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Regulatory Cooperation, Aid for Trade and the General Agreement on Trade in Services

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Abstract

This paper discusses what could be done to expand services trade and investment through a multilateral agreement in the World Trade Organization. A distinction is made between market access liberalization and the regulatory preconditions for benefiting from market opening. The authors argue that prospects for multilateral services liberalization would be enhanced by making national treatment the objective of World Trade Organization services negotiations, thereby clarifying the scope of World Trade Organization commitments for regulators. Moreover, liberalization by smaller and poorer members of the World Trade Organization would be facilitated by complementary actions to strengthen regulatory capacity. If pursued as part of the operationalization of the World Trade Organization's 2006 Aid for Trade taskforce report, the World Trade Organization could become more relevant in promoting not just services liberalization but, more importantly, domestic reforms of services policies.

This paper—a product of the Trade Team, Development Research Group—is part of a larger effort in the department to study the impact of trade in services on economic growth and development. Policy Research Working Papers are also posted on the Web at http://econ.worldbank.org. The author may be contacted at bhoekman@worldbank.org.

Regulatory Cooperation, Aid for Trade and the General Agreement on Trade in Services*

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Introduction

Recent literature surveys document that the potential gains from liberalization of trade in communications, finance, transport, business and other services are large (Hoekman, 2006; Deardorff and Stern, 2007). For many countries the potential gains are significantly larger than those that could be derived from further liberalization of goods trade. Moreover, even exploiting the opportunities arising from goods trade liberalization will require better services. For example, Indian horticultural producers receive only one-sixth of the price that consumers pay because of inefficient storage, transport and distribution (Mattoo, Mishra and Narain, 2007).

Notwithstanding the prospective gains from liberalization, WTO negotiations under the General Agreement on Trade in Services (GATS) have been going nowhere. The best market access offers made in the Doha Round do not even reflect the liberalization that countries have already implemented (Adlung and Roy, 2005). As a result, there is a serious risk of the GATS becoming irrelevant – increasingly lagging behind developments in service technology, regulation and business practice.

After five years of fruitless negotiations on services, in 2006 WTO members launched an effort to complement the bilateral request-offer process with a plurilateral or "collective" approach. This involved subsets of the WTO membership seeking to agree to a common "minimum" set of policy commitments for a given sector. While arguably a step forward, we argue in this paper that for there to be a reasonable prospect of achieving significant increases in the coverage and depth of services commitments by WTO Members, more attention is needed for the regulatory context in which services liberalization takes place. In particular, regulators must be reassured that GATS commitments will not deprive them of the freedom to regulate; that liberalization will not be prematurely thrust upon countries with weak regulatory institutions; and that liberalization will be supported by international cooperation.

Providing credible assurances that GATS commitments will only deprive regulators of the freedom to discriminate, and not limit their freedom in any other way, is necessary but not sufficient for a significant expansion in GATS commitments to occur. As, if not more, important is creating an effective multilateral mechanism to provide regulatory assistance to countries that need it. Dedicated assistance to improve regulatory capacity in developing countries would help reassure policymakers that regulatory inadequacies that could undermine the benefits of liberalization will be diagnosed and remedied before any market-opening commitments take effect. Such assistance is arguably also critical for any significant liberalization of policies restraining temporary entry of foreign services providers: host countries need to be assured that source countries are willing and able to screen services providers, to accept and facilitate their return, and to combat illegal migration.

An important step towards recognizing the importance of technical and financial assistance as a necessary (but not sufficient) condition for liberalization of trade to generate greater benefits in poor countries was made in 2006 with the report on the WTO taskforce on Aid for Trade (WTO 2006). If services in general, and regulatory design and enforcement capacity more specifically, are given greater attention by countries in the operationalization of the recommendations of the taskforce, the prospects for mutually beneficial multilateral liberalization of trade in services could be much enhanced. In this paper we identify a number of areas in which regulatory cooperation and assistance would both be beneficial to recipients and support multilateral liberalization.

The plan of the paper is as follows. Section 1 discusses the economic fundamentals – why services and services trade and investment liberalization matter. Section 2 turns to the WTO and asks why such limited progress has been made multilaterally in delivering greater openness of services markets. Section 3 focuses on what could be done through 'aid for trade' to complement WTO disciplines by helping smaller and poorer members – the majority of the WTO membership – put in place both the regulatory mechanisms needed to achieve efficiency and equity objectives and assist in addressing some of the adjustment costs that will be generated by liberalization. Section 4 concludes.

