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SERVICES: IMPORTANCE OF FURTHER LIBERALIZATION FOR BUSINESS AND ECONOMIC DEVELOPMENT IN THE REGION*

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INTRODUCTION[1]

Developing countries have considerable interests in export markets for services and they stand to gain significantly from reform of their own services sectors. Despite these interests, and the complementarities between developed and developing countries in these markets, negotiations in the WTO on services are proceeding only slowly. Partly this is due to the two-way linkages across broad negotiating areas, particularly the linkage with the agricultural negotiations. Our interest in this paper, however, is restricted to aspects of the services negotiations themselves, developing country interests in commitments in those sectors and the ways in which those commitments contribute to economic and business development. This includes especially the use of those commitments to support unilateral domestic reform which is not directly connected to offers of market access made by trading partners.

The next section provides a brief overview of the main characteristics of world trade in services. We then review the links between trade and development, with special attention to studies of the effects of services liberalization. These general points are illustrated by reference to a number of sectoral case studies, and by remarks about the effects of the liberalization of the movement of labour, a key interest of developing countries. We then review the current state of the WTO negotiations and conclude with some remarks on options for their acceleration and on regional interests in those options.

WORLD TRADE IN SERVICES

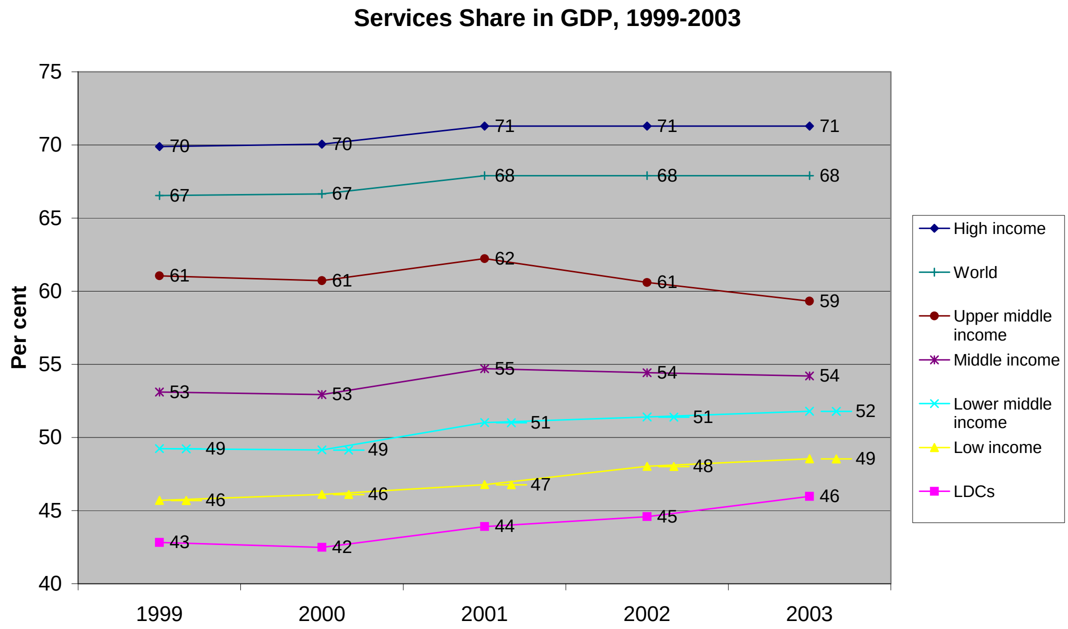
World services exports grew from about 17% of world total trade in 1987 to 20% of total trade in 2003[2]. The growth rate of goods and services exports for high, middle and low income countries has persistently outpaced income growth: according to the World Bank, average annual growth rate of GNP over 1965-1998 was 3.2% for the world, 5.9% for the low-income countries, 3.7% for the middle income and 3.0% for the high income. Corresponding growth rates of exports are 5.7%, 7.0%, 6.1% and 5.7%.

Services are more important components of high income economies: the share of services in GDP ranges from 46% in LDCs to 54% in middle income countries, 59% in upper middle income countries, and 71% in high income countries according to the World Bank definitions (see Figure 1). Developed countries are also the largest exporters and importers of services (Tables 1 and 2). The share of services trade attributed to the developing countries is small. A significant part of the

[1] An earlier version of this paper was presented at the Griffith Asia Institute workshop, August 12-13, 2005, Brisbane.
[2] UNCTAD online database, accessed July 2005

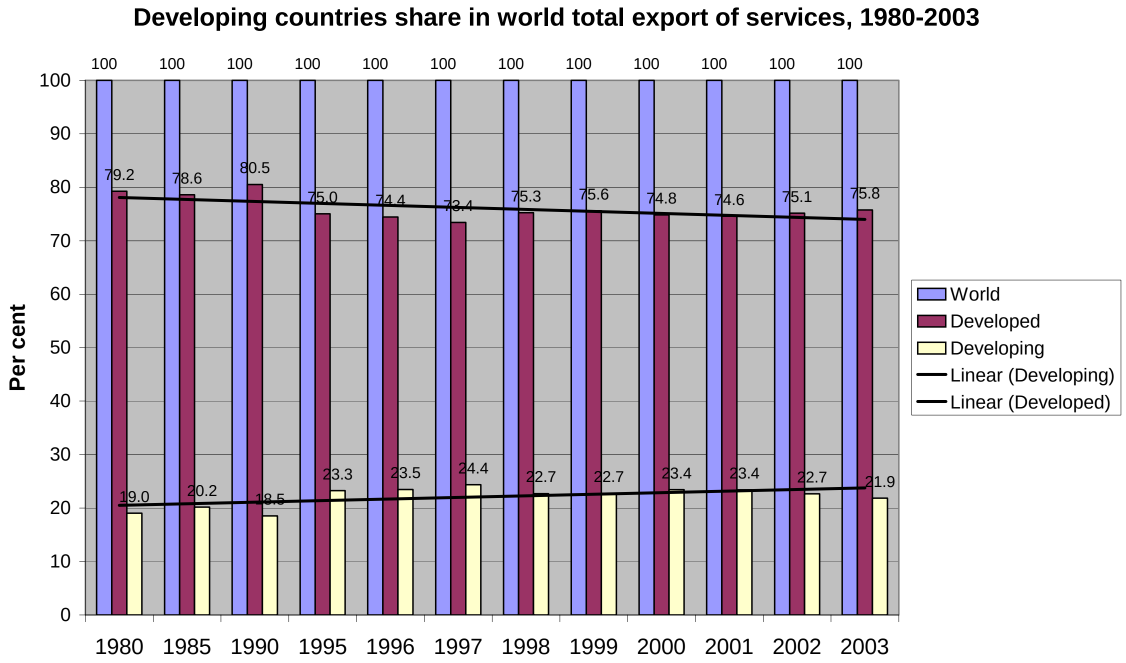
international services transactions are linked to movement of people, or its substitute (in some cases) involving cross border transactions: the share of developing countries in cross-border exports of services has been fluctuating between 22-23% over 1998-2003 (see Figure 2). At the same time, the share of services in total exports has dwindled from 17.5% in 1998 to 14.5% in 2003 on average among the developing countries, and from 21.3% to 15.9% in the LDCs (Figure 3). Some services export areas are of more interest to developing countries as export markets, including maritime transport, tourism, health services, and construction services (Nielson and Taglioni, 2004).

