Market Access for Small versus Large Service Enterprises: The Preferential and Multilateral Trade Liberalization Tracks Compared

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Abstract

Political economy theories of international trade predict the convergence of trade policy preferences between small and large exporting enterprises within a sector. However, this convergence does not generally occur in service trade, which restricts the way a service provider is allowed to supply a service across borders. Services trade agreements differentiate mainly between modes that are 'linked' versus 'unlinked' to commercial presence. The former, which are generally used by large multinationals, were more liberalized in the Uruguay Round than the latter, usually preferred by small enterprises. By comparing the latest GATS offers with the new preferential services trade agreements of the 2000s, this paper explores the extent each liberalization track has been able to narrow the gap between market access given to the 'linked' versus 'unlinked' modes. It shows that whereas there continues to be a bias against the latter in both liberalization tracks due to higher political (economic) sensitivity, the new preferential trade agreements are able to narrow the gap between the market access granted to both 'linked' and 'unlinked' modes—bringing likely real liberalization especially to the latter—, thus leveling the playing field between large and small enterprises.

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Introduction

Small and medium enterprises (SMEs) are usually confined in trade policy literature to the domestic sphere due to their limited international activities (see e.g. Baldwin 2006). In the last few decades, however, more and more SMEs have penetrated international and global markets due, inter alia, to advances in information and communications technologies and the internet (Acs, Morck, and Yeung 2001; OECD 1999, 2004a, 2005; Oviatt and McDougall 1999).

The potential for economic growth and employment creation provided by dynamic and internationalizing SMEs is of great interest for stagnant Western economies and developing countries alike.² In most of those countries that have experienced export-led growth, for instance in East Asia, SMEs have played an integral part. Moreover, with global specialization on the rise, innovative and flexible SMEs will continue to grow in importance for future (global) value chains (Acs et al. 1997; Berry 1998; Sakai 2002). As a result, countries are increasingly seeking to expand their export base towards smaller enterprises.

From mid-1990s, the facilitation of the internationalization of SMEs started to get increasing attention also in various plurilateral and regional fora, such as the G7, OECD, EU, ASEAN, and APEC. Canada took the initiative to bring the issue of SME internationalization to the multilateral service trade negotiation table. In 2001 it submitted a negotiation proposal on SMEs as part of a new round of multilateral service trade negotiations mandated by the General Agreement on Trade in Services (GATS) taking place at the World Trade Organization (WTO) since 2000³. The proposal highlighted the importance of service SMEs and their internationalization and drew attention to various trade barriers that are particularly burdensome to SMEs. This initiative received such broad support from developed as developing countries that it was made into a permanent negotiation issue on the current services negotiation agenda at the WTO. This unexpected confluence of interests between developed and developing countries breaks the traditional dichotomy of interests between them.

Political economy theories of international trade assume the convergence of trade policy preferences between small and large internationalizing enterprises within a sector (Milner 2002). This convergence does, however, not generally happen in service trade, which restricts the way a service

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² SMEs have a higher net growth rate of employment than larger enterprises combined with a higher share of total employment (Kox and Rubalcaba 2007; OECD 2002a). Lately, more attention has been given to the fact that internationalisation seems to correlate with an even larger employment growth as well as with a higher rate of innovation among SMEs (European Commission 2010).

provider is allowed to supply a service across borders. Service trade agreements differentiate mainly between modes that are linked and unlinked to commercial presence. SMEs, and their preference for modes of supply unlinked to commercial presence, are generally framed as a developing country interest; whereas large multinational enterprises (MNEs), and their preference for modes of supply linked to commercial presence, are framed as a developed country interest (Chanda 2001; Ghosh 1997; Mattoo and Carzaniga 2003; Whalley 2004; Winters et al. 2003). I claim that this North-South dichotomy is somewhat misleading. In reality, SMEs form a large majority of all firms in all countries; and MNEs are emerging also from outside of the developed world. This illuminates a large-versus-small enterprise dichotomy in the services sector.4

Parallel to the current multilateral service trade negotiations, governments are also increasingly concluding preferential trade agreements (PTAs) in services (Fiorentino, Crawford, and Toqueboeuf 2009; Marchetti and Roy 2009; Roy, Marchetti, and Hoe Lim 2008). By comparing the latest GATS offers with the new preferential services trade agreements of the 2000s, this paper explores the extent each liberalization track has been able to narrow the existing market access gap in favor of modes linked as opposed to modes unlinked to commercial presence resulting from the Uruguay Round. The analysis shows that whereas there continues to be a bias against the latter in both liberalization tracks due to their higher political (economic) sensitivity, the new preferential trade agreements have been able to narrow the gap between the market access granted to modes linked and modes unlinked to commercial presence—bringing likely real liberalization especially to the latter—, thus leveling the playing field between large and small enterprises. Nevertheless, I do not claim that small service enterprises prefer preferential trade liberalization over multilateral trade liberalization, only that they are more likely to achieve a higher level of market access through the preferential track. If a similar level of market access was politically achievable through a multilateral track that would naturally be preferable.

Overall, the research contributes to the literature on international political economy of service trade liberalization—a topic that is still under-explored. Specifically, this work will add to the theoretical and empirical debates on preferential versus multilateral trade liberalization in services, service trade policy, policy preference deduction, and cross-border labour mobility. My main theoretical contribution

4 Resource-poor SMEs are normally framed as a South issue and large, capital-rich enterprises as a North issue; but SMEs often suffer from a lack of internal resources also in developed countries. A qualitative separation can, however, be made between human capital -intensive SMEs and human capital -scarce SMEs; a separation that reflects traditional North-South divisions. Advanced developing countries tend to fall in between, with increasingly higher levels of human capital.
is to introduce internationalization patterns based on firm size as a basis for deduction of trade policy preferences in services, as well as to highlight the importance of reciprocity to overcome domestic bureaucratic and political economy resistance to the liberalization of modes of supply—and in particular labour mobility—unlinked to commercial presence.

The paper is structured as follows. It begins with a description of the preferable market access modes in services for small versus large enterprises. It is continued by the groundwork for the specific hypotheses followed by the hypotheses themselves. The groundwork includes a discussion of the domestic political economy interests of state- and society-centered actors for and against different market access modes as well as the importance of reciprocity to overcome domestic resistance to trade liberalization. Then, the research methodology is described followed by the statistical findings on market access commitments in preferential and multilateral trade agreements. The summary includes conclusions and policy implications.

**Market Access Modes in Services**

Whereas the main barriers to trade in goods, and thus also the focus of most existing research, is on border barriers among which tariffs are the main ones, trade in services is principally restricted by behind-the-border barriers. These can take the form of various kinds of domestic regulations (e.g. licensing and qualification requirements on the service supplier) and restrictions on the mode of service supply (market access) that is allowed into the importing market\(^5\). Whereas the General Agreement on Trade and Tariffs (GATT) for goods focus on one form of market access, cross-border trade, in the GATS this market access mode is merely one of four (so-called Mode 1). The others require either the movement of consumers (Mode 2)\(^6\) or the movement of factors of production: capital (in the form of

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\(^5\) For a comprehensive discussion on the various form a trade barriers in services can take and how trade in services can be liberalized, see e.g. Deardorff and Stern (2008), Hoekman and Primo Braga (1997), and Hoekman (2006). For an early account, see Feketekuty (1988).

\(^6\) Indirect exports via subcontracting and selling services to large multinational enterprises located in the home market is a central avenue for small enterprises onto international markets and global value chains. When the sale is to a foreign entity in the domestic market, it is considered Mode 2 trade. Nevertheless, since it does not entail the cross-border movement of the service provider and in most cases the services themselves, and since it seldom meets political resistance in the exporting home market, it will not be considered here. There is no definite agreement between GATS Members, however, whether electronic delivery of services, electronic commerce, or outsourcing are to be considered Mode 1 or 2. For example, it is unclear whether a French consumer who buys services over the Internet from a Pilipino Internet site is engaging in cross-border trade or consumption abroad. The classification is particularly important when the transaction involves highly regulated services and it is important to
commercial presence, e.g. through foreign direct investment, called Mode 3) or labour (the temporary movement of natural persons as service suppliers, Mode 4).

