subsidiaries for banking); and
(6) participation of foreign capital in terms of limits on foreign equity or the absolute value of foreign investment.

Although in principle prohibited, if a member desires to maintain one or more of these six measures for a scheduled sector, it may do so as long as it lists them in its schedule. The introduction of a market access commitment in the GATS reflected the fact that the contestability of service markets is frequently restricted by measures that apply to both foreign and domestic entities. The market access article explicitly covers a number of such measures that were felt to be of particular importance. It can be regarded as the equivalent of GATT Article XI (which prohibits the use of quotas) as all the measures listed except for item 5 are quantitative in nature. In practice, however, it differs in that the market access obligation overlaps with the national treatment requirement, as prohibited market access-restricting measures may also violate national treatment (Hoekman, 1996).

The market access provision is clearly not comprehensive in that it does not deal with nondiscriminatory policies that have the effect of restricting competition generally, in the process blocking market access (e.g. because the fixed costs for foreign firms of satisfying the measure are higher than for local firms). Whether the limitations of Article XVI GATS are relevant for foreign suppliers only or for foreign *and* domestic suppliers; and whether national treatment applies to any Article XVI GATS restriction, are questions that are somewhat ambiguous. The *US—Gambling* panel found (and the Appellate Body concurred) that a series of US federal and state measures which ban the supply of services by foreign and domestic suppliers alike, violated Article XVI GATS because the US had not scheduled and market access exceptions for the relevant sector. An example of such laws was the Federal Wire Act, which states that persons that knowingly use a wire communication facility for the transmission in interstate or foreign commerce of bets and wagers or information assisting in the placing of bets or wagers or any sporting event or contest shall be subject to a fine, imprisoned for up to two years, or both. The Illegal Gambling Act calls for fines and/or prison terms for anyone engaging in an illegal gambling business.

It can be argued that the approach of the panel and AB was misconceived. As the GATS is a trade agreement, it should not regulate the conditions of access to a market for the citizens of a state making a liberalization commitment. All that is required is that the measure be transparent. To this effect, Article III GATS obliges WTO members to '... publish promptly... all relevant measures of general application which pertain to or affect the operation of this Agreement'. This provision leaves some discretion to governments to determine what is covered by this obligation. It is also possible for a WTO member to *cross-notify* (under Article III.5 GATS): laws of general application, even if not notified to the WTO, will become public because of domestic law constraints.

From a policy-perspective, trade liberalization would appear to be served if the applicability of Article XVI GATS was restricted to foreign services and services suppliers only (Hoekman and Mavroidis, 2007). As the GATS involves scheduling of domestic regulation, it would seem most appropriate to view Article XVI as a

subset of Article XVII. If such a view is taken, the implication is that WTO members must first decide whether or not to accord national treatment to foreign services and services suppliers. If so, they must indicate this in the column for Article XVII GATS (to comply with Article III on transparency). If they do not, the same reporting requirement obtains. Assuming a government decides not to accord national treatment, and that it wants the relatively more onerous market access condition to be expressed in Article XVI GATS terms, it could choose one or more of the instruments mentioned in Article XVI.2 GATS. It should be noted that this construction of Article XVI GATS does not coincide with the understanding of Article XVI GATS by WTO panels and the Appellate Body.

Other provisions

Other GATS articles address matters such as domestic regulation, recognition of licences and certification of service suppliers, exceptions, policies pertaining to payment for services and the behaviour of public monopolies.

Article VI (Domestic Regulation) requires that members ensure that qualification requirements, technical standards and licensing procedures are based on objective and transparent criteria, are no more burdensome than necessary to ensure the quality of the services concerned, and do not constitute a restriction on supply in themselves. It requires countries to apply regulations in a 'reasonable, objective and impartial manner' to avoid undermining commitments to market access and national treatment. Moreover, countries must have in place appropriate legal procedures to review administrative decisions affecting trade in services. Article VI is among the potentially more important provisions in the GATS given that domestic regulations can have the effect of greatly impeding, if not foreclosing completely, the ability of foreign forms to contest a market. Indeed, given the absence of border-type barriers such as tariffs to restrict trade in services, often access to markets will be impeded, if at all, by domestic regulations. This is one reason why the GATS includes specific market access disciplines. Note, however, that these do not extend to domestic regulation more generally. Nor does Article VI envisage any harmonization of national regulatory policies.

A Working Party on Domestic Regulation is mandated to develop disciplines to ensure that licensing and qualification requirements and related standards are not unnecessary barriers to trade in services (the mandate is provided by Article VI:4). A precursor to this working party, the Working Party on Professional Services agreed in 1998 on a set of principles to ensure transparency of regulations pertaining to licensing of accountants and accountancy services. A noteworthy feature of these disciplines was specific language pertaining to a 'necessity test' for prevailing licensing-related requirements (i.e. a commitment to limit trade only to the extent necessary to achieve the regulatory objective). Article VI GATS gave the Working

Party the mandate to negotiate such disciplines, as it calls for the development of specific disciplines to ensure regulations are not more restrictive than necessary. The extension of a necessity test to domestic regulations on services has been a major source of concern for many NGOs and observers, who note that invariably it will be left to dispute settlement to determine whether the test has been violated.

Article VII (Recognition) promotes the establishment of procedures for (mutual) recognition of licences, educational diplomas and experience granted by a particular member. It permits a member to recognize standards of one or more members and not of others, without violating its GATS obligations—even though services and service suppliers of the former group will have better access to its markets than those of the latter group. The remaining paragraphs of Article VII seek to ensure that this freedom is not abused. Article VII:2 requires a member who enters into a mutual recognition agreement (MRA) to afford adequate opportunity to other interested members to negotiate their accession to such an agreement or to negotiate comparable ones. In this respect, Article VII mandates openness vis-à-vis third countries in a way that Article V, dealing with economic integration agreements, does not. Article VII:3 stipulates that a member must not grant recognition in a manner that would constitute a means of discrimination between countries. Members must inform the Council for Trade in Services about existing MRAs and of the opening of negotiations on any future ones. As of 2007, a total of 21 notifications were received under Article VII:4, of which ten from Latin American countries, four from the United States, three from Switzerland, and one each from the EU, Australia, Norway and Macau. All but one pertains to the recognition of educational degrees and professional qualifications obtained abroad.

Article XIV on exceptions is somewhat broader than what is found in the GATT, providing members with the legal cover to take measures to safeguard public morals, order, health, consumer protection and privacy.

Monopoly or oligopoly supply of services is allowed under the GATS, but governments are required to ensure that firms granted exclusive rights by governments do not abuse their market power to nullify any specific commitments relating to activities that fall outside the scope of their exclusive rights. Article IX recognizes that business practices of service suppliers that have not been granted monopoly or exclusive rights may restrain competition and thus trade in services, and requires that members consult with others on request with a view to eliminating such trade-restricting practices. However, no obligations are imposed regarding the scope and enforcement of competition policy rules—Article IX only requires the provision of nonconfidential information. Given the regulatory diversity prevailing across members in the area of competition policy, going beyond an information exchange obligation was not feasible (the issue of multilateral rules for competition law is discussed in Chapter 13).

Many GATS disciplines apply only to the extent specific commitments are made. This is a consequence of the 'positive list' approach to scheduling commitments.

For example, the balance-of-payments provision (Article XII) applies only for services where specific commitments have been undertaken. It requires that such measures be nondiscriminatory, temporary and phased out progressively as the invoking member's balance-of-payments situation improves. As in the GATT context, no recognition is expressed that import restrictions are second-best instruments to deal with balance-of-payments difficulties. Article XI requires members to refrain from applying restrictions on international transfers and payments for current transactions relating to their specific commitments—it also does not apply generally.

