

## **Integrating Developing Countries in the Global Services Economy<sup>1</sup>**

### **I. Introduction**

The better integration of developing countries in the global services economy should be a priority for Governments across the world and the international community as a whole. Indeed, there is potential for development-enhancing trade in services, including as promoted through the General Agreement on Trade in Services (GATS). The gains stemming from the liberalization of services could potentially be larger than in all other areas of international trade. It is widely recognized today that carefully designed and prepared liberalization can contribute to improve the economic performance of developing countries through their integration in the world economy. This improved performance is, *inter alia*, the result of increased competitiveness and market opportunities for developing country exports and accompanying transfers of skills, information and technology. However, in order for developing countries to benefit from these potential gains they will need to strengthen their domestic supply capacity while reconciling trade, development, social and equity considerations.

The potential for gains in trade in services should not conceal the fact that these gains are not automatic. Indeed, developing and least developed countries have not all gained from liberalization and some have remained marginalized in the world economy.<sup>2</sup> This points to the fact that some preconditions may be necessary in order for countries to benefit fully from the opportunities offered by participation in the global services economy. These include coherent domestic services and development strategies; adequate regulatory, institutional and competition frameworks; as well as the necessary infrastructure. It also indicates that there may be room for improving the multilateral trading system. Among the reforms of the system that can be imagined are the full implementation of the rules and obligations of the system (as some benefits have not materialized simply because the rules have not been implemented so far); the operationalization and improvement of the special flexibilities in favor of developing and least developed countries; the inclusion of measures effectively addressing developing and least developed countries supply constraints; and the completion of the GATS framework (i.e. the GATS Rules and domestic regulation provisions) in a manner which is supportive of development.

However, even if the multilateral trading system were functioning perfectly this would not necessarily eliminate the negative externalities that are sometimes associated with privatization, liberalization and increased services trade (i.e. negative environmental, social and gendered impacts even in the presence of economic rewards). Liberalization should be tailored to produce not only positive economic results but also social and human development

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<sup>1</sup> The views expressed are those of the authors and do not necessarily reflect the views of UNCTAD or its Member States.

<sup>2</sup> It is important to note that there are marked differences in the development of the services economies of the different developing countries. There appears to be trend towards growing concentration of services in a few developing countries. In 2003, twelve developing countries accounted for 71 per cent of service exports of all developing countries, compared to 66 per cent in 1998. Trade in Services and Development Implications, Note by the UNCTAD Secretariat, TD/B/COM.1/71, 2005.

## ICTSD Policy Paper on Trade in Services and Sustainable Development

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gains. Liberalization strategies and policies need to be formulated in such a manner as to minimize the negative social and environmental impacts and maximize gains, while ensuring that all groups of the population, in particular the poorest, benefit from them. In addition to the reforms and improvements that can be brought to the multilateral trading system and to the GATS more specifically, there is a need for flanking policies to accompany liberalization efforts.

The integration of developing countries in the global services economy therefore needs to be evaluated not only in economic and trade terms but also according to the criteria developed by the international community for what liberalization of trade in services *should* achieve, i.e. sustainable development. This vision is embodied in landmark declarations and documents such as the Millennium Declaration of the United Nations and the Millennium Development Goals (MDGs); the Doha WTO Ministerial Declaration (which is said to have launched the *Doha Development Round*); the Declaration and Plan of Implementation emerging from the World Summit on Sustainable Development (WSSD); the Monterrey Consensus on Financing for Development; the São Paulo Consensus and Spirit of São Paulo (developed in the context of UNCTAD XI); the findings and recommendations of the UN Millennium Project Task Force; and the 2005 UN Secretary-General Report “In Larger Freedom”.

The Millennium Declaration for example, cites as the central challenge for the world today to ensure that globalization becomes a positive force for all people. While the declaration recognizes the opportunities offered by globalization it likewise acknowledges that benefits are very unevenly shared and costs unevenly distributed. The declaration therefore recommends that globalization be rendered fully inclusive and equitable, including through policies and measures which correspond to the needs of developing countries and which are formulated and implemented with their effective participation. Among the fundamental values endorsed by the Declaration are: equality (i.e. that no individual or nation be denied the opportunity to benefit from development as well as the equal rights and opportunities of women and men); solidarity (i.e. that global challenges be managed in a way that distributes the costs and burdens fairly); respect for nature (i.e. that the precepts of sustainable development be used to correct the current unsustainable patterns of production and consumption); and shared responsibility (i.e. that responsibility for managing worldwide economic and social development be shared among the nations of the world). Several services sectors are specifically identified in the declaration as key elements for achieving globalization that benefits all. These include education services, health services and services linked to the provision of safe drinking water.

Among the key objectives identified in the Millennium Declaration are those of development and poverty eradication. This basically implies the need to devote all efforts to freeing men, women and children from extreme poverty and making the right to development a reality for everyone. Success in meeting this objective depends, *inter alia*, on achieving an open, equitable, rule-based, predictable and nondiscriminatory multilateral trading system. The declaration further emphasizes the need to assist developing countries in mobilizing the resources needed to finance their sustained development and addressing the special needs of the least developed countries. As can be seen from the above description, the Millennium Declaration goes well beyond simple economic and trade gains to encompass a much broader notion of sustainable development through trade.

The preamble of the Doha Declaration recalls that WTO Members seek to place the needs and interests of developing countries at the heart of the Doha Work Program. Positive efforts, including enhanced market access, balanced rules, and well targeted, sustainably financed technical assistance and capacity-building programs, are to be made to ensure that developing

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countries, and especially the least-developed among them, secure a share in the growth of world trade commensurate with the needs of their economic development. The declaration also states WTO Members state their determination that the organization play its part in securing LDCs' beneficial and meaningful integration into the multilateral trading system and the global economy. The emphasis put by WTO Members on the developmental aspects of the current round of multilateral trade negotiations throughout the declaration is probably an indicator that the trade community has also acknowledged the need to have development at the heart of its initiatives and negotiations. The question nonetheless remains whether this new approach goes beyond noble objectives and hortatory language to become the driving force behind the trade negotiations. Doha is meant to have launched a round of negotiations that will provide real and lasting opportunities for developing countries to participate in the multilateral trading system, based notably on the existence of win-win scenarios for development and the environment. The Doha Declaration emphasizes the major role international trade can play in the promotion of economic development and the alleviation of poverty. This indicates a move from a mercantilist approach to trade negotiations to an approach in which development is embedded.

The WSSD developed targets, timetables and commitments to aid the fight against poverty and a continually deteriorating natural environment. The conference was based on the premise that progress in implementing sustainable development has been extremely disappointing since the 1992 Earth Summit, with poverty deepening and environmental degradation worsening and that a new 'program' for production and consumption was needed. Commitments were made in Johannesburg - on expanding access to water and sanitation, on energy, improving agricultural yields, managing toxic chemicals, protecting biodiversity and improving ecosystem management - and these commitments will serve as the yardstick of success or failure in achieving sustainable development. The conference has concluded a global deal recommending free trade and increased development assistance but also commitment to good governance as well as a better environment.

The Monterrey Consensus, which emerged from the UN Conference on Financing for Development also offers insight on the holistic approach that needs to be taken in order to promote the sustainable development of developing countries. The consensus highlights that in pursuing the goal of eradicating poverty, achieving sustained economic growth and promoting sustainable development, it is necessary to address the challenges of financing development. This observation is based on current estimates of dramatic shortfalls in resources required to achieve the internationally agreed development goals, including those contained in the United Nations Millennium Declaration. Indeed, while globalization offers opportunities and challenges, developing countries face special difficulties in responding to them. Domestic and international resources need to be mobilized and international trade promoted as engines for development. Increasing international financial and technical cooperation for development; sustainable debt financing and external debt relief; and enhanced coherence and consistency amongst the international monetary, financial and trading systems should also contribute to the sustainable financing of development. In the declaration, trade and services and more particularly the movement of natural persons, is recognized as one of the key issues of concern to developing countries in international trade to enhance their capacity to finance their development. The Monterrey Consensus also points to a number of specific services which are supportive of development. These include social, health and education services but also financial services (including banking, insurance and financial intermediation services) which are crucial for the financing of development.

The São Paulo Consensus and Spirit of São Paulo recall that if globalization does offer new perspectives for the integration of developing countries into the world economy and can

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contribute to improving the overall performance of developing countries' economies, it has also brought new challenges for growth and sustainable development. Developing countries have been facing special difficulties in responding to these challenges. The role of the international community and of its organizations is therefore to explore how globalization can support development, and how appropriate development strategies should be formulated and implemented in support of a strategic integration of developing economies into the global economy. This will, in particular, come from a greater understanding of the mutuality of interest between developed and developing economies in sustained and sustainable development. Moreover, the São Paulo Consensus re-emphasizes that trade is not an end in itself, but a means to growth and development. Trade and development policies are an important instrument inasmuch as they are integrated in development plans and poverty reduction strategies aiming at such broad goals as growth, diversification, employment expansion, poverty eradication, gender equity, and sustainable development. Coherence and consistency among trade and other policies for maximizing development gains should be pursued at the national, regional and multilateral levels by all countries. In this context, the São Paulo Consensus underscores the existence of new trading opportunities in niche services sectors where developing countries have potential comparative advantages. Moreover, it emphasizes the contribution that access to essential services can have in terms of poverty reduction, growth and sustainable development. The São Paulo consensus also recalls the fact that in many occasion the developing countries have emphasized the important of effective liberalization of temporary movement of natural persons under Mode 4 of GATS to them. Finally, the declaration underscores that efforts need to be directed at identifying and promoting environmental goods and services of actual and potential export interest to developing countries, as well as monitoring environmental measures affecting exports of developing countries.

The UN Millennium Project Task Force published in early 2005 a report titled 'Investing in Development, A Practical Plan to Achieve the Millennium Development Goals'. The report contains a series of findings and makes recommendations for the achievement of the MDGs. One of the key recommendations that is made by the group of experts is for high-income countries to open their markets to developing country exports through the Doha trade round and help least-developed countries raise export competitiveness through investments in critical trade-related infrastructure, including electricity, roads and ports. With respect to services more particularly the Task Force suggests that liberalization of the movement of labor should be adopted as a high priority in the Doha Round. It also suggests that developing countries take commitments in Modes 1 and 3 in exchange for *real* offers for Mode 4 by developed countries.

In his report titled 'In Larger Freedom' in which he reviews the implementation of the Millennium Declaration, the UN Secretary-General highlights the necessary partnership between civil society, the private sector, governments and international organizations for achieving poverty reduction and development. Among the elements key for achieving these goals are access to education services (and particularly for girls); universal access to basic health services (including to sexual and reproductive health services for women); access to water, sanitation, core infrastructure services, transport and modern energy services. Among the concrete actions for achieving the above the UN Secretary-General suggests *inter alia* the elimination of user fees for primary education and health services.

In discussing what can or should be done to promote the better integration of developing countries into the global services economy this chapter will adopt the broader sustainable development perspective adopted by the international community in these declarations rather than focus on pure economic and trade issues. The chapter will be organized as follows.