Figure 1 Share of services in GDP versus GDP per capita, 1999-2003



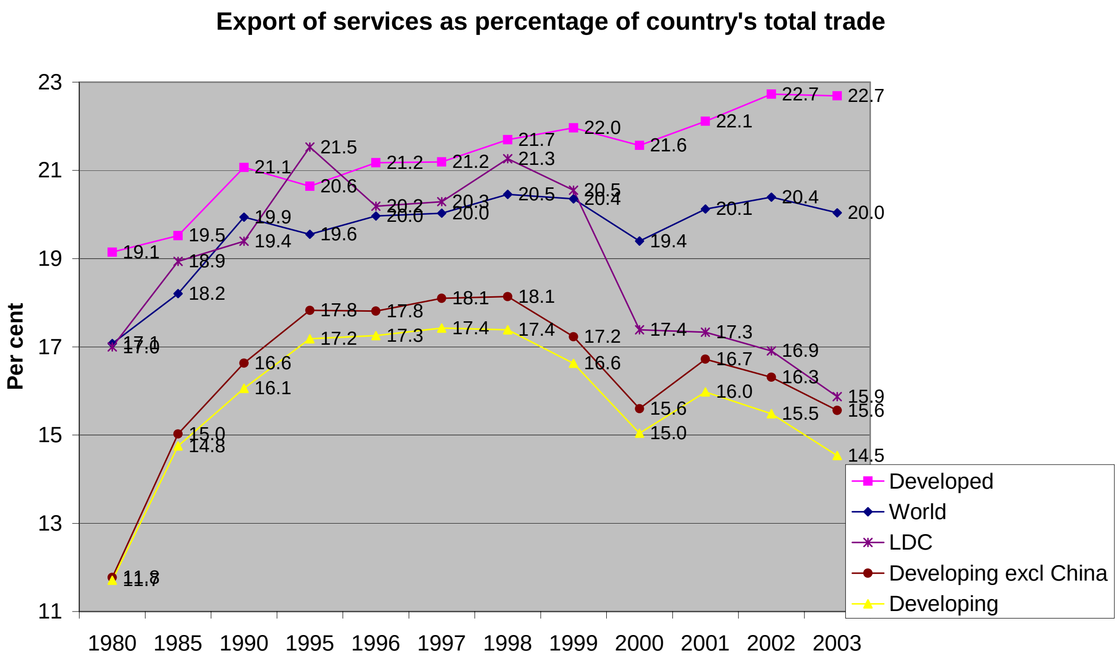
Source: World Development Indicators database: 2002 and 2003 values for High Income and World aggregates are not available, plotted at 2001 level.

Figure 2. The share of developing countries in the world trade in services, 1980-2003



Source: UNCTAD

Figure 3 The share of developing countries in the world trade in services, 1980-2003



Source: UNCTAD

Table 1 Top 20 exporters of commercial services, 2000 (mil $US)

Rank	*Country*	*Total services*	*Transport*	*Travel*	*Other services*
1	United States	296,347	50,490	97,944	147,913
2	United Kingdom	119,542	19,058	21,769	78,715
3	Germany	83,095	19,955	18,555	44,586
4	France	80,917	18,546	30,981	31,390
5	Japan	69,238	25,599	3,373	40,267
6	Italy	56,556	9,291	27,493	19,772
7	Spain	53,540	7,843	30,979	14,718
8	Belgium-Luxembourg	49,789	10,665	7,447	31,676
9	Netherlands	49,318	16,786	7,197	25,335
10	Canada	40,230	7,539	10,778	21,912
11	China, Hong Kong SAR	38,736	12,772	5,906	20,057
12	Austria	31,342	4,354	9,998	16,990
13	Korea, Republic of	30,534	13,687	6,834	10,012
14	China	30,431	3,671	16,231	10,529
15	Singapore	29,099	11,879	5,202	12,017
16	Switzerland	28,881	4,538	7,777	16,566
17	Denmark	24,107	14,232	4,058	5,817
18	Turkey	20,429	2,955	7,636	9,838
19	Luxembourg	20,301	1,331	1,686	17,283
20	Sweden	20,252	4,359	4,064	11,829

Source: UNCTAD

Table 2 Top 20 exporters of commercial services, 2000 (mil $US)

Rank	*Country*	*Total services*	*Transport*	*Travel*	*Other services*
1	United States	224,908	65,699	67,043	92,166
2	Germany	137,253	25,541	52,824	58,889
3	Japan	116,864	35,096	31,884	49,883
4	United Kingdom	99,134	24,132	38,262	36,740
5	France	61,044	17,979	17,906	25,159
6	Italy	55,601	13,140	15,685	26,776
7	Netherlands	51,337	12,886	12,191	26,260
8	Canada	44,118	9,373	12,438	22,308
9	Belgium-Luxembourg	41,868	8,386	10,182	23,300
10	China	36,031	10,396	13,114	12,521
11	Korea, Republic of	33,381	11,048	7,132	15,201
12	Spain	31,283	8,172	5,476	17,636
13	Ireland	31,272	2,627	2,525	26,121
14	Austria	29,653	2,995	8,463	18,195
15	Singapore	26,938	12,478	4,547	9,913
16	China, Taiwan Province of	26,647	6,247	8,107	12,293
17	Saudi Arabia	25,262	2,247	..	23,015
18	China, Hong Kong SAR	24,584	6,241	12,502	5,841
19	Sweden	23,440	3,640	8,048	11,752
20	Denmark	21,488	11,021	5,101	5,366

Source: UNCTAD

TRADE AND DEVELOPMENT

A positive link between trade liberalisation and economic growth has been established in trade literature. Statistical work finds a positive relationship between income per capita and the ratio of trade to the GDP[3], yet the trade share itself may be endogenous and the direction of causality may not be in one direction[4]. Adding measures of countries' trade openness also does not rectify the problem, for countries with more liberal trade policy may also have free-market domestic policies, as well as stable fiscal and monetary policies in place, which in turn would explain their higher level of income.[5] A gravity model of trade demonstrates that geographic location is one of the determinants of volumes of bilateral trade[6]. Nevertheless, the generally accepted wisdom is that a quantitatively large and robust positive effect exists between trade and income[7].

Growth in trade through trade liberalisation has been found to induce a significant increase in productivity[8]. Pressure on domestic industries by competing imports stimulates technological innovations and increased productivity. The significant contribution of trade openness to productivity gains and its impact on the risk premium attached to the country is another effect to be taken into account[9]. The major gains to the developing countries from trade liberalisation accrue, according to Dornbusch (1992), through the following channels:

- improved allocative efficiency;
- access to superior technology and intermediate inputs;
- greater variety of goods;
- advantages of economies of scale and scope;
- increased domestic competition; and
- creation of growth externalities through knowledge transfers.

Studies of the benefits of reform generally show large, but varying, values. The OECD estimated that welfare benefits of full implementation of Uruguay Round commitments would exceed US$200b. According to the GTAP model[10], cutting the level of protection in agriculture, manufacturing and services in half would deliver an annual gain to the world economy of over

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[3] Rodrik, D. (1995b). Trade and Industrial Policy Reform, in *Handbook of development economics. Volume 3B. Handbooks in Economics, vol. 9*, Behrman, Jere; Srinivasan, T.N. (eds). Amsterdam; New York and Oxford, Elsevier Science North Holland**:** 2925-82. provides review of literature on this subject

[4] Helpman, E. (1988). "Growth, Technological Progress, and Trade." *Empirica* **15**(1): 5-25., Rodrik, D. (1995a). "Getting Interventions Right: How South Korea and Taiwan Grew Rich." *Economic Policy: A European Forum* **0**(20): 53-97., etc

[5] Sala-I-Martin, X. (1991). Growth, Macroeconomics, and Development: Comments, in *NBER macroeconomics annual 1991*, Blanchard, Olivier, Jean; Fischer and Stanley (eds). Cambridge and London, MIT Press**:** 368-78.