The WTO Dispute Settlement Body is responsible for disputes under GATS. Retaliation from goods to services and vice versa is possible if this is necessary (so-called cross-retaliation). Thus, if a country finds it needs to retaliate because of noncompliance with a panel recommendation and does not wish to restrict imports of goods, it may retaliate by not complying with some of its service commitments.

The GATS contains no provisions similar to Part IV of the GATT on special and differential treatment for developing countries or accepting the (unilateral) arrangements for tariff preferences that exist for merchandise trade flows (for example, the Generalized System of Preferences). However, Article XIX of the GATS permits developing countries to offer fewer specific commitments than industrialized nations in negotiations, and Article IV calls for special treatment of least developed countries.

The national treatment and market access obligations of the GATS do not extend to government procurement of services or to subsidy policies. The procurement carve-out greatly reduces the coverage of the GATS, as procurement typically represents a significant share of total demand for services such as accounting, consulting engineering and construction. Dealing with procurement and subsidies proved too complicated and Uruguay Round negotiators left these issues for future deliberations. Article X on industry-specific safeguard actions is also largely a shell, with the agreement again calling for continued negotiations on this topic. Discussions on all three subjects were held during 1997–2000, with little result. All three topics were on the agenda of the negotiations that were launched to extend the coverage of the GATS in early 2000.

The structure of specific commitments

As described previously, specific commitments on national treatment and market access apply only to service sectors listed by members, subject to whatever qualifications, conditions and limitations are maintained. As commitments are scheduled by mode of supply as well as by sector, these exceptions may apply either across all modes of supply or for a specific mode. Members also make horizontal

commitments that apply to modes of supply, rather than sectors. These are often restrictive in nature. A common example is an 'economic needs test'. Finally, members have the option of making additional commitments by listing actions to be taken that do not fall under national treatment or market access.

Table 7.5 illustrates the rather complicated structure of schedules of commitments. A member has three broad choices: it may schedule '*None*', meaning that it does not impose any limitation on a specific mode of supply for a sector; '*Unbound*,' implying it is essentially free to regulate as it deems appropriate; or it may introduce specific language to describe its commitment. According to the terminology used in the WTO's 2001 Scheduling Guidelines, the first category is known as *full commitment*; the second, *no commitment*; and the third, *commitment with limitations*. A consequence of the decisions to distinguish between general and specific obligations, to schedule specific commitments by mode of supply, and to allow for MFN exemptions is that very much depends on the content of the schedules. The GATS is not a particularly transparent or user-friendly instrument.

Virtually all commitments made in the Uruguay Round were of a binding nature, that is a promise not to become more restrictive than specified for each scheduled sector. Table 7.6 reports sectoral coverage indicators for national treatment and market access commitments for three groups of countries: high-income countries—OECD members, Hong Kong and Singapore; all other countries; and a subset of large developing countries. The latter comprises Argentina, Brazil, Chile, China, Colombia, India, Indonesia, Israel, Malaysia, Pakistan, Philippines, Poland, South Africa, Thailand and Venezuela. Three indicators are reported. First, an unweighted average ratio. This is the share of sectors where a commitment of some kind was made. Second, a weighted average ratio. This adjusts for whether qualifications and exceptions to national treatment and market access were made in each commitment. The weighting scheme used allocates a 0 to unbound commitments, a 1 to commitments not to impose any restrictions, and 0.5 to commitments where restrictions were maintained (see Hoekman, 1996, for details). Third, the share of sectors where commitments imply full free trade: that is, no exceptions or qualifications on national treatment or market access are scheduled. The higher the latter number, the more liberal the country. These ratios are conceptually similar to NTB frequency and coverage indices (see e.g. Nogues, Olechowski and Winters, 1986). Although imperfect, they do allow for rough comparisons to be made across countries.

Rich countries made commitments of some kind for 53.3 per cent of all services, as compared to 15.1 per cent for developing countries. Commitments made by large developing countries were substantially higher than the developing country average, accounting for 29.6 per cent of the total possible. Over one-quarter of developing countries scheduled less than 3 per cent of all services. The weighted average coverage of market access commitments—adjusting for whether exemptions are

Table 7.5. Format and example of a schedule of specific commitments

Commitment Type	Mode of Supply	Conditions and Limitations on Market Access	Conditions and Qualifications on National Treatment	Additional Commitments
Horizontal (applying to all sectors)	1. Cross-border	None	None	
	2. Consumption abroad	Unbound	Unbound	
	3. Commercial presence (FDI)	Maximum foreign equity is 49%	Approval required for equity stakes over 25%	
	4. Temporary entry of natural persons	Unbound except for intra-corporate transfer of senior staff	Unbound except for categories listed in the market access column	
Sector-specific	1. Cross-border	Commercial presence required	Unbound	
	2. Consumption abroad	None	None	
	3. Commercial presence (FDI)	25% of management to be nationals	Unbound	Independent telecom regulator
	4. Temporary entry of natural persons	Unbound, except as indicated in Horizontal commitments	Unbound, except as indicated in Horizontal commitments	

Notes: 'None' implies no exceptions are maintained—that is, a bound commitment not to apply any measures that are inconsistent with market access or national treatment. 'Unbound' implies no commitment of any kind has been made.

Table 7.6. Sectoral coverage of specific commitments in 1995 (%)

	High-Income Countries	All Other Countries	Large Developing Countries
Market access			
Weighted average	40.6	9.4	17.1
No restrictions	30.5	6.7	10.9
National treatment			
Weighted average	42.4	10.2	18.8
No restrictions	35.3	8.5	14.6
Memo: unweighted average	53.3	15.1	29.6

Source: Hoekman (1996).

listed and policies are bound—for the high-income group was 40.6 per cent; that for developing countries 9.4 per cent; and that for large developing countries 17.1 per cent. Commitments by high-income members implying no restrictions accounted for 30.5 per cent of the total. For developing countries as a group the figure was 6.7 per cent; for the large developing country group 10.9 per cent. Numbers for national treatment commitments were very similar. Clearly, GATS members were far from attaining free trade in services at the end of the Uruguay Round.

7.4. Sectoral Agreements

In the closing days of the Uruguay Round it became clear that it would be difficult to come to closure on a number of services sectors, including financial services, basic telecommunications, maritime transport, and one important mode of supply: movement of natural persons. (Air transport services are excluded from the ambit of the GATS altogether.) Rather than allow a situation to develop where countries would withdraw already tabled commitments in these areas or exempt them from the MFN obligation, it was agreed that negotiations in these sectors were to continue after the establishment of the WTO. Negotiations on financial services, basic telecommunications, natural persons and maritime transport were restarted in the spring of 1994. Those on financial services were to be concluded by July 1995, the others by mid-1996. The negotiations on financial and basic telecom services were eventually concluded successfully. The two others failed. As a result the GATS does not cover air and maritime transportation. It also essentially does

not cover audiovisual services, as this was excluded by many countries through an absence of scheduled commitments and/or MFN exceptions.

The Negotiating Group on Movement of Natural Persons was the first to conclude its work in July 1995. Twenty schedules of commitments resulting from the negotiations were annexed to the GATS, which entered into force one year later. These commitments did not go significantly beyond the status quo. The lack of progress on this issue was due in part to the departure of the Indian ambassador in late 1994, who had up to that point pursued an active linkage strategy, making progress on other service negotiations conditional on attaining concessions on the movement of natural persons. Negotiations on maritime transport services proved very difficult. A large number of countries, including the US, maintain cabotage restrictions—a prohibition on the use of non-national flag vessels to transport cargo within the national jurisdiction. Many developing countries also are signatories to the 1974 UNCTAD Code of Conduct for Liner Conferences, which allows a share of up to 40 per cent of international liner cargoes to be reserved for national carriers. As no progress could be made to liberalize trade in this sector, the negotiating group suspended talks at the end of June 1996.

