

# Trade and Investment in Services

An ADB–ITD Training Module for the  
Greater Mekong Subregion



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Greater Mekong Subregion

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# CHAPTER 1

## Background and Module Structure



### Background and Module Structure

There is increasing awareness worldwide both of the strong case in favor of open services markets and of the high cost of protecting key enabling sectors that contribute centrally to overall economic development, such as financial services, telecommunications, transportation, and energy. At the same time there is growing recognition that opening services markets to foreign competition is no easy task. Doing so involves a broad and complex set of policies, regulatory instruments, institutions, and constituencies, domestic and foreign, public and private. Experience has shown that considerable care must be taken to assess the nature, pace, and sequencing of regulatory reform and liberalization undertakings in services markets if they are to sustain a country's growth and development prospects in a meaningful fashion.

Not surprisingly, trade in services continues to rank among the most complex subject matters in modern trade diplomacy, despite the experience gained over two decades of negotiations conducted at the World Trade Organization (WTO) under the aegis of the General Agreement on Trade in Services (GATS), as well as in the context of an increasing number of preferential trade agreements (PTAs).

The central intermediation functions that services assume and the extent to which their competitiveness affects economy-wide performance both suggest the far-reaching benefits likely to result from attempts at progressively dismantling impediments to trade and investment in services. Numerous recent studies have documented the potential importance of such benefits, which are typically seen as exceeding those emanating from the full opening of trade in agricultural and manufacturing products.<sup>2</sup>

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<sup>2</sup> See Hoekman, B. and A. Mattoo. 2008. Services Trade and Growth. *Policy Research Working Paper 4461*. Washington, DC: World Bank. [www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2008/01/02/000158349\\_20080102162022/Rendered/PDF/wps4461.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2008/01/02/000158349_20080102162022/Rendered/PDF/wps4461.pdf) See also Hoekman, B. 2006. Liberalizing Trade in Services: A Survey. *Policy Research Working Paper 4030*. Washington, DC: World Bank. [http://econ.worldbank.org/external/default/main?pagePK=64165259&theSitePK=469382&piPK=64165421&menuPK=64166093&entityID=000016406\\_20061006151055](http://econ.worldbank.org/external/default/main?pagePK=64165259&theSitePK=469382&piPK=64165421&menuPK=64166093&entityID=000016406_20061006151055)



To date, however, the benefits of pro-competitive reform in services markets have tended to be reaped through unilateral efforts rather than through collective action at the trade negotiating table. Slow progress in services negotiations, over the unfinished rule-making agenda of GATS and especially in the quest for deeper, development-enhancing, liberalization commitments, contributes to the challenges a majority of developing countries continue to experience in mastering the regulatory intricacies of the sector and in mapping a proper role for services in national development strategies.

Many developing countries are handicapped in their ability to engage meaningfully in services negotiations by generally weak negotiating, regulatory, and implementation capacities. More often than not, such difficulties translate into negotiating stances and levels of binding commitments that reflect considerable precaution, resulting in a failure to harness the development potential of services trade and of trade negotiations in the sector properly. Part of the solution is almost certainly targeted technical assistance and capacity-strengthening efforts.

The purpose of this training module is to highlight the contribution of services to development and the role of trade and investment liberalization and effective regulation in key service sectors. Given the breadth of the subject matter, the module cannot purport to cover all aspects of services trade. Nor does it aim to cover issues that other organizations, such as the WTO, the World Bank Institute (WBI), or the United Nations Conference on Trade and Development (UNCTAD) have already addressed—and regularly deploy—in their own comprehensive training materials and courses on trade in services.<sup>3</sup> Indeed, even the Asian Development Bank–International Institute for Trade and Development ADB–ITD course that uses this module covers a broader range of topics than those highlighted in this document.<sup>4</sup> Rather, this module attempts to distill a number

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<sup>3</sup> See, in particular, the web-based training materials prepared by each of the above organizations: World Trade Organization. 2009. *GATS Training Module*. [www.wto.org/english/tratop\\_e/serv\\_e/cbt\\_course\\_e/signin\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/cbt_course_e/signin_e.htm); World Bank. 2007. *WBI E-Course: Trade in Services & International Agreements*. <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/TRADE/0,,contentMDK:21463776~isCURL:Y~menuPK:1428603~pagePK:148956~piPK:216618~theSitePK:239071,00.html>; United Nations Conference on Trade and Development. 2002. *Trade Negotiations and Commercial Diplomacy*. [www.unctad.org/Templates/StartPage.asp?intlItemID=1917&lang=1](http://www.unctad.org/Templates/StartPage.asp?intlItemID=1917&lang=1)

<sup>4</sup> This is the case, for instance, of the law of services trade and the legal architecture of GATS, which the ADB-ITD course covers based on training material prepared by the WTO and the WBI. See World Trade Organization. 2006. *The General Agreement on Trade in Services: An Introduction*. [www.wto.org/english/tratop\\_e/serv\\_e/gsintr\\_e.doc](http://www.wto.org/english/tratop_e/serv_e/gsintr_e.doc); Adlung, R. and A. Mattoo. 2007. The GATS. In Mattoo, A., R.M. Stern, and G. Zanini, eds. *A Handbook of International Trade in Services*. New York: Oxford University Press.





of key policy and rule-making insights arising from the *practice* of trade and investment liberalization in services at both the multilateral and preferential levels, with particular focus on negotiating issues and sector challenges emerging in the Greater Mekong Subregion (GMS). Beyond the key references embedded in the core of this module, readers and participants interested in gaining additional background information on services trade before following this module can find a selection of suggested readings in the Appendix.

The module is divided into five sections; except for this introduction, each is introduced by a statement of key learning objectives and concludes with lists of policy issues for discussion and suggested readings.

Section II draws attention to some of the economic forces at play in services liberalization, explaining the contribution of services to economy-wide performance and development, highlighting the main determinants of service sector growth, and discussing key characteristics that define services and distinguish them from goods in ways that matter for purposes of trade regulation.

Section III focuses on the benefits countries may expect to derive from engagement in services negotiations compared to those achieved through unilateral reforms and liberalization, as well as on the challenge of preparing for services negotiations. In the latter context, it addresses the complex political economy at play, both within national administrations (given the considerable dispersion that characterizes the service sector), and between government agencies and the manifold domestic stakeholder communities affected by services negotiations.

Section IV addresses attempts at crafting rules and opening services trade in the context of preferential trade agreements (PTAs), drawing attention to differences between WTO practice and that emerging at the multilateral trading system's periphery.

Section V focuses attention on the development potential and economy-wide incidence of reforms and key trade negotiating challenges, examining a range of sectors of particular importance to the GMS: financial services, the information and communication technology (ICT) sector, tourism, health-related services, logistics, and labor mobility (so-called Mode 4 trade).

Section VI concludes the module with a few thoughts on the key contribution that a targeted aid-for-trade strategy for services can make in strengthening negotiating capacities, regulatory and implementation performance, and supply responses in the subregion's service sectors with a view to facilitating cross-border trade and investment in goods and services alike.



## CHAPTER 2

# The Contribution of Services to Development

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### Key Learning Objectives

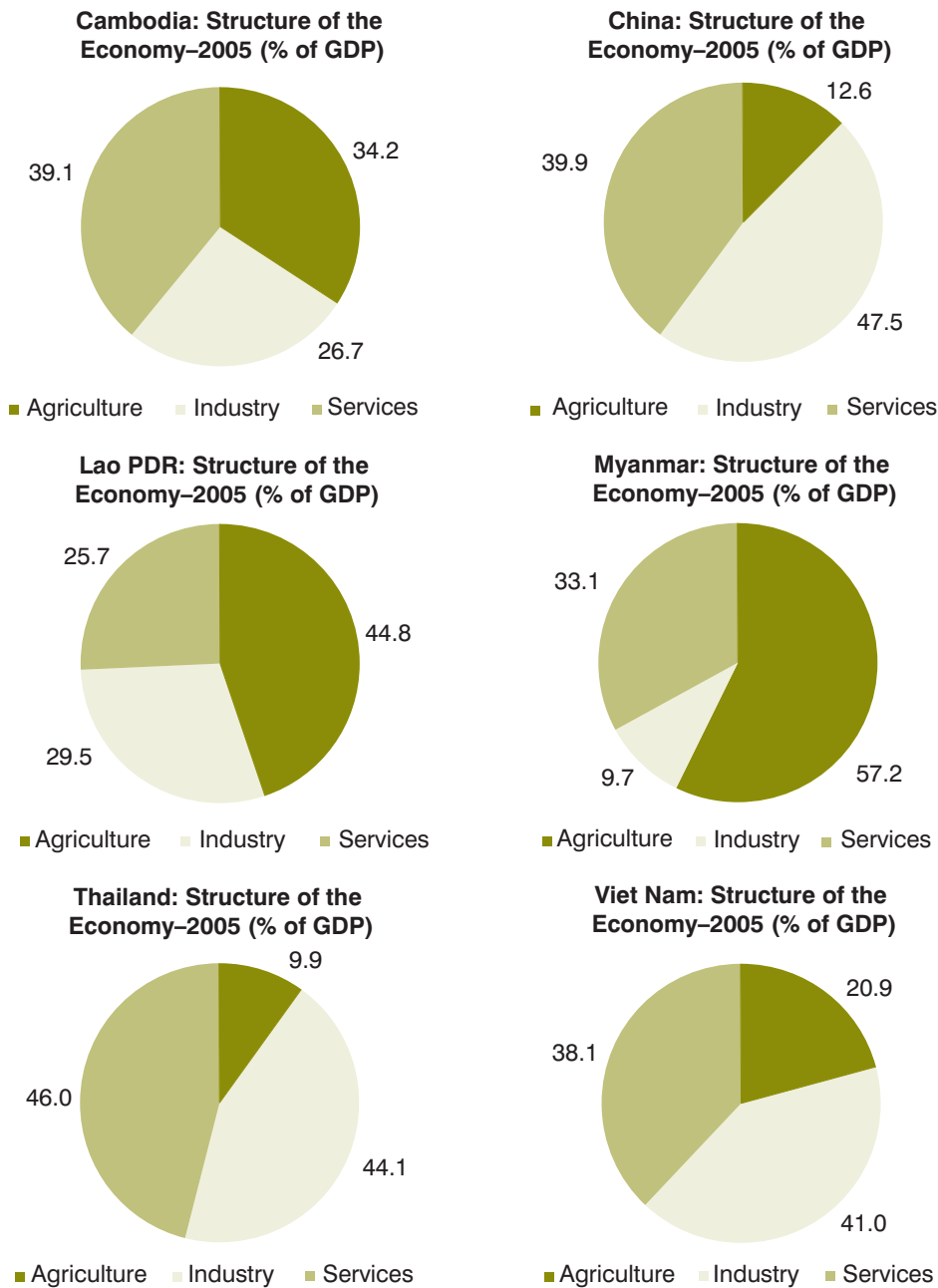
- Appreciating that services exert significant economy-wide effects and can affect investment climates;
- Understanding how the economic cost of protecting inefficient service sector is arguably greater overall than that of protectionism in the goods sector;
- Acknowledging that policy reforms to increase international competition in service industries can boost growth prospects and enhance welfare;
- Understanding the forces that have shaped the rise of services in domestic output and international trade in recent decades;
- Appreciating how services and services trade differ from goods and goods trade, and why such differences matter for purposes of trade regulation and the conduct of negotiations; and
- Understanding that despite the clear potential from greater engagement in services negotiations, services trade liberalization also carries risks and potential costs that need to be anticipated and properly addressed during and after negotiations, notably through appropriate adjustment policies.

The service sector is an important component of any country's economy. It makes a direct and significant contribution to gross domestic product (GDP) and job creation, and provides crucial inputs for the rest of the economy. In the process, services exert significant effects on economy-wide performance and on the overall investment climate. Some service sectors, such as health, education, water, and sanitation, are also directly relevant to achieving important social development objectives.

The trends depicted above can readily be observed in the Greater Mekong Subregion (GMS). Services account for a significant share of the subregion's GDP, ranging from 25.7% in the Lao People's Democratic Republic (Lao PDR) to 39.1% in Cambodia and 46.0% in Thailand according to recent figures (Figure 1). For both Cambodia and Thailand, services already represent the largest share



**Figure 1: The Share of Services in the GMS Economies**  
(Services as % of GDP)



GDP = gross domestic product, GMS = Greater Mekong Subregion, Lao PDR = Lao People's Democratic Republic.

Source: Tiranutti, V. 2008. Trade in Services in the GMS Countries: An Overview. Presentation to the ADB-ITD Training Course on Trade and Investment in Services, International Institute for Trade and Development. Bangkok. 11 February.



of their economies and their leading source of export earnings. The recent rapid liberalization of trade in services in the GMS countries has resulted from a confluence of factors, including regional integration efforts among members of the Association of Southeast Asian Nations (ASEAN), notably through the ASEAN Framework Agreement on Services (AFAS). In addition, the signing of free trade agreements (FTAs) between ASEAN and other economies such as the People's Republic of China (PRC) and the Republic of Korea, along with other FTA initiatives currently underway with Australia, India, Japan, and New Zealand, have given much greater prominence to services trade policy throughout the region.<sup>5</sup>

The importance of policy in the service sector goes beyond the sector itself. Services are essential inputs into virtually all production, and producers depend on services to deliver their output to end users. Because the price and quality of the services available in an economy have major impacts on all sectors, service-sector policies and efficiency-enhancing reforms, including regulatory and institutional changes, can exert major effects on overall economic performance.

An inefficient service sector acts like a prohibitive tax on a national economy. For this reason, the economic cost of protecting an inefficient service sector is arguably greater overall than that of protectionism in the goods sector. Countries are increasingly adopting an open trade and investment regime and a pro-competitive regulatory stance in key infrastructural service sectors—telecommunications, finance, transport, logistics, energy—to maximize benefits from the internationalization of services markets.

Countries able to exploit these opportunities have generally contributed to, and benefited from international economic convergence. In contrast, countries that fail to establish conditions conducive to the efficient provision of key infrastructural services run the very serious risk of falling further behind.

Policy reforms to increase international competition in services industries can boost growth prospects and enhance welfare. Countries with open financial and infrastructure service sectors have been found to experience a growth dividend estimated at 1.5 percentage points of GDP or more.<sup>6</sup> Country- and sector-specific

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<sup>5</sup> For a fuller discussion of trends in regional integration in Southeast Asia, see Section IV.

<sup>6</sup> Hoekman, B. 2006. Liberalizing Trade in Services: A Survey. *Policy Research Working Paper 4030*. Washington, DC: World Bank; Mattoo, A., R. Rathindran, and A. Subramanian. 2006. Measuring Services Trade Liberalization and its Impact on Economic Growth: An Illustration. *Journal of Economic Integration* 21. pp. 64–98; Eschenbach, F. and B. Hoekman. 2006. Services Policy Reform and Economic Growth in Transition Economies, 1990–2004 *Review of World Economics*, 142(4). pp. 746–64.



analyses of services liberalization document the relationship between more open and competitive service sectors and productivity performance in services-intensive sectors such as domestic manufacturing, extractive industries, agriculture, and fisheries.<sup>7</sup> Foreign direct investment (FDI) in services is a major means through which “best practices” and knowledge are diffused to host countries and linkages to regional and production networks established.

Services such as telecommunications, transport, banking and insurance, logistics, and distribution constitute much of the infrastructure that is required for trade. They are used intensively in all production, making up 10%–20%, and sometimes more (an estimated 20%–25% in some countries’ ready-made garments industry), of production costs in both manufacturing and agriculture.<sup>8</sup> These figures and observations attest to the economic and commercial significance of the service sector and of negotiations aimed at progressively rolling back impediments to trade and investment in it.

In many countries, the development process typically coincides with growth of the service sector alongside a steadily reduced share for agriculture in employment and output (Figure 2). The question is thus not whether or not to embrace a more service-centered development path—a process of structural transformation that tends to occur spontaneously as incomes rise and economic development proceeds—but rather how to pursue it and at what pace? A further question is how trade and investment policy, hence engagement in trade and investment negotiations, should accompany such structural adjustment to ensure that it proceeds in an orderly, predictable manner.

### Key Determinants of Service Sector Growth

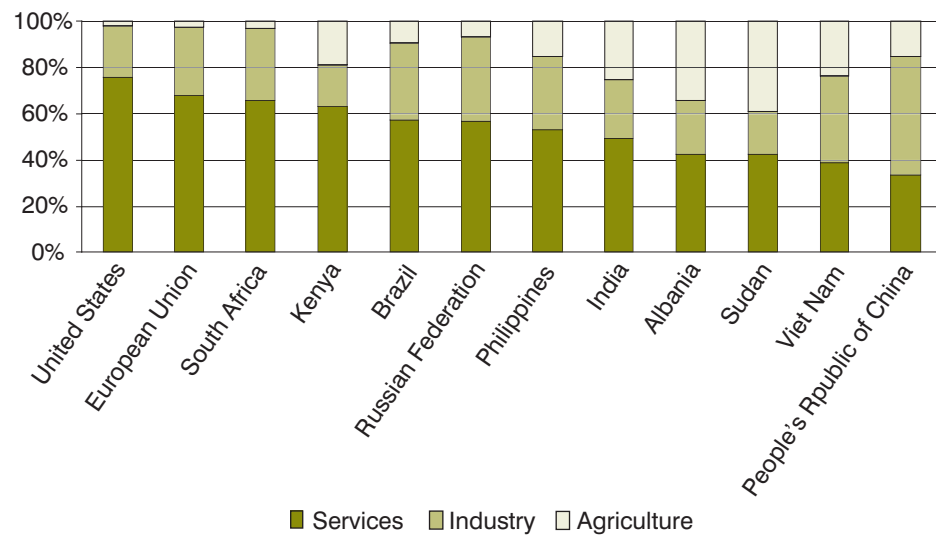
The rising importance of the service sector in domestic economies and its growing contribution to international trade and investment can be traced to a number of structural forces shaping global integration. Five such forces can be identified as contributing most to the increasingly service-centered nature of worldwide production and exchange patterns.

<sup>7</sup> Arnold, J., B. Javorcik, and A. Mattoo. 2007. *The Productivity Effects of Services Liberalization: Evidence from the Czech Republic. Policy Research Working Paper 4109*. Washington, DC: World Bank; Arnold, J., A. Mattoo, and M. Narcisco. 2006. *Services Inputs and Firm Productivity in Sub-Saharan Africa: Evidence from Firm-Level Data. Policy Research Working Paper 4048*. Washington DC: World Bank.

<sup>8</sup> Zedillo, E., and P. Messerlin with J. Nielson. 2005. *Trade for Development. Background report for United Nations Millennium Project*. New York. Chapter 4. Also available: [www.unmillenniumproject.org](http://www.unmillenniumproject.org)



**Figure 2: Share of Services in GDP, Selected Countries, 2006**  
(%)



GDP = gross domestic product.

Source: World Bank.

### Technology

Technological innovation has vastly increased the tradability of services transactions while contributing to dramatic cost reductions in information processing in recent decades. In particular, the revolution in information and communication technology (ICT) has allowed the digitization of data, giving birth to e-commerce and the possibility of remotely supplying an ever more dizzying array of business services—the most tangible manifestations of technology’s contribution to the service economy. Such developments have allowed a large and growing number of developing countries to interpose themselves into the new international division of labor in services trade and to exploit new sources of comparative advantage. It has also allowed developing countries to leapfrog entire stages of infrastructural development, notably through the spread and rapid adoption of mobile technologies (telephony and internet). The service sector-enhancing properties of technology are being felt much more widely than in just the ICT sector; they can be seen in applications as diverse as containerized shipping, the design of long-distance aircraft, and energy storage, reducing costs and facilitating trade with similar far-reaching results.



### Changes in the Organization of Production

The fragmentation of production, the creation of regional and global production networks, and the intensification of competitive pressures that have come in globalization's wake have fundamentally altered the manufacturing process. One important consequence has been the rising strategic importance of logistics management in servicing just-in-time delivery patterns. The growing recourse made to outsourcing services functions—from design to accounting to after-sales services and human resource management—that used to be performed inside manufacturing firms and computed as such in national income accounts has been just as fundamental.

A similar process of fragmentation is under way today in service industries themselves. Making powerful use of the ICT revolution, firms in transportation, banking, insurance, telecommunications, utilities, health care, and various professions and business services are increasingly relying on—and providing—remotely supplied services. In the process, an entirely new geography of services trade has emerged.

### The Growth of Foreign Direct Investment (FDI)

During the past few decades, the growth of foreign direct investment (FDI) has far outstripped that of GDP and international trade, creating ever-tighter links of production and exchange between countries. FDI has arguably been the most powerful vector of globalization, and two successive waves of cross-border investment activity have contributed to the internationalization of the service economy.

A first wave, reaching as far back as the 1960s and continuing today, was led by the spread of manufacturing firms in search of new markets or export platforms. In expanding globally, such firms encouraged the internationalization of home-country service suppliers, which followed their corporate clients abroad in sectors as diverse as construction and engineering, professional and business services, banking and insurance, telecommunications and information services.

A second, more recent, wave of FDI-induced internationalization of the service economy has displayed more endogenous patterns. Major firms in all key service sectors are pursuing their own internationalization strategies in an environment characterized by far greater host-country openness in the wake of pro-competitive regulatory reforms, privatization, and investment liberalization. This second wave has been spawned by the fragmentation of services production and the creation



of ICT-dependent production networks in services, with investors from developing countries becoming increasingly active players in cross-border merger and acquisition activity.

### **The Supply of Human Capital**

Service industries everywhere make abundant use of labor, and the very nature of many service activities, from haircuts to medical services, often implies physical contact and proximity between suppliers and consumers. The scope for adopting labor-saving production methods is generally more limited in services than it is in agriculture, extractive industries, or manufacturing, though cross-border labor arbitrage in the performance of certain labor-intensive service activities has become increasingly possible through ICT applications. While the service economy includes pockets of low-qualified, low-skill, low-pay activities, it also comprises many segments that require above-average skill levels. As Figure 3 reveals, service sectors such as finance, engineering, ICT, health, education, and energy rank among the highest in skill-to-labor ratios. It is hardly a coincidence that the world's richest economies, where average wages and labor productivity levels are highest, are precisely those with the highest shares of services in output and employment. Yet to maintain income and productivity growth, service-centered economies need to devote increased attention to the quality of human capital and its lifelong training. The latter challenges are ones that cross-border trade and investment in services can help meet.

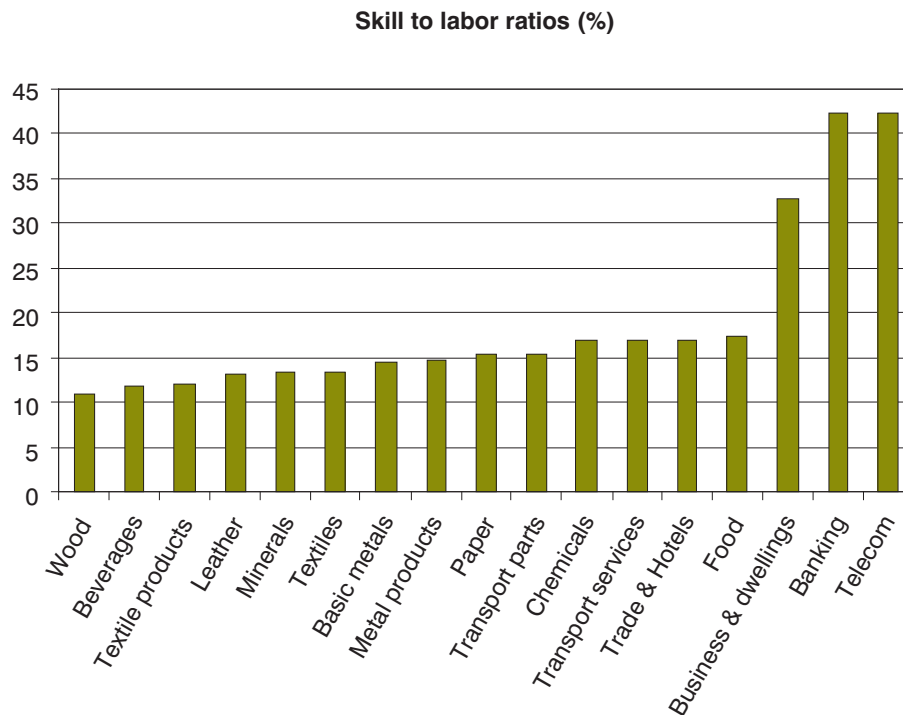
Several developing countries, including some in the GMS, have experienced strong increases in the supply of human capital in recent years as a result of determined efforts at improving overall education and training standards. In some instances, such as the PRC, Viet Nam, and Singapore, those efforts have included trade and investment liberalization aimed at attracting top-ranking foreign providers of higher education.

The supply of skilled workers from developing countries, which by some accounts has increased by a factor of four since the early 1990s, has vastly intensified competitive pressures in a growing global labor market—at times provoking fears among blue- and white-collar workers in rich countries over job displacement arising from the fragmentation of manufacturing and services. At the same time, rising skill levels have made workers more mobile, creating strong demand for managing so-called Mode 4 trade, or the temporary movement of service suppliers, including via trade agreements, in the interests of sending and receiving countries alike.





**Figure 3: Intersector Skill Intensities**



Source: Amin, M., and A. Mattoo. 2006. Do institutions matter more for services? *Policy Research Working Paper 4032*. Washington, DC: World Bank.

### Ideology

Few structural transformations in the world economy are immune from the political, economic, regulatory, or ideological context within which they occur, and the growth of the service economy and the advent of rules governing cross-border trade and investment in services are clearly no exception. The last few decades have witnessed nothing short of a revolution in thinking in political circles about the proper boundaries between the market and the state, notably with regard to ownership and supply of critical service activities such as telecommunications, finance, transportation, and energy. This revolution has been induced in large measure by the four previous key determinants and their interaction.

The collapse of Soviet communism in the late 1980s and the rise of the so-called Washington consensus that ensued, with its emphasis on market-friendly trade



and investment policies, resulted in a marked shift in government attitudes toward service sector regulation. The result in most countries, developed and developing, has been the steady withdrawal of the state as owner-supplier and its emergence as a regulator of services, responding to market failures and officiating in newly competitive markets. Such a profound realignment of government conduct in services led, in turn, to a worldwide wave of privatization, investment liberalization, and the emergence of pro-competitive regulatory regimes and strengthened enforcement of competition policy in important service industries. All of these developments contributed to the internationalization of the service economy, prompting calls, including in trade policy circles, for collective action and for creating rules of the game at the regional and multilateral levels to further the internationalization process and to ensure that the quest for greater market contestability will proceed in a transparent, predictable, and nondiscriminatory manner.

### Defining Characteristics of Services and Why They Matter for Trade Regulation

While services and services trade share many properties with goods and goods trade, goods and services differ in a number of ways that matter significantly for policy design and rule-making. Six distinguishing characteristics appear most important and worthy of analytical attention. Table 1 offers a synthesis of key differences between General Agreement on Tariffs and Trade (GATT) and General Agreement on Trade in Services (GATS) in the light of these characteristics.

**Table 1: Characterizing Differences Between Goods and Services in Trade Law: A Synthesis**

Negotiating Issue	Treatment in GATT	Treatment in GATS
<b>Modes of supply</b>	Cross-border; limited coverage of investment matters (TRIMs); no inherent need for factor mobility in goods trade	Inherent need for addressing factor mobility in services trade; reliance on four modes of supply; cross-border supply; consumption abroad; commercial presence; movement of natural persons
<b>Quality of data, measurement, modelling</b>	Comprehensive, disaggregated robust	Partial, aggregated, weak

*continued on next page*



Table 1: continued

Negotiating Issue	Treatment in GATT	Treatment in GATS
<b>National treatment</b>	General obligation, no exceptions	A la carte in scheduled sectors and modes, subject to limitations; right not to schedule
<b>Most-favored nation treatment</b>	General obligation, no exceptions	General obligation subject to one time exception upon GATS' entry into force or accession; with a weak/non-credible sunset clause
<b>Quantitative restrictions</b>	Prohibited; per se offense	Allowed, subject to listing in scheduled sectors and modes
<b>Diversity</b>	One size fits all; common rules to all sectors subject to goods disciplines	Co-existence of horizontal and sector-specific disciplines in annexes

GATS=General Agreement on Trade in Services, GATT=General Agreement on Tariff and Trade, TRIM=Trade-Related Investment Measures.

Source: Author.

## Intangibility

Unlike goods and the inputs required to produce them, which are tangible by their very nature, many services involve the application and transformation of intangible knowledge into intangible value-adding outputs that are harder to measure in almost all instances, particularly when supplied across borders. This difficulty of measurement largely explains why data on the production and exchange of services remain so weak and highly aggregated, lessening the ability of governments to measure the full contribution of services to output, trade, and development. It also generates economic models with considerably weaker predictive power, confronting governments with greater uncertainty over the likely consequences of alternative policy or negotiating approaches. The result is once again a propensity toward greater precaution in negotiated outcomes and toward legally binding commitments often scheduled at a level below prevailing regulatory and market-access conditions.

The paucity and highly aggregated nature of services trade statistics also hinder attempts at designing an emergency safeguard mechanism (ESM) for services trade under Article X of GATS, or under the services chapters of preferential trade agreements (PTAs). This is so because the current state of services trade data



does not allow us to determine the origin and value of potential import surges in specific service sectors precisely, or to establish credible causal links between such surges and the potential injury faced by “like” domestic service providers. For this reason, a GATS ESM remains elusive a decade and a half after the GATS Article X negotiating mandate was agreed.

### **Nonstorability**

Unlike goods, whose production is typically wholly removed from final consumption, and which can be produced in a plant, stored in a wholesale warehouse, and then shipped to a retail distributor for final purchase, many services can only be consumed at the point of purchase, and therefore require simultaneous production and consumption. It is true that technology now makes it possible to store certain services digitally for deferred consumption. Still, the vast majority of services—from haircuts to real-time medical interventions to phone conversations to consulting services—remain nonstorable. This means that factors of production—capital and labor, each of which has its own complex political economy—must be mobile for most service transactions to occur.

The nonstorable character of many services explains why the definition of trade in services needed to look beyond so-called Mode 1 trade (goods-like cross-border transactions where only the service itself crosses a border) and cover transactions involving the movement of people, either as consumers (Mode 2 trade) or as service providers (Mode 4 trade), as well as services sold via the establishment of a commercial presence in a host country market (so-called Mode 3 trade).

Adding factor mobility to the negotiating equation in services introduces layers of complexity that are simply not present in goods negotiations. Neither are the policy sensitivities that arise over migration-related matters and foreign ownership and control of sensitive economic sectors, which trade in services necessarily implicates.

After they had waged and ultimately won a protracted battle to keep investment issues off the Uruguay Round agenda, developing countries, reluctant to deal with investment-related forms of trade, argued at the outset of the [Uruguay] Round that services negotiations should focus solely on cross-border transactions. However, they quickly came to recognize that such a limitation would involve liberalizing transactions over which host countries had no jurisdictional reach. The result would be that potentially significant differences in regulation could not easily be addressed under a regime based on national treatment. Acknowledging that foreign investment in services could bring significant economic benefits and allow



foreign suppliers to be fully subject to host-country regulatory control, developing countries progressively embraced an approach to defining services under which trade in services comprise four distinct modes of supply. As a negotiating quid pro quo, parallels were established between capital and labor mobility under GATS. The incorporation of Mode 4 trade, an area in which many developing countries enjoy a clear comparative advantage and where Organisation for Economic Co-operation and Development (OECD) countries tend to be more defensive, also allowed developing countries to compensate for the fact that Mode 3 trade was a form of services trade of almost exclusive interest to developed country suppliers at the time of the Uruguay Round (though no longer today).

However, the functional (and legal) equivalence established between Modes 3 and 4 under GATS, which is replicated in many PTAs, cannot mask the stark differences that characterize these modes' respective political attractiveness. To date, Mode 3 remains by far the most significant mode for trading services, accounting for an estimated 60% of transactions and a commensurate share of binding commitments under the GATS, whereas Mode 4 trade (with the exception of labor mobility linked to the operation of foreign investments—so-called intracorporate transferees) accounts for a negligible share both of total services trade and of services commitments (1%–2% in both cases), thanks to onerous restrictions maintained against labor mobility in developed and developing countries alike.