It is crucial to take note that not all market access restrictions are discriminatory to foreign suppliers. Trade liberalization is often not enough by itself: domestic regulatory reform is necessary to give de facto market access not only to foreign competitors but also to domestic ones. In the GATS, each Member country can commit the application of nondiscriminatory Market Access and National Treatment of foreign service suppliers on a subsector and mode-of-supply level (Hoekman 2006; Trachtman 2005).

The literature on the political economy of international trade debates which domestic societal actors favor protectionism and which favor liberalization (for an overview of the debate, see e.g. Alt et al. 1996; Frieden and Rogowski 1996; Milner and Yoffie 1989; Milner 2002; Rodrik 1995). The various models are based on trade in goods and focus mainly on tariff barriers, or complementing or substituting non-tariff barriers. Nevertheless, they do not predict the preferences of export-oriented service enterprises relating to the different market access modes elaborated above. In order to deduce these preferences, internationalization theories offer a useful framework.

Theories on the internationalization of SMEs usually assume that these enterprises face, to a higher extent than larger companies, internal resource constraints in terms of finance, information, management capacity, language skills, and so forth, and external barriers such as market imperfections and regulations. Empirical research confirms this in most cases (Coviello and McAuley 1999; European Commission 2003; Hollenstein 2005; Kilantaridis and Levanti 2000; OECD 2009). It is important to note, however, that small enterprises are not just smaller versions of larger ones, but that the small size and the inherent restraints mostly cause them to adopt differing internationalization strategies (Coviello and McAuley 1999; Hollenstein 2005; Kilantaridis and Levanti 2000).

Service SMEs tend to lean towards “soft” forms of internationalization across borders, that is, exporting mainly via cross-border trade and movement of contractual service suppliers unlinked to commercial presence. These two modes of supply are usually highly inter-connected (usually referred to as mode-interconnectedness) and a low level of market access in one mode may prevent trade via the other mode (Almor, Hashai, and Hirsch 2006; Bell et al. 2003; Coviello and Munro 1997; European Commission 2002, 2003; Hollenstein 2005; Johanson and Vahlne 1977; Roberts 1999; Kilantaridis and...
Levanti 2000; O’Farrell, Wood, and Zheng 1998; Patterson and Cicic 1995). Large service enterprises, on the other hand, tend to prefer “hard” forms of internationalization, that is, commercial presence via different kinds of majority-stake foreign direct investments with exports via the other modes serving a complementary function (especially intra-firm movement of natural persons, see e.g. Bryson, Daniels, and Warf 2004; European Commission 2002; Hollenstein 2005; Nachum and Aharoni 2000; OECD 2005; Patterson and Cicic 1995). Figure 1 shows the two separate paths to international markets reflecting the general preferences of large and small enterprises.

![Diagram showing modes of supply to foreign markets] (Linked to FDI - Large companies: Commercial presence, Movement of natural persons/Intra-corporate transferees. Unlinked to FDI - Small companies: Cross-border trade, Movement of natural persons/contractual service suppliers.)

**Figure 1: Modes of supply to foreign markets generally preferred by large and small companies**

Naturally, this dichotomy is not set in stone, but there are likely to be various overlaps between the two patterns. Still, as a recent survey of SME internationalization in 33 European countries shows, whereas 19% of all SMEs in the business services sector export, only some 3-4% had invested in a commercial presence even if FDI is most common in this sector. Overall, only about 2% of all SMEs have some form of FDI\(^7\) (European Commission 2010).

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\(^7\) When, however, SMEs do choose an ownership mode of entering into international markets, they typically opt for a low-control mode to overcome their resource constraints: these include contractual arrangements, or if equity-based, minority-ownership rather than full ownership (Hollenstein 2005).
Market Access through Preferential versus Multilateral Trade Liberalization Tracks

Most research claims that the same political economy obstacles that prevent deeper liberalization commitments in multilateral services trade negotiations exist also in preferential negotiations and that the PTAs have therefore not been able to remarkably further the liberalization process (see e.g. Adlung and Roy 2005; Dee and Sidorenko 2006; Hoekman and Primo Braga 1997; OECD 2002c; Sauvé Forthcoming). Still, others claim in line with conventional theory, that preferential liberalization allows for more efficient reciprocal bargaining which should lead to more far-going liberalization, since the fear of free-riding on a most-favored-nation (MFN) basis is diminished; even though they do admit that so far reciprocal bargaining has played a smaller role than in goods negotiations (Baier and Bergstrand 2001; Mattoo and Fink 2004; Stephenson 2002). Roy, Marchetti and Lim (2007; 2008) and Marchetti and Roy (2009) also found evidence of this phenomena, as will be shown later in the paper.

This paper answers the following question: To what extent do the current trade liberalization tracks—the preferential and the multilateral—advance the trade policy preferences of large versus small enterprises with respect to modes of supply? I hypothesize that in services trade, preferential trade liberalization is more likely than multilateral trade liberalization to level the playing field between large and small enterprises by giving them more equal market access on their preferred modes of supply.

The main reason for this is the fact that the presumed small enterprise preferences related to market access modes are more politically sensitive than large enterprise preferences and therefore more likely to be agreed upon and implemented among a smaller set of countries based on specific reciprocity than on a multilateral basis based on diffuse reciprocity. Furthermore, I argue that due to

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8 The NAFTA and EU/EEA are notable exceptions, but even there services liberalization has encountered similar political economy obstacles, as will be briefly discussed later.

9 Trade liberalization theories and the evaluation of current trade liberalization developments are typically based on a macro-perspective, either on a global or country level. Multilateralism versus regionalism—research provides no exception. Nevertheless, even if the liberalization advancements on the whole might not seem so substantial, the differences and additional elements can be considerable to certain stakeholders and through them potentially to the economy at large.

10 The terms specific and diffuse reciprocity were first coined by Keohane (1986). Multilateral trade liberalization is based on diffuse reciprocity, that is, on unconditional most-favoured-nation treatment, where concessions given to one party are automatically extended to all others and thus enabling free-riding. Preferential trade liberalization is based on specific reciprocity, that is, on mutually balanced concessions between particular parties.
the qualitatively different preferences of large and small enterprises, the benefits of free-riding on large enterprise lobbying in trade negotiations are limited\textsuperscript{11} and partially indirect\textsuperscript{12} for small enterprises. In contrast, in goods trade negotiations, small enterprises can generally benefit more directly from large enterprises’ push for reduced tariffs and even non-tariff barriers.

The domestic political economy theoretical frameworks can largely be divided into state- and society-centered approaches (Frieden and Martin 2002; Milner 1999; Crystal 2003). The theories vary by how much influence over decision-making they assign to either state-centered or society-centered actors in various issue areas and countries. The state is usually treated as a non-unitary actor with partisan, legislative/executive, or intra-bureaucratic divisions and political interests. The bureaucratic model with fragmented decision-making across government offices, including between federal and provincial offices, is most relevant for this study. Societal actors, or business and labour interest groups, have their own theoretically well-established economic interests, even if policy preferences need to be determined case-by-case.

In the following, the interests and dynamics of these two sets of actors are discussed as they relate to trade liberalization through the different modes of supply. The political economy analysis will form the basis for the formulation of the hypotheses. The hypotheses propose expected outcomes of the multilateral and preferential trade negotiations on market access commitments in services, which are then tested empirically. The domestic and international political economy dynamics and the importance of individual actors and their preferences will not be tested, however, and can thereby not be verified by this research.

**Importance of reciprocity to overcome domestic bureaucratic resistance**

In a two-level game, domestic political sensitivities (level II) are likely to lead to a narrower win-set in inter-governmental negotiations (level I), which diminishes the possibility of reaching a ratifiable agreement (Putnam 1988). Shared domestic decision-making is likely to increase domestic tensions, especially if the decision-making authorities have differing and vested interests (Mansfield, Milner, and Pevehouse 2007; Milner 1997; Milner and Rosendorff 1996). In a multilateral forum, with many narrow domestic win-sets and the likelihood of free-riding, the negotiations are easily stalled or limited to a very

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\item[11] For instance, they are limited to lobbying for non-discriminated market access for cross-border trade unlinked to commercial presence.
\item[12] For instance, this is true when trade liberalization leads to increased competition and reduced prices for infrastructural and network services necessary for small enterprise internationalisation.
\end{footnotesize}
narrow mutual win-set. Reciprocal negotiations in a preferential setting usually widen this mutual win-set as a result of more shared interests and goals.