Section II focuses on the development gains that can be achieved through the liberalization of trade in services and the implications of such trade for the three pillars of sustainable development, i.e. economic, social and environmental development. Section III deals with the flanking policies that must accompany the liberalization process in order to correct some of the negative externalities and impacts that occur in the case of increased services trade and economic growth. Section IV focuses on the GATS' and other regimes' contribution to the integration of developing countries in world services trade. The success of the GATS in achieving the beneficial integration of developing and least developed countries into the services economy will be evaluated in light of alternative liberalization regimes but also in light of the broader developmental objectives that the GATS should seek to achieve as set out in the Preamble of the GATS and Article IV. Section V discusses approaches for improving the GATS framework to better promote the integration of developing countries in the global services economy. Measures supporting the sustainable development of developing countries will be reviewed, including provisions for special flexibilities for developing countries, progressive liberalization, as well as for technical assistance. The paper then offers some concluding remarks.

## **II. Development Gains from International Trade in Services**

The services economy has gained in importance over the last decades, contributing a growing share to gross domestic product (GDP) and employment in all countries. Services have become a fundamental economic activity and play a key role in infrastructure building, competitiveness and trade facilitation. Indeed, an UNCTAD study on the determinants of export performance of merchandise goods points to the important role that services relating to the internal transport infrastructure can have in addressing supply constraints, thereby promoting countries' export performance. This is more particularly important at the early stages of development of the external sector.<sup>3</sup>

### **Box 1: The Contribution of Services to Competitiveness of Economies**

The role of services as inputs into other sectors of the economy is crucial. Services have an important role to play in terms of their contribution to manufacturing output growth and productivity and a positive relationship has been found between the level of *per capita* income and the intensity of use of services in manufacturing industries. Part of the gains comes from the outsourcing of indirect production activities but also from certain structural changes in manufacturing industries, which raise their demand for services as intermediate input. This leads to lower operating costs and increased productivity. But the extent to which a manufacturing firm will use, in the production process, services procured from outside also depends on: (1) the pressures on the firm to improve its competitiveness, which in turn depends on the domestic and international competition it is facing, (2) the availability of services, which depends on the level of development of the services sector in the economy [and on the openness of the economy to imports of foreign services], and (3) the relative cost of in-house provision of services as against their procurement from outside agencies.<sup>4</sup>

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<sup>3</sup> Marco Fugazza, *Export Performance and Its Determinants: Supply and Demand Constraints, Policy Issues in International Trade and Commodities Study Series No. 26*, New York and Geneva, UNCTAD, 2004.

<sup>4</sup> Banga, Rashmi and Bishwanath Goldar, *Contribution of Services to Output Growth and Productivity in Indian Manufacturing: Pre And Post Reforms*, New Delhi, Indian Council For Research on International Economic Relations, Working Paper no. 139, 2004.

The case of India is illustrative of this. Though service inputs contributed little to production of the registered manufacturing sector in India during the 1980s, this contribution has increased dramatically during the 1990s from about 1 per cent in the 1980s to about 25 per cent in the 1990s. The services sector has increased its own demand by raising output growth and productivity of the manufacturing sector in the post-reforms period and this should help the services sector to a certain extent to sustain its growth performance. Trade reforms and liberalization undertaken in the 1990s played an important role in increasing the use of services in the manufacturing sector. Indeed, trade which increased competition in the domestic market was found to be responsible to a certain extent for the increase in the intensity of use of services in the manufacturing sector. This points to the possibility that the Indian services sector might not only succeed in sustaining its own growth but might also help in improving the growth rate of industrial sector in the near future.<sup>5</sup>

Single services sectors can also contribute significantly to the development of an economy. In the Seychelles, for example, tourism services not only generate income, foreign exchange, and employment but also serve as a catalyst for other economic activities such as agriculture, fisheries, crafts and manufacture. Tourism is also the source of government revenues which are used to finance a range of welfare services to citizens at low or very low cost and the development of infrastructure used by the whole community. Finally, tourism justifies and allows to pay for the preservation of the natural environment and cultural heritage of the country. All of this contributes to making the Seychelles' economy globally more competitive.<sup>6</sup>

There are, however, differences in the development of the services economy and infrastructural services across countries and regions. In 2002, services accounted, on average, for 49 per cent of GDP in developing countries, while for developed countries this share was 72 per cent. The share of developing countries in world total exports of services was 22 per cent in 2003, while their share in imports was 24 per cent. Developing countries generally remained net importers of commercial services in 2003,<sup>7</sup> and their services trade has been below global averages. Average annual growth rates for service exports of developed countries increased from 4 per cent during the period 1995-2000 to over 7 per cent during the period 2000-2003. For developing countries, this latter figure was 4 per cent, compared to 3 per cent for the previous period, or 13 per cent for the 1990 – 1995 period. Trends in services imports broadly mirror those in exports, but there are some differences. Compared to past years, in 2000-2003 service imports accelerated in developed countries, matching the trend in services exports. Excluding China, there was a general slowdown in growth of service imports by developing countries, mirroring a lower growth rate in their exports. As a result their share in global imports of services has dropped from 24 per cent in 2000 to 21 per cent in 2003.<sup>8</sup>

Least developed countries (LDCs) have continued to build up export capacities in services, which grew at an average annual rate of 3 per cent from 2000 to 2003. Nevertheless, they still face substantial difficulties in participating in services trade, and their exports are particularly vulnerable to external shocks. In 2003, LDCs accounted for 0.4 per cent of world trade in

<sup>5</sup> Ibid.

<sup>6</sup> Michel, Rosalie, "Tourism and social development in Seychelles", in *Development Bulletin* 60, December 2002.

<sup>7</sup> *Participation of the developing economies in the global trading system*, WT/COMTD/W/136.

<sup>8</sup> UNCTAD, *Trade in Services and Development Implications*, TD/B/COM.1/71.

services, mostly transport and travel services. LDCs' comparative advantage is in the export of labor-intensive services.<sup>9</sup>

The above figures more specifically suggest the economic gains that can accrue from trade in services. Services can, however, also be viewed as important contributors to a sustainable economy. They can favor poverty reduction, including through the informal services sectors, which continue to play an important role in most developing countries. Services can also contribute to gender equality, as many services firms are traditional employers of women, including government. Moreover, certain specific services activities can directly impact favorably on health (services by doctors, nurses, midwives but also hospital services), the environment (sewage, refuse disposal, and sanitation services), and on the general welfare of the population (education, social services, sporting and recreational services). Services trade, which allows for consumption beyond what can be produced locally, will have the effect of multiplying these different impacts. For example, in the case of developing countries, it is considered that trade in services through Mode 4 holds the potential for positively contributing to development through the remittances that workers send back home.

**Box 2: Gains through the Movement of Natural Persons**

Multilateral liberalization of temporary movement of natural persons - through commercially meaningful GATS commitments - could contribute to balance, predictability and equity in the multilateral trading system and thereby lead to increased development opportunities for developing countries. Recent studies have shown that gains from the liberalization of the movement of natural persons could be larger than the total gains expected from all the other negotiating items under current WTO negotiations. World welfare gains from liberalization of the movement of workers could amount to \$US 156 billion per year if developed countries increase their quota for the entry of workers from developing countries by 3 per cent.<sup>10</sup> Another study computed gains of some \$200 billion annually if a temporary work visa scheme is designed and adopted multilaterally.<sup>11</sup> While a significant portion of movements currently taking place is from developing to developed countries, there is also considerable movement of workers between developing countries and some movement from developed to developing countries. Remittances from workers are a major source of capital inflows for many developing countries. In 2003, remittances to developing countries amounted to \$US 93 billion<sup>12</sup>, nearly double the amount of official development assistance (ODA). The total amount of resources remitted could, however, be two or three times higher, since a large number of transactions are realized through informal channels.

Remittances improve countries' ability to finance development objectives, the foremost of which are poverty reduction and improvement of human capital. Their positive role is particularly pronounced for the LDCs - for many low-income countries, remittances as a share of GDP and imports are larger than in the case of middle-income countries. Middle- and lower-skilled workers tend to remit a higher proportion of their income. Policies are needed to support technology transfer that facilitates remittances or investments by making such

<sup>9</sup> Ibid.

<sup>10</sup> Alan Winters et al., *Negotiating the Liberalization of the Temporary Movement of Natural Persons*, Commonwealth Secretariat, March 2002. See also, UNU/WIDER, *Efficiency Gains from the Elimination of Global Restrictions on Labour Mobility*, 2003.

<sup>11</sup> See Dani Rodrik, *Centre for Economic Policy Research*, 2002; skilled and unskilled workers from developing countries would be allowed employment (quota set at 3 per cent of developed countries' labor force) in developed countries for 3-5 years and be replaced on their return.

<sup>12</sup> The World Bank, *Global Development Finance*, 2004, p. 8.

transfers less costly. It is estimated that today, transaction costs can reach 10 to 15 per cent of the total value, with the global business totaling US\$ 6 to 7 billion annually.

There are some concerns that the movement of workers will in some cases lead sending countries to lose some scarce resources. Countries have been experiencing with unilateral, bilateral and multilateral mechanisms to prevent and alleviate brain drain.<sup>13</sup> However, empirical studies suggest that there is an “optimal level of migration” that stimulates pursuit of higher education at home and spurs economic growth. Scarce employment opportunities and the limited capacity for collecting income taxes may limit the actual costs for the individual and the home economy. “Brain circulation” is therefore probably a more appropriate term to describe the exchange of skills in international trade in services. Despite what is often stated, wages are not likely to decline in the host economy, as foreign service providers will not be perfect substitutes for national ones. Mode 4 liberalization is also possibly one of the best ways to reduce permanent or illegal migration and maximize gains for sending and receiving countries.

The impact of other services sectors could, however, appear more problematic in terms of sustainable development if activities are not conducted in an appropriate and regulated context. Examples transport services (with the pollution that can be associated with increased movements of products and people) and financial services (with the negative social impacts of economic crises in the absence of prudential regulation).

Services activities do not necessarily produce either all positive or negative results. Most often they will tend to produce a mix of both and it will be for the authorities to ensure that gains outweigh any negative impacts. For example, tourism and tourism-related services have the potential to positively contribute to such varied objectives such as: rural development, agricultural transformation, community enrichment, social empowerment (particularly for women), and preservation of cultural and heritage traditions. At the same time, there can also be negative social outcomes from tourism activities, including increased incidence of crime, spread of drugs and diseases, including HIV/AIDS, change or loss of indigenous identity and values, culture clashes and ethical issues (e.g. child labor, prostitution and sex tourism). Similarly, the impact on the environment can be complex. The fundamental paradox that underlies the environmental aspect of tourism is that most forms of tourism depend on either a built or natural environment (which will probably lead to increased investment and spending in these areas), but excessive tourism can degrade that same environment through pressures on natural resources, pollution and waste generation and damage to ecosystems. Guidelines, principles and codes of behavior are therefore needed at the local, national and international levels in order to ensure that tourism activities lead to sustainable development.<sup>14</sup>

The impact of services on a sustainable economy will not depend only on the availability or not of services but also on who is providing the services and in what context. In the case of health and education for example, there may a significantly different impact depending on

<sup>13</sup> Among the mechanisms that countries have envisaged or used are return programs that fund the return of workers and help them to establish in their home country; compensations paid by receiving countries or the emigrants to the source countries; and tax holidays for returnees. For a detailed description of the different mechanisms see B. Lindsay Lowell, *Policy Responses to the International Mobility of Skilled Labour*, International Migration Papers 45, International Migration Branch, Geneva, ILO 2001.

