Part III

Services liberalization as a development opportunity

Chapter III

SERVICE TRADE LIBERALIZATION AS A DEVELOPMENT OPPORTUNITY: THE ROLE OF THE WORLD TRADE ORGANIZATION*

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Introduction

Service trade liberalization is one of the most important areas of negotiations in the Doha agenda. Given the complexities involved in this topic, it is safe to assume that service liberalization will remain an important negotiation and research topic beyond the completion of the Doha Round, which at this moment is indefinitely suspended. The "concession demanders" in the area of service trade liberalization are the rich, industrialized countries; partly because of this fact, trade liberalization in services is almost universally believed to be against the trade interests of the developing countries. To some degree, this belief is justified, but only in a technical, negotiation sense.[1]

It is widely known that the other major areas of negotiations for the Doha Round of trade talks are cuts in agricultural subsidies and protection as well as the reduction of industrial tariffs. The implicit "grand bargain" is for industrialized countries such as the United States, France and other European Union members to provide deep cuts in subsidies and protection in the agriculture sector and, in return, developing countries such as Brazil and India will open up their service industries (Financial Times, 2005). This highlights the view that at the general political level, the implicit negotiation linkage for developing countries is to give up service sector and industrial sector protection in exchange for agricultural sector liberalization in the industrialized economies.[2]

However, while this grand vision of a comprehensive exchange of concessions implies that developing countries lose from giving up too much in service liberalization, there are many reasons to believe that even without significant reciprocal concessions in return, developing countries may well benefit from their own liberalization of their service sectors. Service industries, such as finance, act as important intermediates for other

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[1]   Negotiation interests and unilateral economic interests can be quite different. For a discussion of this aspect, see K.C. Fung and others, 2005.

[2]   In some cases, the service sectors of some developing countries may be too small to be considered significant reciprocal concessions. However, these concessions can be seen as long-term gains for the industrialized countries. As developing economies grow, their service sectors will expand. The concessions in the service sectors are locked in.

sectors. Their liberalization (together with judicious regulations and monitoring) can significantly improve the productivity of other industries in the economy. Indeed, the malfunctioning of certain service industries can create economic chaos, as was clearly highlighted by the 1997 Asian financial crisis.

Intellectually, at least in the Asia-Pacific region, the idea that service liberalization can enhance economic development is not totally alien. Given the painful experience of the Asian financial crisis, and the decade-long slow growth in Japan that was at least partly induced by its banking problems, many policymakers are aware of the need to carry out reforms and liberalization in the financial sector. So why is it so difficult to accept service sector liberalization, even though such a policy is expected to foster economic development? For anyone who has any practical policy experience, the answer, at least in part, lies in the political economy of such liberalization. Service trade liberalization has winners and losers. The losers will always attempt to block these policies. Some of the existing domestic regulations exist because of such lobbying in the first place.

Section A of this chapter discusses service trade liberalization as an opportunity for economic development. This discussion is couched in the context of the literature on the so-called East Asian miracle or, from another viewpoint, the literature on the myth of the East Asian miracle. Section B argues that in order to realize this opportunity, it is necessary to understand fully the political economy of such liberalization. A particular approach is taken and a political economy model of service trade restrictions is created. The model is then used to highlight what can be done to relax the political-economic constraints in order to further service trade liberalization and thus economic development. In particular, the role of WTO in fostering such liberalization, and thus development, is highlighted. Section C discusses the growth-accounting literature as applied to East Asia and Southeast Asia, examines the role of services in creating further economic growth, and then focuses on the political difficulty and potential solutions to fostering service trade liberalization. Section D provides an overview of the discussion.

A. Economic growth and service trade liberalization

In a very simple sense, the growth-accounting literature proposes that there exists an economy-wide production function, linking aggregate output to its inputs such as labour and capital.[3] Translating output levels into growth rates of outputs, the growth rate of an economy can easily be translated to the growth rates of its inputs, plus a residual that researchers attribute to technical progress. Using an extremely simplified example, it can be postulated that the economy-wide production function is of the Cobb-Douglas type:[4]

$$Y = AK^aL^{1-a} \tag{1}$$

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[3] Some of the materials used in this section are taken from K.C. Fung, 2006.

[4] The aggregate production function does not need to be Cobb-Douglas, which is used here as an illustrative example only.

where Y is the aggregate output, A is the level of technology, K is capital, L is labour and "a" is the national income share of capital owners. It is clear that economic growth of output can be decomposed into the growth of the inputs and the change of the state of technology:

$$dY/Y = dA/A + a(dK/K) + (1-a)\,(dL/L) \qquad (2)$$

Technical progress can be measured as the "Solow residual", or the residual from the difference between growth of output and growth of inputs. The analysis can be made more complex by incorporating human capital or intangible capital (such as research and development spending) as a third or fourth input. However, the essential analysis remains the same.

Empirically, there has been a very lively debate among prominent researchers such as Young (1995), Lau and Park (2003), Krugman (1994) and Hsieh (2002), who applied this growth-accounting framework to the case of East Asia and Southeast Asia. To summarize their findings, they found that there had been no technical progress in China, the Asian newly industrialized economies (NIEs) and the ASEAN-4 (Indonesia, Malaysia, the Philippines and Thailand) prior to 1985. There was some evidence that after 1985, in the case of most of the Asian economies studied, there was some technical progress.[5] Tables 1 and 2 highlight some results from this literature.

Tables 1 and 2 show that after 1985, even if human capital is included as an input, most Asian economies (except China and the Philippines) exhibited some technical progress. Naturally, Japan has always been an exception. Its growth is propelled by a sizeable degree of technical progress, both before and after 1985.

Table 1. Sources of economic growth in East Asia and Southeast Asia, pre-1985

Country/area	Physical capital	Labour	Technical progress
Hong Kong, China	74.61	25.39	0.00
Republic of Korea	82.95	17.05	0.00
Singapore	63.41	36.59	0.00
Taiwan Province of China	86.60	13.40	0.00
Indonesia	88.79	11.21	0.00
Malaysia	66.68	33.32	0.00
Philippines	66.10	33.90	0.00
Thailand	83.73	16.27	0.00
China	94.84	5.16	0.00
Japan	55.01	3.70	41.29

Source: Lau and Park, 2003.

[5] Using different data, some technical progress for selective economies was found by Chang-Tai Hsieh, 2002.

Table 2. Sources of economic growth in East Asia and Southeast Asia, post-1985

Country/area	Physical capital	Labour	Human capital	Technical progress
Hong Kong, China	41.81	6.46	1.58	50.14
Republic of Korea	44.54	14.98	1.75	38.73
Singapore	37.01	31.30	1.52	30.17
Taiwan Province of China	43.00	10.46	1.38	45.16
Indonesia	62.79	15.91	5.69	15.61
Malaysia	42.87	33.41	3.25	20.47
Philippines	52.18	41.63	6.23	-0.03
Thailand	51.01	13.32	2.36	33.31
China	86.39	10.37	3.27	0.00
Japan	38.21	2.47	1.17	58.14

Source: Lau and Park, 2003.

