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SERVICES, ECONOMIC DEVELOPMENT AND THE DOHA ROUND: EXPLOITING THE COMPARATIVE ADVANTAGE OF THE WTO

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ABSTRACT

Services, Economic Development and the Doha Round: Exploiting the Comparative Advantage of the WTO*

This paper discusses what could be done to expand services trade and investment through a multilateral agreement in the WTO. A distinction is made between market access liberalization and the regulatory preconditions for benefiting from market opening. We argue that moving forward on multilateral services liberalization requires a shift from bilateral request-offer negotiations to a model schedule approach that sets ambitious objectives - ideally full national treatment for the major backbone services. Attainment of such objectives, especially by smaller and poorer members, requires procompetitive regulation and strengthened regulatory institutions in developing countries. This suggests linking implementation of liberalization commitments to the provision of development assistance ('aid for trade') to bolster regulatory capacity and enforcement could enhance the relevance of the WTO for developing countries. Bolstering WTO mechanisms to monitor the actions of both developing and high-income country governments could make the institution much more relevant in promoting not just services liberalization but, more importantly, domestic reform of services policies.

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Introduction

Recent research demonstrates that deep global trade reforms would be good for the world economy as a whole and enhance economic welfare in most developing countries.[1] Although national interests differ, and not all countries may gain, numerous models suggest a key area for multilateral liberalization is OECD countries' agricultural policies. These severely distort world markets for products in which many developing countries have a comparative advantage. It is appropriate therefore that agriculture has attracted most of the attention of negotiators in the Doha Round. However, the emphasis on agriculture has led unfortunately to a relative neglect of services.

The neglect of services matters for several reasons. First, the potential direct gains from reform of services trade for most WTO members are likely to be at least as large as those from goods trade reform. These gains are hard to quantify because services trade and the barriers to such trade are hard to measure. But the potential is evident when we consider that liberalization could lead to improved financial, communications, transport, education, health and a variety of business services through increased cross-border trade, foreign direct investment in services and the temporary movement of individual service providers.

Second, services reform is needed to enable developing countries to take advantage of the new opportunities that are 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: fully exploiting trade opportunities requires access to efficient and competitively-priced transport, distribution and many other services. For example, Sub-Saharan African exporters today pay transport costs that are at least five times greater than the tariffs they face in industrial country markets, but neither international maritime nor air transport services figure seriously on the WTO agenda.

Finally, the WTO negotiating process requires countries that seek market access concessions to offer concessions in turn. Thus, greater ambition in terms of global liberalization of agriculture will require greater opening in services, an area of export

[1] See, for example, Anderson and Martin (2006) and Hertel and Winters (2005).

interest to the OECD countries that protect their agriculture sectors.

A major impediment to making progress on services is the complexity of the underlying policy issues. In the case of both agriculture and manufactures, the negotiating agenda is well-understood, and numerous analyses have informed negotiators and interest groups on the determinants of the value of alternative outcomes – the number of sensitive products that are not liberalized, the level at which tariffs are capped, the coefficients determining the depth of cuts in tariff bindings, etc. The challenge in services is to define meaningful commitments in the WTO that will be beneficial to the countries that undertake them *and* be of value from a mercantilist negotiating perspective. In this paper, we suggest certain elements that would satisfy these requirements at least for the industrial and larger developing countries. These elements include locking in the existing openness of cross-border trade in services, eliminating barriers to foreign investment where there is adequate regulatory preparedness, and facilitating the freer movement of at least some categories of natural persons.

Identifying desirable goals is one thing, getting there another. Fortunately, there is increasing recognition that moving the negotiations forward requires those WTO members that are large enough to play the mercantilist game to engage each other. The 2005 WTO Hong Kong ministerial declaration's inclusion of "plurilateral" negotiations that are limited to a subset of the WTO membership therefore offers a way forward, based on reciprocal commitments by the larger players (OECD, G20) that are extended to all members through the MFN rule.

Beyond the traditional market access agenda, we need to determine what the WTO can do to support domestic policy reforms and strengthened service sectors in developing countries, particularly the poorest countries that are at serious risk of marginalization from global services trade. These countries have weak export interests in services outside of tourism, which is mostly free of restrictions, and unskilled labor services, which face high barriers that are unlikely to be lowered through multilateral negotiations. Furthermore successful liberalization in these countries will require substantial strengthening of domestic regulatory institutions and infrastructure. Aid for trade can play a major role in ensuring that these requirements are satisfied. By adding an additional instrument – development assistance – to the table, the GATS/WTO could

become much more relevant as a mechanism to promote not just services liberalization but, more importantly, to bolster and improve domestic reform in services.

There is an emerging view that additional dedicated "aid for trade" is needed to make the WTO more relevant from a development perspective (Hoekman, 2002; Prowse, 2006). In practice many of the needs at the country and regional level are services-related. Poor countries have found it difficult to attract investment in service sectors and create contestable markets that provide consumers – firms, farmers and households – with quality services. One reason for the weakness of these sectors is the persistence of explicit or implicit barriers to foreign and private participation, which are of course the main focus of trade negotiations. But the removal of such barriers needs to be complemented by action to address more fundamental weaknesses in poor countries' services sectors, including in regulatory institutions.