One prominent feature of the so-called “new economic diplomacy,” which entails trade negotiations in services, is the increased participation of additional ministries and agencies in the trade-policy making process (Bayne and Woolcock 2007; Jordan and Levi-Faur 2007; Hocking 1999). Whereas in the case of goods, the trade negotiation authority is usually affiliated with the trade or foreign ministry, in services the negotiating authority is fragmented between them and various additional ministries, regulatory agencies and bureaus within the government, usually different ones for each service subsector. These specialized offices have their own vested interests and turfs to protect, and can veto or water down even successfully concluded trade negotiations in their sector. The regulators are usually concerned about losing a major share of their discretionary powers, as well as their power overall. In practice, liberalization in many sectors requires a substantial domestic regulatory reform. The regulators need to be convinced that the reform is beneficial for the economy and in alignment with their regulatory goals, otherwise the process is stalled. The trade department often has to take a proactive role to woo and activate a pro-liberalization lobby both among the other parts of the bureaucracy and even exporting firms13 to counter protective lobbies, a task which may often seem an uphill battle (Adlung and Roy 2005; Dam 2001; Feketekuty 2000; Jara and Domínguez 2006; Robert 2000; Zahrnt 2008). In federal states the problem is augmented by shared or overlapping regulatory competences between federal and regional/provincial bureaucracies (Hoekman, Mattoo, and Sapir 2007).

The various regulatory concerns that must be dealt with for reciprocal exchange to be possible complicate both intra-services trade-offs and cross-issue linkages between services and other issue areas such as agricultural and non-agricultural market access. This diminishes the trade negotiation dynamics prevalent in other sectors in which coalitions of domestic winners can be pitched against the domestic losers in different industries to achieve additional liberalization (Feketekuty 2000; Hoekman et al. 2007).

13 In many services sectors both individual firms and business associations may lack information and understanding about the concept of services trade under the GATS. There may not even be awareness that the firms are involved in services trade under the agreement. In general, trade liberalization lobbies may be more difficult to form in the case of services than in the case of goods, since services are still traded less. As a result, the number and political weight of domestic groups favoring protection is likely to be considerably larger than of domestic groups pressing for export market access. Governments and trade departments with an interest in expanding their exports are therefore in many cases forced to take an active role in mobilizing pro-liberalizing lobbies (Adlung and Roy 2005; Hoekman and Kostecki 2001).
The negotiations are made more difficult by the contrary objectives of the trade negotiators and the regulators: the former aim for certainty and the latter for flexibility and autonomy. Trade negotiators try to liberalize and eliminate discriminatory barriers, including regulations, in order to achieve bound market access for their exporters. Regulators, on the other hand, seek to create a regulatory framework that will allow the provision of services in a safe, effective, and competitive manner (Jara and Dominguez 2006).

At a services trade conference in San José in 1999, Feketekuty observed that the uncertainty of the practical implications of making commitments for the regulatory process and for being able to meet regulatory objectives is one clear reason why countries, especially less developed ones, prefer not to bind their hands (Robert 2000; see also Fink and Jansen 2009). Fernandez and Rodrik (1991) show that there is a natural status-quo bias to policy making if some of the winners or losers from reform are not to be identified ex ante. It is safer to reduce existing protection gradually if effects on the domestic economy are unknown.

The desire for flexibility and autonomy on the part of the regulators can be seen as the main reason for the dominance of unilateral trade liberalization in services. The difference between the actual (status quo) and the multilaterally bound levels of market openness tend therefore to be considerably larger than in goods trade, even more so the less developed the country. Multilateral trade liberalization based on diffuse reciprocity has not made much progress in binding the status quo of existing openness. It appears, however, that specific reciprocity on a preferential basis has enabled regulators to overcome their resistance to binding the status quo to a considerably higher level, even if it perhaps has not managed to liberalize much beyond unilateral measures (Hoekman et al. 2007).

Service trade liberalization in highly regulated sectors is, in effect, conditional on regulators accepting each other’s regulatory regimes (Barton et al. 2006; Hoekman 2006). That, in turn, requires trust in the adequacy of those regulatory regimes to achieve the regulatory goals in each subsector and country. Regulatory goals are naturally prone to converge the more similar the regulatory regimes. Moreover, as mentioned earlier, trade liberalization among a chosen set of countries rather than multilaterally allows for a higher level of confidence in the enforcement of the regulatory regimes. For the importing (host) country, these questions are likely to be more important for services trade unlinked to commercial presence than for trade related to commercial presence especially in the more sensitive

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14 Conference on Services Trade and the Western Hemisphere, San José, Costa Rica.

15 See Fink and Jansen (2009):225f for a table of the main objective regulatory concerns and objectives for various services sectors.
sectors, since cross-border trade is regulated and controlled mainly by the exporting (home) country and therefore more prone to create regulatory competition (Barton et al. 2006; Hoekman et al. 2007).

On the other hand, the concerns in developed and developing countries are often opposite. Whereas the regulators in developed countries are mainly concerned by sufficient standards and their enforcement; regulators in (especially poorer) developing countries suffer from a lack of existing regulation and information. This makes regulators in developing countries cautious about obligating themselves to binding commitments before they have suitable local regulation and administrative capacity in place that can also achieve needed social-equity objectives (Hoekman et al. 2007; Robert 2000; Trachtman 2005).16

Political economy of liberalization commitments across market access modes

Commercial presence (Mode 3)

In the GATS, country commitments across the modes are not even, with most commitments scheduled for commercial presence, that is, the least preferable for small enterprises and the most preferred by large multinationals (Adlung and Roy 2005). Prieto (2000), in fact, claims that not only is there a commitment bias towards Mode 3, but also the commitments in the other modes are usually intended to make the commitments in Mode 3 effective.

Within the importing country, commercial presence is preferred by regulators, who can thereby stay in control of the service provision and consumption, and usually not opposed by service workers as it is likely to maintain or increase their employment opportunities. Uncompetitive incumbent firms are normally the only ones resisting opening market access to foreign direct investment by their competitors (Adlung and Roy 2005; Feketekuty 2000; Hoekman and Primo Braga 1997; Hoekman and Kostecki 2001; Hoekman and Winters 2009).17 Yet, even import-competing domestic enterprises tend to feel less threatened by new establishments than by cross-border trade, since commercial presence has

16 Trachtman (2005) points out that this developing country caution to make binding commitments is understandable from the viewpoint that the existing general disciplines relating to domestic regulation in the GATS are somewhat asymmetric in the “wrong direction”: limiting new regulation more strictly than existing regulation. They are thereby more likely to restrict regulatory development in developing countries, where an increase in prudential regulation is usually still needed. Nonetheless, it is important to point out that the GATS does allow for new regulation if it is non-discriminatory and transparent, and does not nullify or impair existing commitments.

17 First-mover advantages combined with significant policy-based barriers and thereby accompanied rents provide also incentives for foreign companies with commercial presence in the PTA partner to resist the opening of markets to other countries (Hoekman and Winters 2009).
shown to be less of a pro-competitive strategy in services. When restricted by the host-country regulations, foreign investors in services tend to have strong incentives to follow the prevailing behavior in the host market (Messerlin 2005).

An incentive for many developing countries to limit cross-border trade (either by leaving it unbound or linking it to Mode 3) and commit commercial presence, is the possibility to increase capital flows into the country with the hope of thereby also increasing local employment and knowledge transfer. On the other hand, many developing countries have fears of adjustment costs from increased competition from more competitive foreign companies in their domestic markets, or simply keep Mode 3 as a bargaining tool to gain Mode 4 access to developed country markets (Hoekman et al. 2007).

