

The General Agreement on Trade in Services: Doomed to Fail? Does it Matter?*

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May 2006

Abstract: Little progress has been made to date in using the GATS framework to lock-in already implemented unilateral reforms, let alone in inducing new liberalization. A number of potential explanations for this limited performance are identified and assessed. These include limited feasibility of using the reciprocity mechanism to mobilize domestic export interests; difficulties of enforcing commitments; weaknesses in domestic (complementary) regulatory capacity; uncertainty regarding the magnitude and distribution of costs and benefits of policy reforms; and a preference for bilateral or regional cooperation. All these factors play a role in reducing the ability of the GATS to be an effective instrument to internalize terms of trade externalities and to act as a credible commitment device for policy reform. Changes in negotiating and enforcement modalities could help strengthen the relevance of the GATS as an instrument of multilateral cooperation.

Keywords: Trade in services, GATS, WTO, aid for trade, transparency

JEL classification: F13, F15

* An earlier version of this paper was presented at the conference “Globalization of the Production of Services: Implications for Small Open Economies,” The Research Institute of Industrial Economics, Stockholm, November 20, 2006. I am grateful to my discussant, Keith Maskus, to Andre Sapir and to participants for comments and suggestions on the conference draft. This paper draws in part on joint work with Aaditya Mattoo. The views expressed are personal and should not be attributed to the World Bank.

Introduction

One of the major results of the Uruguay Round was the creation of the General Agreement on Trade in Services (GATS). By establishing rules and disciplines on policies affecting access to service markets, the GATS greatly extended the coverage of the multilateral trading system. The reason that the original GATT-1947 did not cover services is straightforward: at the time the GATT was negotiated services were mostly nontradable. It is only relatively recently that technological change and regulatory reforms allowed an increasing number of services to be traded internationally through telecommunications networks. The creation of the GATS occurred during a period of far-reaching unilateral reforms of service sector policies, as “natural monopoly” arguments for State-provision or control of major service industries were eroded, and large-scale privatization programs were pursued in many parts of the world, developed and developing.

There were (and are) powerful economic reasons to pursue services liberalization. An efficient, competitive financial sector is critical in ensuring that capital is deployed where it has the highest returns. Lower cost and higher quality telecommunications will generate economy-wide benefits, given that this service is both an intermediate input and a “transport” mechanism for information and other services. Similarly, transport services contribute to the efficient distribution of goods within and between countries. Business services such as accounting and legal services reduce transaction costs associated with the operation of financial markets and the enforcement of contracts. Retail and wholesale services are a vital link between producers and consumers, with the margins that apply in the provision of such services influencing the competitiveness of suppliers on local and international markets.

Thus, given that many services are inputs into production, their cost and quality affects the ability of all firms in an economy to compete. Opening access to new service providers will reduce what Konan and Maskus (2006) call the cartel effect—the markup of price over marginal cost that incumbents are able to charge due to restricted entry; and attenuate what they call the cost inefficiency effect—the fact that in an environment with limited competition, the marginal costs of incumbents are likely to be higher than if entry was open. These effects can have significant impacts on all sectors and households in an economy. In practice, FDI will often be a major channel for foreign providers to supply services and reduce these cost effects. Markusen, Rutherford and Tarr (2005), for example, develop a model where services FDI is a source of new knowledge and competitive pressure, and helps host countries to produce and export more advanced products. In their model, as barriers to trade in producer services fall, costs of imported services drop, and imports

(including through FDI) rise and displace domestic firms. However, the additional varieties available to the economy generate positive externalities for final goods production, raising TFP and welfare disproportionately.

Country simulation studies that analyze the likely impact of services liberalization conclude that removing policies that increase costs can have much greater positive effects on national welfare than the removal of trade barriers – see e.g., Konan and Maskus (2006), Jensen, Rutherford and Tarr (2006), and Rutherford, Tarr and Shepotylo (2005). Instead of the “standard” 0.5 to 1 percent increase in welfare from goods liberalization, introducing greater competition on services markets that removes cost inefficiencies raises the gains to the 5-10 percent range or more. These large effects of services liberalization reflect both the importance of services in the economy, the extent to which they tend to be protected, and the importance of incorporating FDI into the analysis as a “mode of supply”.

One does not have to rely on casual empiricism and numerical general equilibrium modeling to make the case for services liberalization. There is a rapidly expanding body of econometric evidence that policy reforms to increase competition in services industries, including through international liberalization, can help boost growth prospects and enhance welfare. Mattoo, Rathindran and Subramanian (2006) analyze the effects of trade and investment openness for the financial and telecommunications sector on growth in a cross-sectional analysis. Controlling for other determinants of growth, they find that countries that fully liberalized the financial services sector grew, on average, about 1 percentage point faster than other countries. Fully liberalizing both the telecommunications and the financial services sectors was associated with an average growth rate 1.5 percentage points above that of other countries. Focusing on a sample of transition economies, Eschenbach and Hoekman (2006a) explore the impact of financial and infrastructure services policy reforms on per capita income growth of transition economies using time-series data for the 1990-2004 period. Controlling for standard potential explanatory variables, they find that improvements in services policies – infrastructure and finance – have an important, statistically significant positive impact on per-capita growth.

In addition to such cross-country empirical evidence, there is an expanding literature focusing on country-specific analyses of the effects of services liberalization, as well as numerous sector-specific studies, both single country and cross-country (see Hoekman 2006 for a survey). The central conclusion that emerges is that there is a positive relationship between services liberalization, services performance and aggregate performance of the economy. A major channel for the growth effects of services policy reforms is through total

factor productivity at the firm level. FDI has been found to be an important mechanism through which “good practices” and knowledge is diffused to host countries.¹

A key question from the perspective of international cooperation is what role trade agreements can/should play in supporting domestic regulatory reform efforts and enhancing access to foreign services markets. In principle, trade agreements can provide a focal point for liberalization and policy reforms (“good regulatory practices”) and be a way to enhance access to export markets, in part by offering a mechanism through which commitments can be enforced. The stylized fact that looms large here is that very little progress has been made to date in using the GATS framework to lock-in unilateral reforms that have already been implemented, let alone in inducing new liberalization. Indeed, it is fair to say that to date the GATS has been a disappointment.

A number of potential explanations for the limited performance of the institution can be identified. One hypothesis is that the standard mechanisms of reciprocity as developed over 50 years of GATT practice do not (cannot) apply to services. That is, the political economy forces (export interests) that have been harnessed to allow the reciprocal liberalization of trade in goods do not prevail sufficiently in the services context. A related hypothesis is that enforcement of commitments is less straightforward in services, even for countries that can affect their terms of trade. Another possibility is that binding commitments are conditional on (need to be preceded and/or complemented by) other forms of international cooperation to improve the functioning of service markets and to reduce uncertainty regarding the magnitude and distribution of costs and benefits of policy reforms. Such assistance and actions, if inadequate, may preclude governments from using the GATS as a commitment mechanism. Yet another possibility is that services lend themselves better to bilateral/regional cooperation, reflecting either political or economic considerations (similarity in income levels, geographic proximity, etc.).