While the WTO is not and should not become a development organization, we argue that the WTO has a major potential role to play in assisting governments to address the domestic reform agenda in low-income countries by helping to identify these needs and using its "commitment and monitoring technologies" to mobilize both liberalization *and* assistance. Specifically, we argue that if WTO members were to expand the transparency mandate of the organization by making 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. It would do so by raising the policy profile of the services agenda in poor countries, helping governments identify where development assistance is needed, and monitoring the delivery and effectiveness of such assistance.

Technical assistance will not be enough. Even if developing country governments liberalize access to services markets and improve the regulatory framework, poor countries may not see much of an investment response – reputational hurdles, geography, the small size of the market, and sheer poverty may result in a lack of interest and a lack of competition – and thus high prices and or under-served consumers and regions. Additional aid for trade could make a difference on the ground – by targeting entry by new providers and the delivery of services that otherwise would not be provided by profit maximizing firms. Using aid for trade resources can help ensure universal access for key

services, in the process increasing the perceived benefits to poor countries from multilateral engagement.

The plan of this paper is as follows. Section 1 discusses the economic fundamentals – why services and services trade and investment matters for development. Section 2 turns to the WTO market access negotiations and discusses the challenges in harnessing traditional negotiating to deliver openness in services and presents some specific options that could foster additional liberalization. This "traditional" approach is relevant primarily for the larger members of the WTO. Section 3 focuses on what could be done to make the WTO more relevant for all developing countries, including smaller and poorer members – the majority of the WTO membership. Much of the agenda here revolves around appropriate sequencing of autonomous reforms, provision of development assistance to strengthen and improve regulation and using multilateral commitments to overcome political constraints and resistance to opening markets to greater (international) competition. Section 4 concludes.

1. Economic Fundamentals

There is no denying that agricultural reform is central to poverty reduction. In low-income countries, agriculture often accounts for 20-30 percent of GDP and over 50 percent of employment. From a poverty-reduction perspective, the agricultural sector is even more important than these statistics suggest because within low-income economies, poverty is greatest in rural areas that depend on agriculture. Over 70 percent of the world's poor reside in rural areas (Hertel and Winters, 2006). But, even in the poorest countries, services account for 40-50 percent of GDP and a significant share of employment. Not only would improved performance in services produce significant direct benefits, large indirect benefits would come from domestic farmers, households and firms obtaining access to better and cheaper services than they have today. Similarly, while the opportunity to export more agricultural and manufactured products is important, actions to improve the efficiency of the services sectors are vital to exploiting these opportunities.

An efficient and well-regulated financial sector will improve the transformation of savings to investment by ensuring that resources are deployed where they have the

highest returns. Improved efficiency in telecommunications generates economy-wide benefits, as this service is a vital intermediate input and also crucial to the dissemination and diffusion of knowledge. Similarly, transport services contribute to the efficient distribution of goods within a country, and are particularly important in determining the ability of firms to contest international markets. Business services such as accounting and legal services are important in reducing 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, and the margins that apply in the provision of such services influence competitiveness. Education and health services are determinants of the ability of citizens to benefit from trade opportunities.

Services, growth and poverty reduction

Even though empirical studies on services have limitations as a result of data weaknesses, recent research suggests a comprehensive "behind-the-border" policy reform agenda focusing on enhancing competition in services industries 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 (2006) find that services-related policies play an important role in attracting FDI. They explore the impact of financial and infrastructure services policy reforms on per capita income growth using time-series data covering the 1990-2004 period. Controlling for other potential explanatory variables, they find that improvements in services policies – infrastructure and finance – have a large and statistically significant positive impact on per-capita growth.

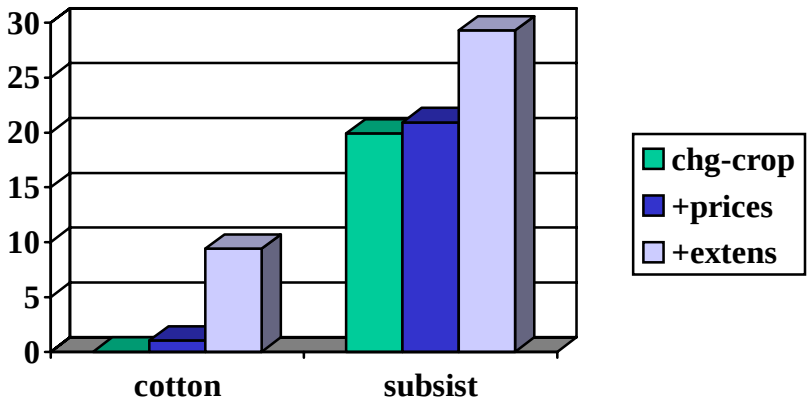
Increasing international competition on service markets will reduce what Konan and Maskus (2005) call the cartel effect—the markup of price over marginal cost that incumbents are able to charge due to restricted entry; and an attenuation of what they call

the cost inefficiency effect—the fact that in an environment with limited competition marginal costs of incumbents are likely to be higher than if entry were allowed. The latter is most important as inefficiency imposes a cost on all sectors and households that consume the services involved. Simulation studies for Egypt and Tunisia 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 – by up to a factor of seven or eight (see e.g., Hoekman and Konan, 2001; Konan and Maskus, 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 6-8 percent. These large effects of services liberalization reflect both the importance of services in the economy and the extent to which they tend to be protected.