Financial services

Financial services were of great importance to the US, reflecting the strength of the US lobbies that sought improved access to foreign markets. As a result the US was unwilling to accept commitments that it regarded as inadequate. At the very end of the Uruguay Round, it was agreed to extend talks on financial services by 18 months, with a deadline of end June 1995. Although the US invoked MFN exemptions for this sector, it was understood these would not be applied until negotiations were concluded. As the 1995 deadline approached, the US indicated that it considered the offers of Japan and several southeast Asian and Latin American countries to be inadequate and that it would invoke its MFN exemptions. In an effort to salvage as much as possible from the negotiations, the EU then proposed that all other participants maintain their offers through the end of 1997. Negotiations resumed in 1997 and were finally concluded successfully in December of that year—with the US participating (and thus removing its MFN exemptions for this sector). A total of 56 schedules representing 70 members were annexed to the GATS (Mattoo, 2000*b*).

Despite the fact that an increasing number of developing countries recognized that a competitive and efficient financial services sector was a condition *sine qua non* for economic development, and that opening markets to foreign financial firms can strengthen domestic financial systems by creating more competitive and efficient host-country markets, agreement proved elusive. One problem concerned fears of the implications of liberalization for weak domestic financial institutions,

and a perceived absence of reciprocity given that many developing countries are importers and not exporters of financial services. Another concern revolved around the implications of GATS rules for management of capital flows and prudential regulation and supervision.

The latter problems were addressed by agreeing that liberalization of capital movements per se is beyond the purview of the GATS, although members are restricted from imposing capital controls that interfere with their specific commitments (except if justified for balance-of-payments reasons). More difficult was where to draw the line as regards the types of regulation that are permitted (policies aimed at increasing the strength and quality of prudential regulation and supervision) and those that should be abolished (policies that act as barriers to trade in financial services) (Key, 2003). An Annex on Financial Services contains a so-called prudential carve-out for domestic regulation of financial services. Included at the insistence of financial regulators, the carve-out allows prudential measures to be imposed to protect consumers of financial services and to ensure the integrity and stability of the financial system. It is unclear what the additionality is of the carve-out, as GATS Article VI essentially provides cover for such regulatory intervention as well.

Most commitments made by WTO members were status quo or less than status quo commitments. However, ten countries used the GATS as a mechanism to pre-commit to future liberalization (Mattoo, 2000*b*), four of which were countries that were seeking to accede to the EU. Most of the others represented relatively large markets—including Brazil, India, Indonesia and the Philippines. Governments of these countries were under substantial pressure to open access to their markets.

Basic telecommunications

Telecommunications services were split between basic and value-added services during the Uruguay Round. By the end of the round, only commitments had been made for value-added services (such as electronic and voice mail or electronic data interchange), and not for basic voice, data transmission, mobile telephony or satellite services. Negotiations on basic telecommunications recommenced in May 1994 with a deadline of 30 April 1996. In the run-up to the deadline, negotiations were deadlocked. As in the financial services talks, the US was of the view that offers on the table were inadequate, in part because the required 'critical mass' of membership (to prevent free riding) had not been achieved. In April the US withdrew its offer of open satellite market access and the negotiations collapsed. Other negotiators regarded the US move as serving narrow, domestic political differences.

In contrast to what happened in the financial services negotiations, the EU or another party to the talks did not take the initiative to extend discussions. Instead,

such an initiative was taken by the Director-General of the WTO, who induced the major players to extend the deadline to February 1997. This was accepted, and negotiations were finally concluded successfully in February 1997, with 55 schedules (representing 69 members) annexed to the GATS. The additional time allowed a number of developing countries to improve their offer—with technical assistance from a group of bilateral donors and multilateral organizations. It also allowed the major players to hammer out difficulties related to differences in prevailing market structures. One such problem concerned international resale of switched telecom services. Because the US is an open competitive market, calls switched through the US by foreign carriers cost relatively little, whereas US carriers were forced to pay much higher fees because many foreign markets were not open. An August 1997 US decision to move to cost-based settlement rates for such payments removed this constraint.

The basic telecommunications agreement is noteworthy in the extent to which countries made commitments to engage in future liberalization. Technological developments—the internet, e-commerce—played an important role in the changing attitude towards increasing competition in the telecom sector. Many developing countries used the GATS as a pre-commitment device—they bound themselves to introduce competition in basic telecoms at precise future dates (Table 7.7). This reflected a recognition that liberalization was in their interest, but should be pursued gradually. Committing to do so a fixed date in the future enhances the credibility of the policy, thus encouraging incumbents to prepare for greater competition as opposed to investing resources in lobbying against implementation of the reform. More generally, the pre-commitment strategy was also seen by many of the governments concerned as an important signalling device towards the international investment community and prospective foreign investors. It is noteworthy that in this area there was no shortage of countries willing to make (pre-)commitments, in contrast to the usual reluctance on the part of many developing countries to use the GATT/WTO as an instrument to lock in policy commitments.

The Reference Paper

A key feature of the agreement that emerged was a 'Reference Paper' setting out regulatory principles to which signatories may subscribe. Technically, this involved making so-called additional commitments in the schedules of participating countries, as allowed by Article XVIII GATS. Some 60 members did so. The need for these principles—which draw on elements of the 1996 US Telecommunications Act—arose from a concern that dominant telecom operators might otherwise abuse their market position and restrict competition from new entrants through their control of so-called bottleneck or essential facilities. This could be because

Table 7.7. Examples of pre-commitments in basic telecommunications

Country	Commitment
Antigua & Barbuda	International voice telephony to be opened as of 2012
Argentina	No restrictions as of 8 November 2000
Bolivia	Restrictions on long distance national and international telecom services removed as of 27 November 2001
Grenada	Exclusive supply until 2006, no restrictions thereafter
Jamaica	Exclusive supply until September 2013, no restrictions thereafter
Trinidad & Tobago	Exclusive supply until 2010, no restrictions thereafter (fixed satellite services open as of 2000)
Venezuela	No restrictions as of 27 November 2000
Cote d'Ivoire	Monopoly until 2005, no restrictions thereafter
Mauritius	Monopoly until 2004, no restrictions thereafter
Morocco	Monopoly until 2001, no restrictions thereafter
Senegal	Abolition of monopoly by 1 January 2007
South Africa	Monopoly until December 2003, thereafter duopoly and consideration of more licences
Tunisia	No restrictions on supply of local calls after 2003
Pakistan	Cross-border supply of voice telephony open by 2004, divestiture of 26% of national monopoly to a strategic investor with exclusive licence for basic telephony for seven years
Thailand	Additional commitments for voice telephone and other services to be made in 2006, conditional upon passage of new legislation

Source: Adapted from Mattoo (2000*a*).

this sector has for a long time been monopolized, and despite efforts to break up these monopolies, control over key infrastructural facilities will not immediately be diversified. Or it could be that large fixed costs and economies of scale render some markets inherently incontestable, i.e. given the minimum efficient scale of operation, the market is simply not large enough to accommodate more than one or two suppliers.

The Reference Paper is wider in scope than Article VIII GATS and its domain more clearly defined than the Basic Telecom Annex. It calls for the establishment of an independent regulator for telecoms. Its disciplines apply to any 'major supplier', defined as one who 'has the ability to materially affect the terms of participation (having regard to price and supply) in the relevant market for basic telecommunications services as a result of: (a) control over essential facilities; or (b) use of its position in the market'. Notably, the conditions to qualify as a 'major supplier', and therefore to be subject to the disciplines in the Reference Paper, do not include government responsibility for its existence, unlike in the case of Article VIII monopolies.