What follows first briefly describes the coverage and main disciplines of the GATS, and then discusses the hypotheses just mentioned.

¹ For example, in a firm-level analysis of the Czech Republic for the period 1998-2003, Arnold, Javorcik and Mattoo (2006) find a positive relationship between FDI in services and the TFP performance of domestic firms in manufacturing. They conclude that the presence of foreign services providers is the most robust services variable affecting TFP in user firms.

1. The GATS Status Quo

Services have unique characteristics that affect their tradability. Typical characteristics include: (i) intangibility – so that international transactions in services are often difficult to monitor, measure and tax; (ii) nonstorability – so that production and consumption often must occur at the same place and time; (iii) differentiation – services are often tailored to the needs of customers; and (iv) joint production, with customers having to participate in the production process.

As the conventional definition of trade – where a product crosses the frontier – would miss out on a whole range of international transactions, the GATS takes an unusually wide view of trade, which is defined to span four modes of supply:

- *Mode 1 – Cross-border*: services supplied from the territory of one Member into the territory of another.
- *Mode 2 – Consumption abroad*: services supplied in the territory of one Member to the consumers of another.
- *Mode 3 – Commercial presence*: services supplied through any type of business or professional establishment of one Member in the territory of another (i.e., FDI).
- *Mode 4 – Presence of natural persons*: services supplied by nationals of one Member in the territory of another. This mode includes both independent service suppliers, and employees of the services supplier of another Member.²

GATS rules operate at two levels. First, there is a set of general rules that apply across the board to measures affecting trade in services, of which the most important are transparency and the most-favored-nation (MFN) principle. Second, there are so-called specific commitments by Members on market access and national treatment. Article XVI (market access) lists a set of measures that restrict *market access* and that a WTO Member may not maintain or adopt, unless this is specified in its schedule.³ Article XVII (national treatment) covers both *de jure* and *de facto* discrimination against foreign services or service suppliers.

In the case of both market access and national treatment, the scope of the commitments of WTO members is determined by what they put in their schedules. These schedules of specific commitments are made on a sector-by-sector and mode-of-supply basis, with countries having the option of making no commitments at all (“unbound”), a partial commitment, or a full commitment (“none”) – i.e., specifying that no limitations are

² The GATS does not apply either to measures affecting natural persons seeking access to the employment market of a Member, or to measures regarding citizenship, residence or employment on a permanent basis.

³ These include limitations on: (a) the number of service suppliers; (b) the total value of services transactions or assets; (c) the total number of services operations or the total quantity of service output; (d) the total number of natural persons that may be employed in a particular sector; (e) specific types of legal entity through which a service can be supplied; and (f) foreign equity participation (e.g. maximum equity participation).

maintained on market access as defined by Art. XVI and/or on national treatment (Table 1). The associated complexity of the schedules makes it difficult to “quantify” the coverage of GATS. Most efforts to do so have tended to use either a simple count of sectors/modes where commitments are made or employ a weighting scheme that is a function of the type of commitment made. Although it is unclear what “unbound” means – actual policy may be quite liberal in practice – in characterizing commitments this is not relevant: “unbound” means that there is no commitment. More difficult is how to weight the various restrictions that countries list across sectors and modes of supply. This is analogous to the problem affecting efforts to characterize the restrictiveness of national policy stances through indices. Although arbitrary, one simple and transparent way of weighting is to give a weight of zero to “unbound” type commitments; a weight of 1 to full commitments (i.e., “none” is scheduled in a specific cell of the matrix in Table 1), and a weight of 0.5 to commitments where restrictions are specified. Table 2 illustrates the type of data that results for the EU.⁴ While the specific indices are not economically meaningful, they provide a basis for cross-country comparisons and monitoring changes in commitments over time.

Table 1: Example of a schedule of specific commitments

Country X, Sector Y	Conditions and limitations on market access	Conditions and qualifications on national treatment	Additional commitments
1. Cross-border	Commercial presence required	Unbound	
2. Consumption abroad	None	None	
3. Commercial presence (FDI)	25% of management to be nationals	Unbound	Independent regulator
4. Temporary entry of natural persons	Unbound, except as indicated in Horizontal Commitments	Unbound, except as indicated in Horizontal Commitments	

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

Analyses of commitments made in the Uruguay Round suggest that these were of a (partial) standstill nature, that is, a promise not to become more restrictive than already was the case for scheduled sectors (Hoekman, 1996). No WTO member came even close to locking in all unilateral reforms that had already been implemented – the (weighted average) coverage of specific commitments as of 1995 did not exceed 50 percent for most countries (see e.g., Table 2 for the EU). Most developing countries have commitments that are well below 50 percent of all services and modes of supply. In many WTO members actual policies

⁴ The variation in EU Members’ commitments illustrates that the EU is not (yet) a customs union (Langhammer 2004).

are much more liberal than what is committed to in the GATS. For example, in a recent paper, Barth, Marchetti, Nolle and Sawangngoenyuan (2006) combine data on specific GATS commitments on financial services with measures of actual policy in this sector for 123 countries drawn from Barth, Caprio and Levine (2006). They conclude that in practice applied policy is much more liberal than what was committed to in the GATS. Eschenbach and Hoekman (2006b) come to the same conclusion for the set of transition economies that were EU accession candidates. Adlung and Roy (2005) note that with the exception of commitments by a number of countries to liberalize access to telecommunications markets little progress was made in extending the coverage of the GATS post-1995.

Table 2. GATS Commitments by EU-15 Member States, by Mode of Supply

Mode:	Market Access				National Treatment				All
	1	2	3	4	1	2	3	4	
EU*	52.6	68.1	67.1	0.0	52.3	68.4	67.4	0.0	47.0
Belgium	51.0	68.1	64.2	0.3	51.0	68.4	67.4	1.0	46.4
Germany	51.6	66.8	65.5	1.0	50.3	67.7	67.1	0.6	46.3
Denmark	51.3	67.1	65.8	2.6	51.9	68.4	65.8	3.9	47.1
Spain	51.0	68.1	59.7	1.3	52.3	68.4	67.4	1.9	46.3
France	49.4	67.4	57.1	6.5	50.6	68.4	66.5	1.0	45.8
Greece	45.2	67.4	56.1	9.0	49.4	68.4	66.8	0.0	45.3
Italy	46.8	67.7	57.4	2.9	47.1	68.4	66.5	7.7	45.6
Ireland	50.6	68.1	63.5	0.0	51.0	68.4	67.4	0.0	46.1
Luxembourg	52.6	68.1	66.8	0.0	52.3	68.4	67.4	0.0	46.9
Netherlands	52.6	68.1	66.8	0.0	52.3	68.4	67.4	0.0	46.9
Portugal	43.5	67.7	51.0	2.9	49.0	68.4	67.1	4.2	44.2
UK	52.6	67.7	66.1	0.0	52.3	68.4	67.4	0.0	46.8
Austria	55.8	68.7	64.8	8.7	53.5	68.7	67.7	10.0	49.8
Sweden	47.4	60.0	50.0	0.6	48.1	60.0	53.5	1.9	40.2
Finland	51.3	58.7	52.3	0.6	52.6	58.7	56.8	36.1	45.9
Standard deviation	3.2	3.0	6.1	3.1	1.8	3.2	4.3	9.2	2.0
Mean	50.2	66.6	60.5	2.4	50.9	67.2	65.5	4.6	46.0

Source: Eschenbach and Hoekman (2006b).