The positive association between more efficient service sectors and overall economic performance implies that services policy reforms will help reduce poverty – as sustained economic growth is the most powerful instrument to reduce poverty. Underlying this aggregate, indirect relationship are many channels through which better services can directly improve economic outcomes for poor households, for example, by enhanced consumption of health and education. Another channel is by enhancing the benefits of trade reforms. A number of recent country studies that have investigated the likely impacts of trade reforms on the poor conclude that greater trade opportunities can raise incomes but only if poor households produce products for the market. This may require active intervention to help households switch from subsistence to cash crops and improve productivity—through extension services, access to credit and transportation services, and investments in infrastructure.

Some specific examples are helpful to illustrate the importance of domestic policy actions to enhance the benefits of global trade reforms. Nicita (2006) concludes that overall, multilateral trade liberalization would have only a small impact on Ethiopian households. This is partly because the likely policy changes would have only small impacts on the world prices of products exported by Ethiopia, and partly because exports represent only a small part of Ethiopia's GDP, so that even a hypothetical doubling of the country's export values would not have much impact on overall poverty. Critically,

Figure 1: Income Effects of Global Trade and Complementary Reforms for Cotton in Zambia



within Ethiopia, markets are poorly interconnected and households largely engage in subsistence activities, so that the price and quantity effect of trade polices will be much attenuated.

Balat, Brambilla and Porto (2006) focus on Zambia and also conclude that only small impacts can be expected from global trade reform because it will generate only small changes in prices for Zambian exports and imports and because home-produced goods account for very large shares of both income and expenditure for households. They show that in the case of cotton, agricultural extension services would have much greater impacts in reducing poverty than the expected rise in the price of cotton that would result from an ambitious Doha round agricultural reform. They also show that from a poverty perspective it is important s that households shift out of subsistence and into cotton. Figure 1 summarizes their findings. It compares current subsistence farmers with the same characteristics as cotton growers and shows that most of the gains would come from switching to cotton. This would boost incomes by 20 percent. Extension services that enhance productivity would improve incomes by another 8 percent. In contrast, higher cotton prices add only 1 percent to the incomes of existing cotton producers; they would benefit much more from the extension services. Other studies with similar conclusions can be found in Hoekman and Olarreaga (2006) and Hertel and Winters (2006).

Significant gains in poor countries from global trade reforms depend on actions to move households out of subsistence agriculture. Global trade reform by itself will not

ensure this. Domestic supply constraints are the main reason for the lack of trade growth and diversification in many of the poorest developing countries. Without action to improve supply capacity, reduce transport costs from remote areas, increase farm productivity and more generally improve the investment climate, trade opportunities cannot be fully exploited and the potential gains from trade will not be maximized. The needed reforms span numerous areas, but many of them are services-related.

Services Export Interests

In addition to the "import dimension" stressed above, developing countries also have an export interest in services. Their exports of services have grown nearly four-fold in the last decade, to attain a share of the global marketplace of 18 percent. In large part this reflects growth in so-called business process outsourcing (BPO) services. This activity arises from the outsourcing (and out-location through FDI) of non-core business processes throughout the value chains of both manufacturing and services industries. Within BPO activities, the more advanced developing countries, such as India, are moving from providing only low-end back-office services (data entry, etc.) to more integrated and higher-end service bundles in fields such as customer care, human resource management, and product development. This move is creating space for other developing countries, from China to Senegal, to step into the more standardized segments of the market.

There is great potential for other services exports as well. Health services are an important example where developing countries have an export interest, either by attracting foreign patients to domestic hospitals and doctors, or by temporarily sending their health personnel abroad. A major barrier to this trade is the lack of portability of health insurance in OECD countries. For example, US federal or state government reimbursement of medical expenses is limited to certified facilities in the United States or in a specific U.S. state. This constraint is also significant because it deters elderly persons from retiring abroad. Those who do retire abroad are often forced to return home to obtain affordable medical care. The potential impact of permitting portability could be substantial. If only 3 percent of the 100 million elderly persons living in OECD countries retired to developing countries, they would bring with them possibly US$30 to 50 billion

annually in personal consumption and $10 to 15 billion in medical expenditures (UNCTAD and WHO, 1998). Mattoo and Rathindran (2005) find that extending health insurance coverage to overseas care for just fifteen types of tradable treatments could produce savings for the United States of over $1 billion a year even if only one in ten American patients travel abroad. The lower costs of health services abroad offer the opportunity to extend medical benefits to people who currently are not insured.

