Thinking Ahead on International Trade (TAIT) Paper

Services Trade and Doha[a]

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Biography

Dr. Sübiday Togan has been a Professor of Economics since 1986 and Director of the "Centre for International Economics" at Bilkent University in Ankara, Turkey. Most recently, Dr. Togan is a member of the High Level Expert Group on Trade (Bhagwati-Sutherland committee). His numerous publications include "Telecommunications Policy Reform in Turkey" (2009), "Turkey: Trade Policy Review" (2005), and "Turkey: Economic Reform and Accession to the European Union" (2005). Dr. Togan attended Johns Hopkins University as a Fulbright Scholar where he received his PhD in Economics in 1972.

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Thinking Ahead on International Trade (TAIT)

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SERVICES TRADE AND DOHA

Modern economies are increasingly dominated by services, which cover a broad range of industries, encompassing 'network industries' such as electricity, natural gas and telecommunications, other 'intermediate services' such as transport, financial intermediation, distribution, construction and business services, and 'final demand services' such as education, health, recreation, environmental services, tourism and travel. Currently, 73 percent of GDP in high income countries originates in services, and even in low income countries services generate 46 percent of GDP.

Services for a long time were believed to be non-tradable, but technological changes and the demise of natural monopoly arguments for state-provision of major service industries have allowed an increasing number of services markets to be contested internationally through cross-border trade (mode 1) and commercial presence (mode 3).[1] But data on the magnitude of international service transactions are weak. The primary source is the balance of payments which refers mainly to cross-border trade and consumption abroad (mode 2). Calculations reveal that services trade as defined by modes 1 and 2 in 2006 amounted to about 20 percent of world trade as measured by the balance of payments. Noting that the value of sales of services by affiliates of multinationals as reported by 'foreign affiliate trade in services' (FATS) for a number of OECD members is about 50 percent greater than cross border exports of services, and considering a figure of US$0.1 billion for trade in mode 4 (presence of natural persons), aggregate international transactions in services is estimated to amount to 29 percent of world trade in 2006.[2]

Economic theory emphasizes that countries can derive welfare gains from freer trade, and that the proposition applies to both goods and services. But the types and forms of liberalization of services are quite different from those of liberalization of merchandise trade. Barriers to the flow of goods typically arise as customs and other physical restraints on trade administered at national borders and as non-tariff barriers (NTBs). Thus, for goods trade, most discussion of liberalization focuses on tariffs and on NTBs. On the other hand, barriers to trade in services are typically regulatory in nature, and outcomes of services liberalization depend heavily on the regulatory environment.

Recent research indicates that barriers to services trade remain prevalent, and that service barriers in both high income and developing countries are higher than those for trade in goods. Policies are more liberal in OECD countries, Latin America and Eastern Europe,

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[1] The General Agreement on Trade in Services (GATS) distinguishes between four modes of supplying services trade: cross border supply (mode 1), consumption abroad (mode 2), commercial presence (mode 3), and presence of natural persons (mode 4). While mode 1 refers to services supplied from the territory of one member into the territory of another, mode 2 consists of services supplied in the territory of one member to the consumers of another. On the other hand mode 3 refers to services supplied through any type of business or professional establishment of one member in the territory of another (i.e., FDI), and mode 4 includes both independent service suppliers, and employees of the services supplier of another member.

[2] B. M. Hoekman and M. M. Kostecki (2009) *The Political Economy of the World Trading System: The WTO and Beyond*, Oxford University Presss.

whereas most restrictive policies are observed in MENA and Asian countries. Overall pattern of policies across sectors is increasingly similar in developing and industrial countries. Whereas telecommunications and banking services are more competitive, transport and professional services remain bastions of protectionism.[3]