1. Gains from Trade in Services

It is only relatively recently that technological change and policy reforms allowed an increasing number of services to be traded internationally through telecommunications networks. These developments have allowed an increasing number of services markets to be contested internationally through cross-border trade (mode 1 of the GATS) and FDI (mode 3).[1] The average annual growth rate of business service exports for Brazil and China during 1995-2005 was 15 percent, for India it was 25 percent.[2] As a result, the share of traditional services such as transport and tourism in world trade has been falling steadily, although in absolute terms these activities have been growing at similar rates as world trade in goods, driven by improvements in technologies and reductions in the unit costs of transporting both containers and people across the globe.

Policy reforms – liberalization, privatization – have complemented changes in technology in supporting the expansion of trade in services. These policy reforms have mostly been implemented by governments autonomously. There are powerful economic reasons to pursue policies to increase the contestability of services markets. 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, as this service is both an intermediate input and a “transport” mechanism for information services and other products that can be digitized. Similarly, transport services contribute to the efficient distribution of goods within and between countries and are the means through which services providers move to the location of clients (and vice versa). 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 distribution services are a vital link between producers and consumers, with the margins that apply in the provision of such services influencing the competitiveness of firms on both the local and international market.

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.

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[1] Four ways or “modes” of engaging in trade in services are distinguished in the GATS: cross-border (mode 1); through movement of the consumer to the location of the provider (mode 2); through longer-term cross border movement of the provider – i.e., establishment of FDI (mode 3); and temporary movement of providers (natural persons) (mode 4).
[2] The leader in this area was Ireland, with an annual rate of business services export growth of 31.6 percent.

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.

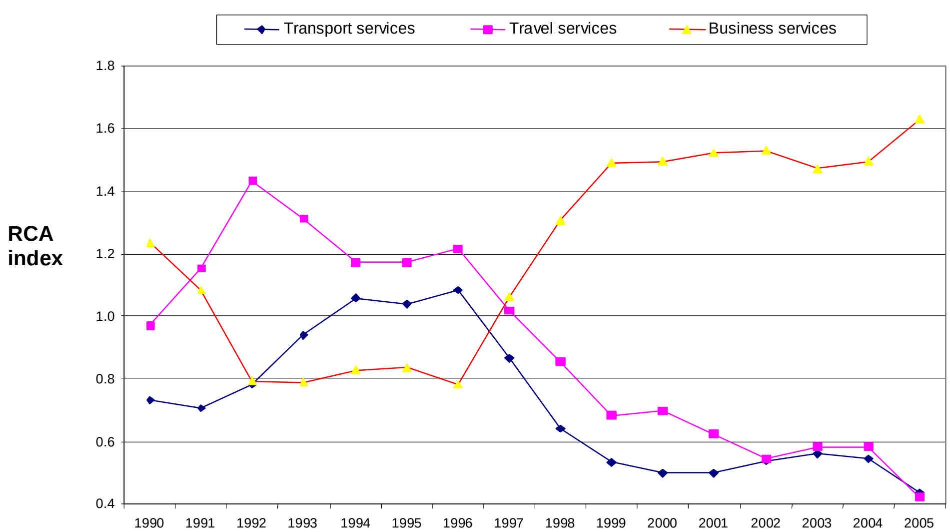
The positive association between more efficient service sectors and overall economic performance implies that services policy reforms will help reduce poverty – as sustained economic growth is the most powerful instrument to reduce poverty. Underlying this aggregate, indirect relationship are many channels 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. Numerous country studies have concluded 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, better access to credit and transportation services, and investments in infrastructure.[3] 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

[3] See, e.g., the country studies in Hertel and Winters (2006) and Hoekman and Olarreaga (2007).

many of them are services-related.

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 – reflected in a rising index of revealed comparative advantage in business services (Figure 1) – is creating space for other developing countries, from China to Senegal, to step into the more standardized segments of the market.