A major potential source of gain in services is mode 4 – liberalization of temporary movement of service suppliers. Temporary movement offers arguably a partial solution to the dilemma of how international migration is best managed given the substantial political resistance that exists against it in many high-income countries. It enables the realization of gains from trade while addressing some of the concerns of opponents to migration in host countries, while also attenuating the brain drain costs for poor source countries that can be associated with permanent migration. Research has shown that if OECD countries were to expand temporary access to foreign service-providers by the equivalent of 3 per cent of their labor force, the global gains would dominate those associated with full liberalization of merchandise trade (Walmsley and Winters, 2003; Winters, 2004). Both developed and developing countries would share in these gains, and they would be largest if both high-skilled mobility and low-skilled mobility were permitted.

2. Market Access Negotiating Logic: Opportunities and Constraints

The economic fundamentals summarized above illustrate that services are a key dimension of multilateral negotiations from a development perspective. The WTO can potentially help to improve services performance by inducing countries to liberalize access to markets, thus increasing competition. The WTO is driven by mercantilism: the desire by members to improve their access to the markets of other members. The role of WTO negotiations is to mobilize export-oriented groups that seek better access to foreign markets to support domestic liberalization in areas of interest to trading partners. Market access concessions could be exchanged within services or through cross-issue linkages between goods and services. A broad-based multi-issue approach could help define a negotiating set that is large enough for all players to identify potentially Pareto-improving

packages of reforms. As noted, a link between services and agriculture will have to be made if protectionist policies in agriculture are to be reduced substantially.

Apart from furthering market access, it is less clear what the WTO can do to improve Members' service performance through improved regulation and enhancing the business environment and investment climate. The focus of the WTO process is not on the welfare or growth prospects of members, or on the identification of "good" policy. Nor does the WTO have access to financial resources or to mechanisms to redistribute the gains from global trade and investment reforms across members. This raises the question what the WTO might do to address many of the issues discussed in the previous section that are important for development. Absent actions to address them many countries may not be in a position to fully realize the potential benefits of trade reforms in services *or* goods.

The remainder of this section focuses on the "bread and butter" of the WTO – market access. The next section turns to the question of what might be done through the WTO to improve the domestic services environment in developing countries.

Identifying goals for the services negotiations

One problem is that negotiators have failed to identify a set of broad goals for the services negotiations that make sense from a development perspective, would provoke engagement from the business community, and satisfy the overall mercantilist constraint of ensuring a "balance of concessions". A specific fear created by the GATS is it will deprive regulators of the freedom they need to achieve social objectives. Because negotiators have failed to provide the necessary reassurance, regulators are reluctant to make new commitments. The implication is that at this stage of the development of the GATS, a balance needs to be struck between securing improved market access while preserving desirable regulatory freedom. Such a balance could be achieved by limiting commitments to measures that discriminate (pre- and post-entry) against foreign providers of services - as opposed to seeking disciplines that also target measures that do not discriminate in any way – that is, generally applicable sectoral regulation. Making national treatment the primary discipline covering all forms of *de jure* and *de facto* discrimination (pre- and post-establishment) would cover the bulk of the most important

prevailing restrictions. A focus on policies that discriminate would not only diminish fears of the intrusiveness of the GATS, it would also reduce the opacity of current GATS disciplines and the resulting uncertainty regarding the exact implications of making commitments.

Turning to the modes of supply that are distinguished in the GATS, Mattoo (2005) argues that specific objectives should include (i) locking-in the currently open regimes for cross-border trade in a wide range of services sectors; (ii) eliminating barriers to foreign investment in sectors where the regulatory pre-conditions already exist; (iii) committing to phased elimination where these conditions can be met at a foreseeable date; and (iv) allowing greater freedom of temporary movement for individual service providers as intra-corporate transferees and to fulfill specific services contracts. The first goal is essentially 'painless' in that openness is the prevailing status quo; however, realization of the others will involve potential adjustment costs and complementary regulatory reform and institutional strengthening in many developing countries.

Towards de facto differentiation

Achieving these objectives will arguably require a change in negotiating approach. WTO Members have been proceeding bilaterally, submitting requests to others and responding to requests with (conditional) offers. Requests have tended to be highly ambitious and offers mostly minimalist. This negotiating process has resulted in a low-level equilibrium trap where little is expected and less offered. Assuming agreement to limit negotiations to policies that discriminate, the next question is whether to stick to the bilateral request-and-offer approach or to shift to alternative approaches that are more akin to negotiating formulae. In the sphere of trade in goods, WTO members have sought to use a formula on the basis of which they cut tariffs and/or subsidies. In the Doha Round both agriculture and the NAMA negotiations revolve in part on formulae-based negotiating modalities. There are a number of reasons to favor formulae/model schedules. 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 the weaker party than bilateral negotiations. Formulae also help reduce the transactions costs of negotiations – avoiding the need to barter commitments sector-by-sector, country-by-country. Thus,

formulae can help overcome the difficulty in accomplishing an exchange (and balance) 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. At best, it would be possible to measure differences in the sectoral coverage of commitments, possibly weighted by some crude measure of the level of openness. As it is very difficult to determine the restrictiveness of policies, any assessment of the implied level of openness will be inherently subjective. If recourse is made to quantitative indicators, the most straightforward – if not only – possible measure is arguably the number of commitments entailing no restrictions on national treatment by sector and sub-sector (Hoekman, 1996). Any other type of coverage index approach will not be meaningful insofar as there will always be ways for Members to schedule sectors while maintaining restrictions – e.g., economic needs tests or similar requirements. In our view anything short of full national treatment as the focal point is not meaningful from an economic, systemic or development perspective. Nor would a less ambitious approach do much in our view to move the broader Doha agenda (agriculture in particular) forward, as anything less will be seen for what it is – an effort to create the impression of progress.