### Intermediation

Perhaps the single most important economic insight that flows from a consideration of the differences between goods and services is that nearly all of services-provision has a dual purpose: it is an important economic activity in its own right and, critically, provides inputs into the production of other goods and services. Services such as telecommunications, finance, energy, transportation, and logistics are always and everywhere embedded into all a nation produces, brings to market, or exports.

For this reason, trade policy for services can be likened to trade policy for capital goods imports. Simply put, the aim of policy should be to progressively reduce the economy-wide tax that service sector inefficiency represents. Regardless of where a country's comparative advantage may happen to lie—and for many developing countries it may not lie in the export of many types of services—it can be magnified if firms can secure access to services of higher quality and lower price. This implies that all countries, not only those that are the leading suppliers of services, have a stake in services negotiations.



The central intermediation task services perform—the fact for instance that telecommunications or finance are used pervasively in almost any economic transaction—recalls how imports can expose domestic suppliers to potentially more efficient products, producers, and production methods, or even to a range of services that are not available locally. While this claim runs against the mercantilistic instincts that predominate in trade negotiations, it is critically important to policy to look at services negotiations as a means of helping an economy attain a higher growth and efficiency. The far-reaching degree of unilateral liberalization in services policy that developing countries have pursued in recent decades attests to their growing recognition of the key intermediation role services play in the development process.

### **Protection Behind Borders**

Again unlike goods, the border is arguably of marginal significance to trade in services, except for Mode 4 trade (temporary movement of service providers), because trade and investment protection in services takes the form of domestic regulation, rather than border measures such as tariffs. The negotiating agenda in services may thus be likened to that characterizing nontariff measures (NTMs) negotiations in goods trade. If several decades of NTM negotiations have taught trade officials anything, it is that such talks are slow, ponderous, and typically protracted, involving differences in regulatory regimes that are often deeply entrenched politically and that offer conveniently subtle and often disguised forms of trade and investment discrimination to home-country governments and firms. The nontariff-like nature of services negotiations offers one more explanation of why progress tends to be snail-paced.

In goods trade under GATT, once a tariff is levied at the border, “like” domestic and foreign goods must be accorded national treatment without exception. The relative irrelevance of the border as a locus of trade regulation explains why this core nondiscrimination principle of national treatment cannot be applied across the board (i.e., as a general obligation) to all services transactions. Rather, under GATS, national treatment commitments are the expression of voluntary scheduling decisions in those sectors, subsectors and modes of supply of interest to World Trade Organization (WTO) members, and are subject to the right to maintain any limitations thereto (so long as the latter are scheduled in committed sectors and modes of supply).

The diverse nature of potentially restrictive service sector regulations—rooted in measures that are overtly discriminatory (and thus in violation of national treatment), that quantitatively constrain the level of competition in the marketplace (for example, by limiting the number of competitors or transactions or their value),



or that result from unduly burdensome nondiscriminatory domestic regulatory conduct—further illustrates the range of policy measures, regulatory interests, and policy sensitivities likely to be at play in services negotiations.

Historical reliance on sector-specific forms of reciprocity in sectors such as banking, aviation and other transport modes, and audiovisual services further explains why, unlike GATT, GATS allows WTO members to deviate from the core principle of most-favored-nation (MFN) treatment, arguably indefinitely.<sup>9</sup>

### High Regulatory Intensity

The transparency obligations found in services agreements tend to be quite detailed and generally more onerous than those applicable to goods trade; they often involve extensive notification requirements, the creation of “one-stop shop” inquiry points, the establishment of administrative tribunals, the speedy rendering of administrative decisions, recognition of prior comment rights to foreign suppliers and investors on proposed laws and changes to existing legislative and regulatory measures, and similar conditions. The explanation is heavy reliance on behind-the-border regulatory measures as instruments of protection in services trade, combined with the extensive degree of regulation found in major service sectors.

State intervention tends to be pervasive in light of the high incidence of market failure in services markets. Four main types of market failure affecting service industries can be identified, with differing effects on trade (Table 2). First is the tendency of many services markets, particularly those characterized by network properties—such as telecommunications, energy distribution (pipelines, electricity), sanitation services, railways, and airports—to be highly concentrated and characterized by monopoly or oligopoly. In such circumstances, incumbents can easily deter new market entry—a monopoly can prevent it completely—or abuse their dominance by engaging in anticompetitive cross-subsidization between competitive and noncompetitive market segments, or by maintaining unduly burdensome conditions of access to their networks for the purpose of supplying services competitively. The impact on trade is obvious: dominant firms can easily nullify or impair the value of market-opening commitments. This must prompt a deliberate response in the form of pro-competitive safeguards directed at market failure. One example in the trade field is the Reference Paper on Pro-Competitive Regulatory Principles appended to the WTO’s 1997 Agreement on Basic Telecommunications, which imposed a number of competition policy-like disciplines on dominant firms with a view to ensuring that commitments to promote

<sup>9</sup> The obligation to sunset MFN exemptions listed under Annex II of GATS after a period of 10 years only applies “in principle.”





competition in basic telecommunications services would not be frustrated by abusive interconnection charges by firms with market power.<sup>10</sup>

**Table 2: Dealing with Domestic Regulation: Domestic and International Policy Responses**

Market Failures	Service Sectors Concerned	Possible Trade Policy Response (GATS or PTAs)	Possible National Policy Responses
<b>Monopoly/Oligopoly</b>	Network services: telecommunications; transport (terminals and infrastructure); environmental services (sewage); energy services (distribution networks)	Generalizing key disciplines in telecommunications reference paper 'to ensure cost-based access to essential facilities, such as roads, rail tracks, terminals, sewers, networks or pipelines.  Strengthening disciplines to deal with anticompetitive conduct	Developing pro-competitive regulation to protect consumer interests where competitive market structures do not exist
<b>Asymmetric Information</b>	Intermediation and knowledge-based services: financial services, professional services, etc.	Implementing nondiscrimination; possibly applying a "necessity" test	Strengthening domestic regulation to remedy market failure in an economically efficient manner
<b>Externalities</b>	Transport, tourism, etc.		
<b>Social Objectives:</b> <b>Universal Service</b>	Transport, telecommunications, financial, education, health		Devising economically efficient means of achieving social objectives in competitive markets

GATS=General Agreement on Trade in Services, PTA=preferential trade agreement.

Source: Mattoo, A., and P. Sauvé. 2003. *Domestic Regulation and Services Trade Liberalization*. Washington, DC: Oxford University Press.

<sup>10</sup> "The Reference paper on Pro-Competitive Regulatory Disciplines is a set of additional, voluntary, competition-promoting disciplines agreed in the context of the WTO's 1997 Agreement on Basic Telecommunications."



Three other types of market failure are prominent in services markets: information asymmetries, which provide the rationale for licensing regimes in professional services or for prudential regulation in financial markets; (negative) externalities, which are typically associated with pollution (noise, air, water) or environmental damage stemming from transportation or tourism, especially ecologically fragile environments;<sup>11</sup> and universal access objectives, which predominate in sectors, market segments, or geographic areas where the market cannot be relied upon to provide services deemed essential to the exercise of citizen rights (such as education, health, transport services in remote regions, or access to a telephone or to the internet in rural areas).

In the latter three cases, regulation enacted in response to market failure may not always restrict trade directly, but may represent an unduly burdensome means of attaining an otherwise legitimate public policy objective. It is in regard to such domestic regulatory measures that the GATS Article VI:4 mandate calling for the development of stronger disciplines on nondiscriminatory regulatory conduct have been envisaged.

Trade agreements such as GATS or the services provisions of PTAs should not be seen as undermining the sovereign right of countries to regulate their services markets in pursuit of public policy objectives—a right that is reaffirmed in the preambles to most agreements. Rather, trade agreements afford ways of questioning the *means* used to secure compliance with legitimate public policy objectives, of encouraging countries to pursue regulatory objectives in a manner that minimizes adverse effects on trade and investment whenever possible, and of ensuring that such objectives, and the means to achieve them, remain proportional, are not unduly burdensome, and are not disguised trade restrictions. Developing disciplines on nondiscriminatory regulatory conduct has proven highly contentious at both the WTO and PTA levels, raising delicate policy sensitivities across regulatory communities and civil society.

### Diversity

Services, like goods, display considerable diversity, yet such diversity holds different implications in services trade; it contributes to an architecture that juxtaposes horizontal disciplines, applicable to all sectors subject to GATS rules, with a set of vertical rules, embedded in a series of sector annexes that deal with

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<sup>11</sup> State intervention in the form of regulation may also be motivated by the desire to generate positive externalities, such as in the case of film or television and radio broadcast quotas aimed at securing “shelf space” for domestically produced cultural content that may contribute to strengthening national cohesion and promote diversity in content offerings.



the regulatory specificities of individual sectors (telecommunications, financial services, maritime transport, civil aviation) or specific negotiating issues (MFN, movement of service suppliers). No analogous sector-specific treatment can be found in GATT with the exception of separate agreements dealing with trade in dairy products, bovine meat, and subsidies for civil aircraft.

The dual nature of services rules affirms several realities. First, one size most likely does not fit all, given the diversity of sectors involved, the differing nature of market failures to which regulation responds, the political strength of various regulatory agencies involved, the particular policy sensitivities at play, and so on. Second, responsibility for the conduct of negotiations must be shared between trade, foreign, and sector ministries and affiliated regulatory agencies, given the complexity of the subject matter and the challenge for services negotiators. They must master—indeed “speak”—highly diverse regulatory languages and must properly represent the complexity of offensive and defensive interests typically found in individual countries. Third, the sheer novelty of the subject matter—services trade was negotiated for the first time in a multilateral setting a mere two decades ago—entails a certain amount of tension between the trade and sector regulatory communities, requiring mutual learning by doing for its release. Addressing the specific policy concerns of the regulators (such as a prudential carve-out in financial services, pro-competitive disciplines in basic telecommunications, and clarification that the granting of temporary entry privileges does not confer a right of access to labor markets and is not a route to permanent residence or citizenship) through dedicated annexes has been a useful means of maintaining broad sector coverage while also ensuring that such concerns are properly addressed.

Finally, services negotiations require mastery of the art of dealing with, and at times orchestrating interaction with, various interest groups. In particular, building bridges with user groups and consumer coalitions may prove an essential means of overcoming internal resistance to change. In sectors where predominantly defensive concerns are expressed (such as antiliberalization), key industry players or industry associations will typically be “closer” to the sector ministry and affiliated regulatory agencies than to the trade or foreign ministry in charge of conducting overall negotiations. Enlisting user communities to lobby for domestic regulatory change may be an important means of overcoming domestic or international blockage on specific issues. The opening of telecommunications markets achieved in the Uruguay Round, for instance, was greatly facilitated by the clamor from the financial industry—a highly influential lobby in most countries—for lower input costs in running their global operations over public telecommunication networks and proprietary networks that required access to the public networks.



### The Need for Complementary Policies and the Key Role of Regulation

Experience suggests that the pursuit of competition-enhancing reforms in services is hardly ever an easy task, particularly in resource-constrained countries. There is often a need to balance the promotion of greater competition with the legitimate role of government intervention to offset market failures and to achieve noneconomic objectives such as the universal provision of education or health care services. Regulatory reforms must be designed carefully, so that such objectives are attained in an efficient manner.

Disciplines on domestic regulation arising from trade agreements can play a significant role in promoting and consolidating domestic regulatory reform efforts. Such disciplines can also equip developing-country exporters with the means to address regulatory barriers to their own exports in foreign markets. As repeated bouts of financial market instability in a number of emerging markets have shown in recent years, inadequate domestic regulation may give rise to serious internal distortions, which in turn can entail equally severe social dislocation. At the same time, inadequacies in domestic regulation, for example in the field of professional licensing, can legitimize external barriers to trade, to the detriment of developing-country exporters.

For service sector policies—and national commitments on trade and investment in services in the WTO or in PTAs—to contribute to development, liberalization will need to be accompanied by strengthened regulation in many instances. In many settings, regulation and competition policy may need to be in place to complement liberalization. Regulatory intervention will also typically be required to ensure that liberalization improves access to essential services by the poor or the geographically disadvantaged.

Liberalization of the service sector is not a panacea, and many of the benefits flowing from greater market openness may take time to materialize. In contrast, the costs associated with the rationalization of service industries will appear early on under the guise of changes in the structure of industry ownership and possibly labor displacement. Affected workers, incumbent firms (domestic or foreign), and bureaucracies, who will often perceive liberalization as a threat to employment, profitability, or rent-seeking behavior respectively; opposition from these groups adds to the complexity of liberalization efforts with respect to services.



For a number of reasons, the adjustment associated with greater market openness in services trade and investment is generally smoother in many sectors than in some more traditional areas of goods production. First, adjustment in service industries such as telecommunications and finance often occurs within a dynamic sector environment, where expanding market segments and firms can more readily absorb workers from shrinking sectors. Workers who are negatively affected by structural changes may find it easier to reposition themselves in a dynamic economy generating favorable income and employment opportunities than in a stagnant system that defies or resists change.<sup>12</sup> Second, some three-quarters of international trade continues to take place in manufactured products. This generally means that service sector workers are less directly exposed to trade-led job displacement; though, as noted earlier, ICT-induced labor market arbitrage and the steady rise in skill levels in developing countries have both intensified labor market pressures noticeably in recent years. Third, and perhaps most importantly, because they exhibit less sector-specific professional specialization and above-average educational levels, service sector employees tend to have greater overall labor market mobility. This mobility may explain the observed tendency for displaced workers in nonmanufacturing activities to experience shorter periods of unemployment, higher overall reemployment rates, and smaller earnings losses on average upon reemployment than workers in manufacturing.<sup>13</sup>

Experience has shown that services trade liberalization carries risks and potential costs as well as benefits. For example, foreign providers might cherry-pick the most profitable market niches and show limited interest in more marginalized market segments or user communities, displace domestic providers, and contribute to

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<sup>12</sup> Adlung, R. 2000. Services Trade Liberalization from Developed and Developing Country Perspectives. In Sauvé, P. and R.M. Stern, eds. *GATS 2000: New Directions in Services Trade Liberalization*. Washington, DC and Cambridge, MA: Brookings Institution Press and Center for Business and Government, Harvard University. pp. 112–131.

<sup>13</sup> Research carried out by Lori Kletzer at the Peterson Institute for International Economics shows that import competition is associated with low reemployment rates because of the individual characteristics of workers vulnerable to rising import job loss. She concludes that it is not import competition per se that is at fault; it is who gets displaced from (and employed by) industries with rising import competition. “What limits the reemployment of import-competing displaced workers? The same characteristics that limit the reemployment of all displaced workers: low educational attainment, advancing age, high tenure, minority status, and marital status. Compared to high school dropouts, workers with a college degree (or higher), [the great majority of whom are employed in service industries] are 25 percentage points more likely to be re-employed, high school graduates 9.4 percentage points more likely and workers with some college experience 11 percentage points more likely to be re-employed.” See Kletzer, L. 2001. *Measuring the Costs of Trade-Related Job Losses*. Testimony prepared for the United States Senate Committee on Finance. Washington, DC. 20 July. <http://finance.senate.gov/072001ktest.pdf> use the following link: <http://bookstore.petersoninstitute.org/book-store/110.html>



brain drain in certain professions.<sup>14</sup> Government intervention to correct for market failures through regulation and to ensure sufficient competition is therefore crucial if the benefits of services liberalization are to be realized. Indeed, regulation is crucial in most service sectors whether or not they are open to trade and investment. For example, regulation is required to

- create a level playing field and facilitate competition between market players (for example, by ensuring access to networks for new entrants in the electricity or telecommunications sector);
- guarantee the quality of the services provided (for example, by specifying licensing requirements for service providers such as doctors, engineers, and architects);
- protect consumers (for example, from fraudulent practices);
- ensure the provision of sufficient information (for example, about the availability and features of services provided);
- prevent environmental degradation (such as that arising from high levels of tourism or use of transport infrastructure);
- ensure adequate access to critical services (such as electricity, water, sanitation services, health, and education);
- maintain financial stability (in the banking sector); and
- minimize disruptions in supply (for instance, in electricity markets).

However, domestic regulation can be unnecessarily burdensome, and can sometimes interpose a disguised barrier to services trade and investment.

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<sup>14</sup> A recent World Bank study on service sector reforms in Zambia documents some of these concerns: despite significant financial market liberalization—foreign banks and insurance companies today manage two thirds of Zambian bank assets and insurance premiums—credit available to the private sector remains, at 8% of GDP, lower than in the preliberalization period. As of 2005, 90% of bank loans were made to some 5,000 Zambian individuals; firms outside the country's three main cities had to give collateral 65% greater on average for securing bank loans; and nearly 80% of fixed telephone lines are found in the capital Lusaka and the country's copper belt, which together account for 30% of total population. See Mattoo, A. and L. Payton, eds. 2007. *Services Trade and Development: The Experience of Zambia*. New York and Washington, DC: Palgrave-Macmillan and the World Bank.



Barriers can sometimes be an unintended consequence of a regulation (as when required professional qualifications are available only from national educational establishments), but are sometimes imposed deliberately to prevent or limit foreign entry (as with limits on foreign equity participation, or requirements for foreign entrants to form joint ventures with domestic companies).<sup>15</sup>

Liberalizing trade in services usually involves some degree of regulatory reform to make it easier for foreign firms to enter the market. But new or more sophisticated regulatory frameworks are also often required to ensure that liberalization delivers the expected benefits. And the establishment of an appropriate regulatory framework can also be important in enabling a country to take advantage of potential export opportunities by developing well-functioning domestic service sectors that meet world standards of provision. For example, by facilitating the development of a safe and reliable health-care system, a good regulatory framework can enable a country to take advantage of new opportunities to sell health-related tourism services. Similarly, an appropriate legal and regulatory framework in the financial sector can help to build consumer confidence in a new offshore financial center.

Other complementary policies can help to maximize the benefits and minimize the risks of service sector liberalization. These vary from sector to sector, and may include the provision of education and training (for example, in information technology (IT), medicine, or languages) that will enable domestic firms as well as individuals to take advantage of service sector export opportunities, mechanisms to enhance spillovers and technological diffusion from foreign export providers, and strategies to manage the temporary movement of service suppliers, to facilitate greater remittances and maximize their likelihood of return with enhanced skills, networks, and capital.

Summing up, there is much evidence showing that the potential gains from service sector liberalization are substantial. But there are also risks that need to be considered against the risks of not liberalizing. A range of complementary policies,

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<sup>15</sup> For a comprehensive discussion of the relationship between domestic regulation and international trade in services, see Delimatsis, P. 2007. *International Trade in Services and Domestic Regulations: Necessity, Transparency and Regulatory Diversity*. London: Oxford University Press. See also Krajewski, M. 2003. *National Regulation and Trade Liberalization in Services: The Legal Impact of the General Agreement on Trade in Services (GATS) on National Regulatory Autonomy*. The Hague: Kluwer Law International. Mattoo, A. and P. Sauvé, eds. 2003. *Domestic Regulation and Service Trade Liberalization*. Washington, DC: Oxford University Press; and Sauvé, P. Completing the GATS Framework: Addressing Uruguay Round Leftovers. *Aussenwirtschaft*. 57(3). pp. 310–341.





including appropriate regulation, the creation of competitive market conditions, the provision of specialized training of adequate quality and scale, and policies to protect health, environment, and consumers and ensure adequate access to services, are crucial if liberalization is to deliver the expected benefits.

### Policy Questions for Discussion

- Why does the importance of policy in the service sector go beyond the sector itself?
- How can an inefficient service sector act like a prohibitive tax on a national economy?
- What policy implications, including in the trade field, can be said to flow from the fact that services are used intensively in the production of all goods and services?
- From the perspective of GMS countries as a whole or your own country, which of the various determinants of recent service sector growth has had the strongest influence on overall performance?
- How problematic is the lack of adequate data on services and services trade in formulating policy in the sector? Does such a problem affect your country's negotiating strategy in services?
- How does the need for factor mobility affect the conduct of services negotiations? Does such mobility facilitate or complicate such negotiations?
- Why is national treatment not a general obligation in services agreements, when it is for goods trade?
- What is the most important source of market failure to which service sector policy responds in your country?
- How has the shifting boundary between the market and the state affected the design of trade policy in services in your country?
- What are some of the downsides of opening up service sectors to foreign competition and what means do governments have to mitigate such risks while reaping the potential gains from liberalization?



### Key Readings

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# Chapter 3

## Why Negotiate on Services?



### Key Learning Objectives

- Acknowledging that many of the potential gains from services policy reforms can be secured through autonomous actions by the governments of developing countries;
- Understanding the benefits of assigning a trade policy dimension to a country's service sector development through engagement in services negotiations at the bilateral, regional, and multilateral levels;
- Understanding how services exports can be an important part of a developing country's growth strategy;
- Appreciating the key contribution that enhanced access to services imports can make to the development process;
- Acknowledging the need to better situate services and services trade policy in a broader development strategy;
- Mastering the manifold elements of sound preparations for services negotiations; and
- Understanding the benefits of conducting an audit of domestic service sector regulation in the context of trade negotiations.

### Engagement in Negotiations versus Autonomous Liberalization

Trade in services can help create opportunities for countries to expand their output of services in sectors where they enjoy a comparative advantage, thus creating jobs, contributing to gross domestic product (GDP) and employment gains, and generating foreign exchange earnings. This can be especially important for countries that are relatively isolated from world goods markets, either because they are too small to specialize in manufacturing, or suffer from poor transport infrastructure, or are landlocked. Many countries in sub-Saharan Africa as well as within the Greater Mekong Subregion (GMS) are afflicted by these problems. Table 3 shows the growing contribution both exports and imports of services have made to the trade performance of GMS countries in recent years.

**Table 3. Trends in Services Exports and Imports in GMS Countries, 2000–2005**

Exports of Services by GMS Countries						
(\$ million)						
	2000	2001	2002	2003	2004	2005
<b>Cambodia</b>	428	525	604	545	801	1,107
<b>PRC</b>	30,431	33,334	39,745	46,734	62,434	74,404
<b>Lao PDR</b>	176	166	174*	126*	176*	184*
<b>Myanmar</b>	478	408	426	249	255	277
<b>Thailand</b>	13,868	13,024	15,391	15,798	19,040	20,647
<b>Viet Nam</b>	2,702	2,810	2,948	3,272	3,867	4,176

Imports of Services by GMS Countries						
(\$ million)						
	2000	2001	2002	2003	2004	2005
<b>Cambodia</b>	329	349	377	434	513	631
<b>PRC</b>	36,031	39,267	46,582	55,306	72,133	83,796
<b>Myanmar</b>	328	361	309	420	460	428*
<b>Thailand</b>	15,460	14,610	16,720	18,169	23,077	27,605
<b>Viet Nam</b>	3,252	3,382	3,698	4,050	4,739	5,282
<b>Lao PDR</b>	43	32	28*	39*	43*	47*

GMS = Greater Mekong Subregion, Lao PDR = Lao People's Democratic Republic, PRC = People's Republic of China.

Note: \* = estimate.

Source: WTO Trade Profile 2007. [www.wto.org/english/res\\_e/booksp\\_e/anrep\\_e/trade\\_profiles07\\_e.pdf](http://www.wto.org/english/res_e/booksp_e/anrep_e/trade_profiles07_e.pdf)

Liberalization of international trade in services often requires action on multiple fronts. For example, research at the World Bank suggests that some \$1.4 billion could be saved every year if just 1 in 10 US patients were treated abroad for 15 standardized medical procedures.<sup>16</sup> However, health insurance plans in developed countries often impede trade in health-related services. Modifying public and private health insurance regimes and contracts to make reimbursement independent of the location of the medical provider, and to allow it to extend to the associated travel costs, would allow a greater share of the potential gains from trade in health services to be realized.

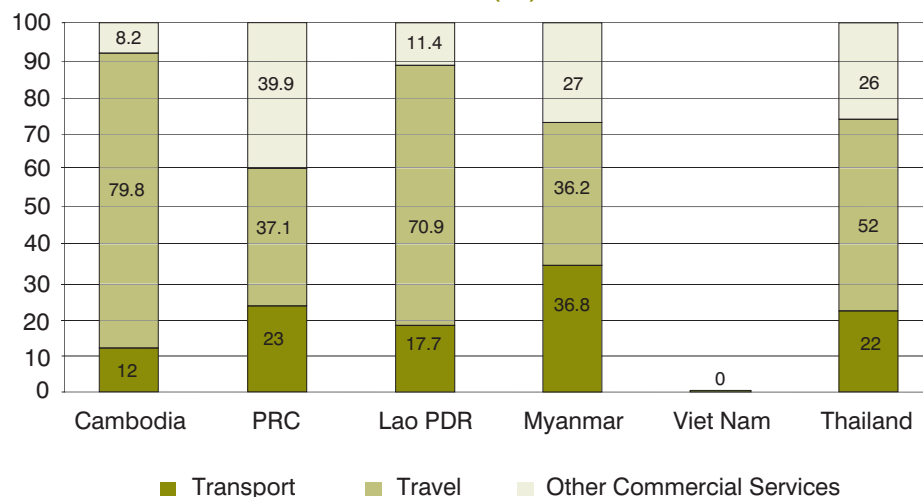
<sup>16</sup> Mattoo, A., and R. Rathindran. 2006. How Health Insurance Impedes Trade in Healthcare. *Health Affairs* 25(2). pp. 358–368.



Most of the potential gains from services policy reforms can be secured through unilateral actions by the governments of developing countries. Detailed, country-specific analysis can identify where liberalization will be unqualifiedly beneficial, and where better regulatory interventions are needed to complement the opening of services markets. A recent comprehensive World Bank study of service sector policy in Zambia is a good example of such analysis, identifying actions that can and should be taken by the government and areas where international cooperation is needed to improve service sector performance.<sup>17</sup>

Services exports can be an important part of a developing country's growth strategy. For example, India has been capitalizing on a boom in exports of IT-enabled services, as multinational firms have outsourced a growing range of administrative and other functions to lower-cost countries. Labor-intensive tourism and the wellness industry that seeks to add value to tourism activities is now a significant part in the economy of many developing countries, including throughout the GMS, as can be inferred by the high share of travel receipts depicted in Figure 4.

**Figure 4: Sectoral Breakdown of GMS Countries' Services Exports, 2006 (%)**



GMS=Greater Mekong Subregion, Lao PDR=Lao People's Democratic Republic, PRC=People's Republic of China.

Note: Data for Viet Nam not available.

Source: WTO Trade Profile 2007. [www.wto.org/english/res\\_e/booksp\\_e/anrep\\_e/trade\\_profiles07\\_e.pdf](http://www.wto.org/english/res_e/booksp_e/anrep_e/trade_profiles07_e.pdf)

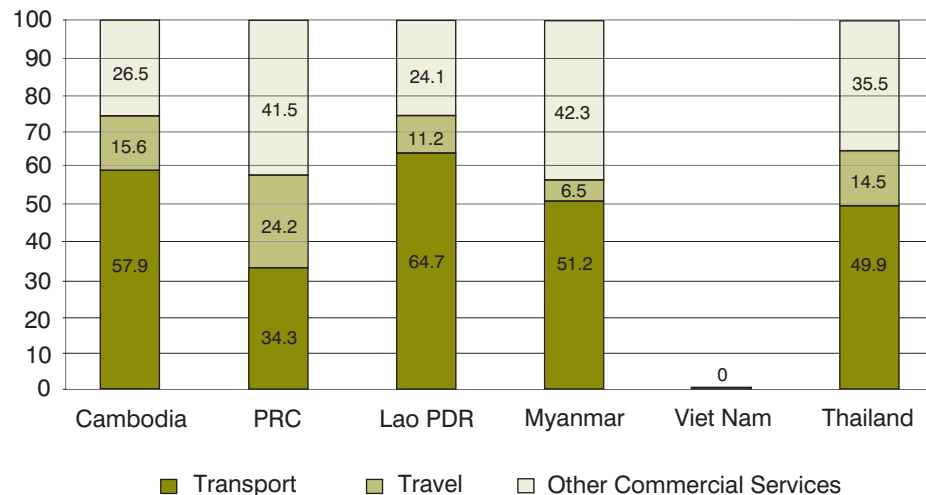
<sup>17</sup> Mattoo, A., and L. Payton, eds. 2007. *Services Trade and Development: The Experience of Zambia*. New York and Washington, DC: Palgrave-Macmillan and the World Bank.



However, trade in services can lead to import gains as well, by stimulating competition and introducing international best practices, particularly in matters of domestic regulation, skills and technologies, and investment capital. The entry of foreign providers can yield better services for domestic consumers, improve the performance and competitiveness of domestic firms, and—given that much trade in services actually occurs through foreign direct investment or “commercial presence” in General Agreement on Trade in Services (GATS) terminology—serve to bring much-needed capital into the country. Allowing foreign service providers can also help stimulate investment in infrastructure development where such development has been stifled because public sector budget constraints or limited access to international capital markets make government or domestic private sector funding difficult to secure.

Figure 5 describes the structure of service imports in the GMS. The data reveal the critical importance that transportation services imports play, commensurate with the subregion’s strong dependence on external markets and its insertion in regional and global production networks in manufacturing.<sup>18</sup>

**Figure 5. Sectoral Breakdown of GMS Countries’ Services Imports, 2006 (%)**



GMS=Greater Mekong Subregion, Lao PDR=Lao People’s Democratic Republic, PRC=People’s Republic of China.

Note: Data for Viet Nam not available

Source: WTO Trade Profile 2007. [www.wto.org/english/res\\_e/booksp\\_e/anrep\\_e/trade\\_profiles07\\_e.pdf](http://www.wto.org/english/res_e/booksp_e/anrep_e/trade_profiles07_e.pdf)

<sup>18</sup> Figures 4 and 5 also usefully recall the extent to which services trade data are aggregated; note the catchall “other commercial services” category.



The bulk of services trade occurs through foreign direct investment (FDI), because service suppliers typically need to establish a commercial presence to access host-country markets effectively and to tailor their service offerings to local needs and conditions. Not surprisingly, the service sector accounts for almost half of the global *stock* of FDI, and some two-thirds of annual FDI flows have been directed toward service industries in recent years.<sup>19</sup> More important still from a policy perspective, more than four of five barriers to international investment are found in the service sector.<sup>20</sup>

Developing countries have much to gain from scheduling deeper commitments on FDI in services (commercial presence or Mode 3 trade), particularly in critical infrastructural services such as telecommunications, finance, energy, and transport. Barriers to investment in these sectors are among the highest in many developing countries. Greater Mode 3 trade can form the basis for developing an export capacity in professional, financial, transportation, and even health and education services.

In marked contrast to agriculture, services negotiations take place against a backdrop of far-reaching recent trade and investment liberalization, much of it unilaterally decreed. Negotiations thus play starkly different roles in the two sectors. In agriculture, negotiations are crucial in driving even the most modest reforms. In services, multilateral (or regional) negotiations essentially play a complementary role, affording countries periodic opportunities to lock in the domestic policy reforms they are likely to have enacted recently. Such considerations of political economy imply that services negotiations can generate significant gains simply by harvesting existing levels of market openness in services markets. But they also point to a real dilemma: whether and how to push for a grand bargain on services if market opening is already occurring unilaterally? Simply put, what incentives can be found to translate ongoing liberalization into *negotiated* commitments?

A trade-negotiated bargain on services is worth pursuing for at least two main reasons. First, unilateral liberalization, while genuine and widespread, is far from uniform across regions, countries, sectors, and modes of supply. Prohibitive barriers remain, particularly in areas of the greatest interest to developing countries, such as the movement of service suppliers. Second, in the mercantilistic

<sup>19</sup> United Nations Conference on Trade and Development. 2004. *World Investment Report 2004: The Shift Towards Services*. Geneva.

<sup>20</sup> Sauv , P., M. Molinuevo, and E. Tuerk. 2006. *Revealed Policy Preferences in Selected International Investment Agreements*. United Nations Conference on Trade and Development. Investment Issues Series. Geneva.





world of trade negotiations, developing countries can gain leverage to push more credibly for necessary technical and financial assistance to implement service sector commitments, or for commitments from trading partners in other priority areas of a negotiation, by locking in service sector reforms in the form of binding commitments. Simply put, services negotiations offer developing countries the opportunity to act in their own economic interest and be paid for it at the negotiating table.

