



Open Services Markets Matter

Summary

Despite the failure of WTO members to launch a new round at the 3rd Ministerial Conference held in Seattle at the end of 1999, further negotiations under the General Agreement on Trade in Services (GATS) formally commenced on 1 January 2000, as foreseen under the Uruguay Round's so-called "built-in" agenda. The GATS ranks amongst the chief accomplishments of multilateral trade diplomacy at the end of the 20th century, but it is at the centre of the controversies surrounding trade policy at the start of the new millennium. As the services negotiations have progressed, the GATS has become the critical focus of civil society groups representing a range of interests. Arguments against the GATS concern principally the threat it is alleged to pose to countries' sovereign rights to regulate the production, sale, distribution or import of service activities. While many of the claims made are based on misunderstandings of the Agreement's *modus operandi*, concerns about the GATS, its effect on public services, its implications for national sovereignty and governments' ability to regulate are genuine and need to be addressed. The GATS negotiations provide a ready-made opportunity for governments to inform concerned constituencies about the Agreement and its impact on national economic and social goals. To serve a useful purpose, however, the public policy debate must be based on facts and not misconceptions.

This Policy Brief summarises some of the key findings of ongoing OECD work on the benefits of open services markets. The work has a threefold purpose. First, to recall the economic case that underpins service sector reforms and the policy rationales for pursuing open service markets through trade and investment liberalisation. Second, to address concerns over the effects of the GATS by explaining the operation of the Agreement, the obligations WTO Members undertake and the policy options they may pursue under it. Third, to point out some of the key negotiating challenges of the current GATS round and recall the potential the GATS holds for anchoring development-enhancing reforms in service markets. ■

The internationalisation of services

Harnessing the Economy-Wide Effects of Service Sector Efficiency

Who gains from open services markets?

The complexity of services reform

How does the GATS operate?

Addressing the GATS critique

Reaping the benefits of open services markets: still a long way to go

Looking ahead: future challenges

Further Reading

Where to contact us?

The internationalisation of services

The share of services in world-wide economic activity has in recent years expanded markedly. Services dominate the economic landscape of advanced economies, accounting for close to 70 percent of production and employment in the OECD area. While the share of services in world GDP increased by five percentage points between 1980 and 1998, the corresponding increase for low and middle-income countries was nine percentage points, suggesting far-reaching structural changes in domestic economies. Demand for services such as health, education or tourism rises as societies and indi-

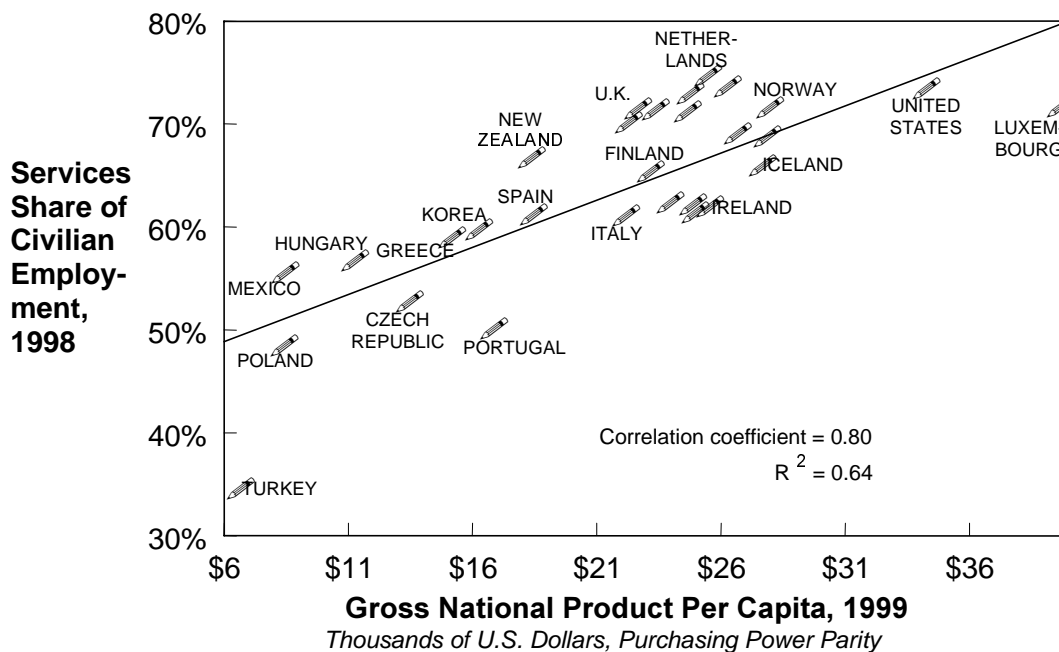
viduals become richer, typically outpacing demand for manufacturing or agricultural products. As Figure 1 shows, there is a strongly positive correlation between the share of services in employment and overall development levels.