Assuming the national treatment focal point is adopted, the question of sectoral coverage will need to be determined, as will the issue of determining which/how many WTO members need to make commitments. Rather than seek an overall numerical coverage target, a more fruitful collective approach would be for groups of Members, akin to the "friends" groups that already exist, to champion clearly specified goals that are embodied in "model schedules." The latter would entail agreement among these countries that the sectors concerned are of economic interest to them and allow clarity as to what types of commitments will be expected in those sectors. This approach could also be used for specific modes – most notably mode 1.[2] The building blocks of model

[2] The model schedule approach already has a track record in the GATS, having been used in the Understanding on Financial Services, the Telecommunications Reference Paper and the Model Schedule

schedules are relatively straightforward, and some have already been proposed for specific modes.[3] The idea is to create a focal point for liberalizing 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.[4]

These types of approaches allow for de facto differentiation between WTO members in terms of participation and depth of services commitments. From the broader perspective of attaining a Doha Round outcome that involves meaningful liberalization of agricultural policies and merchandise trade there must be a balance of concessions. In particular, as mentioned, large developing countries – e.g., the G20 for concreteness – 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. The proposed type of approach discussed above allows for the latter set of countries to be effectively exempted from participation – they would be able to "free ride".

The countries that must be part of the negotiation set cannot be determined ex ante – this is endogenous and will depend on the issue – but past practice suggests that for sectoral liberalization agreements to be applied on a MFN basis the "internalization" ratio needs to be fairly high – say on the order of 90 percent of total trade.[5] The pursuit of such a "k-group" approach (Schelling, 1978) should be more feasible than it is for goods trade because of the way the GATS is structured.[6] It embodies significant scope for

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for Maritime Transport. In each case, the premise was that agreement on standardized commitments would secure a higher level of commitment overall than if Members devised their liberalization offers independently.

[3] See e.g., Mattoo and Wüntsch (2004) and Chaudhuri, Mattoo and Self (2004).

[4] From an economic perspective the focus could be on the key "backbone" sectors – the services that are inputs into all other economic activities: transport, distribution/logistics, telecommunications, financial services, and education as well as on sectors and modes where developing countries have an export interest. We would also argue in favor of a relatively aggregated approach, focusing on 2-digit sectors so as to reduce negotiation and transactions costs and to minimize uncertainty regarding the coverage of new or unclassified services at a more disaggregated level.

[5] This was the figure used in the negotiations on the Information Technology Agreement – see Hoekman and Kostecki (2001).

[6] In the international relations/game theory literature a k-group is used to describe the minimum number of

flexibility through its use of positive list approach to define the country coverage of specific commitments. The prospects for pursuit of a k-group approach were enhanced by the Hong Kong ministerial meeting, which explicitly identified the option of "plurilateral" talks. These can be pursued on a horizontal or sectoral basis.

What about the poor countries? Many would argue that the proposed "free riding" will not necessarily be beneficial to them. We share this view, but would argue that the types of beneficial policy reforms that are needed are best pursued through a different mechanism that provides greater assurances that countries will benefit from making commitments. The rationale for the proposed small group 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. A more à la carte approach that stresses assistance and cooperation and ex post clarity of the benefits of making WTO commitments is more appropriate to the needs of the poorest countries. We return to this in Section 3 below.

Facilitating negotiations through broader cooperation, particularly on Mode 4

Facilitating regulatory cooperation could help deal with apprehensions about liberalization on all modes. For example, in financial services, confidence in cooperation by the home country regulator of suppliers could facilitate greater openness to both commercial presence and cross-border trade by host countries. Similarly, in international transport services, confidence in the enforcement of home-country competition law may increase the willingness to liberalize in importing countries.

The area that is probably of greatest interest to many developing countries – whether large emerging markets or the LDCs – in direct trade terms is to achieve progress on mode 4. To date, mode 4 has been (another) millstone for the services negotiations. To support a positive outcome on mode 4, Members need to recognize that simply asserting that mode 4 is about trade in services and *not* about migration cannot

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countries ('K") out of a larger set ("N") that internalizes enough of the total potential gains from cooperation to make it feasible (i.e., despite the fact that the remaining N-K players will free ride).

dispel the deep-rooted fears raised by the entry of foreign providers in many countries. Whatever one's views of the legitimacy of those fears, to make progress they have to be acknowledged and addressed. One way to take a more cooperative and less antagonistic approach to mode 4 is to draw upon the experience of a few relatively successful bilateral and regional trade agreements.