Dispute settlement and enforcement

There have been few services disputes since 1995, perhaps in part reflecting the limited scope of the specific commitments of WTO members. The first GATS case involved telecommunications exports from the US to Mexico and centered on the conditions under which foreign (US) telecom operators could terminate calls in Mexico. The US argued (successfully) that the Mexican regulation of termination charges was not in conformity with GATS rules, in that prices charged were not “cost-oriented.” A second dispute involved a complaint by Antigua and Barbuda concerning US policies prohibiting foreign suppliers from offering gambling and betting services to US consumers over the Internet. The US had made

a full mode 1 commitment in the sector that includes gambling services, thus prohibiting market access restrictions through import quotas or limitations on the number of service suppliers. The question was whether this commitment precluded the US from banning the provision of gambling services for all firms, including US ones. Appellate Body ruled that regulatory measures that have the effect of a zero quota fall are equivalent to a market access restriction, and that given that the US had made a mode 1 commitment, were prohibited. However, this ruling did not preclude the US from justifying a ban under other GATS provisions if it had wanted to do so (e.g., by invoking the general exceptions article that allows for actions motivated by public health, safety and moral objectives).

Noteworthy in the second case was that the plaintiff was an extremely small country, illustrating a benefit of WTO membership for such countries – it is very unlikely that Antigua would have been able to get the attention of the US on the matter through bilateral channels. While this is clearly a major positive dimension of the WTO framework, it remains a mercantilist body. An implication is that there was really nothing Antigua could do to force the US to comply. In the event, the US changed its legislation to make it explicit that Internet gambling is prohibited. This had major implications for the industry, mostly UK-based, which experienced steep declines in market value as stock prices plunged reflecting the loss of a major market.

2. Moving Forward: Political Economy Puzzles and Challenges

Expanding the coverage of the GATS should be beneficial to WTO members individually and collectively. First, the potential direct gains from reform of services trade for most WTO members are likely to be large, given the evidence that barriers to trade and investment in many markets are still high, in particular for mode 4 trade. Second, services reform is needed to enable developing countries to take advantage of the new opportunities that arise from goods trade liberalization. Many poor countries lack trade capacity and competitiveness, reducing the ability of their firms to benefit from access to export markets or to compete with imports. Improving competitiveness is largely a service agenda: better access to efficient and competitively priced transport, distribution and many other services. Third, the WTO negotiating process requires countries that seek market access concessions to offer concessions in turn. Thus, greater ambition in terms of liberalization of agriculture is likely to require greater opening in services, an area of export interest to many of the OECD countries that protect their agriculture sectors.

Adlung and Roy (2005) point out that the provisional (conditional) offers made by WTO members in the 6 years following the launch of new negotiations on services (mandated by the GATS to commence in 2000, and subsequently folded into the Doha Round) were not ambitious. Essentially offers were limited to further (still incomplete) lock-in of past liberalization. While not without value, of course, this suggests there was not much interest in using the GATS as a vehicle to commit to actual liberalization of markets. It may be that limited ambition reflected negotiating tactics – a desire to signal the need for OECD countries to make “meaningful” offers in other areas such as agriculture. However, such considerations should not have precluded making conditional offers as this could easily have been made part of the conditionality. Indeed, one can argue that the absence of such conditional offers may well have reduced the “quality” of offers on agriculture and manufactures.

Why so little movement? Is there a fundamental problem that is specific to services/GATS? Or is it the case that governments are still in “learning mode” and thus understandably risk averse? While the services agenda is more complex than goods trade, the arguments that are sometimes offered that the GATS is “new” and Members are still feeling their way forward are not compelling. It has been more than 10 years since the GATS entered into force, and policymakers have been dealing with services in a trade-negotiating context now for over 20 years. While the characteristics of services certainly makes it more difficult to negotiate liberalization than in the case for goods trade, complexity can only be part of the explanation. A key factor is that there is simply too little private sector engagement and lobbying in support of the GATS process, and substantial resistance from those that perceive GATS commitments as being (potentially) costly. The latter include both the standard “losers” from liberalization – the import-competing industries and those employed there that have built up firm-specific or industry-specific skills – *and* regulators of the various services sectors. The latter are a group that does not figure much in goods trade policy discussions.

What scope for reciprocity?

The basic mechanism that makes trade negotiations “work” is that exporters are induced to take on import-competing interests in each of the countries participating in a multilateral negotiation process. The negotiation alters the prevailing political economy equilibrium that has generated/supports the status quo set of policies in each country by giving exporters a carrot (better access to foreign markets) that induces them to mobilize political support for domestic reforms. Insofar as the services agenda revolves around market access, standard

reciprocity dynamics should work as well or badly as they do in the case of trade in goods, i.e., resistance to welfare-improving reforms by those currently benefiting from restrictive policies can be overcome by offering export interests better access to foreign markets. Trade agreements can also be a vehicle for improving services regulation and help prevent regulatory capture, through both surveillance and setting rules of the game that make such capture less likely— e.g., a requirement that regulators be independent.

In practice, however, the lack of progress in expanding the coverage of the GATS suggests that reciprocity is not working its magic for services. One potential reason is that the export side of the mechanism may be weaker than in the case of goods. In the case of developing countries – the majority of the WTO membership – most are small and therefore not of great interest to the large players in the WTO, constraining their prospects of negotiating significant additional access to major markets.⁵ Moreover, many developing countries do not or do not perceive themselves to be (potential) services exporters. While many poor countries are significant exporters of services, in that services generate a substantial share of their total foreign exchange earnings, often this is derived from activities where the relevant policies are under the control of the exporter, not the importer. The most important such “service” is tourism, where the export revenue generated depends primarily on measures that the tourism destination country puts in place itself.