[6] Linnemann, H. (1966). *An econometric study of international trade flows*. Amsterdam, North-Holland., Frankel, J.-A. (1997). "Regional trading blocs in the world economic system."

[7] Frankel, J.-A. and D. Romer (1999). "Does Trade Cause Growth?" *American Economic Review* **89**(3): 379-99.

[8] Ibid.

[9] Stoeckel, A., K. Tang and W. McKibbin (1999). "The Gains from Trade Liberalisation with Endogenous Productivity and Risk Premium Effects." *Technical paper prepared for the seminar "Reason versus Emotion: Requirements for a Successful WTO Round", Seattle, 2 December 1999.*

[10] Hertel, T. W., Ed. (1997). *Global Trade Analysis: Modeling and Applications*. Cambridge, Cambridge University press.

US$400b. Full elimination of all barriers would produce an annual gain to the global economy of $US750b[11]. Modelling work by the Australian Productivity Commission found that the net benefit to the world as whole from elimination of all post-Uruguay Round barriers to trade in goods and services is in excess of US$260b, with half of this gain (US$130b) resulting from removal of impediments to trade in services[12].

Trade-related reforms alone may not produce significant benefits without institutional capacity, including enforceable property rights, commercial codes and bankruptcy rules as well as sound corporate and public governance. Nevertheless, trade reforms and economic liberalisation may help create a demand for the development of such institutions. These institutional questions are of special importance in services. Winters (2004) summarises empirical evidence on the relationship between trade liberalisation and growth and concludes that in general, liberalisation induces at least transitory but possibly also a longer-term increase in growth. A large component of this effect is caused by increased productivity, but other factors such as regulatory institutions, property rights and investment regimes, transparency and anti-corruption measures, and human capital development play an important role. Santos-Paulino (2005) surveys the literature on trade liberalisation and economic performance in developing countries.

Availability of cheaper intermediate service inputs through the inter-industry input-output relations and the TFP growth through import-embodied technology transfer produce welfare gains to developing countries in the modelling analysis by Robinson, Wang et al. (2002) using CGE with transport (international shipping) costs. Konan and Maskus (2004) find large gains from services trade liberalisation using CGE model of Tunisia's economy, with benefits accruing more evenly across factors than in the goods liberalisation scenario, and with smaller adjustment costs. Modelling results for Egypt demonstrate that liberalisation of services trade through foreign investment (commercial presence) is responsible for the largest share in estimated welfare gains (Konan and Kim (2004)). Romer (1994) points out that trade restrictions result in the reduced supply of intermediate goods to an economy with an infra-marginal effect on productivity. The argument can be extended to services such as those provided in the infrastructure, communications and financial sectors.

Dollar and Kraay (2004) find that globalising developing countries that have implemented trade liberalisation reform by reducing tariff barriers in the 1980s are enjoying higher per capital growth rates decades later and are catching up with the developed economies. Developing countries

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[11] DFAT (1999). *Global Trade Reform: Maintaining Momentum*. Canberra, Department of Foreign Affairs and Trade. Commonwealth of Australia.

[12] Dee, P. and K. Hanslow (2000). Multilateral Liberalisation of Services Trade. Staff Research Paper. Canberra, Productivity Commission.

that failed to open up to trade are lagging behind. Absolute poverty levels in the globalising countries have also reduced, supporting the evidence for the pro-poor economic growth through trade liberalisation.

The Australian Productivity Commission (using the multi-region FTAP model which includes foreign investment) found that completely liberalising trade in telecommunications and financial services would increase world real gross national product (GNP) by 0.2 per cent. The global gains from removing barriers to trade in these sectors come from three sources: improvements in the allocation of resources, increased returns to the world stock of capital, and increased product variety. In essence, imposing a barrier to trade of any kind distorts primary factor markets, generating a ‘rent’ (a mark up of price over opportunity cost) to the incumbent and a ‘tax’ on local capital users. Liberalising trade in financial services is estimated to increase world GNP by 0.1 per cent, with an additional 0.1 per cent GNP gain stemming from the liberalisation of telecommunications (Verikios and Zhang (2003), Verikios and Zhang (2004)).

Whalley (2004) provides a critical review of the current body of literature on quantifying welfare effects of the services trade liberalisation, including the problems associated with constructing measures of trade restrictiveness and modelling methodology. He concludes that liberalization of foreign establishment and the movement of people are of the greatest importance to developing countries: “If service trade liberalisation is a surrogate for improved functioning of global factor markers in which more capital flows to developing countries and more labour flows from them, developing countries could benefit in a major way” (p. 1250).

Nielson and Taglioni (2004) review the major studies of the effect of barriers to trade and investment in services. They point out the differences between types of barriers to trade, which can be rent creating and/or cost creating. Some impediments to trade and investment have the effect of limiting competition and raising prices thereby adding to the profits of incumbent producers. Liberalising these measures may create efficiency gains but would also lead to relatively large transfers between producers and consumers. Other impediments have the effect of adding to costs and liberalizing those measures can provide gains to both incumbent producers and downstream consumers. Welfare gains from this reform will also be significant. These distinctions suggest the political economy of managing reform will differ between types of impediments.

A number of studies have attempted to assess the extent and impact of impediments between economies and across sectors. In their review of these studies Nielson and Taglioni conclude that

- on average, developing countries have more restrictive barriers than developed economies
- those economies are expected to gain more from liberalization

- the estimates are that gains from services liberalization are of the order of 5 times those of the gains from goods liberalization.

There is however considerable variation in the estimates of these gains, reflecting the methodology used to estimate the scale of the impediments and the nature of their effects (rent vs cost creating). The gains from reform are even greater when capital mobility and options for foreign direct investment are made explicit, and when the likely imperfectly competitive nature of services markets is recognized. Further comment is offered below on studies which focus on mode 4 delivery.

The key point however from this review of studies is the following:

> for most countries, including many developing countries, export-related gains from services liberalisation are neither the only nor the largest basis of expected gains. A large portion of benefits from services liberalisation derive, not from seeking better market access abroad, but from the increased competitiveness and efficiency of the domestic market (Nielson and Taglioni, 2004, Abstract)

Thus the greater gains are available not from removal of barriers to exports or establishment in foreign markets, but from domestic reform in ways which do not simply remove impediments to foreign entry but which remove impediments to entry by all firms (foreign or domestic) and which create more competitive markets.

SECTORAL CASE STUDIES

The following sections report case studies of the effects of restrictions in banking, telecommunications and health services, and also examine some of the key issues involved in the liberalization of restrictions on the movement of people.

Banking and Financial Services

Financial contracts are crucial in facilitating the settlement of trade and distributing resources efficiently across time and space. Risk management and liquidity is very important to the smooth functioning of financial markets. The ability to access, process and use financial information more efficiently benefits providers of financial services, allowing them to respond faster and expand the range of products and services they can offer. Market access allowed to foreign service providers creates extra competition in the market and leads to technology transfer.