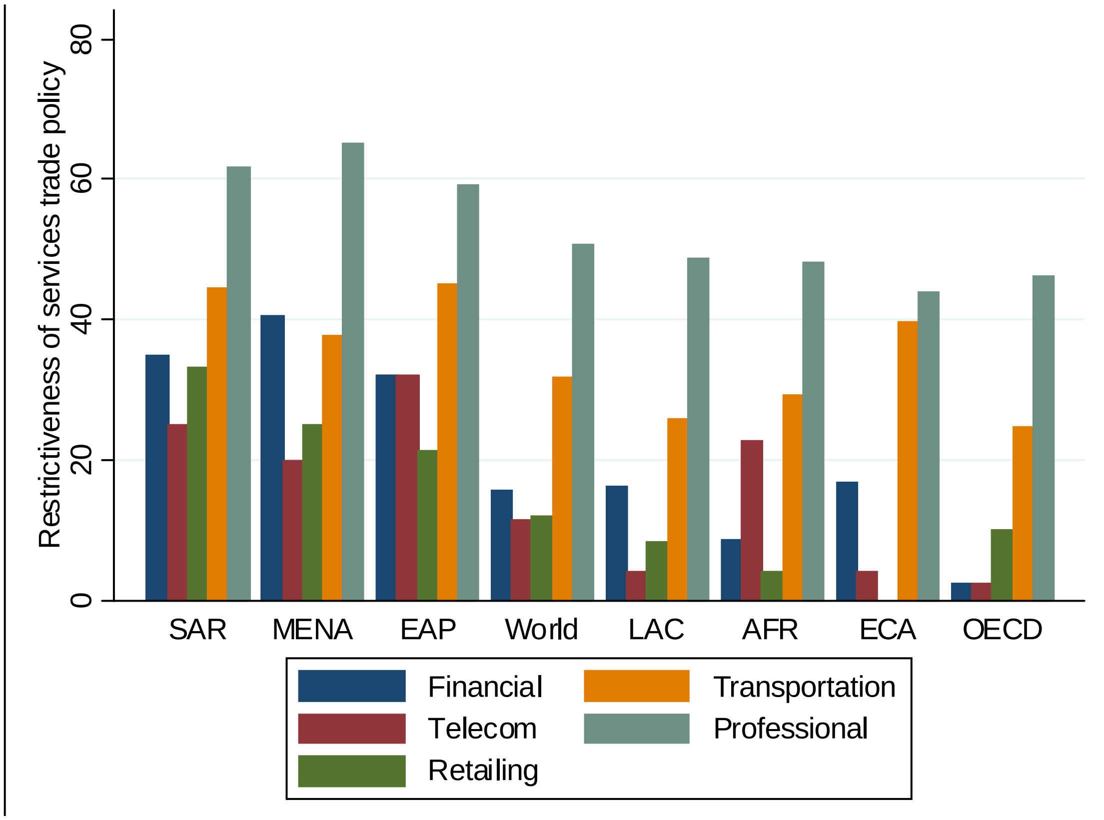

Figure 1: Gootiiz and Mattoo (2009)

Barriers to services trade lead to inefficiencies in service sectors and to high costs of services. Since the productivity and competitiveness of goods and services firms depend largely on access to low cost and high-quality producer services such as transportation, distribution, telecommunications and finance, and since they have powerful influence on economic growth, as it has powerful influence on economic growth it is of utmost importance to increase the efficiency of service industries.

In principle countries can choose to liberalize a service sector unilaterally and try to derive efficiency gains. Indeed, during the last two decades there has been significant unilateral liberalization in services by different countries driven by the prospects of large welfare gains. Many countries have taken action to increase competition on service markets by liberalizing FDI and privatizing state-owned or controlled service providers. But unilateral liberalization may be constrained by the fact that a country cannot on its

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[3] B. Gootiiz and A. Mattoo (2009) “Services in Doha: What is on the Table?”, *Journal of World Trade,* 43, n. 5: 1013-1030.

own gain improved access to larger foreign markets. Second, a country may face difficulty increasing competition. Finally, a country may lack the expertise and resources to devise and implement the appropriate domestic regulatory policies. Hence, multilateral and regional liberalization have advantages over unilateral liberalization.

In recent years the number of regional trade agreements has increased significantly. Many provide for free trade in goods but also include some measures to facilitate trade in services. Such agreements could lead to gains from liberalization of trade in services. But not much has been achieved in terms of actual liberalization with the exception of the EU and a small number of agreements between high-income countries. Furthermore, there is caution on both sides in cases when one of the parties is a developing country and the other a developed country. In developed countries there is caution towards trade liberalization mainly because of the associated greater liberalization of the movement of individuals (Mode 4 of GATS). On the other hand there is caution in the developing world towards liberalization of the sector reflecting the concern that any future regional liberalization of the sector will be largely one sided in the results it will yield. Their belief is that in regional services liberalization developed country service providers will gain significantly improved access to developing country service markets, but the converse will likely not happen.

Multilateral negotiations on services began during the Uruguay Round, which culminated in the signing of the GATS in 1995. Article XIX GATS required members to launch new negotiations on services no later than 2000, and periodically thereafter. Initial negotiations were launched in 2000, which later became part of Doha. Between 2000 and the end of 2005, WTO members pursued a bilateral approach to negotiations, submitting request to others and responding to requests with offers. But large asymmetries in interest across membership impeded progress. In 2006 WTO members launched an effort to complement the bilateral request offer process with a plurilateral or 'collective' approach. This involved subsets of the WTO membership seeking to agree to a common 'minimum' set of policy commitments for a given sector. But not much progress could be achieved until now.