The Reference Paper also goes beyond GATS provisions by requiring interconnection on nondiscriminatory, transparent and reasonable terms, conditions

(including technical standards and specifications); of a quality no less favourable than that provided to other suppliers, including its own; priced at cost-oriented rates; in a timely fashion; sufficiently unbundled so that a supplier need not pay for network components or facilities it does not require; at any technically feasible point in the network. Competition safeguards oblige members to prevent a major supplier from abusing control over information, or engaging in anticompetitive cross-subsidization.

The Reference Paper is characteristic of the 'WTO approach' in that the primary concern is to ensure effective market access. Wider concerns about consumer interests and how they may be affected by monopolistic behaviour are not addressed, nor is any focal point provided for regulators regarding the need for and modalities of regulation or competition law. Although the paper was a 'standardized text', some countries customized it in their schedules. Many of the terms and disciplines imposed by the paper are not very specific. What the meaning is of 'anticompetitive', 'cost-oriented', 'independence', etc., is not defined precisely—implying that this is something that will be left to case law.

A start down this path was initiated in 2002 with a dispute between Mexico and US (*Mexico—Measures Affecting Telecommunications Services*). The dispute revolved around claims by the US that the Mexican government was not abiding by its commitments under the Reference Paper, in particular the requirement that dominant operators provide (and price) international interconnection services on the basis of cost. The US also claimed that Telmex had established a de facto cartel comprising itself and a 'competitive fringe' that resulted in restricting access of foreign (US) suppliers. The panel concluded that the international settlement rates charged by Telmex to US telecommunications service suppliers were not cost-based and that Mexico did not provide access to and use of public telecommunications transport networks and services (a violation of Sections 5a and b of the Annex on Telecommunications).[4] Mexico was called upon to remove specific restrictions on the commercial negotiation of international settlement rates and shift towards pricing on the basis of long-run average incremental cost. The panel also found that Mexico failed to abide by Section 1.1 of the Reference Paper, which requires signatories to maintain appropriate measures to prevent anticompetitive practices. However, it concluded that Mexico should be permitted to impose restrictions on the resale of international services from Mexico to other countries.

[4] *Mexico—Measures Affecting Telecommunications Services*, Report of the Panel, 2 April 2004, WT/DS204/R. For international phone calls to take place, a telecom carrier must be able to connect into the destination country's telecommunications network. This generally either involves a payment to an operator in the destination country for completing the call, or by leasing capacity (lines) in the destination country and routing calls over those lines. The latter is called 'international simple resale'. The latter was also at issue in this case as the US opposed restrictions that were imposed by Mexico on such resale.

This case was the first 'pure' GATS case in that reference was only made to GATS provisions. It also was the first to address a clear competition issue and to require a WTO member to change its domestic law regulating a service sector. Perhaps most noteworthy is that the panel did not limit itself to the international dimension of telecom regulation in Mexico (international settlement rates) but extended its finding to domestic interconnection regulation. Moreover, the case illustrates that although the panel based much of its reasoning on competition policy principles and arguments, at the end of the day the focus was almost exclusively on market access. Sidak and Singer (2004) argue compellingly that from a welfare (consumer) viewpoint, the types of concerns used by the panel to motivate its decision are more appropriately addressed by the two country's competition authorities, and that the panel used the wrong definition of the relevant market.

The panel to some extent 'wrote law' by interpreting the meaning of anticompetitive practices as including horizontal price-fixing and market-sharing agreements—on the basis that these tend to be per se illegal under most competition laws. This is nowhere specified in the GATS, the Annex on Telecoms or the Reference Paper (the latter only mentions a list of anticompetitive practices, including cross-subsidization). Whether one agrees or not that the panel should have interpreted this language, it is noteworthy that the practices that were deemed anticompetitive were mandated by government regulation (law).[5]

7.5. Expanding the GATS: From Uruguay to Doha

The GATS has been characterized by almost continuous negotiations and deliberations in committees and working parties focused on expansion of the coverage of the agreement. The post-Uruguay Round sectoral negotiations discussed above are an example, as were efforts to agree on more specific disciplines on domestic regulation under Article VI GATS. As of the second half of the 1990s onward, most of the focus was on unfinished business from the Uruguay Round in

[5] In June 2004, the US and Mexico reached an agreement that implements the panel recommendations. The main features of the agreement notified to the WTO Dispute Settlement Body were that Mexico will remove the provisions of the law relating to the proportional return system, uniform tariff system, and the requirement that the carrier with the greatest proportion of outgoing traffic to a country negotiate the settlement rate on behalf of all Mexican carriers for that country. It will also allow the introduction of resale-based international telecommunications services in Mexico by 2005, in a manner consistent with Mexican law. The United States recognized that Mexico will continue to restrict International Simple Resale (use of leased lines to carry cross-border calls) to prevent the unauthorized carriage of telecommunications traffic.

the area of rules, and an effort to expand the specific commitments in the Doha Round.

Emergency safeguards, subsides and procurement

A number of 'outstanding' rule-making issues were left open after the Uruguay Round for further work and discussion. Thus, the GATS has no rules on subsidies, does not cover public procurement and has no emergency safeguard mechanism. A Working Party on GATS Rules was tasked with negotiating disciplines in these areas. After more than ten years of discussions, agreement on such disciplines remains to be obtained. This may appear rather surprising, considering that subsidies are widely used by governments for a variety of reasons; that public purchases of services can account for 5 per cent of GDP or more; and that governments invariably insist on the inclusion of emergency safeguards in any trade agreement they negotiate. In our view the explanation for the persistence of these lacunae is that the economic case for GATS-specific disciplines in any of these areas is weak.

There is nothing services-specific about procurement: in principle any multilateral disciplines should cover goods and services—as is the case under the plurilateral Agreement on Government Procurement (see Chapter 11). Of primary importance for foreign firms is to have access to procurement markets, and frequently this can only be achieved if they can establish a commercial presence in a country. If the sectoral coverage of the GATS is expanded and foreign providers are able to access markets, the contestability of procurement markets will be enhanced at the same time (Evenett and Hoekman, 2005).

In the services context any disciplines on subsidies will have to focus primarily on domestic production or operating subsidies—the distinction between export and production subsidies found in the GATT is much harder, if not impossible, to make in practice. It is also much harder to envisage emulation of the main GATT discipline—countervailing duties. This implies a need to agree to substantive rules (harmonization) if members want to discipline the use of subsidies, including tax incentives. Difficulties will immediately arise in defining and distinguishing between what is 'legitimate' and what is not. Although there are clearly potential sources of gain for WTO members associated with a set of subsidy disciplines (insofar as subsidies impose negative external effects), subsidies will frequently be the most efficient instrument to pursue specific objectives or to address market failures. Examples could be to ensure universal access to services, promote regional development, or to redistribute income. Cross-subsidies may also sometimes be an appropriate second-best instrument for developing country governments (Laffont and N'Gbo, 2000).

The negotiating history and experience under the GATT-1947 illustrates that agreement on subsidy-related disciplines is difficult to obtain, and that any

disciplines may easily be circumvented. Even the EU—which goes much further than the WTO in this area—has encountered recurrent difficulties in enforcing restrictions on the use of state aids. The North American Free Trade Agreement does not even try to tackle this issue. Given there is a rationale for subsidies in many contexts and the revealed preference of many governments to use subsidies, it would appear more effective to seek to extend the reach of the national treatment principle to subsidy policies. Given national treatment, there should be less concern about the impact of subsidy policies, allowing the principle of 'subsidy freedom' to prevail. As in the procurement case, what matters most is market access and national treatment and the current structure of the GATS is geared precisely towards those commitments.