Figure 1: Shifting Comparative Advantage -- India's RCA for Services Exports



As noted above, the increase in global trade in business services reflects a mix of technological changes that allow more services to be traded cross-border and policy reforms. However, numerous barriers to trade and investment continue to prevail in most countries. The consensus view is that the tariff equivalents of these barriers are a multiple of those affecting merchandise trade.[4] Studies that use available information on prevailing policies conclude that further services liberalization would have much greater positive effects on national welfare than the removal of trade barriers – see e.g., Konan and Maskus (2006) on Tunisia and Jensen, Rutherford and Tarr (2006) on Russia. Instead of the "standard" 1 percent increase in welfare from goods liberalization, introducing greater competition on services markets raises the gains to the 5-10 percent range or more. These large potential effects of services liberalization reflect both the importance of services in the economy and the extent to which many of them continue to be protected. Insofar as such protection reflects standard political economy factors – a desire by domestic incumbents and workers to retain rents, fears by policymakers regarding adjustment costs – there appears to be great scope to use the WTO as a mechanism to implement additional liberalization.

2. The GATS: Asymmetric Interests and Regulatory Constraints

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 original GATT-1947 did not cover services for the simple reason that at the time the GATT was negotiated, services were mostly nontradable. 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 not only a mechanism for enhancing access to export markets and overcoming resistance by domestic interests to liberalization, but also may be a vehicle for agreement on policy reforms ("good regulatory practices"). The stylized fact that looms large here is that while some progress has been made to date in using the GATS framework to lock-in unilateral reforms that have already been implemented, the GATS has played virtually no role in inducing new liberalization. Indeed, it is fair to say that to date the GATS has been a disappointment.

[4] See Hoekman (2006) and Mattoo, Stern and Zannini (2007). No comprehensive, cross-country, comparable datasets exist that allow a summary assessment of the prevailing levels of services trade and investment barriers.

Adlung and Roy (2005) have assessed both the current coverage of specific commitments of WTO members in the GATS and the offers that were on the table as of 2006, when negotiations were suspended. For many countries the coverage of specific commitments is well below 50 percent of all services and modes of supply. Adlung and Roy conclude that not only do the requests and offers made in the 6 years following the launch of negotiations on services in 2000 imply little if any liberalization of policies; most countries were not even willing to use the GATS as a vehicle to "lock in" existing levels of openness.[5]

The lack of progress on services matters for several reasons. First, as mentioned in the Introduction, the extant research concludes that the potential direct gains from reform of services trade for most WTO members are likely to be large. Second, services reform is needed to enable developing countries to take advantage of the new opportunities that arise from goods trade liberalization. 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. Third, the WTO negotiating process requires countries that seek better market access to offer improved access to their own markets. In particular, attaining global liberalization of agriculture – a key objective of many developing countries – will require them to offer a quid pro quo. Greater opening in services, an area of export interest to many of the countries that protect their agriculture sectors is one obvious quid pro quo. For example, services exports are of key importance for the EU and India, two WTO members that confront serious political resistance to reducing barriers to trade in agriculture.

A number of possible explanations for the lack of headway can be identified. As is well known, the WTO is driven by mercantilism: the desire by members to improve their access to the markets of other members. One explanation for the limited progress is that the standard mechanisms of reciprocity as developed over 50 years of GATT practice

[5] A number of studies have shown that there is often a major gap between the actual level of openness of sectors and the level of commitments in the GATS. For example, Barth et al. (2006) compare data on specific GATS commitments for financial services with measures of actual policy in this sector for 123 countries. They conclude that in practice applied policy is much more liberal than what was committed to in the GATS.

do not readily apply to services. There are at least two possible reasons for this: (i) the export interests that have been harnessed to allow the reciprocal liberalization of trade in goods do not prevail sufficiently in the services context; and (ii) regulatory concerns impede the ability (willingness) of WTO Members to engage in what Jagdish Bhagwati has termed "first difference" reciprocity (Hoekman, Mattoo, and Sapir, 2007).[6]

Asymmetric interests

In the case of merchandise trade all WTO members have clear interests in improving access to export markets. Some countries are more diversified than others and all have differential specific interests – but all countries are exporters of goods that are subject to trade barriers in partner country markets. Thus they have exporters that see potential benefits from multilateral negotiations. This is less the case for services. While many developing countries – the majority of the WTO membership – are significant exporters of services, often the associated foreign exchange earnings are derived from activities where the relevant policies are under the control of the government as opposed to trading partners. 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 cross-border trade in services via telecommunications networks is concerned, developing countries have export interests, but this channel for trade is often not constrained by policy in the importing country (with the exception of services such as gambling where importing countries may reserves the activity to the State or ban it altogether). 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 FDI (mode 3, or establishment), most developing countries do not

[6] These issues were identified early on in the literature on trade in services. On the problem of asymmetric interests, first difference reciprocity and limited and concentrated export interests, see e.g., Hoekman (1994, 1997). On the importance of sectoral regulation and the interests of regulators was identified by economists early in the process of multilateral negotiations on services – see e.g., Feketekuty (1988) and Messerlin (1990).

have significant "offensive" interests – they do not have indigenous multinational service providers seeking better access to foreign markets. This is a mode that is primarily of interest to firms based in high-income countries and large emerging economies.