Governments at all levels of development face the difficult task of designing service sector reforms so as to generate sustainable gains in overall economic performance, while minimizing adjustment costs to avoid social hardship and promoting access to essential services for the poor. While this task remains first and foremost a *domestic* policy challenge, services negotiations can nonetheless help support domestic policy reform efforts in five distinct ways.

First, reciprocity-based bargaining can help governments overcome domestic opposition to reform. Pursuit of reforms and further liberalization can be easier to implement if a government can demonstrate that its exporters will benefit from improved market access gained in other areas of a trade negotiation. Because most developing countries have fewer internationally competitive service sectors than do industrial countries, this may limit the scope for reciprocal bargaining under GATS or the services chapters of preferential trade agreements (PTAs). Comprehensive trade agreements conducted as single undertakings offer scope for cross-sectional trade-offs, which will likely be necessary to ensure an equitable exchange of market access concessions.

Second, domestic reforms cannot address barriers in foreign markets. The only feasible means of doing so is by pursuing reciprocal liberalization opportunities with key trading partners.

Third, a commitment that is binding under international law and therefore more difficult and costly to reverse can strengthen the credibility of domestic policies, contributing to an improved investment climate. A government can send a powerful signal to investors that it is committed to opening its services markets, and to safeguarding such openness, by locking in current policy under international law or progressively closing the gap between existing policies and international commitments. The credibility-enhancing properties of multilateral commitments rank among the most important features of GATS and, more broadly, of World Trade Organization (WTO) rule making. The same applies to bound commitments made under PTAs.



Fourth, services agreements offer the possibility of precommitting to future liberalization, which is intended to instill a greater sense of urgency about needed domestic regulatory reforms while promoting orderly adjustment. A scheduled commitment to future liberalization may be more credible than a purely domestic announcement of reform, particularly in countries saddled with higher risk premiums. Under precommitment, all stakeholders in a given sector face a clear, irrevocable deadline to prepare for a reformed policy environment.<sup>21</sup>

Fifth, additional commitments on transparency and on domestic regulation can be important complements to the removal, under services agreements, of explicit barriers to trade in services. Such good governance disciplines assure foreign traders and investors that commitments to liberal market access will not be nullified or impaired, whether by the imposition of regulatory barriers to services trade or by the nontransparent and discretionary implementation of service sector regulations, such as allocation of licenses. In addition, multilaterally agreed principles of transparency and domestic regulation can help promote the adoption of “best practice” or “pro-competitive” regulation at home, as has happened in the telecommunications sector.<sup>22</sup>

### Preparing for Services Negotiations

Service sector reform is complex, and it is critical that liberalization efforts be rooted in and accompanied by (in some instances, preceded by) sound regulation and regulatory enforcement capacity.<sup>23</sup> For these reasons, it can present formidable challenges to developing countries, which are likelier on average to have weaker regulatory regimes and enforcement capacities. These considerations point to the need for progressivity in market opening and to the equally critical need, today fully acknowledged in trade diplomacy, to invest in trade-related capacity building. Services agreements are well equipped to meet these needs.

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<sup>21</sup> With the exception of a significant number of precommitments in the 1996 Agreement on Basic Telecommunications, WTO members have so far not made extensive use of precommitments under GATS. It is widely expected, however, that precommitments will become more widespread for countries that seek to engage fully or immediately in negotiations but are unwilling or unable to liberalize fully or immediately.

<sup>22</sup> See Mattoo, A. and P. Sauvé, eds. 2003. *Domestic Regulation and Services Trade Liberalization*. Washington, DC: Oxford University Press.

<sup>23</sup> The following section draws on Marconini, M. and P. Sauvé. 2009. *A Services Negotiation Checklist*. Trade Department, World Bank. Washington, DC.



### **Situating Service Sector Policy in National Development Plans**

Preparations for international negotiations in services should ideally come once a country has defined a road map for service sector development situated against the broader canvas of a national development strategy. (The road map should be drawn with broad stakeholder participation and interagency coordination.) However, this is rarely the case in practice, as countries “get caught” in negotiating processes that “cannot wait” for overall domestic priorities and strategies to be fully defined and placed in sequence. This lack of preparedness is why countries, particularly developing ones, often do not feel ready to respond to the deep and complex regulatory and policy issues, and the highly targeted nature of market opening requests, that almost invariably arise in negotiations with more sophisticated trading partners. Not surprisingly, many developing countries feel that international negotiations become the leading force dictating the nature and pace of key domestic reform decisions.

In developed countries, trade negotiation in services is typically an effort to adapt already well-developed regulatory regimes to the challenges of globalization and the fast-moving demands of the international marketplace. In developing countries, more often than not regulatory regimes are inadequate or incomplete at the outset of negotiations. Thus, when governments are confronted at the services negotiating table with the need to think hard and fast about whether, how, and to what extent to adapt domestic regulatory regimes to foreign requests, they rarely have an optimum level of domestic regulation in place. The search for the optimum and the merely feasible coincides, often in the absence of previous experience or empirical evidence about the effect of different approaches to similar regulatory challenges.

Preparation for international negotiations, particularly in an area as complex as services, can therefore be seen as an exercise in regulatory adaptation and approximation. Countries ideally should know what they want *before* they negotiate. Typically, however, there is insufficient time to achieve consensus on goals, so that the best that countries can expect is to figure out where their key offensive and defensive interests lie *during* the negotiation, under all information limitations. In such a situation, a negotiation offers the opportunity to clarify, and eventually to rectify, suboptimal regulatory situations. A country will thus aim in negotiations toward an equilibrium between what is being demanded by trading partners and what is deemed acceptable by domestic political constituents.

### **Intergovernment Coordination and Multistakeholder Consultations**

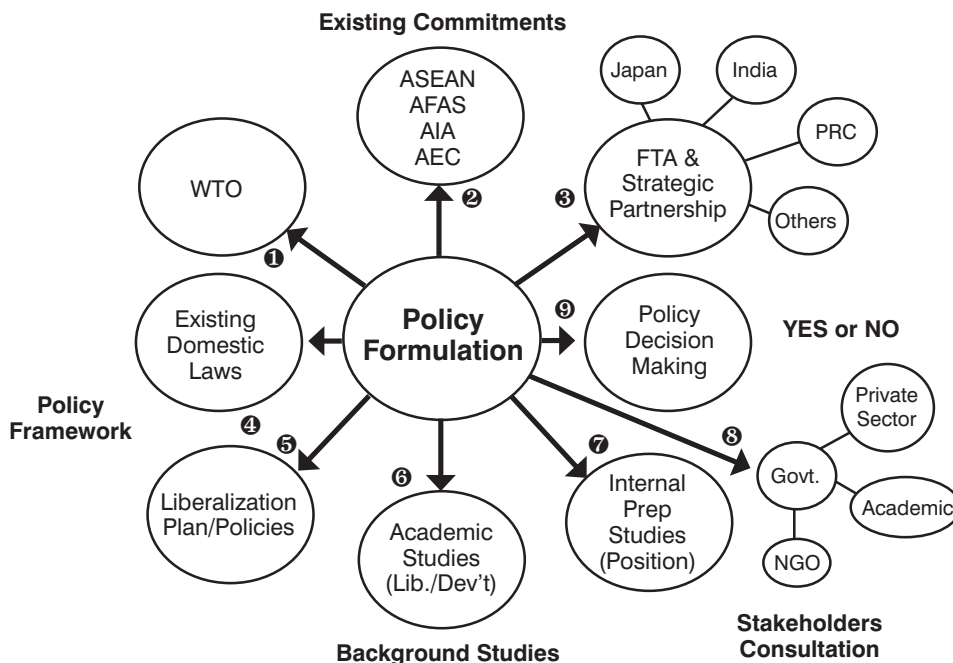
The first step in preparing for negotiations and establishing a national development strategy for services is setting up a credible, transparent, and efficient process of stakeholder consultations and coordination within government for the work at hand. Such coordination often rests with foreign or trade ministries, which are often responsible for conducting the negotiations themselves. Intragovernment



coordination is so important that it alone is liable to determine the effectiveness of a country's participation in international negotiations. The last thing a government wants is for different ministries or agencies to be saying different things about the same set of negotiations—or worse yet for trading partners to be confused as to where authority and accountability are ultimately vested.

The main objective of internal coordination is the establishment of national positions on all service-related issues dealt with in specific negotiations. A secondary objective is the achievement of consistency and coherence in the way a particular country or government manages its external trade environment. This is an important demand placed on coordinating agencies, since it requires an additional check on positions taken across various forums and negotiating settings (such as the WTO or various PTAs). Figure 6 shows the policy decision matrix used by the Ministry of Commerce in Thailand in preparation for the

**Figure 6: Trade Policy Formulation Checklist in Thailand**



AEC = ASEAN Economic Community, AFAS = ASEAN Framework Agreement on Services, AIA = ASEAN Investment Agreement, ASEAN = Association of Southeast Asian Nations, FTA = free trade agreement, NGO = nongovernment organization, PRC = People's Republic of China, WTO = World Trade Organization.

Source: Vonkhorn, P. 2008. Preparing for FTA Negotiations: Thailand's Experience. Presentation to the ADB-ITD course on Trade and Investment in Services. Bangkok. 13 February.

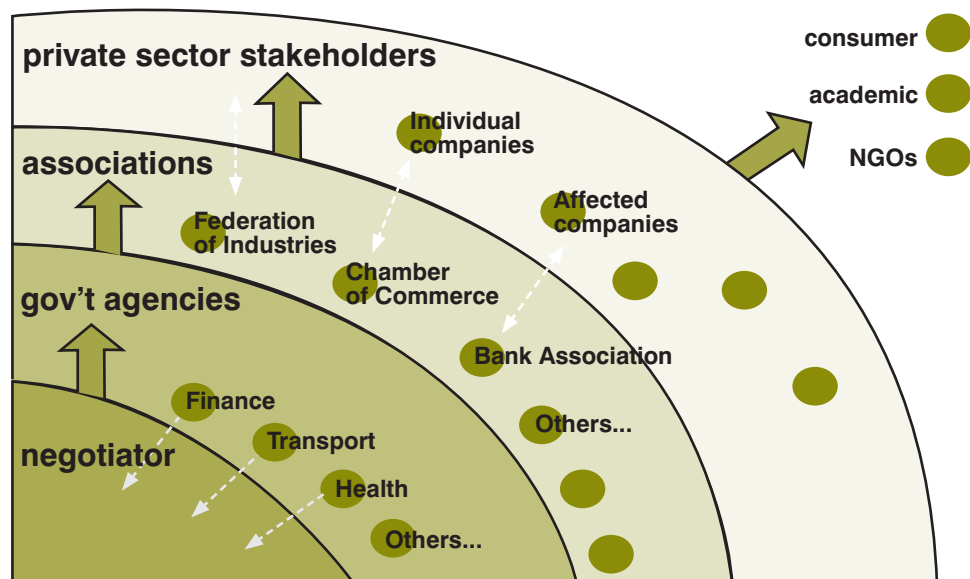


various negotiations in which it participates. The matrix reveals the country's full awareness of the need for policy decisions to rest on sound analytical inputs and an extensive consultation process within and outside government circles, with a view to ensuring that Thailand pursues a coordinated and coherent set of objectives across various negotiating forums.

A government needs to be mindful of positions taken or interests pursued in other negotiations, and seek overall consistency and coherence—for example, while coordinating for WTO/GATS negotiations. Consistency and coherence must characterize not only a country's scheduled commitments governing access to its services market, but also its positions regarding rules and principles that may vary across agreements and negotiating processes (such as positive versus negative lists, or sectors and disciplines that may be covered in PTAs but not at the WTO level such as digital trade/e-commerce and government procurement of services).

While governments must ultimately assume the responsibility of carrying out their country's trade negotiating strategy, they can significantly enhance their legitimacy if they include key external stakeholders—the private sector and civil society at large—in the coordination process (Figure 7).

**Figure 7: Negotiating Essentials: Interagency Coordination and External Stakeholder Consultations**



NGO=nongovernment organization.

Source: Vonkhorporn, P. 2008. Preparing for FTA Negotiations: Thailand's Experience. Presentation to the ADB-ITD course on Trade and Investment in Services. Bangkok. 13 February.



Again, the task is daunting, since the conduct of multistakeholder consultations often involves a broad variety of potentially conflicting interests, ranging from mercantilistic export interests to concerns over consumer protection or the preservation of a country's cultural heritage. Governments sometimes regard such a consultative process as difficult and potentially restrictive of their sovereign decision-making prerogatives. But if they do not have the backing of important affected constituencies, positions taken at the negotiating table may mean very little when the time comes to ratify negotiated outcomes or engage in their implementation, at least in democratic societies where governments are held accountable for what they decide and negotiate.

Governments need to consult as broad and representative a mix of stakeholders as possible. They may have to balance institutions of a national and subnational character, depending on the weight of such institutions in each case. Also, they need to strike a balance between institutions that are horizontal in nature (such as a chamber of commerce representing several sector interests) and those of a more vertical or sector character (for example, the banking federation)—although as in government, it is still relatively rare for the private sector, particularly in developing countries, to be organized around all-inclusive coalitions dealing with services (Box 1).

### **Box 1: Organizing Services Coalitions in Developing Countries**

The integration of services into the multilateral trading system during the Uruguay Round and the subsequent liberalization processes that have followed at the bilateral, regional, and multilateral levels have alerted major private sector stakeholders, particularly in developed countries, to the necessity of monitoring these processes and influencing rules and negotiated outcomes to their advantage.

In a number of countries, industry associations and enterprises have established organized services-related private sector advocacy groups to lobby relevant government and nongovernment constituencies and to voice corporate interests and concerns on services trade matters.

The private sector in some developed countries took the lead in creating coalitions of service industries, which were designed to serve as umbrella organizations or informal networks that bring together service firms and business associations to discuss and strategize on policy issues of interest, strategically representing the voice of the industry.

The majority of the coalitions established in developed countries were created after the conclusion of the Uruguay Round. Most of these coalitions operate through small and

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Box 1: continued

flexible secretariats. They tend to represent the interests of larger services enterprises, whose views and interests may not always coincide with those of small and medium-sized enterprises. However, the interests of smaller companies can readily be taken into consideration through their affiliation with sector services associations that are members of larger coalitions. The majority of these coalitions are operated by private sector companies; their respective governments play no institutional role. This enables the coalitions to discuss their positions freely and coordinate them, formulate policies independently, and undertake action in a manner that serves their own interests.

Existing coalitions are more visible in high-income countries. This can be attributed to a host of factors, including the lack of awareness of the importance of services in many developing countries' economies; the prevalence of forces in many countries that are not supportive of public-private collaboration and that will not endorse the concept of institutionalizing private sector policy lobbying mechanisms; and a lack of adequate funding.

Very few existing coalitions are dedicated solely to advancing their members' interests in regional and multilateral trade negotiations. In almost all cases, their mandates also encompass more domestic objectives, such as establishing proprietary databases on export opportunities in foreign markets, improving statistical measurement of service sector data, encouraging governments to implement domestic, economic, fiscal, and monetary policies conducive to a service-friendly environment, and assisting in enhancing public and private awareness of the strategic economic and social role of service sectors.

### **Policy Lobbying by Service Coalitions: Impact on Trade Policy Formulation**

Service sector coalitions from developed countries tend to have significantly wider mandates, and consequently a more extensive sphere of interest and broader constituencies, than their developing country counterparts. While developing-country coalitions have been limited to lobbying their own government constituencies, those in developed countries typically are concerned with legislative constituencies, government constituencies in foreign markets, and other stakeholders. Also, some member companies in developed country coalitions possess considerable political weight in their own right, owing to their size and global presence.

Thanks to their greater financial and human resource capacity and sophistication, developed-country coalitions are generally more active and aggressive in lobbying their own national constituencies. In many instances their efforts are sustained by institutionalized two-way consultation processes. Some developed-country coalitions have come to realize that their own governments must address the export interests of their trading partners if they are to attain their export interests in foreign markets.

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Box 1: continued

The clearest example is the US Coalition of Service Industries (CSI), which has lobbied the United States Trade Representative and the Congress for years to ease trade restrictions in areas of export interest to members' trading partners, in the context of World Trade Organization (WTO) negotiations. CSI hopes that, in return, US trading partners may open their own services markets in sectors of export interest to members.

Service industry coalitions are not the only private sector players voicing industry interests in multilateral and preferential trade negotiations. Other national, regional, and international lobbies play an important role, although they generally encompass other tracks of trade negotiations, such as agricultural and nonagricultural goods. Among the most active of these lobbies at the international level is the International Chamber of Commerce (ICC).

It remains very difficult to document the influence that service industry coalitions exert on services trade liberalization empirically. However, there is significant anecdotal evidence suggesting that such coalitions are among the most effective forces influencing government positions vis-à-vis services trade negotiations. They may achieve more significant results in bilateral and regional trade negotiations, in which, unlike member states, they may have greater leverage, address policy concerns over shorter time frames, and often pursue more narrowly defined trade, investment, and regulatory objectives with partner countries than in the multilateral trade process.

### **Future Challenges and Opportunities**

Service sector coalitions face several key challenges, including the heterogeneous nature of the service sector and the occasional conflict of intersector interests that results from such diversity; the ongoing backlash against globalization, which often targets the alleged dangers of service sector liberalization for domestic policy space, social security, employment, or access to public services; the occasional adverse effect of lobbying by influential nonservice private sector players in focusing, in some instances, disproportionate government attention on other economic sectors, notably agriculture; and the ongoing burden to explain and draw attention to the importance of the service sector in formulating trade policies. This last challenge tends to be compounded by budgetary constraints.

However, despite these challenges and the fact that there are, as yet, few developing country coalitions representing the service sector in relevant forums, one may expect that the number and organizational quality of services industry coalitions will keep increasing, due to the following factors:

- (i) the rapidly growing importance of services in the economies of developed and developing countries and the consequent increasing appreciation of the vital role

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Box 1: continued

of service businesses in shaping economic policy making and international trade trends;

- (ii) the mounting tendency of national and multinational service industries to organize themselves in order to enhance their ability to explore new export markets and develop strong lobbies able to influence national, regional, and multilateral trade policies;
- (iii) the integration of more services-related trade and investment rules and liberalization commitments in bilateral, regional, and multilateral trade agreements; and
- (iv) the increasing role played by existing coalitions, mainly from developed countries, in assisting in the establishment of similar coalitions in the developing world.

In particular, international organizations can play a vital capacity building role. Notably, the International Trade Commission has taken up this challenge through its “World Trade Net” initiative, which supports services communities’ efforts in developing countries to become institutionally organized in order to address their interests and objectives effectively.

Source: El-Etreby, R. 2008. Globalization of Services Trade & the Establishment of Industry Coalitions. *ITC World Trade Net Business Briefing*. 14 April.

The balance that needs to be struck in consultations between business associations, trade unions, and nongovernment organizations (NGOs) active in the services field poses a especially sensitive issue. In particular, NGOs tend to take vocal positions on a number of significant matters pertaining to services trade—often questioning the very benefits of liberalization itself, and cautioning against the treatment of services with public good characteristics (such as education, health, water distribution, and cultural industries).

### **Conducting a Trade-Related Regulatory Audit**

Since the very currency of services negotiations consists of domestic regulation, much of the preparatory work will need to focus on the domestic regulatory regime: how is it framed? what objectives does it pursue? with what degree of efficiency? how rooted in international standards or international best practice are domestic regulatory requirements? how user-friendly are domestic rules and administrative procedures? how are domestic regulations applied and who applies them? how trade- and investment-friendly are domestic regulatory regimes? can domestic regulatory objectives be attained in less trade- or investment-restrictive ways?



An inventory or trade-related audit of domestic regulatory measures “affecting services and trade in services” should be compiled on the basis of existing legislation or regulation.<sup>24</sup> Such an internal exercise can be very useful and should be pursued even in the absence of external negotiations, as it will strengthen interagency coordination and help promote a healthy dialogue between officials involved in domestic and external policy matters, while promoting a culture of regulatory reform and periodic regulatory impact assessment and review.

Trade and investment negotiations offer excellent ready-made opportunities for engaging in such an exercise and building trade-related capacity among regulatory officials who may know little about international agreements, trade law, and negotiating processes. The exercise can also help augment knowledge among trade officials who may not have a full understanding of the intricacies of sector regulatory issues and challenges.

Conducting an audit of all service-related regulation can prove daunting, particularly since such an exercise may go beyond measures subject to services trade negotiations (Box 2). This is why enhancing government officials’ understanding of the intricacies of trade law is particularly important. If nothing else, officials need to distinguish domestic regulatory conduct that may legitimately be expected to arise in international trade discussions from more purely domestic matters of nondiscriminatory conduct. Regulatory officials naturally tend to view their work as primarily domestic in nature. Yet the advent of trade disciplines on services in GATS and PTAs has clearly revealed that much of what regulators consider domestic in nature actually lies within the realm of trade negotiations.

### **Box 2: Performing a Trade-Related Regulatory Audit in Services**

Services negotiations typically rest on the two-way interaction afforded by the request-offer process. This interaction can underpin attempts to benchmark a country’s domestic approach to services regulation with that of its main trading partners, identify means of achieving greater policy convergence, and move in the direction of “best” (often pro-competitive) regulatory practices. Negotiators also need to identify precisely what policies and measures can (and cannot) be addressed in the negotiations, in response to requests from trading partners. These are conditions favorable for a useful policy

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<sup>24</sup> For a fuller discussion of the practical means of conducting a trade-related regulatory audit, see Sauv , P. 2008. Conducting a Trade-Related Regulatory Audit in Financial Services. Mimeo, Trade Department, World Bank. Washington, DC.



Box 2: continued

dialogue between trade officials, sector regulators, and officials in other government agencies and departments, as well as stakeholders in business and civil society. Two-way policy interaction can also help answer the central question: what policy objectives developing countries ultimately wish to pursue in their GATS/PTA negotiations, both domestically and in foreign markets? Questions that may arise in such a domestic dialogue so as to inform the request-offer process include the following:

- What is the policy objective pursued by the relevant regulatory measure?
- Is the policy objective consistent with overall government policy?
- How transparent is the regulatory measure and the process to adopt it?
- Are private sector stakeholders, domestic and foreign, consulted before the enactment of new policy measures?
- When was the policy measure, law, or regulation enacted?
- When was the measure last invoked?
- Is it periodically reviewed?
- Is the government satisfied that the policy objective is being achieved and has it developed a framework to assess the effectiveness of its regulatory regime?
- Can the policy objective be achieved through other means or in a manner that might lessen its restrictive impact on trade or investment?

An audit of a country's regulatory regime in the context of negotiations on services trade and investment liberalization may thus generate positive policy spillovers for domestic regulatory conduct and design, and may contribute to a strengthening of consultation within and outside government in the services field. Among the reasons why governments might be interested in a trade-related regulatory audit are the following:

- ensuring that key regulatory objectives, including prudential, consumer protection, and social policy objectives, are met in the most efficient (least wasteful of scarce public resources) manner;
- identifying antiquated or inefficient regulations and adopting or converging toward international best practices (for instance, in the field of financial services, this may allow a benchmarking of the degree to which domestic prudential standards and regulations approximate agreed international norms such as those found at the Bank for International Settlements, the International Organization of Securities Commissions, and the International Association of Insurance Supervisors);
- encouraging the adoption of market access-friendly (pro-competitive) regulation where feasible;

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Box 2: continued

- building trust among departments within the government (that is, encouraging a “whole of government” approach to domestic regulation) through closer dialogue between trade negotiators, line ministries, and sector regulators;
- deepening dialogue with external stakeholders, including regional and local governments, producers and users or consumers, NGOs, and the academe; and
- gaining a clearer sense of the reasons behind the possible continued need to maintain measures that are potentially trade- and investment-restrictive.

One useful starting point for such an audit is a list of nonconforming measures; a negative list of measures that would be found in breach of the key liberalizing provisions found in trade agreements—national treatment, market access (quantitative restrictions), local presence requirements, and most-favored-nation (MFN) treatment—if they were not inscribed in reservation lists. One would then describe comprehensively the sector nature of these measures (for definitional purposes), the level of government at which they are applied (national, subnational, or municipal), their legal basis (that is, a full citation of the law or regulation in question), and the precise nature of their nonconformity. Recourse to such an audit was pioneered in the context of preparing the negative lists of nonconforming measures defining the parties’ legally binding commitments under the North American Free Trade Agreement.

There are several uses to which a trade-related regulatory audit may be put, including:

- providing a comprehensive overview of the trade and investment-restrictive components of a country’s regulatory regime;
- identifying regulations in need of reform and possibly elimination (the latter can be useful bargaining chips);
- confirming the legitimacy and continued need for trade or investment-restrictive regulations;
- gaining clarity about the implicit hierarchy of trade and investment-restrictive measures (for example, understanding which type of restrictive measure is most likely to be deemed market access-unfriendly by trading partners), where the hierarchy may include nondiscriminatory and prudential measures, particularly quantitative restrictions (that is, market access measures);
- identifying measures that may be scheduled in trade agreements for the purpose of making new or improved negotiating offers); and
- anticipating partner-country negotiating requests and assessing the choice between opening up or reforming regulations and leaving them unchanged.

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Box 2: continued

It bears noting that the negative-list-based regulatory audit described above focuses policy attention on measures that are either overtly discriminatory (measures violating the national treatment and MFN provisions of trade agreements) or that overtly constrain the quantum of competition allowed in the market (market access or nondiscriminatory quantitative restrictions). A trade-related regulatory audit conducted along these lines may therefore not always capture all nondiscriminatory measures that are unduly burdensome or that act as disguised restrictions to trade and investment, for which trade disciplines are being sought under GATS Article VI:4 work program. Identifying such measures is inherently more difficult and requires considerably more dialogue between trade negotiators, line ministries, and sector regulators, as well as greater technical competence on the part of trade ministries than is often on offer.

Despite these caveats, a trade-related regulatory audit that maps the universe of explicitly restrictive government measures affecting trade and investment in services can still yield important gains in transparency and help anticipate negotiating red lines and implementation bottlenecks. In turn, the homework and regulatory dialogue that flow from such an exercise can help promote a culture of pro-competitive regulatory reform in countries that attempt it. Conducting an audit is indeed a useful means of preparing for services negotiations. It can help negotiators to master the sector intricacies and the technical details that are the very essence of services negotiations conducted along request-offer lines, can provide service providers with a one-stop inventory of restrictive measures maintained at home (and by trading partners where reciprocated or mandated by trade agreements), and can afford negotiators a complete road map of measures to target and rank order in future negotiations. None of these benefits can readily be achieved without precise information on the regulatory status quo.

Source: Sauv , P. 2008. *Conducting a Trade-Related Regulatory Audit in Financial Services*. Mimeo, Trade Department, World Bank. Washington, DC.

The body responsible for coordinating the preparatory work for negotiations should aim to gather an inventory of measures that will enable governments to seek answers to at least a few basic policy questions:

- whether the existing regulation or regulatory regime is adequate and acceptable or whether it needs changing;
- whether any needed changes can be contemplated within the time frame of ongoing international negotiations; and
- whether regulatory changes can be “offered” in international negotiations.



The answers are important because offers in services negotiations may involve giving binding effect to existing regulatory situations, and countries should avoid scheduling legally binding measures that domestic regulators do not find adequate or fully developed. Additionally, changes to domestic regulation that may be needed or contemplated for domestic political reasons can be valuable negotiating tools. Why not promote such changes while there is still time to seek reciprocal concessions from trading partners?

Given prevailing weaknesses in regulatory regimes and market structures, many developing countries tend to focus mostly on the defensive interest of protecting one's own market from foreign competition. Yet, negotiations are about requests, not just offers. Regulatory inventories and the capacity building of officials are beneficial, but there are additional matters that need to be addressed for a country, particularly a developing one, to put together a realistic, development-enhancing request.

Putting together targeted negotiating requests requires detailed information about the full range of measures that prevent effective access to the markets of key trading partners. The breadth of services trade and the diversity of sectors render information-gathering a large and complex task, with which many developing countries, even larger ones, experience great difficulty. Trade-related technical assistance can provide developing country suppliers with greater economic intelligence on market access conditions and opportunities in export markets, access to distribution channels, information on product standards, business-to-business dialogue and networking, and other subjects. The potential payoff from such targeted efforts is clear.

The ultimate strategy to be followed in service negotiations and their implementing documents (position papers, offers, requests, and so on) must be informed by matters unrelated to services. Trade negotiations are often pursued as so-called single undertakings where nothing is agreed until all is agreed. Services negotiations are thus typically part of a broader process that includes all sectors of a country's economy. Negotiations on agriculture and industrial products, to cite only the most obvious and conspicuous sector examples, necessarily have a huge impact on what is being negotiated in services—what is being demanded, what is being offered, the overall approach to the negotiations, and possibly the rules and principles under negotiation. Thus, in addition to self-contained concerns relating to the service sector, a negotiating strategy for services must be informed by the limits and opportunities arising in other areas subject to the single undertaking.



### Policy Questions for Discussion

- Beyond the benefits of unilateral liberalization, what are the most compelling reasons engaging in services negotiations can yield tangible benefits?
- Is there a national development strategy for services that should be informing the preparatory phase of negotiations?
- Are there sector-specific strategies that should be informing the preparatory phase of negotiations?
- Should the government assist in the development of a national coalition representing service-sector interests?
- Has thought been given to the contribution of regulatory reforms in the development of the domestic service market, and to the link between such reforms and the international trade negotiations at hand?
- Is a coordinating authority, agency, or ministry fully in place and ready to operate in the services field?
- Have capacity building needs been identified with respect to the overall approach to liberalization and trade agreements? Have readiness to liberalize, the strategies to adopt in negotiating liberalization, and the advantages from negotiating, particularly in terms of access to foreign markets, been fully considered?
- Are other external priorities relating to services and services trade, as pursued under other agreements, clear to all participants in the preparatory process? Examples are the positions and commitments taken in the context of bilateral, regional, or thematic agreements, such as PTAs, investment treaties, and mutual recognition agreements (MRAs).
- Is there already an inventory of measures affecting trade in services at the horizontal and sector levels? Is there a sublist of trade- and investment-restrictive measures affecting services?
- Once a trade-related regulatory audit has been conducted, what regulatory measures can be considered adequate, necessary, or in need of change?
- When regulatory changes are deemed necessary, can or should they be contemplated in the context of ongoing or planned trade and investment negotiations? If so, should they be presented as part of negotiating offers in relevant international negotiations?



- What criteria should be applied in choosing which measures or modes of supply, in which sectors, to offer as bound, partially bound, or unbound in negotiations?
- Has a clear distinction been established between offensive and defensive interests in the negotiations? In particular, have export interests been identified so as to contribute to the elaboration of a realistic request list?
- Have export market studies been conducted by government or the private sector?
- Has relevant information (public, private, international) regarding export interests been compiled, analyzed, and circulated among participants in the preparatory phase?
- Does the coordinating entity periodically consult all relevant stakeholders in the private sector and civil society at large before and during the conduct of negotiations?
- Is the consultation process with stakeholders broad enough to be truly representative?

### Suggested Readings

Marconini, M., and P. Sauvé. 2009. *Negotiating Trade in Services: A Practical Guide for Developing Countries*. Trade Department, World Bank. Washington, DC.

Mattoo, A. 2006. Services in a Development Round: Proposals for Overcoming Inertia. In Newfarmer, R., ed. *Trade, Doha and Development: A Window into the Issues*. Washington, DC: World Bank.

Sauvé, P. 2008. *Conducting a Trade-Related Regulatory Audit in Financial Services*. Mimeo, Trade Department, World Bank. Washington, DC.