Services have been the fastest growing component of cross-border trade and investment activity for the better part of the last decade and a half. Estimates show that total measurable trade in services, as defined by the various types of transactions subject to multilateral disciplines under the GATS, stood at some \$2.3 trillion at the end of 2000. This represents 7.6 percent of world output and over a third of total trade in goods and services. Such figures are useful reminders of the economic

and commercial significance of the sector and of negotiations aimed at progressively rolling back impediments to trade and investment in it.

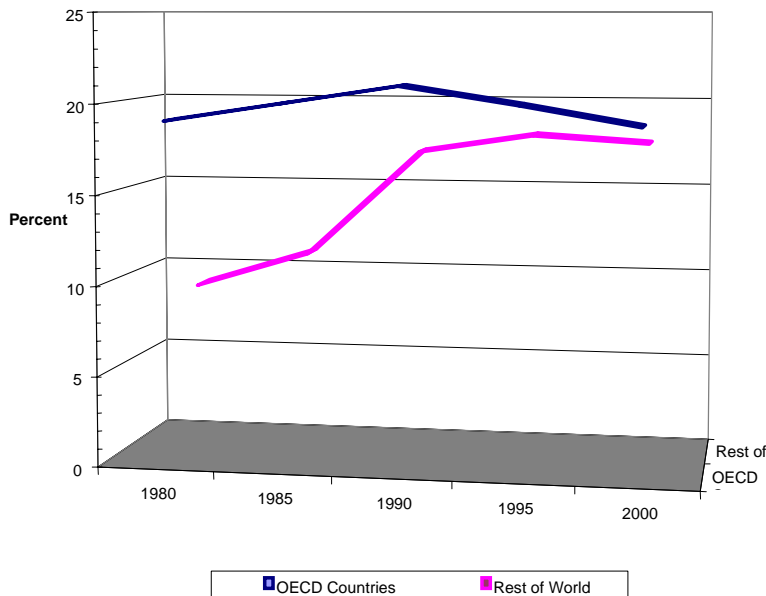
Although OECD countries dominate global trade and investment in services, developing countries are often highly specialized in – and dependent on – services exports as a source of foreign exchange earnings. While services once accounted for much more trade among industrialised countries than they did among developing countries, the gap has nearly disappeared (see Figure 2). Developing countries are today active *demandeurs* in services negotiations, especially in areas where they enjoy strong comparative advantages (e.g., tourism, labour mobility). ■

Figure 1
Relationship Between Services Employment and National Income



Sources: Calculated from OECD

Figure 2
Converging trends in services trade



Source: Calculated from World Trade Organisation data.

Harnessing the Economy-Wide Effects of Service Sector Efficiency

An inefficient service sector acts like a prohibitive tax on a national economy. For this reason, the economic cost of protecting inefficient service sectors is arguably of greater overall significance than that flowing from protectionism in the goods sector. Adopting a liberal trade and investment regime and a pro-competitive regulatory stance in key infrastructural service sectors – telecommunications, finance, transport, energy – will be essential for countries to maximise benefits from the internationalisation of services markets.

Countries able to exploit these opportunities will find that such internationalisation can make a positive contribution to international economic convergence. In contrast, countries that fail to establish conditions conducive to the efficient provision of services run the very serious risk of falling further behind.

Many countries, developed and developing, have in recent years undertaken far-reaching regulatory reforms targeted at increasing competition in key service sectors. To a significant extent these reforms have been driven by changes in technologies that have facilitated the provision of services at much lower cost and allowed competition to emerge in markets that were traditionally regarded as natural

monopolies. Service sector reforms have also been pushed by manufacturing and agricultural interests, as well as by downstream service “users”, who have themselves come under greater competitive pressure as trade and investment barriers are lowered.