However, even if research and development spending is included as an additional input, the researchers found that there had been no technical progress for East Asian and Southeast Asian economies, pre- or post-1985.[6] Thus, economic growth in much of post-1985 Asia can be attributed to human capital, and research and development spending. These observations about the sources of economic growth do not imply the absence of sizeable technical progress at a sectoral level (e.g., Korean cell phones or Taiwanese laptop manufacturing). However, for the economy as a whole, technical progress did not show up in growth accounting. In general terms, therefore, before 1985 economic growth in Asia was due exclusively to growth in traditional inputs (physical capital and labour). After 1985, some growth was propelled by non-traditional inputs such as human capital, and research and development.

At the policy level, it appears that Asian and other developing economies should continue to invest in education (to enhance human capital) and increase spending on research and development. The problems with these sources of growth are two-fold. First, they are costly, particularly spending on research. Second, the results may take a long time to realize. Despite these problems, in the longer term there are no good alternatives to making investments in intangible capital and human capital.

Service sector liberalization can be a complementary policy to investment in these other forms of capital. Service sectors such as finance, distribution, logistics, transport and telecommunications act like infrastructure and lubricants for other industries in the economy. They can be viewed in a variety of ways in the context of growth accounting. One simple way is to think of them as another form of intangible capital, so that the growth of output of a developing country can be seen as:

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[6] For more details, see L.J. Lau and J.S. Park, 2003.

$$dY/Y = dA/A + a(dK/K) + b(dL/L) + (1-a-b)(dS/S) \qquad (3)$$

where S is the amount of service output available for production and "b" is the labour share of national income. A more subtle way to incorporate service into the aggregate production function is additionally to allow a separate amount of service-enhanced amount of physical capital (much like human capital) in the production function. With gradual liberalization of services over time, the growth rate of the national output increases while other factors remained constant. A third way to incorporate service liberalization in the growth-accounting framework is to assume that service sector liberalization will increase A, or the level of technology. While it is necessary to perform the actual empirical work to see how much services can contribute to development, the important basic conceptual point is:

> Service trade liberalization constitutes an important channel for economic growth, in addition to investment in education and spending on research and development.

B. Political economy of service trade liberalization

If indeed service trade liberalization is a new channel for economic development, and one that growth accounting may not have taken into account, then why is service trade liberalization so difficult to achieve? The basic answer lies in the political economy aspects of such liberalization. There has been extensive literature on trade liberalization associated with WTO. On liberalization of selective service sectors, many influential and insightful papers have also been written (Sapir, 1998, Hoekman and Messerlin, 2000, and Hoekman and Braga, 1997, among others). However, in terms of theoretical research work focusing on the political economy of liberalizing trade in services, the literature has been minimal by comparison.[7]

This section aims to provide a simple, tractable model of the political economy of service sector liberalization in order to illustrate some possibilities for research in this area. The model, while simple, will allow the capture of some of the important stylized features of the service sector that are often alluded to in the literature (see, for example, Hoekman and Messerlin, 2000, Warner, 2000, and Sauve and Wilkie, 2000). Furthermore, the model will also permit consideration of the links between the liberalization of a developing country's service industry and liberalization in the agricultural sector of industrialized countries. In addition, it highlights how, despite the fact that liberalizing the service sectors improves the welfare and growth prospects of the developing countries, political economy considerations can still hinder economic development. The model further highlights how multilateral trade negotiations sponsored by WTO can help the liberalization process.

According to the General Agreement on Trade in Services (GATS), there are four types of trade in services. Karsenty (2000), and Ito and Krueger (2003) discussed these modes extensively. They are:

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[7]   Some recent exceptions include K.C. Fung and A. Siu, 2006, and some related theoretical modelling work by J. Francois and I. Wooton, 2001.

(a) Cross-border trade in which services can be produced in one country and delivered to another economy (for example, banking services that are provided to foreigners via mail or telephone, which are counted as exports of service);

(b) Trade in which consumption occurred abroad, i.e., domestic residents go abroad to consume the products (for example, tourism);

(c) Services provided via foreign direct investment. That is, sales provided to foreign nationals by foreign branches and subsidiaries of the home entities (for example, foreign subsidiaries of insurance companies or hotel chains);

(d) Services are provided by movement of natural persons. This category includes people such as consultants, accountants, doctors, etc. moving from the home country to the foreign country to deliver the services.

In addition, several stylized economic characteristics of the service industries affect trade liberalization in the sector (see, for example, Feketekuty, 2000, Francois and Wooton, 2001). This section considers the following aspects:

(a) The frequent perception of service trade barriers as qualitatively different from trade barriers in goods.[8] Instead of tariffs and quotas, trade barriers in services are often closer to regulatory barriers (e.g., regulations in telecommunication) and entry barriers (e.g., restrictions against entry by foreign banks);

(b) Due to barriers to entry and other inherent economic characteristics, service industries often exercise various degrees of market power. In other words, they are quite often imperfectly competitive;

(c) The use of service industries, and particularly producer services as "lubricants" for other industries (e.g., in trade-related services, finance, distribution, etc.)

Aspect (c), the intermediate roles of some services, often leads observers to call on the governments of the developing countries to recognize the virtues of unilateral liberalization, and to proceed with domestic reforms in the service industries without regard for global negotiations. While this is eminently reasonable – and a fair amount of reforms have actually taken place, particularly in East Asia – it may appear unrealistic, given that most governments (particularly those of developing countries) will be subject to influences from special interests. This section shows that WTO, with its sponsoring of multilateral trade negotiations, can help relax the political-economic constraints and allow a greater degree of service sector liberalization.

1. An illustrative political-economic approach

To start the model, consider an open economy (a developing country) with two sectors: a formal sector that is open to international liberalization negotiations and an

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[8] For attempts to measure trade barriers in the service sectors, see P. Dee and K. Hanslow, 2001.

informal sector that is not open to trade. The formal sector comprises three industries – the service industry, the manufacturing industry and the agricultural business (agribusiness) industry. The producer service industry is government-regulated, so trade barriers exist in the form of entry barriers against foreign affiliates. The manufacturing industry is also competing with imports. However, the agribusiness industry is producing for home consumption as well as for exports. An attempt is made here to depict a situation of a developing economy that may be involved in the Doha Round of trade talks (e.g., Brazil). It is exporting agricultural products while importing manufacturing goods and services.

The informal sector produces the numeraire good N using mobile homogenous labour only. The technology for the numeraire good is constant return to scale. The mobile factor is supplied inelastically to the developing country's economy. As long as the informal sector is active, the constant marginal product of the mobile factor fixes its economy-wide return to unity.

Total population in the economy is normalized to one. A fraction α^s of the population are the owners of capital in the service industry, a fraction α^m of the population are the owners of capital the manufacturing industry, and α^a is the fraction of the population who are capital owners in the agricultural business. The remaining $1-\alpha^s-\alpha^m-\alpha^a$ (hereafter, α^w) individuals are the owners of the mobile factor (labour), which is used in both the formal and informal sectors, and earn a fixed return normalized to one. The owners of the mobile factor are assumed to be politically inactive. The owners of capital organize as interest groups for political activities.