The one mode where developing countries confront particularly high barriers and that is therefore of great relevance to potential exporters is mode 4. However, mode 4 is politically extremely sensitive. Insofar as there are no serious prospects for mode 4 liberalization in the GATS framework, most of the potential export interests in many developing countries are disengaged from the process.

These considerations imply that a key driver 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 (FDI) agenda. The implication is that if access negotiations are to be restricted within the services arena, deals are likely to be limited to mode 3 exchanges (largely an intra-OECD/large emerging markets affair) or better access for developing countries through mode 4 to OECD markets in return for mode 3 liberalization by developing countries. As argued below, a precondition for making headway in the liberalization of mode 4 is regulatory cooperation between host and source countries – limiting the focus to "trade policy" concessions by potential host countries (e.g., seeking to negotiate market access quotas) is only likely to be feasible if complemented by a commitment by source countries to manage such trade.

Regulatory constraints

The intangible nature of most services makes it hard for buyers of services to investigate or test their quality prior to purchase. The extent of asymmetric information often creates a necessity to regulate services in order to protect consumers. Regulating services may also be desirable in order to remedy other types of market failures, including imperfect competition, which is often present in network services such as telecommunications where the number of providers is limited, and externalities. Externalities may cause a problem if there is also imperfect information – e.g., in the case of financial services, where the failure of one institution may cause problems to the entire sector. For all these reasons, activities tend to be highly regulated.

Although consumers should in principle favor reforms that increase the number of suppliers and, in principle, lower prices and/or increase the range of services offered, they may in fact oppose them for fear that reforms will lower service quality and/or increase the market power of (foreign) firms. Regulators may be concerned that trade liberalization will impede their ability to enforce domestic regulatory standards. Trade will bring with it regulatory competition if services suppliers are only subject to the norms and standards that apply in their home markets. This is particularly likely to be the case for mode 1 trade. As case in point was the dispute between Antigua and Barbuda and the US on gambling services. The WTO Panel and Appellate Body ruled that the US prohibition of internet gambling was inconsistent with the specific commitments the US had made on market access, even though the US prohibition applied *equally* to foreign and US providers. The inconsistency arose because specific commitments on market access preclude even non-discriminatory (regulatory) prohibitions. Similarly, if mode 4 trade is permitted to occur on the basis of the qualifications and certifications obtained in the home country of providers, there may be concerns regarding whether host country norms are met. A critical – and difficult – question then is how to differentiate between legitimate concerns relating to quality and performance, and regulatory requirements that simply constitute barriers to entry, creating rents for incumbents by raising prices.

In addition to concerns about the ability to enforce national regulatory standards, in developing countries liberalization may raise an additional regulation-related issue: achieving social equity objectives. The impacts of more competitive market structures following liberalization on access to services by poorer households in developing countries have been mixed. In cases like mobile telecommunications, a positive relationship has been observed in many developing countries because initial conditions were bad – few households had access. However, in other areas, like financial services, unless improved regulatory measures are put in place, liberalization may have an adverse effect on access to credit for rural areas and the poor. Putting in place mechanisms to ensure better access to services post-liberalization is important from an equity perspective. It is also important from a political economy perspective to bolster support for implementing efficiency enhancing policy reforms and sustaining them over time.

Absent actions to address regulatory weaknesses, countries may not be in a position to fully realize the potential benefits of trade reforms in services (*or* goods).