# Chapter 4

## A Burgeoning Periphery: Selected Issues in the Preferential Liberalization of Services Trade

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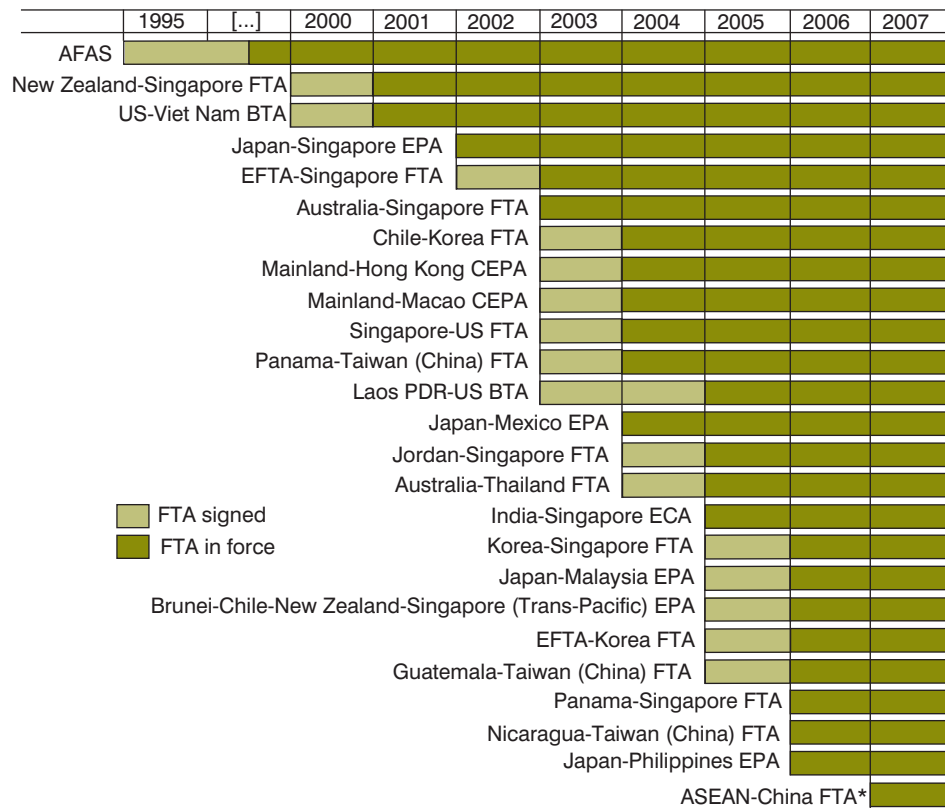
### Key Learning Objectives

- Appreciating how regional and multilateral efforts at services rule making are closely intertwined processes, with much iterative learning by doing, imitation, and reverse engineering;
- Determining the manner and extent to which regional agreements have provided governments with policy space in which to experiment with various approaches to rule making and market opening in the area of services trade;
- Identifying the leading policy motivations behind the pursuit of preferential liberalization of trade in services;
- Understanding the economic effects of preferential liberalization in services and how they differ from those observed for trade in goods;
- Appreciating the differences in overall negotiating architectures emerging from a growing set of preferential trade agreements (PTAs) covering services;
- Gaining a better appreciation of the policy implications flowing from competing approaches to rule making and market opening, including the implications for preserving policy space;
- Assessing the degree to which PTAs have achieved World Trade Organization (WTO)+ outcomes in rule making and market-opening terms;
- Determining whether PTAs offer greater scope for promoting trade- and investment-facilitating regulatory convergence; and
- Understanding the legal disciplines PTAs have to meet to be deemed WTO-compatible and the economic effects of those disciplines.



There is a large literature on the costs and benefits of integration agreements on trade in goods, but little comparable analysis of the implications of such agreements in services.<sup>25</sup> Such a gap is surprising given the strong growth in the last decade and a half in the number of preferential trade agreements (PTAs) featuring detailed disciplines on trade and investment in services. Figure 8 depicts the frenzied pace

**Figure 8: East Asian PTAs Featuring Services Provisions, 1995–2007**



AFAS=ASEAN Framework Agreement on Services, ASEAN=Association of Southeast Asian Nations, BTA=bilateral trade agreement, CEPA=closer economic partnership arrangement, ECA=economic cooperation agreement, EPA=economic partnership agreement, PTAs=preferential trade agreement, FTA=free trade agreement.

Source: Fink, C., and M. Molinuevo. 2007. East Asian Free Trade Agreements in Services: Roaring Tigers or Timid Pandas? *East Asia and Pacific Region, Report No. 40175*. Washington, DC: World Bank.

<sup>25</sup> For a fuller discussion of the law and economics of preferential treatment in services, on which this section draws, see Mattoo, A. and P. Sauvé. 2008. Regionalism in Services Trade. In Mattoo, A., R. M. Stern, and G. Zanini, eds. *A Handbook of International Trade in Services*. New York: Oxford University Press.



of service sector PTAs concluded in East Asia from 1995 through 2007, several of which involve countries in the Greater Mekong Subregion (GMS).

Regional attempts at developing trade rules for services have paralleled efforts at framing similar disciplines in the World Trade Organization (WTO) under the aegis of the General Agreement on Trade in Services (GATS). Because they have typically been negotiated concurrently, regional, and multilateral efforts at services rule making are closely intertwined processes, with much iterative learning by doing, imitation, and reverse engineering. Experience gained in developing the services provisions of preferential trade agreements (PTAs) has built up significant negotiating capacity in participating countries, providing expertise available in a multilateral setting.

The proliferation of regional initiatives has provided governments with policy space in which to experiment with various approaches to rule making and market opening in the area of services trade. In particular, regional initiatives have afforded governments the ability to pursue policy approaches differing from those emerging from the incipient multilateral framework under GATS. Because GATS itself remains incomplete, with negotiations pending in a number of important areas (including emergency safeguards, subsidies, government procurement, and domestic regulation), such regional experimentation has generated a number of useful policy lessons in comparative negotiating and rule-making dynamics. The efforts countries have devoted to developing rules for services trade liberalization at the regional level have typically come in the wake of far-reaching changes in their services and investment policy frameworks over the last decade.

For many countries, regional negotiations offer the opportunity to pursue, deepen, or lock in the policy virtue practiced domestically in recent years and to reap the “signaling” benefits likely to flow from such policy consolidation.

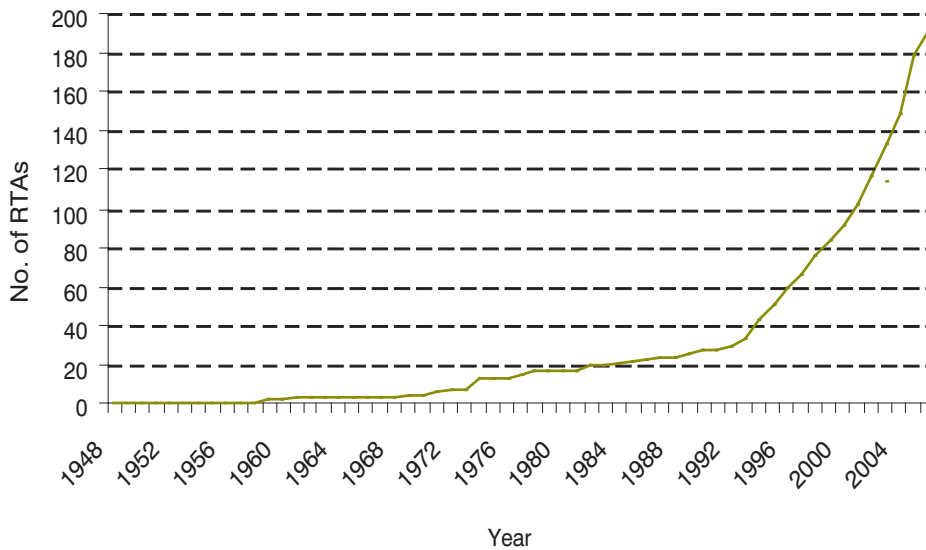
### **Why Go Preferential on Services?**

A paradox of modern trade diplomacy is the unprecedented rise in PTAs in the immediate aftermath of the Uruguay Round, which achieved a significant broadening of the multilateral trading system’s membership and an equally remarkable deepening of its rules (Figure 9). Today, few PTAs do not feature a comprehensive body of disciplines targeted at the progressive liberalization of services trade.

Governments’ quest for greater expediency is undoubtedly one reason for the rise of PTAs. Prodded by a private sector that increasingly views the WTO and its



**Figure 9: On the Rise: PTAs Concluded Between 1948–2006**



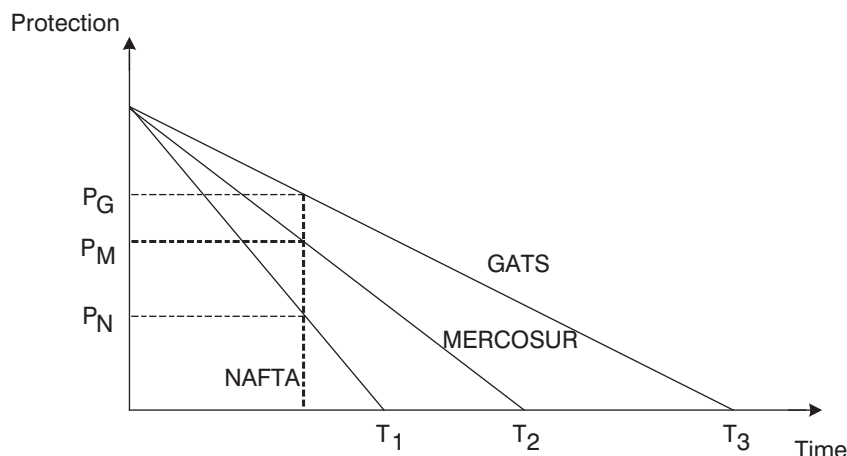
PTA = preferential trade agreement, RTA = regional trade agreement.

Source: WTO, RTA Gateway, at [www.wto.org/english/tratop\\_e/region\\_e/region\\_e.htm](http://www.wto.org/english/tratop_e/region_e/region_e.htm)

reliance on single undertakings and consensus-based decision making as recipes for negotiating gridlock, governments have to PTAs to achieve faster and deeper liberalization among a smaller subset of like-minded trading partners. Figure 10 offers a simple diagrammatic view of the strong presumption that PTAs can secure superior outcomes—lower levels of trade protection achieved with greater ease in a shorter time span. The figure, indeed, shows how one should expect negotiations among smaller subsets of countries to achieve deeper liberalization (i.e., a lower level of resulting protection) over shorter periods of time than that observed at the multilateral level.

The gains from preferential agreements are likely to be significant where there is scope for economies of scale, as in certain international transport and financial services, and for securing increased competition, as in business or professional services. In principle, these gains can also be achieved through most-favored-nation (MFN) liberalization, but in practice the fuller integration of markets may require a deeper convergence of regulatory regimes, which may be more feasible in a regional or preferential context. The regulatory intensity of services trade has indeed prompted countries to view PTAs as useful conduits for trade- and

**Figure 10: Do PTAs offer a faster route to services liberalization?**



GATS = General Agreement on Trade in Services, MERCOSUR = Mercado Común del Sur, NAFTA = North American Free Trade Agreement, PTA = preferential trade agreement.

Source: Mattoo, A. and P. Sauvé. 2006. Regional Agreements in Services Trade. In Mattoo, A., R. M. Stern, and G. Zanini., eds. *A Handbook of International Trade in Services*. London and Washington, DC: Oxford University Press for the World Bank.

investment-facilitating convergence in domestic regulatory practices. PTAs such as the North American Free Trade Agreement (NAFTA) or the ASEAN Framework Agreement on Services (AFAS) have registered far greater (though still limited) progress concluding mutual recognition agreements in various professional services (such as engineers, architects, accountants, nurses, and foreign legal consultants) that has proven possible at the multilateral level under Article VII of GATS.<sup>26</sup>

More efficient bargaining may also be possible in a PTA context than at the multilateral level, because outsiders cannot free ride on the reciprocal exchange of concessions, as they can on a general MFN obligation. In such circumstances, preferential trading arrangements will typically command political appeal even though they may be second best economically.

<sup>26</sup> One reason for this observed pattern is that participation in mutual recognition agreements (MRAs) pursued under GATS Article VII must in principle be open to any petitioning party able to satisfy such agreements' regulatory requirements, whereas MRAs pursued within the context of "closed" PTAs undertaken under Article V are an accepted departure from MFN treatment under GATS.



A further attraction of PTAs, particularly in “newer” areas like services where developing countries may have defensive concerns (rooted, for example, in the small average size of domestic firms or their limited experience in world markets), is to use preferential settings to engage in learning by doing in a less fully competitive environment than that which might flow from MFN liberalization. This attraction may explain the rising salience of South–South agreements covering services trade.<sup>27</sup>

### Architectural Divergences Between PTAs and the WTO

While PTAs covering services tend to replicate GATS in scope and coverage, there are significant variations in the modalities used to open markets.<sup>28</sup> As Table 4 shows, three basic approaches to scheduling commitments can be found in a sample of East Asian PTAs covering services.

Almost half of East Asian PTAs covering services use a GATS-like hybrid list approach to scheduling liberalization commitments. This approach combines a positive selection of sectors, subsectors, and modes of supply with a negative list of nonconforming measures maintained in committed sectors, subsectors, and modes of supply.

The second method of scheduling is the negative list approach, which presumes that all measures affecting trade and investment in services are automatically fully bound at free (with no limitations) unless they are specifically reserved in annexes (reservations lists) to the agreement, including annexes affording scope for reserving future measures. Forty percent of East Asian PTAs covering services follow a negative list approach. A third approach involves a pure positive list, in which members agree to specify only those measures that are free of restrictions in specific sectors, subsectors, or modes of supply. As Table 4 reveals, only two such agreements can be found in East Asia, both of them involving the People’s Republic of China (PRC) and the separate customs territories that belong to it (Hong Kong and Macau). Finally, a fourth negotiating modality, found exclusively in the Lao People’s Democratic Republic (Lao PDR)–US Bilateral Trade Agreement, consists of listing sectors in which trade can take place unencumbered.

<sup>27</sup> See United Nations Conference on Trade and Development. 2008. *South–South Trade in Asia: the Role of Regional Trade Agreements*. Geneva.

<sup>28</sup> PTAs follow the GATS in excluding the bulk of air transport services as well as services supplied in the exercise of government authority. PTAs also mimic the GATS by extending trade disciplines to all measures *affecting* trade in services, including those maintained at the subnational level.

**Table 4. Negotiating Modalities in East Asian PTAs**

GATS/Hybrid List Approach	Negative List Approach	Pure Positive List Approach	Other Approaches (Only a List of Sectors)
AFAS	Australia–Singapore	PRC–Hong Kong	Lao PDR–US BTA
ASEAN–PRC	Chile–Korea	PRC–Macau	
Australia–Thailand	Guatemala–Taipei, China		
EFTA–Korea	Japan–Mexico		
EFTA–Singapore	Singapore–Korea		
India–Singapore	Nicaragua–Taipei, China		
Japan–Malaysia	Panama–Singapore		
Japan–Philippines	Panama–Taiwan		
Japan–Singapore	Singapore–US		
Jordan–Singapore	Transpacific Strategic		
New Zealand–Singapore	Economic Partnership		
Viet Nam–US	(SEP (Brunei, Singapore, New Zealand, Chile)		

AFAS = ASEAN Framework Agreement on Services, ASEAN = Association of Southeast Asian Nations, BTA = bilateral trade agreement, EFTA = European Free Trade Association, Lao PDR = Lao People's Democratic Republic, PRC = People's Republic of China, PTA = preferential trade agreement, US = United States.

Source: Sauv , P. and M. Molinuevo. 2008. Does Architecture Matter? The Treatment of Trade and Investment in Financial Services in Selected Preferential Trade Agreements. *NCCR Trade Regulation Working Paper No. 2008/9*. Bern: World Trade Institute.

A recent comprehensive review of East Asian PTA commitments in services, undertaken at the World Bank, suggests that some qualification is required for the often-held belief that negative listing yields inherently greater and more transparent liberalization.<sup>29</sup> Some agreements using negative listing provide a clearer road map of existing regulatory impediments, whereas others fall short of expected transparency because they use sweeping sector or mode-specific carve-outs or exclude entire categories of measures (such as subnational measures).<sup>30</sup>

<sup>29</sup> See Fink, C. and M. Molinuevo. 2007. *East Asian PTAs in Services: Raging Tigers or Timid Pandas?* Mimeo, Trade Department, World Bank. Washington, DC.

<sup>30</sup> One troubling example stems from recent PTA practice by the US, which increasingly uses sweeping negative list reservations that exclude all measures affecting services at the subnational level. Recent US PTAs are also notable for excluding Mode 4 commitments.



Evidence on the presumed greater impact of negative listing on induced levels of liberalization is also mixed. Some parties have reached hybrid list agreements that achieve greater liberalization than their negative list agreements with other partners. For example, Singapore's positively listed commitments in its PTA with Japan provide significantly greater coverage than its negatively listed commitments in its PTA with Australia. However, there is little doubt that done properly, negative list agreements may yield important benefits in regulatory transparency and by locking in the regulatory status quo.

In an important new development, exemplified in the most recent Japanese PTAs, negotiators aim to secure the best properties of negative and hybrid listing. These Japanese PTAs maintain a GATS-like hybrid approach to scheduling, preserving the right of countries to pick and choose those sectors, subsectors, and modes of supply in which they desire to make commitments. At the same time, they balance this flexibility with the twin obligations to schedule the regulatory status quo (that is, there is no GATS-like right to schedule commitments that offer less access than that which exists under the scheduling country's current laws and regulations) and to exchange nonbinding lists of nonconforming measures (that is, a nonbinding negative list of trade and investment restrictions in all sectors is embedded in the PTA) so as to promote greater regulatory transparency.

### Have PTAs Advanced the Unfinished Rule-Making Agenda of GATS?

The argument has been made that PTAs in the services field provide scope for creating so-called optimum regulatory areas, on the ground that the aggregate adjustment costs of regulatory convergence and policy harmonization are likely to be smaller when foreign regulatory preferences are similar and regulatory institutions are broadly compatible, which is likelier to be true for countries that are "closer" in physical, linguistic, cultural, or historical terms.<sup>31</sup>

In general, however, the practice of PTAs in services, including those negotiated in East Asia, suggests that limited progress is being made in the various areas of rule making that have posed recurring difficulties in a WTO/GATS setting. These include issues such as nondiscriminatory domestic regulation, emergency safeguard measures, and subsidies in services trade. In most PTAs, negotiators seem to be waiting for the unfinished business of GATS to sort itself out in Geneva with a view to adopting such advances at the level of preferential agreements.

<sup>31</sup> See Mattoo, A. and C. Fink. 2002. *Regional Agreements and Trade in Services: Policy Issues*. Policy Research Working Paper 2852. Washington, DC: World Bank.





In most instances, PTAs address domestic regulation in a manner analogous to that found in Article VI of GATS, focusing on procedural transparency and ensuring that regulatory activity does not lead to disguised restrictions on trade or investment in services. The European Union (EU) itself and certain agreements between the EU and countries in pre-accession mode, are the only PTAs that have made measurable progress in delineating the possible elements of a necessity test aimed at ensuring broad proportionality between regulatory means and objectives. Such an outcome is potentially foreseen under the mandate of GATS Article VI:4, but progress at the negotiating table has been limited to date with the exception of accounting disciplines agreed by WTO members in 1999 and which feature a number of policy objectives deemed legitimate for purposes of professional licensing.

A number of PTAs, notably those entered into between developing countries and major Organisation for Economic Co-operation and Development (OECD) trading partners, have gone beyond the WTO in adopting transparency provisions that mandate prior notification requirements, an issue long championed by a number of OECD countries but one that has proven controversial in the WTO context. This development offers an interesting example of what could be described as “tactical” or “demonstration effect” preferentialism, with regional advances creating precedents that their proponents hope will facilitate their replication at the multilateral level.

With few exceptions, PTAs have made similarly little headway in tackling the key unfinished rule-making items on the GATS agenda—notably disciplines on an emergency safeguard mechanism (ESM) and subsidies for services—where governments confront the same conceptual challenges, data limitations, and political sensitivities at the regional level as they do on the multilateral front. For instance, it is interesting to note that the countries of Southeast Asia, which have been among the most vocal proponents of an ESM in GATS, have not adopted such a provision in their own (AFAS).<sup>32</sup>

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<sup>32</sup> NAFTA has provided one example of sector experimentation (in financial services) with safeguard-type measures. Under the terms of NAFTA’s chapter on financial services, Mexico was allowed to impose market share caps if the specific foreign ownership thresholds agreed to—25% and 30% for banks and securities firms, respectively—were reached before 2004. Mexico could only invoke market share limitations once during 2000–2004 and could only impose them for a 3-year period. Under no circumstances could such measures be maintained after 2007. It bears noting that Mexico did not make use of such provisions during its transition to a national treatment regime in financial services, even after the aggregate share of foreign participation in its financial system rose significantly higher than the thresholds mentioned above, in the wake of successive takeovers by Spanish and US banks. Mexican authorities felt that these takeovers proceeded in an orderly manner.



The adoption of regional disciplines on subsidies in the services area has proven elusive, except for the EU (including its pre-accession agreements with countries in Central and Eastern Europe) and the Australia New Zealand Closer Economic Relations Trade Agreement (ANZCERTA). That is particularly true for countries with federal political systems, given the extent of subnational policy activism (and the concomitant reluctance to take on binding obligations) in this area. Whereas a number of PTAs, such as South America's Mercado Común del Sur (MERCOSUR), replicate the call made in GATS to develop future disciplines on subsidies in services trade, others, notably NAFTA and numerous NAFTA-type agreements in the Western Hemisphere, specifically exclude subsidy practices from coverage. The European Free Trade Association (EFTA)–Singapore FTA requires that “sympathetic consideration” be given to requests by a party for consultations where subsidy practices affecting trade in services may be deemed to have injurious effects. Meanwhile, the Japan–Singapore New Partnership Agreement features generic provisions on subsidies applicable to trade in both goods and services.

More progress has been made at the regional level in opening up government procurement markets for services, though through government procurement negotiations per se, as with the WTO's Government Procurement Agreement (GPA), rather than services negotiations. The approach taken in PTAs is very similar for the most part to that adopted in the WTO—nondiscrimination among members within the scope of scheduled commitments combined with procedures to enhance transparency and due process. PTAs whose members are all parties to the GPA, such as EFTA and the Singapore–Japan FTA, specifically mention that the relevant GPA articles apply, and most agreements concluded in the Western Hemisphere basically replicate GPA disciplines at the regional level. However, it bears noting that unlike the GPA, which applies in principle to purchases by both state and subnational governments, many PTAs provide for binding government procurement disciplines at the national level only.

In investment rule making, PTAs have achieved considerable progress while there has been no progress in the WTO. Most PTAs allow investor-state arbitration alongside WTO-like state-to-state dispute settlement.<sup>33</sup>

Finally, rules of origin that condition who ultimately qualifies for preferential treatment under PTAs are generally addressed in services agreements under

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<sup>33</sup> For a fuller discussion of the evolution of international rules on investment, see Beviglia-Zampetti, A., and P. Sauvé. 2007. International Investment. In Sykes, A.O. and A. Guzman, eds. *Research Handbook in International Economic Law*. London: Edward Elgar.



provisions dealing with denial of benefits.<sup>34</sup> The literature on rules of origin has focused almost exclusively on merchandise trade flows and hence on policies for determining the origin or nationality of tangible products. Much less attention has been devoted to the increasingly important issue of how to determine the origin of producers, which is primarily what the study of rules of origin in services trade and investment is concerned with. The issue arises because suppliers must often be physically present in the territory of consumers to contest a service market whether as individual service providers performing cross-border transactions on a temporary (contract) basis or as entities with a commercial presence in a foreign market. As a consequence, governments that are signatories of trade and investment agreements need to ascertain whether services suppliers originate in other countries, so that they can extend or deny the benefits provided under such agreements to those suppliers. Experience shows that rules of origin for services and investment can play a significant role in determining the degree to which regional trading arrangements discriminate against nonmember countries, which affects the extent of potentially costly trade and investment diversion. When levels of protection differ between participating countries in a regional trading arrangement, the effective preference granted to a nonmember trading partner will depend on how restrictive the applied rule of origin is. In the extreme, if one participant has a fully liberalized market, the adoption of a liberal rule of origin by the other participants can be likened to MFN liberalization, as services and service suppliers can enter or establish themselves in the liberal jurisdiction and from there move to—or service—the other partner countries.

For efficiency, origin rules for services should allow third-country service suppliers to take advantage of and contribute to the benefits of an integrating area, particularly suppliers with a commercial presence (Mode 3). Third-country investors and service providers that establish a commercial presence in the integration area can take full advantage of the expanded market opportunities afforded by the creation of a PTA, under a liberal rule of origin aimed at ensuring that established foreign operators are not mere shell companies but conduct substantial business operations in the host-country market.<sup>35</sup> Not surprisingly, participants who seek

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<sup>34</sup> For a fuller discussion of rules of origin in services trade, see Beviglia-Zampetti, A., and P. Sauvé. 2006. Rules of Origin for Services: Economic and Legal Considerations. In *The Origin of Goods: Rules of Origin in Regional Trade Agreements* Cadot, O., A. Estevadeordal, A. Suwa-Eisenmann, and T. Verdier, eds.. London: Oxford University Press.

<sup>35</sup> More restrictive rules of origin conditioning preferences may impose various conditions, such as local incorporation (such that benefits are denied to branches of entities incorporated in third countries), place of incorporation or location of headquarters, or ownership and control tests aimed at limiting PTA benefits to local juridical persons. Examples of such tests can be found under MERCOSUR or the Andean Pact.



to benefit from preferential access to a protected market and deny benefits to third-country competitors are likely to argue for restrictive rules of origin—such as service providers that are regionally dominant but not globally competitive, and that wish to thwart third-country competition in a regionally integrating area.

Rules of origin for services and investment in a PTA can thus play an important role in promoting or inhibiting access to the most efficient suppliers of services. In many service sectors, the most efficient (or globally competitive) suppliers will tend to be either developed-country firms or firms originating outside an integrating area. Accordingly, rules of origin that restrict benefits to nationals of member states can have the detrimental effect of locking integrating partners into suboptimal patterns of production and consumption. When services involve significant location-specific sunk costs (as many do, particularly network-based services), the problem may be compounded and generate longer-term deadweight losses, because first movers (even if relatively inefficient) can exert long-term dominance and extract monopolistic rents. The problem with location-specific sunk costs is that a country may be stuck with inferior suppliers for a long time even if it subsequently liberalizes on an MFN basis. Indeed, because of the importance of sunk costs in many service industries, sequential entry (which preferential liberalization with restrictive rules of origin can easily promote) can produce very different results from simultaneous entry. If entry is costly, an incumbent may indeed be able to deter it fully, leading to greater market concentration and a reduction in consumer welfare.<sup>36</sup>

### Do PTAs Achieve Deeper Liberalization?

The depth of services liberalization varies considerably across PTAs, as is readily seen in ASEAN and in agreements concluded between its members and third countries. On the one hand, several PTAs only marginally deepen liberalization beyond GATS, raising serious questions about their very rationale.<sup>37</sup> On the other hand, some agreements significantly deepen the breadth and quality of sector bindings (the level of restrictiveness) of their members' GATS commitments.<sup>38</sup>

<sup>36</sup> For a fuller discussion, see Mattoo, A. and C. Fink. 2002. Regional Agreements and Trade in Services: Policy Issues. *Policy Research Working Paper 2852*. (June). Washington, DC: World Bank.

<sup>37</sup> Arguably the Thailand–Australia and Malaysia–Japan PTAs are examples.

<sup>38</sup> For a comprehensive discussion of WTO+ advances in PTAs, see Roy, M., J. Marchetti, and H. Lim. 2008. The Race Towards Preferential Trade Agreements in Services: How Much Further than the GATS? In Panizzon, M., N. Pohl, and P. Sauvé, eds. *Trade in Services: New Perspectives on Liberalization, Regulation and Development*. Cambridge: Cambridge University Press.



The Lao PDR–US Bilateral Trade Agreement lies at one extreme, with Lao PDR adopting full national treatment commitments in all sectors as well as an extensive set of unrestricted market access commitments. Given the least-developed country (LDC) status of the Lao PDR, it is arguable that the level of its services commitments is probably more reflective of its acute negotiating capacity constraints than its commitment to sweeping services liberalization.

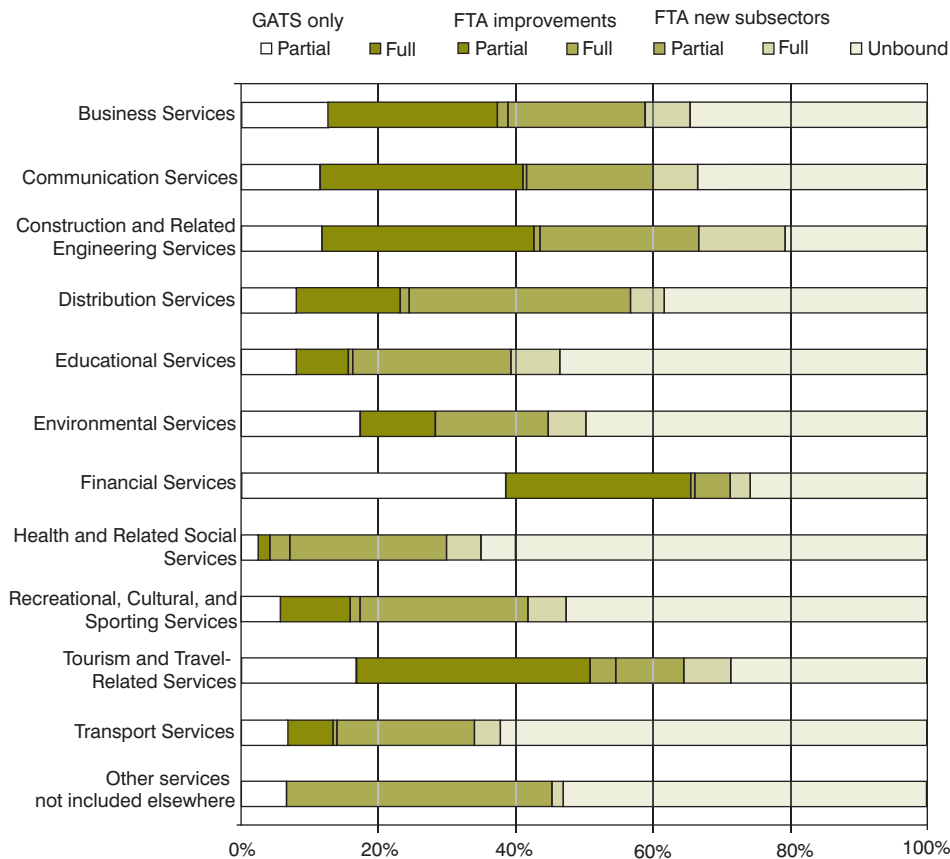
An aggregated measure of the GATS+ nature of market-opening commitments in Asian PTAs in services can be found in the exhaustive analysis recently carried out by Fink and Molinuevo. The results, whose sector breakdown is summarized in Figure 11, reveal that while GATS+ PTA advances are significant across all sectors, they are particularly noticeable in business services (reflecting the emergence of digital trade, e-commerce, and the outsourcing revolution in services), distribution, education, health, and transport services, all areas that have proven difficult in the WTO context during the Uruguay Round and more recently the Doha Development Agenda. The relatively lesser relative progress in areas such as telecommunications and financial services brings to mind that these are precisely the sectors where GATS negotiations have been most successful, lessening the scope or perceived need for advances in a PTA context.

East Asian PTAs confirm the partial, incremental nature of market opening in services, particularly apparent when commitments are analyzed on a modal basis (by mode of supplying services), as can be seen from Figure 12. From a positive point of view (albeit not an entirely surprising one, given the reluctance of countries to contemplate Mode 4 liberalization on an MFN basis), the most significant GATS+ advances in East Asian PTAs are to be found in the two modes likely to generate the strongest developmental returns: Mode 4 (movement of natural persons) and Mode 3 (commercial presence). Mode 4 is the least committed of all modes under GATS; mode 3 is the most committed of all modes and the principal means through which services are traded internationally. The East Asian PTA experience reveals lesser improvements in regard to Modes 1 (cross border supply) and 2 (consumption abroad). Again, this is not surprising. Host countries are reluctant to commit what they cannot (easily) regulate, as with cross-border trade, and they have a limited ability to influence Mode 2 trade determinants.

However, closer scrutiny reveals that the results described above require further analysis. For example, Mode 4 advances in East Asian PTAs are actually marginal (and always partial, as can be expected), and tend to result in quite minor (if potentially symbolic and precedent setting) changes to labor market outcomes.