The service industry has n identical domestic firms,[9] each producing a homogenous service output s at a price $P^s(S)$, where $S = ns$. Each firm in the industry produces its service output s with an identical production function f, using capital and the mobile factor labour. With the standard properties of the production function,[10] we can generate the dual cost function C^s, which depends on the quantity of the producer service output s and the factor prices r and w.[11] As discussed above, one important characteristic of service industries is that they tend to have market power, so it is assumed that these firms are Cournot-Nash oligopolists. Each firm's profit function π^s is:

$$\pi^s = sP^s(S) - C^s(s, w, r) \tag{4}$$

It is assumed that these service providers are shielded from foreign competition. An increase in n will denote foreign entry and a liberalization of service trade.[12]

$$S_n > 0 \tag{5}$$

$$\pi^s_n < 0 \tag{6}$$

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[9]   The industry can also be allowed to contain some foreign firms. The results will not be altered.

[10]   *f* is continuous from above, quasi-concave and non-decreasing.

[11]   The wage rate is actually fixed at one.

[12]   We have thus focused on a particular mode of service trade, namely trade via the movement of foreign firms to the domestic market.

where the subscripts n denotes partial derivatives.[13] A reduction of the trade barriers in the service industry will thus increase the total volume of services (which, in turn, will reduce the price of providing the service). However, foreign entry will also lead to a reduction in the profits of the incumbent domestic service firms. Here, the losers from service trade liberalization (the incumbent service providers in the developing countries) are identified.

Next, we turn to the manufacturing firms and the agribusinesses. The profit functions of each can be represented by:[14]

$$\Pi^m = mP^m(M) - C^m(m, w, r, P^s) \tag{7}$$

$$\Pi^a = aP^a(S) - C^a(a, w, r) \tag{8}$$

Note that the price of the service output is used as an input to the manufacturing industry in equation (7). This captures a second feature of the service industry, in which services such as distribution and trade-related services are used as "lubricants" for other industries.

Next, the political-economy side of the model is developed, which will allow discussion of trade liberalization in the service industry in a more realistic setting. The model is similar in structure to Grossman and Helpman (1994), Rama and Tabellini (1998), and Fung and Lin (2001). To do this, we first turn to the demand side of the economy. All individuals in this developing economy are assumed to have the same preferences. The indirect utility function of each individual in group i has the form:

$$V^i = I^i + CS^i(P^m, P^a) \tag{9}$$

where CS = consumer surplus derived from consumption of the manufacturing good and the agricultural product. It is assumed that the producer service output is not directly consumed by individual consumers.

The gross indirect utility functions for each individual in each group are: $V^s = n\pi^s/\alpha^s + CS^s$, $V^m = \pi^m/\alpha^m + CS^m$, $V^a = I^a + CS^a$, $V^w = I^w + CS^w$, where I^a is the return to the specific capital in the agricultural sector and I^w is the fixed return to the mobile factor.

With no lobbying, it is assumed that the policymakers can choose an appropriate level of n to maximize social welfare. The government's objective function is given by:

$$\underset{n}{Max}\, W = \alpha^s V^s + \alpha^m V^m + \alpha^a V^a + \alpha^w V^w \tag{10}$$

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[13]   The derivations of these partials are available upon request.

[14]   It can be assumed that the capital owners in the manufacturing industry are earning rents in an imperfectly competitive environment and that the capital owners in the agribusiness are owners of the specific factor – capital – in each industry. An expansion of trade due to trade liberalization in European Union or the United States agriculture will allow the capital owners in this industry to earn a higher real rate of return.

where W is the social welfare level that can be attained in the absence of any political contributions to the government. The socially optimal n is then given by $n^w = arg\ max\ W$.

The lobbying structure follows the Grossman and Helpman (1994) framework, which applies the Bernheim and Whinston (1986) study on menu-auctions and common agency. The various interest groups, as bidders, offer various contribution schedules corresponding to different entry barriers to the government at the first stage. The government, as the auctioneer, sets n by evaluating the weighted sum of contributions and aggregate social welfare at the second stage. An equilibrium is a set of contribution schedules and the politically determined number of producer service providers.

The equilibrium contribution schedules imply that the interest groups contribute up to the point where the marginal benefit from the resulting change in the number of providers exactly equals to the marginal contribution costs. In equilibrium, the contribution schedules of each interest group are given by:

$$\alpha^i V^i_n = \lambda^i_n (n) \tag{11}$$

where i is the lobby group, $\lambda^i_n (n)$ is the contribution schedule provided by interest group i.

2. Lobbying by producer service providers

First, it is assumed that only the producer service providers will lobby to restrict entry to their own industry. The government's objective is to maximize the possibility of being re-elected. With lobbying, other than providing a high standard of living to the public, the government has another resource to enhance its possibility of being re-elected, i.e., contributions provided by the interest groups. With lobbying, the government's objective function contains not only the aggregate social welfare, but also the total level of political contributions. The objective function can be written as:

$$Max_n\ V^G + (\beta^s - 1)\big[\lambda^s(n)\big] + W \tag{12}$$

where $\beta^s > 1$ represents the weight that the government puts on the contributions provided by the interest groups.[15]

Using equations (13) and (14), the first order condition of the government's optimization problem is:

$$V^G_n = \beta^s \alpha^s V^s_n + \alpha^a V^a_n + \alpha^m V^m_n + \alpha^w V^w_n = 0 \tag{13}$$

The politically determined number of providers is given as $n^p = arg\ max\ V^G$. By totally differentiating equation (16) with respect to n and β (and evaluating β at 1), it is shown that lobbying by the service providers will lead to entry barriers.

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[15] $\beta > 1$ implies that the government values a US dollar offered by the interest groups more than a US dollar in the hands of the public.

By restricting entry, the economic rents of the incumbent service providers are increased. In the context of the Doha Round, it is assumed that the any relaxation of the entry barriers will lead to entries by foreign firms. These entry barriers thus constitute trade barriers. So far, it has been shown that lobbying by the service providers leads to trade restrictions in services.

C. Liberalizing producer service trade restrictions

1. Cross-cutting lobbying

Given that trade restrictions are the result of explicit lobbying by the insiders of the service industries, and that the economic rents are captured by these incumbents, what can be done to try to relax these politically determined trade barriers? If it is now assumed that the manufacturing firms are also allowed to lobby, the objective function of the government becomes:

$$Max_n\ V^G = (\beta^s - 1)[\lambda^s(n)] + (\beta^m - 1)[\lambda^m(n)] + W \tag{14}$$

where $\beta^m > 1$ is the weight attached by policymakers to the contributions made by the manufacturing capital owners. The first order condition for maximization of this modified objective function is:

$$V_n^G = \beta^s\alpha^s V_n^s + \alpha^a V_n^a + \beta^m\alpha^m V_n^m + \alpha^w V_n^w = 0 \tag{15}$$

Essentially, the government places more weight on the interests of the incumbent service providers as well as the manufacturing capital owners because they provide funds to the government. What are the effects of allowing an industry to lobby for the entry and trade policy in another industry? That is, what are the effects of allowing cross-cutting lobbying? It results can be seen by totally differentiating equation (12) with respect to n and β^m. The resulting politically determined number of producer-service providers will be larger than when only the service providers are allowed to lobby. Intuitively, this is precisely because producer services are used as lubricants in other industries. The manufacturing capital owners lobby to relax the trade and regulation barriers in order to allow foreign affiliates to enter the service industry. With a larger number of providers, the price of the service output declines, which, in turn, raises the profits of the owners of manufacturing firms.