Mattoo (1999) examines patterns of market access commitments in financial services (banking and direct insurance) made under GATS negotiations (the FSA 1997 package of commitments). Developing economies of Asia and Latin America appeared to be lagging behind in liberalisation of their financial sector compared to the Eastern European and African participants. The degree of financial sector protection in developing countries exceeds that in the developed countries as demonstrated in Figure 4. Murinde and Ryan (2003) provide further discussion of the African banking sector performance in view of the potential entry of foreign service providers due to the market liberalisation commitments made under GATS. Analysing the pattern of commitments in banking services, Harms, Mattoo and Schuknecht (2003) find that agricultural and textile exporters have scheduled fewer market access measures in banking services, raising the question of whether services negotiations are being used as a bargaining chip by developing countries with strong export interests in the protected markets of developed members.

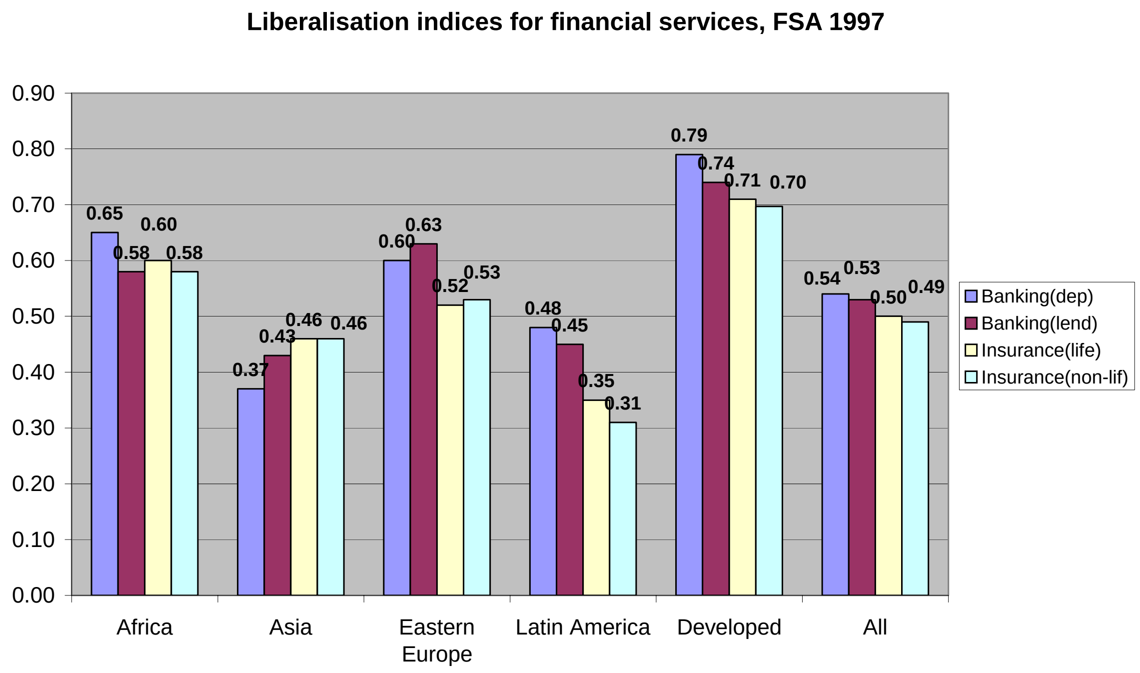
(Dee, 2003) reports an index of restrictions to foreign entry into banking; the index provides a measure of discrimination against foreign entrants embedded in the non-prudential domestic regulations and rules. Economies with more liberal market access provisions for foreign service providers are statistically associated with higher GNP per capita (Figure 5)[13].

Trade liberalisation measures including market access commitments have to be coordinated with the state of development of domestic regulatory framework, with sequencing of reform and liberalisation measures becoming an important issue. An empirical study by Fink, Mattoo et al. (2003), encompassing 86 geographically dispersed developing countries, has found that the gains from the simultaneous privatisation and introduction of competition regulation in the telecommunications market are higher than those resulting from privatisation followed by competition policy reform. Effective competition policies implemented in domestic market are essential to ensure that liberalisation of market access does not result in foreign service provider capturing monopoly rents and impeding entry of other players.

Restrictive public policy measures are not the only impediments to international trade in services. Private business practices in the markets exempt from application of the national competition laws (such as maritime transport conferences) result in higher prices to the consumer. Fink, Mattoo et al. (2002b) demonstrate that restrictive business practices have a stronger effect on international shipping prices than public policies, and propose a set of measures to bring maritime shipping cartels under the umbrella of domestic competition law and strengthening multilateral disciplines using GATS Article IX.

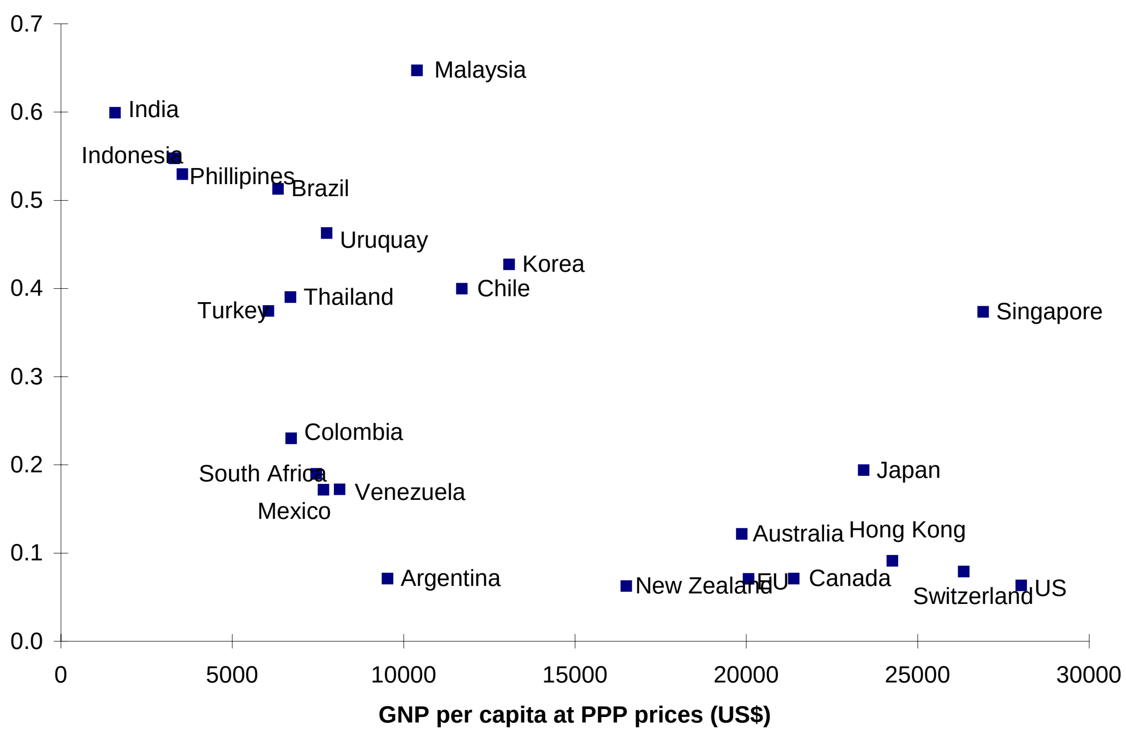
[13] The index was based on policy information up to 31 December 1997, hence most of the recent unilateral liberalisation activities in financial sector have not been reflected in the calculations.