The prevalence of regulation further complicates and constrains use of the traditional GATT reciprocity mechanism for services because it is very difficult to design multilateral rules and national commitments in a way that clearly separates or distinguishes between measures that are protectionist and measures that have good domestic efficiency or social equity rationales. As the focus of WTO negotiations is not on the welfare of members or on the identification of "good" policy, regulators may therefore be concerned that market access negotiating dynamics could adversely affect their ability to design and implement regulatory norms that maximize national welfare.[7]

Emerging Multilateral Responses

Between 2000, when as specified in the GATS new multilateral services negotiations were launched, and the end of 2005, WTO Members pursued a bilateral approach to negotiations, submitting requests to others and responding to requests with (conditional) offers. Requests tended to be highly ambitious and offers mostly minimalist. The large asymmetries in interests across the membership impeded progress, with most small and poor countries not perceiving much of an incentive to offer significant commitments.

A different tack was introduced at the December 2005 WTO ministerial meeting in Hong Kong. Annex C of the 2005 WTO ministerial declaration endorsed a shift towards plurilateral or collective negotiations among subsets of members. Plurilateral requests were to be made by end February 2006, followed by bilateral/plurilateral negotiations leading to submission of revised offers by July 2006. The idea was to limit talks to a critical mass of countries, so as to reduce transactions costs while still ensuring that most of the gains from agreement would be internalized among those participating. The pursuit of what Schelling (1978) has called a "k-group strategy" – the minimum number of countries ('K") out of a larger set ("N") that internalizes enough of the total potential gains from cooperation to make free riding by the remaining N-K players feasible – is easier to implement in the WTO setting for services than it is for goods trade

[7] One potential explanation for the steadily expanding number of bilateral or regional trade agreements that include services is that cooperation on services policies is easier to achieve in a small numbers context.

because of the way the GATS is structured.[8] The positive list approach to define the country coverage of specific commitments on a sector-by-sector basis already requires that negotiations be sectoral.

The decision to move to negotiations among subsets of countries and focus on agreeing to a set of "minimum standards" for liberalizing commitments— 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 – implies a move away from the type of first difference reciprocity that is the bread and butter of GATT negotiations. Instead, the focus becomes achieving a common set of policies that apply to all signatories, while allowing for de facto differentiation between WTO members in terms of participation. Countries that have little to offer for a specific sector or mode are effectively exempted from participation – they can "free ride" on the outcome of negotiations between the "principal stakeholders".

Plurilateral talks were pursued among some 30-40 countries starting in early 2006.[9] Requests were tabled for legal; architecture/ engineering; computer-related; postal/courier; telecommunications; audiovisual; construction; distribution; education; environmental; financial; maritime; air transport; and energy services, as well as cross-border trade (modes 1/2); mode 3; mode 4; and MFN Exemptions (general, financial and audiovisual) (Chaudhuri, 2006). The negotiations involved mostly OECD members and large emerging economies. Requests were generally less ambitious than those made bilaterally, which often called for full market access and national treatment in sectors of export interest to the demandeur. Two rounds of talks were held before the Doha round was suspended in July 2006. A third set of meetings occurred in April 2007 after negotiations resumed. News reports suggest that although progress was made as a result of the shift to the new negotiating modalities, the inability to move forward on agriculture and nonagricultural market access dominated the efforts of negotiators. At the time of writing it is not possible to assess what the ultimate outcome of the plurilateral approach will be (might have been).

[8] Article XIX GATS mentions plurilateral negotiations as modality that could be used by Members.
[9] Past practice suggests that for sectoral liberalization agreements to be applied on a MFN basis the "internalization" ratio needs to be on the order of 90 percent of total trade. This was the figure used in the negotiations on the Information Technology Agreement.

Although WTO members clearly recognized a change in tack was needed to deal with the problem of asymmetric interests, the shift towards small(er) group negotiations does not address the regulatory constraints identified above: worries about regulatory autonomy (which apply as much to the large players involved in the plurilateral talks as to the countries that are permitted to free ride) and limitations in the capacity of poor countries to put in place and enforce regulatory measures to complement liberalization. Indeed, by effectively excluding the majority of the WTO membership from negotiations, the plurilateral approach creates a new problem: exempted countries may not be confronted with a need to liberalize, but they also are excluded from the potential gains associated with undertaking domestic policy reforms themselves. Moreover, insofar as such reforms are needed to exploit export opportunities, they may also lose out on that front. The first problem can be resolved through explicit measures that guarantee to regulators that their autonomy will not be constrained by the GATS. Mattoo (2005) and Hoekman, Mattoo and Sapir (2007) argue that making national treatment the primary objective of negotiations would do much to provide such assurances. The second problem requires actions to assist developing countries to improve domestic regulatory capacities. Despite increasing recognition among WTO members that more needs to be done to provide assistance to developing countries to bolster trade capacity – exemplified by the creation in Hong Kong of an "Aid for Trade" taskforce – to date services have not attracted much attention in aid for trade deliberations.