In reality, existing regulations in the service industries are often opaque, complex and convoluted. For example, information and specific knowledge about the financial industry or telecommunications industry are difficult to master. That is why rents in services are often captured by insiders. To facilitate cross-cutting lobbying, these regulations should be made more transparent and consistent. The process of government policymaking should also be made more transparent; however, this is not always the case, particularly in developing economies. Thus:

Allowing cross-cutting lobbying by the manufacturing industry will enhance trade liberalization in the service industry. In general, more transparency in policymaking and regulations in the service sector will facilitate service trade liberalization.

2. State-owned service providers

In many service industries of developing economies, the provision of services is often done by state-owned enterprises. Suppose we assume that $\theta < n$ is the number of incumbent service providers in the economy. Bureaucrats and government ministries directly own these entities, and the economic profits of the state-owned firms go directly to the treasury of the government. Both the government bureaucrats and ministries derive explicit and implicit income from the state ownership of these service providers. The maximization of the government objective function becomes:

$$V_n^G = \beta^s \alpha^s V_n^s + \alpha^a V_n^a + \beta^m \alpha^m V_n^m + \alpha^w V_n^w + \alpha^b V_n^b = 0 \qquad (16)$$

where V_n^b is the impact of a relaxation of the trade restriction in the service industry on the utility of the government bureaucrats in control of the state-owner service providers, and α^b is the fraction of the population that comprise government bureaucrats who control these state-owned service providers. By differentiating equation (13) with respect to n and α^b, we can easily see that reducing the number of government-owned service providers will lead to a more relaxed policy towards service trade. The reason is simple: trade restrictions allow government bureaucrats to capture some of the economic rents in the service industry. These rents are proportional to the number of service firms under government control. Thus, we have:

Reducing the number of state-owned service providers will enhance trade liberalization in the service industry.

3. Multilateral cross-sectoral negotiations

In the literature, there has always been a notion that cross-sectoral negotiations will enhance liberalizations across the board. For the current proposed cuts in subsidies and tariffs in the European Union farm sector, it is clear that these cuts are contingent on "satisfactory" openings in the service industries in the developing countries. In our model, this feature can be seen by incorporating lobbying by the agribusinesses, with the first order condition of the government objective function being:

$$V_n^G = \beta^s \alpha^s V_n^s + \beta^a \alpha^a V_n^a (t) + \beta^m \alpha^m V_n^m + \alpha^w V_n^w + \alpha^b V_n^b = 0 \qquad (17)$$

where β^a is the weight attached by the policymakers on the contributions provided by farmers and t is the farm tariff rate imposed by the European Union. Without cross-sectoral negotiations, the impact of liberalizing the service industry on domestic farmers is only through their consumption of the lower-priced manufacturing goods. With linked negotiations, a larger n will also lead to a lower t, which raises the returns to the

specific capital owned by the lobbyists from the domestic farm sector. By differentiating equation (14) with regard to n and t, it can be seen that linked negotiations will lead to an easing of the trade barriers in the service sector. Thus:

> Cross-sectoral negotiations will enhance trade liberalization in the service sector. Multilateral trade negotiations sponsored by WTO relax the political-economic constraints and can lead to more liberalization in the service sectors.

D. Conclusion

Service trade liberalization is an important component of the now stalled Doha Round of multilateral trade talks. Viewed from the perspective of the literature of Asian growth accounting, we can easily conceptualize service liberalization as an additional important channel for economic development. While it is true that the East Asian and Southeast Asian economies need to continue investing in human capital as well as research and development, it is also safe to say that service trade liberalization can be a powerful ingredient in fostering more economic growth. In order to gauge the quantitative importance of service trade liberalization for growth rates, actual empirical research needs to be conducted in this area in the future.

While it is relatively easy to think of service trade liberalization as a positive force for economic development, it is also not difficult to see that reforms and liberalization in services have not been sufficient. To understand such contradictions further, a simple theoretical model has been constructed in this chapter that depicts the various political-economic facets of trade liberalization in the service sector in the context of the Doha Round trade talks. First, a model was built that incorporates three stylized features of the service sector:

(a)   Trade barriers often occur in the form of entry barriers;

(b)   Producer service providers are used as lubricants in other industries; and

(c)   Service firms often have market power.

To discuss liberalizing the service sector, it is the authors' opinion that an explicitly political-economy model along the lines pioneered by Grossman and Helpman is more appropriate than the depiction of a welfare-maximizing government. By using this simple formal model, it has been shown that lobbying by the service providers leads to trade restrictions in the service industry.

This model has then been used in discussing several interesting issues in the context of global trade negotiations. First, allowing cross-industry lobbying (in the sense of allowing the manufacturing capital owners to lobby for influences in the service industry's entry restrictions) will enhance trade liberalization in the service sector. Next, it was noted that in many developing economies, service providers are often owned by the State. By using this model, it has also been shown that reducing the number of state-owned service

providers will ease trade restrictions in the service industry.   Finally, the issue of cross-sectoral negotiations has been considered. Proposed liberalization by the European Union and the United States is contingent upon "satisfactory" openings in the service sectors of the developing countries. This model has shown that such linked negotiations would indeed lead to greater trade liberalization in the service sector.

It has been argued here that multilateral trade talks sponsored by WTO would help relax political-economic constraints and push service trade liberalization further along. Future research will be needed in examining the institutional details of the political-economic forces in various developing countries in order to develop this line of inquiry.

This chapter has provided a general framework that lays out the theoretical aspects that would liberate economies from their political constraints and allow developing countries to engage in service sector liberalization. Overall, it has been shown that institutions such as WTO, which will eventually facilitate service sector liberalization, will (at least indirectly) go a long way towards enhancing economic development in developing countries.