**Figure 11: GATS+ Advances in East Asian PTAs Covering Services: Sector Breakdown**



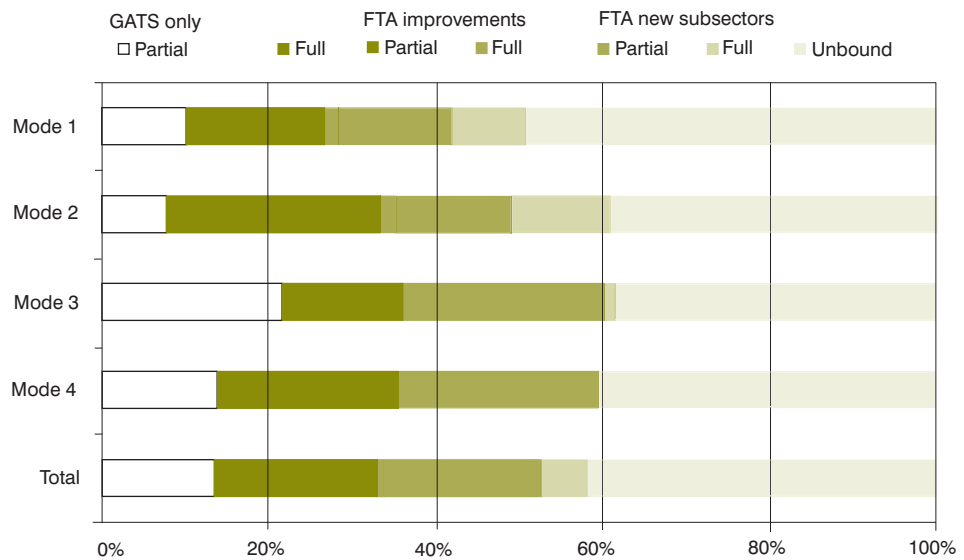
GATS=General Agreement on Trade in Services, FTA=free trade agreement, PTA=preferential trade agreement.

Source: Fink, C., and M. Molinuevo. 2007. East Asian Free Trade Agreements in Services: Roaring Tigers or Timid Pandas? *East Asia and Pacific Region, Report No. 40175*. Washington, DC: World Bank.

Consider the novel labor mobility provisions featured in recent Japanese PTAs. These are aimed at assisting partner-country service providers in nursing and other health-related occupations with training in the home country before admission to Japan, to help them comply with Japanese licensing requirements. Although the numerical quotas remain extremely low compared to the capacity



**Figure 12: GATS+ Advances in East Asian PTAs Covering Services: Modal Breakdown**



GATS=General Agreement on Trade in Services, FTA=free trade agreement, PTA=preferential trade agreement.

Source: Fink, C., and M. Molinuevo. 2007. East Asian Free Trade Agreements in Services: Roaring Tigers or Timid Pandas? *East Asia and Pacific Region, Report No. 40175*. Washington, DC: World Bank.

and negotiating interests of the partner countries, these provisions nonetheless are a step forward in the treatment of Mode 4 issues given population aging and labor market shortages in OECD countries. At the same time, full liberalization is more frequent for Modes 1 (possibly reflecting rising comfort levels toward digital trade and e-commerce) and 2 (possibly reflecting near impossibility of, and limited policy interest in, restricting transactions initiated by sovereign consumers).

### WTO Disciplines on Integration Agreements in Services

Like its goods counterpart, General Agreement on Tariffs and Trade (GATT) Article XXIV, Article V of GATS spells out the conditions that PTAs need to satisfy to be deemed WTO-compatible. Three such conditions apply:



- PTAs addressing services must achieve substantial coverage. This is arguably different from the equivalent GATT provision to “cover substantially all sectors” because the language in GATS is understood to extend to modal coverage. This means that such PTAs cannot exclude any particular mode of supplying services (say, Mode 4) on an a priori basis.
- PTAs must eliminate existing discriminatory measures and prohibit new or more discriminatory measures. This means that a standstill (a moratorium on new protection) is sufficient to satisfy Article V’s liberalization threshold.
- PTAs are not to result in higher trade and investment barriers against third countries relative to what prevailed before the PTA (to be determined on a sector basis).

GATS Article V:3(b) introduces some elements of special and differential treatment into services rule making by granting developing countries flexibility to accord more favorable treatment to firms and services that originate in parties to an integration agreement (for example, South–South PTAs such as MERCOSUR).

GATS Article V disciplines are generally considered weaker than those maintained for goods trade, for two main reasons can be advanced in explaining such an outcome. First, the subject matter was relatively new at the time of drafting Article V disciplines, which disposed WTO members toward the rule-making precaution such novelty entails, particularly as they had little sense of the likely pace, nature, and extent of services liberalization in crafting such disciplines. Second, the drafting of Article V paralleled the negotiation of PTAs among major rule-making powers in the WTO; the United States and Canada were involved in the NAFTA talks and the EU was negotiating with several partners in the developing world and at the periphery of Europe. Such parallelism most likely lowered WTO compliance requirements to the extent that powerful members were unlikely to see their preferential liberalization forays unduly circumscribed.





### Policy Questions for Discussion

- What are the most important forces behind the recent proliferation of preferential trade agreements (PTAs)?
- Are PTAs useful laboratories in which to test new approaches to rule making and liberalization in services trade?
- Are developing countries in general and Greater Mekong Subregion (GMS) ones in particular more likely to be regional “rule makers” than multilateral “rule takers”?
- Can PTAs be seen as a variant of the infant-industry argument for protection?
- Are there meaningful differences between PTAs concluded between developing countries and regional agreements linking developed and developing countries?
- How efficient are PTAs as a means of building negotiating capacity in services-related areas? How fungible is such knowledge? Can it easily be deployed in a World Trade Organization (WTO) or Association of Southeast Asian Nations (ASEAN) setting?
- What are the distinguishing features of trade in services that warrant closer policy attention in assessing the economic effects of PTAs?
- As a general rule, should nonpreferential liberalization be preferred to preferential liberalization, given that only the former can guarantee access to the most efficient suppliers of services?
- Is there a risk that PTAs covering services may lead to a spaghetti bowl of overlapping and potentially contradictory regulatory requirements?
- What are the economic implications of maintaining distinct regulatory regimes and practices for preferential “insiders” and third country “outsiders”?
- Is it true that a PTA chapter on services featuring a liberal rule of origin (based on a substantial business operations test) directed toward third country investors is equivalent to most-favored-nation (MFN)-based liberalization?
- Does the practice of preferential liberalization in services trade support the proposition that PTAs constitute optimal regulatory areas?



- Should PTAs be required by the WTO to feature an accession clause making them open to any country or group of countries that desires to join?
- What are the most significant advances made by PTAs in the services field over General Agreement on Trade in Services (GATS)? Are such advances most pronounced in rule making or market access (liberalization) terms?
- Can one identify “best practice” PTA advances that could usefully be considered for adoption at the multilateral level?
- What explains the fact that on the whole, PTAs have not made extensive headway on much of the “unfinished agenda” of GATS (including emergency safeguards, subsidies, government procurement, and domestic regulation)?
- What are the advantages and disadvantages of a negative list approach to scheduling liberalization commitments for services trade?
- Have PTAs been able to treat the movement of capital (investment) and labor (service suppliers) with greater overall balance than has been achieved to date in the WTO?
- What are the core disciplines that a PTA covering services must comply with to be deemed WTO-compatible?
- Should developing countries in general and GMS ones in particular make greater use of the policy flexibility afforded to them under Article V:3(b) (which allows developing countries negotiating integration agreements among themselves to give more favorable treatment to firms originating in parties to the agreement)? What economic considerations should weigh in such a decision?



### Suggested Readings

Fink, C., and M. Molinuevo. 2007. East Asian Free Trade Agreements in Services: Roaring Tigers or Timid Pandas? *East Asia and Pacific Region, Report No. 40175*. Washington, DC: World Bank.

Mattoo, A., and P. Sauvé. 2008. Regionalism in Services Trade. In Mattoo, A., R. M. Stern, and G. Zanini, eds. *A Handbook of International Trade in Services*. New York: Oxford University Press.

Roy, M., J. Marchetti, and H. Lim. 2008. The Race Towards Preferential Trade Agreements In Services: How Much Further Than the GATS? In Panizzon, M., N. Pohl, and P. Sauvé, eds. *Trade in Services: New Perspectives on Liberalization, Regulation and Development*. Cambridge: Cambridge University Press.

United Nations Conference on Trade and Development. 2008. *South–South Trade in Asia: The Role of Regional Trade Agreements*. Geneva.

# Chapter 5

## Sector Dimensions



### Key Learning Objectives

- Identifying the key negotiating challenges in six service sectors of central importance to the development of Greater Mekong Subregion (GMS) economies: financial services, services relating to information and communication technology (ICT), tourism, health-related services, transportation and logistics services, and the temporary movement of service suppliers (Mode 4 trade);<sup>39</sup> and
- Investigating the contribution of sound sector policy to the development process for each of these six sectors, identifying sector-specific regulatory challenges in the GMS and assessing the policy challenges associated with taking up these sectors in a trade policy context.

As discussed in Section II.2.6 above, the complex political economy and legal architecture of services agreements cannot be understood without a finer appreciation of the sector diversity of the service economy, the heterogeneous nature of market failure and concomitant regulatory responses applying across sectors, and the differing policy and negotiating challenges such diversity entails. The section that follows draws attention to the development potential and economy-wide incidence of reforms and trade negotiations in a range of sectors of particular importance to the Greater Mekong Subregion (GMS): financial services, the information and communication technology (ICT) sector, tourism, health-related services, logistics and labor mobility (Mode 4 trade).<sup>40</sup>

<sup>39</sup> For a discussion of sector challenges in services trade, see ODI. 2008. The Contribution of Services to Development and the Role of Trade Liberalization and Regulation. ODI Briefing Notes, Paper presented to the VIth OECD Global Forum on International Investment. Paris. 27–28 March.

<sup>40</sup> Unlike other sections of the module, this section does not include sector-specific policy questions for discussion. Instead, leading topics are highlighted in the short chapeau paragraph that introduces the discussion of each sector. Sector-specific suggested readings appear in the Appendix to the entire module rather than at the end of this section.



## Financial Services

*The financial sector plays a crucial role in the economy, and evidence shows that liberalization can improve financial sector performance, with secondary benefits for the rest of the economy. However, there are also risks associated with liberalization, for example to financial stability, and access to financial services. Careful sequencing of reform, appropriate regulation, and other complementary policies are required to ensure that liberalization delivers the expected benefits.<sup>41</sup>*

### The Role of the Financial Sector and the Benefits of Market Opening

Considerable empirical evidence can be adduced showing that the financial sector plays a crucial role in the economy, mobilizing savings and intermediating their use, underpinning private sector development, facilitating investment in businesses, technology, and training, and contributing to productivity, competitiveness, and growth.<sup>42</sup> Access to financial services also contributes directly to poverty reduction, enabling poor households to strengthen their livelihoods, for example by investing in microenterprises, and to better manage the risks they face.

Evidence also shows that opening up the financial sector to trade can significantly improve a country's overall financial sector performance, with important secondary benefits for the rest of the economy.<sup>43</sup> Openness to foreign financial services providers can result in greater efficiency, dynamism, and innovation. It can stimulate improvements in domestic banking performance, and has significant potential benefits for consumers through improved service delivery, and for the economy as a whole through a more efficient allocation of capital.

### Linking Trade Liberalization to Ongoing Domestic Reform Efforts

The liberalization of trade in financial services is helpful for domestic financial system modernization, but it is not a sufficient condition. Liberalization is desirable to serve the development needs of the domestic financial system, by improving efficiency and the allocation of resources through healthy competition with foreign providers. There is already a substantial body of literature on the positive relationship between

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<sup>41</sup> For a fuller discussion of challenges posed by the treatment of financial services in trade agreements, see Stephanou, C. 2008. Including Financial Services in Preferential Trade Agreements—Lessons of International Experience for China. Mimeo, Trade Department, World Bank. Washington, DC:

<sup>42</sup> See Claessens, S. and M. Jansen, eds. 2000. *The Internationalization of Financial Services: Issues and Lessons for Developing Countries*, Washington, DC and Geneva: World Bank and World Trade Organization.

<sup>43</sup> See Matoo A., R. Rathindran, and A. Subramanian 2001. Measuring Services Trade Liberalization and its Impact on Economic Growth: An Illustration. *World Bank Policy Research Working Paper 2655*, Washington, DC: World Bank. August.



finance and growth and on the spillover effects of entry of foreign financial services providers, particularly banks, although there are also important sequencing and speed considerations and other preconditions to the process of financial liberalization.<sup>44</sup> More specifically, the benefits from trade liberalization in financial services depend critically on the market's attractiveness to foreign providers ("If you build it, they will come"), as well as on complementary regulatory reforms. The latter includes the adoption of international prudential standards, the elimination of measures that inhibit financial sector development, and the strengthening of the enabling financial infrastructure environment (rule of law, credit bureaus, collateral registries, accounting and auditing standards, payment systems, and the like). It is important to note that such reforms go well beyond trade policy and cannot therefore be tackled solely in the context of a trade agreement per se.

Opening up the financial sector to trade is indeed often just one component of a package of financial reform measures that are undertaken together, and that may include the elimination of government intervention in the financial sector, privatization, domestic market liberalization (allowing new entry by domestic financial providers), and capital account liberalization.

Experience from across the world, particularly in Southeast Asia, attests to the significant risks associated with the wider process of financial sector liberalization, including financial instability, bankruptcies, and the increased chance of financial contagion when other market segments and major institutions in other countries experience financial difficulties. Thus a range of complementary policies and the careful sequencing of reform are now widely seen as centrally important to managing such risks and to maximizing the benefits of market opening. Critical components include:

- a stable macroeconomic framework, to minimize the risk of financial instability;
- adequate financial supervision and regulation, to encourage prudent risk taking and financial discipline in the banking system;
- the necessary institutional infrastructure, such as an effective legal framework for insolvency, and adequate corporate governance and accounting systems;

<sup>44</sup> For a recent overview of the evidence on finance and growth, see Demirguc-Kunt, A. and R. Levine. 2008. Finance, Financial Sector Policies, and Long-Run Growth. *Policy Research Working Paper 4469*. Washington, DC: World Bank. For spillover effects, see Clarke, G., R. Cull., M. S. Martinez Peria, and S. Sanchez. (Spring 2003), Foreign Bank Entry: Experience, Implications for Developing Economies, and Agenda for Further Research, *The World Bank Research Observer*, Vol. 18, No 1. On preconditions for effective financial services liberalization, see, for example, International Monetary Fund 2007. *Reaping the Benefits of Financial Globalization*. Research Department Discussion Paper. Washington, DC. International Monetary Fund.



- procompetitive regulatory reform, under which government controls over the actions of financial institutions are progressively removed, such as directed lending policies and interest rate ceilings, which are likely to hamper performance and deter new entry;
- bank restructuring, to resolve problems associated with high levels of nonperforming loans and to put domestic banks on a sustainable footing, thus avoiding bankruptcies and creating a level playing field with new foreign entrants; and
- commercialization and privatization, to create market incentives and to improve the competitiveness and productivity of domestic banks.

### **Approaches to Liberalizing Trade in Financial Services**

Countries have achieved the liberalization of trade in financial services in three main ways: unilaterally, by opening their financial systems to international competition in the context of domestic reform efforts; at the multilateral level under General Agreement on Trade in Services (GATS); and on a reciprocal or preferential basis by concluding bilateral or plurilateral preferential trade agreements (PTAs), of which free trade agreements (as opposed to customs unions) are the most common type. Depending on the context and circumstances, one or more of these approaches have been used in various countries to liberalize specific subsectors or modes of financial services provision.<sup>45</sup>

Unilateral market opening has been the most common way to liberalize trade in financial services. Most developed countries have adopted such a strategy, progressively liberalizing their financial markets over a relatively long period. Many developing countries followed or are following the same path, although in some cases, such as Mexico's, the advent of a crisis led to or accelerated the market opening process. When the time came to negotiate GATS, the latter countries merely bound at or below the regulatory status quo in their schedules, consolidating the actual prevailing degree of openness. The People's Republic of China (PRC) and some recent World Trade Organization (WTO)-acceding countries (such as Cambodia and Viet Nam) are the clearest examples of liberalization of trade in financial services in a multilateral context. By comparison,

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<sup>45</sup> See Saez, R. December 2006. Trade in Financial Services: The Case of Chile. Mimeo. World Bank. Washington, DC; Arbeláez, M. A., A. Flórez, and N. Salazar. August 2006. Financial Services in the Colombia-US Free Trade Agreement. Mimeo. World Bank. Washington, DC; Echandi, R. 2006. The DR-CAFTA-US FTA Negotiations in Financial Services: The Experience of Costa Rica. Mimeo. World Bank. Washington, DC.



there are very few examples of de novo liberalization stemming from preferential trade agreements (PTAs); one exception is Costa Rica's decision to open up its market in insurance services, which previously had been a public monopoly, in the context of the recently concluded Dominican Republic (DR)–Central American Free Trade Agreement (CAFTA).

### Including Financial Services in PTAs: Lessons from Experience

Broadly speaking, there are three main reasons why countries include financial services disciplines and commitments in PTAs. First, and typically the most important, is that they have offensive interests in this sector and that there are asymmetric bargaining powers between the negotiating counterparts. In such cases, a country includes financial services commitments either because it is forced to do so by the negotiating partner (perhaps as a quid pro quo for securing market access in another sector), or because it has offensive interests in financial services and is able to impose them on the counterpart—typically in a North–South PTA context. Second, and less commonly, a country will use financial services trade agreements either to lock in recent unilateral liberalization or to advance the government's reform agenda by precommitting to future market opening, the idea is to overcome any lingering resistance from domestic constituencies and to provide a positive signal to foreign investors. Argentina in GATS and Costa Rica in CAFTA seem to have been examples.<sup>46</sup> Finally, countries may include financial services in PTAs for strategic or political reasons, rather than purely economic reasons. The clearest examples of such cases involve plurilateral regional trading bloc initiatives, such as the Andean Community and MERCOSUR in Latin America and possibly the ASEAN Framework Agreement on Services (AFAS), though the latter has registered greater relative progress on internal liberalization.<sup>47</sup>

Arguments in favor of including financial services in PTAs have to be weighed against the potential drawbacks, including regulatory sensitivities and the related fear of limiting "policy space" in the sector; potential distortions that could arise from giving preferential treatment to specific counterparts (especially where first-mover advantage is important); strategic considerations (commitments made

<sup>46</sup> See Bouzas, R. and H. Soltz. 2005. Argentina and the GATS: A Study on the Domestic Determinants of GATS Commitments. In Gallagher P., P. Low, and A. Stoler, eds. *Managing the Challenges of WTO Participation*. London: Cambridge University Press; and Echandi, R. 2006. The DR–CAFTA–US FTA Negotiations in Financial Services: The Experience of Costa Rica. Mimeo. World Bank. Washington, DC.

<sup>47</sup> A fourth, more technical, reason for including financial services in a PTA would be to ensure that the agreement has "substantial sector coverage" and therefore constitutes a lawful exemption to the nondiscrimination requirement articulated in GATS Article V. This issue can be addressed by not carving out financial services from the scope of the agreement a priori.





with one PTA counterpart can become a floor in multilateral or other bilateral trade negotiations); and the administrative problems that arise from managing a complex web of financial services liberalization rules with different countries. By far the most important negotiating factors until now have been regulatory sensitivities and strategic considerations, whose effect has been evident in the GATS negotiations and scheduling of commitments.

International experience on the inclusion of financial services in PTAs is still too recent to allow a comprehensive and robust evaluation of its effects on domestic financial systems and overall welfare. There are insufficient data and methodologies to assess the ex post impact (as opposed to estimating it in advance). Although there have been numerous studies on the effects of foreign entry (particularly by banks) resulting from unilateral liberalization, there is no comparable literature on the effects of PTA-induced financial liberalization. A priori, those effects do not appear very significant, since most PTAs seem to be primarily used to consolidate and lock in existing unilateral liberalization rather than to promote further market opening and domestic regulatory reform.

Even if a commonly accepted methodology of impact assessment was established, the short time span since the negotiation or entry into force of most PTAs that include financial services—the earliest, and rather atypical, example being the North American Free Trade Agreement (NAFTA) in 1994—means that their contribution still cannot be fully assessed. In particular, financial services commitments and disciplines, including dispute settlement mechanisms, have not been put to the test during a market downturn or a significant revision of domestic financial system policy priorities, which is typically when constraints on “policy space” and regulatory sensitivities kick in.

### **Implications of Liberalization for Access to Financial Services**

The concern is often voiced in negotiating circles that foreign financial institutions may be tempted to cherry-pick the most profitable market niches in developing-country markets. Indeed, most foreign institutions do focus on areas where local profit opportunities are perceived to be greatest, such as providing financial services to larger firms and wealthier clients in urban areas. Increased competition in these market segments can help to increase access to credit in other segments by forcing other banks to move into them. Moreover, some of these effects may well be the by-products of market access restrictions that limit the range of services that foreign banks or insurance companies may engage in or that constrain their geographical scope within a host country. A number of World Trade Organization (WTO) members, indeed, place quantitative limitations on the extent of commercial presence of foreign financial institutions, or limit their presence to specific geographic locations



or market segments. At the same time, removal of directed lending and privatization of state-owned banks as part of an overall package of financial reform may reduce access to financial services for some segments of the population and the corporate sector, especially state-owned enterprises. Governments need to create an enabling environment to reduce the costs associated with widening access by commercial banks by fashioning a better legal framework to enforce contracts and ensure that regulation does not undermine incentives to widened credit access.

## The ICT Sector

A properly functioning information and communication technology (ICT) sector is important for development, as it improves the efficiency of households, firms, sectors, and the country as a whole. It also provides significant new opportunities for exports of services from developing countries. Appropriate regulation, trade liberalization, and other complementary factors, such as good quality skills, play a key role in developing the ICT sector.

### ICT and Development: The Role of Regulation

The internet revolution has made it possible to deliver an ever-wider range of services electronically, creating a world market for international sourcing of services ranging from remote call centers to sophisticated software development. A growing share of this market has been captured by developing countries from Asia to the Caribbean (Box 3). In addition to creating export opportunities for both developed and developing countries, ICT services also play an important role as inputs to the manufacturing process and to the production of other services, increasing productivity and enhancing competitiveness across the entire economy. They can also play a critical input role in agricultural and fisheries markets, providing operators with real-time access to information on prices and market trends.

Evidence suggests that a well-developed ICT sector contributes to faster growth, better economic performance at the firm level, and improved household welfare because it increases efficiency.<sup>48</sup> ICTs enable firms to access knowledge and information, reduce transaction costs, supply remote markets more easily, improve decision making across the value chain through better and easier communication, and improve the flexibility of firms to respond to consumer demand.

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<sup>48</sup> Matoo A., R. Rathindran, and A. Subramanian. 2001. Measuring Services Trade Liberalization and its Impact on Economic Growth: An Illustration. *World Bank Policy Research Working Paper 2655*. Washington, DC: World Bank. August.

However, countries differ markedly in their ability to take full advantage of the ICT revolution. Telephony and internet penetration rates show considerable variance across countries, and the digital divide (both within and across countries) remains an obstacle to ICT, even though the spread of mobile telephony has been impressive in most regions of the developing world in recent years. However, Tables 5 and 6 show that the mobile telephony and internet penetration rates in GMS countries remain relatively weak even though the rate of growth of such penetration is rising fast in the subregion.

**Table 5: Mobile Phone Subscribers per 100 Inhabitants in GMS Countries, 2002–2006**

GMS country	2002	2006	2006 World ranking (of 195)
<b>Cambodia</b>	2.9	7.9*	132
<b>PRC</b>	15.9	34.9	96
<b>Lao PDR</b>	1.0	10.8*	174*
<b>Myanmar</b>	0.1	0.4*	195*
<b>Thailand</b>	25.8	65.5	71
<b>Viet Nam</b>	2.4	18.2	119

GMS=Greater Mekong Subregion, Lao PDR=Lao People's Democratic Republic, PRC=People's Republic of China.

\*: 2005 data.

Source: United Nations Conference on Trade and Development. 2008. *Information Economy Report 2007–2008: Science and Technology for Development—The New Paradigm of ICT*. New York.

**Table 6. Internet Users per 100 Inhabitants in GMS Countries, 2002–2006**

GMS country	2002	2006	2006 World ranking (of 195)
<b>Cambodia</b>	0.2	0.3*	188*
<b>PRC</b>	4.6	10.4	104
<b>Lao PDR</b>	0.3	0.4*	185*
<b>Myanmar</b>	0.0	0.1*	195*
<b>Thailand</b>	7.7	13.1	96
<b>Viet Nam</b>	1.9	17.2	85

GMS = Greater Mekong Subregion, Lao PDR = Lao People's Democratic Republic, PRC = People's Republic of China.

\*: 2005 data.

Source: United Nations Conference on Trade and Development. 2008. *Information Economy Report 2007–2008: Science and Technology for Development—The New Paradigm of ICT*. New York.



Development of the ICT sector depends above all on the availability of good telecommunications infrastructure. Reform of telecommunications involves market liberalization (including pricing, nondiscriminatory access to and use of the networks of dominant suppliers, and cost-based interconnection and leasing of lines) and competition, private sector participation, effective pro-competitive, independent regulation, and trade and investment liberalization vis-à-vis foreign firms (a task for international negotiations).

Technological advances in telecommunications and computer industries have allowed developing countries endowed with a well-educated and cost-competitive workforce to compete successfully in the world market for computer-related services. While the remarkable performance of the Indian software industry is perhaps the most celebrated case, such export success is hardly confined to South Asia and can be found in many parts of the GMS, most notably in Viet Nam and Thailand. Box 3 examines the recent growth of IT-related outsourcing and the policy inputs most likely to support such growth.

### **Box 3: Moving Upscale: Exporting Services Through Outsourcing**

By helping overcome hurdles of time, space, and size, electronic networks afford developing-country firms the means to integrate global services markets. Outsourcing and back-office operations, covering computer and related businesses as well as professional, financial, health, and audiovisual services, have become key areas of export interest for developing countries. An efficient information and communication technology (ICT) sector opens up new export frontiers for developing countries, including landlocked countries traditionally constrained by high transport costs. ICTs enable specific services (and goods) to be traded or offshored without traditional transport modes. Outsourcing can both leverage and help to support existing service exports, as in the audiovisual sector, where developing countries with large film and broadcasting industries, such as Brazil, India, or Mexico, are also increasingly moving into outsourced postproduction for other films.

To reap such benefits, developing countries will need modern, efficient infrastructure (especially in telecommunications), solid educational systems (with a premium placed on the acquisition of language skills), and the means to supply services to developed-country markets on a cross-border basis. Meanwhile, developed countries must support such trends by resisting calls to erect new barriers for fear of white-collar job displacement. Regulations in importing countries also affect offshoring opportunities. For instance, some US states have recently banned offshoring of public sector services

*continued on next page*



### Box 3: continued

due to employee concerns about job losses. Protectionism has also been visible, but to a lesser extent, in Europe, where some groups feel threatened by the potential for direct job losses that would only be indirectly compensated by the gains from outsourcing. Concerns over data protection regimes can also constrain offshoring opportunities for developing countries. Mitigating such barriers to trade will remain an important offensive interest in trade negotiations for key developing country exporters of ICT services.

Source: Organisation for Economic Co-operation and Development. 2003. *Services Liberalization: Identifying Opportunities and Gains—Key Findings*. Paris.

Market reforms can boost productivity and stimulate investment, enhancing the performance of the ICT sector. Market-friendly strategies can also allow governments to meet social and economic objectives, such as increasing access to ICTs, and generate needed government revenues from telecommunication services.

Competition has become more common in the ICT sector. Looked at globally, Latin America is the region of the developing world that has introduced the most competition, with 61% of countries with some form of competition in basic voice services, as compared to 55% in the Asia-Pacific region and 51% in Africa. In mobile telephony, under more liberal aggregate conditions, the Asia-Pacific region leads with 78% of its countries having introduced competition as compared to 76% in the Americas and 75% in Africa. Private sector participation in telecommunications is almost everywhere on the upswing. Some 78 developing countries have now privatized their telecommunications operations, raising close to \$80 billion during 1990–2006.

Effective regulation of telecommunication is important, particularly in countries with small markets that might allow only one or a few telecommunication firms to operate, due to natural monopoly characteristics. When markets have been privatized, effective regulation is critical for the benefits to be felt in the form of low-cost interconnection costs to broadband services for households and businesses, especially small- to medium-sized enterprises (SMEs). The creation of effective regulatory agencies, independent from political influences and from former monopoly suppliers, that have the technical skills to monitor firms and the capacity to enforce pro-competitive regulation is crucial, if always a daunting condition, for successful reform in the ICT sector.



Country case studies reveal unambiguously that trade liberalization and openness to foreign firms help in the development of the ICT sector.<sup>49</sup> Foreign-owned telecommunication firms often have more skills and capabilities than local firms, are at the forefront of technological developments, and bring telephone and internet access to areas that were previously not serviced. Experience also shows that trade and investment liberalization is more beneficial when accompanied by complementary pro-competitive regulation. An effective domestic competition policy framework with sound enforcement is particularly important. For example, in Brazil, Chile, and Thailand, privatization that allowed the entry of several foreign or new domestic firms led to large improvements in the spread of ICTs, while in Argentina and Viet Nam, privatization that admitted only a single foreign firm or delays in the pace of privatization limited new competition, with less significant effects on prices paid by households and businesses, thereby limiting the spread of ICTs. While regulation could be used to enforce access to less profitable rural areas, a more efficient way of ensuring coverage in such areas is by providing output-based subsidies. This course has been experimented with successfully in many parts of the developing world.

### Policy Requirements for ICT Growth

The ICT sector is still underdeveloped in the poorest developing countries although a trend of improvement is noticeable in many, including in the GMS. The sector arguably deserves a strategy covering a number of issues:

- the establishment of a good telecommunications infrastructure, with market-based pricing, private sector participation, and appropriate regulation;
- an independent, technically competent regulator;
- a suitable competition policy framework with adequate investigation and enforcement capabilities and regulatory independence;
- an appropriate legislative framework for data protection, electronic signatures, encryption regimes, and similar issues;
- an offensive approach to maintaining and improving access for IT-enabled services worldwide through more liberal commitments under Modes 1 and 2

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<sup>49</sup> See, for instance, Sauvé, P. *Fostering Trade Through Private–Public Dialogue: WTO Negotiations on Trade in Services and Economic Implications—Telecommunications and Financial Services*. Report on a Roundtable on Trade in Services, International Trade Centre. Geneva. April 2007.



(cross-border supply and consumption abroad) and associated Mode 4 commitments to temporary labor mobility of skilled ICT workers in the markets of major trading partners, via the WTO and in PTAs; and

- the provision of suitable education and training, with more attention to vocational and technical tertiary education including language skills, and to links with private sector needs.

## Tourism

*Tourism is the biggest export service sector in many low-income developing countries. Its value is already significant and is set to increase further in all world regions, especially in developing countries, reflecting increased demand, comparative advantages, and ongoing liberalization. Throughout the GMS, as in most parts of the world, the tourism sector is already liberal compared to other key service sectors, but essential complementary reforms in air access and visa procedures are less well advanced. There are also some specific tourism categories, including tour guides and the small hotel segment, where regulatory protection may support domestic competitiveness objectives.*

## Tourism and Development

International tourism receipts and tourist arrivals have more than doubled in the past 15 years, reaching \$700 billion and involving 800 million travelers in 2005 (UN World Tourism Organization).<sup>50</sup> Average annual growth rates in arrivals during 2000–2005 were 5% in sub-Saharan Africa, 7% in East Asia and the Pacific, and 3% for the world. Figures 13 and 14 highlight the strong growth in tourist arrivals and tourism expenditures experienced by GMS countries from 1990 through 2004.