The economic case for an ESM is also weak. One reason for this is again the structure of the GATS. The positive list approach to scheduling commitments allows governments to maintain a variety of discriminatory or market access restricting measures. In addition, the ability (right) to regulate also ensures that governments retain the capacity to intervene to achieve social objectives. Both factors attenuate the need for safeguards. Moreover, insofar as governments do make commitments and come under pressure to re-impose protection (discrimination), they may invoke the re-negotiation modalities that are built into the GATS.

More specifically, a GATT-type ESM is difficult to rationalize (and design) in the services context because of the various modes of supply that can be used for service providers. Given that mode 3 will often be used, a safeguard would require taking action against foreign firms that have established a commercial presence. Why a government would want to do this is unclear, as it is likely to have a major chilling effect on FDI, and, as important from a political economy perspective, will affect negatively the national employees of the targeted foreign-owned firms. These considerations suggest that if a safeguard measure was to be considered, it would most likely exempt mode 3. A consequence could then be to make an ESM a tool to distort the choice of mode of supply (i.e. an instrument of industrial policy): it could create incentives to choose FDI as a mode of supply even if other modes are more efficient (leading away from the principle or objective of modal neutrality).

There is, however, one potentially compelling argument for seeking to develop an emergency safeguard mechanism. A case could be made that the extremely limited nature of liberalization commitments to date on movement of natural persons (mode 4) is in part due to the nonexistence of safeguard instruments. As this is a mode of supply that is of major interest to developing countries and one on which almost all countries maintain stringent restrictions, one could envisage a safeguard instrument that is linked to mode 4 liberalization commitments. The rationale would be to provide liberalizing governments with an insurance mechanism that can be invoked if there are unexpected detrimental impacts on their societies.

Article XIX GATS negotiations and the Doha Round

Article XIX GATS required members to launch new negotiations on services no later than 2000, and periodically thereafter. Initial talks were launched in 2000, and later became part of the 2001 Doha Development Agenda. Much of the pre-Doha talks centred on sector-specific questions, including the need to add new sectors not defined in the GATS classification list, such as energy services, and on an assessment of trade in services. Developing countries were insistent that members abide by Article XIX:3, which states that in establishing the negotiating guidelines and procedures, the Council on Trade in Services is to carry out an assessment of trade in services in overall terms and on a sectoral basis with reference to the objectives of the agreement, including those set out in Article IV:1 (on increasing participation of developing countries in world trade through specific, negotiated commitments). One dimension of this pertained to obtaining credit for autonomous liberalization Many governments had undertaken autonomous reforms and did not want the status quo set of policies to be the baseline for new negotiations—they wanted to have 'credit' for what they had already done. Specific proposals were also put forward on GATS rules. As of the launch of Doha, some 70 proposals on approaches, issues and sectors by more than 40 members had already been tabled.

In March 2001, a set of modalities and guidelines for market access negotiations was agreed. These specified that negotiations would proceed on the basis of requests and offers. The Doha declaration built on this, stating that:

> The negotiations on trade in services shall be conducted with a view to promoting the economic growth of all trading partners and the development of developing and least-developed countries. We recognize the work already undertaken in the negotiations, initiated in January 2000...and the large number of proposals submitted...We reaffirm the Guidelines and Procedures for the Negotiations adopted by the Council for Trade in Services... as the basis for continuing the negotiations, with a view to achieving the objectives of the GATS... Participants shall submit initial requests for specific commitments by 30 June 2002 and initial offers by 31 March 2003. (para. 15)

The negotiations were conducted in Special Sessions of the Council for Trade in Services. The 2002 and 2003 deadlines for initial requests and offers laid out in the Doha declaration were missed, as were virtually all subsequent deadlines, reflecting not only the difficulties specific to the services talks but also, as, if not more, importantly, the lack of progress on agriculture and NAMA. Independent of the need for cross-issue linkages, many developing countries resisted making additional commitments on services unless there was a significant quid pro quo within services, in particular better access for mode 4. There was also active opposition to the services talks by a number of NGOs of various stripes, some of which opposed liberalization generally, with many especially concerned with access to health, water and educational services and worried that commitments in these areas would result

in inequitable outcomes. Although many high-income countries argued that these concerns were misplaced, given that nothing in the GATS constrains the right of governments to regulate sectors, they did not do enough to address them in a credible manner—e.g. by explicitly linking GATS commitments to the need to put in place appropriate regulation and assist partner countries to improve their regulatory enforcement capacity. A major factor underlying the lack of progress in negotiations was the marked absence of OECD services industries seeking better access to export markets.

Between 2000 and the end of 2005, WTO members pursued a bilateral approach to negotiations, submitting requests to others and making (conditional) offers. Requests tended to be highly ambitious and offers mostly minimalist, especially if compared to actual, applied policies. Adlung and Roy (2005) compared the offers as of 2005 with then existing specific commitments of WTO members. For many countries the coverage of specific commitments was well below 50 per cent of all services and modes of supply. Adlung and Roy conclude that not only did the requests and offers made in the six years following the launch of negotiations imply little if any liberalization of policies; but also most countries were not even willing to use the GATS as a vehicle to 'lock in' existing levels of openness. A number of studies have shown that there is often a major gap between the actual level of openness of sectors and the level of commitments in the GATS. For example, Barth, Caprio and Levine (2006) compare data on specific GATS commitments for financial services with measures of actual policy in this sector for 123 countries. They conclude that, in practice, applied policy is much more liberal than what was committed to in the GATS.

Political economy factors

Why so little movement? Is there a fundamental problem that is specific to services/ GATS? Although the services agenda is more complex than the goods trade, it has been more than ten years since the GATS entered into force, and policymakers have been dealing with services in a trade-negotiating context now for over 20 years. Thus, complexity—although a factor (see e.g. Adlung, 2006)—can only be part of the explanation. A key factor in our view was that there was simply too little private sector engagement and lobbying in support of the GATS process to overcome resistance from those that perceive GATS commitments as being (potentially) costly.

One reason for this may be that markets had already become much more open. The boom in trade in services summarized earlier in this chapter was driven in part by policy reforms and decisions by governments around the world to relax restrictions on foreign provision of services, including through FDI. These reforms

in conjunction with booming world trade and investment in services clearly will reduce the incentives of firms to invest resources in supporting multilateral efforts to further open markets—times were good. This is not to say there were no incentives left—both the negotiating requests and the literature on services clearly document that significant barriers to trade and investment continue to prevail. But on the margin it appears to have been the case that services exporters did not perceive there to be a high enough return to actively supporting the Doha talks. One factor underlying this perception may have been the more high-profile opposition to services commitments of NGOs (discussed below). Another may be the incentive effects identified by Blanchard (2007) for mode 3 that were discussed above.

In the case of developing countries—the majority of the WTO membership—most are small and therefore not of great interest to the large players in the WTO, constraining their prospects of negotiating significant additional access to major markets. Moreover, many developing countries are not, or do not, perceive themselves to be (potential) services exporters. Although many poor countries are significant exporters of services, in that services generate a substantial share of their total foreign exchange earnings, often this is derived from activities where the relevant policies are under the control of the exporting government itself, not its trading partner. The most important such service is tourism, where the export revenue generated depends primarily on measures that the tourism destination country puts in place itself.

As far as mode 1 services trade is concerned, developing countries are exporters, but this is often not constrained at all, with the exception of services such as gambling where importing countries may reserve the activity to the state or ban it altogether. But most of the business process outsourcing, call centres, etc. that are growth areas for many countries are not constrained by trade policy measures in the destination or importing country. Although there is certainly increasing opposition against such trade in high-income countries, outside of government contracts there is little that is currently done to restrict such activities from being 'offshored'. Turning to mode 3, most developing countries do not have significant 'offensive' interests, in contrast to high-income economies.