<sup>14</sup> Rashad Cassim, Wendy Jackson and Lucille Gavera (eds.), *International Trade in Services and Sustainable Development: The Case of Tourism in South Africa*, Trade Knowledge Network, 2004

whether the government is the main provider (in which case considerations such as universal access may be determinant) or whether there is a mix of public and private provision. Similarly, in some cases where foreign competition is present this may reduce the gains that accrue to the developing country (e.g. in the case of tourism, many gains are captured by the tour operators in developed countries as opposed to the countries of tourist destination). The overall impact of these services on the sustainability of developing countries' development will therefore largely depend on the underlying characteristics of the markets (i.e. the type of services being provided, of consumers and of service suppliers) as well as on the regulatory and institutional frameworks in place in developing countries. The impact of services may also depend on the mode of supply through which they are being supplied (e.g. cross-border supply can be considered as particularly interesting from a sustainable perspective as it may constitute a valuable alternative to both the movement of persons to supply services and the supply of services through goods). A better understanding of all of these elements is therefore crucial to assess the potential for services trade to contribute positively to growth and sustainable development.

**Box 3: New Trading Opportunities for Developing Countries  
Through Cross-border Supply and Outsourcing of Services**

The development and spread of modern information and communications technology has allowed for an increasing share of international trade in services to take place through cross-border supply. The careful negotiation of commercially meaningful commitments for Mode 1 - specifically in telecommunication, business and computer services - would be an important contribution to the liberalization of services in a mode of export interest to several developing countries. Commitments could range from substantial liberalization to commitments binding existing regimes.

Linked to this phenomenon, recent technological developments in computer and related services are making the outsourcing of many services an increasingly efficient option for firms. This is giving rise to new trading opportunities for developing countries. Outsourcing is used by enterprises seeking to take advantage of low-wage countries, focus on core activities in fewer locations in order to save costs, and take advantage of productivity gains and access to additional skills. However, the fear that growth of services outsourcing may lead to employment losses in developed countries has given rise to protectionist tendencies, which may prevent these firms from taking advantage of the gains to be made from outsourcing.

Overall, the trade of outsourced services is taking place between developed and developing countries, as well as within each group, with developing countries strongly involved in the rise of outsourcing. The gains for receiving countries could be enormous, given that the export earnings derived from outsourcing are often accompanied by a number of related advantages, including FDI, human capital formation and knowledge spillover. Global outsourcing expenditures are expected to grow to US\$ 827 billion in 2008 and the volume of outsourcing should increase by 30 to 40 per cent each year over the next five years.

In order to capture the new trading opportunities from outsourcing, developing countries can implement a number of domestic policies, relating inter alia to infrastructure development; improvement of the legal and regulatory framework; human resource development; etc. International policies can also help. In addition, a moratorium could be placed on any restrictive policies relating to outsourcing (e.g. government procurement). In all these areas, there is need to explore options for the best way to arrive at meaningful liberalization.

While countries can harness services trade for both economic growth and sustainable development, developing countries need to ensure that the multiple characteristics of service sectors (i.e. their potential for positively contributing to the economy but also the negative externalities that they sometimes produce) are taken into account and that the adequate regulations, institutions and policies are in place to achieve the desired outcomes. Authorities need to acknowledge that there exist certain interdependencies between trade and development policies and that this will not always lead to easy policy choices. Indeed, it may be difficult to allocate resources to trade-related objectives when faced with pressing development priorities (e.g. pandemics and widespread poverty) just as it may be difficult to allocate resources to long-term sustainable development objectives in the presence of more concrete and short-term economic rewards from trade.

There is a need to strike a balance between the objectives of efficiency and equity. Both the market and the state have an important role to play in the development process, and it is essential to ensure that their respective roles are complementary. Further development of the private sector may be critical for economic growth. At the same time, the role of the state is vital for designing and implementing development strategies, reducing poverty and attaining equitable income distribution, building physical and human infrastructure, addressing market failures where they occur, ensuring consumer protection, employment safety nets, and providing enabling macroeconomic conditions and a sound regulatory framework.

### **III. Supplementary Measures for Achieving Development-Enhancing Services Trade: The Need for Flanking Policies**

In many respects, the various regimes for liberalizing trade in services are not enough to guarantee that developing countries' broader developmental objectives for building a competitive domestic supply and trade in services are achieved. Benefits are not automatic and there may be a number of costs associated with trade in services, arising principally from market failures. Flanking policies can be seen as a tool to ensure that not only the economic effects of trade in services are taken into account by policy makers but also the cultural, social, environmental and distributional impacts. Flanking policies must accompany liberalization in order to ensure that sustainable development is achieved. Measures need to be put in place both domestically and at the international level.<sup>15</sup>

The type of costs or impacts that flanking policies will need to address include unemployment, raising prices of services, anticompetitive practices and a whole range of negative social and environmental externalities. Policies will have to be designed with the objective of, *inter alia*, meeting development costs, limiting the risk of crowding out of local players and potential job losses, ensuring safety nets, guaranteeing access by all to certain essential services or at least making services available to a greater proportion of the population, ensuring competition, maintaining health and safety standards, limiting urban sprawl, contributing to regionally balanced socioeconomic development, reducing poverty, etc.

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<sup>15</sup> Indeed, while countries retain the main responsibility for their economic and social policies, domestic measures need to be complemented and supported by an enabling global environment, which is essential for developing countries to integrate successfully into the world economy. Among the measures that need to be achieved at the international level is the coherence and consistency of different economic and trade measures.

Flanking measures can also be used to address supply-side constraints and ensure competitive outcomes. Addressing supply-side constraints involves, *inter alia*, addressing developing countries' lack of access to finance and new technologies, the high cost and low quality of distribution and transport services, the bad state of infrastructure services generally, and the lack of supporting institutions, including for SME-specific measures. Among the measures that can lead to increased competitiveness of the services economy in developing countries are measures aiming to create an enabling environment for investment, technology and enterprise development; measures providing for the adoption and financing of information and communication technology (ICT); as well as measures for efficient transport facilities and trade facilitation arrangements which help to reduce overall transaction costs. Among the more specific measures that can be considered in this context are subsidies and other support measures to service suppliers, incentives for consumers to consume domestically produced services and safeguard mechanisms. The first will ensure that the suppliers can grow beyond infancy status and move on to become more efficient producers even when faced with foreign competition. Incentives for consumers to consume domestically are an indirect means of providing domestic services suppliers with a (captive) market large enough to allow them to expand their production. The third category of measures provides service suppliers with temporary relief from competition from foreign service suppliers in order to allow for adjustment. However, as will be discussed later, trade liberalizing regimes may put certain limits to countries' ability to use these measures.

Competition issues are also particularly crucial in developing countries as anti-competitive measures considerably reduce the positive effects of trade liberalization for consumers and enterprises, especially SMEs. Competition law, institutions and authorities should be put in place in order to safeguard developing countries against anti-competitive behavior in their markets. Indeed, where the adequate regulatory framework for competition is not in place liberalization may imply the replacement of domestic monopolies and dominant players by foreign monopolies and dominant players.

By using flanking policies the authorities attempt to integrate developmental, cultural, social, environmental or even national security perspectives in addition to the economic perspective in their trade policymaking and economic planning. The overall objective is to strike a balance between the different types of considerations. The flanking policies can either limit trade activities (zoning regulations, operating hours, etc.) or put conditions to the exercise of these activities (e.g. local content requirements (local materials, suppliers and services); requirements for the creation of employment opportunities, introduction of advanced technology, upgrading of local technology, or skills development; qualification requirements; and technical standards) with the view to achieving specific economic, social and environmental results. This can be considered an important step towards managing the interaction between trade and broader development policies at the national level.

**Box 4: Providing Universal Access to Essential and Infrastructure Services**

Essential services can serve as an example of services where flanking policies must accompany privatization and liberalization. Several services are in the general interest of the public and, indeed, essential for human life (e.g. health or the provision of water). Consequently, governments need to ensure their adequate provision, including to the poor and marginalized. While traditionally, the provision of such services has rested with the public domain, the last decades have seen a trend of opening up essential services sectors to domestic and foreign competition. However, this has produced mixed results, sometimes increasing the price of services for the poor or entailing considerable adjustment costs.

The same can be said for several key infrastructural services. Privatization without creating conditions of competition, or the increase of entry in sensitive sectors (e.g. financial) without adequate prudential supervision and full competition serve as examples. If the transition process had been adequately managed and regulated, it would – in theory – have been possible to fully reap the benefits of privatization and liberalization policies.

Research has been devoted to identifying the delicate combination of competition and regulation that is required to make privatization and liberalization contribute positively to development. One policy recommendation that has come out of this research is the need for increased competition and for complementary regulations with a social purpose. A non-discriminatory universal service obligation is one example of such regulations. Some countries have successfully experimented with regulations to ensure universal services, with subsidy schemes or universal service obligations being possible options. Chile, in the case of telecommunications, has adopted a scheme involving several elements: a universal service levy (one per cent) to generate finances, and a competitive bidding process to allocate funds. The latter should encourage operators to adopt the best technology and cost-saving practices. Ultimately, this system has allowed Chile to significantly increase the number of household telephones with a minimum level of subsidies.<sup>16</sup> Not all countries have been as successful though. India's experience in telecom highlights the difficulties that can arise when implementing universal service obligations for private sector providers. While targets were set and stipulated in the various license agreements, it has not been possible to meet them. Inadequate enforcement mechanisms and overly ambitious targets are among the reasons for failure. Ghana recently (end 2004) established a fund - The Ghana Investment Fund for Telecommunications (GIFTEL) – with the aim to developing the communications infrastructure in rural areas of the country thereby contributing to the requirement of the Millennium Development Goals. The fund is financed by contributions by the five operators in the telecommunications industry (one per cent of contribution from their revenue) as well as other sources, including Parliamentary allocation, profits from investments made by the board of the fund as well as grants, donations and other voluntary contributions. The Minister of Communications and Technology explained at the launching of the fund that “in [Ghana’s] new telecommunications policy, it is recognized that the demands of equity and access to marginalized groups and communities may in some cases be inadequately addressed by market forces and therefore required the adoption of affirmative policies and initiatives to ensure such access.”<sup>17</sup> It remains to be seen how Ghana will allocate the funds collected as the success of the initiative is likely to vary in function of whether the funds are granted to a single or small number of licensed firms or allocated based on competitive bids many firms.<sup>18</sup>

Countries without the necessary flanking policies may not reap the full benefits from liberalization and the costs of integration in the world services economy may outweigh the

<sup>16</sup> Aaditya Mattoo, *Economics and Law of Trade in Services*, 2004, World Bank.