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

The one mode where all developing countries do confront particularly high barriers and that is therefore of great relevance to potential exporters is mode 4. It is unlikely however that much can be achieved on mode 4 access to high-income country markets, especially for less skilled services activities. Mode 4 is very politically sensitive and in practice, insofar as importing countries are willing to consider relaxing barriers, experience suggests they will do

⁵ Note that in contrast to goods, developing countries do not have nonreciprocal preferential access to OECD service markets. That is, there is no GSP for services.

so only on a bilateral basis in a bilateral setting. However, the lack of serious prospects for mode 4 liberalization in the GATS framework effectively removes many potential export interests in many poor developing countries from the process.

A related factor that may help explain the very limited progress that has been made to date is that the GATS has a strong sectoral focus (Sapir, 1999). Its coverage is determined by a positive list, with governments scheduling commitments on a sector-by-sector basis. Given that most countries will not be significant (potential) net exporters in most sectors, reciprocity requires that countries find the required balanced of concessions across different services sectors, or, if countries do not have strong export interests in any services, in other WTO areas. Even if one abstracts from the latter set of countries, crafting a series of bilateral deals on services among the subset of countries with services interests may be difficult.

These considerations imply that a key dimension of the reciprocity mechanism – services exporters – is either missing or much weaker in many WTO members than is true for goods. The exception are large service firms that are based in high-income economies, which have clear interests in selling more services to both OECD and to developing countries. This is mostly a mode 3 agenda. The result is a rather unbalanced picture as far as export interests are concerned – in effect, if trades are to be restricted within the services arena, it would have to involve deals that are limited to mode 3 exchanges (largely an intra-OECD/large emerging markets affair) or that involve access to developing nations for mode 4 in the OECD in return for mode 3 access by developing countries for OECD firms. As mode 4 liberalization on an MFN basis is currently a non-starter, this implies that large services firms from OECD countries must be willing to throw their weight behind efforts to reduce agricultural and manufactures protection in order to “buy” better access to developing countries. To date, there has been little evidence of such a dynamic emerging in OECD countries with high protection of the farm sector.

What about the anti-services liberalization forces? Here there are two groups in the services context that operate in addition to the standard ones that also apply in the goods context (import-competing firms, workers, unions). First, the incentives for domestic political engagement by a variety of groups to favor unilateral liberalization are likely to be stronger for many services. Second, there are likely to be incentives for sector regulators to resist international cooperation on regulatory measures that is anchored in a trade agreement/motivated by trade concerns.

Because inefficient service industries generate costs for downstream users in many sectors, unilateral reform incentives may be larger than for trade in goods and be less

susceptible to roll-back, reducing the need to use international commitment mechanisms such as trade agreements. Allowing high cost, low quality services to dominate on a market will be detrimental to almost everyone in an economy, with large users having strong incentives to push for measures – such as deregulation, privatization, and liberalization – that generate more competition in the provision of these upstream suppliers of inputs (Hoekman and Messerlin, 2000). With the exception of EU members, in practice the majority of reforms that have been implemented by most countries since the 1980s have been autonomous. Although for much of this period multilateral commitment mechanisms did not exist and this were not an option, the extent of unilateral reform that has been observed suggests such mechanisms may not be needed as much as in the case of goods trade.

A number of theoretical and numerical analyses help to explain the unilateral reforms that have been pursued by many countries. Grossman and Rossi-Hansberg (2006) develop a model of offshoring of services in which all factors, skilled and unskilled, gain. Markusen, Rutherford and Tarr (2005) conclude that trade in services may be a general equilibrium *complement* for unskilled local labor (in that it fosters overall demand for such labor). Konan and Maskus (2006) find that adjustment costs associated with service-sector reforms may be lower because of the absence of corner solutions: as most services will continue to be produced locally (for technical or economic reasons), after liberalization there will still be demand for labor in services. These results do not imply that there are no losers from services liberalization, but do suggest that in terms of size and concentration they will be smaller than may be the case for goods liberalization.

Hoekman and Messerlin (2000) also argue that the scope for traditional reciprocity-driven services market access negotiations may be more limited than for goods because of concerns relating to regulatory autonomy – a perception that harmonization may not be optimal, and that marginal “quid pro quo” changes to domestic regulatory policies will not enhance welfare, and indeed, could easily lower it. The situation here is very different from that applying to merchandise trade liberalization, where marginal, reciprocal reductions in tariffs will be welfare improving for small countries and the world as a whole, and where reciprocity is needed for large countries to gain from liberalization. Thus, sectoral regulators can often be expected to be less than enthusiastic about efforts to negotiate their turf. An additional regulation-related complicating factor is that successful liberalization in developing countries will often require substantial strengthening of domestic regulatory institutions and infrastructure.

The upshot is that traditional, mercantilist bargaining on a country-pair basis through a request-offer process may not do much to harness trade negotiations in the pursuit of liberalization and policy reform. Achieving greater coverage of the GATS will arguably require a change in approach. WTO Members have been proceeding bilaterally, submitting requests to others and responding with (conditional) offers. Requests have tended to be ambitious, offers mostly minimalist. The result can be characterized as a low-level equilibrium trap where little can be and is expected. In the sphere of trade in goods, WTO members departed from request-offer negotiations in the Kennedy Round (1963-65), when a linear tariff-cutting formula was adopted. This was followed by a non-linear formula approach in the Tokyo Round (1973-79) and again a negotiation centering on formulae in the ongoing Doha Round. Baldwin (2006) argues that the shift to formula-based negotiations re-invigorated multilateral liberalization, which had leveled off in the 1960s. Something similar could be considered for services. In a world of unequal bargaining power multilaterally agreed formulae that are seen to be equitable and efficient are likely to produce a more favorable outcome for weaker parties than bilateral negotiations. Formulae can also help reduce the transactions costs of negotiations – avoiding the need to barter commitments sector-by-sector, country-by-country, and helping to overcome the difficulty of attaining a balanced exchange of concessions between countries that do not necessarily have a reciprocal interest in each other’s markets.

Possible “formulae-type” approaches for services include quantitative targets for the coverage of schedules of commitments and so-called model schedules. In services, quantitative assessments of offers are unlikely to be helpful because even the best available methods of quantifying barriers to trade are hopelessly inadequate. If recourse is made to quantitative indicators, the most straightforward – if not only – possible objective measure is arguably the number of commitments entailing no restrictions on national treatment by sector and sub-sector (Hoekman, 1996). Anything short of full national treatment as the focal point is not meaningful from an economic, systemic or development perspective.

Analogous to what was done in the Information Technology Agreement, agreement could be sought among a subset of WTO members regarding either sectors that are of common economic interest and the types of commitments that should be made. The building blocks of such “model schedules” are relatively straightforward, and some have already been proposed for specific modes.⁶ The idea is to create a focal point for liberalizing

⁶ See e.g., Mattoo and Wütsch (2004).

commitments—either by agreeing on a certain threshold level of commitments for the model schedule, thus shifting the burden on a Member to justify its refusal to concede the threshold level rather than on other Members to extract the minimum concessions, or via a “zero-for-zero” analogue – e.g., the number of sectors or sub-sectors without any national treatment exceptions.