Figure 4 Financial services liberalisation indices based on GATS FSA 1997 commitments



Source: Mattoo (1999)

Figure 5 Banking foreign restrictiveness indices and GNP per capita at PPP prices, 1996



Source: Dee and Nguyen-Hong (2003), based on McGuire and Schuele (2000)

Telecommunications and transport

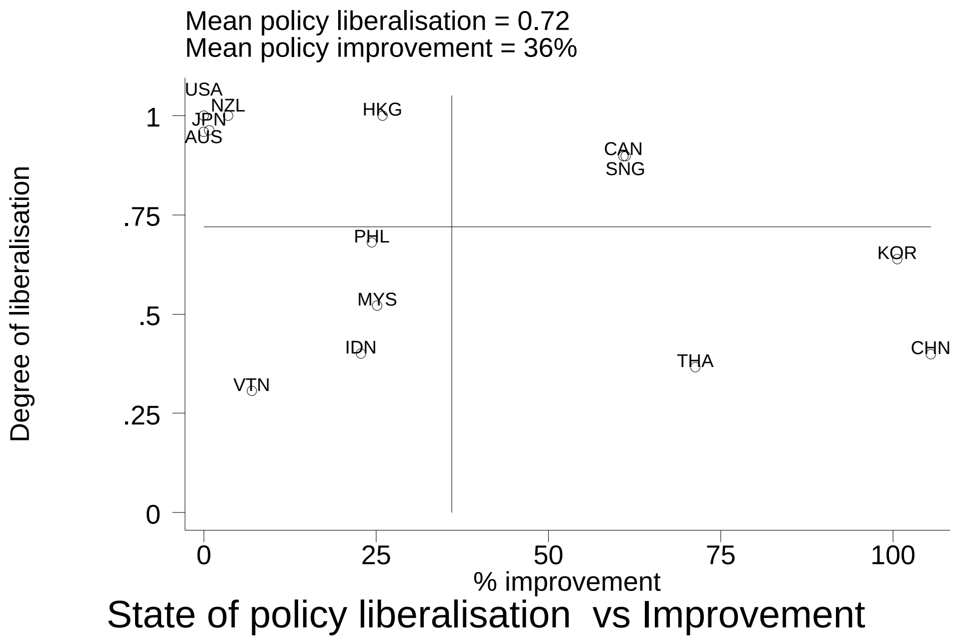
Infrastructure services such as telecommunications and financial services are intermediate inputs into production of all other goods and services. Availability of cheap and efficient financial and telecommunications services has also been demonstrated to facilitate international trade.

Fink, Mattoo and Neagu (2002a) estimate a gravity model which includes telecommunications costs and find that international variations in communications costs influence bilateral trade flows, with the larger impact on differentiated products whose production uses telecommunications services more intensively than the production of homogeneous products. Fink, Mattoo and Rathindran (2001) analyse the state of telecommunications reform in Asia and find evidence for a slow unilateral liberalisation process since the adoption of the Reference paper on basic telecommunications. Their econometric analysis confirms that telecommunications reform (including privatisation, competition and regulation) yields higher market outcomes such as fixed lines penetration, service quality and labour productivity. The authors conjecture that to stimulate further liberalisation of the sector in the region, there must be other members with significant interest in telecommunications willing to make concessions in other sectors of export interest to the developing countries, such as agriculture, textile and movement of individual service providers.

Findlay, Lee, Sidorenko and Pangestu (2005) have examined actual policy scores in telecommunications sector for APEC economies and found that actual policies have improved over 1998-2002 in a number of East Asian countries, including Thailand, China, South Korea and Singapore. Even so, a significant number of ASEAN economies (those in the lower left quadrant of Figure 6) show a less than average degree of openness of their telecommunications market, and have made only limited unilateral progress over the period 1998-2002.

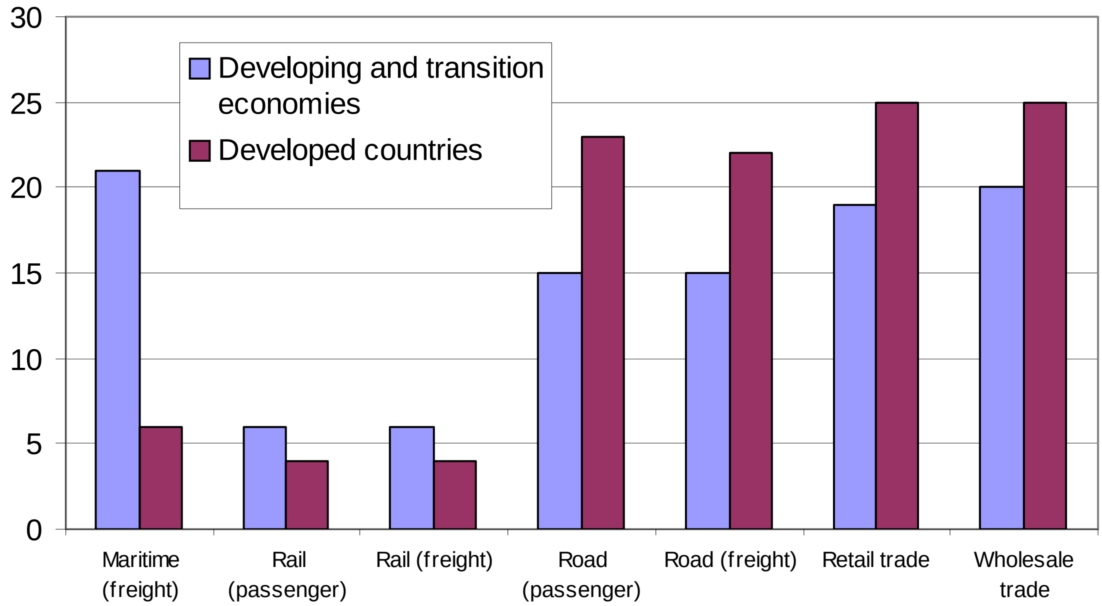
Benefits of trade openness in sectors such as transport and distribution have been analysed by Robinson, Wang et al. (2002) using a CGE model with transport costs (international shipping), Fink, Mattoo and Neagu (2002b) and Findlay and Fink (2005). Figure 7 demonstrates that developing countries are lagging behind in making market access commitments in transport and distribution sectors, with the significant exception of maritime transport.

Figure 6 Telecommunications policy liberalisation and the rate of liberalisation, 1998-2002



Source: Findlay, Lee et al. (2005):119

Figure 7 Number of WTO members scheduling transport and distribution services



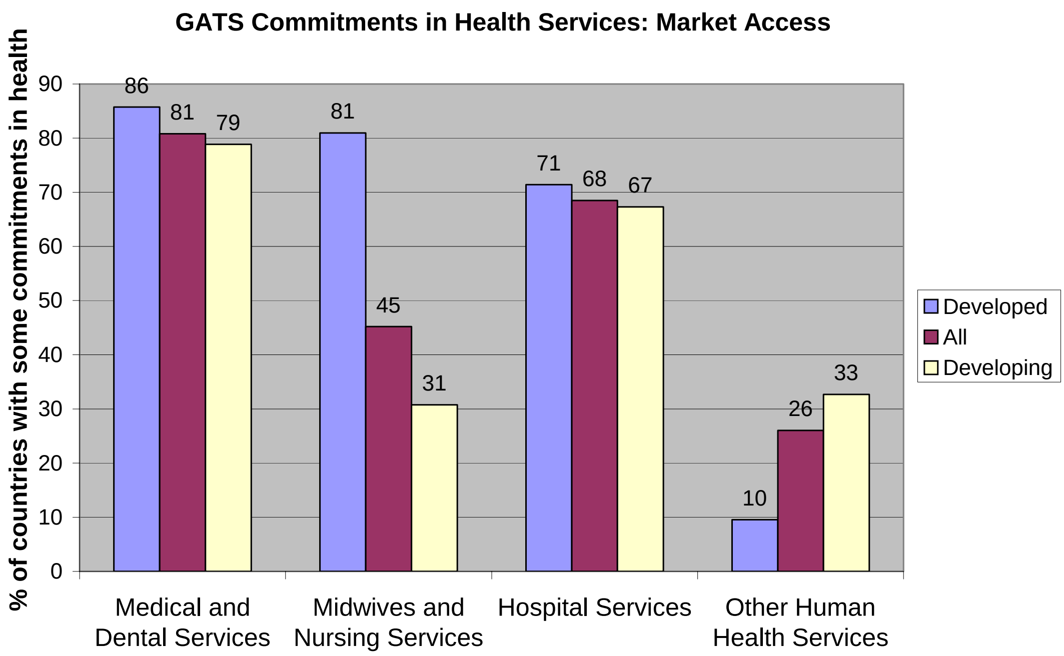
Source: Findlay and Fink (2005)