**Cross-border trade (Mode 1)**

Cross-border trade is more restricted due to opposition to market access concessions from regulators in the importing country as well as from import-substituting companies and their employees. Since regulators in the importing country have little control of the supply of services through Mode 1, they are often reluctant to give un-discriminated market access in sensitive and regulated sectors on a multilateral level, where the level of consumer protection, the quality of services, and legal standards vary widely (Feketekuty 2000; Hoekman and Primo Braga 1997; Hoekman and Kostecki 2001; Hoekman et al. 2007). In such cases, countries either do not commit the sector or continue to maintain limitations such as nationality/permanent residency, or commercial presence requirements in order to keep the provision of the service under their jurisdiction18 (Chaudhuri and Karmakar 2009).

In order to retain a higher level of control of services supply in their market, importing country regulators especially in developed countries and more advanced emerging countries can therefore be expected to favor more far-reaching liberalization in Mode 1 through PTAs with a subset of (preferably similar) countries. As a matter of fact, PTAs in services are increasingly including a provision on the right of non-establishment, that is, no local commercial presence required as a precondition for the delivery of services (subject to the right to reserve and list existing non-conforming measures), which can be expected to promote e-commerce as well as other forms of cross-border trade. There is no equivalent general clause in the GATS19 (OECD 2002b; Stephenson 2002; Mattoo and Sauvé 2008).

18 In this paper, these kinds of restrictions render the cross-border commitment void, or unbound.

19 In the GATS, if a country wants to demand commercial presence as a precondition for service delivery through cross-border trade, however, they should list this as a national treatment limitation. Otherwise, it might be a violation of their Mode 1 commitment (Mattoo and Sauvé 2008).
Fear of regulatory competition can become a stumbling block even in a preferential setting, though, if the level of regulation varies substantially, as could be seen in the polemic regarding the new Internal Market Services Directive from 1996 in the European Union. Similarly, import-competing firms are less likely to show resistance to exporting foreign firms that are faced with the same regulatory burden and cost structure as they in their local market (that is, trade through Mode 1 from similar countries or through Mode 3 from any country) than to exporting foreign firms facing lower costs in foreign jurisdictions (trading through Mode 1) (Messerlin 2005; Hoekman and Winters 2009; Hoekman et al. 2007).

The exponential growth of offshoring of services to more price-competitive markets is raising the resistance among import-competing firms and labour in developed countries to cross-border trade—especially as offshoring is moving upstream to ever-increasing skill levels where SMEs are likely to be more competitive—, even if developed countries themselves are still by far the largest exporters of the same services (Chase 2008; Chaudhuri and Karmakar 2009; Hoekman et al. 2007; Hufbauer and Stephenson 2007; Mattoo and Wunsch-Vincent 2004; Messerlin 2005).

Nevertheless, regulators are keenly aware that in step with technological advances, especially in telecommunications and the spread of the internet, cross-border trade is increasingly out of their hands and committing market access for cross-border trade is merely reflecting facts on the ground. Moreover, many services in which cross-border trade was earlier considered technically unfeasible are now considered tradable; these services include distance education, telemedicine, and hotel bookings over the internet (Chaudhuri and Karmakar 2009). We can therefore expect a diminishing gap between the level of commitments on commercial presence and cross-border trade in both multilateral and preferential trade agreements. Whereas Mode 1 is generally acknowledged to be the main mode of SME trade, it is also an important complement to Mode 3 trade and therefore also in the interest of MNEs.

There are a few published comparisons between GATS Uruguay Round commitments with the GATS offers in the latest round of service trade negotiations and commitments in the most liberal preferential trade agreement for each country. The studies focus on commitments for cross-border trade and commercial presence (Roy et al. 2007; Roy et al. 2008; Marchetti and Roy 2009; for an assessment of initial GATS offers, see also Adlung and Roy 2005). Specific reciprocity is shown to be on average relatively more important for cross-border trade than for commercial presence. Cross-border trade (Mode 1) was committed on average in 31% and commercial presence (Mode 3) in 44% of all 155 subsectors in the GATS schedules. In GATS offers the respective percentages are 38% versus 53%. The best PTAs raise the committed subsectors to 73% for Mode 1 and 85% for Mode 3. Whereas the
difference between Mode 1 and Mode 3 commitments is 28% in GATS offers, it is merely 14% in PTAs (Roy et al. 2008).

**Movement of natural persons (Mode 4)**

The temporary movement of natural persons as service suppliers (Mode 4) is the most protected of all the four modes of supply. It is at the trade-migration nexus, even though efforts are being made to deny the connection to labour migration policies and to only speak about trade liberalization. In 2004, the OECD arranged a seminar on “Trade and Migration: Building Bridges for Global Labour Mobility,” bringing together trade and migration officials from nearly one hundred countries to create a better understanding of the relationship between the regimes. They stated that even though Mode 4 is not a migration category or concept, it is in practice regulated by migration policies. They defined GATS Mode 4 as a form of temporary labour migration, which itself is a subset of temporary migration (OECD 2004b). Henry (2003) portrays Mode 4 to be in the intersection between immigration, labour and trade policies. He says that even if the overall state goals might be overriding, the language and rationale of the different policy communities often differ to the extent that misunderstandings, and even antagonisms, are not uncommon. The main reason is their difference in focus and preoccupation.

It is unclear in most countries who has the final authority over Mode 4 issues. Not only are ministries or agencies of trade, labour, and immigration involved, but also offices dealing with national security and sector-specific regulatory authorities. In certain countries, as notably in the USA, the competence lies not with the executive but the legislative branch of government. Each one of these, and other possible agencies, have their own interests and main constituencies. Whereas trade ministries cater mainly to business needs and seek an open trading environment, immigration authorities are more defensive in their approach and are not geared towards the needs of business. Labour ministries, on the other hand, are mainly concerned with meeting labour market development needs, if needed via temporary foreign labour. They do not control entry, though, and are in general more concerned with employer-employee relationships at the national level than with foreign service providers who are supposedly not entering the local labour market (Young 2000).

Apart from a general opposition to binding Mode 4 commitments by labour unions, regulators, as well as labour policy and immigration officials, the latter two in particular prefer reciprocal commitments from other important trading partners (Henry 2003). Governments do not want to lose their autonomy to regulate the movement of natural service suppliers, even of a temporary nature, since the state of the economy and the local labour markets tend to fluctuate. Defining and binding
commitments on economic needs tests, quotas, time durations, sectoral coverage and so forth are met with hesitation from regulatory authorities, who see the local labour market as dynamic rather than static (Young 2000; Persin 2008).

Bilateral and regional agreements offer normally more flexibility and facilitate joint action, such as monitoring of movements in both the home and host country. They enable also faster re-negotiation of agreements in case of disruptions in the labour market than is possible in a multilateral setting (OECD 2002d, 2004b; Persin 2008).

Typically, the temporary movement of natural persons as service suppliers (Mode 4), other than concerning highly-skilled intra-corporate transferees (ICTs), is portrayed as a developing country interest only and as such diametrically opposed to the interests of developed countries (Chanda 2001; Chaudhuri, Mattoo, and Self 2004; Ghosh 1997; Mattoo and Carzaniga 2003; Whalley 2004; Winters et al. 2003; Winters 2008).\(^{20}\) In other words, whereas SMEs and contractual service suppliers (CSSs) continue generally to be framed as developing country interests, and ICTs and large MNEs as developed country interests, I claim that this dichotomy is somewhat misleading.\(^{21}\) In reality, SMEs are in a large majority in all countries; and MNEs are emerging also from outside of the developed world, which points rather to a large-versus-small enterprise dichotomy. This reality is reflected in the current multilateral service trade negotiations, where several developed countries have been at the forefront proposing and requesting increased market access for CSSs as a way to facilitate trade by their SMEs.\(^{22}\) It becomes

\(^{20}\) It was the grand North-South bargain between capital and labour during the Uruguay Round establishing the GATS that resulted in services trade being defined and negotiated by modes of supply (Self and Zutshi 2003).