Such approaches are very different from the bilateral request-offer approaches that have been used to date – and failed. They would allow for needed differentiation between WTO members in terms of participation and depth of services commitments. From the broader perspective of attaining a Doha Round – or future round – outcome that involves meaningful liberalization of agricultural policies and manufactures trade there must be a balance of concessions. In particular, large developing countries must make liberalization commitments that are perceived to be of value to OECD countries. But smaller and poor developing countries have little to offer the OECD countries in this type of exchange – their markets are too small. A “formula” approach allows for the latter set of countries to be effectively exempted from participation.

The countries that must be part of the negotiation set cannot be determined *ex ante*, but past practice suggests that for liberalization agreements to be applied on a MFN basis the “internalization” ratio needs to be fairly high – on the order of 90 percent of total trade.⁷ The pursuit of such an approach should be more feasible than it is for goods trade because of the way the GATS is structured. It embodies significant scope for flexibility through its use of a positive list approach to define the country coverage of specific commitments. The prospects for a critical mass approach were enhanced by the Hong Kong ministerial meeting, which explicitly identified the option of “plurilateral” talks limited to a subset of (willing) members.

“Free riding” will of course not necessarily be beneficial to poor or small countries. However, the rationale for a critical mass approach to market access negotiations is not to let poor country governments “off the hook” but to recognize that there is little they can do to influence the outcome of market access negotiations. That is, they have few incentives to play this game, and will find it hard therefore to argue domestically that the *quid pro quo* received justifies potentially painful domestic reforms. As discussed further below, a more *à la carte* approach that stresses assistance and cooperation may be more appropriate to the needs of the poorest countries. Softer forms of cooperation – policy dialogue, engagement and development assistance – may help to put in place regulatory preconditions for liberalization

⁷ This was the figure used in the negotiations on the Information Technology Agreement.

to be beneficial. By strengthening such non-binding dimensions of cooperation, the GATS could become a more relevant mechanism to promote not just services liberalization but also to bolster and improve domestic policy for specific services.

National treatment vs. disciplines on domestic regulation

Would the suggestions made above sufficiently increase the incentives of services (and other) industries to engage their governments and support offers that are more far-reaching? Most probably not, although the effective removal of a large number of countries from the table would reduce transactions costs and lower the incentive for smaller/poorer countries to block progress. A complementary measure could further enhance the prospects of more constructive engagement by larger players by bolstering the scope to use traditional reciprocity mechanics: explicitly removing generally applicable, nondiscriminatory regulatory policies and measures from the negotiating table. Reciprocity dynamics are driven by export interests. The focus should therefore be on policies that are most directly restricting access to foreign markets and discriminating against foreign suppliers of services. By explicitly limiting the focus on such policies, which implies accepting whatever general regulatory requirements are in place in a market, an added “benefit” is that regulatory agencies should be much less concerned about the outcome of the negotiating process.

The provisions of the GATS dealing with domestic regulations are weak. The reason is straightforward: effective multilateral disciplines will rapidly encroach upon national sovereignty and could unduly limit regulatory freedom. The weakness of the disciplines on domestic regulation is often argued to reduce the relevance of the GATS as a pro-competitive instrument. There is some evidence (and a lot more argument) in the literature that stronger horizontal disciplines for domestic regulations would be beneficial in enhancing the contestability of service markets and lowering the costs and increasing the quality of services. Domestic regulation that applies to all firms whatever their nationality may be a more important source of inefficiency/costs than policies that discriminate against foreign suppliers. That is, the “rectangles” associated with regulations that raise costs for all users, limit entry possibility for all new service firms independent of nationality, or are simply redundant because similar but different rules already apply to foreign firms in their home market may be much larger than the “triangles” generated by the efficiency losses from (the tariff equivalent of) discriminatory policies.

The potential benefits of reducing policy heterogeneity through harmonization and/or mutual recognition can be large. Kox and Lejour (2006) for example analyze the impacts of

remaining policy heterogeneity on trade and investment costs for EU service firms doing business in other EU countries. Complying with idiosyncratic national regulations generates fixed market-entry costs for each export market. They develop an indicator for bilateral policy heterogeneity – based on an OECD dataset of product market regulation – that is used to explain bilateral services trade and services FDI in the EU using a gravity model. They find a strong negative impact of policy heterogeneity costs on intra-EU services trade and FDI. Kox and Lejour project that the original 2004 Services Directive could increase intra-EU services trade by 30% to 62% and direct investment in services by 18% to 36%.

However, EU-type policy harmonization and mutual recognition is already difficult enough to implement inside the EU. Pursuing a horizontal set of disciplines for regulation in the GATS is likely to be an order of magnitude harder. A common fear is that GATS disciplines will deprive regulators of the freedom they need to achieve social objectives. While this fear is overblown – as noted, existing disciplines on domestic regulation are quite weak – because negotiators have failed to provide the necessary reassurance, regulators are reluctant to make new commitments. The implication is that limiting attention to improving market access while making it explicit that regulatory freedom will prevail may be desirable in increasing support for (reducing opposition to) expanded commitments in the GATS. Thus, the idea would be to limit negotiating attention to commitments on policy measures that discriminate against foreign providers of services, both pre- and post-entry into a market. Efforts to negotiate disciplines for generally applicable sectoral regulation would be put in abeyance – akin to what was decided on competition and investment policy following the WTO Ministerial meeting in Cancun.

Making discriminatory policies the primary discipline to be negotiated would cover only a share of the prevailing restrictions. However, it is by no means trivial. Thus, national treatment implies the right of establishment as long as domestic firms are permitted to contest a market. Given that FDI in services will create employment and is often subject to less opposition than efforts at regulatory harmonization or recognition (Messerlin, 2006), this can be an effective way to increase competition on markets. In principle, national treatment would also imply that foreign firms obtain access to government procurement markets for services. However, as procurement is explicitly excluded from the GATS, this would need to be negotiated separately.

While the proposed approach will certainly generate gains from international cooperation that are less than if cooperation were to extend to regulatory measures that segment markets, it is not that clear in any event that much can be done through the GATS on

domestic regulation. By removing one, important, reason for regulators to oppose their governments making commitments in “their” area, resistance from a powerful set of interest groups in all countries could be greatly reduced. A focus on policies that discriminate would not only diminish fears of the intrusiveness of the GATS, it would also reduce uncertainty regarding the implications of making commitments.

3. Supporting Services Reforms in Poor Countries

Although for many developing countries the WTO reciprocal process arguably cannot deliver much – they have very limited ability to negotiate better access and thus do not see much (political) gain to making commitments themselves – domestic liberalization is important for firms and consumers in these countries.⁸ Reforms in these countries are as, if not more, important than in more advanced countries, and span both discriminatory and nondiscriminatory (regulatory) policies. But, they may not be able to benefit from liberalization – and thus GATS commitments – if the preconditions for doing so have not been satisfied. There is likely to be substantial uncertainty as what those preconditions are and what the sequence should be in which they are addressed (the same applies for the size and distribution of the associated costs and benefits). Many of the preconditions will have nothing to do with the ambit of the WTO but require domestic efforts/action.