The inclusion of labor mobility in the framework of a multilateral trade agreement implies that obligations are assumed by host countries to provide market access on an MFN basis regardless of conditions in source countries. Greater progress might be feasible if more is done to also impose obligations on source countries. This is a key element of regional agreements (e.g. APEC) that have facilitated mobility of skilled workers and bilateral labor agreements (e.g. between Spain and Ecuador, Canada and the Caribbean, Germany and Eastern Europe) that have to a limited extent improved access for the unskilled. Source country obligations in these agreements include pre-movement screening and selection, accepting and facilitating return of workers, and commitments to combat illegal migration. Cooperation by the source can help address security concerns, ensure temporariness and prevent illegal labor flows in a way that the host country is incapable of accomplishing alone. In effect, such cooperation constitutes a service for which the host may be willing to "pay" by allowing increased access.

How might such elements be incorporated in a multilateral agreement? One possibility is that host countries commit under the GATS to allow access to any source country that fulfills certain pre-specified conditions – along the lines of mutual recognition agreements in other areas. Even if these conditions were unilaterally specified and compliance determined unilaterally, it would still be a huge improvement over the arbitrariness and lack of transparency in existing visa schemes. Although negotiating these conditions multilaterally and establishing a mechanism to certify their fulfillment would be an improvement over the unequal, non-transparent and potentially labor-diverting bilateral context, this is simply not feasible in the short run. Given the large differences in the ability of source countries to satisfy whatever conditions are put in place there is a clear case for high-income countries also providing assistance to poorer countries to attain them (we discuss the subject of aid for trade in services below).

One other problem needs to be addressed: in the current GATS framework, when

a country makes a market access commitment, it is obliged to grant a fixed level of access every year in the future regardless of domestic economic conditions. In contrast, bilateral labor agreements allow host countries to vary the level of access depending on the state of the economy. One example is the bilateral agreement between Germany and certain Eastern European countries, under which the quota on temporary migrants increased (decreased) by 5% for every one percentage point decrease (increase) in the level of unemployment. It may be desirable to consider GATS commitments along these lines, which allow necessary flexibility in a transparent, predictable and objectively verifiable manner. This would be a big improvement over the opaque and discretionary economic needs tests that infest current GATS schedules.[7]

3. Supporting Services Reforms in Poor Countries

Although we have argued that for many developing countries the WTO process cannot deliver – they have very limited ability to negotiate better access and thus do not see much (political) gain to making commitments themselves – own liberalization is important for firms and consumers in these countries. The adoption of an explicit k-group strategy should not imply that poor countries are ignored; reforms in these countries are as, if not more, important than for the more advanced developing countries. But, they may not be able to benefit from liberalization – and thus GATS commitments – if the preconditions for doing so have not been satisfied. And 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). Moreover, many of the preconditions have nothing to do with the ambit of the WTO but require domestic efforts/action. We argue that assistance needs to be given to poor countries to remedy domestic inadequacies, and that the WTO potentially has a role as a focal point and monitor of not just market access commitments, but also trade-related development assistance.

[7] We should stress that these types of arrangements constitute managed trade and are certainly not first-best. The suggestions are instead pragmatic ones that in our view would lead to a Pareto improving outcome given the political constraints that restrict the feasibility of implementing superior policies.

A softer, critical role for the WTO

While market access in services is negotiated within the WTO, 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 the two processes. This disconnect persists even though it is clear that improved regulation – ranging from prudential regulation in financial services to pro-competitive regulation in a variety of network-based services – will be critical to realizing the benefits of services liberalization in many sectors. Policy intervention will also be necessary to ensure universal service because liberalization per se will not always deliver adequate access to the poor. There is a need to determine whether there are good reasons to defer liberalization and/or not to make binding commitments. For example, 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 may be good reasons to hold back on making unconditional liberalization commitments.

These considerations help explain both 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 and conditional framework. This could involve a "soft law" form of cooperation that revolves around the creation of a mechanism that focuses explicitly on identification of national objectives for a given sector, collaboration among members in identifying policy instruments that could be used to pursue the objectives and providing 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 beyond the status quo by changing the focus from seeking commitments on the basis of quid pro quo arguments (which are weak to start with and perceived with great suspicion by many governments) to one where the focus is on attaining the objectives of the countries that are currently being asked to make commitments 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).[8] 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 ("G90") 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, by adding a process through which national objectives, constraints, and possible policy instruments are identified. Importantly, a goal of the process would be to identify where development assistance could be most effectively used to help attain the national objectives. The TPRM would then be 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. One result would be a reduction in uncertainty regarding the value of making specific commitments to countries over time, as these would be based on the experience obtained by having implemented them already.[9]

In an nutshell, the implications of the suggested approach are that the primary roles of the WTO would 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, monitoring the provision of development assistance, as well as a lock-in device for policy reforms that have been

[8] 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."

[9] The type of model we have in mind is discussed in more general terms in Hoekman (2005). As discussed there, the process would need to involve national regulators and economic policymakers – i.e., extend beyond the trade officials representing countries at the WTO.

deemed to be beneficial. Again, the appropriate role of the WTO in this area is not to provide assistance, or to allocate it. What the WTO can best do is to be the focal point for regular policy attention and interaction on services. No other organization can play that role or has an incentive to do so.

The proposed approach does not imply ceasing to negotiate binding disciplines. Instead it would put the focus more strongly on a country's identification and pursuit of a national policy agenda and priorities and to link this to aid-for-trade. Rather than focus predominantly on legally binding commitments, the emphasis would be put on identifying the goals and objectives of governments and how these could be met, with specific commitments under the GATS being one element of the latter.