In all GMS countries, tourism has become a major source of employment and export earnings, and the leading source of services receipts. For instance, according to data from the World Tourism Organization, tourism accounts for 79.8% of Cambodia's total exports of transport, travel, and commercial services combined. A similar pattern obtains in the Lao People's Democratic Republic (Lao PDR), where tourism accounts for an estimated 71% of total services exports.<sup>51</sup>

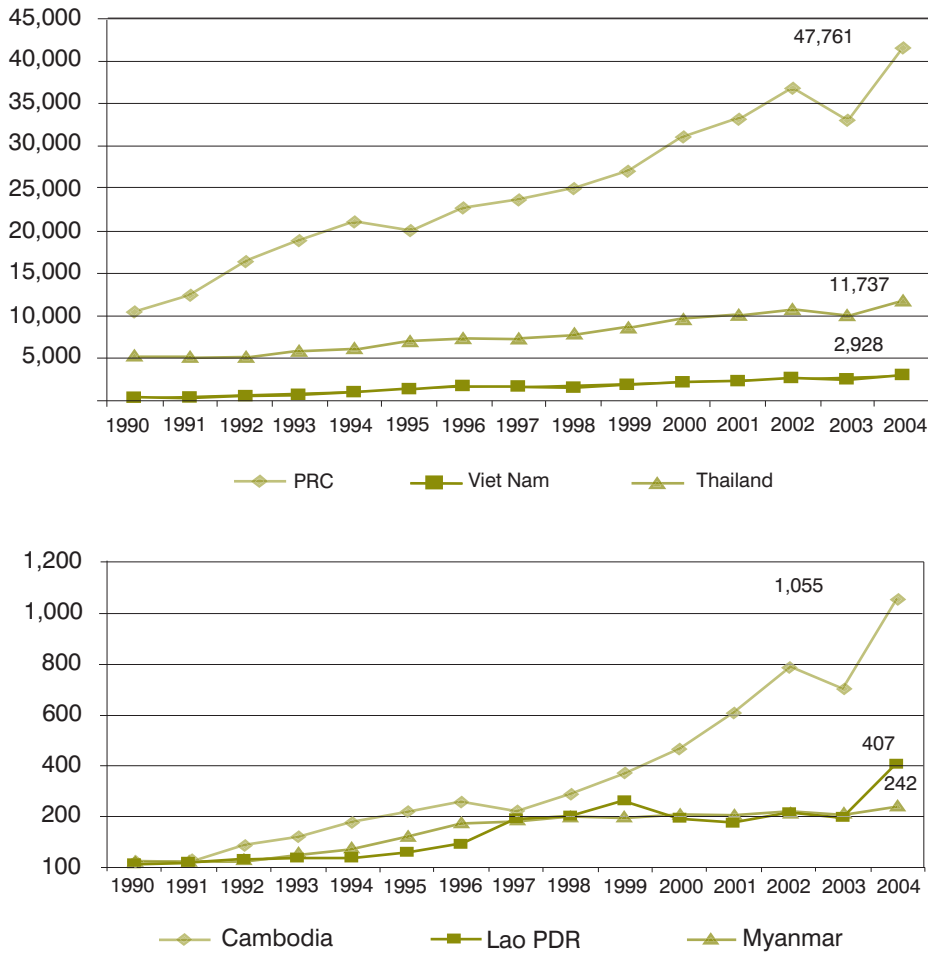
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<sup>50</sup> World Tourism Organization. 2007. *Trends in International Tourism*. Madrid: World Tourism Organization.

<sup>51</sup> World Trade Organization. 2008. *WTO Trade Profile 2007*. Geneva.



**Figure 13. Tourism Arrivals in GMS Countries, 1990–2004**  
(‘000 people)



GMS=Greater Mekong Subregion, Lao PDR=Lao People’s Democratic Republic, PRC=People’s Republic of China.

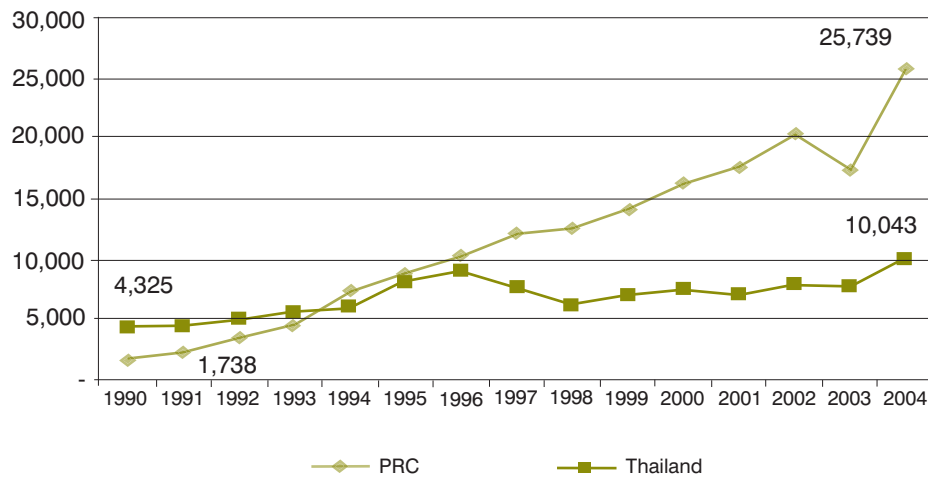
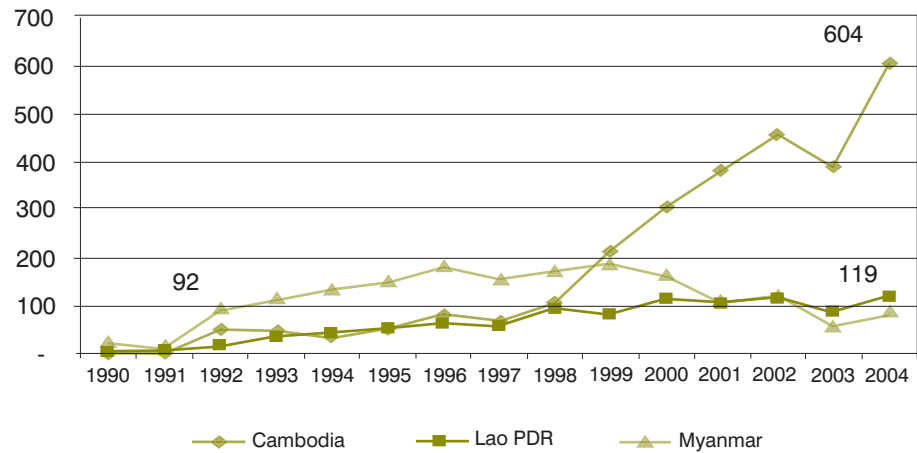
Source: United Nations Conference on Trade and Development. Trade Statistics. <http://stats.unctad.org/Handbook/TableViewer/tableView.aspx>

Tourism benefits the poor through employment opportunities. It offers labor-intensive and small-scale opportunities compared with other nonagricultural activities, employing semiskilled and casual workers in small and medium-sized enterprises, a high proportion of women, and offering an opportunity for self-employment.





**Figure 14. Tourism Expenditure in GMS Countries, 1990–2004**  
(\$ million)



GMS=Greater Mekong Subregion, Lao PDR=Lao People's Democratic Republic, PRC=People's Republic of China.

Source: United Nations Conference on Trade and Development. Trade Statistics. <http://stats.unctad.org/Handbook/TableViewer/tableView.aspx>



Tourism also provides economic opportunities in remote areas and in places that put a high value on natural resources and culture, all of which tend to favor the poor. Econometric studies that capture the dynamic effects of tourism on growth support the hypothesis that growth can be tourism-led. They also show that in some cases tourism contributes more to growth than some traditional sectors. The poorer the country, the greater the overall effects of tourism tend to be. This would suggest that tourism is a first step toward diversification, but that as countries become more developed they move increasingly into higher value-added sectors, including within tourism (for example, by introducing wellness or health-related tourism).<sup>52</sup>

Tourism's effects on the rest of an economy typically operate via infrastructure (including air travel, ports, and roads), human resource development (specifically workforce training), diversification, and private sector development (especially SME development and entrepreneurship linkages). Box 4 describes a number of recent initiatives designed to boost the tourism industry in the GMS.

#### **Box 4: Regional Initiatives on Tourism Development in the Greater Mekong Subregion**

The liberalization of trade, investment, and travel within the Greater Mekong Subregion (GMS) countries' borders since the early 1990s has led to economic, trade, and tourism growth in the border areas. The Asian Development Bank (ADB) estimated that foreign border-area visitors accounted for 60% of all visitor movement to GMS countries in recent years. The level of border-area visitor flows varies from country to country. The PRC's Yunnan Province is the area that generated the highest flow of GMS border-area visitors, accounting for up to a third of total border visitor flows to the subregion in recent years (mainly to eastern Myanmar and northern Viet Nam), followed by Cambodia (mainly to Thailand), Thailand [primarily to Cambodia, Myanmar, and the Lao People's Democratic Republic (Lao PDR)], and Myanmar (to Yunnan and Thailand).

Because cross-border tourism plays a significant role in the overall expansion of the tourism industry in the GMS countries, sustaining its current level of growth has become a top-priority policy for governments in the subregion, as has gearing the growth toward benefiting the poor and socially and economically marginalized groups.

*continued on next page*

<sup>52</sup> For a discussion of the pro-poor effects of tourism development in the GMS, see Tiranutti, V. 2008. The Liberalization of and National Strategies on Tourism in Cambodia and Lao PDR: Lessons for LDCs. Paper presented at an Asia-Pacific Economic Cooperation Seminar on The Impact of Liberalization on Trade in Services. Jakarta. 28–29 October.



Box 4: continued

ADB's GMS Economic Cooperation Program, which started in 1992, helps facilitate economic, trade, and investment growth in the GMS in a variety of sectors, tourism included. Under the Mekong Tourism Development Project (MTDP), a Tourism Working Group (TWG) was established. Its members include representatives from the tourism authorities of the six GMS countries. The group meets biannually to discuss progress and strategic plans in the development of the subregion's tourism industry. The TWG discusses issues including the facilitation of cross-border transport and pro-poor tourism. To facilitate cross-border transport, Cambodia—the lead country in the Southern Tourism Corridor Zone—has initiated consultations with Thailand on the issuance of visas to foreign nationals and the distribution of free visas to citizens from GMS countries. In addition, the TWG has launched a website promoting tourism in the GMS (<http://exploremekong.org/site/>).

On pro-poor tourism, ADB has outlined its poverty alleviation strategy in its report, *The Greater Mekong Subregion Tourism Sector Strategy*<sup>53</sup>, where it has argued that the development of tourism should go hand in hand with the generation of income and jobs for both the urban and rural poor, with local community empowerment, and with increased security in food self-sufficiency, health, land tenure, and the rights of women and children. To achieve such objectives, ADB set out implementation plans that link natural, cultural, and historic tourist attractions to locations where poverty is prevalent, in order to offer members of poor communities opportunities for employment and new markets for their farm, handicraft, and other products. In 2005, ADB initiated pro-poor tourism demonstration projects in all GMS countries. In the southern GMS alone, the demonstration projects are being implemented in Stung Treng, Ratanakiri, and Siem Reap provinces in Cambodia; Phongsaly, Houapan, and Xienghuang in the Lao PDR; and Ubon Ratchathani and Sisaket in Thailand. The main objective is to lift 158,000 persons in the targeted areas out of poverty by 2010 and up to 1.2 million by 2015.

In addition, the World Bank's International Finance Corporation (IFC) launched a pro-poor tourism project, "Stay Another Day," in three GMS countries—Cambodia, Lao PDR, and Viet Nam—under the Mekong Private Sector Development Facility (MPDF) program. The aim is to entice foreign tourists who have visited the countries' main tourist attractions to spend more time there, visiting local communities, nonprofit organizations, and socially responsible enterprises that conduct alternative tourism programs. Such programs include visiting Fair Trade-certified craft producers, learning about NGOs' wildlife conservation and poverty reduction activities, dining in hospitality training centers for the poor, or staying in a villager's homestay lodge. The aim is to promote tourism as a means to generate income for local communities and organizations working on alleviating poverty among marginalized populations in the three countries, so that they can directly benefit from tourism growth in their countries. MPDF is a multidonor initiative financed jointly by donor countries including Australia,

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<sup>53</sup> ADB. 2004. *The Greater Mekong Subregion Tourism Sector Strategy*. Manila: Asian Development Bank.



Box 4: continued

Canada, the European Union, Finland, Ireland, Japan, New Zealand, the Netherlands, Norway, Sweden, and Switzerland. Currently, there are 52 Stay Another Day member organizations in Cambodia, 45 in Lao PDR, and 17 in Viet Nam.

On a larger scale, a regional effort to promote tourism jointly has been launched by the Association of Southeast Asian Nation (ASEAN) member countries. In 2005, ASEAN tourism ministers signed the Langkawi Declaration on "Shifting Paradigm—Prospering the Region." Close cooperation in the field of tourism among ASEAN members is a goal of the ASEAN Economic Community (AEC) plan, and the declaration is intended to broaden and deepen the signers' cooperation toward fuller ASEAN integration by 2010. In addition, the member countries have jointly launched an ASEAN Tourism website ([www.asean-tourism.com](http://www.asean-tourism.com)) to promote the region as a travel destination for international tourists. Other cooperation initiatives include the ASEAN Tourism Association (ASEANTA: [www.aseanta.org](http://www.aseanta.org))—a nonprofit tourism association whose members are both public- and private-sector tourism organizations in ASEAN. One of the objectives of the association is to undertake marketing activities in promoting tourism to travelers from around the world.

Source: Tiranutti, V. 2008. The Liberalization of and National Strategies on Tourism in Cambodia and Lao PDR: Lessons for LDCs. Paper presented at an Asia-Pacific Economic Cooperation Seminar on The Impact of Liberalization on Trade in Services. Jakarta. 28–29 October.

### The Role of Regulatory Reform in Supporting Tourism

Tourism regulations govern the operations of hotels, restaurants, tour operators, and tour guides, in the form of rules on the use of fiscal incentives, land tenure, and health and safety issues in the destination country. Complementary regulatory factors include measures in areas as diverse as transportation, temporary migration, environmental or vocational training, and regulations and policies in source countries (such as regulations dealing with health and safety and competition policy).

The World Economic Forum compared countries on a tourism competitiveness index incorporating factors such as environmental regulation, safety and security, health, government's prioritization of tourism, air transport, tourism and ICT infrastructure, and human, cultural, and natural resources. It found that a higher score on the index was associated with more tourist arrivals.



A more streamlined administrative business environment can help promote the development of the tourism sector. Investment policies sometimes fail to include the tourism sector, although in practice many countries use fiscal incentives to attract hotels, cruise ships, and other tourist enterprises. Despite their increasing use, there is little empirical evidence attesting to the effectiveness of such measures. Better administration of investment incentive programs, including better formulation and monitoring of underlying objectives, could be helpful.

Tourism regulations governing enhanced air access, simplified (and less costly) visa arrangements, and equal treatment of foreign and domestic hotel operators may help develop the sector. Some countries restrict certain activities, such as ecotourism resorts. However, restricting the tourism industry to locals could deprive a potentially vibrant sector of the skills, capital, and marketing networks that partnering with foreign players, or allowing foreign providers greater latitude for market entry on their own, could make available. At the same time it may be more efficient to promote domestic capabilities, using transparent immigration procedures for recruiting tour guides or nondiscriminatory competition policies toward large-scale hotel chains or tour operators if need be. Promoting domestic capabilities includes better access to credit for local entrepreneurs and enhanced access to computerized marketing systems.

Tourism is a key export service sector that features prominently in trade negotiations covering services. While unilateral regulatory reform and liberalization is already happening, often with beneficial economic effects, developing countries with strong negotiating interests in tourism development are beginning to articulate their policy needs in trade policy settings, at the WTO (where several developing-country members advanced a collective request in the sector) and in PTAs. Box 5 describes the tourism commitments of three GMS countries—Cambodia, the Lao PDR, and Thailand—in various negotiating settings.

**Box 5: Opening Trade in Tourism Services in the Greater Mekong Subregion: Commitments by Cambodia, Thailand, and the Lao PDR**

**Cambodia**

Tourism and the garment industries are the two main lifelines of the Cambodian economy. Tourism generates income for the large portion of the country's population that is involved in all tourism-related sectors, from restaurants and hotels to small and

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Box 5: continued

medium-sized enterprises engaged in souvenir selling, tour guiding services, spas, and handicraft producing. The number of tourists going to Cambodia has steadily increased, from 118,183 tourists in 1993 to 2,015,128 in 2007, an almost twenty-fold increase. The government expects the number of tourist arrivals to reach 5 million in 2015.

Cambodia has been an Association of Southeast Asian Nation (ASEAN) member since 30 April 1999. It has submitted its services liberalization commitments to other ASEAN members as part of its obligations under the ASEAN Framework Agreement on Services (AFAS). The last (sixth) AFAS package was completed in 2007. Liberalization of services under AFAS is a gradual effort for most of ASEAN members, who add more subsectors over time. This progressive process of liberalization is in accordance with ASEAN's goal of establishing an ASEAN Economic Community (AEC) and achieving a "free flow of services" by 2010. As part of this mission, tourism is one of the 12 priority sectors to be liberalized by 2010. As a result, AFAS has now become more comprehensive than other trade liberalization frameworks to which ASEAN members have made legally binding commitments, including the General Agreement on Trade in Services (GATS).

Under AFAS, all three countries have made the highest level of commitments, greater than their commitments under GATS, the ASEAN–China Free Trade Agreement (FTA), and the ASEAN–Korea FTA. Whereas Cambodia included five tourism subsectors in its AFAS schedule of commitments (Hotels, Restaurants, Travel Agencies and Tour Operators Services, Tourist Guide Services, and Convention Centers), it included only four in GATS.

In general, Cambodia adopted a comprehensive approach to services liberalization. Most of the country's services scheduled for commitments under GATS openly welcome foreign investment, as the country scheduled "None" for Mode 3 in most of its service sectors. However, because no foreign equity holding limitation is specified in Cambodia's Foreign Investment Law, the foreign equity limit in Cambodia's GATS schedule of commitment varies according to the type of service under consideration. For example, foreign equity participation in travel agency services is limited to 51%, while 100% foreign ownership of convention centers is allowed, provided that the enterprise offers services with the capacity to cater for at least 3,000 people. Cambodia also requires an economic needs test in certain sectors such as restaurants, where the criteria for granting the necessary permit include the number of existing restaurants and the proposed restaurant's impact on them, the historical and artistic characteristics of the location, geographic spread, impact on traffic conditions, and creation of new employment.

#### **Thailand**

Tourism makes a larger contribution to Thailand's economy—around 6% of gross domestic product—than to that of any other Asian nation, making the country the

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Box 5: continued

clear leader in the Greater Mekong Subregion (GMS) and a Southeast Asian tourism powerhouse. An estimated 14 million tourists visited Thailand in 2006, making the sector the country's third-most-important source of foreign exchange earnings behind automotive exports (motor vehicles and parts) and electrical machinery. The sector employs an estimated 4 million people, almost 10% of the country's labor force.

Thailand's services commitments differ in some respects from those of Cambodia. Under AFAS, Thailand's level of commitment in tourism is relatively comprehensive, including nine subsectors that mainly center on accommodation businesses (Hotels, Motels, Holiday Homes, Caravan and Camping Sites, and the like). The comprehensive list of subsectors included in its AFAS schedule reflects Thailand's confidence in its competitiveness among ASEAN members in the tourism industry.

For most of the tourism subsectors under AFAS, Thailand has decided to liberalize Modes 1, 2, and 3 fully, allowing foreign investment from within ASEAN members; the exception is Travel Agency and Tour Operator Services subsector, which has an additional requirement that a certain number of the directors be of Thai nationality. Under GATS and ASEAN-China FTA, Thailand commits five of its services subsectors, adding Hotel Management to its list.

It is instructive to compare the commitments of Thailand and Cambodia with respect to tourist guide services. Cambodia includes this service in its schedule of commitments under all of its services agreements, although Mode 4 remains unbound except for executives and those in managerial positions, as specified in the horizontal section of the relevant schedules. Also, Cambodia requires its tourist guides to be of Cambodian nationality. Thailand, by contrast, does not include tourist guides in any of its commitments, since tourist guides are included in List 3 of the Foreign Business Act, which lists the types of business activities foreign enterprises are prohibited from engaging in. In addition, tourist guides are one of the 39 professions reserved for Thai nationals. In the case of Cambodia, although Article 263 of the Labor Law requires that employers of any professionals must give first priority to Cambodian citizens, there is no list of professions reserved for Cambodian nationals.

The three countries described in this box also differ in their approaches toward foreign investment. Cambodia allows 100% foreign participation in all investment projects, including tourism, although foreign investment in hotels must be for three-star hotels or higher. Similarly, the Lao People's Democratic Republic (Lao PDR) permits 100% investment participation by foreign enterprises. By contrast, Thailand's Foreign Business Act restricts foreign ownership in all business activities to 49%.

**Lao PDR**

Tourism gained momentum in Lao PDR after the country's economic reform under the New Economic Mechanism (NEM) in 1986, which shifted the country away from socialist central planning toward a market economy. The number of visitors to the country has risen dramatically within a short 15-year span—from a mere 4,929 tourists

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Box 5: continued

in 1991 to 1.2 million in 2006. Thai tourists accounted for more than half (55.6%) of the total number arriving in Lao PDR in 2006, followed by travelers from Viet Nam, the People's Republic of China, the United States, France, the United Kingdom, Japan, Australia, Germany, and Canada, although the figures from the latter countries remain small. Since 2000, tourism has been the highest revenue generator for the Laotian economy, followed by electricity exports and garment sales.

Since becoming an ASEAN member in 1997, Lao PDR has gradually expanded its services liberalization, including tourism. During the initial package of commitments under AFAS (1997), the first and only service sector scheduled for liberalization was tourism. Later, the country added other sectors such as financial services into its AFAS schedule of commitments, and modified its commitments in the tourism sector to better manage and attract foreign investment aimed to improve the country's position in the global tourism industry. Lao PDR now allows all types of foreign investment in tourism, from joint ventures (to which foreign investors must contribute at least 30% of total equity investment) to wholly foreign-owned enterprises. But it has upgraded its requirements for foreign investors in the hotel business: hotels in which foreign enterprises have an equity stake must be three-star or higher, up from the earlier two-star standard. This change has created space for domestic investors to capture a less capital-intensive market targeting lower-middle-income tourists, while gearing foreign investment in tourism toward a more skill-based, technologically advanced sector that would help upgrade the skills of local people and avoid pitting local small and medium-sized enterprises (SMEs) against more sophisticated foreign investors head-on.

Because tourism development is one of the activities covered by the country's foreign investment promotion law, foreign enterprises investing in the tourism industry in designated areas of Lao PDR—particularly outside the main tourist destinations such as Luang Prabang or Vientiane—are entitled to tax and duty exemptions, especially if the projects are geared toward ecotourism, since this is the form of tourism that is being promoted by the Lao government.

As Lao PDR is not yet a World Trade Organization (WTO) member—it is currently in accession negotiations—its GATS services commitments do not yet exist. The country, however, has committed to liberalizing three of its tourism subsectors under AFAS: Hotels, Meal Serving Services with Full Restaurant Services, and Beverage Serving Services Without Entertainment. Lao PDR also maintains the same level of commitment in tourism under the ASEAN–Korea FTA, but does not include tourism as part of its commitments in the ASEAN–China FTA.

Source: Tiranutti, V. 2008. The Liberalization of and National Strategies on Tourism in Cambodia and Lao PDR: Lessons for LDCs. Paper presented at an Asia–Pacific Economic Cooperation Seminar on The Impact of Liberalization on Trade in Services. Jakarta. 28–29 October.





The tourism sector raises a host of policy challenges in a trade policy setting, spanning issues as diverse as infrastructure financing, competition policy, investment and trade promotion, and aviation liberalization. Box 6 describes the novel provisions on tourism services embedded in the Economic Partnership Agreement (EPA) recently concluded between the European Union (EU) and the member countries of the Caribbean Forum of ACP (Africa Caribbean Pacific) States (CARIFORUM) in the Caribbean.

**Box 6: Using Preferential Trade Agreements to Advance Tourism Development: The European Union–CARIFORUM Economic Partnership Agreement**

The recently concluded European Union (EU)–CARIFORUM Economic Partnership Agreement (EPA) provisions dealing with tourism services offer a novel approach to an industry in which a majority of CARIFORUM countries have strong offensive interests.<sup>54</sup> Such provisions, which draw their inspiration from proposals for a General Agreement on Trade in Services (GATS) Annex on tourism services that a number of CARIFORUM members have cosponsored in the context of the Doha Development Agenda, focus attention on the prevention of anticompetitive practices, the question of mutual recognition, promotion of sustainable forms of tourism, compliance with environmental and quality standards, and development cooperation and technical assistance.

The inclusion of disciplines on anticompetitive practices was of key importance to CARIFORUM states because the global tourism industry is characterized by vertically integrated market structures and consolidated distribution channels controlled by a limited number of large international players, many of which are in the EU.<sup>55</sup> Specifically, Article 111 of the EPA compels the parties to maintain or introduce measures to prevent suppliers from materially affecting, “the terms of participation in the relevant market for tourism services by engaging in or continuing anticompetitive practices, including, inter alia, abuse of dominant position through imposition of unfair prices, exclusivity clauses,

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<sup>54</sup> The CARIFORUM comprises the member countries of the Caricom, Haiti, and the Dominican Republic.

<sup>55</sup> Caribbean Regional Negotiating Machinery. The CARIFORUM–EC Economic Partnership Agreement (EPA). Treatment of Tourism in the EPA. Brief No. 3200.3/EPA-09[08]. 21 February 2008.



Box 6: continued

refusal to deal, tied sales, quantity restrictions, or vertical integration. “The inclusion of such anticompetitive disciplines is a precedent-setting case of the incipient internationalization of competition law, albeit on a sector basis, like the reference paper on basic telecommunications appended to the 1997 Agreement on Basic Telecommunications of the World Trade Organization.

EPA provisions on the prevention of anticompetitive practices, mutual recognition, and development cooperation are all legally binding, while those dealing with access to technology, small and medium enterprises, and compliance with environmental and quality standards are framed as best endeavors. This combination of binding and nonbinding provisions is an interesting example of variable geometry in rule making that may reflect the dynamics of negotiations.<sup>56</sup> The CARIFORUM countries likely found the nonbinding provisions more important than their EC counterparts did, but their priority was to ensure that the key provisions relating to anticompetitive behavior, mutual recognition, and development cooperation were made legally binding.

The EPA has distinct development cooperation provisions for tourism services, in contrast to the generic provisions of other sectors. The EC explicitly commits to help in the advancement of the tourism sector in the CARIFORUM states and the parties agree to cooperate in a non-exhaustive list of specific areas including capacity building for environmental management, the development of internet-based marketing strategies for small and medium-sized tourism enterprises, and the upgrading of national accounts systems to facilitate the introduction of tourism satellite accounts at the regional and local levels.<sup>57</sup>

Source: Sauv , P. and N. Ward. 2008. The EU-CARIFORUM Economic Partnership Agreement: Assessing the Progress on Services and Investment. NCCR–Trade Regulation Working Paper, No. 2008/12. World Trade Institute. Bern: May.

<sup>56</sup> Caribbean Regional Negotiating Machinery. The CARIFORUM–EC Economic Partnership Agreement (EPA). Treatment of Tourism in the EPA. Brief No. 3200.3/EPA-09[08]. 21 February 2008.

<sup>57</sup> A tourism satellite account (TSA) is a statistical instrument to analyze the economic importance of tourism. According to the European Commission, a complete TSA contains detailed production accounts of the tourism industry and their linkages to other industries, employment, capital formation, and additional nonmonetary information on tourism. See [www.unwto.org/statistics/index.htm](http://www.unwto.org/statistics/index.htm) and [ec.europa.eu/enterprise/services/tourism/tourism\\_satellite\\_account.htm](http://ec.europa.eu/enterprise/services/tourism/tourism_satellite_account.htm)



## Health-Related Services

*Developing countries, including in the GMS, are increasingly engaged in trade in health services internationally, although there are still many regulatory barriers to trade.<sup>58</sup> While lifting these barriers is likely to stimulate trade further, little empirical work has been devoted to measuring the net effects of trade liberalization for health systems in developing countries. Preliminary evidence does suggest that the effects depend on the presence of domestic complementary policies, such as developing good public–private partnerships, designing appropriate financing mechanisms, strengthening skills and regulatory capacity, all of which may help harness the positive potential of liberalization in the sector.*

Trade in health services is a complex subject matter, involving an understanding of the numerous interconnected facets that constitute a country's health system (and often that of its main trading partners), its domestic economy, health and trade policy and their formulation, and the conduct of international negotiations at both the regional and multilateral levels. As a result of its income level, its geography and climate, its supply of human capital, and its broader development objectives, each country faces a unique set of policy circumstances, opportunities, and constraints with regard to trade in health services. However, a number of common factors that underpin each of these specific contexts can be identified, including the state of the domestic health care system, the trade and policy framework in the health sector, the infrastructural and regulatory framework within which health services are supplied domestically and traded internationally, and the availability of data and qualitative information on trade in health-related services.

### Rising Trade in Health Services but Limited Trade Policy Attention

Trade reforms in recent decades have extended beyond merchandise to encompass services, including the promotion of new entry, commercialization, and competition in health-related services such as health care, hospital management, health insurance services, the remote supply of medical services, and the temporary movement of medical personnel.<sup>59</sup>

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<sup>58</sup> For a fuller depiction of the policy challenges arising in the liberalization of health travel and tourism in the Asia–Pacific region, see United Nations Economic and Social Commission for Asia and the Pacific. 2008. *Medical Travel in Asia and the Pacific: Challenges and Opportunities*. Bangkok. See also *The Economist*. 2008. Operating Profit. 15 August.

<sup>59</sup> For a fuller discussion of key trends in the globalization of health-related services, see *The Economist*. 2008. Operating Profit. 15 August.



Trade agreements allow countries to undertake legally binding commitments on trade and investment in health-related services and to formulate such commitments in accordance with domestic health policy objectives, if they so desire. The commercialization of health-related services, such as hospital care, health insurance, or managed care and the emergence of a health-related tourism industry, has generally been limited to middle-income developing countries and has not reached a pervasive level even in most such countries. Within the GMS Thailand stands out as a country where considerable attention and resources have been devoted to developing the sector.

Though limited, available evidence suggests that there is generally reduced scope for the commercialization of health-related services, and thus for significant cross-border trade and investment in the sector, in poorer countries. The combination of low incomes, acute resource constraints (including human resources) in health care, limited access to health services, and poor health-care infrastructure all significantly limit the scope for supplying services on a commercial, for-profit basis in such environments.<sup>60</sup>

International trade in health-related services remains small, accounting for an estimated 0.4% of health spending in developed countries.<sup>61</sup> However, cross-border trade and investment activity in health-related services are growing fast under the combined influence of factors including rising incomes in developed and developing countries (spending on health-related services—including health-related tourism—is highly income-elastic), demographic change (particularly the aging of populations in developed countries, with consequent pressures to contain health budgets), technological applications that facilitate the remote supply of an increasing range of health-related services (including to isolated populations in developing countries), continued foreign direct investment (FDI) liberalization in health-related services, and high and growing demand for skilled medical personnel and their cross-border mobility.

A growing number of developing countries, particularly middle- and higher-income countries (many of which are in South and Southeast Asia), today regard health services, especially those that can be combined with tourism-related activities, as a potentially significant source of foreign exchange earnings, FDI attraction, and skills upgrading. Such countries have been devoting increasing policy attention to building health-related export clusters, and some have developed targeted

<sup>60</sup> Atlas Mondial de la Santé, Paris, Editions Autrement, 2008.

<sup>61</sup> Lautier, M. 2005. Les exportations de santé des pays en développement: le cas tunisien. *Notes et Documents No. 25*. Paris: Agence Française du Développement.



investment promotion strategies in the sector. Examples include countries like Brazil, India, Malaysia, the People's Republic of China, Singapore, South Africa, and Thailand, in medical tourism (Mode 2), exploiting their cost advantage and the quality of part of their health sector, and the Philippines in nursing services trade via temporary migration of health personnel (Mode 4). Filipino nurses constitute an estimated 76% of foreign nurse graduates in the United States. While these exports may become an important share of a country's foreign exchange earnings, it is crucial that development of a trade strategy complement government's primary objective, providing greater (and ultimately universal) health care coverage to local communities. Several health care enterprises originating in developing countries now manage hospitals and supply health care through a commercial presence in foreign markets (Mode 3), typically in other developing countries (for example, through South-South investment). Box 7 describes the key elements of the medical tourism strategy put in place in Thailand in recent years.

### **Box 7: Devising a Medical Tourism Strategy in Thailand**

Thailand was particularly hard hit by the financial crisis in 1997. To compensate for the significant drop in revenues caused by the economic crash, private hospitals started to explore the business of treating overseas patients. Since then certain private hospitals have had considerable success in tapping the international patient market through affordable pricing of high-quality medical procedures.