Recent research indicates that the Uruguay Round commitments are on average 2.3 times more restrictive than current policies. Currently at Doha offers improve on GATS commitments, but at this stage the gap between offers and actual policy is still large. Doha offers are on average 1.9 times more restrictive than the actual policies.[4] There is a reasonable prospect that offers will be improved. In 2008, the chair of the Trade Negotiations Committee held a 'signaling exercise' among ministers from 31 countries. The participating ministers indicated that they might significantly improve their services offers.

[4] Ibid.

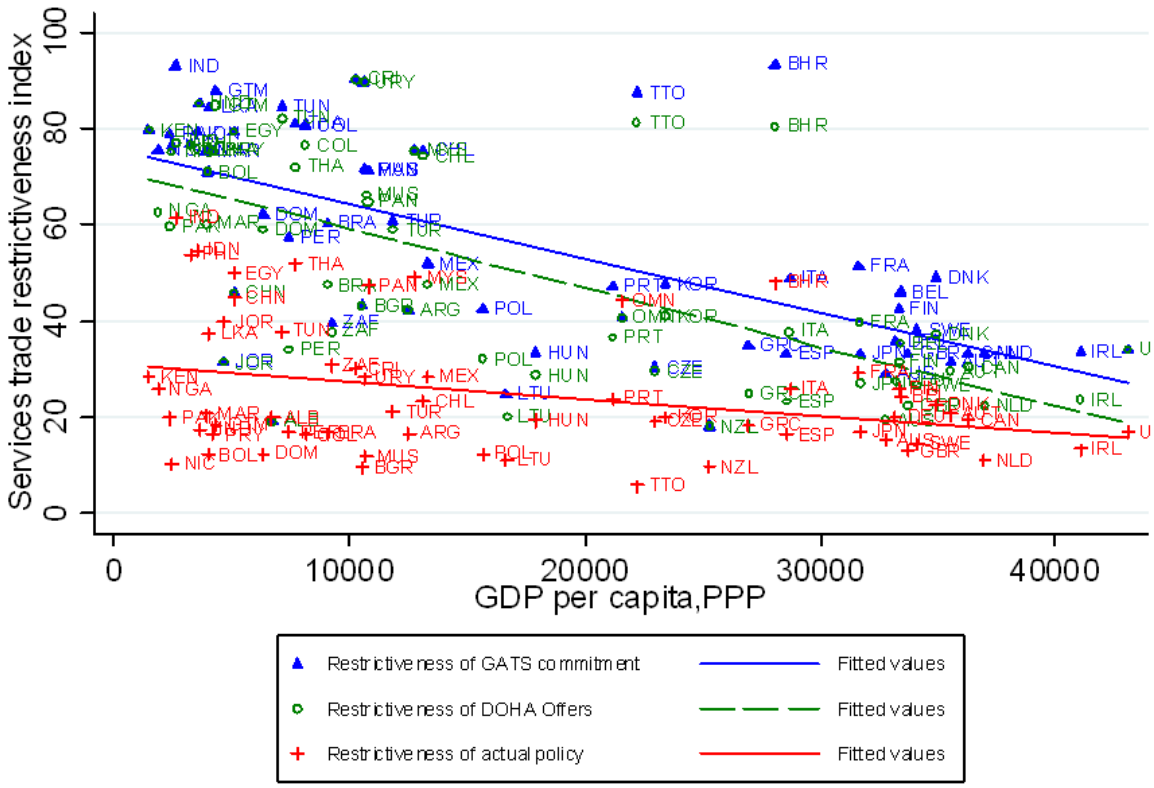

Figure 2: STRI for 61 countries, excluding Qatar and 31 countries that did not submit offers. Gootiiz and Mattoo (2009)

Why was there so little progress to liberalize trade in services through the WTO in Doha, although potential gains from trade liberalization are considerably large? One explanation for the limited progress is that the standard mechanisms of reciprocity developed through GATT practice, the desire by members to improve their access to markets of other members, do not apply to services. There are at least two possible reasons for this: (i) the export interests that have been harnessed to allow the reciprocal liberalization of trade in goods do not prevail sufficiently in the services context; and (ii) there are on the part of developing countries fears about possible market failures.