3. Supporting Services Reforms in Developing Countries

In the WTO services negotiation, many developing countries have pursued three goals: retaining flexibility in making liberalizing commitments; securing commitments from other countries in sectors and modes of export interest to them; and obtaining assistance to enhance the capacity of their services sectors. To date they have succeeded in achieving only the first goal. Over the last decade, the international trading community has moved towards progressively less demanding positions vis-à-vis the poorest developing countries. GATS Article IV on the Increasing Participation of Developing Countries notes that "Particular account shall be taken of the serious difficulty of the least-developed countries [LDCs] in accepting negotiated specific commitments in view of their special economic situation and their development, trade and financial needs." The December 2005 Hong Kong Ministerial Declaration went even further, stating, "We recognize the particular economic situation of LDCs, including the difficulties they face, and acknowledge that they are not expected to undertake new commitments."

With respect to the other two goals, the LDCs have had less success. Beginning with GATS (in Articles IV and XIX), and continuing through the Hong Kong Ministerial Declaration, there have been exhortations that WTO Members "give special priority to providing effective market access in sectors and modes of supply of export interest to LDCs, through negotiated specific commitments …" (Article XIX GATS). As already noted, little has been offered in the area of greatest export interest for the LDCs: mode 4, especially the provision of services through the movement of unskilled workers.

Assistance to develop services sectors has also not been very forthcoming in the WTO context, although calls to mobilize additional aid resources to support trade capacity-building in developing countries have proliferated in recent years.[10] The focus of the WTO is on market access. 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 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 may be good reasons to defer liberalization and/or not to make binding commitments if there are weaknesses in prudential or pro-competitive regulation, adjustment costs are likely to be severe and affect the feasibility/sustainability of reform.

At the 2005 WTO ministerial in Hong Kong a number of specific commitments were made by high-income countries to expand allocations for trade assistance. The

[10] An important first step towards mobilizing additional resources was the commitment by the G-8 Heads of Government at Gleneagles 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. At the September 2005 IMF/World Bank annual meetings, Ministers endorsed the need to expand aid resources to bolster trade capacity in developing countries.

Ministerial Declaration requires Members to provide “targeted and effective technical assistance and capacity building for LDCs ... to strengthen their domestic services capacity, build institutional and human capacity, and enable them to undertake appropriate regulatory reforms.” The challenge is to operationalize this commitment and to extend it to a broader set of developing countries.

The ministerial meeting agreed to create a task force with the mandate to make specific proposals on moving forward on aid for trade to the WTO General Council in July 2006. In its July report – one of the few instances where a deadline established in the Doha round was met – the taskforce stressed the central role of country ownership and of mainstreaming trade into countries’ development strategies, and called on donors to provide additional funding on a predictable basis. The report defined aid for trade as covering assistance for trade policy (including training, analysis, and institutional and technical support), trade development activities (including trade and investment promotion, business support services, trade finance and other activities), development of trade-related physical infrastructure, building productive capacity, and support for trade-related adjustment. This wide definition of aid for trade implies that many services will be covered, although where the boundaries may lie in practice remains to be determined.

The report proposed that WTO members explore the necessity of establishing a mechanism similar to the Integrated Framework for Trade-related technical Assistance (IF) – a joint venture involving the IMF, ITC, UNCTAD, UNDP, WTO and the World Bank that assists LDCs in identifying trade priorities and designing project proposals to address them – to assess priorities in non-LDCs; calls for donors to make funds available for building infrastructure and removing supply-side constraints – over and above capacity building and technical assistance – including in the form of co-financing with multilateral development bank; urged donors and agencies, together with regional banks and organizations, to step up their efforts to identify regional, sub-regional and cross-border trade projects; proposed an annual review of Aid for Trade by a monitoring body in the WTO to be discussed in the WTO General Council, and suggested that an assessment of aid for trade be included in WTO Trade Policy Reviews.[11]

[11] See Prowse (2006) and Njinkeu and Cameron (2007) for in-depth discussions of “aid for trade,” including the genesis and functioning of the IF and options for moving forward.