Annex

Structure of the political-economy model of service trade liberalization

The structure of the political-economy model of service trade liberalization is:

$$\pi^s = sP^s(S) - C^s(s, w, r) \tag{1}$$

The first and second order conditions are:

$$d\,\pi^s/ds = \pi^s_s = P + sP' - C^s_s = 0 \tag{2}$$

$$d\,\pi^{s2}/d^2\,s = \pi^s_{ss} = 2P' + sP'' - C^s_{ss} < 0 \tag{3}$$

For the liberalization experiments that we want to study, we assume that a stable Nash equilibrium is holding:

$$D = P'n + sP''n - C^s_{ss} < 0 \tag{4}$$

$$K = P' - C^s_{ss} < 0 \tag{5}$$

These stability conditions are derived formally in Seade (1980). It is assumed that these service providers are shielded from foreign competition. An increase in n will denote foreign entry and a liberalization of service trade. Using (1) to (5), it is shown that:

$$S_n = s(P' - C^s_{ss})/D > 0 \tag{6}$$

$$\pi^s_n = -s(P - C^s_{ss})\,\pi^s_{ss}/D < 0 \tag{7}$$

where the subscripts n denotes partial derivatives. A reduction of the trade barriers in the service industry will thus increase the total volume of services (which, in turn, will reduce the price of providing the service). However, foreign entry will also lead to a reduction of the incumbent domestic service firms' profits.

Next, turn to the demand side of the economy, all individuals in this developing economy are assumed to have the same preferences, and they maximize the utility function:

$$U^i(N, m, a) = N^i + u^i(m, a) \tag{8}$$

where $i = s, m, a$ and w (individuals in each of the four groups); N^i is the consumption of the numeraire good. The function $U(\cdot)$ is differentiable, increasing and strictly concave in all arguments. Utility is maximized, subject to the budget constraint:

$$I^i \geq N^i + P^s s + P^m m + P^a a \tag{9}$$

where I^i is the net income of individual I in each group.

For all other details of the model, see Fung and Siu (2005).

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Comments

DEVELOPMENT DIMENSION OF SERVICES LIBERALIZATION

By Gloria O. Pasadilla and April Lacson

Fung and Siu (2006) argued that the level of services liberalization could be explained in the context of a power play between domestic liberal and protectionist forces. More specifically, they argued that the presence of domestic interest groups for or against liberalization influences policymakers through lobbying activities to pursue or block liberalization of sectors. Most of their arguments rely on the premise that either domestic service providers or the manufacturing industries are concentrated enough to allow cooperation between players in launching an effective lobby. The problem of collective action is that no single player, unless deeply invested in the interests of the services sector such as a state-owned monopoly, will take on the costs of lobbying when the resulting benefits will accrue to everyone in the industry.

Their model can be one plausible explanation for the slowness of services liberalization in WTO, but other explanations may hold as well. Various country experiences (some examples of which are described below) show that liberalization or continued protection of services do not occur as a result of lobbying. The Czech Republic, for example, pursued liberalization as part of its transition from communism while Turkey liberalized financial services as part of its structural adjustment programme. The same holds true for the experiences of other countries, where no significant lobbies or parliamentary debates ruled the day, but through economic restructuring pressure from without.

Especially when it comes to WTO, various concerns colour the negotiations on services liberalization through GATS. These include the concern of government officials over the national ability to cope with a liberalized market, worries over having the necessary regulatory institution and resources to manage liberalization, uncertainty as regards the effect of liberalization on employment and domestic industry as well as future policy flexibility, and inadequacy of data and research on the effects of service liberalization. Of course, that concern is somehow related to the prevailing political economy that is partly explained by Fung and Siu (2006), but the model does not completely determine a government's position.

Another reason for the hesitation over liberalization comes from a perception that services liberalization is primarily a developed country agenda. To some extent, the assumption is valid. In 2003, developed country share of total world exports of services was as high as 75.8 per cent (Findlay and Sidorenko, 2005) while developing countries generally remained net importers (UNCTAD, 2005). Developed country economies also rely more heavily on services than developing countries. As much as 71 per cent of developed country GDP comes from services whereas for least developed countries, services only account for about 46 per cent of GDP (Findlay and Sidorenko, 2005).

Yet, just as trade is not a zero-sum game, neither is services liberalization. In fact, estimates suggest that merely halving the amount of protection in the sector promises to bring an increase in income five times greater than that brought by liberalization in the trade in goods (World Bank, 2003). Theoretically, liberalization brings with it a number of benefits such as "improved allocative efficiency, access to superior technology and intermediate inputs, greater variety of goods, advantages of economies of scale and scope, increased domestic competition and creation of growth externalities through knowledge transfers" (Dornbusch, 1992 in Findlay and Sidorenko, 2005). Further, Nielson and Taglioni (2004) argued that because developing countries had more barriers to services trade than developed ones, gains from liberalization from the sector would be greater for the former than for the latter. Finally, while export-related gains may be substantial, they argued that greater benefits from liberalization would come from increased competitiveness and efficiency of domestic markets than from acquiring more market access and capturing market share abroad (Dornbusch, 1992, in Findlay and Sidorenko, 2005). However, despite the theorized benefits, developing countries remain hesitant over liberalizing services, especially since, as far as the Doha Round is concerned, developed countries appear intent on acquiring concessions on market access for the sector while apparently little progress has been achieved in agriculture.

Country experiences of services sector liberalization

It is an incontrovertible fact that developed countries have a comparative advantage in exporting services, because major financial, telecommunication, shipping, air transportation and other services are mostly owned by businesses headquartered in rich countries. The question is whether the opening of the services sector is only one-sided; that is, whether developing countries do not, themselves, benefit from it. What are developing country experiences of liberalization of services?

Although anecdotal in nature, country experiences show that services liberalization does have its benefits to the liberalizing country itself. First, lifting restrictions on market entry allows new players, both foreign and domestic, to challenge existing monopolies and promote a more competitive environment. Competition, in turn, spurs efficiency gains as erstwhile monopolies strive to improve productivity and avoid loss of market share. New entrants, on the other hand, bring in new investment and even innovations. Foreign players, especially those from developed countries, bring in new techniques, knowledge, processes, and technology that, in turn, compel domestic competitors to adapt or innovate. This occurred in Argentina when it liberalized its energy sector, in Uganda when it liberalized its telecoms, and in the Czech Republic, where a general equilibrium analysis showed that services liberalization had positive downstream cost effects on manufacturing industries (Arnold and others, 2006).

The mere increase in the number of service providers already provides a benefit to consumers in terms of increased accessibility of services, higher penetration rates for telecoms and expanded choices for consumers. In Argentina's electricity sector and the Philippines' airline industry, a drop in the prices together with improvements in the quality

of services even occurred as service providers tried to outdo each other and capture greater market shares. Privatization and removal of subsidies, on the other hand, add to the government treasury or, at least, result in a reduction in public subsidies.

The table summarizes selected country experiences in services liberalization in a variety of sectors. In all the examples, the service sector, prior to liberalization, was dominated either by a monopoly (usually state-owned) or by a small number of large conglomerates. In many cases, this led to limited service accessibility, high prices and low quality. This was the case for the Philippine air transportation industry before liberalization when Philippine Airlines (PAL) remained the country's sole carrier. As a monopoly, the company had little incentive to improve services to customers, especially since losses were offset, if not totally covered, by government subsidies. Consequently, despite the fact that PAL flights were expensive and frequently late, customers were forced to use their services. After liberalization, which involved deregulation and privatization efforts, five carriers entered the market offering variety, choice and lower airfares. The PAL administration thus had to shape up, and while PAL airfares were initially 11-34 per cent higher than those of local competitor Cebu Pacific, in recent years a degree of price convergence has been noticeable (Austria, 2000).