Although in the case of good trade WTO members have interests in improving access to export markets, the same turns out to be not true in the case of services. There is lack of corporate interest by OECD service firms in search of access to foreign markets. Since unilateral reforms have resulted in a boom in service exports, the service firms do not perceive market access to be their priority. They must also be discounting the probability of policy reversals and thus the value of the WTO as a mechanism to lock in liberal policies.

The most important reason for lack of interest in multilateral services negotiations is the concern on the part of developing countries about possible market failures. Since GATS is mainly concerned in the reduction of regulatory barriers to market access and discriminatory national treatment across all four modes of supply of services between the countries, there is no guarantee that liberalization of services through GATS will lead to welfare gains unless

- competition/contestability of markets is enhanced,
- effective regulation that will deal with market failures is insured, and
- equity objectives such as access to services for disadvantaged regions, communities or households are attained.

Hence, improved prudential and pro-competitive regulation will be necessary to deliver the full benefits of liberalization. Since these are challenging objectives, international efforts to achieve these goals could be enhanced. One mechanism that could help to achieve these objectives is the development of 'services knowledge platform' that would bring together sectoral regulators, trade officials and stakeholders to assess current policies and identify beneficial reforms. The platforms could be assisted by external assistance from development partners as part of multilateral 'aid for trade' initiative.[5]

The mode that is of great relevance to developing countries is mode 4. But almost all countries impose high barriers to mode 4. Research indicates that global gains would be over US$150 billion if industrial countries were to allow temporary access to foreign service providers equal to just three percent of their labor force, and that potential gains could be shared equally by the industrial and developing countries.[6] However, it is unlikely that much can be achieved on mode 4 access to high income countries unless a package would be developed balanced from a mercantilist perspective.[7] Such liberalization could be developed by making it conditional on the fulfillment of specific conditions by source countries. One possibility is that host countries commit under the GATS to allow access to any source country that fulfills certain pre-specified conditions along the lines of mutual recognition agreements in other areas. Since developing countries want better mode 4 access and continued ability to use mode 1 to export services, while high income OECD countries want better access to developing countries through mode 3, a deal could be developed under the conditions specified that involves liberalization of these modes benefitting both sides.

Finally, it should be noted that there is nothing in the GATS or WTO that encourages and assist countries in generating comprehensive information on applied policies in different service sectors. The Trade Policy Review's contain some, but in general

[5] B. Hoekman and A. Mattoo (2011) "Services Trade Liberalization and Regulatory Reform: Reinvigorating International Cooperation", Centre for Economic Policy Research Discussion Paper No. 8181.
[6] L. A. Winters, T. L. Walmsley, Z. K. Wang and R. Grynberg (2003) "Liberalizing Temporary Movement of Natural Persons: An Agenda for the Development Round", *World Economy*, 26(8): 1137-61.
[7] A. Mattoo (2005) "Services in a Development Round: Three Goals and Three Proposals", *Journal of World Trade*, 39, 1223-38.

inadequate information on trade barriers and statistical data on services. Thus, there is lack of information on trade and investment flows, the data are highly aggregated, and bilateral data are very limited. But a comprehensive database of services trade, investment policies and improved statistics are essential for any meaningful policy discussion on services. Data on all applied policies, whether scheduled or not, could best be collected by the WTO, and the WTO could make this publicly available together with improved statistics on services.

If the outcome of multilateral negotiations on services is to garner political support by developed as well as developing countries, a package to be negotiated among a critical mass of major players on services such as the 25 largest services economies could be developed. These 25 countries should move to greatly increase their binding coverage and also pre-commit to liberalization by certain date in the future. The package to be negotiated among these countries within the WTO could span the elements:

- A pledge not to impose any new restrictions, especially on cross border trade and investment, by inscribing binding language to this effect in the schedules of specific commitments in the GATS.
- Inscribing in each country's specific commitments to implement reforms by a certain date in the future to liberalize trade in services, especially on FDI and in the air and maritime transport sectors although they are presently not included in the negotiations;
- Establishing a credible mechanism for regulatory assistance to support liberalization commitments by developing countries through 'services knowledge platform';
- Agreement to expand the scope for temporary movement of services suppliers, conditional on a set of source country obligations and transparent criteria relating to host country economic conditions; and
- Mandating the WTO Secretariat to collect and report data on all applied policies by different service sectors for all the participating countries.[8]

[8] B. Hoekman and A. Mattoo (2010) "Services Trade Liberalization and Regulatory Reform: Re-invigorating International Cooperation", A VoxEU.org publication, Dec. 24.