Policy advice and assistance for regulatory reform and public investments in services infrastructure are provided by international financial institutions and specialized agencies. There is virtually no link between these processes and trade agreements/WTO. This disconnect persists even though it is clear that improved regulation – ranging from prudential regulation in financial services to pro-competitive regulation of network-based services – may be critical to realizing the benefits of services liberalization. Weaknesses in existing mechanisms for prudential or pro-competitive regulation, the need to alleviate adjustment costs, and the desire to ensure universal access in liberalized markets are all examples of potential good reasons to hold back on making binding liberalization commitments.

Such considerations may be additional factors explaining the limited use that has been made by poor countries of the GATS and their resistance to making additional specific commitments to guarantee access to their markets. A possible approach to recognizing the perceived uncertainty of the magnitude and distribution of the costs and benefits associated with making GATS commitments is to adopt a more flexible framework. This could involve economic cooperation that focuses on identification of national objectives for a given sector,

⁸ This section draws in part on Hoekman and Mattoo (2007).

collaboration among WTO members in identifying policy instruments that could be used to pursue the objectives, the provision of assistance to do so, as well as regular monitoring and assessments of the effects of the policies adopted and assistance provided. Such a process would go well beyond the status quo by changing the focus from seeking commitments on the basis of quid pro quo arguments (which as discussed above are weak to start with) to one where the focus is on helping countries that are currently being asked to make commitments achieve their objectives in an efficient manner.

Much of the attention directed at the WTO tends to center on the process of negotiations and the dispute settlement mechanism. However, the functions of the WTO extend beyond rulemaking and enforcement. One of its tasks is to increase the transparency of member trade policies through the Trade Policy Review Mechanism (TPRM) (Art. III WTO). The objective of the TPRM is "... achieving greater transparency in, and understanding of, the trade policies and practices of Members ... [through] the regular collective appreciation and evaluation of the full range of individual Members' trade policies and practices and their impact on the functioning of the multilateral trading system. It is not, however, intended to serve as a basis for the enforcement of specific obligations under the Agreements or for dispute settlement procedures, or to impose new policy commitments on Members." (Annex 3, WTO). Annex 3 WTO, Section B states further that "Members recognize the inherent value of domestic transparency of government decision-making on trade policy matters ... and agree to encourage and promote greater transparency within their own systems, acknowledging that the implementation of domestic transparency must be on a voluntary basis and take account of each Member's legal and political systems." Services are included in the ambit of the TPRM. Indeed, the WTO is currently the only multilateral body that has the mandate to review all the services trade-related policies of countries.

Instead of calling for all developing countries to make additional GATS commitments and/or to ignore the majority of these countries because they are of limited commercial interest, an alternative would be to build on the precedent established by the TPRM. A goal could be to identify where development assistance could be most effectively used to help attain the national objectives, with the TPRM extended to monitor not just national trade-related policies but the services "performance" of both the country concerned and the provision and effectiveness of the aid provided by donor countries. Over time this could reduce uncertainty regarding the value of making specific commitments to countries as these would be based on the experience obtained in implementing domestic policies for the sector concerned. The role of the WTO would therefore be expanded to act as a focal point for

considering the international dimensions of national services policies on a regular basis, a mechanism for increasing the transparency of policy and outcomes, and monitoring the provision of development assistance, as opposed to primarily a lock-in device for negotiated policy reforms. The appropriate role of the WTO is not to provide assistance, or to allocate it. But the WTO can be a focal point for regular interaction on and monitoring of services policies. No other organization has as strong an incentive to do so.

Such an approach does not imply ceasing to negotiate binding disciplines. Instead it would put greater stress on the identification and pursuit of a national services policy agenda and link this to development assistance. Prospects for mobilizing the needed assistance have increased with the support that has been expressed the idea of allocating additional aid to support trade capacity. In the 2005 Hong Kong Ministerial meeting of the WTO a task force on aid for trade was established. In its report, the task force makes a number of recommendations for the operationalization of aid for trade. Numerous questions remain to be addressed, including how resources should be managed and allocated, what countries will be eligible, and what the role of the WTO and the various development institutions should be.⁹

Whatever is agreed on the allocation mechanisms and modalities, much of the aid for trade agenda at the country level revolves around improving the quality and cost of services. The agenda goes far beyond technical assistance to help countries make market access commitments, and extends to assistance for regulatory strengthening and resources to strengthen services-related infrastructure. To benefit from trade opportunities, many developing countries must bolster the competitiveness of their firms and farms by lowering the cost of, and increase access to, services such as energy, transport, finance, and communications. This in turn requires a mix of policy reforms – including liberalization – and investments in infrastructure, training, and institutional development. There is need for a high degree of country specificity in both diagnosis and remedial action.

Monitoring and enforcement of GATS commitments

While the constraint of market size in enforcement of negotiated commitments is well understood – small countries may not be able to credibly threaten retaliation if needed – of equal if not greater importance is that very small countries are much less likely to be the subject of disputes than larger ones. This may reduce the value of GATS commitments (and,

⁹ See Prowse (2006) for an in-depth discussion of issues and options.

indeed, WTO membership) for such countries. Eschenbach and Hoekman (2006b) analyze the extent to which 16 transition economies used the GATS to commit to service sector policy reforms. They compare GATS commitments with the evolution of actual policy stances over time in these countries, using an index of service sector policy that is compiled by the European Bank for reconstruction and Development (EBRD). While there is substantial variance across transition economies on both the “quality” of actual policies, changes in this over time, and their GATS commitments, they find an inverse relationship between the depth of GATS commitments and the “quality” index of actual services policies.

The 16 transition countries in their sample can be divided into three overlapping, non-exclusive categories. The first spans countries that have the prospect of accession to the EU. All such countries are in practice more open than their GATS commitments suggest. These countries do not need the GATS as a liberalization device. The fact that on average their policy performance is inversely related to their GATS commitments suggests that they relied on other mechanisms, in particular the EU *acquis communautaire*, as a focal point and lock-in mechanism. However, the EU accession candidate countries that did the most through the GATS – Hungary and the Baltic states – are also among the transition countries that have attracted the largest inflows of FDI relative to their GDP or overall investment. Their use of the GATS suggests there was perceived additionality in making commitments in the WTO, despite the high probability of accession to the EU (a probability that was probably seen to be lower by the markets for the Baltic states in the 1990s than for Hungary).