<sup>17</sup> GIFTEL launches in Accra 10 November 2004, Boahene Asamoah / DG Press, available at [http://ghanatelecom.com.gh/gt\\_aboutus/newsdetails.asp?pnnum=1&id=50&search=giftel](http://ghanatelecom.com.gh/gt_aboutus/newsdetails.asp?pnnum=1&id=50&search=giftel) (visited 13 June 2005) and Fund for Communications Development established, available at <http://www.ghana.co.uk/news/content.asp?articleID=13212#> (visited 13 June 2005).

<sup>18</sup> There are a number of mechanisms for ensuring universal access in telecommunications that can be implemented alone or in combination. These include: market-based reforms (privatization, competition and cost-based pricing), mandatory service obligations (e.g. imposed by license conditions), cross subsidies, access deficit charges (paid by telecom operators to subsidize the access deficit of incumbents), and universality funds. For more details on these different mechanisms see Hank Intven, Jeremy Oliver, and Edgardo Sepulveda, *Telecommunications Regulation Handbook*, Washington, The World Bank, 2000.

benefits. However, flanking policies should not be viewed as the panacea for all development-related challenges linked to trade liberalization. There are certain limits to this approach. Indeed, the emergence of various rule-based regimes for international trade means that the space for national economic policy, i.e. the scope for domestic policies, is now often restricted by international disciplines, commitments and global market considerations.

Such a trend can be exemplified by the inclusion of services in the multilateral trading system which brought domestic regulatory issues within the ambit of the WTO. This is in marked contrast with the GATT's focus on border measures. Article XXVIII of the GATS defines the very broad nature of the measures that are covered by the Agreement which include "any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form". This new focus of the GATS on domestic regulations may lead in certain cases to the need for Members to change/adapt or improve their regulatory frameworks relating to services. This is provided for in the 'right to regulate' principle contained in the preamble of the GATS, the Guidelines and Procedures for the Negotiations on Trade in Services, and also the Doha Ministerial Declaration.

From the perspective of developing countries, it is crucial that the Agreement retains sufficient flexibility for regulatory and institutional diversity. Indeed, developing countries will not always be in a position to adopt the type of frameworks or upgrade their institutions to the levels that may exist in more developed economies. This is why it is important that a wide range of policy options remain available to governments, in spite of their GATS obligations and commitments. If the GATS were shown to constrain developing countries developmental policies options this would prove particularly negative given the many policies (for supporting growth, poverty reduction, re-distribution, protection of the environment, and other social objectives) that need to be put in place in order for these countries to achieve a sustainable development of their economies.

However, even where policy space is available, the policy mix that will produce the desired results will have to be determined on the basis of 'trial and error' and concrete experiences of what works and what does not in each country. For example, not all options may be practical to implement, particularly for developing countries. Since the adequate policy response will depend on country-specific national development potentials and socio-economic circumstances, as well as different initial conditions in terms of size, resource endowment, economic structure and location no easy, one-size-fits all approach can be developed. To date there is a lack of understanding about the exact functioning of the various policy suggestions, and there is even less understanding about how these options may play out in different economic and social scenarios and how the different reforms should be sequenced. In order for privatization and liberalization to deliver their expected benefits more analytical work should be devoted to flanking policies, their pros and cons, the range of situations in which they produce desirable results and their potential for failures. Finally, relying on flanking policies to make privatization and liberalization work should not foreclose the more fundamental question about whether or not private sector involvement is the most suitable option in the first place.

#### **IV. The GATS' and Other Regimes' Contribution to the Integration of Developing Countries in World Services Trade**

It should be kept in mind that liberalization of trade in services through the GATS is but one among many policy options available to Governments for developing, regulating and liberalizing their services sector. Broadly, options for countries range from domestic reform

## ICTSD Policy Paper on Trade in Services and Sustainable Development

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measures aimed at developing the local services industry (including through privatization) and autonomous liberalization (decided either independently or in the context of broader reforms, including under the aegis of the international financial institutions), to bilateral and regional economic integration or trade agreements. The GATS, and its contribution to integrating developing countries into the global services economy, can therefore be evaluated in comparison to these alternatives means for achieving liberalization.

### *GATS*

The GATS is the first multilateral framework of principles and rules for progressive liberalization of trade in services and as such can be considered an important tool for achieving the integration of countries into the global services economy. Indeed, the GATS allows WTO Members to negotiate reciprocal benefits in exchange for locking-in their policy reforms in the services sector.

It is difficult to clearly determine and evaluate the impact of the results of the Uruguay Round GATS negotiations and their effect on the integration of developing countries in the global services economy and on their development. Isolating the impact of the Uruguay Round negotiations from the impacts of the other measures and regimes for liberalizing services is an arduous task.

Given the difficulty of assessing the value of commitments in terms of trade balance or development impact the coverage of trade commitments by WTO Members has often been used as a proxy measure and only very general and qualitative analyses have been undertaken at this stage. Members' specific commitments vary widely in sectoral coverage, extent of limitations to market access and national treatment and Modes of supply coverage. In general, there is a correlation between the degree of development of the services sector and the coverage of the sectors offered. It should be noted however, that this does not necessarily mean that developing countries with an interest in developed country markets are well served since developed countries have largely excluded some important services sectors, for example audiovisual, maritime services, and specific sub-sectors in financial services and business services, as well as Mode 4 from their commitments. The emphasis of most commitments put forward by all countries, including the developed countries, is on commercial presence mode of supply and movement of persons in the form of intra-corporate transferees. Until recently perhaps, most developing countries were not in a position to benefit from the commercial presence mode of supply, given the high cost of establishment in developed countries and the weaknesses of developing countries' firms in terms of financial and human capital and access to distribution networks, information channels and technology. Sectors of particular interest to developing countries such as tourism-related services, construction and engineering, business services, health-related services and maritime transport, are included in the commitments of the developed countries. However, only top management personnel are allowed to move to provide these services while developing countries' interests reside in natural persons with medium-to lower-skill levels.

The mode of supply through movement of natural persons has been committed in nearly all schedules by "horizontal" commitments in the limited categories of intra-corporate transferees (i.e. managers, specialists, executives) and business visitors. The commitments do not indicate sectoral specificity or specific occupational categories. The value of these commitments is limited in light of their connection with Mode 3 commercial presence commitments. Moreover, it should be noted that national treatment in most cases is left unbound. Finally, most of the commitments in Mode 4 are still subject to economic needs test (ENTs).

The Uruguay Round commitments of both the developed and developing countries can therefore generally be considered to have been mainly status quo commitments. Whilst developing countries may acknowledge that the consolidation of the status quo has guaranteed security of access, which can favorably impact on trade and investment in services, the potential of the Uruguay Round commitments for significantly increasing their integration into the global services economy can be considered relatively limited. Indeed, even where market access and national treatment has been granted, developing country services and service suppliers may not be able to out-compete more efficient competitors from developed countries. From the developing country side, however, status quo commitments have represented a higher level of concession as they reflected recent reforms, supported *inter alia* by the international financial institutions.

Given the complexities associated with quantifying barriers and limitations to market access or national treatment and the bindings on different modes of supply of services the development of quantifiable criteria has not been as easy as in the case of goods trade. While identifying quantifiable values either for the existing level of market access or for the proposed liberalization remains a challenge, several attempts are being conducted to improve available data and analyses of the services economy.<sup>19</sup>

An attempt can be made to assess the success of the current round in achieving the integration of developing countries into the global services economy based on the views of developing countries.<sup>20</sup> The initial offers that have been submitted to date already allow for a preliminary assessment of the current negotiations' potential for increasing developing countries' participation in trade in services. Such an analysis may be useful as it would not make sense to wait until the end of the round to assess whether the stated developmental objectives are being achieved. Moreover, the Negotiating Guidelines and Procedures for the Negotiations specifically provide that - in addition to the ongoing assessment exercise the results of which should allow to adjust the negotiations (paragraph 14) – there shall be regular review of progress in the negotiations to consider the extent to which Article IV is being implemented and suggest ways and means of promoting the goals established therein (paragraph 15). Several of the initial offers seem to go back on previous commitments taken or to produce no real change in the level of commitment, even where modifications have been introduced. This is done either by redefining the sector or sub-sector to which a commitment applies or by going from one partial commitment to another one. There are no signs of real progress in the liberalization of Mode 4 in categories and skill levels of interest to developing countries. In some cases, a few limitations are removed, new categories of services suppliers are introduced or the definition of professionals broadened. However, these changes remain

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<sup>19</sup> The void in statistics on trade in services is not total and several existing statistical domains can be used as starting point for the compilation of data on trade in services. Among the useful sources are the: IMF Balance of Payments (BOP) data, Foreign Affiliates Trade in Services (FATS) data, and Manual on Statistics of International Trade in Services (MSITS). However, none of these cover services trade comprehensively and this implies that assessment of trade in services will continue to have to rely on qualitative information to supplement the quantitative data and to resort to proxy measures.

<sup>20</sup> See for example Proposed Liberalization of Mode 4 Under GATS Negotiations, Communication from Argentina, Bolivia, Chile, the People's Republic Of China, Colombia, Dominican Republic, Egypt, Guatemala, India, Mexico, Pakistan, Peru, Philippines and Thailand, TN/S/W/14, 3 July 2003 and Review of Progress in Negotiations, Including Pursuant to Paragraph 15 of the Guidelines for Negotiations, Tourism Services, Communication from Brazil, Colombia, Dominican Republic, El Salvador, India, Indonesia, Nicaragua, the Philippines and Thailand, TN/S/W/23, 29 September 2004

limited to highly skilled professionals, related to Mode 3. Furthermore, there is no indication of any attempts to streamline or increase the efficiency of processing mechanisms for visa and work permits. This implies that the liberalization commitments may not be very ‘meaningful’ from the perspective of many developing countries. Few initial offers indicate that countries are abandoning MFN exemptions. This can be cause for concern as the impact of the exemptions has not yet been assessed and potential negative repercussions on developing countries deflected. Finally, in the cover pages to their offers certain WTO Members refer to the notion of reciprocity. While the GATS request-offer process naturally builds upon bargaining and exchange processes, flexibility should be maintained for developing countries and reciprocity should not be requested of them.

#### *Autonomous Domestic Reforms*

Domestic measures to develop the local services industry, though they can be elaborated before liberalization of trade in services *per se*, may have a widespread impact on liberalization once it occurs. Indeed, measures that will affect such elements as the domestic competitive environment, access to finance and development of skills and know-how will, at a later stage, impact positively or hinder the ability of domestic services and service suppliers to compete on international markets. The advantage of such domestic policies, as of autonomous liberalization, is that they can go through a stage of regulatory and institutional experimental trial and error and can ultimately be reversed if the authorities realize that intended results are not being achieved.

The choice of reform policies for services sector ranges from preserving the role of the Government in the provision of services, and more particularly those with public goods characteristics, to full privatization and liberalization of the sector. All these may be viable or not depending on the prevailing economic and social conditions in a country and in the international markets.