The number of international patients visiting Thailand has increased from 500,000 in 2001 to an estimated 1.25 million in 2005. In 2006, 30 private hospitals in Thailand accommodated 1.4 million international patients, generating a total turnover in excess of \$1 billion.

The Thai Department of Export Promotion believes that the main factors behind the observed increase in the number of foreign patients visiting Thailand are the international accreditation of the Thai health-care industry, the country's advanced medical technology, competent healthcare professionals, and reasonable cost for medical services. International patients who visit Thailand for medical treatment are classified by the Thailand Department of Export Promotion, Ministry of Commerce, into three broad groups:

- *Expatriates*, comprising foreigners who work in Thailand and its neighboring countries. These patients generally receive care for heart disease blood-pressure problems, and respiratory problems, as well as plastic surgery.

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Box 7: continued

- *Direct fly-ins*, comprising foreigners who visit Thailand specifically to use Thai health-care services. These patients generally receive care for heart disease and kidney disease, as well as neurosurgery and eye care.
- *Tourists*, comprising foreigners who are tourists in Thailand and require Thai health-care services. These patients generally receive care for such things as common diseases and respiratory ailments.

An estimated 60% of international patients visiting Thailand are expatriates, 30% are direct fly-ins, and 10% are tourists. Japan contributes the biggest share of medical travelers coming to Thailand (15%), followed by the United States (11%), the United Kingdom (9%), the Middle East, and other countries in Southeast Asia (8% each).

In June 2004, the Thai Government published its health-care policy, announcing its goal to develop and promote Thailand as the leading health-care provider in Asia by 2010. The government sought to increase marketing and public relations targeted at foreigners, improve management performance in medical institutions, and develop health-care products and services. The areas in Thailand that are being promoted as international health-care centers include Bangkok, Phuket, Chiang Mai, and Koh Samui.

The Thai Ministry of Public Health is working closely with the Ministry of Tourism to promote medical travel to Thailand. Moreover, Thailand and Malaysia are exploring joint promotion of medical travel in the face of increasing competition from neighboring countries. However, private Thai hospitals are making even greater efforts to attract medical travelers. Bangkok's Bumrungrad Hospital is the leader in the field and is considered to be one of the frontrunners in medical travel worldwide, though a number of other hospital groups are also providing strong competition. Hospitals in Thailand offer a host of facilities, such as assistance in interpretation in more than 10 languages. Quality is assured through international accreditation schemes.

Source: United Nations Economic and Social Commission for Asia and the Pacific. 2007. *Medical Travel in Asia and the Pacific: Challenges and Opportunities*. Bangkok.

Despite these developments, few countries have yet made trade and investment rule making, including in respect of trade in health-care services, central to their pursuit of domestic health-care reforms. Instead, for the most part they have pursued unilateral reforms, exhibiting significant policy caution while experimenting with various approaches to commercialization and trade and investment liberalization in the sector. The vast majority of such reforms have been undertaken outside of formal, legally binding, trade and investment agreements, whether bilateral, regional, or multilateral.



Trade agreements also exhibit considerable regulatory caution in health services. WTO members scheduled the fewest commitments in the Uruguay Round and in subsequent accession negotiations in the health sector. Moreover, it is notable that not a single negotiating proposal aimed at promoting the liberalization of trade and investment in health-related services was advanced in the WTO's Doha Development Agenda (DDA). Nor has a collective request been formulated in the sector. This does not, of course, preclude individual WTO members from addressing bilateral market-opening requests to specific trading partners in the health sector, though a number of leading WTO members, notably the EU and Canada, have made public their intention not to make requests or formulate offers in the sector.

### **Trade in Health Services: Differences Across Modes of Supply**

The policy literature devoted to cross-border trade and investment in health-related services has drawn useful attention to the potential benefits and costs of each of the four modes of transacting such services internationally.<sup>62</sup> These are important elements to consider in approaching the policy interface between trade and health services and in deciding whether, how, and to what extent the trade policy process—both trade and investment rule making and market-opening commitments—can or should be assigned a particular role alongside ongoing domestic reforms in the health-care sector.

One of the potential benefits of Mode 1 trade in health-related services (an example of such trade is telemedicine) is that it enables services to reach geographically remote areas, helping to alleviate domestic human resource constraints and providing cost-effective surveillance and treatment of certain diseases. Telemedicine may also provide new trading opportunities for countries that can insert themselves into the new international division of labor made possible by the application of ICTs in a growing number of service activities, including health services. The costs or downside of remotely supplied services include the potential reallocation of resources from rural and primary health care to specialized services that are more likely to cater to the affluent few who are better able to afford the necessary technology.

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<sup>62</sup> See in particular Chanda, R. 2002. Trade in Health Services. *Bulletin of the World Health Organization*. 80. pp. 158–160. See also Chanda, R. and R.D. Smith. 2006. Trade in Health Services and GATS: A Framework for Policy Makers—Annex. In Blouin, C., N. Drager, and R.D. Smith, eds. *International Trade in Health Services and the GATS: Current Issues and Debates*. Washington, DC: Oxford University Press.



The principal potential benefit of Mode 2 trade in health-related services (that is, consumption of health-care services by foreigners in the host country) lies in its potential to improve the host-country health-care system by generating additional resources for investment in health care. Mode 2 trade can become an important source of foreign exchange earnings and add to the multiplier effects of tourism-related activities in the host economy. The potential downside of Mode 2 trade is similar to that of Mode 1: it may create a dual market structure, with higher quality care supplied to affluent consumers (domestic and foreign) to the detriment of poorer segments of the host country population. A related concern is the potential crowding out of the population from higher-standard health facilities at the expense of the public health care system. Furthermore, the development of Mode 2 trade activities geared toward foreign consumers may attract scarce human resources away from public health-care institutions. As for the countries supplying health-care tourists, the import of health-related services through consumption abroad may also constitute a drain on their foreign exchange reserves.

The potential benefits of Mode 3 trade in health-related services (that is, the establishment of foreign health-care institutions in the host country) are that it can generate additional investment in the health-care sector, contribute to upgrading health-care infrastructure, facilitate employment generation, and provide a broader array of specialized medical services than those available locally. Mode 3 trade may also provide a stimulus to the development of health insurance services domestically. The potential downside of Mode 3 trade, as with Modes 1 and 2, is growing inequality in access and the emergence of a two-tiered health care system. This two-tiered system may result from an internal “brain drain,” as foreign commercial ventures may encourage health professionals to migrate from the public to the private health-care sector.

The major potential benefit of Mode 4 trade in health-related services (that is, movement of health care professionals) is that it may promote the exchange of clinical knowledge among professionals and therefore contribute to upgrading their skills, thereby also raising medical standards. The potential downside of Mode 4 trade arises from the danger that these mobile health care professionals, often trained at considerable home country expense, may never return, thus reducing the quality of services available to home country consumers.

### **The Effects of Trade-Related Regulation on Health Systems**

An efficient and equitable health service sector is not only a development objective per se but also a fundamental driver of growth and poverty reduction at the macro and micro levels. The policy attention recently devoted to the trade and health interface





has revealed how inadequacies in the quality or supply of health-related services may dampen labor productivity and act as a deterrent to inward FDI in all sectors.

Regulation of health services can play an important role in a country's development by affecting the efficiency and equity of the domestic health system, and by affecting the economy directly (for example, in exports and employment). Countries impose three main types of regulatory barriers to trade in health services: approval requirements for clinics and hospitals, qualification and licensing requirements for professionals, and rules governing reimbursement from mandatory health insurance schemes. These rules are sometimes stringent and may represent binding constraints on trade. For example, a number of East Asian countries, such as Malaysia, the Philippines, and Thailand, only allow minority foreign ownership for hospitals, and the United Kingdom (UK) Department of Health prohibits the National Health Service (NHS) from paying for treatment for NHS patients at hospitals more than three hours distant by air, thereby ruling out most developing countries. Removing these barriers is likely to stimulate trade in health services, with a number of potential risks and benefits for the regulating country's health system.

For example, increased foreign investment due to the removal of barriers on foreign ownership may widen the range of services provided in the domestic economy but also divert scarce human resources away from the public sector. While liberalization of health services may yield efficiency gains and increased investment, it can also worsen inequities in the distribution and quality of such services. Empirical evidence assessing the net effects of trade liberalization on health systems, especially in developing countries, remains scant.

As noted earlier, the effects of trade liberalization are likely to apply to very poor countries only to a limited extent, because they are much less involved in health services trade than upper- and lower-middle income countries. For example, there were no least-developed countries among the 15 largest exporters of doctors to the UK in 2004; 8 of those 15 were developing countries. Within the GMS, although Lao PDR is one of the most liberal East Asian countries with respect to foreign investments in the health sector, no foreign hospitals operate in the country. Most likely, least-developed countries show scarce participation in trade in health services for the same reasons their goods trade is limited—domestic supply constraints and market size more than regulatory barriers.

### **The Need for Complementary Policies**

There is growing consensus that the effects of liberalization of trade and investment in health services on developing countries depend on domestic



policies, regulations, and institutions. Governments can adopt a variety of policies to minimize the potential costs of liberalization and maximize its beneficial effects. Adequate regulatory capacity in the health sector is crucial to ensure that the overall impact of liberalization, whether domestic or external, is beneficial. Strengthening regulatory systems in health care is a complex task, which requires strong political commitment by the governments involved combined with technical assistance from donor countries and specialized health agencies. Box 8 sets forth a number of regulatory best practices in medical tourism development.

#### **Box 8: Best Practices in the Management of Medical Travel**

- Medical travel is an established, ongoing phenomenon, and the development of a national level evidence-based policy within the overall framework of health system performance, human resource availability, and ethical recruitment and health policy objectives is essential for it to be managed for the benefit of all concerned.
- Capacity building in the health sector, including on trade issues, can enable effective and informed participation of the health sector in crucial trade policy negotiations, and commitments on health-related issues should be made taking into account a public-health perspective.
- Balanced policies and regulations can be used in order to manage medical travel patient flows in a manner that is beneficial to both sending and receiving countries. Examples of enabling policies that have been implemented by countries in Asia include liberalizing visa requirements for medical travel, tax benefits for the development of the industry, and agreements to allow greater temporary mobility of medical professionals. Memorandums of understanding between sending and receiving countries have also been useful in regulating patient flows and ensuring delivery of good-quality treatment.
- Mutual recognition agreements for medical professionals at the international level, including through national and international accreditation systems, can also play a key trade-facilitating role in smoothing the movement of professionals with a view to ensuring that good quality of care is maintained.
- Implementation of consumer protection policies and practices is also essential to manage the process of medical travel, especially policies focusing on cross-border compensation, liability issues, and issues related to the portability of health insurance. Measures to protect consumers could be encapsulated in an “International Patients’ Bill of Rights,” as is currently under discussion in certain forums.

Source: United Nations Economic and Social Commission for Asia and the Pacific. 2007. *Medical Travel in Asia and the Pacific: Challenges and Opportunities*. Bangkok.



Governments can promote linkages between the public and private segments in order to increase the reach of health services provision within the country. Other ways of maximizing the benefits from private sector participation include the promotion of professional collaboration and exchanges between the private and public segments, and the taxation of the foreign (and domestic) commercial segment to raise resources for the public segment.

Along with establishing sound regulatory regimes, governments also need to secure appropriate financing mechanisms to widen access to health services, which is often restricted for some population segments in low-income countries. Evidence from Cambodia suggests that a system of user fees with subsidies to those in need (for example, through health equity funds) may be a solution.<sup>63</sup> A more indirect form of cross-subsidy is to require health care personnel to spend a certain period in public hospitals or remote areas before they can be hired by the private sector.

Investment in the health sector of developing countries is often neither sufficient nor efficiently deployed; this is a root cause of several of the negative effects of liberalization. For example, the problem of two-tiering in health care can often be traced to domestic factors such as low wages, poor working conditions, and inadequate infrastructure in the public sector. This allows the private sector to attract skilled personnel by providing better pay, superior medical equipment, and better overall working conditions. The moral is that resources need to be better allocated to train a larger pool of health professionals and to improve their working conditions in the public sector, especially in rural areas. This is likely to involve considerable financial and organizational effort in most developing countries (including measures such as revamping management procedures to increase efficiency).

### Transportation and Logistics Services

*The cost of international transport services is a crucial determinant of a developing country's export competitiveness. In many countries, particularly those with relatively low bound or applied tariff rates, transport costs are often a greater impediment to international trade than tariffs and other trade barriers. In most countries, policy can and must make better use of existing transport resources and must significantly improve the efficiency of services. At the domestic level, targeted infrastructure*

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<sup>63</sup> United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP). 2007. *Medical Travel in Asia and the Pacific: Challenges and Opportunities*. Bangkok: UNESCAP.



*investments, regional cooperation on transportation, and trade facilitation initiatives can play an important role in improving the transport competitiveness of exporters. Liberalizing services policy in logistics can produce substantial cost reductions and widen the availability and choice of services. The preponderance of anticompetitive practices by transport service providers also demands the development of efficiency-oriented competition policies in the sector.*

### **More Obstructive than Tariffs: The High Cost of Transport Barriers**

Recent work by the World Bank has shown that slower annual growth of more than one half of a percentage point is associated with a doubling of shipping costs across economies.

Transport costs can have major impacts on spatial development patterns within and across countries. The economic geography literature that has flourished since the 1990s makes the importance of geography in explaining patterns of trade and economic development increasingly clear. For example, access to the sea and distance to major markets have been shown to exert strong effects on shipping costs, which in turn strongly influence trade flows in manufactured goods.<sup>64</sup> As foreign barriers to trade are removed, firms have an incentive to move to regions with good access to foreign markets, such as border areas or port cities, especially in sectors where exports account for a large share of total sales.

Inefficient internal transport systems can sharpen inequalities within countries, disconnecting hinterland regions from international commerce. Countries laboring under multiple geographic handicaps, such as being landlocked, lacking navigable rivers and lakes, or having a tropical or desert ecology, invariably tend to rank among the poorest in the world.<sup>65</sup> In the context of the GMS, the relative poverty of Lao PDR has long been understood as at least a partial result of the country's landlocked status and geographic characteristics.

High transport costs are a direct disincentive to exports. For most developing countries, particularly smaller ones higher transport costs feed directly into import and export prices. High transport costs can also reduce the competitiveness of

<sup>64</sup> Limao, N., and A.J. Venables. 2001. Infrastructure, Geographical Disadvantage, Transport Costs and Trade. *World Bank Economic Review*. 15. pp. 451–479.

<sup>65</sup> Radelet, S., and J. Sachs. 1998. Shipping Costs, Manufactured Exports, and Economic Growth. Paper presented at American Economic Association meeting, Harvard University. Cambridge, Massachusetts; Redding, S. and A.J. Venables. 2004. Economic Geography and International Inequality. *Journal of International Economics*. 62. pp. 53–82.



manufacturing operations, as the cost of capital goods imports rises. Reduced competitiveness discourages efficiency-seeking FDI, a form of investment of considerable importance to countries and firms seeking to integrate regional or global production networks. High transport costs may also impair the competitiveness of firms. If services are unreliable and infrequent, or if a country lacks efficient logistics management, firms are likely to maintain large and costly inventories at every stage of the production chain. Findings from recent World Bank research suggest that cutting inventory levels in half could reduce unit costs of production by up to 20%.<sup>66</sup> Cutting down on the length of transport services is also key for countries and producers that specialize in trading perishable commodities, products where tastes change rapidly, and those whose production requires just-in-time deliveries (such as ready-made garments).

Recent research at the Asian Development Bank Institute confirms that the development of cross-border road infrastructure in the GMS has had a positive effect on regional trade growth.<sup>67</sup> This result suggests that promotion of regional trade may require a deliberate policy shift toward investments in roads in border areas. In this light, cross-border road infrastructure becomes an important part of a broader effort to encourage regional integration to benefit GMS economies that are less endowed with natural seaports, such as the landlocked Lao PDR. Figure 15 highlights the striking evolution in the density of road networks and especially cross-border road links within the GMS. It shows how the establishment of East–West and North–South cross-border trade corridors creates conditions for much greater trade integration within the region, allowing disadvantaged subregions to be more fully connected into regional manufacturing networks in or to reach export markets for agricultural commodities more easily.

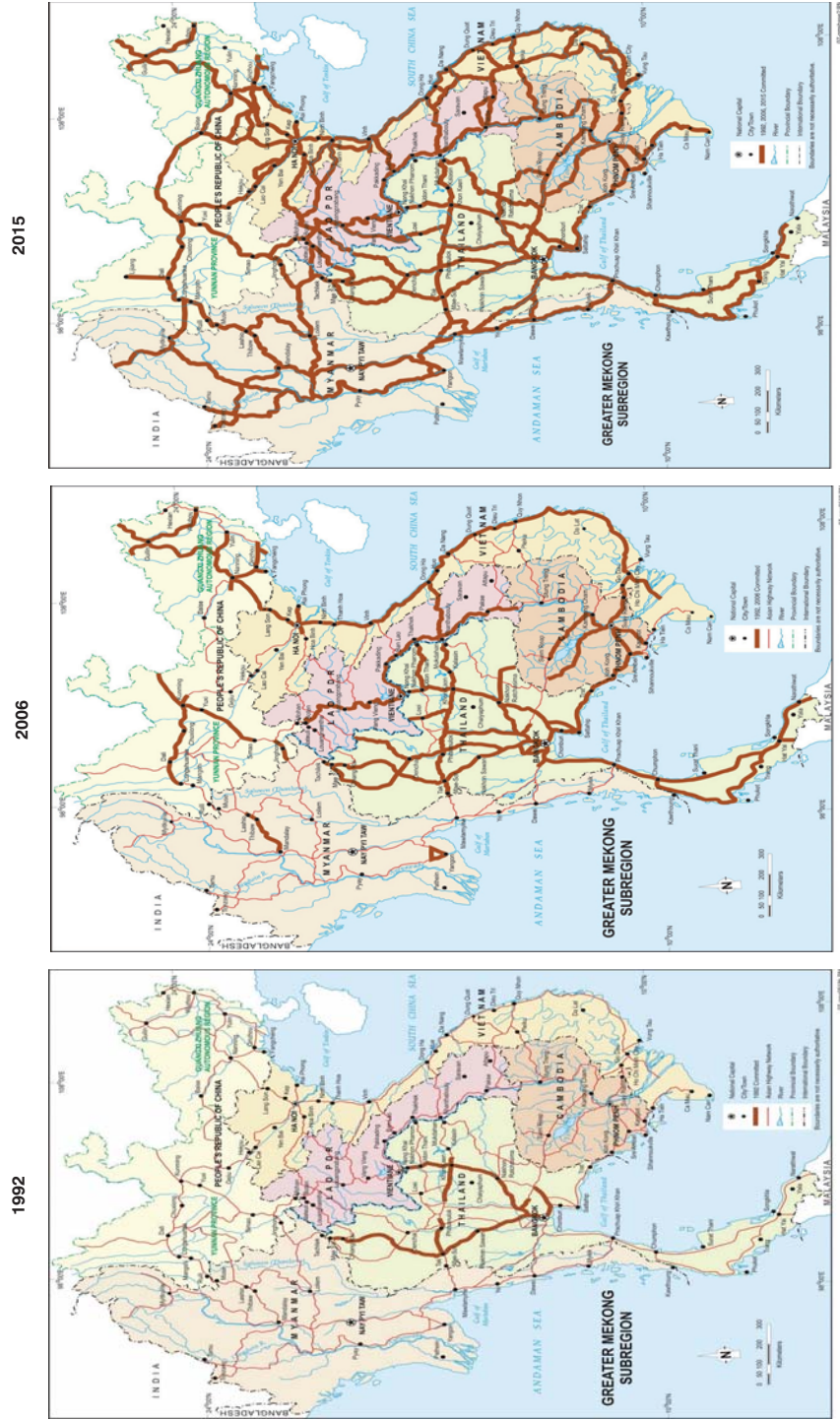
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<sup>66</sup> World Bank. 2002. *Global Economic Prospects and the Developing Countries 2002: Making Trade Work for the World's Poor*. Washington, DC.

<sup>67</sup> Edmonds, C., and M. Fujimura. 2008. Impact of Cross-Border Road Infrastructure on Trade and Investment in the Greater Mekong Subregion. *Integration & Trade Journal*. 28. pp. 267–296. Also available: [www.iadb.org/intal/detalle\\_tipo.asp?idioma=ENG&cid=234&tid=4](http://www.iadb.org/intal/detalle_tipo.asp?idioma=ENG&cid=234&tid=4)



**Figure 15: Evolution of the Road Transport Network in the Greater Mekong Subregion, 1992, 2006, and 2015**



Source: Ding, L. 2008. Trade Facilitation and Development in the Greater Mekong Subregion (GMS). Presentation to the ADB-ITD Course on Trade in Services. Bangkok, 12 February





### **Barriers to Competition in Transportation Services**

Numerous public trade barriers and private commercial practices hamper the provision of international maritime and air transport services. Maritime transport policies such as cargo reservation and limitations on the provision of port services often protect inefficient service providers and restrain competition unduly. Practices that restrain competition among shipping lines and port terminal operators around the world pose the risk that the benefits of government reforms will be captured by private firms. Despite the progressive liberalization of reciprocal access rights in bilateral air agreements, international air transport remains one of the service sectors where governments maintain practices that significantly impair competition. Ownership rights in the current regime of bilateral air service agreements continue to be highly restrictive, depriving national companies of the capital needed to consolidate. International airline alliances, while enhancing network efficiency, can also be detrimental to efficiency if they impede effective competition.

### **The Central Importance of a Trade Facilitation Agenda**

Trade liberalization is necessary but not sufficient to support successful integration of developing countries into the world trading system. Comprehensive trade facilitation reform, crafted to reduce trade transaction costs, also plays a vital role.<sup>68</sup> For some countries improvements to infrastructure and related institutions could do more to boost trade than removal of remaining tariffs. Recent research at the World Bank concluded that upgrading the quality of road infrastructure networks in Europe and Central Asia to the regional average could expand trade by \$45 billion– net.<sup>69</sup>

Research based on data reported in the World Bank's Doing Business in 2006 concludes that each day of transit delay reduces export volumes by 1% on average.<sup>70</sup> Put differently, each day of delay is equivalent to distancing a country by about 100 kilometers from all trading partners. For example, if the Central African Republic reduced its factory-to-ship time from 116 days to the world average of 22, exports would nearly double. It is estimated that only about a quarter of transit delays are due to poor road or port infrastructure. Three-quarters are due

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<sup>68</sup> Wilson, J.S., C.L. Mann, and T. Otsuki. 2005. Assessing the Benefits of Trade Facilitation: A Global Perspective. *The World Economy*. 28(6). pp. 841–871.

<sup>69</sup> Francois, J., and M. Manchin. 2006. Institutions, Infrastructure, and Trade. Policy Research Working Paper 4152. Washington, DC: World Bank.

<sup>70</sup> Shepherd, B., and J.S. Wilson. 2006. Road Infrastructure in Europe and Central Asia: Does Network Quality Affect Trade? *Policy Research Working Paper 4104*. Washington, DC: World Bank.



to administrative hurdles—customs procedures, tax procedures, clearances, and cargo inspections—often imposed before the containers reach the port. The problems are magnified for landlocked countries, whose exporters need to comply with different requirements at each border. Harmonizing transit and customs procedures is one way to increase efficiency.<sup>71</sup>

Recent research at the Organisation for Economic Co-operation and Development (OECD) analyzed the relationship between time for exports and imports, logistics services, and international trade. Time-consuming procedures were found not only to reduce trade volumes, but more importantly to reduce the probability that firms would enter export markets for time-sensitive products at all.

The research shows how a broader range of products are becoming time-sensitive today, following the proliferation of modern supply chain management techniques in manufacturing as well as retailing. Labor-intensive products such as clothing and consumer electronics are increasingly time-sensitive, and many developing countries urgently need to shorten lead times to stay competitive in these sectors. The research shows how trade facilitation, trade liberalization in logistics services, and appropriate domestic regulatory reforms can be implemented at relatively low cost in low-income countries, and that the gains from reforms can be substantial.<sup>72</sup>

The importance of a trade facilitation agenda in the GMS encompassing both the “hardware” of trade infrastructure—roads, ports, airports—and the “software” of administrative procedures and the host of logistics services involved with managing borders—warehousing, customs brokering, freight forwarding, express delivery services, inspection services, port and airport management services, the application of ICTs to customs clearance procedures—cannot be underestimated. The region has witnessed a spate of regional and bilateral integration and regulatory cooperation initiatives in recent years, not only within the GMS itself but also under ASEAN and Asia-Pacific Economic Cooperation (APEC) programs. The volume of intraregional trade has grown markedly, reducing dependence on third-country export markets, and the composition of trade within East Asia has taken on new shapes. Countries in the region are increasingly specializing in intermediate and finished products, for which the effectiveness of transport infrastructure plays an important role in trade, FDI, and international integration. With the rapid rise of

<sup>71</sup> Djankov, S., C. Freund, and C. Pham. 2006. Trading on Time. *Policy Research Working Paper 3909*. Washington, DC: World Bank.

<sup>72</sup> Organisation for Economic Co-operation and Development. 2006. Services and the Time-Sensitivity of International Trade. Working Party of the Trade Committee. Paris.





regional ties in Asia, moves toward deeper integration of the economies of the region will hold higher promise if accompanied by initiatives that help improve trade efficiency and reduce costs.<sup>73</sup> Box 9 highlights the key policy parameters of the logistics road map agreed to by ASEAN countries.

### **Box 9: Major Policy Areas of an ASEAN Logistics Road Map**

#### **1. Encouraging the Integration of the ASEAN National Logistics Systems**

—by increasing communications at the regional level to identify actions in the logistics sector to support and facilitate trade flows between ASEAN countries

#### **2. Encouraging the Progressive Liberalization of Logistics Services**

—to make them better able to respond to the opportunities available for ASEAN integration and for increasing competitiveness

#### **3. Increasing Trade, Logistics, and Investment Facilitation**

—to identify the means needed to improve transport logistics facilities and priorities for investment

#### **4. Building ASEAN Logistics Capacity**

—by encouraging human resource development in the sector and an environment conducive to developing the sector

#### **5. Promoting ASEAN Logistics Service Providers**

—by identifying them and providing channels for their greater participation in the sector

#### **6. Promoting Multimodal Transport Capacity**

—especially containerized transport

**Source:** Banomyong, R. 2008. The ASEAN Logistics Sector Road Map: A Policy Formulation Exercise. Presentation prepared for an ITD-ADB course on Trade in Services. Bangkok. February.

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<sup>73</sup> See Asian Development Bank. 2006. *Asian Development Outlook 2006: Routes for Asia's Trade*. Manila. See also De, P. 2008. Trade Costs and Infrastructure: Analysis of the Effects of Trade Impediments in Asia. *Integration and Trade Journal*. 28. pp. 241–266.



### Temporary Movement of Service Providers (Mode 4)

*Trade in services via Mode 4 is an increasingly important component of services exports for developing countries in general and GMS ones in particular. This type of trade can benefit countries through remittances and return migration and by filling specific skill gaps, although concerns about brain drain persist. Several regulatory barriers erected in receiving countries still severely restrict much Mode 4 trade. In order to reap the full benefits of Mode 4 trade, developing countries could enhance their lobbying efforts to reduce these barriers in other countries, reduce their own barriers in areas where skills are scarce, and implement complementary policies such as expanding the skill base and creating incentives for return.<sup>74</sup>*

Trade in services via the temporary movement of natural persons (Mode 4) may help developing countries exploit their comparative advantage in semiskilled and unskilled labor. Some developing countries have a comparative advantage in specialized skilled labor, and Mode 4 can help them as well. This is an increasingly important component of services exports for many developing countries, which send abroad a number of different service providers such as nurses, teachers, and domestic workers, as well as more skilled workers such as medical doctors, architects, and engineers.

The economic, trade, and competitiveness benefits for developing countries of the movement of natural persons supplying services extend beyond the short term. By providing employment opportunities abroad on a temporary basis, Mode 4 trade can be an effective tool in addressing unemployment in the domestic (sending) country economy, thereby contributing directly to poverty reduction.

Workers' repatriated earnings, in the form of remittances transferred to their home countries, are an important way of generating investment and savings and promoting accelerated development of the domestic economy. In recent years, remittances have emerged as one of the most stable, continuous, and countercyclical sources of external finance in developing countries. For many such countries, particularly poorer ones, such flows dwarf FDI and official aid flows as a source of external funding.

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<sup>74</sup> For a fuller discussion of the treatment of labor mobility in trade agreements, see Organisation for Economic Co-operation and Development. 2002. *Service Providers on the Move. Policy Brief*. Paris.



Furthermore, as workers return to their home countries after temporary employment abroad, the knowledge and experience they have acquired can stimulate the growth of domestic service sectors and enhance their countries' ability to assimilate and apply new technologies. Studies suggest that skilled individuals are more likely to emigrate, thus raising concerns about brain drain for sending countries. These flows are mainly South–North, although South–South Mode 4 trade is increasingly important. South–South is an effective way for developing countries to fill some of their gaps in specific skills through the temporary import of service providers. For example, the number of foreign nurses in Botswana is roughly equal to that of Botswanan nurses abroad, suggesting that imports of nurses in Botswana are helping mitigate the potential negative effect of migration on domestic capacity.

#### **Policy Restrictions on Mode 4 Trade**

Mode 4 trade still has not reached its potential because of a number of regulatory barriers posed by recipient countries with a view to protecting domestic labor markets and satisfying security concerns fueled by substantial immigration. These barriers include immigration rules, discriminatory treatment of foreign providers, and recognition of qualification. Virtually all countries impose quantitative restrictions on temporary migration and the quotas are usually substantially lower than the actual demand for entry.<sup>75</sup>

Rigid restrictions often apply to South–South migration as well. Most countries require an economic needs test before they will grant a work permit for a foreign temporary supplier of services. A typical needs test requires a prior thorough search within the domestic market for a similar services supplier before the authority will accept the visa application. Another barrier is wage parity requirements between services providers, which recipient countries typically impose on domestic

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<sup>75</sup> One example is the US quota system for H1B visas (for professional service providers), the main scheme for the temporary import of highly skilled professionals by the US. The scheme was introduced in 1990 to allow US firms fill gaps in highly skilled jobs for which domestic workers were not available. Given the success of the program (especially for computer-related jobs), the yearly quota of employer-sponsored immigrants grew rapidly from 65,000 to 195,000 in 1999–2002, fuelled in part by the Y2K problem. Once the program became established, the quota was easily filled, with the number of applications far exceeding it. Following increased security concerns, the visa cap was taken back to the initial level of 65,000 in 2003 (a level the US could not breach in light of its commitments under GATS). This new quota is wholly inadequate to the potential Mode 4 import of highly skilled service suppliers in the US labor market. The US Citizenship and Immigration Service currently receives the full quota of applications from companies several months in advance of the beginning of the financial year. Recognition of the inadequacy of the current US cap can be seen from the fact that it continues to be routinely breached, the US having issued far more temporary H1B visas in recent years than is formally allowed.



employers. This often erodes the cost advantage of employing foreign suppliers, especially from developing countries, who may be willing to provide the service at a lower cost than domestic suppliers. As well, residency or even citizenship requirements are a prerequisite in several countries for services provision. These requirements clearly penalize foreign providers, often making Mode 4 supply unviable. Finally, inadequate recognition of formal qualification and training may constrain the ability of certain service suppliers to provide their services abroad. Examples of this constraint abound in developed and developing countries alike. For example, South Africa requires a fairly cumbersome procedure in order to register as an engineer or an architect holding a related degree from other Southern African Development Community countries. The implementation of mutual recognition agreements (MRAs) may facilitate this process, especially in the context of PTAs. Further liberalization of Mode 4 trade is constrained in developed (and often in developing) countries by security concerns (as with the recent restrictions in the number of H1B visa granted by the United States), which tend to increase public opposition to immigration, fears about loss of jobs and of lower wages, and the like.

#### **Mode 4: Are There Limits to Trade Policy?**

Little progress has been made to date in liberalizing temporary movements of service providers in a trade policy context—an area of clear comparative advantage for developing countries that has holds greater potential to boost global welfare than complete merchandise trade liberalization.<sup>76</sup>

Multilateral liberalization of trade in services through Mode 4 is a key unfinished development agendum of the Uruguay Round. For any trade negotiation covering services, it is also an essential element of a balanced and development-oriented outcome. Liberalization of Mode 4 must be buttressed by a reduction and streamlining of market entry conditions if the international trading system is to assure substantive development gains.