<u>Health services</u>

Developing countries have recognised their cost advantage in providing health care services to the ageing population of the developed countries. ASEAN member economies have included health care as one of the priority sectors for advanced integration. Competitive cost structures, the availability of skilled medical workforce, technological advancement along with the natural endowments, geographical position and cultural links all create a comparative advantage for several ASEAN economies to export health services.

The costs and benefits of liberalisation of trade in health services are outlined in Sidorenko and Findlay (2003) and Sidorenko (2003). Notwithstanding the high level of protection of the health care sector in most of the developed countries and the high share of publicly provided services in the total mix, developing countries have scheduled even fewer liberalising commitments in several healthcare-related sectors, especially in those granting market access to foreign medical professionals and nurses (see Figure 8). Where some commitments are made, however, their depth is limited.

Figure 8 Market Access Commitments in Health Services



Source: Sidorenko (2003):286

<u>Movement of natural persons (Mode 4)</u>

International mobility of workers has increased dramatically over the recent decades, including both unskilled and skilled workers. A large share of this flow represents unregulated (illegal) migration between neighbouring countries, but there is also a growing mobility of professional skilled labour (see OECD (2001), OECD (2002), OECD (2002), OECD (2003) etc). Demographic shifts and the ageing of populations in developed countries has created domestic labour market imbalances and an increased demand for foreign labour.

There are potentially large benefits to both sending and receiving countries resulting from the increased mobility of workers. Gains to sending countries include remittances. Receiving countries benefit from satisfaction of the otherwise unfilled demand for certain types of skills.

Within East Asia, there has been a significant increase in cross-border flows of labour over the past two decades. Demand for skilled labour has also increased in countries such as Japan, South Korea, Taiwan, Singapore and Malaysia as they have advanced in the development of knowledge-based economies. It has been estimated that temporary skilled migrants accounted for up to a quarter of all higher level workers in Singapore, and around 5-10% in Malaysia and Thailand in recent years (Manning and Bhatnagar (2004)). Regional opportunities to further facilitate mobility of professional services providers in ASEAN are further examined in Manning and Sidorenko (2005). Economic importance of international mobility of labour for ASEAN countries is illustrated by the growing share of workers' remittances in GDP of the labour-exporting members such as Philippines and Cambodia (see Table 1). At the same time, countries such as Philippines and India are taking advantage of their skilled English-speaking workforce endowment and export the "IT-enabled services" including computer related services and business process outsourcing such as call centers, medical prescription services, payment systems and financial processing etc. (Mattoo and Wunsch-Vincent (2004))

Table 3. Workers' remittances as percentage of GDP, selected ASEAN countries, 1995-2001

Country /	*Workers' remittances as % of GDP*						
Year	***1995***	***1996***	***1997***	***1998***	***1999***	***2000***	***2001***
Cambodia	0.35	0.34	0.35	2.38	2.49	3.05	3.31
Indonesia	0.32	0.35	0.34	1.01	0.79	0.79	0.74
Lao People's Dem. Rep.	1.24	2.42	2.34	3.89	0.04	0.04	0.04
Malaysia	0.13	0.16	0.19	0.26	0.41	0.38	0.42
Myanmar	0.36	0.51	0.57	0.50	0.38	0.25	0.23
Philippines	7.23	5.88	8.26	7.87	9.08	8.18	8.56
Thailand	1.01	0.99	1.10	1.27	1.19	1.38	1.09

Source: UNCTAD, June 2005

Winters, Walmsley, Wang and Grynberg (2003) estimate that an increase in inflow of temporary skilled and unskilled foreign workers from developing countries (equal to 3% of the developed countries' total workforce) would generate an additional US$156b pa in world welfare (equivalent to an 0.6 per cent of the world GNP). The gains will be shared between developed and developing countries, with most of the gains attributed to the liberalisation of restrictions on unskilled rather than skilled labour.

The contribution of skilled professional migration and overseas graduate students to the US knowledge economy has been evaluated in Chellaraj, Maskus and Mattoo (2005). The authors found strong positive impact of the number of foreign graduate students and skilled migrants on the number of patent application, patents awarded to the US universities and other non-university entities. Amin and Mattoo (2005) in a game-theoretical model find that Pareto improvement can be realised not through more liberal commitments by host country to allow temporary entry, but rather to enable host countries to commit to repatriation. If the source country undertakes obligations such as pre-movement screening of temporary migrants, facilitation of their return and commitments to combat illegal migration, the joint outcome may correct the current problem of too little temporary and too much permanent migration.

Major impediments to movement of natural persons are lack of transparency in entry requirements an procedures, complicated visa application process, lack of recognition of previous training, qualifications and degrees, and labour market (economic needs) tests (Chanda (2001)).

Chaudhuri, Mattoo and Self (2004) assess the current state of GATS commitments on Mode 4 and propose a framework for negotiating further liberalisation of movement of natural persons. Concerns such as cultural identity, the drain on public resources and problems of assimilation are not nearly as relevant to the increased mobility of professionals as they are for unskilled foreign labour. What really worries policymakers, preventing them from making any binding commitments under Mode 4, are issues of national security and difficulties to enforce temporariness. If temporary workforce shortages filled by recruiting foreign labour correct themselves and the temporary entrants change their status to permanent in interim, a new labour market imbalance is created, with longer-term costs such as the need to re-train those temporarily unemployed. Chaudhuri, Mattoo and Self (2004) proposed a model schedule on Mode 4 commitments based on broad horizontal commitments and supplemented by deeper sectoral commitments where possible. The schedule is supplemented by a Reference Paper that formulates measures to improve transparency in temporary entry requirements and procedures, and minimum disciplines for domestic regulation under Article VI:4 (qualification requirements and procedures, technical standards and licensing requirements). The proposal seeks the extension of current GATS commitments on Mode 4 to go beyond the categories linked to commercial presence (such as intra-company transferees, managers and specialists) and include individual service providers/ contractual service suppliers.

SERVICES IN REGIONAL AGREEMENTS

Liberalisation of trade in services may advance in a unilateral, plurilateral or multilateral way. The major argument against a PTA as opposed to multilateral liberalisation is its trade creation versus trade diversion effects. The relative welfare effects of the preferential trade arrangement depend on the relative magnitude of these effects. Apart from the trade creation and trade diversion phenomena, there is also, as a rule, some redistribution of the revenue within the newly created preferential trade area, with its winners and losers. The aggregate effect of the PTA on the total welfare thus is ambiguous, depending on the particular conditions[14]. To yield unambiguous welfare gains, the PTA must involve those sectors in which the partner economy is the sole source of imports. In such a situation, there will be no trade diversion effect, and no associated welfare losses. Even if this is the case, multilateral liberalisation will always provide even larger gains. The mercantilist rationale used to justify regional and multilateral bargaining over reduction of tariffs and non-tariff barriers in goods trade does not extend immediately to services trade, as pointed out in Dee and Sidorenko (2005). Several levels of product differentiation (by economy, firm and even individual consumer) are inherent in services. This high differentiation of services along with the regulatory nature of barriers to their international tradability weakens the case for preferential liberalisation and favours non-preferential and unilateral measures.