The one mode that is of great relevance to potential exporters from developing countries is mode 4. Figure 7.5 presents data drawn from Gootiz and Mattoo (2008), which shows that all countries impose high barriers to mode 4 trade. It is unlikely however that much can be achieved on mode 4 access to high-income country markets, especially for less skilled services activities. In the case of the EU, for example, the initial offers made during the Doha Round were most limited in the areas that were of greatest interest to developing countries—in particular mode 4, but also mode 1 (see Table 7.8). In part this is a reflection of the difficulties EU members have in liberalizing these modes within the EU context (Hoekman, Mattoo and Sapir, 2007), which reflect regulatory policies and not the absence of

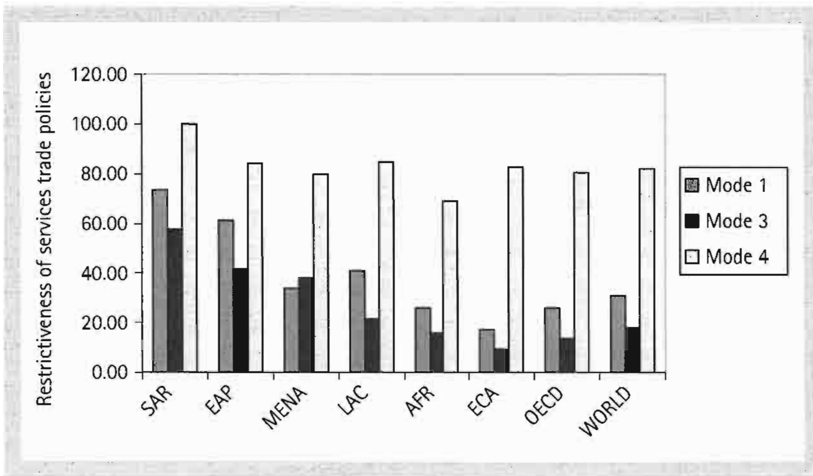

Fig. 7.5. Services trade restrictiveness indices by mode

Source: Gootiz and Mattoo (2008).

national treatment. Mode 4 is very politically sensitive and in practice, insofar as importing countries are willing to consider relaxing barriers, experience suggests they will do so only on a bilateral basis in a bilateral setting. The lack of serious prospects for mode 4 liberalization in the GATS framework effectively removes many potential export interests in many poor developing countries from the process.

A related factor that may help explain the very limited progress that has been made to date is that the GATS has a strong sectoral focus. Its coverage is determined by a positive list, with governments scheduling commitments on a sector-by-sector basis. Given that most countries will not be significant (potential) net exporters in most sectors, reciprocity requires that countries find the required

Table 7.8. EU-15 commitment index in services (per cent)

Mode of Supply	Pre-Doha (1994)	April 2003 Offer	Difference (% Points)
Mode 1	50.5	57.2	6.7
Mode 2	66.9	88.2	21.3
Mode 3	63.0	82.9	19.9
Mode 4	3.5	4.5	1.0
Total	46.0	58.2	12.2

balanced of concessions across different services sectors, or, if countries do not have strong export interests in any services, in other WTO areas. Even if one abstracts from the latter set of countries, crafting a series of bilateral deals on services among the subset of countries with services interests may be difficult.

The forgoing implies that a key dimension of the reciprocity mechanism—services exporters—may be much weaker in many WTO members than is true for goods. The exception are large service firms that are based in high-income and emerging market economies, which have clear interests in selling more services to each other. The result is a rather unbalanced picture as far as export interests are concerned—in effect, if exchanges of 'concessions' are to be restricted within the services arena, it would have to be an intra-OECD/large emerging markets affair.

Regulatory considerations and concerns

If pro-liberalization forces are relatively weak, certainly compared to the Uruguay Round, resistance to enhancing the GATS became stronger over time. Opposition came from two groups. The first is familiar from the goods context: import-competing firms/incumbents, workers, unions—those who stand to lose from liberalization. Second, distinct from the goods context, sectoral regulators may resist international cooperation on regulatory measures that is anchored in a binding trade agreement or is motivated by trade concerns.

In both OECD and developing countries there are incumbent firms and workers with firm-specific skills that may lose from liberalization. The offers that have been tabled in the Doha Round reveal that OECD countries are most willing to make concessions in modes 2 and 3, where the levels of commitment were already fairly substantial prior to Doha. The markets of all of the more advanced industrialized economies tend to be relatively open, helping to explain the fact that these countries account for some 75 per cent of global trade in services—both cross-border and FATS. Although there is political resistance to mode 1 trade driven by worries about the employment impacts of offshoring and greater use of business process outsourcing to locations in developing countries, policies that restrict such trade are primarily regulatory in nature, and not affected by the WTO talks. The mode that is most affected by outright barriers, mode 4, and that is of great interest to many developing countries, is the mode OECD countries are least willing to open.

Resistance to liberalization in developing countries varies across sectors and modes (Hoekman, Mattoo and Sapir, 2007; Gootiz and Mattoo, 2008). Differences in policy stance across sectors are driven by the differential impacts of technology and the legacy of past structures. In telecommunications, many countries have exploited new technological possibilities by directly introducing competition,

especially in mobile communications. Adjustments by public sector incumbents were facilitated by the fact that telecom markets have been growing rapidly, with overall sectoral employment expanding. Other technology-dependent sectors such as IT-enabled business services never confronted pressure for protection of the domestic market—there were no incumbents. In other sectors where restrictions continue to prevail this is often driven by the legacies of past policies that limit the ability of domestic firms to confront competition. For example, in countries dominated by public sector banks with excessive staffing levels and weak balance sheets as a result of directed lending at nonmarket rates, large displacements will result from full liberalization. Adjustment and employment concerns therefore may be an important factor impeding liberalization.

The intangible nature of most services makes it hard for buyers of services to investigate or test their quality prior to purchase. The extent of asymmetric information often creates a necessity to regulate services in order to protect consumers. Regulating services may also be desirable in order to remedy other types of market failures, including imperfect competition, which is often present in network services such as telecommunications where the number of providers is limited. Externalities may cause a problem if there is also imperfect information—e.g. in the case of financial services, where the failure of one institution may cause problems to the entire sector. For all these reasons, activities tend to be highly regulated.

Although consumers should, in principle, favour reforms that increase the number of suppliers and, in principle, lower prices and/or increase the range of services offered, they may in fact oppose them for fear that reforms will lower service quality and/or increase the market power of (foreign) firms. Regulators may be concerned that trade liberalization will impede their ability to enforce domestic regulatory standards. Trade will bring with it regulatory competition if services suppliers are only subject to the norms and standards that apply in their home markets. A case in point was the dispute between Antigua and Barbuda and the US on gambling services. Thus, if trade is permitted to occur on the basis of the qualifications and certifications obtained in the home country of providers, there may be concerns regarding whether host country norms are met.

The scope for traditional reciprocity-driven negotiations in services is inherently more limited than for goods because of concerns relating to regulatory autonomy. The prevalence of regulation complicates and constrains use of the reciprocity mechanism for services because it is very difficult to design multilateral rules and national commitments in a way that clearly separates or distinguishes between measures that are protectionist and measures that have a good domestic efficiency or social equity rationale. A critical challenge then is how to differentiate between legitimate concerns relating to quality and performance, and regulatory requirements that simply constitute barriers to entry, creating rents for incumbents by raising prices. Marginal 'quid pro quo' changes to domestic regulatory policies

may not enhance welfare—indeed, they could easily lower it. Regulators may therefore be concerned that market access negotiating dynamics could adversely affect their ability to design and implement regulatory norms that maximize national welfare.