#### *RTAs*

While the domestic choices and environment will be crucial in allowing countries to reap the benefits of trade in services the different regional or international regimes for the liberalization on trade and services are also key enabling environments for developing countries successful integration into the world economy. The most interesting among alternative regimes is possibly that of regional trade agreements (RTAs).<sup>21</sup> The last years have seen a proliferation of RTAs covering trade in services. Some agreements are signed only among developed or developing countries, while others have a combination of signatories. Some of these agreements follow the GATS approach towards market opening (i.e. the positive-list hybrid approach<sup>22</sup>) while others use the NAFTA-inspired negative-list approach<sup>23</sup>. Similarly, as regards content, they either represent standstill commitments (which is closer to what the GATS model as was described earlier) or real liberalization.

In terms of the substantive provisions also some of these RTAs simply mirror the GATS (e.g. with respect to domestic regulation or recognition issues), others go beyond it (so-called GATS plus agreements, e.g. with respect to *a priori* transparency<sup>24</sup>). *A contrario*, there are

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<sup>21</sup> Luis Abugattas Majluf, *Swimming in the Spaghetti Bowl: Challenges for Developing Countries under the “New Regionalism”*, New York and Geneva, UNCTAD, 2004, (UNCTAD/ITCD/TAB/28).

<sup>22</sup> E.g. MERCOSUR, ASEAN or the EU-Mexico FTA.

<sup>23</sup> E.g. ANZERTA or the Andean Community.

<sup>24</sup> Negative list agreements may serve as an another example, as they tend to result in a greater degree of liberalization than that currently enshrined in the GATS.

RTAs that fall short of the relevant GATS provisions (e.g. parts of NAFTA type of agreements, excluding the local level from the coverage of the agreements).<sup>25</sup>

Where RTA negotiations follow a negative list approach towards liberalization, they tend to result in developing countries binding their market opening at a stage more liberal than their multilateral GATS commitments. Such far-reaching commitments may not always positively impact on developing countries' integration in the international trade in services, particularly if they are negotiated in unequal conditions, e.g. between a Northern country and a South-South regional grouping, with the former not having completed its own integration process. In fact, such circumstances could impede South-South trade from growing, as it may be overtaken by the respective North-South imports. Thus, questions whether, how, and with whom to pursue services liberalization in a regional context, are crucial. They need to be taken carefully, and on the basis of the countries specific, economic, social and developmental situation and objectives.

Multiple negotiating processes have resulted in an increasingly complex and overlapping network of rules, where obligations differ in various aspects. It is therefore difficult to assess whether regional agreements go beyond the multilateral trading system in achieving the integration of developing countries in the global services economy, even though in the case of North-South RTAs, the liberalization envisaged is possibly deeper and faster than the one achieved at the multilateral level. The smaller number of participants maybe renders this possible but some RTAs may also have negative impacts such as placing particular pressure on developing countries' domestic regulatory frameworks.

On a more positive note, a step-by-step approach beginning with South-South regional liberalization before moving to the multilateral arena may allow for more sustainable introduction of the domestic industry to foreign competition. Developing countries may also use RTAs proactively - and more particularly South-South RTAs - with a view to furthering their developmental objectives. For example, for RTAs among a smaller subset of countries it may be possible to make more headway on certain issues of developmental importance than for negotiations at the multilateral level, where convergence is slower in materializing. Certain aspects of regulatory coordination and harmonization are a point in case. In the case of the Andean Community for example, certain regulations concerning transport, financial and telecommunications services are being harmonized. In other areas, RTAs might also allow for lessons to be learnt for the multilateral trading system. The movement of natural persons might serve as an example.<sup>26</sup> For instance, several regional agreements, including CARICOM<sup>27</sup> and NAFTA<sup>28</sup> have achieved more liberalization of the movement of natural persons than under the GATS. Indeed, so far, GATS-like liberalization of trade in services through Mode 4 has not led to commercially meaningful commitments for movement of

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<sup>25</sup> Similarly, some agreements countries allow countries to exclude whole sectors from their coverage (as opposed to the GATS, which does not consider *a priori* exclusion), while others tend to contain sectoral exclusions that are wider than those in the GATS. [Also, RTAs have generally made little progress in developing disciplines on non-discriminatory domestic regulation potentially affecting trade in services, and also on addressing safeguards and subsidies.]

<sup>26</sup> E.g. for North-North (ANZERTA) and South-South (CARICOM, the Andean Community), as well as for North-South RTAs (NAFTA).

<sup>27</sup> These categories are: (i) persons engaging in non-wage earning activities of a commercial, industrial, agricultural, professional or artisanal nature, non-wage is defined as self-employed; (ii) managerial, technical and supervisory staff of economic enterprises, including the spouses and immediate dependent family; (iii) temporary services-providers; and, university graduates, media-workers, sportspersons, artist and musicians.

<sup>28</sup> These are business visitors, professionals, intra-corporate transferees and traders and investors.

developing country service providers. These examples are illustrative of how RTAs may in some cases achieve a better integration of developing countries than the multilateral trading system.

**Box 5: SADC Negotiations for a RTA on Trade in Services**

The Southern African Development Community (SADC) negotiations, as contained in the Maseru Ministerial Declaration adopted in June 2000 follow a three-track implementation plan utilizing the GATS-Plus approach, SADC approach and the consolidation of the two approaches to develop a regional negotiating strategy. The following services sectors are earmarked for liberalization commitments: Communications, Transport, Financial, Tourism, Construction and Energy.

Under the GATS-Plus approach, sectors subject to commitments at the WTO level becomes the starting point of the negotiations. The main advantage with this approach is that negotiators will be able to use the experience they have already acquired under the GATS negotiations and to utilize the GATS guidelines and procedures, where appropriate. The SADC approach involves the analysis and implementation of work already undertaken by the relevant SADC sector coordinating units dealing with services sectors. This also entails the involvement of all the stakeholders in the negotiations so that the necessary expertise and particularities of a sector or country are taken into consideration during the negotiations. The consolidation of these two approaches, GATS-Plus and SADC, leads to the identification of the progress already achieved and the level of binding commitments at the WTO of the countries in the region. The level of work already undertaken, at the national, regional and multilateral level, can then be used as the basis for the regional negotiations and decisions then taken at the regional level will act as a means for developing proposals, requests or offers for the multilateral negotiations.

To initiate discussions and make comparable assessments between Member States, data on the laws and regulations affecting trade in services at the national level has been collected and recorded in an agreed template format. The templates basically give the status quo of the sector and will serve as the basis for the negotiations. Member States will also utilize the templates in developing their schedules of commitments. SADC Member States have agreed to the elements for an Annex to the trade protocol on trade in services. The Annex will serve as the framework for liberalizing trade in services at the SADC level. The ultimate aim of the liberalization process is that each Member will treat the services emanating from other Members, and the suppliers of such services, in the same way as its own services suppliers, and the services they supply.

RTAs, including North-South RTAs, can be helpful insofar as they are pursued with clear developmental objectives, and may result in the negotiation of operational, development-oriented obligations and cooperation mechanisms to build services supply capacity, particularly in infrastructural services.<sup>29</sup> Another advantage is that RTA negotiations can provide the negotiating countries with a reason to undertake an overall and comprehensive assessment of the state of their services trade, their regulatory environment as well as their

<sup>29</sup> The negotiation of an RTA may also entail a series of challenges – particularly for developing countries. Imbalances in negotiating strength and capacities may create pressures and result in the adoption of far-reaching obligations, which – ultimately – do not reflect the particular country's development priorities.

sectoral performance. Ultimately, the information obtained through this process, can also feed into the countries' negotiating positions in the GATS negotiations. Finally, RTAs, in particular South-South RTAs, can enhance cooperation and collaboration amongst developing countries. Such cooperation can span a wide array of forms, ranging from cooperation between services regulators, to broader forms of cooperation, including for infrastructural, competition or trade-facilitation related purposes.

**Box 6: ACP-EU Economic Partnership Agreements (EPAs)**

The Cotonou Agreement (2000) between ACP countries and the EU which replaces the Lomé Convention establishes a comprehensive framework for ACP-EU relations. Amongst the objectives at the heart of this new agreement are: economic development, the reduction and eradication of poverty, and the smooth and gradual integration of ACP States into the world economy. One means for achieving these objectives will be the conclusion between groups of ACP countries and the EU of WTO-compatible trading arrangements. The EPA negotiations should also contribute to capacity building, including measures to enhance competitiveness, strengthen regional integration and upgrade infrastructure. An EPA should build upon and strengthen the regional integration process and complement and support national strategies, policies of adjustment and structural transformation.

While there is no firm obligation under the Cotonou agreement to liberalize trade in services, Parties have agreed on the objective of extending their partnership to encompass liberalization of services (Article 41(4)). Services liberalization should be progressive, in principle based on the positive list approach, and adapted to the level of development of the ACP countries and regions concerned both in overall terms and in terms of their services sectors and sub-sectors and to their specific constraints, and should be underpinned by the principles of S&D treatment, asymmetry and positive regional discrimination. Given the importance of a sound regulatory framework, it is agreed that Parties would retain the right to regulate, and to introduce new regulations on, the supply of services within their territories in order to meet national policy objectives. The negotiations would also address special safeguard mechanism. Improvement in Mode 4 will be discussed in the context of the EPA negotiations. While it is necessary to support the ACP for the development of their services sector, further discussion is needed as regards the sequencing between support for the development and strengthening of the services sector in the ACP countries and the negotiation of liberalization commitments.

This section attempted to show that in many respects it is possible to envisage going beyond what GATS provides for when seeking to achieve meaningful liberalization of trade in services for developing countries with a view to achieving their better integration in the global services economy, including through alternative trade negotiating fora. It nonetheless makes sense to seek to improve the results of liberalization achieved in the multilateral trading system by influencing the domestic environment in which this liberalization will take place. This can be done, as was indicated previously, prior to the liberalization measures or at the same time, including through adequate flanking policies which ensure that liberalization leads not only to economic growth but also allows for the kind of results called for in the Millennium Declaration and São Paulo Consensus.

In addition to flanking policies and reform policies in the services sector, measures could also be put in place in the GATS or broader WTO context. There is some concern that the current developmental aspects of the GATS, as in other WTO agreements, are not leading to expected results. The next section reviews the existing developmental provisions of the GATS. The

current attempts being carried out in the Committee on Trade and Development to render certain S&D provisions of the GATS more effective and operational, and the pros and cons of this approach are discussed. Finally, suggestions are made for developmental provisions that could be included in the *new* negotiating areas under the GATS.

## **V. Improving the GATS Regime**

The section examines whether the GATS Agreement allows countries to fully benefit from the opportunities offered by participation in the global services economy and if the agreement needs to be improved. As was indicated earlier, one of the main questions in this context is whether the Agreement preserves developing countries' fundamental right to regulate their services economy and allows them to put in place the relevant domestic regulations pertaining to liberalization of trade in services and development. In order to answer this question the main obligations of the GATS that could affect the policy flexibility of the GATS are discussed. Given the bottom-up nature of the GATS, the more constraining obligations are not the general obligations which cover such elements as most-favored nation treatment and transparency but rather the specific commitments on market access, national treatment and additional commitments.