Argentina's electricity sector experienced a similar broad pattern as the Philippines' air transportation sector before and after liberalization. Prior to liberalization efforts, the electric sector was dominated by large monopolistic conglomerates concentrated across the different stages of energy creation, transmission and distribution. Energy transmission was inefficient and 20 per cent of energy created was left unpaid for due to illegal hook-ups. Prices were high, averaging at US$ 60/MWh, and blackouts were frequent. After liberalization, foreign entry was allowed and a number of competitors entered the sector. Eventually, the sector was producing more than enough energy to supply the entire country and even for exports. Blackouts were reduced by between 22 and 39 hours per year to 6 hours per year, while prices were reduced to US$ 27-US$ 28/MWh (Centre for Energy Economics, undated).

Of course, the amount of benefits depends on a number of factors such as the extent of liberalization, the safety nets in place and whether the nature of the business environment is conducive and facilitating or prohibitive (e.g., availability of infrastructure and the efficiency of government bureaucracy in processing new entrants). Further, not all services liberalization leads to a more competitive environment. In some cases, foreign players merely replace domestic monopolies and oligopolies while collusive practices remain (e.g., the cement industry in the Philippines). Nevertheless, although brief, the examples above show that, at the very least, services liberalization is not all pain and no gain. There are benefits to be had and, in realizing that fact, the question now becomes, why do countries still obstinately refuse to open up. Further, given the existence of the GATS framework, why not open up the services sector through the multilateral negotiations. Why not GATS?

Highlight summary of selected country experiences in services liberalization

Country/industry	Reform programme	Condition before reform	After liberalization
Uganda/telecoms	– Privatization of state monopoly – Allow foreign entry – Expansion of telecom services	– Coverage concentrated in cities and towns – Service monopolized by state-owned enterprises – Low penetration rate of fixed lines and mobile phones	– Fifty-six districts have point of presence for delivery of telecom services – A jump from 68,000 to 840,000 customers between 1998 to 2003 – Increased penetration rates from 0.24/100 to 3.5/100 inhabitants – Mobile lines increased from 12,500 in 1998 to 872,704 in 2004 – Fixed lines increased from 57,366 in 1998 to 67,234 in 2004 – Lower tariffs for end-users and a decline in rates for international calls (International Telecommunications Union, undated)
Turkey/financial services	– Relaxed rules on bank entry – Eliminated controls on interest rates and financial intermediation – Turkish residents allowed to open foreign currency accounts in banks – Capital accounts opened up	– Interest rate regulation led to non-price competition – Of 42 banks in 1980, only four were foreign – Concentrated market dominated by large public and private banks – Directed credit programmes absorbed 75 per cent of all loanable funds	– Twelve net entries of foreign banks, mostly American, European and Middle Eastern – Fees on letters of credit declined from 1.5 per cent to 0.5 per cent – Fees on letters of guarantee feel from 4 per cent to 1 per cent – Greater efficiency and resource utilization – Improved credit evaluation – Improved bank marketing – Recruitment and staff quality increased (Denizer, 2000)

Philippines/financial services	– Easing of entry restrictions	– Few, very large, expanded universal banks – Sector is dominated by the Government – High bank interest spreads and profit	– Doubling of bank branches – Ten foreign banks established in 1995 alone – The number of mergers and acquisitions increased between 1998 and 2003 – Foreign ownership increased, with less than half of the banks remaining purely Filipino-owned in 2003 – Greater bank accessibility due to an increase in bank branches – Bank spread over savings deposit was cut in half, implying greater operational efficiency and dissipation of monopoly profits (Pasadilla and Milo, 2005)
Philippines/air transport liberalization	– Privatization of state-owned monopoly – Elimination of restrictions on domestic routes, and frequencies – Deregulation of air fares	– Philippine Airlines (PAL) had no incentive to be efficient or to meet customers. demands due to monopoly situation – PAL subsidized by government and beset with losses	– Entry of five competitor airlines free to choose their routes, capacity and fares – Expanded choices for passengers – Convergence in rates of airline fares among airlines (e.g., in 1997, PAL fares were 11-34 per cent higher than local competitor Cebu Pacific, but have since declined considerably (Austria, 2000)
Argentina/electricity services	– Privatization of 25 state electric companies – Allowed entry of foreign competition	– Poor management, insufficient investment, financial and operational difficulties	– Increased generation of electricity – Country now meets demand and even exports electricity – Price declined to US$ 27-US$ 28/MWh

– Division of electricity industry into generation (competitive), transmission (regulated monopoly), and distribution (regulated monopoly)	– Blackouts due to reliance on hydropower – A total of 20 per cent of power was going to non-paying customers (illegal hook-ups) – Electricity prices averaged US$ 60/MWh – Rates frozen in pesos for utility consumers and led to company losses due to exchange rate devaluations	– Loss of power due to illegal hook-ups decreased from 20 per cent to 7 per cent in 1999 – Northern Buenos Aires companies reduced outages from 22 hours per year in 1992 to 6 hours per year in 1995 – Southern Buenos Aires companies reduced outages from 39 hours per year in 1992 to 6 hours per year in 1995 (Centre for Energy Economics, undated)

Why not the GATS?

While unilateral liberalization has its benefits, liberalization through multilateral agreements arguably has more advantages. First, if successful, services liberalization through GATS would involve reforms across a wide array of services and countries. The sheer number of the players involved in the multilateral negotiations alone is enough to overtake gains from unilateral liberalization. Commitments made in WTO also give credibility to state policies. At the same time, GATS has flexibility provisions that allow countries greater ability to choose what sectors to liberalize and to what extent. Multilateral liberalization is also preferable to regional trade liberalization as trade diversion effects from the latter may outweigh its trade creation effects, i.e., giving preference to the less efficient service provider results in wasteful resource allocation and negative externalities to parties outside the agreement.

However, a look at the number and nature of commitments to GATS shows that little progress has been made despite the proclaimed advantages of multilateral services liberalization. Adlung and Roy (2005) found that, on average, only one-third of all services sectors of all member countries are committed to GATS; even then, as of 2005, most of the commitments are limited by exclusions, special arrangements and limitations on market access and modes of entry.

Since flexibilities in GATS allow member countries considerable leeway in deciding which sectors to liberalize and to what extent, committing a sector does not necessarily imply significant liberalization. In fact, the total ratio of limitations to commitments is 2:2, suggesting that for every commitment made there are about two limitations accompanying it (Adlung and Roy, 2005).

One explanation for the lack of progress in negotiations in GATS is that the very features that make it advantageous also weaken it. Having many members at the negotiating table slows down and complicates negotiations while policy lock-in enforced through sanctions makes the autonomy provided by unilateral liberalization more appealing. Further, while the flexibility provisions under Article XIX: 2 of GATS allow members to pace liberalization, they also encourage countries to slack off and offer limited commitments without substantially liberalizing the sector. GATS, for example, does not oblige WTO members to commit a specific number of sectors. In fact, a country need only make one commitment in a single sector to show its official acceptance of the Uruguay Round (Stephenson, 2001). Thus, partly due to this flexibility, countries have not committed more sectors, taking advantage of the leeway provided.