The taskforce does not provide specific proposals in its report to operationalize its recommendations. Numerous questions remain to be resolved, 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. 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 much current assistance (as illustrated for example by the language on technical assistance for services negotiations in the Hong Kong ministerial declaration). It spans helping countries overcome the political economy factors that impede liberalization; improving domestic regulation; adopting measures that spread the benefits of liberalization to poor and disadvantaged households; support for the pursuit of regional cooperation; and measures that are preconditions for obtaining and exploiting better market access in export markets. What follows briefly discusses each of these areas.

Political economy: redistributing rents and dealing with adjustment costs

Poor policies in many countries often reflect standard political economy forces: those who gain (or are not hurt) from current policies are more economically and politically powerful than those who lose. In the case of telecommunications, for example, the incumbent provider may confront an administered price structure (with artificially high international prices and artificially low local prices). Liberalization will require tariff rebalancing to allow the incumbent to compete on the international segment. The resultant increase in local call prices is likely to be resisted by the politically vocal urban consumers, though the prospect of more competitive mobile telephony may dilute such opposition. Putting in place transparent and credible compensatory measures (e.g. voluntary retirement schemes, access to cheaper mobile telephony) could help persuade the incumbent's employees and urban consumers to accept reform.

Similar forces play out in other sectors. In Zambia,[12] a country that being landlocked confronts higher transportation costs than many coastal countries, high costs are partly due to restrictions that Zambia imposes on air and road transport. While these

[12] What follows draws on detailed analyses in Mattoo and Payton (2007).

are detrimental to exporters, they benefit import competing interests and domestic transport service providers.[13] In accounting, local professionals in Zambia are geared almost entirely towards the lucrative large firm market and the use of international accounting and auditing standards. Although these are recognized to be excessively burdensome (costly) for SMEs, the accounting profession has an interest generating the revenue associated with audits.

Identifying the magnitude and incidence of the costs and benefits of prevailing policies that inhibit competition from foreign providers and developing mechanisms to assist losers is one area where aid for trade resources can make a difference in helping governments deal with vested interests that resist changes to the status quo.

Implementing appropriate domestic regulation

As noted previously, regulation is often needed in services sectors to achieve efficiency and equity objectives. Designing appropriate regulatory standards and institutions takes time, as they often must be tailored to national circumstances to be effective and attain the desired objective. An increasing body of evidence has shown that a "one size fits all" approach – including international "best practice" norms – may not be appropriate. Reverting to the example of Zambia, in addition to the accounting example just mentioned, burdensome regulatory requirements for banks relating to documentation, collateral, and money laundering restrict access to credit for small enterprises and the rural poor, while not affecting much large firms or the urban rich. A fear of being blacklisted generates a chilling effect on the incentives for banks to explore or propose less burdensome alternatives to regulatory requirements.

The Zambia case illustrates the types of complementary measures that will have the most effect in increasing the gains from liberalization will not be uniform across countries. Barth, Caprio and Levine (2006), in the first comprehensive cross-country assessment of the impact of the Basel Committee's influential approach to bank regulation, conclude that there is no evidence that any single set of "best practices" is appropriate for promoting well-functioning banks. There is need, therefore, for a high

[13] E.g., foreign entry in cabotage activities is prohibited and international transporters may move products between two foreign countries only if they pass through their own country.

degree of country specificity in both diagnosis and remedial action. This is more time- and labor-intensive – i.e., expensive – than is the adoption of (international) norms "off the shelf."

Improving domestic access to better services

For the poorest countries in particular, the desired investment response to liberalization (entry by foreign providers) may be muted and take long to materialize.[14] 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 will result in limited access, if any, for many poor households or rural communities. Improving the distribution of access to services could be achieved 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 of dubious value. 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 the last decade has improved our understanding of how universal access policies can be used to complement market-based reforms to improve access for the poor to 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.[15] This would ensure that the poor to reap some of the benefits of competition, and while minimizing outlays for the government – the "reverse auction" process allows it to discover the true

[14] What follows draws in part on Hoekman and Mattoo (2007).
[15] The picture is less clear for 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 been less willing to experiment with new policies in these areas.

cost of service provision. Countries such as Chile, Peru and Uganda have put in place such mechanisms, which have helped to expand services to areas that otherwise would not have access. Based on the Chilean experience,[16] Kenny and Keremane (2007) estimate that an upper bound on the amount needed for achieving universal access to basic telecommunications using competitively awarded subsidies to private providers in developing countries is some $5.7 billion. Of this amount, $1.8 billion could not be supplied by a reasonable tax on existing providers, and would need to be generated from outside the sector. Most of this – some $1.5 billion –would be needed in Africa.