Mobilizing and allocating aid for services trade

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.[10] In Hong Kong a number of specific commitments were made by donors to expand allocations for trade assistance. There is still considerable uncertainty how aid for trade is best operationalized. The Hong Kong ministerial calls for the creation of a task force with the mandate to make specific proposals to the WTO General Council in July 2006. Numerous questions need 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.[11]

Whatever is agreed on the allocation mechanisms and modalities, much of the aid for trade agenda at the country level in our view revolves around improving the quality and cost of services. The agenda goes far beyond technical assistance to help countries make market access commitments – the focus of the status quo (as illustrated for example by the language on technical assistance for services negotiations in the Hong Kong ministerial declaration). The agenda spans not just technical assistance for

[10] An important first step towards mobilizing additional resources to address such needs and bolster trade capacity was the commitment by the G-8 Heads of Government in 2005 to increase aid to developing countries to build physical, human, and institutional capacity to trade, and to grant additional support for trade capacity building, to take advantage of the new opportunities to trade that will result from a positive conclusion of the Doha Round. At the September 2005 IMF/World Bank annual meetings, Ministers endorsed the need to expand aid resources to bolster trade capacity in developing countries.

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

regulatory strengthening but resources to strengthen services-related infrastructure. As discussed previously, to benefit from trade opportunities, many developing countries must bolster the competitiveness of firms and the farm sector through actions to lower the cost of, and increase access to, services such as energy, transport, finance, and communications. This in turn requires a mix of policy reforms and investments in infrastructure, training, institutional development, etc.

The types of intervention that will have the most effect in increasing the gains from liberalization are unlikely to be uniform across countries. For example, Barth et al. (2006) offers a recent – indeed, the first – comprehensive cross-country assessment of the impact of bank regulation on the operation of banks and assesses the validity of the Basel Committee's influential approach to bank regulation. They conclude that viewing the reform of bank regulation and supervision as a narrow technical issue is risky because the impact of bank regulation reflects host countries' complex economic and political institutions. They find no evidence that any single set of "best practices" is appropriate for promoting well-functioning banks in every country. Furthermore, their results suggest that the conventional prescriptions of empowering direct official supervision of banks and strengthening capital standards may be ineffectual. Indeed, it may even have perverse results. A key finding is that fortifying official supervisory oversight and disciplinary powers actually impedes the efficient operation of banks, increases corruption in lending, and therefore hurts the effectiveness of capital allocation without any corresponding improvement in bank stability. Their conclusion that societies that emphasize market-based monitoring of banks enjoy superior outcomes may be open to question, but there is no questioning the powerful cautionary message that there are few well-established and standardized prescriptions for bank regulation. There is need, therefore, for a high degree of country specificity in both diagnosis and remedial action.

Supporting regional cooperation on services

For small countries in particular there may be economies of scale that can be realized through regulatory cooperation – harmonization or mutual recognition of qualifications, technical standards, prudential regulation, etc. Technical assistance could be used to determine "what, where and how much". For example, should regulations in say,

professional services be harmonized first within a subset of, say, COMESA countries, on a COMESA-wide basis, or directly vis-à-vis the EU (in the context of the future Economic Partnership Agreement), or not at all? To some extent the needs confronting governments with respect to regional cooperation are similar to those that arise in the GATS context: whether to bind (in some or all dimensions) immediate or gradual market opening, or not to bind at all. But much of the agenda at a regional level will span issues that are not relevant to a multilateral context – e.g., "local" cross-border spillovers or club goods such as roads and shared ports, joint tourism marketing, development of regional infrastructure hubs, etc.

For smaller countries, regulatory cooperation may allow the substantial fixed costs associated with regulatory bodies to be shared. For example, in basic telecommunications, apart from spectrum monitoring equipment, computers and programs, there is the cost of professional assistance for activities such as interconnection, cost estimation and spectrum management. An example is the Eastern Caribbean Telecommunications Authority (ECTEL), the first regional telecommunications authority in the world. Although the member countries retain their sovereign power over licensing and regulation, ECTEL provides technical expertise, advice and support for national regulations. Apart from the economies of scale in establishing a common regulator, there are at least three other advantages. It will promote the development of harmonized and transparent regulation in the region, allow for a greater degree of independence (and hence credibility) in regulatory advice, and enhance bargaining power in negotiations with incumbents and potential entrants.

Improving domestic access to better services

Improving regulation is important but the payoffs to the associated investments are a function of the private sector response. For the poorest countries in particular, this response may be muted and take long to materialize. Moreover, structural factors such as economic size or location may imply that some countries or parts of countries will not be attractive enough to induce entry by private firms, whether foreign or domestic. Or, the market may be too small to allow vigorous competition.

Such situations could be addressed to some extent by targeting aid for trade on

service providers to encourage them to provide services in remote and disadvantaged regions in poor countries and/or to lower the prices of such services below what would be needed to cover costs. In our view this could be an important dimension of an effective "aid for trade" strategy to complement and support multilateral trade reforms. Here we are not thinking of fiscal investment or entry incentives of the type offered by virtually all developing countries to foreign investors. These are costly and in any event of dubious value insofar as incentives are generally not conditional on performance requirements of the type we are envisaging here. Instead, the idea is to use development aid funds to induce services firms – foreign or nationally owned – to provide specific services to households that otherwise would not be served.