\(^{21}\) There exists, however, a dichotomy within Mode 4 between developed and developing countries that is based on skill levels, with more advanced developing countries falling in between the developed and less developed countries. In addition, the less advanced the country, the more Mode 4 seems to be interpreted as labour migration as opposed to traditional trade. In other words, what remains primarily a developing country interest is the movement of so-called independent professionals (mainly self-employed looking for temporary “employment” abroad) as well as semi- and low-skilled labour: each of which is usually closer to employment and labour migration than trade as well as unlinked to other modes of supply (Winters 2008; Winters et al. 2003; Chaudhuri et al. 2004).

\(^{22}\) See, for instance, negotiation proposals on SMEs by Canada (S/CSS/W/48, TN/S/W/36) and the USA (S/CSS/W/135) to the WTO Council for Trade in Services and the subsequent discussions during Special Sessions where developed countries, such as the EU countries, highlighted the importance of SMEs to their economies.
clear, therefore, that all governments share an interest to negotiate market access for movement of labour taking SME needs into account.\textsuperscript{23}

The market access for independent and contractual service suppliers\textsuperscript{24} is usually much stricter and limited to fewer sectors than CSSs. Regulators as well as labour policy and immigration officials are expected to favor the former over the latter, since they are easier to monitor and are less likely to overstay their work permits. In addition, whereas ICTs, in a similar fashion to commercial presence, fall within the regulatory jurisdiction of the host country, it is less clear whether that would be the case for CSSs. The fear of regulatory and wage competition, and the difficulty to control the compliance to host country regulation in case it is stipulated, render service supplier movement on a contractual basis a more politically sensitive issue for regulators, labour, and import-competing firms than either ICTs or short-term employment of foreigners in host-country companies (Carzaniga 2009; Persin 2008).\textsuperscript{25} Hufbauer and Stephenson (2007) argue, in contrast, that by its nature, contract-based presence is more likely to be temporary, and therefore more acceptable politically in host countries than permanent migration.

Labour unions tend to object to GATS Mode 4 commitments for the additional reason that temporary service providers are less likely to join the unions than permanent immigrants or more controlled bilateral migrants flows and are thus more likely to dilute the power and influence of the unions (Persin 2008).

\begin{flushleft}
\textsuperscript{23}Nevertheless, a qualitative separation can be made between human capital-intensive SMEs and human capital-scarce SMEs; a separation that reflect traditional North-South divisions. Again, advanced developing countries tend to fall in between, with increasingly higher levels of human capital.
\textsuperscript{24}An independent service supplier, or so-called independent professional, refers to a self-employed service supplier who engages in the supply of a service based on a contract with a juridical or natural person in the host country. The line is often blurred between actual employment and the fulfillment of an independent contract, since the service supplier is directly remunerated by the customer in the host country. A contractual service supplier is an employee of a company with no commercial presence in the host country who engages in the fulfillment of a contract between the home country employer and the host country juridical person, or in some cases a natural person. The CSS is remunerated by the home-country employer.
\textsuperscript{25}The biggest controversy regarding the recent European Services Directive, which entered into force in 2006, concerned precisely the issue of whether home-country or host-country regulations (including on wages and working conditions) would be applied to cross-border trade and posted workers, that is, CSSs (Hoekman et al. 2007; Messerlin 2005; Nicolaïdis and Schmidt 2007; Hoekman and Winters 2009).
\end{flushleft}
Unlike multilateral negotiations, preferential trade negotiations are not supposed to *a priori* preclude negotiations on any modes or sectors according to rules set out in the GATS. Yet, even if movement of labour is normally furthered through regional and bilateral agreements, political sensitivity related to the movement of natural service suppliers is said to have been too high to break the stalemate not only in the multilateral but also in most preferential negotiations, in particular if one partner is a developing country. The bias towards high-skilled ICTs is said to be replicated in preferential agreements (Hoekman and Kostecki 2001; Mattoo and Olarreaga 2000; Mattoo and Sauvé 2008; Nielson 2003). Nevertheless, the comparison is usually between market access commitments made along stereotypical North-South lines: on the one hand, for high-skilled ICTs, and on the other hand, for independent professionals or medium and low-skilled labour not related to any other mode of supply.

Carzaniga (2009) does a rough estimation of commitment levels in the Doha Round offers as of January 2008. Out of 71 offers (including 30 revised offers, the EC offer counted as one), only about half include improved general, not sector-specific, commitments. Most improvements relate to ICTs and business visitors and only a few to natural persons unlinked to commercial presence.

Carzaniga also compares the publicly available Doha offers with PTAs notified to the WTO between 2000 and 2007. Like the assessment of Doha offers, the assessment of PTA commitments is based solely on the general, so-called horizontal, commitments. Essentially, this means that the focus is on the categories of natural persons and the general restrictions applicable to them. The omission of sectoral analysis hides a very significant aspect of the potential improvement in commitments. As a general assessment, however, she concludes that whereas most countries have gone beyond their existing GATS commitments by both deepening existing commitments and expanding into new categories of natural persons in their PTAs, the improvements are only marginal in comparison to their latest offers at Doha. In particular, progress has been most limited in categories unlinked to commercial presence, that is, for CSSs and independent professionals. Ten countries out of thirty-three have introduced CSSs as a new category in PTAs and two have improved on their GATS offer.

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26 A notable exception is the Internal Market of the EU/EEA, but the free movement of people and service labour has been the source of friction even there leading, for instance, to the host-country rule in the aforementioned European Services Directive and to transitory restrictions on the movement from new member countries to old ones both during the Southern Enlargement in the 1980s and during the Eastern Enlargement in the 1990s.

27 Not all are made public, but Carzaniga has access to them as she is working at the WTO Secretariat.
In general, a preferential negotiating setting is easier to comprehend. It is therefore likely to reduce the uncertainty of the cost and benefits for the domestic constituency and thus facilitate farther going liberalization (Hoekman and Primo Braga 1997).

Hypotheses

Based on the discussion in this chapter, I expect preferential trade liberalization based on specific reciprocity to better reflect small enterprise preferences on market access than multilateral trade liberalization based on diffuse reciprocity, that is, unconditional MFN, and propose the following:

Even though the level of commitments\(^{28}\) on intra-corporate transferees is likely to be higher in both the new GATS offers and preferential trade agreements than the level of commitments on the politically more sensitive contractual service suppliers – thereby enabling mode-interconnected trade between commercial presence and intra-corporate transferees preferred by large enterprises and preventing mode-interconnected trade between cross-border trade and contractual service suppliers preferred by SMEs –

I hypothesize that preferential trade liberalization is more likely than multilateral trade liberalization to level the playing field between large and small enterprises by

1) *increasing the market access given to cross-border trade relative to market access given to commercial presence*;
2) *increasing the market access given to contractual service suppliers relative to market access given to intra-corporate transferees*; (thereby also)
3) *facilitating more mode-interconnected trade by more even commitments on cross-border trade and contractual service suppliers*.

Research Methodology

The research methodology is empirical and based on quantitative methods. In order to empirically test for the hypotheses, a new database of commitments was built by giving either a score of 0 (no commitment) or 1 (commitment) for each mode of supply in each subsector based on criteria described further below. The final database consists of the number of subsectors that is committed for

\(^{28}\) For simplicity, the potential commitments in the GATS offers are here also called commitments.
each mode per agreement and country. The hypotheses are tested by using paired samples t-test\(^29\) for inferential statistics.

The research focuses on the developments after year 2000, when the second round of GATS negotiations started and most preferential service trade agreements were negotiated.\(^30\) It includes all countries that were a member of an Economic Integration Agreement (as PTAs are called in the GATS) signed between 2000 and 2008 and subsequently notified to the WTO under GATS Article V by the end of 2009, and that had a published GATS offer from the current GATS negotiations (latest revised and published offer compared).\(^31\) Only the best PTA for each country is chosen with the number of commitments for contractual service suppliers (CSSs) as the first-hand criteria.