Another perspective involves the political economy of services liberalization. In particular, Fung and Siu (2006) argued that the level of services liberalization depended on a number of factors, particularly the presence of domestic interest groups for or against liberalization. They argued that little or no liberalization occurred in the presence of domestic service providers who, they assumed, would naturally lobby against reforms in the sector. The existence of state monopolies also hinders liberalization since, like domestic, non-state service providers, they run the risk of losing market share and facing intense

competition from new entrants should the country loosen restrictions (Fung and Siu, 2006). However, as stated above, the absence of liberalization in general and commitment to GATS in particular, is explained by more than domestic lobbying efforts.

Some developing country policymakers, for example, are worried over government ability to establish and finance the necessary regulatory institutions to manage and oversee the liberalization of the sector. The World Bank estimates that the establishment of a telecom regulatory board to oversee telecom liberalization would cost about US$ 2 million per year – a sizeable sum for countries such as the Dominican Republic, for which US$ 2 million already represents 5 per cent of the government budget (World Bank, 2003).

Another concern involves access to services once subsidies are removed. While a country may benefit from competition effects and possibly lower prices, the poor may be unable to provide themselves with these services despite diminished costs (Findlay and Sidorenko, 2005; World Bank, 2003). Education and health are two sectors where removal of government subsidies and possible consequent marginalization of the poor is a crucial issue, especially since these sectors serve to build and develop a country's human capital. Thus, if left without remedy, instead of leading to development, services liberalization may actually hinder countries from achieving it. Finally, the common fear that foreign entry may crowd out domestic service providers also plagues the mind of developing country policymakers, leading to hesitancy in committing more sectors than are necessary to legitimize membership in WTO (UNCTAD, 2005).

Hesitation over making substantial commitments towards GATS may also be explained by the dearth of economic studies and statistics regarding the area, adding to the paucity of knowledge about the sector. Where statistics exist, data may be insufficient or incompatible with GATS classification. The GATS framework, for example, does not coincide with those used by statisticians (Stephenson, 2001). Countries without the resources to devote to research are thus hampered by their inability to identify which sectors will benefit from liberalization and to what extent. Further, even where a country has sufficient resources to fund such research, the impact of services liberalization is hard to quantify and establish, given the difficulty of calculating price equivalents for the sundry list of non-tariff barriers that plague the sector (Stephenson, 2001).

From a negotiator's point of view, offering new commitments within GATS also diminishes, if not totally eliminates, policy flexibility. Uncertain about the effects of liberalization, governments naturally want the option of reversing policies should opening up the sector prove disastrous due to excessive competition, a complete rout of small domestic service providers, a macroeconomic imbalance due to sudden entry of huge investment inflows or other unintended consequences.

In addition, the nature of the services sector makes liberalizing it more difficult than liberalizing trade in goods. The sector is subject to a variety of barriers to trade such as regulatory and cross-border policies restrictions. Moreover, whereas an executive order or decree may be sufficient to lower tariffs in goods, services liberalization may involve deeper legislative and even constitutional amendments to change specific regulations (Adlung and Roy, 2005).

Finally, because of the service sector's relative novelty, there is a lack of definite knowledge about which subsectors comprise services and how liberalization could possibly affect them. Some members have even added new classifications in their schedule of commitments. This multiplicity of definitions makes it difficult to determine what a country has committed (UNCTAD, 2005). While GATS does have one standard classification, countries are free to use other classifications as long as they are mentioned in the schedule of commitments, thus introducing greater complexity to the negotiations and its implementation.

Even when a country decides to commit, the novelty and complexity of services may lead to disagreements over interpretation of the extent and nature of commitments. Two landmark cases, both involving the United States, serve to highlight the problem. These are discussed below.

(a)   United States-Antigua and Barbuda online gambling[1]

This case involved the small country of Antigua and Barbuda and the United States over the latter country's gambling measures. Antigua and Barbuda, a country whose economy thrives on online gambling, claimed that several of the United States' domestic laws (i.e., the Wire Act, the Travel Act, the Illegal Gambling and Business Act) and the state laws of Louisiana, Massachusetts, South Dakota and Utah were inconsistent with the United States' commitments to GATS. In particular, these laws unfairly discriminate against online gambling service providers in Antigua and Barbuda, and contradict mode 1 commitments concerning market access (World Trade Organization, undated).

The United States claimed that gambling was not included in its list of commitments and, further, that the prohibition on online gambling was allowable under the exceptions provided under GATS Article XIV (a) and (c) to "protect public morals". Antigua countered that when the United States included the liberalization of "other recreational services" in its schedule, it implicitly included gambling based on the United Nations Central Product Classification (Thayer, 2004). Clearly, depending on which interpretation is favoured, the United States either will be guilty of scrimping on its commitments or will be honouring it.

The decision of the Panel favoured Antigua and Barbuda, and it agreed that the inclusion by the United States of "other recreational activities" did include gambling and, based on the principle of technological neutrality,[2] also included online gambling. Further, the Panel found that the total prohibition of Internet gambling was in violation of Article XVI of GATS as it was tantamount to imposing a zero quota on foreign service providers.

The subsequent Appellate Body decision still favoured Antigua and Barbuda (World Trade Organization, undated). Crucially, though, the Appellate Body differed with the Panel in that it accepted the United States' defence that the measures under issue were

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[1]   The dispute between the United States and Antigua and Barbuda was the first e-commerce case to be brought before the WTO dispute settlement body.

[2]   Technological neutrality was defined as non-discrimination as regards the means of delivery of service, electronic or otherwise (WTO, undated).

"necessary to protect public morals" and were thus permissible under Article XIV of GATS. As a result, the Appellate Body only found the Interstate Horse-racing Act to be in violation of the United States commitments to GATS. Despite this, some United States senators were still dismayed at the finding and reacted against what they perceived was an overstepping of jurisdiction by WTO, especially since the finding necessarily implied changing domestic law (Richtel, 2004). Despite this grievance, the United States did express its willingness to comply. However, disagreements have arisen between Antigua and Barbuda and the United States over whether the United States has indeed substantially complied with the rulings. A panel was again established to decide on the issue and its ruling has yet to be circulated (World Trade Organization, undated).

Thus, apart from the variability in the interpretation of a country's commitments, the case also emphasizes the difficulty faced by a small country in making a large major partner comply with rulings when the threat of sanctions and, given the miniscule size of Antigua and Barbuda, the actual carrying out of the threat cannot compel compliance.

(b)   United States-Mexico and telecommunications[3]

As in the preceding dispute, the second case also involved the United States, but this time as a complainant against Mexico's telecommunication laws. Under the WTO Telecommunications Agreement, Mexico had committed to allowing market access and providing national treatment to foreign service providers of voice telephony, circuit-switched data transmission services, facsimile services, private leased circuit services, paging services and cellular phone services. The only limitation to market access was its provision that international traffic be routed through a company with a duly authorized concession from the Secretariat of Communications and Transport (Sherman, 2006).