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. Funds would be made available to 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 of the policies put in place in Chile, the Dominican Republic, Peru, and Uganda, these terms could be established as the result of an reverse 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 in areas that would otherwise be underserved.[17]

[16] The subsidy needed to provide universal access in Chile varied across sub-regions, with poor, sparsely populated areas requiring a larger per capita subsidy. Income density explains over 60 percent in the variation of subsidy cost. Kenny and Keremane (2007) therefore use income density data for other countries to estimate what would be needed to achieve universal access.

[17] 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 "aid for trade" 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. See e.g., Hoekman and Prowse (2005) for a discussion of preferences and aid for trade.

Supporting regional cooperation on services

The potential benefits of regional cooperation in addressing supply side constraints for small and land-locked countries can be large. Regional cooperation can lower costs and enhance global competitiveness of exporters by removing duplicative regulatory controls, and allowing firms and governments to realize economies of scale by spreading the fixed costs of services provision and regulation over a larger area. The establishment of transport and trade facilitation corridors linking two or more countries can be a mechanism that reduces trade costs both directly and indirectly – by increasing the incentives of all countries involved to monitor "performance" of the corridor.

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.

Technical assistance to determine "what, where and how much" is particularly important in the regional context. 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.

Facilitating market access 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 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.

Immigration authorities in host economies must be assured that source countries will cooperate to screen services providers, to accept and facilitate their return, and to combat illegal migration. The approach pursued to date in the WTO by developing countries has been to request that potential host countries make binding commitments on an MFN basis, regardless of the conditions that prevail in source countries or measures that governments in such countries should implement in order to manage mode 4 trade. 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. 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. This is an area where regulatory cooperation between host and home countries, supported by development assistance from rich countries, could do much to assuage fears on the part of voters and governments in the North that mode 4 is simply another form of long-term migration.

4. Concluding Remarks

Little progress has been made in WTO services negotiations since these were launched in 2000. In part this is because liberalization of trade in goods has been central to discussion to date – there has been less interest in, and thus attention given to, the services agenda. The neglect matters. Greater trade in services can do much to improve consumer welfare and the productivity of firms and farms in WTO members by providing a greater variety of quality services at lower prices.

WTO members have begun to recognize some of the constraints affecting multilateral cooperation on services trade policies. The shift to a small group, plurilateral set of negotiations in 2006 reflected recognition that many developing countries have little incentive to participate in mercantilist bargaining over market access. The increasing prominence of "aid for trade" reflects increasing acceptance of the idea that market access negotiations need to be complemented by measures to help developing countries benefit from liberalization.

A precondition for achieving greater ambition in the services negotiations is to put in place mechanisms that will bolster pro-competitive regulation and strengthen regulatory authorities in developing countries. Many countries need assistance to put in place the regulatory mechanisms that can help ensure the potential benefits from liberalization are realized. There is great potential for donor 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.

Accommodating the interests of the small and poor countries by providing them with "aid for trade" in services is desirable in itself, but also necessary to ensure smooth and expeditious progress in the WTO. Aid is a necessary complement, not a substitute for the core role of the WTO: to provide a mechanism to make binding policy commitments. All countries, including the poorest, can benefit from making reform more credible and certain through legally binding international commitments that are costly to revoke. Even in instances where there is reason to defer market opening, for example, to give the incumbent and/or regulator time to prepare for competition, there is still a good rationale for governments to make reform objectives credible through binding commitments to future liberalization. Such commitments avoid the danger of perpetual infancy and hence perpetual protection by confronting incumbents and regulators with a credible deadline by when they must be equipped to deal with openness.

The comparative advantage of the WTO in the aid-for-trade context is to act as a focal point for the trade-related capacity building agenda – providing "space" and a mandate for trade interests in developing country members to defend trade projects as priorities for national action and support by donors and international agencies. We have argued in this paper that addressing national trade needs and priorities must span the services sectors. Doing so may over time bolster support in developing countries for making multilateral liberalization commitments. But even if it does not result in such an outcome, a much greater emphasis on services in the operationalization of aid for trade will be beneficial in itself.

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