### *Articles XVI, XVII and XVIII as Constraints to Policy Flexibility?*

Articles XVI (Market Access) and XVII (National Treatment) provide the description of the measures Members are no longer entitled to impose once they have taken specific commitments in specific sectors, sub-sectors, activities and modes.<sup>30</sup> It is these prohibitions that could raise problems as concerns countries' policy flexibility. More specifically, Article XVI prevents Members from imposing a number of limitations on the market access granted to foreign services and services suppliers, unless these are specified in the schedule of commitments. The article provides the following lists of prohibited measures: limitations on the number of service suppliers; limitations on the total value of service transactions or assets; limitations on the total number of service operations or on the total quantity of service output; limitations on the total number of natural persons that may be employed in a particular service sector; measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and limitations on the participation of foreign capital. Article XVII in contrast does not provide a specific list of prohibited measures but indicates that "in the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, *in respect of all measures affecting the supply of services*, treatment no less favorable than that it accords to its own like services and service suppliers." (Emphasis added)

A recent dispute settlement case relating to services exemplified the type of constraints that can bear on Members' policy flexibility on the basis of the provisions for specific commitments. In the US - Gambling case<sup>31</sup> the exact scope of Article XVI was interpreted by the Appellate Body (AB). Indeed, in assessing whether the US regulation banning internet

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<sup>30</sup> WTO Members retain the largest policy flexibility when they take no specific commitments in a given sector. When they do decide to take commitments under Articles XVI, XVII and XVIII they can still retain flexibility by putting limitations and conditions to their commitments. However, this requires that countries have a good understanding not only of the measures that they are currently implementing but also insight on the measures that they may wish to impose in the future.

<sup>31</sup> United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services, WT/DS285/AB/R

gambling was a prohibited measure under Article XVI.2 the AB ruled that the prohibition in paragraph (a) of the article of numerical quotas should be understood to include any restriction that has the *effect* of a quota. Similarly, the limitation on the total number of service operations or on the total quantity of service output in paragraph (c) prohibits Members from applying a measures that results in a zero quota. This interpretation substantively expands the scope of Article XVI which was previously considered as relatively straightforward since it provides a list of the prohibited market access restrictions. The article must now be viewed as more complex and as covering not only quantitative restrictions *per se* but also substantive and qualitative restrictions.<sup>32</sup>

This ruling seems to indicate that other measures covered by Article XVI could also be interpreted in such a broad manner. WTO Members should therefore review their domestic legislation to assess whether they are not maintaining measures that have *the effect* of the prohibited measures listed by Article XVI. The case also highlights once more the need for careful drafting of schedules of specific commitments.

It is possible to consider that the interpretation of Article XVII could lead to similarly broad interpretations by a Panel or the AB given the similarity in the structure of the two articles (which both indicate what measures Members may not maintain unless specified in their schedules). Article XVII may even be more difficult to implement given that it does not provide a list of the prohibited measures.

In the Mexico – Telecom case<sup>33</sup> several of the issues that the Panel had to take a decision on were linked to Article XVIII (Additional Commitments) as they dealt with obligations that Mexico was said to have taken under the Reference Paper on Telecommunications. The Panel's finding that Mexico had failed to fulfill its commitments under the Reference Paper highlights that even where Members accept to take part or all of the additional undertakings of the Reference Paper on a voluntary basis<sup>34</sup> it may still be relatively difficult for them to ensure that their domestic regulation will be found to be in compliance with these obligations. For example, the Panel found that actions by service suppliers that were required by Mexico's Federal Telecommunications Commission were inconsistent that that country's GATS commitments under the Reference Paper. It seems unlikely that Mexico would have taken additional commitments if it had not intended to abide by them. This illustrates the fact that countries may not always realize when taking commitments the extent to which these will limit their future policy options.

The case also underscores the need for countries taking commitments to have sufficient foresight on the type of policies that they may wish to take in the future. Indeed, Mexico tried to justify imposing higher interconnection rates on foreign service suppliers in order to strengthen its domestic infrastructure and services capacity. This is indeed provided for by paragraph 5(g) of the Annex on Telecommunications which states that "a developing country

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<sup>32</sup> Pauwelyn, Joost, "WTO Softens Earlier Condemnation of U.S. Ban on Internet Gambling, but Confirms Broad Reach into Sensitive Domestic Regulation", ASIL Insight, April 2005. Some commentators feel, however, that this interpretation of the range of measures covered by Article XVI may be broader than the drafters may have anticipated and that the ruling blurs the line between measures covered by Article XVI and by Article VI (Domestic Regulation). See WorldTradLawn.net Dispute Settlement Commentary.

<sup>33</sup> Mexico – Measures Affecting Telecommunications Services, WT/DS204/R.

<sup>34</sup> Though the Reference Paper is a document agreed upon by Members each country can decide which obligations it wishes to take.

Member may, consistent with its level of development, place reasonable conditions on access to and use of public telecommunications transport networks and services necessary to strengthen its domestic telecommunications infrastructure and service capacity and to increase its participation in international trade in telecommunications services.” However, for this option to remain available WTO Members must schedule conditions to the commitments. The Annex however adds that for this to be done “such conditions shall be specified in the Member's Schedule”, which Mexico had not done, forgoing in this manner any opportunity to use this possibility in the future.<sup>35</sup>

#### *The Permanent Nature of GATS Commitments*

Another challenging element for WTO Members is that their GATS commitments are quasi-irreversible. GATS Article XXI provides the conditions and the mechanisms for the modification and withdrawal of Members’ scheduled commitments. However, for now only one WTO Member has initiated such a procedure, namely the European Communities, in order to harmonize the commitments of the recently acceded States to the community’s commitments. It can nonetheless be questioned whether more flexibility would not be needed in the case where a Member realizes that its scheduling does not allow for it to maintain all the measures that it deems necessary to reach its policy objectives. A solution that could be considered is to have commitments (possibly in the most sensitive sectors of a Member’s offer) first go through an initial ‘trial phase’ of five years for example (until the following negotiating round) and then either be confirmed or suspended (this would be a one-time opportunity for Members to do this). This solution would need to be carefully thought through, including to determine what would need to be done in the case of Mode 3 commitments where foreign enterprises would have already established their presence in the domestic market. The situation of these firms could be considered separately from that of firms located in other countries which would not face the same losses in terms of investments (e.g. by the grandfathering of those firms already present in the market).<sup>36</sup>

The difficulties arising from the lock-in nature of the commitments also from the fast technological changes that can occur in the areas of services and notably in the manner in which they are exchanged. This may point to the need for flexibility in modifying commitments in light of technological change. Since the Uruguay Round negotiations trade in services that is actually taking place through Mode 1 has certainly grown to levels that are in no way reflected by Members’ levels of commitments. Development of telecommunication networks, advances in information technology and the advent of electronic commerce have all contributed to a dynamic new environment for trade in services which have led to a boost to trade, including in sectors where commitments were previously considered technically infeasible.

Some WTO Members consider that the principle of technological neutrality is sufficient to deal with this issue. Indeed, Members developed an understanding on this principle during the telecommunications negotiations that were held subsequent to the Uruguay Round which

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<sup>35</sup> This is similar to the case of a number of other policy tools (e.g. subsidies and universal service/universal access obligations to service providers) which remain available to WTO Members. However, in order for developing countries to use them in the interest of their domestic service suppliers and consumers, they must schedule conditions and limitations to market access and national treatment in all sectors where they take GATS commitments.

<sup>36</sup> For a similar approach see for example Thailand’s commitments for banking and other financial services where a measure relating to foreign equity participation may be envisaged for a period of up to 10 years, with foreign shareholders who enter in this period being grandfathered thereafter with respect to the absolute amount of their equity holding.

basically implies that a commitment (in basic telecoms) applies regardless of the means used to supply that service or the form in which it is supplied - unless specified in the commitment that it only covers a particular means or form of supply. However, there is no agreement between Members on whether this principle can be applied to their Uruguay Round commitments or whether this should be the case for any new commitment. Indeed, the point could be made that the understanding reached in the context of basic telecommunications does not have a binding legal status and should not be confused with application of such a concept to all GATS commitments, past and future. Such automatic extension of commitments is not necessarily in line with the notion of progressive liberalization and the positive list approach at the heart of the GATS. And it may even be detrimental if the technological innovations led to opportunities for developing countries to develop certain new domestic services industries – process for which certain policy flexibility may be necessary. It could be preferable to have a review mechanism that could be initiated between rounds when Members feel that technological changes warrant a re-listing or extension of GATS commitments.

The fact that modifying commitments seems almost impossible may lead countries wishing to retain policy flexibility in specific areas to take no or very limited specific commitments. The question can be raised whether it would not be preferable to allow for certain flexibility to delist or re-list commitments than to oblige them to adopt such cautious position.

*Implementing and Improving GATS Provisions for Development Flexibility*

While these may be the more constraining articles of the agreement other GATS articles were included with the specific intention of favoring developing countries. These include the GATS Preamble and Articles IV (Increasing Participation of Developing Countries), XIX (Negotiation of Specific Commitments), Article XXV (Technical Cooperation) and other provisions providing for technical cooperation such as the Annex on Telecommunications.

**Box 7: The Development Provisions of the GATS**

The different development provisions of the GATS respectively:

- state that liberalization of trade in services should aim to achieve the development of developing countries;
- recognize the right of Members, and particularly developing countries, to regulate, and to introduce new regulations, on the supply of services within their territories;
- call on the facilitation of the increasing participation of developing countries in trade in services and the expansion of their service exports including, inter alia, through the strengthening of their domestic services capacity and its efficiency and competitiveness;
- call for liberalization in priority in sectors and modes of interest to developing countries;
- request that special priority be given to the least-developed country Members;
- indicate that the process of liberalization should take place with due respect for national policy objectives and the level of development of individual Members, with appropriate flexibility for individual developing country Members, and
- provide for technical assistance to developing countries, including by making available information on recent developments in ICT and assisting in transfer of technology, training and other activities.

Negotiating documents for this current round have also been drafted with the inclusion of developmental elements. The Guidelines and Procedures for the Negotiations on Trade in Services begin by recalling the main developmental provisions of the GATS. But these guidelines also provide that to ensure the effective implementation of Articles IV and XIX.2, the Council for Trade in Services in Special Session, when reviewing progress in negotiations, shall consider the extent to which Article IV is being implemented and suggest ways and means of promoting the goals established therein. The Negotiating Guidelines also introduces concrete elements to address developing countries constraints, e.g. the requirement for the needs of smaller delegations to be taken into account, for example through the scheduling of meetings in sequence rather than in parallel. Finally, the Modalities for the Special Treatment for Least Developed Countries similarly provide specific elements for the treatment of LDCs.