The number of countries fulfilling the above criteria amount to 49: 31 developed and 18 developing according to the World Bank 2005 GNI index.\(^32\) This means that 49 GATS schedules are compared with 49 PTA schedules. It is worth noting, however, that whereas the PTAs are binding agreements, the GATS offers can still be fully or more likely partially withdrawn. In other words, the GATS offers portray the current best-case scenario through the multilateral track and the PTAs the best preferential bound commitments in force for each country. By multiplying the number of schedules with 51\(^33\) of the 155 subsectors in the W/120 –list used in the GATS schedules for cross-border trade,

\(^{29}\) The paired samples t-test is the correct t-test to be used here since there is positive correlation between the dependent variables (here: number of commitments for the two compared modes) for each country.

\(^{30}\) By comparing GATS offers with PTAs, unfair comparison to the GATS schedules from 1995 can be avoided. In 1995, cross-border trade was technically unfeasible in many subsectors and raised fears and questions in many countries.

\(^{31}\) In order not to distort the dataset, the EU enlargements, EFTA, and Island – Faroe Islands PTA are not reviewed since these can be seen as part of Wider Europe integration arrangements rather than typical free trade agreements. China’s agreement with Hong Kong, China, is also excluded.

\(^{32}\) The EU member states will be studied separately due to differences in their commitments. The countries are: Developed/ Australia, Bahrain, Canada, EFTA 4, EU 19, Japan, Rep. of Korea, New Zealand, Singapore, and USA(countries in italics declare themselves as developing in the WTO negotiations); Developing/ Chile, China, Costa Rica, EU 8, India, Malaysia, Mexico, Morocco, Pakistan, Panama, and Thailand.

\(^{33}\) The subsectors were chosen from within eight of the twelve sectoral clusters in W/120: business-; construction and related engineering-; distributional-; educational-; environmental-; financial-; tourism and travel related-; and recreational, cultural and sporting- services.
commercial presence, and both types of labour movement we get approximately 20,000 observations on which the statistical analysis is based.

The subsectors were chosen based on a review of relevant plurilateral requests, EU bilateral requests, the EU offer (which seems in general to be the most liberal on CSSs of all the countries studied), WTO service council meeting reports and some other documents to see which subsectors seem to be the most requested for CSSs and also important for cross-border trade.34 Thereby the choice of subsectors is subjected to the toughest test. If all subsectors had been chosen, the test results would have been considerably more obvious, since in no GATS schedules were other subsectors than those chosen here committed for CSSs. On the other hand, movement of CSSs and in some cases cross-border trade would not have been a feasible mode of supply in some of the omitted subsectors. By leaving them out, the test measures what it is aimed to measure: the extent to which the two trade liberalization tracks level the playing field between small and large enterprises in sectors most relevant for the former.

The leading criteria for the counting of the number of committed subsectors was to clearly separate between modes linked and unlinked to commercial presence, so that commitments bound for cross-border trade and CSS that had any form of a link to commercial presence, and for the former also to residency, were excluded from the count. In a similar manner, commitments on CSS based on personal contracts or employment with a host-country employer were excluded. Existing analyses of commitments for cross-border trade and movement of natural persons do not take the restrictiveness of these requirements into account and portray therefore a more open regime than is actually the case for businesses with limited resources to invest in a commercial presence.35 Moreover, in counting the number of committed subsectors for each mode of supply (score: commitment=1, no commitment=0),

34 Magdeleine and Maurer (2008) point out in a working paper on measuring movement of natural persons that the movement of contractual service suppliers can basically be more important than cross-border trade, even if interconnected, in most of the studied subsectors. Therefore it is logical to choose the sectors based on contractual service suppliers, but where cross-border trade is also important.

35 Earlier studies have typically taken one or both of the following approaches in measuring the level of bound commitments in trade agreements: counting the number of committed subsectors or assessing the depth of commitments by using a frequency measure such as the simple index developed by Hoekman (1996, the index allocates a score of 0 if a mode/sector is unbound or non-committed; a 0.5 if it is partially committed; and a 1 if it is fully committed.) Both methods basically equate a highly restrictive commitment (e.g. with a citizenship requirement) with a highly liberal one (e.g. with some marketing restrictions). Most of the studies tend to focus on commitments on Modes 1 and 3.
an unbound market access commitment counted as no commitment even if national treatment was committed. Likewise, commitments that require citizenship, nationality, or permanent residency were considered unbound irrespective of the mode of supply, as they prevent foreign market access in practice and should therefore not be credited.

**Findings**

The results of the statistical analysis reveal a clear and statistically highly significant tendency towards modes connected to commercial presence among the 51 studied service subsectors which are in general the most liberalized and the most suitable for trade at arm’s length. This bias is to be seen in both the multilateral and the preferential market access commitments, even if, according to the hypotheses, the gap is smaller in preferential trade agreements.

Table 1 shows the paired samples statistics on the number of commitments across market access modes and types of agreements for the 49 countries in the sample. The table presents the results for two stages of paired samples t-test for each hypothesis: the first stage entails the paired samples t-test comparing the number of commitments per mode of supply in either GATS offers or best PTAs (first eight columns); and the second stage tests the actual hypothesis by comparing the gaps in the number of commitments for the two modes between the two types of agreements.

Column 3 in Table 1 shows the means of the number of commitments for the 49 countries in their GATS offers and best PTAs. The commitments for commercial presence (Mode 3) were on average for 39 subsectors in GATS offers and for 47 subsectors in PTAs. Cross-border trade (Mode 1) was on average committed for 30 subsectors in the former and for ten more in the latter (for an illustration see Figure 2.) The Mode 3 commitments are on average in 77% and Mode 1 in 60% of the studied 51 subsectors in the GATS offers. In PTAs the respective percentages are 91% versus 79%. Whereas the difference between Mode 3 and Mode 1 commitments is 17% or 9 subsectors in GATS offers, it is slightly lower at 12% or 6 subsectors in PTAs (compare with the larger differences across all 155 subsectors as presented on page 14.)
The difference between the level of commitments for intra-corporate transferees (ICTs) and contractual service suppliers (CSSs) is more obvious, as can be expected. There are, however, ten countries that did not open up their markets to CSSs through either type of agreement. The difference between commitments for ICTs versus CSSs is therefore more likely when comparing all 49 countries than if concentrating on the 39 that were prepared to commit market access for CSSs at least in a PTA.

In the following, the tougher sampling criteria of 39 countries will be discussed (to compare with the full sample of 49 countries, see Table 1). Figure 3 and

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36 Costa Rica, Iceland, Japan, Liechtenstein, Mexico, Morocco, New Zealand, Norway, Panama, and USA.
Table 2 show the commitment levels for the 39 countries.

The number of commitments for ICTs mounted to 37 (or 73% of the chosen 51) subsectors on average in GATS offers and to 45 (88%) subsectors in PTAs. The numbers are considerably lower for CSSs, even if far more countries offer on CSSs in the GATS than during the Uruguay Round. The average number of committed subsectors for CSSs in the GATS, 15 (29%), was clearly less than half of the commitments for ICTs. This gap of 22 subsectors is halved in PTAs when the average level of commitments on CSSs increase to 33 (65%) subsectors. The difference in the number of countries with commitments for CSSs—31 in GATS compared with 39 in PTAs—clearly have an effect on the means even in this smaller sample of 39 countries.

![Figure 3 Number of Commitments for Intra-corporate Transferees and Contractual Service Suppliers (Hypothesis 2), n=39](image)

The difference in market access for the modes preferable for either large or small enterprises becomes most obvious when we look at trade through modes that are inter-connected based on the notion that in many cases restrictions in one mode can prevent trade through another. The commitments are compared subsector by subsector where both commercial presence and intra-corporate transferees have got market access versus where both cross-border trade and contractual service suppliers have got market access. Only when both inter-connected modes are committed, the subsector is considered to be committed. Whereas ICTs can by definition not exist without commercial presence and the interconnected statistics can thus be based on ICTs (commercial presence is in certain cases possible without ICT), Mode 1 and CSSs are not necessarily dependent on each other and do not
therefore always coincide. The number of combined commitments can therefore be less than commitments in the least liberalized mode of supply.