The experience of a number of countries in a number of sectors has improved our understanding of the universal access policies that must complement market-based reforms to ensure improved access for the poor at least in infrastructure services. In network industries such as telecommunications or electricity private providers could compete for performance-based subsidies related to providing services to the poor.[12] This would ensure that the poor to reap some of the benefits of competition, and allow the government to discover the true cost of service provision. For instance, in Chile, government subsidies equivalent to less than 0.5 percent of total telecommunications revenue, allocated through competitive bidding in 1995, mobilized 20 times as much private investment to extend basic telephone services to rural areas (Wellenius, 2000).

An international arrangement that replicates the key elements of successful national schemes may be one way to use additional aid for trade resources to increase support for pro-competitive reforms. This could involve countries (or regions) that are willing to eliminate barriers to investment being given assistance to put in place both the necessary regulatory reforms *and* granted access to a "universal service provision fund" in instances where the investment response from domestic and foreign firms had been inadequate. The fund would provide a subsidy to firms to create infrastructure and/or provide services in the relevant region or country at pre-specified terms. Along the lines

[12] But the picture is far less clear in other, especially social, services. We do not know whether this is because these services are inherently different, e.g. because performance is so much more difficult to measure, or because Governments have justifiably been far less adventurous in experimenting with new policies in these areas.

of the policies put in place in Chile and several other countries, these terms could be established as the result of an auction or bidding process under which firms would indicate the minimum level of subsidy they would require to fulfill the mandate set out by the government. Note that this form of assistance does not target specific industries or firms, as would industrial policies or trade preferences. Rather the objective would be to improve the availability and quality of services for all firms, farms and households.[13]

4. Conclusions

Numerous recent assessments of the impacts of ambitious global trade policy reform (liberalization) on poverty have concluded that the associated relative price changes will generally benefit the poor disproportionately, including the poor in the poorest countries.[14] Agriculture is very important here – the best available global models clearly reveal that most of the gains in the area of trade reform for goods will be due to agriculture. But the global models neglect what may well be the greatest source of potential gains from trade liberalization: services.

The Doha negotiations on services are not making much progress. In part this is because liberalization of trade in goods has been central to much of the discussion to date – there has been less interest in, and thus attention given to, the services agenda. The neglect matters. Foreign services suppliers can do much to improve competitiveness and consumer welfare in developing countries by providing a greater variety of quality services at lower prices. The costs of neglecting services are both direct – less being done through the Doha Round to improve services policies – and indirect – reducing the incentives for the EU and other industrialized countries to do more on agriculture.

There is much that can and should be done through the WTO on services, but this will require a change in approach and emphasis. The focus to date on negotiating market access commitments (liberalization) on a quid pro quo basis does not do enough to generate the political economy support/incentives needed for countries to take a strong

[13] In the case of trade preferences proposals have been made to shift towards financial instruments, on both efficiency and systemic grounds, and as a mechanism to compensate beneficiary countries for the erosion of the value of preferences as MFN barriers are lowered. The services proposals made in this paper could also be part of an effort to address preferences erosion losses, but they are primarily focused on the set of countries that have not been able to utilize preferences as a result of supply constraints.

[14] See, e.g., the various papers in Hertel and Winters (2006) and Hoekman and Olarreaga (2006).

interest in the services talks. This is true especially for small, poor countries that do not offer much in the way of an attractive market to (potential) foreign suppliers, and whose private sector does not perceive significant opportunities to contest foreign service markets. But, even for larger countries there are legitimate concerns regarding the ability to put in place the regulatory preconditions to benefit from opening up service markets to greater foreign competition.

Moving forward on multilateral services liberalization arguably requires a change in negotiating modalities. Shifting from bilateral request-offer methods to a model schedule approach that sets ambitious objectives – full national treatment for the major backbone services – may improve prospects for achieving a more ambitious Doha Round outcome. But a precondition for achieving agreement on an ambitious focal point for the services negotiations is to put in place mechanisms that will bolster pro-competitive regulation and strengthen regulatory authorities in developing countries. It is here that the WTO could play a much more prominent role, both through a shift towards "model schedules" to define more relevant sectoral commitments, and by helping to mobilize the technical and financial assistance that is needed to improve regulatory capacity in poor countries.

Many countries need assistance to put in place the regulatory mechanisms that can help ensure the potential benefits from liberalization are realized. Such assistance needs to go beyond the public sector in developing countries and be used to more directly attract investment into the poorest countries and generate the incentives for firms to provide services in markets and areas that otherwise would not be served in poor countries. There is great potential for OECD countries to both do good – assist developing countries to benefit from services-related reforms – while also doing well in terms of obtaining better access to developing country markets. The comparative advantage of the WTO in this connection is to act as a focal point, a mechanism to increase transparency and accountability in both developing countries as regards policies and outcomes, and in industrialized countries in terms of the assistance that has been granted.

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