A second group is composed of countries that are relatively open in as measured by their GATS coverage indices and practice as measured by the EBRD indices. One commonality of many of the countries in this category is that most were not members of the GATT-1947. The fact that the WTO accession process is much more demanding for new entrants than it is on incumbents in terms of pressure to make commitments (see Hoekman and Kostecki, 2001) may help explain the greater alignment between actual policy indices and the level of GATS commitments.

The third group is composed of countries that score low on the EBRD index of actual services policies but high in terms of GATS commitments. This group includes Armenia, Georgia, the Kyrgyz Republic, Moldova, and the FYR Macedonia. These countries have no or little chance of joining the EU in the near future. With the exception of Macedonia, they are geographically or culturally distant from the EU, have small markets, and were not GATT members in 1994. For these countries the GATS appears to have been either a failure – in not helping to promote improvements in services policies in the period following accession – or

irrelevant in the sense that commitments were made that governments either did not intend to implement or could implement without resulting in a significant change in actual policies. Thus, for many of the non-EU accession candidates – especially those in Central Asia – the WTO appears to be a weak commitment device. One explanation is that the small size of the markets concerned generates weak external enforcement incentives.

The poorest countries in the WTO system are almost completely disengaged from enforcement of market access rights and commitments through formal dispute settlement litigation. Although more advanced and larger developing countries have started to use the Dispute Settlement Understanding (DSU)—e.g., Central American countries have initiated cases against each other; India has challenged the European Union, Brazil has taken on the United States—the least developed countries (LDCs) are mostly absent, whether as complainants, respondents or third parties. The reason is most likely a mix of capacity constraints – limiting offensive use of WTO dispute settlement mechanisms – and the small size of their markets, which make enforcement action against them unprofitable for affected exporters.

Given that many (if not most) of the gains to trade liberalization of a particular import market accrue to domestic consumers (and consuming industries) through access to lower priced services and greater varieties, the failure of the WTO system to enforce commitments in many developing countries has sizable costs *within* those countries. The basic argument is that while governments may complain about having their policies challenged under WTO dispute settlement, the process is needed for commitments to be supported by domestic industries and firms.

Greater transparency of policy – not just identification of the existence of policies, but assessments of their effects – may help offset the weakness in the enforcement incentives that are inherent in the status quo. More frequent and in-depth analysis of services trade policies in WTO members – as well as the extent to which high-income countries have provided assistance to address priorities that were identified by developing countries, mentioned earlier – could support more constructive engagement of business and NGOs with the WTO and the GATS. If WTO members were to expand the transparency mandate of the organization to make the WTO a focal point for multilateral discussions and assessments of the state of members' service sectors, the institution could do much to help address the needs of its poorer members by raising the policy profile of the services agenda in these countries and identifying where investments/assistance are needed. By combining its commitment and monitoring “technologies” to mobilize liberalization commitments that are conditional on

assistance, and monitoring the delivery and effectiveness of such assistance, the WTO could play a useful role in both helping members and expanding the coverage of its agreements. Greater efforts to ensure transparency do not necessarily have to involve the WTO itself. Research and public interest bodies can do much to help shed light and build consensus by identifying good (better) policies, their economic impact, including distributional effects within and across countries, and whether alternative instruments exist that could attain governmental or societal objectives (more) efficiently.

4. Preferential Trade Agreements: an Alternative?

International cooperation on trade in services is of course not limited to the GATS. Regional integration agreements (RIAs) to liberalize international transactions in services became increasingly prominent starting in the 1990s. Although many early RIAs did (and do) not go much beyond the GATS, more recent vintage agreements often do. Roy, Marchetti and Lim (2006) conclude that the substance of the disciplines (rules) that are included in recent RIAs are not dissimilar to those in the GATS, but that many of the RIAs covering services reported to the WTO since 2000 (see Table 3) tend to have a sectoral coverage that greatly exceeds the commitments the countries involved made in the GATS. This applies both to the existing GATS commitments and the offers that were on the table in the Doha round as of mid 2006 when the talks were suspended. They also find that RIAs that involve the US have the most comprehensive coverage and deepest levels of commitments.

Developments in Latin America (the FTAA), the fact that RIAs have not been very successful in addressing disputes in services (witness the Telmex case mentioned earlier, which went to the WTO even though the parties were both NAFTA members), the resistance inside the EU to fully liberalizing intra-EU services trade, all illustrate that the challenges to services liberalization may not be that much easier to address regionally than multilaterally. It continues to be the case that most services policy reforms tend to be implemented unilaterally.

Table 3: Post-2000 Preferential Trade Agreements that include Services

PTA	Entry into Force	Date of Signature	WTO Notification	Negative or Positive List?	GATS-type Market Access Obligation for Mode 3?
New Zealand – Singapore	Jan. 2001	Nov. 2000	Sept. 2001	Positive List	Yes
EFTA – Mexico	Jul. 2001	Nov. 2000	Aug. 2001	Positive List	Yes
EC – Mexico	Mar. 2001	Oct. 2000	June 2002	Positive List	Yes
Chile – Costa Rica	Feb. 2002	Oct. 1999	May 2002	Negative List	No (not for mode 1)
Japan – Singapore	Nov. 2002	Jan. 2002	Nov. 2002	Positive List (Japan used negative list for mode 3 NT).	Yes
Singapore – Australia	Jul. 2003	Feb. 2003	Oct. 2003	Negative List	Yes
US – Chile	Jan. 2004	June 2003	Dec. 2003	Negative List	Yes
US – Singapore	Jan. 2004	May 2003	Dec. 2003	Negative List	Yes
Chile – El Salvador	June 2002	Oct. 1999	Mar. 2004	Negative List	No (not for mode 1)
Republic of Korea – Chile	April 2004	Feb. 2003	April 2004	Negative List	No (not for mode 1)
EC-Chile	Mar. 2005	Nov. 2002	Nov. 2005	Positive List	Yes
EFTA – Singapore	Jan. 2003	June 2002	Jan. 2003	Positive List	Yes
China – HKC	Jan. 2004	Sep. 2003	Jan. 2004	Positive List (for China)	Yes
China – Macao China	Jan. 2004	Oct. 2003	Jan. 2004	Positive List (for China)	Yes
EFTA – Chile	Dec. 2004	June 2003	Dec. 2004	Positive List	Yes
US – Australia	Jan. 2005	Aug. 2004	Dec. 2004	Negative List	Yes
Thailand – Australia	Jan. 2005	Jul. 2004	Jan. 2005	Positive List	Yes
Panama – El Salvador	April 2003	March 2002	April 2005	Negative List	No (neither for mode 1)
Japan – Mexico	April 2005	Sep. 2004	April 2005	Negative List	No (neither for mode 1)
US – Bahrain	Aug. 2006	Sep. 2004	-----	Negative List	Yes
US – Oman	-----	Jan. 2006	-----	Negative List	Yes
US – CA + DR	Mar. 2006	Aug. 2005	Mar. 2006	Negative List	Yes
US – Morocco	Jan. 2006	June 2004	Jan. 2006	Negative List	Yes
US – Peru	-----	April 2006	-----	Negative List	Yes
Japan – Malaysia	-----	Dec. 2005	-----	Positive List	Yes
Korea – Singapore	Mar. 2006	Aug. 2005	Feb. 2006	Negative List	No
US – Colombia	-----	Feb. 2006 (conclusion of negotiations)	-----	Negative List	Yes
Singapore – India	-----	June 2005	-----	Positive List	Yes

Source: Roy, Marchetti and Lim (2006).