An additional regulation-related complicating factor is that successful liberalization in developing countries will often require substantial strengthening of domestic regulatory institutions and related infrastructure. The impacts of more competitive market structures following liberalization on access to services by poorer households in developing countries have been mixed. In cases like mobile telecommunications, a positive relationship has been observed in many developing countries because initial conditions were bad—few households had access. However, in other areas, like financial services, unless improved regulatory measures are put in place, liberalization may have an adverse effect on access to credit for rural areas and the poor (Mattoo and Payton, 2007). Putting in place mechanisms to ensure better access to services post-liberalization is important from an equity perspective. It is also important from a political economy perspective to bolster support for implementing efficiency-enhancing policy reforms and sustaining them over time. Absent actions to address regulatory weaknesses, countries may not be in a position to fully realize the potential benefits of trade reforms in services (*or* goods) (Hoekman and Mattoo, 2007).

A shift in approach: the 2005 Hong Kong ministerial

The December 2005 WTO ministerial meeting in Hong Kong appeared to recognize that the status quo approach, bilateral request–offer negotiations, was not generating the desired results. Annex C of the Hong Kong Ministerial Declaration endorsed a shift towards plurilateral or collective negotiations among subsets of members. The idea was to limit talks to a critical mass of countries, so as to reduce transactions costs while still ensuring that most of the gains from agreement would be internalized among those participating. The pursuit of what Schelling (1978) has called a '*k*-group strategy'—the minimum number of countries ('*K*') out of a larger set ('*N*') that internalizes enough of the total potential gains from cooperation to make free riding by the remaining *N-K* players feasible—is easier to implement in the WTO setting for services than it is for goods trade because of the way the GATS is structured. Article XIX GATS mentions plurilateral negotiations as modality that could be used by members. The positive list approach to define the country coverage of specific commitments on a sector-by-sector basis already requires that negotiations be sectoral.

The decision to move to negotiations among subsets of countries and focus on agreeing to a set of 'minimum standards' for liberalizing commitments—thus shifting the burden on a member to justify its refusal to concede the threshold

level rather than on other members to extract the minimum concessions—implied a move away from first difference reciprocity. Instead, the focus becomes achieving a common set of policies that apply to all signatories, while allowing for de facto differentiation between WTO members in terms of participation. Countries that have little to offer for a specific sector or mode are effectively exempted from participation—they can free ride on the outcome of negotiations between the principal stakeholders.

Plurilateral talks were pursued among some 30–40 countries, basically OECD members and the larger developing economies, starting in early 2006.[6] Requests were tabled for legal; architecture/engineering; computer-related; postal/courier; telecommunications; audiovisual; construction; distribution; education; environmental; financial; maritime; air transport; and energy services; as well as cross-border trade; mode 3; mode 4; and MFN exemptions. Requests were generally less ambitious than those made in the earlier bilateral request–offer process, which often called for full market access and national treatment in sectors of export interest to the *demandeur*. Although progress was made as a result of the shift in negotiating modalities, the inability to move forward on agriculture and nonagricultural market access dominated the efforts of negotiators. This shift illustrated the more general trend towards limiting negotiations to a critical mass of countries.

Although WTO members clearly recognized a change in tack was needed to deal with the problem of asymmetric interests, the shift towards small(er) group negotiations does not address the regulatory constraints identified above: worries about regulatory autonomy (which apply as much to the large players involved in the plurilateral talks as to the countries that are permitted to free ride) and limitations in the capacity of poor countries to put in place and enforce regulatory measures to complement liberalization. Indeed, by effectively excluding the majority of the WTO membership from negotiations, the plurilateral approach creates a new problem: exempted countries may not be confronted with a need to liberalize, but they also are excluded from the potential gains associated with undertaking domestic policy reforms themselves. Moreover, insofar as such reforms are needed to exploit export opportunities, they may also lose out on that front. The first problem can be resolved through explicit measures that guarantee to regulators that their autonomy will not be constrained by the GATS. Mattoo (2005) argues that making national treatment the primary objective of negotiations would do much to provide such assurances. The second problem requires actions to assist developing countries to improve domestic regulatory capacities. Despite increasing recognition among WTO members that more

[6] As noted in earlier chapters, past practice suggests that for sectoral liberalization agreements to be applied on a MFN basis the 'internalization' ratio needs to be on the order of 90 per cent of total trade. This was the focal point used in the negotiations on the Information Technology Agreement (see Chapter 6).

needs to be done to provide assistance to developing countries to bolster trade capacity—exemplified by the creation in Hong Kong of an 'Aid for Trade' taskforce—to date services have not attracted much attention in aid for trade deliberations.

7.6 Future Challenges

Whatever the outcome of the Doha Round talks, experience to date suggests that WTO members confront a number of challenges relating to both the architecture of the GATS and the balance of benefits and costs associated with GATS membership.

National treatment and market access. On the architectural front, a priority area for action is to clarify the relationship between national treatment and market access obligations. As argued previously, there is overlap between the two disciplines—some (many) market access limitations are discriminatory, and thus would also violate national treatment. It would have been far clearer to make national treatment the primary discipline covering all forms of *de jure* and *de facto* discrimination (Hoekman and Mattoo, 2007). Arguably the bulk of empirically important restrictions today are discriminatory measures. Nondiscriminatory measures are less of an economic problem and likely to be more of a political issue—because multilateral disciplines in this area are more likely to be seen as intrusive.

Sectoral coverage. Important sectors including maritime transport, air transport services and audiovisual services have all been excluded from key GATS disciplines. Although interests in the latter tend to be highly concentrated and countries have a variety of noneconomic objectives that may motivate restrictive policies, exclusion of the transport sectors significantly reduces the relevance of the GATS. In addition the limited use that has been made to date by members to lock in applied policies also limits the relevance of the agreement.

Domestic regulation. A major question confronting members is whether it is desirable to develop horizontal disciplines for domestic regulations, and, if so, whether it is feasible. Although it is certainly the case that domestic regulation can be a major trade barrier, it is not clear to us that seeking to agree on disciplines on nondiscriminatory regulation is a particularly useful endeavour. Going further down the path of defining criteria for a 'necessity test' approach—putting the burden of proof on governments to show that a particular regulation which has detrimental effects on foreign providers is necessary to achieve an objective—will be difficult to apply in the WTO. The much weaker integration ambitions that

prevail among WTO members and the absence of supranational enforcement can easily lead to disputes regarding what is 'necessary' and put an excessive burden on the dispute settlement system. Attention might more productively focus on expanding the reach of the national treatment principle, abolishing MFN exemptions, and ensuring that MFN applies in the area of standards and mutual recognition. Given the limited reach of existing national treatment commitments and prevalence of discriminatory policies, a focus on national treatment is both less intrusive and conceptually much more straightforward than seeking to move further into the domain of domestic regulation. This is not to deny that there is not potentially a high rate of return on efforts to agree on common norms on a sectoral basis—but this may be better done outside the WTO by specialized bodies that bring together the competent regulators and decision-makers. We return to the broader question of where to draw the boundaries of the WTO in the penultimate chapter.