This is what we can see in the statistics where the average commitment levels for the interconnected modes unlinked to commercial presence are slightly lower than if only measuring the commitment levels for CSSs. Both unlinked modes are committed on average in only 13 (25%) subsectors in GATS offers, more than doubling to 28 (55%) subsectors in PTAs (see Figure 4.). The gap in the level of commitments for the two sets of modes, linked versus unlinked, is 24 subsectors in GATS offers and reduced to 16 subsectors in PTAs. The gap is still considerable, though, even in the PTAs. As noted earlier, this gap would be considerably larger if all subsectors would be considered, since CSSs are seldom given market access outside of these chosen subsectors whereas ICTs are.

![Figure 4 Number of Commitments for Mode-interconnected Trade (Hypothesis 3), n=39](image)

The paired samples tests for all these differences in commitments for linked versus unlinked modes described above and listed in Table 1 and
Table 2 show high t-values at a higher than 99% level of confidence for either set of countries (see column 7). This reveals a clear systematic bias against unlinked modes that are preferred by SMEs in both preferential and multilateral agreements. Next we will measure the statistical significance of reciprocity to reduce this bias.

In order to statistically test the hypotheses on page 18, I operationalize them as follows:

**Hypothesis 1**: The gap between the number of commitments for Commercial Presence and Cross-border Trade in PTAs is smaller than the comparable gap in GATS;

**Hypothesis 2**: The gap between the number of commitments for Intra-corporate Transferees and Contractual Service Suppliers in PTAs is smaller than the comparable gap in GATS; and

**Hypothesis 3**: The gap between the number of commitments for Commercial Presence & Intra-corporate Transferees and Cross-border Trade & Contractual Service Suppliers in PTAs is smaller than the comparable gap in GATS.

The statistical findings (see Table 1) confirm the hypotheses by showing overall highly significant results for the paired samples statistics between types of agreements. The average gap between the commitments on commercial presence (Mode 3) and cross-border trade (Mode 1) is larger by two subsectors in GATS offers than in PTAs (Hypothesis 1). While the difference in the gaps is not large, it is statistically highly significant at 1%.

Hypotheses 2 and 3 can clearly be accepted at 1% significance for both the entire sample of 49 countries and the sub-sample of 39 countries. In the latter sample, the mean paired difference between the gaps in commitments for ICT and CSS in the two types of agreements is as large as 11 subsectors. For the interconnected modes the mean paired difference between the two types of agreements is half of that at 5 subsectors. The results indicate a relatively stronger effect of direct reciprocity on commitment levels on CSS and Mode 1&CSS than on the corresponding linked modes.

In conclusion, specific reciprocity can therefore be confirmed to play a more important role for modes unlinked to commercial presence than for modes linked to commercial presence. The gap between the number of committed sectors for the two types of modes is significantly smaller in a preferential setting than in a multilateral setting. Preferential trade liberalization is therefore more likely than multilateral trade liberalization to level the playing field between small and large enterprises.

As mentioned earlier, if all 155 subsectors had been chosen for the comparison, the test results would have been considerably more obvious, since in no studied GATS offers are other subsectors.
committed for CSSs than those chosen here. On the other hand, in certain PTAs, the amount of subsectors committed for CSSs could clearly override the number of subsectors chosen here.\textsuperscript{37}

Some caution is needed when interpreting the results since only the most liberal PTAs for each country are included in the sample, which implies that had all the existing PTAs for the studied countries been included, the mean number of commitments would likely have been smaller and the gaps between the types of commitments likely not as large. On the other hand, the GATS offers are only offers and the final schedules of commitments could still turn out to be either more liberal or more restrictive, or in the worst case scenario, not realized at all if the Doha Round fails. The preferential market access commitments are at least final and binding and provide therefore a more predictable trading environment.

When discussing market access commitments, it is important to keep in mind, however, \textsuperscript{a} that they tend to be only partial bindings of the existing unilateral status quo; and \textsuperscript{b} that they can hide onerous non-discriminatory domestic regulatory requirements. Moreover, the number of sectors –statistics hide the possibility of only a narrow sectoral commitment or a shallow commitment. They also hide improvements and deepening of commitments within a subsector.

\textsuperscript{37} It is important to note, however, that since the number of committed subsectors for CSS was chosen as the best PTA criteria, the results especially for Mode 1 and ICT could be different if either of those were chosen as criteria.
Table 1 Paired Samples Statistics on the Number of Commitments across Market Access Modes and Types of Agreements, n = 49

<table>
<thead>
<tr>
<th>Variables</th>
<th>Agr. Type</th>
<th>n</th>
<th>Mean</th>
<th>Std.</th>
<th>CI 95% [Lower, upper]</th>
<th>t</th>
<th>df</th>
<th>Mean</th>
<th>Std.</th>
<th>CI 95% [Lower, upper]</th>
<th>t</th>
<th>df</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mode 3 GATS</td>
<td>49</td>
<td>38.939</td>
<td>30.510</td>
<td>8.429</td>
<td>0.773</td>
<td>10.901</td>
<td>48</td>
<td>2.347</td>
<td>0.771</td>
<td>[0.797, 3.897]</td>
<td>3.045</td>
<td>48</td>
</tr>
<tr>
<td>Mode 3 PTA</td>
<td>49</td>
<td>46.755</td>
<td>40.673</td>
<td>6.082</td>
<td>0.718</td>
<td>8.4661</td>
<td>48</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mode 1 PTA</td>
<td>49</td>
<td>42.939</td>
<td>26.388</td>
<td>16.551</td>
<td>2.121</td>
<td>7.804</td>
<td>48</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ICT PTA</td>
<td>49</td>
<td>42.939</td>
<td>22.531</td>
<td>20.408</td>
<td>1.872</td>
<td>10.901</td>
<td>48</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: *** Significant at 1%.
Table 2 Paired Samples Statistics on the Number of Commitments across Market Access Modes and Types of Agreements, n = 39

<table>
<thead>
<tr>
<th>Variables</th>
<th>By Agr. Type</th>
<th>n</th>
<th>Mean</th>
<th>Std.</th>
<th>CI 95% [Lower, upper]</th>
<th>t</th>
<th>df</th>
<th>Mean</th>
<th>Std. Error</th>
<th>CI 95% [Lower, upper]</th>
<th>t</th>
<th>df</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mode 3</td>
<td>GATS</td>
<td>39</td>
<td>39.897</td>
<td>8.897</td>
<td>[7.203, 10.591]</td>
<td>10.633***</td>
<td>38</td>
<td>2.000</td>
<td>0.805</td>
<td>[0.371, 3.629]</td>
<td>2.485***</td>
<td>38</td>
</tr>
<tr>
<td>Mode 1</td>
<td></td>
<td></td>
<td>31.000</td>
<td>6.897</td>
<td>[5.197, 8.598]</td>
<td>8.212***</td>
<td>38</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mode 3</td>
<td>Best</td>
<td>39</td>
<td>47.026</td>
<td>40.128</td>
<td>6.897</td>
<td>[5.197, 8.598]</td>
<td>8.212***</td>
<td>38</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mode 1</td>
<td>PTA</td>
<td>39</td>
<td>31.000</td>
<td>6.897</td>
<td>[5.197, 8.598]</td>
<td>8.212***</td>
<td>38</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

Note: *** Significant at 1%.
Nevertheless, whereas ICTs is an existing (work) visa category in most countries, there is not a clear visa category for CSSs in many countries, partially since it is still a rather new type of labour movement. In cases where market access for CSSs is bound for the first time or where the subsectors have been clearly expanded from earlier commitments, both which are more common in PTAs than in GATS offers, we can expect there to be some real market liberalization and not only a binding of existing status quo.

Regional and cultural affinity does not explain this pattern: of the compared 49 PTA schedules only is to the benefit of a regional party (China’s schedule with ASEAN). The remainder of the best PTAs are cross-regional according to WTO’s country classification. There is no significant difference in the effect of reciprocity between developed and developing countries in the sample. In general, developing countries have been as reluctant, if not even more so, as developed countries to give market access to CSSs.