The United States claimed that Mexico had failed to ensure that the major supplier with the necessary concession from the Secretariat of Communications and Transport provided interconnection on "terms, conditions...and cost-oriented rates that are...reasonable". Mexico was also committed to providing "appropriate measures" against anti-competitive practices and the United States claimed that the country was unable to provide such "appropriate measures" to prohibit anti-competitive practices by Telmex, its major telecom supplier, and to ensure non-discriminatory treatment and conditions. Clearly, several terms from the agreement was ambiguous and open to interpretation. Depending on how one defines "cost-oriented" and "appropriate", Mexico could either be in violation of, or in compliance with its GATS commitments (Sherman, 2006). Unable to agree, the two parties referred the matter to the WTO dispute settlement mechanism.

Subsequently, the Panel found in favour of the United States. Telmex, for example, was found to have imposed rates that were 75 per cent higher than demonstrated costs for domestic termination. That, the Panel decided, was clearly not "cost-oriented". Further, under Mexico's Rules for the Supply of International Long-Distance Services (ILD Rules), operators were "required to apply a uniform settlement rate" and that this rate was negotiated

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[3]   The dispute between Mexico and the United States was the first case involving services.

by the supplier with the "greatest share of outgoing calls to a particular country". Thus, the ILD actually compelled Telmex, the major supplier in the country, to engage in anti-competitive prices that eliminated price competition in the market. Thus, as to whether Mexico had initiated appropriate measures[4] against anti-competitive practices, the Panel found that Mexico had failed especially since anti-competitive practices did exist and that the ILD itself compelled the major supplier, Telmex, to engage in such a practice (Ryan, 2004). As a result, Mexico was required to amend or remove several laws found to encourage or promote anti-competitive and discriminatory practices, particularly the law requiring that the carrier with the largest proportion of outgoing traffic be the sole negotiator on behalf of all Mexican service providers for international traffic (Sherman, 2006).

In sum, both cases summarized above serve to highlight how differences in the interpretation of commitments, and the key terms in these commitments, can lead to differences in the extent of actual services liberalization as opposed to that promised under a country's schedule. This highlights the necessity of care, assiduous diligence and specificity during negotiations and the drafting of schedules, so that countries do not end up either committing sectors they do not wish to liberalize in the first place or liberalizing sectors beyond the desired extent.

Conclusion

Despite the fact that services liberalization brings numerous advantages, developing countries remain diffident in opening the sector. While individual country experiences show that loosening restrictions in the sector and allowing foreign entry leads to several benefits, the continuing perception that services liberalization is primarily a developed country concern makes developing countries wary of liberalizing.

Not surprisingly, GATS has posted little progress as countries offer limited commitments watered down by numerous restrictions. The lack of agreements over substantial services liberalization stems from a number of factors. While, Fung and Siu (2006) cited the power of lobbying groups to advocate for or against liberalization, other factors appear to prove more explanatory. The paucity of data and economic research on the effects of liberalization on particular services sectors, coupled with the natural complexity of the trade barriers involved and the services sectors itself, naturally make countries hesitant over committing sectors – even more so since commitments to GATS brings sanctions if countries fail to comply.

Further, loss of policy flexibility upon committing to GATS makes unilateral liberalization more appealing. Finally, as the United States-Mexico and Antigua and Barbuda-Unites States cases show, the complexity of the sector easily lends itself to misunderstandings over the interpretation of country commitments, adding to country concerns should they find themselves forced to liberalize sectors they never intended to open in the first place.

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[4] "Appropriate measures" is taken to mean measures that are sufficient to forestall anti-competitive practices (Ryan, 2004).

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IMPACTS ON HUMAN DEVELOPMENT MUST ALSO BE CONSIDERED

By Yumiko Yamamoto

Although this chapter analyses the impact of service trade liberalization on economic development, this commentary is focused more on the potential impacts of trade agreements in services on human development.

This chapter assumes that economic development resulting from trade liberalization in services will benefit all; owners of the capital in the services, manufacturing industries and agricultural business as well as the owners of the mobile factor (labour). Social welfare in the model can be maximized without much increasing the benefits to labour. Moreover, the literature so far has not found sufficient supporting evidence that benefits from economic development will trickle down to all, including marginalized groups of people.

In the case of East Asia, which is discussed in this chapter, the income disparities among households remain slight compared with other regions, even after rapid economic growth. However, this is due to relatively high literacy rates supported by a universal educational system and the development of other social services that are not yet available in many parts of the Asia-Pacific region.

Benefits from economic development (e.g., GDP growth) are unlikely to be shared by the poor. In fact, trade liberalization in services has the potential to worsen people's well-being (human development) for the following reasons:

(a) The chapter focuses on the analysis of the service sectors, such as finance distribution logistics, which are used as "lubricants" for other industries. However, the direct beneficiaries from liberalization in these sectors are the owners of the capital in services, manufacturing and agricultural businesses but not labourers, and especially the marginalized groups of the populations in developing countries.

As the authors point out, these sectors are trade-related service sectors; therefore, the majority of the populations in LDCs and low-income developing countries do not have access to such services. In the financial sector, low-income household members do not have bank accounts. They mainly use public transportation or transportation provided by unorganized workers, such as three-wheelers. Therefore, trade liberalization in industry-centred businesses has little positive impacts on human development.

(b) The General Agreement on Trade in Services (GATS) and bilateral trade agreements do not limit negotiation coverage to particular sectors in services.

This also includes human development-sensitive sectors such as health, education, sanitation and utilities (e.g., water).

An analysis of mode 3 in Asia, in a forthcoming UNDP publication, has found that newly acceded countries, some of them LDCs, have been obliged to accept much more stringent commitments in their terms of accession to WTO, sometimes in human development-sensitive sectors such as health, education and environmental services.[1]

Trade liberalization in the areas of health services, education and water supply is likely to worsen human development – especially in the case of the well-being of women and their families – by decreasing access by the poor to such social services within/ between nations. For example, Latin American and African experiences have shown that the liberalization of water supply (with foreign investment) leads to the introduction of expensive service fees. As a result, poor communities in those regions have not received affordable supplies of potable water and the well-being of people in low-income households is deteriorating further. Moreover, they have to walk further to fetch "free" potable water from wells, thus increasing the time spent on unpaid domestic work – a burden that tends to be borne by women and children.

In conclusion, it is hoped that the authors will subsequently (a) capture the distributional effects of gains from trade liberalization in services, and (b) suggest specific policies for compensating the losers in the liberalization of services and/or ensure equal opportunities for people to gain access to such services.

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[1]   P. Ortega, forthcoming, "Policy Space and the General Agreement on Trade in Services (GATS): Analysis of WTO Commitments by Asian Countries on Commercial Presence (Mode 3)" Discussion Paper. Colombo: UNDP RCC.