**Box 8: Modalities for the Special Treatment for LDC Members  
in the Services Negotiations**

The main elements of development flexibility included in the Modalities can be summarized as follows:

- Particular account shall be taken of the serious difficulty of LDCs in undertaking negotiated specific commitments.
- LDCs are facing serious difficulty in addressing a number of complex issues simultaneously, and lack institutional and human capacities to analyze and respond to offers and requests - this should be factored into the negotiating process.
- Members shall exercise restraint in seeking commitments from LDCs, they shall generally not seek the removal of conditions which LDCs may attach when making access to their markets available to foreign services.
- There shall be flexibility for LDCs for opening fewer sectors, liberalizing fewer types of transactions, and progressively extending market access in line with their development situation. LDCs shall not be expected to offer full national treatment, nor are they expected to undertake additional commitments under Article XVIII of the GATS on regulatory issues which may go beyond their institutional, regulatory, and administrative capacities.
- Members shall give special priority to providing effective market access in sectors and modes of supply of export interest to LDCs, through negotiated specific commitments.
- Members shall take measures, in accordance with their individual capacities, aimed at increasing the participation of LDCs in trade in services. Such measures could include: i) strengthening programs to promote investment in LDCs, ii) reinforcing export/import promotion programs; iii) promoting the development of LDCs' infrastructure and services exports through training, technology transfer, enterprise level actions and schemes, intergovernmental cooperation programs, and where feasible, financial resources; and iv) improving the access of LDCs' services and service suppliers to distribution channels and information networks, especially in sectors and modes of supply of interest to LDCs.
- LDCs have indicated that Mode 4 is one of the most important means of supplying services. Members shall to the extent possible consider undertaking commitments to provide access in mode 4, taking into account all categories of natural persons identified by LDCs in their requests.
- LDCs shall be granted appropriate credit for their autonomous trade liberalization. In addition, Members shall refrain from requesting credits from LDCs.
- In developing any multilateral rules and disciplines, Members shall take into account the specific interests and difficulties of LDCs.

- Targeted and coordinated technical assistance and capacity building programs shall continue to be provided to LDCs. Technical assistance shall also be provided to LDCs to carry out national assessments of trade in services.

Now that provisions these provisions have been adopted it is important that LDCs and other WTO Members ensure that they are effectively being implemented. Regular reporting on the implementation of the modalities to the Special Session of the CTS could be one means to ensuring that they do not remain simply words on paper but actually contribute to the strengthening of the weakest Members of the multilateral trading system.

While these provisions and guidelines are very important, they may remain good intentions unless developing countries regularly monitor their implementation by WTO Members. One way to successfully monitor this implementation and to contribute to the review of the negotiations would be through the use of benchmarks. Indeed, additional trade and development benchmarks could be elaborated in the context of the services negotiations in order to assess how effectively these negotiations are contributing to developing countries' integration in the international trading system and the benefits that they are deriving from the negotiations. The benchmarks could attempt to measure the negotiations' expected contribution to i) the development of developing countries supply capacity and competitiveness, ii) developing countries' increasing share in world services trade, iii) the openness international markets to developing country exports and the openness of developing country markets to foreign imports, iv) the reduction of poverty and gender inequality, v) and contribution to other sustainable development objectives, including employment generation, skills development, technological innovation, and improved use of environmental resources. Additionally, improving existing measures for development flexibility – where their implementation has proven unsatisfactory in the past - is one possibility for achieving the increased participation of developing countries in world trade in services. Finally, it may also be useful to consider including developmental elements in new areas, currently still under negotiations. These could touch upon the areas of market access (and the recognition of qualifications necessary to make such access commercially meaningful), domestic regulation, safeguard measures and disciplines for subsidies. The latter two approaches will be discussed here.

When seeking to favor the increased participation of developing countries in the global services economy, progress can be sought with respect to the operation of provisions providing for different treatment of developing and least developed countries. The Doha Work Program includes a mandate for WTO Members to review all S&D provisions with a view to strengthening them and making them more precise, effective and operational. More specifically, the Doha Declaration, in conjunction with the Decision on Implementation-Related Issues and Concerns, mandates the Committee on Trade and Development to identify which of those S&D provisions which are mandatory, and to consider the implications of making mandatory those which are currently non-binding. This mandate is being carried out by the Committee on Trade and Developed (CTD) in special sessions, however, part of the work has also been passed on to the relevant WTO bodies (the CTS in the case of the proposals relating to services).<sup>37</sup> The new deadline for this negotiating area was established by

<sup>37</sup> In early 2003, the Chairman of the General Council suggested an approach for addressing agreement specific proposals on S&D. The proposals were divided into three distinct categories: category I is composed of those proposals on which there appears to be a greater likelihood of reaching an

the July Framework and provides that the CTS will come forth with recommendations on specific proposals by July 2005.

The GATS, like the other WTO Agreements, contains development-related flexibilities in favor of developing countries. These include the Preamble to the agreement, Articles IV (Increasing Participation of Developing Countries), IV (Economic Integration), XV.1 (Subsidies), XXV (Technical Cooperation) and well as paragraphs 5(g) and 6(c) of the Annex on Telecommunications. However, as with many of the other S&D provisions under the WTO agreements, countries have raised concerns that the provisions do not necessarily lead to the desired results. As concerns services, the proposals on S&D that were submitted principally dealt with GATS Articles VI and V and market access for developing and least developed countries.<sup>38</sup> The proposals attempt to render the developmental aspects of the GATS more precise, effective and operational. For example, The African Group submitted a proposal for the development of periodic benchmarks for the financial and technical cooperation by developed country Members designed to achieve the objectives of Article IV. Developed country Members would also have the obligation to report twice a year on how they are complying with the targets set out by the Committee on Trade and Development for the operationalization of Article IV. The African Group also suggested that developed country Members reserve quotas for the supply of services by developing country suppliers and for developed countries not to adopt horizontal limitation with respect to the movement of natural persons from developing countries. The group of LDC WTO Members also put forth a proposal for multilaterally agreed criteria to be established for giving priority to LDC under Article IV.3 as well as when developing further disciplines and obligations under the Agreement.<sup>39</sup>

**Box 9: Improving the Development-related Provisions of the GATS**

Among the mechanisms that could be envisaged to make development-related provisions of the GATS more effective are the following:

- i) the setting of benchmarks on financial and technical cooperation and other arrangements in favor of developing countries,
- ii) notifications by developed country Members regarding how they are contributing to the objectives enshrined in the developmental provisions, of the GATS,
- iii) monitoring by the CTS and possibly the CTD as to whether the provisions are leading to the desired outcomes,
- iv) effect market access, including through quotas or preferential access, for developing and least developed country service suppliers (particularly in Modes 4 and 1), and
- iv) the inclusion of developmental provisions in the new GATS rules to be developed (for domestic regulation, safeguards and subsidies).

agreement; category II consists of proposals under negotiations and which are being considered by different WTO bodies so as to get a better response within the framework of negotiations or at the technical level; category III groups all the proposals on which Members have wide divergences of views. See General Council Chairman's Proposal on an Approach for Special and Differential Treatment (JOB (03)/68). Category I includes 4 proposals relating to the GATS (for Articles IV.3, XXV, IV, and paragraph 6 of the Annex on Telecommunications). Category II includes 3 proposals relating to the GATS (for Articles IV, IV.3, and V.3). Category III contains no GATS-related proposals.

<sup>38</sup> See the proposal by the African Group, TN/CTD/W/3/Rev.2 and the proposal by the LDCs, TN/CTD/W/4/Add.1.

<sup>39</sup> See respectively WTO documents TN/CTD/W/3/Rev.2 and TN/CTD/W/4/Add.1.

In any event, it is important that whatever provisions are finally adopted be targeted to address the interests and constraints of developing countries; commensurate with their level of development, regulatory and institutional preparedness; and drafted in clear and enforceable language.

While the efforts to make existing provisions precise, effective and operational are a worthy endeavor, the question remains whether the current GATS framework is sufficient for embracing a broader developmental approach which goes beyond the objective of increasing developing countries' participation in trade in services to take into account social, environmental and human welfare factors. Since the existing GATS framework may still fall short of addressing all dimensions of development it may be useful to assess whether new developmental provisions could be introduced in the course of the current negotiations with a view to helping developing countries to integrate successfully into the global economy and to reap greater benefits from globalization. The following are a few suggestions of areas where improvements could be sought.

#### *Preferential Measures in Favor of Developing Countries*

More efforts need to be devoting to devising ways in which developed countries can provide preferential treatment to developing countries under the various regimes for services liberalization.

Among the mechanisms that can be envisaged at the multilateral level are the following: i) within market access quotas, preferential allocation for services and service suppliers of developing countries, ii) special provisions in developed countries' procurement regimes according preference to developing countries' service suppliers (including to their small and medium sized suppliers), iii) support for regulatory development and institution building (including through financing, technical assistance, information exchange and partnerships between institutions and other collaborative projects at government and association level), iv) elimination of ENTs vis-à-vis services and service suppliers of developing countries, and v) assistance to developing countries service suppliers for meeting the various (visa, language and other) requirements for supplying services in their markets.

It is important to note that there may be even more scope for preferential treatment for developing and least-developed countries at the regional level. For example, in the context of the EU-ACP EPAs preferential treatment could be granted to the various groups of countries negotiating with the EU. In the context of services more specifically, it could be envisaged that the EU would be in a position to provide preferential treatment more readily to these groups of countries rather than make GATS commitments that will be multilateralized to all WTO Members. Among the specific areas where such preferential treatment could be granted are: market access in various sensitive services sectors (e.g. ), increased liberalization and specific quotas for supply of services through Mode 4, and facilitation of the recognition of qualifications of service suppliers from developing countries.

#### *Introducing Policy Flexibility in the Future Disciplines on Domestic Regulation*

Though in some cases the obligations Members accept to take may be clear, as was shown above, in other situations the exact scope of their obligations are still not well defined. The fact that the GATS is still a relatively new agreement and that many provisions have not been tested so to say may make some countries fear that taking binding commitments will prevent them from adopting policies that they feel are necessary for their development. Moreover, the

GATS negotiations in certain areas, may reduce governments' policy space further still. Among the areas currently under negotiations where these considerations may be particularly relevant are the negotiations for disciplines on domestic regulations according to GATS Article VI.4. Article VI.4 of the GATS mandates the development of necessary disciplines to ensure that measures relating to qualification requirements and procedures, technical standards and licensing requirements and procedures do not constitute unnecessary barriers to trade in services. When pursuing this mandate, one objective of WTO Members could be to ensure that developing countries' export interests are not hindered by overly burdensome qualification and licensing requirements and procedures as well as technical standards. Given their potential to export via MNP, questions relating to where and how effectively visa issues are dealt with are particularly important for developing countries. For example, some developing countries have had negative experiences with administrative procedures for obtaining visas and entry permits. They are keen to determine to what extent the disciplines under Article VI.4 could help to address these difficulties<sup>40</sup> or what alternatives exist - transparency being one such option (e.g. in the case of professionals as service providers, making readily available in a consolidated form information on all measures pertaining to the movement of natural persons).

Whatever the form of disciplines that are adopted in the end developing countries need to ensure that these take into account the asymmetry in regulation and institution development between themselves and more developed economies. The right to regulate is of particular importance for developing countries, as many of them do not yet have an optimal regulatory and institutional framework in place. Thus, developing countries need to ensure that any possible future disciplines do not prejudice their flexibility to undertake regulatory and institutional reform and their ability to meet public policy objectives. Specific consideration may need to be given to: developing countries' need for flexibility and ways to implement it (e.g. regarding the concepts of transparency, less trade restrictiveness, or national policy objective that are currently in discussion under the Article VI.4 mandate) and technical assistance in the context of regulatory reform. Ultimately, to maximize developmental gains, future disciplines on domestic regulation should facilitate exports of developing countries, particularly through MNP.