An important challenge in trade agreements is to separate Mode 4 trade (of a temporary character) from immigration-related matters, so as to mitigate the difficult and often emotive political and cultural issues that can hamper realization of the full benefits of facilitated temporary entry for home and host countries alike. It is generally believed that liberalized, but regulated, movement of temporary

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<sup>76</sup> Walmsley, T., and L.A. Winters. 2005. Relaxing the Restrictions on the Temporary Movement of Natural Persons: A Simulation Analysis. *Journal of Economic Integration*. 20(4). pp. 688–736.



workers from developing- to developed-country markets could help to attenuate problems of clandestine and illegal immigration.

While developing countries are pinning high hopes on Mode 4 liberalization in the DDA and in PTAs, it is essential that expectations be kept rational. Indeed, Mode 4 liberalization typically faces three daunting challenges. The first challenge stems from the inherently cyclical nature of labor markets and the corresponding reluctance of labor market and immigration officials in receiving countries to take on quasi-permanent legal commitments in a trade policy setting. The second challenge is WTO-specific, arising from the obligation under GATS to extend liberalization commitments on a most-favored-nation (MFN) treatment basis, a privilege many WTO Members may be reluctant to bestow on foreign workers, particularly those in lower- to medium-skilled worker categories. Recourse to bilateral guest-worker programs and labor cooperation agreements remain important policy alternatives in this regard. A third challenge, alluded to above, is the inherent difficulty of separating trade from nontrade components in immigration policy.

While trade is an important driver of labor mobility, it is by no means the only or always the most important one. Thus, it is far from easy to address temporary access to labor markets in a multilateral trade policy setting, and to deal with the worker categories that would have the greatest impact on poverty reduction if their workers were granted enhanced temporary mobility. Table 7 offers a summary depiction of some of the principal benefits and costs associated with heightened labor mobility for sending (typically developing) countries. It bears recalling that global labor migration, including that of temporary labor, involves a considerable amount of South–South mobility, so that the benefits and costs set forth in Table 7 are often equally valid in recipient developing countries.

Progress on the labor mobility agenda may thus well be more feasible, and the policy downsides more easily contained, under bilateral (guest-worker) or plurilateral labor market agreements than in the WTO (or indeed in a trade policy setting).

Still, while obstacles to a bigger bargain on Mode 4 trade are significant, there is undeniable scope for progress in the DDA and in PTAs, not least because the underlying forces whose effects Mode 4 can mitigate—population aging and acute labor shortages in certain occupational categories in developed-country labor markets, and a rising supply of workers in all skill categories from developing countries—are not about to abate.

A development-friendly outcome on Mode 4 in trade agreements would include the following elements:



**Table 7: Socioeconomic Benefits and Costs of Temporary Migration for Sending Countries**

Benefits	Costs
<p>1. Impacts on domestic labor market including:</p> <ul style="list-style-type: none"> <li>- broadening of employment opportunities for workers, especially if there are none in the home country;</li> <li>- easing of effect of supply of excess labor on domestic market, particularly in low-skilled categories;</li> <li>- easing burden of unemployment and underemployment; and</li> <li>- facilitating broader objectives of adhering to Millennium Development Goals—right to work, human rights, and right to development standards.</li> </ul>	<p>1. Reduced growth and productivity because of lower stock of highly skilled workers, and externalities in certain sectors and countries, and stages in migration cycle</p>
<p>2. Stimulus to investment in domestic education and individual human capital investment formation</p>	<p>2. Loss of public investments in public education with exodus of skills</p>
<p>3. Return of skilled workers increasing local human capital, transfer of skills, and links to foreign networks (brain gain and circulation)</p>	<p>3. Loss of human capital (brain drain), particularly when highly skilled workers are recruited; reduced quality of essential services, especially in occupations also much in demand at home, for example, in health and education sectors</p>
<p>4. Technology transfer, investments, and venture capital contributed by diasporas</p>	<p>4. Potential loss of domestic capacity to innovate and build research-and-development capacity</p>
<p>5. Potential contribution to increased trade flows in goods and services between sending and receiving countries</p>	<p>5. Loss of fiscal revenue from taxation of workers</p>
<p>6. Inflow of remittances and foreign exchange as sources of development finance, channeled into social and physical infrastructure at household level</p>	<p>6. Potential diminution of remittances over time: over-reliance on remittances potentially leading to exchange rate overvaluation, and the neglect of other sectors</p>

*continued on next page*



Table 7: continued

Benefits	Costs
7. Increased education and other opportunities, including provision of social safety nets for those left behind	7. Social impacts potentially including separation that leads to family disintegration, increased incidence of school dropouts, and drug addiction arising from unsupervised children left behind
8. Poverty reduction, escaping poverty trap, and raising living standards; better opportunities for future generations	8. Selective migration, potentially causing increasing disparities in incomes in the home country and harming the migrant if rights are not respected (some receive lower wages than locals doing the same job; others suffer destitute working conditions or maltreatment)
9. Gender equity and welfare; economic, social, and political empowerment	9. Potential of physical or sexual abuse and harassment for women migrants in some recipient countries

Source: United Nations Conference on Trade and Development. 2008. *Assuring Development Gains and Poverty Reduction from Trade: The Labor Mobility and Skills Trade Dimension*. Geneva.

- broadening the categories of service providers eligible for temporary entry to include independent workers and contractual service providers;
- including some lower-skilled levels and occupations, notably in areas such as construction, agriculture, and personal care services;
- eliminating economic needs tests or reducing their importance by making them more predictable through the establishment of common, transparent criteria;
- simplifying, streamlining, and easing the granting of temporary entry visas, work permits, and licensing requirements and procedures; and
- facilitating the recognition of professional qualifications, through mutual recognition agreements and horizontal application of the GATS guidelines on accounting to other regulated professions, among other things.



## Policy Implications

Estimates show that an increase in OECD countries' quotas equivalent to 3% of the total labor supply in importing countries would generate a rise in world welfare of \$156 billion, which would mainly accrue to developing countries.<sup>77</sup> Developing countries could lobby to lift barriers in importing countries, developed and developing alike.

It is important that importing countries also recognize the importance of Mode 4 trade in filling their own economies' skill gaps in certain areas. Complementary policies in exporting countries are often crucial in ensuring that positive potential effects materialize. Evidence indicates that the brain drain appears to have a negative impact on countries where the share of skilled migrants in the total skilled population is high. A clear implication is that countries need to expand the human capital base in those professions whose services they are likely to export. The Philippines is a good example of creating skills and then managing the mobility of skilled workers. Accredited training institutions for nurses have more than doubled from 1999 through 2006, with the private sector contributing to a rapid escalation of education and training capacity. India has been pursuing similar policies with information technology workers. The involvement of the private sector would require an effective education regulatory body (to oversee quality control). Developed countries may also have an incentive to fund training facilities in developing countries as an effective way to improve their own access to skilled workers.

Developing countries need to create incentives for migrants to return in order to benefit fully from their skills. Policies such as the active institutional management of migration and systems that allow a returning skilled migrant to rejoin his or her industry at a level appropriate for his or her experience may help create these incentives. A relatively successful example of this is the Philippine Overseas Employment Administration, which was created in 1995 to promote the return and reintegration of migrants. This institution grants several privileges to returnees, including tax-free shopping for one year, loans for business capital at preferential rates, and eligibility for subsidized scholarships. Effective cooperation between sending and receiving countries is also crucial to increasing the number of return migrants. Cooperation may involve bonding schemes, where part of the wage of the temporary migrant is paid upon return, or in an account based in the home country.

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<sup>77</sup> Walmsley, T., and L.A. Winters. 2005. Relaxing the Restrictions on the Temporary Movement of Natural Persons: A Simulation Analysis. *Journal of Economic Integration*. 20(4). pp. 688–736.



## Chapter 6

# The Contribution of Aid for Trade in Services

### Key Learning Objectives

- Understanding why capacity building is one of the foundations on which consensual support for the pursuit of new market opening and rule-making initiatives in the trade field, including trade in services, rests;
- Appreciating the specific capacity-building challenges that arise in services trade and how they differ from those arising in goods trade;
- Identifying capacity enhancement needs in services trade at each phase of the trade negotiating cycle: in preparation for negotiations, in their conduct, in the implementation of agreed terms, and in supply-capacity terms;
- Determining whether and how capacity strengthening can help to promote a richer harvest of market access commitments while alleviating bottlenecks in policy formulation and implementation;
- Exploring novel advances in the aid-for-trade services negotiations linkage arising from recent preferential trade agreement experience; and
- Identifying the role that public–private partnerships can play in enhancing the productive and export capacities of developing-country service providers.

With increased awareness of the relevance and importance of trade for development, bilateral and multilateral agencies have begun to mobilize significant resources to support trade-related technical assistance and capacity building (TRTA/CB) in developing economies.<sup>78</sup> In a relatively short time, TRTA/CB has become one of the fastest-growing areas of development assistance, fueled by the significant capacity-enhancement commitments made in the context of the World Trade Organization's (WTO) Doha Development Agenda (DDA) and the accelerating pace of regional and bilateral trade talks, many of which feature an important TRTA/CB component.

<sup>78</sup> This section draws on Sauvé, P. 2007. Services-Related Projects in Aid for Trade. In Njinkeu, D. and H. Cameron, eds. *Aid for Trade and Development*. Cambridge: Cambridge University Press. pp. 293–299. This section also draws on Marconini, M. and P. Sauvé. 2009. *A Services Negotiation Checklist*. Trade Department, World Bank, Washington DC.



Capacity building is among the foundations on which consensual support for the pursuit of new market opening and rule-making initiatives in the trade field rests today. Donor economies have a major stake in supporting the trade-related capacities of developing economies. It is in their interest to help developing economies overcome trade capacity gaps, negotiate effectively and credibly, implement trade agreements, and honor their contractual obligations under those agreements. If they do not, many developing economies may lose faith in the benefits of open-market policies, be shackled by a low capacity to sustain imports, and above all, remain dependent on foreign aid for their development.

### Capacity Enhancement Challenges in Services Trade

Managing service sector reforms requires that market opening be accompanied by a careful combination of competition and regulation. The reform process can present important challenges to resource-constrained governments in many developing countries, particularly least-developed countries (LDCs) and small and vulnerable economies (SVEs). It also highlights the need for progressive liberalization, a feature trade agreements are generally well framed to promote, and to the equally critical need, today fully acknowledged in the DDA and in numerous other negotiating forums, to invest in trade-related capacity building aimed at building sounder negotiating and regulatory regimes and implementing institutions in developing countries.

In the services area, an approach that combines aid for trade with trade and investment liberalization commitments could help promote progress in the negotiations while addressing the legitimate concerns voiced by many developing-country governments and civil society organizations about asymmetries at the negotiating table. Because of the sheer diversity of the sector realities encompassed by services trade, a coherence-promoting aid-for-trade package in services requires close cooperation and coordination among numerous multilateral institutions, bilateral donors, and civil-society actors (both private sector and nongovernment organization representatives).

The DDA and WTO ministerial declarations are replete with references to trade-related technical assistance and capacity building, none of which are legally binding. To guard against the very real risk that the absence of technical assistance may stymie needed reforms and unduly hold back liberalization commitments, consideration could be given to establishing a more formal link between enhanced market access commitments by developing countries and additional assistance by developed countries and relevant multilateral agencies.



Such a link could lend greater credibility to both liberalization and technical assistance programs. Indeed, the development promise of the DDA and the ubiquitous calls for coherence in policy making would be well served if one of the tangible dividends of a completed DDA were up-front commitments by the leading multilateral and regional lending agencies to a strengthening of regulatory institutions and of supply responses in developing countries. As Box 10 shows, that is arguably what the European Union has attempted to do in the context of its Economic Partnership Agreement (EPA) with CARIFORUM member states. Time will tell whether, how, and to what extent that example can be replicated at the multilateral level at the end of the DDA.

**Box 10: Addressing Aid for Trade in Services: the EC-CARIFORUM Economic Partnership Agreement**

The cooperation elements of the Economic Partnership Agreement (EPA) affirm the EC's attempt to infuse the agreement with a concrete development dimension. In so doing, the EPA charts useful new territory at a time when the multilateral community is struggling to give operational meaning to the concept of aid for trade. Part I of the EPA, which focuses on the issue of a Trade Partnership for Sustainable Development, contains the umbrella provisions on development. However, more issue- and sector-specific development provisions can be found in all of the EPA's various titles.

Part I of the EPA makes it clear that development cooperation can take financial and nonfinancial forms. Further, Article 7(3) clarifies the relationship between the EPA and the Cotonou Agreement<sup>79</sup> by providing that "EC financing is to be carried out according to the framework of rules and relevant procedures provided for in the Cotonou Agreement, in particular the programming procedures of the European Development Fund (EDF) and within the framework of relevant instruments by the General Budget of the European Union."

The EPA text does not have explicit language about the level of development financing made available overall or for the specific issues and sectors subject to the agreement. This has sparked much criticism throughout the CARIFORUM region over the alleged unbalanced nature of the agreement; its development provisions remain somewhat abstract and not legally enforceable, while its liberalization commitments are up front, legally binding and enforceable. Responding to such critiques, the Caribbean Regional Negotiating Machinery (CRNM) has cautioned that "any perceptions about the EPA's

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<sup>79</sup> The Cotonou Agreement refers to the non-reciprocal arrangements governing trade between member states of the EU and their former colonies in Asia, Caribbean, and Pacific (ACP) regions.



Box 10: continued

practical deficiencies with respect to the treatment of development and development cooperation and assistance should first be tempered by the recognition that as a trade agreement, the EPA should not be perceived to be the primary vehicle through which development may be achieved.”<sup>2</sup> Rather, it should be considered as “one strategic instrument in a range of economic development strategies.”<sup>3</sup>

According to the Joint Declaration on Development Cooperation appended to the EPA, a package of €165 million has been set aside for the next six years to fund TRTA/CB activities that have been identified and rank ordered in the Caribbean’s regional indicative plan (RIP). This regional package includes an incentive tranche of €32 million for adhering to principles of good governance, democracy, and the rule of law. CARIFORUM states have indicated that the region intends to devote 30% of the RIP and the full amount of the incentive tranche to issues of EPA implementation. In addition to funding for the RIP, each CARIFORUM state will receive funds for its national indicative plan (NIP) but must identify two priority projects for such additional funding. The Dominican Republic and Jamaica have already announced that they will be using the financing under their respective NIPs for EPA implementation.

The development priorities identified in Part I of the EPA include: (i) provision of technical assistance to build human, legal, and institutional capacity in the CARIFORUM states to facilitate compliance with the commitments of the EPA; (ii) assistance for capacity building and institution building for fiscal reform; (iii) provision of support measures aimed at promoting private sector and enterprise development; (iv) diversification of CARIFORUM exports of goods and services through investment and development of new sectors; (v) enhancement of the technological and research capabilities of CARIFORUM states to facilitate the adoption of, and compliance with, internationally recognized SPS measures, technical standards, and labor and environmental standards; (vi) development of CARIFORUM innovation systems; and (vii) development of infrastructure in support of trade.

The generic cooperation provisions contained in the EPA’s Investment, Services and E-Commerce chapter are complemented by a few sector specific cooperation provisions, the most developed being those agreed for the tourism sector. The cooperation activities envisioned in this chapter are premised on the belief that trade-related technical assistance and capacity building are important elements in complementing the liberalization of services and investment, supporting the CARIFORUM states’ effort to strengthen their capacity in the supply of services and facilitating the implementation of scheduled commitments.

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<sup>80</sup> Caribbean Regional Negotiating Machinery. 2008. *RNM Update 0802*. [www.crnrm.org/documents/updates\\_2008/rnmupdate0802.htm](http://www.crnrm.org/documents/updates_2008/rnmupdate0802.htm)

<sup>81</sup> Caribbean Regional Negotiating Machinery. 2008. *RNM Update 0802*. [www.crnrm.org/documents/updates\\_2008/rnmupdate0802.htm](http://www.crnrm.org/documents/updates_2008/rnmupdate0802.htm)



Box 10: continued

Subject to the provisions of Article 7, which deals on the question of development financing, the specific cooperation envisaged includes providing support for technical assistance, training, and capacity building in a number of areas. These include: (i) improving the ability of CARIFORUM service suppliers to gather information on the EC parties and meet their regulations and standards; (ii) improving the export capacity of local service suppliers; (iii) facilitating interaction and dialogue between service suppliers of both the EC parties and the CARIFORUM states; (iv) addressing quality and standards in those areas where the CARIFORUM states have undertaken commitments; (v) developing and implementing regulatory regimes for specific services at the CARIFORUM level and in the signatory CARIFORUM states; (vi) establishing mechanisms for promoting investment and joint ventures between service suppliers of the parties; and (vii) enhancing the capacities of investment promotion agencies in CARIFORUM states.

An additional feature of the EPA's development dimension is the establishment of a regional development fund (RDF). According to EPA Article 8(3), the RDF will be used to mobilize and channel EPA-related development resources from the European Development Fund and other potential donors. The parties have agreed that the CARIFORUM states are to endeavor to establish the fund within two years of the date of signature of the agreement. While there are some basic rules about transparency and accountability, the EC will not be playing a role in the management of the fund. One of the aims of the RDF is to increase the speed at which funds are disbursed to the CARIFORUM countries.

Source: Sauv , P., and N. Ward. 2008. The EU-CARIFORUM Economic Partnership Agreement: Assessing the Progress on Services and Investment. *NCCR Working Paper 2008/10*. Bern: World Trade Institute.

### The Need for a Tailored Response

The particular nature of services trade and of services liberalization imparts a number of special features to the aid-for-trade (TRTA/CB) debate in the sector. Because the impediments to services trade are not tariffs by their nature, governments do not lose revenue when engaging in services trade liberalization. In the absence of tariff protection, there is no significant erosion of preferences arising in services trade, and hence little need for compensatory payments for countries or regions affected by MFN-based negotiating advances.

Moreover, negotiated outcomes are far likelier to result in status quo commitments (that is, policy consolidation, or even less) than to generate de novo market



opening, suggesting that there is no significant post-liberalization adjustment pressure in most negotiating settings. This implies that discussions of an aid-for-trade response in services can generally be divorced from concerns over the design and adequacy of compensatory financing for the potential “losers” from market opening.

This is not to say that market opening in services cannot produce distributional downsides. It most surely can, as with liberalization in any given sector. The main point is that significant new market opening is rarely the norm at the negotiating table, apart from countries seeking accession to the World Trade Organization (WTO), whose average level of General Agreement on Trade in Services (GATS) commitments is in most instances much higher than that scheduled by developed countries during the Uruguay Round.

Moreover, any such opening should be properly sequenced and should include precommitments to future liberalization in accordance with GATS Article 18 (Additional Commitments). Proper sequencing should mitigate significant adjustment pressures and to ensure that market opening and regulatory strengthening are carried out concomitantly. Adjustment pressures resulting from market opening initiatives in services could be further addressed through an operational emergency safeguard mechanism; this is an area of unfinished rule making in services trade where progress remains desirable [but where ongoing discussions have tended to bog down over repeated, and ultimately futile, attempts to import General Agreement on Tariffs and Trade (GATT) practices into GATS].

### **Designing a TRTA/CB Agenda for Trade in Services**

If there is no need to respond to concerns over preference erosion and significant postliberalization dislocation pressures, the question arises where additional assistance can best be directed in the services field.

Developing countries face two central challenges in undertaking service sector reforms. First, they must identify the elements of good (economically sound) services policy. Second, they must assess how good policy at the domestic level can be supported by multilateral (or bilateral or regional) negotiations.

To address the clear deficit in negotiating, enforcement, and supply-side capacities that the majority of developing countries face in services negotiations, a practical TRTA/CB component should be embedded into all trade agreements, at the WTO and in PTAs. Such a component should aim at:



- strengthening the ability to negotiate from a more thoroughly analyzed and articulated position;
- overcoming informational deficits at the negotiating table;
- better managing the process of market opening and the ensuing implementation burden and costs; and
- enhancing the ability to supply newly opened foreign markets.

### **Strengthening Negotiating and Analytical Capacities**

Aside from weaker negotiating and implementation capacities, developing countries typically face greater difficulties in identifying where their negotiating interests in the services field—both offensive and defensive—ultimately lie. For this reason, efforts aimed at helping governments craft a strategic road map for their service sector and the role that trade policy and trade agreements can play in pursuit of that sector's interests are especially important.

Despite its innate promise, liberalizing services trade entails multiple challenges that cannot be underestimated, particularly in light of the limited administrative and negotiating capacities of many developing countries. A country needs to gather significant knowledge before it can submit sensible market opening requests and make informed offers. This task includes identifying opportunities and challenges for its exporters, determining the capacity-building needs of its negotiators, line ministries, and regulatory agencies, and assessing the likely economic and social impacts of various liberalization scenarios.

A large number of developing countries have encountered recurring difficulties in identifying their specific sector interests in services negotiations, the barriers to their exports, or the impact of detailed requests by trading partners (particularly those from developed countries) on their service sectors. Such challenges are compounded when developing country administrations are stretched by several concurrent negotiations at the bilateral, regional, and multilateral levels.

Two particular concerns for developing countries are how to evaluate requests received from trading partners and how to formulate their own requests and offers. The latter task is particularly complex because it requires countries to determine their national policy objectives and the competitiveness of each sector or subsector. In addition, to evaluate negotiating positions, they must determine, among other things, the optimal sequencing of the steps involved in liberalization,



the capacity of domestic firms to provide the services in question, whether this capacity would be positively or negatively affected by further competition in the market, and the adequacy of domestic regulatory regimes and enforcement capacities. Other elements of such an evaluation include the impact of market opening on investment, employment, access to higher quality imports or more efficient foreign suppliers, gender, access to essential services, and poverty alleviation.

Much capacity-building effort in services has so far focused on helping negotiators and policy officials master the legal provisions of services agreements such as GATS. For many poorer countries (LDCs and SVEs), this remains an important challenge, particularly where trade expertise is especially weak or shallow in trade and foreign ministries and even more so in relevant line ministries and regulatory agencies. Short-term training directed toward overcoming such knowledge gaps retains its salience in many poorer countries.

However, acquiring the analytical tools to determine a country's readiness to liberalize, to develop government-wide negotiating strategies, and to help domestic service providers take full advantage of the market access opportunities arising from regional and multilateral liberalization efforts is a more pressing need, and arguably more conducive to harnessing the pro-development potential of services liberalization.

Technical assistance with analytical tools deserves greater attention from multilateral agencies and the donor community. It should take the form of dissemination of knowledge of best practices by developed and developing countries that have been successful reformers. Invariably, these will be countries that have developed efficient communication channels with the multiplicity of stakeholders that must be involved in services negotiations.

South-South learning is particularly important, and involving experts from developing countries with pertinent experience is likely to prove most effective. It may be easier to deploy such a diversity of trade-related technical assistance through international organizations than through bilateral donors from the Organisation for Economic Co-operation and Development (OECD) area.

### **Addressing Informational Deficits at the Negotiating Table**

Many developing countries must overcome acute informational deficits regarding the nature and importance of impediments to their own service exports in the markets of their main trading partners if they are to share more broadly in the





gains arising from the reciprocal opening of service markets afforded by request-offer negotiations.

Putting together targeted negotiating requests requires detailed information about the full range of measures preventing effective access to the markets of key trading partners. The breadth of services trade and the diversity of sectors render information gathering a large and complex task, with which many developing countries, even larger ones, experience great difficulty.

While all WTO members suffer from an informational deficit in services negotiations, many developing countries are at a particular disadvantage because they lack the large network of embassies, organized industry associations (coalitions of services industries), foreign affiliates of home country chambers of commerce, and even individual companies present in local markets from which many developed countries can gather information. Thus, negotiating requests by developed countries tend to be more specific, focusing on previously identified and rank-ordered sector-specific or horizontal measures whose progressive elimination or liberalization is being sought. Many developing countries are unlikely to be in a position to make similar types of requests, particularly in the early stages of the request-offer process. This tends to place developing countries in an inherently defensive posture, and leads to commitment patterns that display considerable precaution and may be of limited development benefit to host nations and little commercial value to exporting nations.

Thus, TRTA aimed at providing developing country suppliers with greater economic intelligence on market access conditions and opportunities in export markets, access to distribution channels, information on product standards, business-to-business dialogue, networking, and the like promises a substantial payoff.

### **Strengthening Implementation and Regulatory Enforcement Capacities**

If there is one area where technical assistance can make a difference, it is in strengthening regulatory agencies and their staff in developing countries. Regulatory institutions are costly and require staff with sophisticated legal and economic skills. Yet sound domestic regulation is critical to realizing the full benefits of open services markets and responding to their potential downsides.

Technical assistance faces a host of challenges thanks to the multiplicity of modes of supplying services and the consequent regulatory intensity of services trade and related factor movements. Assistance directed at enhancing a host country's investment climate may be particularly important in strengthening the



competitiveness of the service sector, given the predominance of commercial presence as a mode of supplying services.

At the same time, the growing importance of cross-border trade, including the possibility of remotely supplying services markets, highlights the need for greater regulatory convergence, the development and adoption of international standards, and the negotiation of mutual recognition agreements to facilitate cross-border trade in services. Low standards and related inadequacies in domestic regulation can frustrate developing country service providers' access to foreign markets. More focused capacity-building efforts can also yield strong development dividends by helping developing countries improve domestic standards and qualifications for services, notably by strengthening their participation in regional or global standard-setting initiatives.

Developing countries should also receive enhanced assistance in the post-negotiating/post-implementation phase in designing reforms that properly factor the impacts of liberalization on the poor and improve their access to essential services, running the gamut from sanitation to transport, telecommunications, small-scale finance, education, and health. While most of these complementary policy challenges lie outside the realm of trade negotiations, getting them right can help build needed support for market-opening efforts. However, implementing such policies in an economically sound manner can present numerous challenges to weak bureaucracies, and many developing countries, particularly LDCs, will require outside support and a fair amount of time to meet them.

Service exporting firms in industrial countries also have a stake in ensuring that markets are opened, that such opening is sustainable, and that it occurs in a stable regulatory environment. These objectives can be served by enhanced private sector support for improved regulatory institutions and universal access policies. Thus, it is necessary to devise means for the private sector to contribute financial resources, people, and expertise to enhance regulatory reform efforts in developing countries.

### **Enhancing Supply Capacities**

Finally, a coherent aid-for-trade package in services needs to target the very real constraints that many developing-country exporters face in attempting to supply newly opened markets. Despite the growing number of success stories in sectors such as energy, business process outsourcing, construction, or environmental services, there are too few examples of companies from developing countries significantly involved in export trade.



Several reasons may be adduced to explain this fact, starting with the large fixed costs of entering what are often capital-intensive sectors and the global presence of very large companies that are in the market already. Even in sectors where developing countries are exporting, studies reveal a number of common problems facing their exporters, including lack of access to financing for export or business development, difficulties establishing credibility with international suppliers, lack of access to reliable and inexpensive infrastructure, and lack of access to a range of formal and informal networks and institutional facilities necessary for trade.

Because of its central focus on the private sector, supply-side capacity building involves a different set of institutional actors from those concerned with the strengthening of trade negotiating or regulatory capacity. Such differences matter for assistance design and interagency coordination efforts. Again, greater private sector involvement from service exporting firms and coalitions of service industries in industrial countries could usefully complement the efforts of bilateral donors and regional and multilateral agencies such as the International Trade Centre (ITC), the World Bank, or the Asian Development Bank (ADB).

### Policy Questions for Discussion

- To what extent is the ability of developing countries to engage in services negotiations held back by negotiating and implementation (that is, regulatory capacity) shortcomings?
- How can developing countries best diagnose the various bottlenecks that stand in the way of meaningful participation in services negotiations?
- Is there an internal capacity to identify and analyze important internal obstacles to fuller participation in international negotiations in services?
- Should developing countries attempt to leverage targeted aid-for-trade assistance in return for greater engagement in services negotiations?
- Should service-specific aid-for-trade modalities be embedded in preferential trade agreements (PTAs) covering services or feature as a complement of any newly completed World Trade Organization (WTO) negotiating round?
- How can a services road map help governments identify and rank-order their capacity-strengthening priorities in services trade?
- Should commitments to new or enhanced market opening be sequenced with commitments by partner countries in services-related aid for trade?



- What must the government know to make informed requests to trading partners and respond to their requests in the domestic market?
- How does a developing-country government best determine its readiness to liberalize its services market?
- How sound are the processes of intragovernment coordination and of external stakeholder consultations in pursuing a market-opening strategy, and how do governments assess their possible weaknesses—and hence capacity-building needs—in both processes?
- Has the government identified specific rule-making issues to which it intends to attach priority importance in the conduct of services negotiations?
- Has the government considered teaming up with other WTO members or regional partners to formulate proposals and negotiate on selected rule-making issues?
- Should developing countries with relatively weak negotiating capacity focus primarily on offensive and defensive market access issues and leave rule making to more powerful countries?
- Has the government considered the pros and cons of participating in collective requests and offers on selected rule-making, thematic, or sector issues, with a view to overcoming resource constraints and achieving economies of scale in the conduct of negotiations?
- What criteria does the government rely on in choosing which measures and modes of supply, in which sectors, should be offered as bound, partially bound, or unbound in the negotiations?
- Are the negotiating skills of the country's trade and regulatory officials adequate to take an active part in—and influence—discussions in services negotiations?
- Has a clear distinction been established between defensive and offensive interests in the negotiations?
- Are the country's negotiating "red lines" clearly established, and does a process exist to revisit them in the light of developments within and outside the services negotiations?
- Have export interests been identified so as to contribute to the elaboration of a realistic request list?
- How does the government compile information on foreign barriers affecting the country's service suppliers?



- Has the government considered how best to cooperate with various international organizations, bilateral donors, and expert nongovernment organizations (NGOs) in formulating negotiating proposals on selected rule-making, market-opening, and development issues?
- To what extent should new or improved commitments in services trade be conditioned on whether host countries can properly manage the process of market opening and whether they possess the required capacity in regulatory enforcement and implementation? To what extent should governments take account of the possible recurring costs of implementing new regulatory regimes and institutions, as well as other adjustment costs, in scheduling new or enhanced commitments in services trade?
- What policy tools are required to assist what are often small-scale service exporters in developing countries to take advantage of newly opened market access opportunities?
- What forms of advisory services and training opportunities are best able to assist in strengthening trade- and investment-promotion organizations and private service companies in developing countries?
- What are the most efficient ways of making market intelligence on developed- and emerging-country service markets and export opportunities available to services exporters in developing countries?
- What forms of assistance, including assistance provided by private companies, are best able to help developing-country firms enhance quality standards and more easily meet host-country certification and licensing requirements?
- What forms of assistance are or should be available to help developing-country firms or industry associations take part in the activities of standards-making bodies in service industries?
- What training and technical assistance is needed to help industry providers, industry associations, and licensing bodies in developing countries participate in and benefit from mutual recognition agreements designed to facilitate trade and overcome the potentially trade-impairing aspects of regulatory diversity?
- What funding opportunities exist to help small service exporting firms from developing economies take part in trade missions to developed- and emerging-country markets as well as in buying missions for services importers from developed countries?



- How can leading developed- and emerging-country suppliers of services be made to share their expertise on service sector research and development, access to finance, quality control, recognition, and other matters?
- How can financial institutions in developing countries be encouraged to overcome their aversion to lend to service sector firms with limited physical capital and significant intangible assets?

### Suggested Readings

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## Appendix

# Suggested Additional Readings on Trade in Services

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### **General Overviews on the Law, Economics, and Political Economy of Services Trade**

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### **Measurement Challenges in Services Trade**

- Maurer, A. 2008. Measuring Trade in Services. In Mattoo, A., R.M. Stern, and G. Zanini, eds. *A Handbook of International Trade in Services*, Washington, DC: World Bank.



## Overview of Commitments Under the General Agreement on Trade in Services and Recent Developments in Services Negotiations Under GATS

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### Services Trade and Development

- Mattoo, A., and L. Payton. 2007. *Services Trade & Development—The Experience of Zambia*. Washington, DC: World Bank.
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#### Financial Services

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