Direct mutual reciprocity plays perhaps a smaller role in EU’s European Partnership Agreement with 16 Caribbean countries (Caribbean Forum, or CARIFORUM, sub-grouping of the African-Caribbean-Pacific, or ACP, countries), which is a continuation to a long-standing development policy of the EU towards the ACP countries. Nevertheless, whereas the former PTAs were non-reciprocal, the new EU-CARICOM agreement aims to facilitate the “smooth and gradual integration” of the CARIFORUM countries in the world economy through “progressive, reciprocal and asymmetric liberalization of investment and trade in services” (Art. 60). SMEs and their preference for modes unlinked to commercial presence are emphasized and there is clearly more far-going liberalization on these modes as compared to the EU’s GATS offer. Similarly, CARIFORUM countries have been willing to bind at least their existing openness and some of them even to make new commitments, including on CSSs, albeit restrictive ones. The EU-15 and EU-27 commitment patterns follow the total sample pattern with no significant difference.

Conclusions

The changing trade scene with more and more small enterprises going international and even global has gained the attention of governments not only in (advanced) developing but also in developed countries. The benefits gained from employment and innovation growth, especially in knowledge-intensive business services sectors have induced governments, inter
alia, to strengthen their efforts at expanding their export bases to include more small enterprises. But how serious are they about it?

This paper shows the necessity for differentiation to be made between the trade policy preferences of small and large companies in the services sector. The effects of trade barriers should be studied separately for both sets of stakeholders so that a more real picture can emerge of the de facto trade restrictions facing different companies and economies in various trade regimes. Internationalization theories, small business studies, and published country trade consultations with their business sector\(^{38}\) show that the preferred market access modes differ between small and large enterprises. Small enterprises typically prefer exporting via “soft” modes of supply that are unlinked to commercial presence, whereas large enterprises prefer “hard” internationalization channels using foreign direct investment and related modes of supply.

Even if exporting SMEs exist in and are of interest not only to developing but also to developed countries, large developed countries are generally likely to feel the weight of large enterprises more than smaller developed or developing countries. They are therefore liable to direct their main focus and market power towards forwarding the interests of large companies, whereas the smaller developed countries and developing countries put more emphasis on smaller companies. This can be seen, for instance, in the negotiation emphasis of the US and the EU versus the smaller Australia, Canada, Norway, and most developing countries in the current multilateral trade negotiations.\(^{39}\) Nevertheless, larger developed countries are also benefitting from increased market opening for their SMEs, and in the case of the EU, are also requesting market access in modes unlinked to commercial presence in their bilateral requests at the GATS.\(^{40}\)

\(^{38}\) See e.g. European Commission (2002) as well as the Negotiation Proposals on SMEs by Canada (S/CSS/W/49 and TN/S/W/36), the USA (TN/S/W/5), and Mauritius (TN/S/W/8) to the WTO Council for Trade in Services.

\(^{39}\) Personal interviews with trade policy officials at the WTO in Geneva (May 2008) and in Ottawa (Feb. 2010). Naturally, in those small countries in which one or a few large companies control a significant share of GDP, their weight might be even larger than comparably in a large country.

\(^{40}\) See EU initial requests at: http://www.esf.be/.
The paper analyzed the recent round of service trade negotiations at the multilateral and preferential level comparing to what extent both liberalization tracks offer market access on the preferred modes of supply to small versus large enterprises. The general hypothesis was that small enterprises are likely to face more restrictions than large enterprises on their preferred modes of supply due to the higher political (economic) sensitivity of modes unlinked to commercial presence. Specific reciprocity through preferential trade liberalization is more likely than multilateral trade liberalization to overcome the domestic political economy restraints to modes unlinked to commercial presence and thus level the playing field between small and large enterprises by providing more even market access in their respective preferred modes of supply. The hypothesis was statistically clearly confirmed, in particular for the cross-border movement of service personnel where the difference of market access for movement unlinked and linked to commercial presence is large through the multilateral track. Yet, the playing field remain highly uneven on the whole and show that the balance of interests tips towards protecting the domestic market as opposed to the interest to expand the export base to include more small enterprises.

This finding has policy implications for the choice of and timing of issues in different negotiating fora. If political sensitivity related to trade barriers critical to small enterprise internationalization is more likely to be overcome in a preferential setting than in a multilateral setting, then preferential trade negotiations can be encouraged. It can be seen as a stepping-stone to multilateralism: in case political (economic) barriers can be surmounted in a preferential setting, then they are easier to be overcome at a later stage in a multilateral setting. Pushing too hard to further the movement of labour in a multilateral setting can further increase the domestic fears and inflame the negotiation dynamics. A step-by-step approach can be advisable to gain positive experience which can reduce the domestic resistance.

In other words, if countries want to expand their export bases towards smaller enterprises, they either need to find a way to overcome domestic political restraints to provide the necessary market access in a multilateral setting, which is always a first-best option for an economy and also for small enterprises, or a green light must be given to conclude more PTAs that can incorporate a more liberal market access regime for small enterprises. A fresh and more holistic look at the agreements from an SME perspective can therefore give valuable input to the negotiating governments, since as World Bank Lead Economist Bernhard Hoekman
remarks: “A fundamental challenge confronting governments is to make trade agreements more relevant to the needs of firms and consumers in member countries” (Hoekman 2006, 51).

Generally, the issue of SMEs and in particular their preference for market access for the movement of labour unlinked to commercial presence are framed as only developing country interests and as such in direct contrast to developed country interests. By reframing the issue as an interest of all countries, which it is albeit of a differing weight, this confrontational setting could perhaps be broken and advancements could more likely be made from a mutual focal point. Until now, the traditional framing has the overhand despite developed country initiatives to the contrary in the actual multilateral negotiations. The mutual interests narrow down mainly to human-capital intensive SMEs and skilled labour from both developed and advanced developing countries, but if no further liberalization can be achieved first in them, then liberalization is highly unlikely in less human-capital intensive services and lower skilled labour further down the line. It is noteworthy that even as SMEs and the movement of labour are of obvious importance also in South-South trade, they face the same political economic resistance and barriers there.

The current single focus on the developed-developing or North-South dichotomy prevents a maturing of the debate and negotiations to see the common interests across this boundary. This notion has wider political economy implications for the deduction and analysis of country interests in international negotiations as well as the importance of framing negotiation issues in order to reach mutually benefitting results, since the framing can set the scene for either a confrontational or a mutually advantageous negotiation setting. Many services negotiation issues show unexpected alliances across developed-developing country boundaries pitting these mixed groups on opposing sides of the negotiation table. This can be seen in the multilateral services negotiations, inter alia, in the various plurilateral request demandeur and recipient country groupings, as well as in the domestic regulation country groupings based on different approaches to regulation issues. When analyzing many of these

41 See fn. 22. Moreover, in the actual trade negotiations, Canadian and Australian trade negotiators often stress the market access needs of SMEs where market access conditions can already be considered sufficient for MNEs (Personal interviews at the WTO in Geneva, May 2008, and in Ottawa, Feb. 2010.)

42 This was a point that was repeatedly confirmed during several preliminary interviews with both researchers and trade negotiators at the WTO during May 2008.
new trade issues, it might be more fruitful and intriguing to take a renewed look at what forms the countries’ interest around the issue in question and analyze the alliances, negotiation positions, and results based on the facts on the ground instead of taking a traditional North-South dichotomy as a semi-automatic starting point.

In addition, the discussion in this paper on the importance of specific reciprocity to overcome domestic political economy resistance to issues that are particularly relevant to certain stakeholders and countries calls for a more nuanced debate on the advantages and disadvantages of preferential versus multilateral trade liberalization.

Further research is called for both with a larger sample of countries and including all PTAs signed by each country to verify whether the hypotheses and findings hold in a more general sense. With a larger sample it would also be possible to analyze the effect of timing on commitments. The author’s assumption is that later agreements would be more liberal than earlier ones, especially on modes unlinked to commercial presence. The assumption is based on the premise that technological change, regulatory developments, and positive experiences with earlier liberalization would render these modes both more tradable at arm’s length and less politically sensitive. Naturally, these developments could affect not only preferential liberalization but also multilateral liberalization. In addition, since so little is known of the actual domestic political economy dynamics related to service trade liberalization in general and the various modes in particular, comparative country studies in domestic service trade policy dynamics would be needed both in relation to both preferential negotiations and multilateral negotiations.
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