#### *Emergency Safeguard Mechanism and Subsidies as Instruments for Preserving Policy Space*

Another area where the importance of preserving policy space appears clearly is the negotiations for an emergency safeguard mechanism. Indeed, the discussions on an emergency safeguard mechanism draw attention to the need for countries to preserve the flexibility and the possibility of implementing measures to address the adjustment costs of liberalization. The major changes that often accompany trade liberalization call for government to monitor, re-evaluate and sometimes re-regulate sectors in function of evolving market realities. The same realities that justify the need for an emergency safeguard mechanism (difficulty in predicting impact of liberalization commitments, sector prone to unforeseen developments) account for the need for policy space. The adoption of an ESM, possibly in addition to the introduction of other measures, would contribute to embrace liberalization and its gains with the assurance that they will be able to adjust to the changes brought about by the liberalization in a satisfactory manner. Negotiations on possible emergency safeguard measures (ESM) have been identified as an area of developmental importance, albeit characterized by lack of consensus on the key issues of the desirability and feasibility of such measures. There are several grounds on which to justify ESM in services. The nature of services trade renders it prone to unforeseen developments, and a safety belt

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<sup>40</sup> Communications from Colombia (July 2004).

could assist countries in their liberalization efforts. It could also help address adjustment costs and losses due to liberalization and reform (e.g. unemployment) within a particular window of time.

Such safeguard mechanism could generally be considered a favorable element for developing countries. Measures to be taken could include such things as the subsidization of the affected sector or the imposition of quantitative restriction. Moreover, the ESM to be developed could contain S&D provisions for developing countries, *inter alia* with a view to preventing the number of suppliers from developing countries from decreasing below a certain level or average level from a recent representative period if a quantitative restriction is imposed on Mode 4 suppliers or by granting the right to seek an extension of an ESM application period only to developing countries. There would nonetheless remain a number of concerns to be addressed. These include: fears of abuse, the fact that Mode 4 is possibly the easiest “target”, and the risk of creating an overly burdensome mechanism.

Many Governments subsidize services sectors such as air, maritime and public railway transport, telecommunications, utilities (water and electricity) and public-good-type services (education and health).<sup>41</sup> Studies have found evidence that in many cases countries provide export support to their services suppliers, both companies and natural persons.<sup>42</sup> Export support in services is either granted in general to all services exports, or is granted to some specific services.<sup>43</sup> The case is that many countries are extending existing support measures available for trade in goods to services activities, and also implementing particular programs to support services exports.<sup>44</sup> Available figures confirm that the amount of aid provided is far from negligible.<sup>45</sup> Such subsidies to services industries can have a detrimental effect on international trade, in particular exports of developing countries. Negotiating disciplines to address trade-distortive effects of subsidies, which is mandated by Article XV of the GATS, could result in a more favorable situation for developing countries. Unfortunately, the negotiations have for now not moved significantly beyond the exchange of information, principally in relation to examples of services-related state support measures. Discussions have also relied largely on information contained in Trade Policy Reviews. The preliminary discussions on definitions and principles, have sought to draw on the Agreement on Subsidies and Countervailing Measures and the Agreement on Agriculture, while keeping in mind the specificities of services.

Developing and developed countries differ in their use of export subsidies, the former tending to rely on a more selective approach and the latter tending to use, *inter alia*, export promotion regimes, export financing and export guarantees.<sup>46</sup> These two groups of countries

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<sup>41</sup> *Subsidies and Trade in Services*, S/WPGR/W/9.

<sup>42</sup> Refer to UNCTAD forthcoming study on subsidies.

<sup>43</sup> The first case would for example be the regime in place in Brunei Dar as Salaam where all services exports benefit from preferential tax treatment. Refer to APEC (2003) *op.cit.*

<sup>44</sup> ECLAC (2003), Francisco Prieto: *Fomento y Diversificación de las Exportaciones de Servicios*, *Serie Comercio Internacional*, División de Comercio Internacional e Integración, Santiago de Chile, Diciembre.

<sup>45</sup> In the case of Australia, for example, for which the latest TPRM Report provides disaggregate data, for example, assistance to exporters of services amounted to A\$ 1.35 billion in the five years from 1997 until 2002, being granted to almost every services sector through direct financial assistance, funding to institutions and tax expenditures available to exporters. This amount is almost 30 per cent of all support to services reported during the same period. (WTO S/WPGR/W/25/Add.4 page 7)

<sup>46</sup> E. Brau et al., *Officially Supported Export Credits: Developments and Prospects*, IMF, 1995; IMF, *World Economic and Financial Surveys*, 1995. In the case of the United States, the Department of Commerce lists 161 export programs administered by different agencies. The situation is similar in the

also differ in the capacity to subsidize. Negotiations on subsidies disciplines must pay attention to the special concerns of developing countries, e.g. subsidies aimed at building competitiveness in priority service sectors and meeting social and development objectives and the priority removal of trade-distorting subsidies of developed countries. This would contribute to a more equitable and non-discriminatory multilateral trading system. Notification of developed countries' subsidy programs, including those implemented under regional integration schemes, must be encouraged.

*Continued Need for Targeted and Effective Technical Assistance*

Devising provisions for development flexibility may not be sufficient as many developing countries still face difficulties in implementing trade agreements. These need to be supplemented with technical and financial assistance to countries for implementing their commitments, devising appropriate policies for the development of the local services industry and infrastructure, strengthening their domestic regulatory and institutional frameworks. Finally, capacity building will also be need for participating in regional and multilateral negotiations as well as in the work of standard-setting organizations.

In a recent communication by a group of developing countries relating to future disciplines on domestic regulation several proposals for granting additional flexibilities to developing countries were put forth.<sup>47</sup> Among the concrete suggestions made are the following: i) account to be taken of the degree of development of services regulations and institutional capacities and of the particular need of developing countries to regulate and to introduce new regulations, ii) requirement that Members in the preparation and application of measures covered by the disciplines ensure that licensing/qualification requirements and procedures, and technical standards do not create unnecessary obstacles to exports from developing country Members, iii) longer time-frames for compliance of developing countries to the disciplines, iv) technical assistance on mutually agreed terms and conditions (e.g. credits, grants and training in necessary technical and administrative skills) regarding the establishment and strengthening of developing countries' institutional capacities to regulate the supply of services to meet national policy objectives, v) technical assistance on mutually agreed terms and conditions aimed at assisting developing country service suppliers meet the relevant requirements and procedures in export markets, and vi) requirement that Members encourage and facilitate the active participation of developing countries in the relevant international organizations. The sponsoring countries also suggest that the operation and implementation of all of these measures be periodically examined by the Council for Trade in Services.

**VI. Conclusion**

Developing a sustainable services sector is vital for all countries. Infrastructural and other dynamic sectors can contribute to poverty alleviation and human development, thereby furthering the achievement of the Millennium Development Goals. The integration of developing countries in the global services economy through new export opportunities needs to be supported and facilitated. Coherence and consistency among trade and other policies implemented at the national, bilateral, regional and multilateral levels by countries are also important for maximizing the contribution of such policies to development.

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EC and other OECD countries, which employ multiple programs. OECD, *Export Credit Financing Systems in OECD Member and Non-Member Countries*, 2002 Supplement.

<sup>47</sup> Elements for Draft Disciplines on Domestic Regulation, Communication from Brazil, Colombia, Dominican Republic, Peru and the Philippines, Room Document.

Preconditions for ensuring development gains include measures aimed at the appropriate sequencing and pace of reform, domestic supply capacity building and increased competitiveness, and universal access by all, especially the poorest, to essential services. Services trade can create employment opportunities and promote poverty alleviation and human development. Adopting a participatory multi-stakeholder approach (involving trade negotiators, regulators, legislators, professional associations and civil society) in the formulation of policies and appropriate regulatory frameworks would ensure that their particular concerns are taken into account. It must be recognized that regulatory reform entails adjustment costs and necessitates regulatory capacity and institution building, as well as technical assistance.

Assessment of trade in services and policy reform can help developing countries to improve their national policy frameworks and to negotiate more effectively at the international level. Moreover, the knowledge of the economy gained from the assessment exercise would allow to tailor the process of integration into the world economy to the level of economic development of each country and the capacity of its institutions and enterprises. Indeed, the experience of developing countries reveals that, for positive outcomes to result, liberalization must proceed at a speed that is not too rapid for local actors, the regulatory framework and social safety net must be adequate, and there must be a competitive business environment and suitable accompanying policies to ensure that economies enhance their capacity to integrate beneficially into the world economy.

From a sustainable development perspective it is important that governments and international organizations keep in mind the wide-range of impacts that can and should be measured in determining the type of assessment to carry out. When deciding to embark on assessment in the context of trade negotiations, Governments must not only determine the policy priorities but also the types of impacts that they deem most crucial to the determination of their negotiating position and future trade policy. They will also have to decide who to involve in the process. In order to allow for the broadest range of concerns and interests to be dealt with in the assessment, governments should consider adopting a participatory, multi-stakeholder approach. Among the possible focuses for assessment are the following:

- the economic, developmental and social impacts,
- the assessment of impacts on human development,
- the assessment of the impacts on human rights,
- the impacts on health and the health care system,
- the impact on the sustainability of the economy,
- the impact on employment, and
- the impact on education and cultural policies.

Finally, a repeated or recurring process may be necessary as opposed to one-time assessment. These options are not mutually exclusive, but rather they can be combined to complement each other.

The importance of sequencing reforms is well established in theory, but the specific content of this sequencing is less clear, and having a number of benchmarks on how to proceed would facilitate decision-making. It should be recognized that there is no “one size fits all” policy framework, either across services sectors or across countries.

Trade policies of developing countries should suit their needs and circumstances, be integrated into broader development policies and aimed at reducing poverty, supporting

## **ICTSD Policy Paper on Trade in Services and Sustainable Development**

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*Draft – Not to be Quoted*

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growth, sustainable development as well as gender equality. In implementing national trade and trade-related policies, developing countries need to pursue a strategic and appropriately sequenced approach to liberalization after careful analysis and assessment of their domestic service economy.

Overall, developing countries should be able to arrive to a point where their participation in world services trade leads to economic gains that outweigh costs (including adjustments costs), accompanied by net social and net environmental gains. The challenge is to elucidate what policy framework should be used for what sectors and under what national and international conditions in order for services to contribute positively in developing countries to the three pillars of sustainable development.

Given that development is said to be at the heart of the Doha Work Program, and in order to implement the Millennium Development Goals, GATS negotiations should seek to ensure better prospects for developing countries in terms of a more balanced and equitable distribution of benefits from trade liberalization. Liberalization in Mode 4 and sectors of particular interest to developing countries will be the litmus test in this respect. The review and evaluation of the services negotiations – which is to determine the extent to which Article IV is being implemented – will also prove crucial for assuring development gains.