Achieving regional liberalization of services markets is difficult. The experience of the EU – by far the deepest regional initiative to date – is illustrative. To a large extent the 1992 Single market initiative revolved around actions aimed at integrating services markets. Numerous papers have documented how national regulatory regimes continue to segment EU services markets. Progress in other regional agreements is much less than in the EU. Park (2002), for example, employs a cross-section gravity analysis of services trade flows and finds that the EU is the only RIA where intra-RIA (bilateral) trade is more than predicted. For other Agreements such as Mercosur, NAFTA, and the Andean pact, trade in services is less than what would be predicted.

That said, when it comes to the regulatory agenda, it may be easier/more feasible to implement strategies such as mutual recognition – as done in the EU Services Directive – to lower the costs of regulatory heterogeneity and redundant or duplicative regulatory requirements. That there are potential gains from this is clear, but equally clear is that moving down this path is difficult. As mentioned, even in the EU there still remains much scope for further liberalization of trade in services.¹⁰

As mentioned previously, one important mode of supply for many developing countries is mode 4. This mode has been the subject of a number of bilateral agreements that provide quota-based additional access for specific types of service suppliers for which there is excess demand in the importing country. Examples include agreements between the UK and South Africa and Ghana, and between Israel and the Philippines. Neighboring countries generally may also have better access to rich country markets through movement of natural persons, even though this often will not be part of formal mode 4 arrangements. Given the revealed preference of countries to address mode 4 movement of service suppliers on a country-by-country basis, bilateral agreements on this mode are likely to (continue to) dominate efforts at an MFN-based approach through the GATS.

¹⁰ See, e.g., Kox and Lejour (2006) and Lejour and Palma Verheijden (2004). The latter compare the intensity of intra-EU trade in services with that observed in Canada and find that trade in the latter is two times higher as a share of GDP than in the former.

5. Concluding remarks

Most countries have made only limited use of the GATS to create a more secure trading environment by making legally binding market access commitments. It is clear that greater advantage could be taken of the opportunity offered by the GATS to lend credibility to past or ongoing reform programs by locking these in, and to further liberalize access for foreign providers. To some extent this may reflect a perception on the part of users of services that there is not much need for trade agreements to harness desirable domestic liberalization because such liberalization can be implemented on a unilateral basis, or through RIAs. However, the available empirical evidence suggests that barriers to trade in services are often quite high, suggesting this cannot be more than a partial explanation at best.¹¹

The revealed lack of ambition is likely to reflect both limited support for using the GATS by export interests and concerns on the part of other groups in society, including regulators and NGOs, that making more commitments could have detrimental consequences that go beyond the adjustment costs that would be incurred by import-competing industries. The implication is that the process of quid pro quo bilateral bargaining that is multilateralized through the MFN rule is not as effective as it has proven to be for trade in goods.

To advance the process of services liberalization beyond levels undertaken independently, or even, less ambitiously, to significantly expand the use of the GATS as a lock-in device for past reforms, reciprocity must play a central role. While not discussed at any length in this paper, the needed reciprocity extends beyond the domain of services – cross-issue linkages will be required. Thus, the “fact” that mode 4 will not be liberalized in a major way by OECD countries in the short term – even though the economic/demographic forces in aging rich societies imply that such liberalization is “win-win” – suggests that the quid pro quo for any services liberalization by developing countries will be sought outside of services. But given a strong interest in agriculture and the removal of remaining barriers to trade in labor-intensive manufactures, larger emerging markets, especially for major agricultural developing country exporters, will

¹¹ The available evidence is surveyed and summarized in Hoekman (2006) and Dee (2005).

inevitably be called upon to make commitments on services: this is one area where OECD countries have clear “offensive” interests.

The willingness to offer more meaningful commitments may increase if some of the concerns of governments regarding the payoffs to – and implications of – agreeing to multilateral rules on domestic regulations can be addressed. While multilateral rule-making can help to promote and consolidate domestic regulatory reform, at this stage in the process of multilateral cooperation on services trade policies, limiting the focus on national treatment could attenuate concerns about regulatory autonomy while delivering significant gains in terms of greater competition on services markets. Going beyond national treatment may not have substantial benefits in terms of additional market access, while creating potentially significant political/regulatory opposition to what is often regarded as an intrusive erosion of national sovereignty, even if in fact the extent of such erosion may be limited. At the same time, by focusing more explicitly on policies that discriminate against foreign firms, both service export industries and users of services in importing countries may have greater incentives to support the process than they perceive to have at present.

Limiting the focus of negotiations (through formulae approaches) to a critical mass of WTO members, effectively exempting the majority of poor and small developing countries from making binding commitments (i.e., allowing for MFN free riding), could further improve the prospects of getting reciprocity to work more effectively in services. Restricting the set of players would reduce negotiating costs and take away perceived needs to “block” the process by governments of these countries that worry about the net benefits of acceding to a particular request or set of requests. If, in addition, this was complemented with a shift towards actively helping poorer countries achieve and implement beneficial domestic reforms through development assistance, interest groups in these countries might over time come to see more advantages flowing from more active participation in the GATS. It is a platitude that there is no one size fits all when it comes to regulation and the associated enforcement institutions. A “soft law” type of approach that is based on economic cooperation and policy dialogue may well be a more appropriate and effective mechanism to promote a better regulatory environment in these countries. Greater multilateral monitoring of domestic policies and their effects will be

particularly important for these countries, given that they will have made fewer binding commitments. This is likely to be needed in any event if one accepts the argument that the WTO dispute settlement mechanism is of limited relevance in enforcing WTO rules for poor/very small countries.

To answer the questions posed in the title of this paper, GATS is not doomed to fail, but making progress will require a change in modus operandi and the use of additional instruments and mechanisms – it is necessary to go beyond negotiating legally binding policy commitments. Making the GATS work better does matter. While there are good reasons to expect unilateral reforms in services industries to be undertaken and maintained, there is substantial evidence that barriers to trade remain significant, and that there are large potential gains from further pro-competitive reform. Harnessing multilateral cooperation to help deliver such reforms is therefore important. But as important is the cross-issue linkage dimension – services commitments will be needed to help generate the political support that is needed for liberalization of trade in other areas such as agriculture. If the GATS cannot deliver this, the costs of failure will extend beyond the opportunities forgone to improve the functioning of services markets.

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