The potential liberalising effect of the regional trade arrangement depends on the breadth of coverage and on the structure of the agreement. This is especially the case for services liberalization. One will often find a gap between the actual levels of policy openness/restrictions, and the level legally bound in the agreement. The legal structure of the agreement itself may be more or less liberalising, depending on whether a negative or a positive list approach is used. The schedules of country specific commitments in AFTA follow the GATS and are built upon the positive list approach. The schedule of commitments in NAFTA and CER, to the contrary, is constructed by the negative list approach. Although the negative list approach is usually preferred on liberalization grounds, there are a number of difficulties associated with compiling negative lists and a permanent exclusion of sensitive sectors[15].

Most of the modelling studies confirm that the benefits of multilateral liberalisation exceed those resulting from the regional liberalisation. The benefits are very significant: for example, the FTAP model used by the Australian Productivity Commission demonstrated that the net benefit to

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[14] See Panagariya, A. (2000). "Preferential Trade Liberalization: The Traditional Theory and New Developments." *Journal of Economic Literature* **38**(2): 287-331. for an excellent discussion of the theory of preferential trade liberalisation and its welfare implications

[15] Sauvé, P. (2000). Making Progress on Trade and Investment: Multilateral versus Regional Perspective, in *Services Trade in the Western Hemisphere: Liberalization, Integration, and Reform*, S. Stephenson (eds). Washington, D.C., Organization of American States : Brookings Institution Press**:** 72-85.:82

the world as whole from elimination of all post-Uruguay round trade barriers to be in excess of US$260 billion. Half of this gain (US$130 billion) comes from liberalisation of services trade. Liberalisation of agriculture contributes US$50 billion in benefits, with the remaining gain of US$80 billion attributed to manufactured goods[16].

Dee and Gali (2003) provide an ex-post evaluation of 18 recent PTAs (traditional and new-age) on merchandise trade and investment and find the evidence of trade diversion exceeding trade creation in all but six cases. The non-(goods)trade provisions of PTAs (in particular, those related to investment and services), are estimated to produce a more positive effect. The authors conclude that real progress may be achieved if regional negotiations are used to advance negotiations on investment, services, competition policy and government procurement, and the outcomes extended on a non-preferential basis. Stephenson (2002) examines recent regional agreements in services involving developing countries (including AFAS, MERCOSUR, NAFTA and CARICOM) and finds that such agreements may yield significantly higher degrees of market openness for member service providers. The challenge is to translate these achievements into the progress in the multilateral setting as well.

Some regional fora have undertaken their own steps in advancing Mode 4 liberalisation. The ASEAN Framework Agreement on Services signed in December 1995 was conceived as a GATS-plus agreement. The ultimate objective if to achieve the free flow of services between the ASEAN member economies before 2020. By June 2005, ASEAN four packages of commitments on the liberalisation of services trade were concluded resulting from three rounds of negotiations under AFAS. Assessing achievements in liberalisation of Mode 4, Manning and Sidorenko (2005) find that those are mostly at the level of the GATS, and the development of meaningful liberalising measures has been slow. Among the priority sectors for advanced liberalisation are “e-ASEAN” and health care services[17]. The Roadmap for Integration of e-ASEAN Sector scheduled (Article XIV) and the Roadmap for Integration of Healthcare Services (Article XIX) both envisage facilitation of professional mobility in these sectors.

CURRENT STATE OF NEGOTIATIONS

Recommendations to developing countries on the most beneficial way to advance GATS negotiations formulated in Mattoo (2000) remain relevant. They include eliminating restrictions to market access through improved Article XVI commitments, liberalisation of Mode 4, developing pro-competitive principles for network sectors following the telecommunications Reference Paper,

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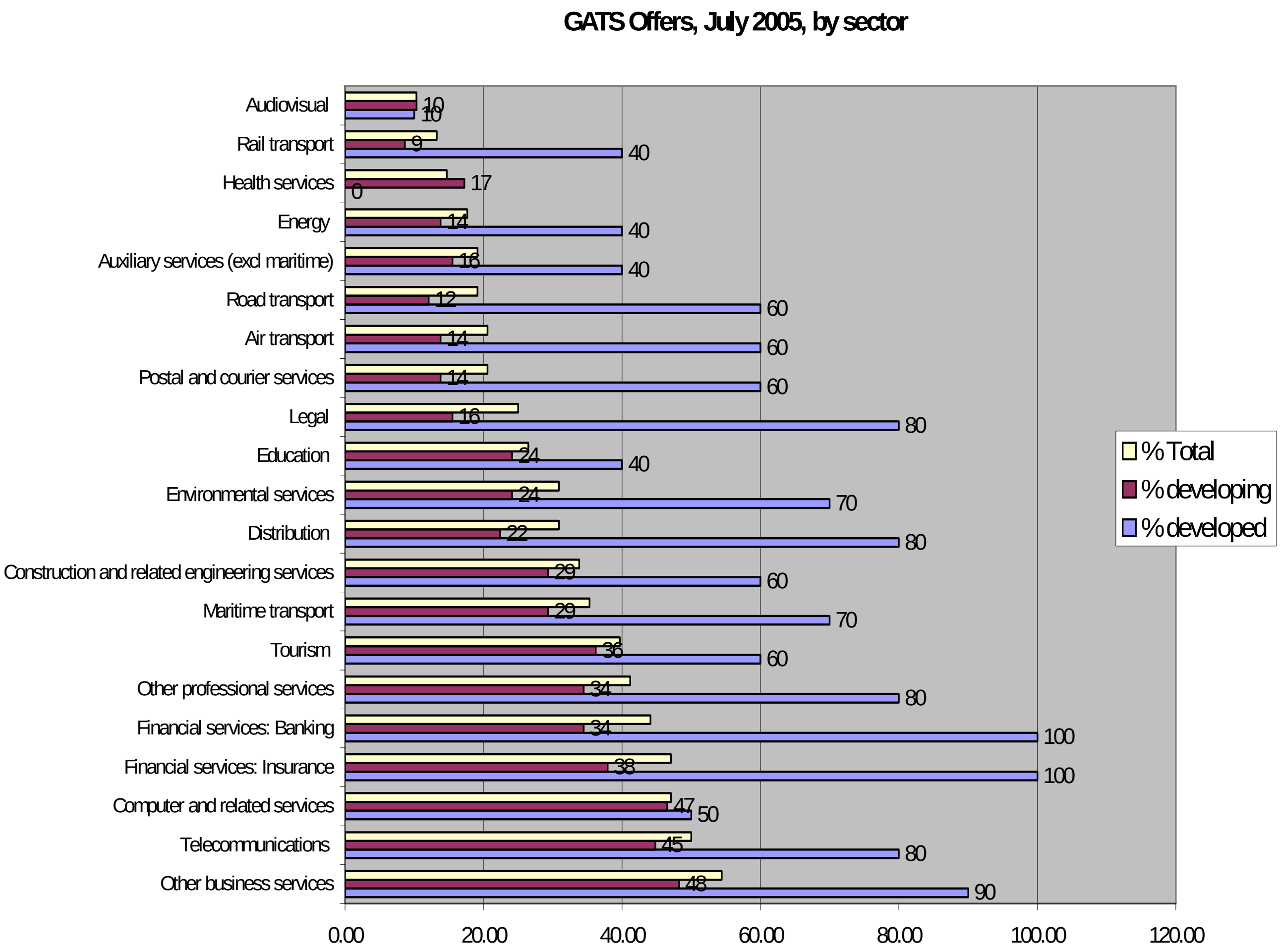
[16] Dee, P. and K. Hanslow (2000). Multilateral Liberalisation of Services Trade. Staff Research Paper. Canberra, Productivity Commission.
[17] ASEAN Framework Agreement for the Integration of Priority Sectors, Vientiane, November 29, 2004

development of disciplines for domestic regulation and other rule-making objectives (safeguards, government procurement and subsidies).