Aid for trade. The focus of the WTO is on market access. Policy advice and assistance for regulatory reform and public investments in services infrastructure are provided by international financial institutions and specialized agencies. There is virtually no link between the two processes. This disconnect persists even though improved regulation—ranging from prudential regulation in financial services to pro-competitive regulation in a variety of network-based services—will be critical to realizing the benefits of services liberalization in many sectors. Policy intervention will also be necessary to ensure universal service because liberalization by itself may not improve access for the poor. There may be good reasons to defer liberalization and/or not to make binding commitments if there are weaknesses in prudential or pro-competitive regulation, or if adjustment costs are likely to be severe and affect the feasibility/sustainability of reform. More important than rules on domestic regulation, especially for developing countries, is to focus on complementary initiatives such as regulatory transparency, improving domestic regulatory capacity and clarification of issues like applicable jurisdiction. This implies that the Aid for Trade agenda in services needs to go far beyond technical assistance to help countries make market access commitments—the focus of the language on technical assistance for services negotiations in the 2005 Hong Kong Ministerial Declaration. Regulation-related assistance will need to be supplied by the appropriate international development agencies and specialized professional and sectoral entities. We return to this subject in Chapter 12.

Modal or technological neutrality. The current approach to scheduling specific commitments distinguishes between the four modes of supply that define trade (Article I GATS). As a result, national schedules may distort incentives to use the most efficient mode, while also creating uncertainty regarding the rules that prevail in instances where more than one mode is used to service a market. Such uncertainty can also create difficulties in predicting how a panel will interpret the

schedules, and thus reduces the perceived benefits from initiating dispute settlement procedures. One way to reduce potential inconsistencies in commitments across modes within a specific sector is to require one-to-one mappings between commitments on modes ('nondiscrimination across modes') (Feketekuty, 1998). Such a technological neutrality principle was embodied in the Agreement on Basic Telecommunications. Modal neutrality is an objective worth pursuing because, as is often emphasized in the literature, trade and investment have increasingly become complementary. It is also frequently noted that it will become more difficult to maintain a clear distinction between trade in goods and trade in services, as technology may give producers the choice of delivering their products in tangible or in disembodied (digitized) form. A priori, it would appear that any multilateral disciplines should apply equally to international transactions regardless of the mode of supply.

Some fundamental 'architectural' issues arise here. For example, a case can be made that WTO members should consider developing disciplines that distinguish between trade and investment, with trade in goods or services being subject to a set of common rules, and movement of factors of production being subject to another set of rules. This in effect has been the approach taken in the NAFTA, which includes a separate chapter on investment (in goods or services), which is distinct from the rules relating to cross-border trade (in goods and services). This approach results in much greater consistency and clarity of the applicable rules and disciplines than the current WTO structure. These are longer run questions that must be addressed at some point. For the time being, within the GATS setting, a focus on modal neutrality can be a useful halfway house.

Achieving greater transparency. It is widely recognized that the 'scheduling technology' used in the GATS does not greatly promote transparency. A fundamental need is to improve the available information on status quo policies. This will facilitate national reform efforts and help identify where the multilateral process can support such efforts. Unfortunately, there is nothing in the GATS or the WTO that encourages and assists countries in generating comprehensive information on applied policies and evaluating the impact of these policies. Some progress was made in the Uruguay Round with the creation of the Trade Policy Review Mechanism, but more can and should be done. Priority should be given to greatly improving statistics and data on trade barriers and entry-cum-operating restrictions in services. Analogous to the role played by the OECD secretariat in compiling information on agricultural policies in the 1980s, international organizations and policy institutes should devote the resources required to document the status quo and to put this information in the public domain.

The importance of strengthening capacity to collect and analyse information cannot be overemphasized. A common mistake made by governments involved in regulatory reform is to reduce the ability of agencies to compile the information

needed to monitor the impact of reforms. Better information on status quo policies, their effects, and the impact of GATS-based liberalization agreements will assist governments to make policy and provide stakeholders (business, civil society) with the information needed to engage in the domestic policy formation process. One option that deserves serious consideration in this connection is to resurrect an Australian proposal made at the 1996 WTO ministerial meeting to engage in a negative list *reporting* exercise of prevailing policies in services for transparency purposes. This should be accompanied with adequate technical and financial assistance to help developing countries, in particular LDCs, participate in the transparency exercise.

7.7. Conclusion

There is widespread recognition among governments and civil society that pursuit of regulatory reforms in the services area can have large payoffs. In this respect the political context today is quite different from that prevailing in 1986 when the Uruguay Round was launched. Opposition to liberalization certainly exists in many countries, and nations differ on the desirable modalities and speed with which to pursue reforms. There are also valid concerns regarding the need to put in place the appropriate regulatory policies and strengthen regulatory institutions before certain types of liberalization are undertaken. But the thrust of policy in the majority of nations is towards a more market-oriented stance, as is reflected in widespread privatization of utilities, telecom operators, airlines and so forth. The success of the financial and basic telecom sectoral talks was largely due to the fact that most of the governments involved were convinced of the need to pursue regulatory reforms in these sectors, including liberalization and elimination of entry barriers. This was a pre-condition for both agreements to materialize—it was clear that the associated regulatory reforms did not go beyond what had already been accomplished or decided in the national (unilateral) context.

A significant expansion of the coverage of national treatment and market access commitments is needed to make the GATS more relevant. The potential scope for tradeoffs in the GATS context is quite large, and there should be no need to rely on cross-issue linkages if a critical mass approach is taken by WTO members. An obvious linkage strategy *within* services would be an exchange of mode 3 for mode 4, with developing countries making greater national treatment and market access commitments on FDI across a wide range of sectors, in return for significant expansion of access to high-income markets through movement of natural persons. Although reform in services has been and will continue to be primarily driven

by domestic priorities, the challenge is to make the GATS a more effective device to support domestic reforms. One way to do that began to emerge in Hong Kong in 2005 in the shape of an Aid for Trade initiative, and the strengthening of the Integrated Framework for Trade-related technical assistance (see Chapter 12). Using the GATS more as a lock-in device, as a mechanism to commit to future reforms at specified dates, greater efforts to ensure that developing country service suppliers are granted better access to the larger markets, especially through mode 4, and a willingness to put sectors such as air and maritime transport on the negotiating table would go far towards making the GATS a more relevant instrument.

7.9. Further Reading

Geza Feketekuty, *International Trade in Services: An Overview and Blueprint for Negotiations* (Cambridge: Ballinger, 1988) offers a comprehensive contemporary discussion of why services were put on the agenda in the Uruguay Round. See Julian Arkell, 'Lobbying for Market Access for Professional Services', in Michel Kostecki (ed.), *Marketing Strategies for Services* (Oxford: Pergamon Press, 1994) for an insider's account of lobbying and marketing strategies employed by service sectors in the GATS negotiations and in other fora to enhance access to foreign markets.

The economics of services and services negotiations are discussed in Aaditya Mattoo, Robert M. Stern and Gianni Zannini (eds), *A Handbook on International Trade in Services* (Oxford: Oxford University Press, 2008). Bernard Hoekman, 'Liberalizing Trade in Services: A Survey,' *Policy Research Working Paper No. 4030* (World Bank, 2006) provides a comprehensive survey of the economic literature.

Various GATS-related topics are discussed in depth in Patrick Messerlin and Karl Sauvant, *The Uruguay Round: Services in the World Economy* (Washington, DC: World Bank, 1990), which also includes a number of country-specific viewpoints. UNCTAD and the World Bank, *Liberalizing International Transactions in Services: A Handbook* (Geneva: United Nations, 1994) discusses many of the policy issues that arise in liberalizing services, focusing on all four modes of supply. Sumantha Chaudhuri, Aaditya Mattoo and Richard Self discuss options and challenges in making progress on Mode 4 in 'Moving People to Deliver Services: How Can the WTO Help?' *Journal of World Trade* 38 (3) (2004): 363–93.

John Croome, *Reshaping the World Trading System: A History of the Uruguay Round* (Deventer: Kluwer Law International, 1999) provides a comprehensive discussion of the services negotiations. Jagdish Bhagwati, 'Trade in Services and