With the mandate to enter the negotiations no later than 1 January 2000, most of the WTO members failed to meet the initial agreed deadline of 30 March 2003 to submit their services offers. By February 2005, only 47 offers were received, 37 by developing countries, representing 71 members (the EU offer counted as representing 25 member states). A new deadline of 31 May 2005 was proposed to submit improved services offers. Based on the report by the Chairman to the Trade Negotiations Committee WTO (2005), the total number of initial offers by 1 July 2005 was 68 representing 92 members. Some 24 developing countries' offers remained outstanding, and if the LDCs (31) are added, there were 55 initial services offers still outstanding in this round of negotiations. Two ASEAN LDC members (Cambodia and Myanmar) had failed to submit an initial offer.

The Chairman has expressed his disappointment with the quality of the submitted offers, with majority failing to provide any significant improvement. The average number of commitments as currently offered would improve from 51 to 57. Less than a half have scheduled commitments in distribution, postal and courier services, or road transport, or have improved horizontal commitments under Mode 4. Sectoral analysis of the initial offers is represented in Figure 9. Overall, there is a much smaller liberalisation offered by developing countries in all sectors but health services (included 17% of all developing countries' offers), and an equal reticence in making market-opening commitments in audiovisual services (10% of both developed and developing members offered any commitments in this area). Sectors in which commitments show the most liberalising activity included financial services, computer and related services, telecommunications and other business services.

Figure 9 GATS offers, July 2005, by sector



Source: WTO (2005)

The common assessment of the offers to date is that they offer little more than 'standstill commitments', and in the case of some developing countries, including in ASEAN, are not even committing those countries to policies which are already in place. This situation has prompted discussion of how more meaningful offers can be prompted from WTO members, and more specifically how 'meaningful' might be measured. The extent of sectoral coverage (either the absolute number of sectors or the percentage of heretofore-uncommitted sectors) of the offers made (even with reservations) is one indicator which is under discussion.[18] Some members have

[18] In a speech before the Coalition of Service Industries, St Regis Hotel, Washington on 20 September 2005, USTR Portman said that the US would seek 'high quality commitments from key developing countries' in financial services, telecommunications, computer-related services, express delivery, distribution and energy services. He mentioned 'unrestricted direct investment and unlimited supply of cross border services' were listed as elements of the 'quality' of commitments.

proposed that scores be applied to commitments.[19] Others have suggested the benchmarking approach would facilitate linkages with other negotiations, particularly in agriculture.

These proposals also include suggestions to add plurilateral agreements to the multilateral approach. The proposals suggest that groups of interested members would make commitments to particular sectors as soon as the membership of the group accounted for an agreed proportion of world trade in services in those services. Developing countries have reported their opposition to this approach. Some developing countries have also opposed the overall benchmarking strategy with its focus on a common level of ambition, on the grounds that the GATS was designed to provide members, especially developing countries, with flexibility.

The treatment of mode 4 varies among these proposals. The EU has linked its commitments on mode 4 to commitments by others on rights of establishment (mode 3). It has also suggested that its mode 4 commitments would only apply to sectors covered by the benchmark approach. On the other hand Taiwan has called for mode 4 commitments to be 'de-linked' from mode 3.

NEXT STEPS

The research shows that the significant gains for developing countries are associated with domestic reform of the impediments to competition that affect both foreign and domestic suppliers. Reforms of this type create larger gains than those which remove impediments to foreign entry. Even in those cases larger gains are available from commitments which are made multilaterally. Following Dee's (2005) conclusion, while there may be a few areas where PTAs can supplement a domestic regulatory reform program, because they tend to be preferential, they also divert the efforts of reform away from the areas where the large gains are available.

In this context, what is the value of commitments in the WTO process? The earlier assessments were that the Uruguay Round commitments as well as current offers amount to little more than standstill commitments. Disappointment with the WTO process continues to be reported. But it has much to offer a domestic reform process. Findlay and Fink (2005), drawing on Mattoo (2002), suggest the following:

> First…an international agreement may provide an opportunity for domestic service providers to secure access to export markets (and the) market access opportunities that trading partners might provide as part of a package of commitments may be sufficient to shift the balance in the domestic policymaking process to support reform at home.

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[19] More details of these proposals and the plurilateral agreements are reported in Bridges Weekly Trade News Digest 9(31), 21 September 2005. Proponents of the benchmarking approach include the EU, Australia, Korea, New Zealand, Taiwan, and Switzerland.

> Second, a trade commitment can add to the credibility of the policy change….A trade agreement has the potential to add value, as commitments are binding under international law—including those to be applied at a future date. If the policy change is not made, trading partners have recourse to dispute settlement and may impose trade sanctions.
>
> Third, trade agreements may offer a forum for regulatory cooperation. Such cooperation can … underpin market-opening commitments by assuring traders and investors that liberal market access will not be impaired by the imposition of regulatory barriers, (establish) regulatory principles that governments promise to fulfil,…aid the harmonisation of regulatory standards and promote recognition of foreign regulations in order to open markets to international competition.

To this list could be added the contribution of commitments to the transparency of policy-making processes. Commitments also oblige members to apply the GATS principles of domestic regulation in the relevant sectors.

Developing countries have export market interests in services, which add to the contribution of these negotiations, but their main value is through their support for domestic reform. Success in that respect therefore requires the statement of a development plan, which includes an assessment of the priority areas for domestic reform (that is, an assessment of sectors in which restrictions on entry are relatively high and whose removal would create significant welfare gains), and the derivation of negotiating positions from that development plan.

Given these contributions of international commitments, Findlay and Fink (2005) identify contributors to progress in the negotiations. This includes further work to identify gains from exchange of commitments either within sectors (perhaps across modes) or across sectors. They also stress the value of putting reform programs together with capacity building. On the latter they suggest that:

> Developing countries, for example, may be cautious to commit to greater market opening in transport and distribution, fearing their regulatory systems are ill prepared for the additional complexities of international competition. … Commitments by developed countries to technical assistance and international enforcement of competition law could be explicitly linked to developing countries' market opening commitments.

To this list might be added the production of model schedules of commitments (freight logistics is an example of a sector where a group of WTO members have developed a model for others to follow). There is also the scope for all WTO members to at least bind current policy, which will add to the transparency of their policies and provide reassurance to trading partners, including those considering establishment as the best mode of supply.

Findlay and Fink observe that implementation of these steps requires careful preparation and coordination among different ministries (a feature of service sector impediments is the number of agencies involved in the administration of the various elements) and with the private sector (see OECD 2002b). It is valuable therefore, they suggest, to establish procedures and institutional arrangements for consultation within government and with a range of private sector interests: the latter should include not just import competing firms but also those with export interests and those who are significant consumers of services.

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