The importance of policy in the service sector goes beyond the sector itself. Services are essential inputs into the production of virtually all other goods and services, and producers depend on services to deliver their output to end-users. Because the price and quality of the services available in an economy have major impacts on all sectors, service sector policies and efficiency enhancing reforms – including regulatory and institutional

changes – can exert major effects on overall economic performance. Accordingly, services liberalization should not be viewed as a “concession” to other countries, but a precondition for enhancing domestic economic performance. ■

Who gains from open services markets?

Open services markets bring direct economy-wide benefits through the facilitation and encouragement of innovation, efficiency, and quality improvement. These benefits accrue to individual consumers; employees who, contrary to popular belief, tend in most sectors to earn higher wages than in manufacturing; small and medium-sized enterprises (SMEs) – as both service consumers and suppliers; producers in other sectors (e.g. user industries), and to society as a whole. When they are regulated in accordance with sound, efficiency-enhancing principles, open trade and investment regimes provide the best opportunity for wider (and informed) consumer choice and better quality products. They will also reduce the scope for wasteful resource use and rent seeking; constrain the power of individual economic operators and enhance overall economic performance.

Empirical assessments of services policy reform in developing countries reveal positive economy-wide benefits flowing from the removal of service sector inefficiencies. Such benefits are in fact quite large relative to what is usually found using similar types of models to assess the impact of merchandise trade liberalization.

The benefits from continued services reform and liberalization, while undoubtedly larger in relative terms for developing countries, are by no means negligible for OECD countries. Indeed, empirical studies point to a number of favourable economy-wide outcomes in those OECD countries where competition-enhancing regulatory reforms in service industries have gone further: (i) the share of services in domestic output, employment growth and the catch-up in productivity growth have been higher; (ii) distribution systems have been modernized; (iii) rail and road freight transportation have become less costly; (iv) air transport networks have been modernized and made more efficient, and airfares for all categories of travellers declined substantially; and (v) telecommunications and electricity supply have become more efficient and cheaper, especially for industrial consumers. Moreover, in many industries, regulatory reform has been matched by technical progress, innovation and product diversification. And competitive pressures in liberalized markets have encouraged productivity-enhancing investment, particularly in information and communication technologies. ■

The complexity of services reform

Pursuit of reform in services is no easy task, however, as there is often a need to balance the scope for promoting greater competition with the legitimate role that exists for governments to intervene to offset market failures and to achieve non-economic objectives, such as the universal provision of education or health care services. Care must

however be taken that regulatory reforms are designed so that such objectives are attained in an efficient manner.

Strengthened multilateral disciplines on domestic regulations can play a significant role in promoting and consolidating domestic regulatory reform. Such disciplines can also equip developing country exporters with the means to address barriers to their own exports in foreign markets. As repeated bouts of financial market instability in a number of emerging markets has shown in recent years, inadequate domestic regulation may give rise to serious internal distortions which, in turn, can entail equally severe social dislocation. At the same time, inadequacies in domestic regulation, for example in the field of professional licensing, can legitimise external barriers to trade, to the detriment of developing country exporters.

For service sector policies – and national commitments on trade and investment in services in the WTO or in regional trade agreements – to contribute to development, liberalisation will need in many instances to be accompanied by *strengthened* regulation. In many settings, regulation and competition policy may need to be in place to complement trade and investment liberalisation. Regulatory intervention will also typically be required to ensure that liberalisation improves access of the poor or the geographically disadvantaged to essential services.

Liberalization of the service sector is not a panacea, however, and many of the benefits flowing from greater market openness may take time to materialize. In contrast, the costs associated with the rationalization of service industries will appear

early on under the guise of changes in the structure of industry ownership and possibly labour displacement. Opposition from affected workers, incumbent firms (domestic or foreign) and bureaucracies, who will often perceive liberalization as a threat to employment, profitability or rent-seeking behaviour, add to the complexity of liberalization efforts with respect to services.

An important dimension of services trade and investment liberalisation is that the adjustment associated with greater market openness is generally smoother in many service sectors than in some more traditional areas of goods production. This is so for three reasons. First, adjustment in service industries such as telecommunications and finance often occurs within a dynamic sectoral environment, where expanding market segments and firms can more readily absorb workers from shrinking sectors. Workers that may be adversely affected will find it easier to re-position themselves within a dynamic economy generating favourable income and employment opportunities than in a stagnant system defying or resisting change. Second, most international trade – close to four-fifths of it – continues to take place in manufacture products. This generally lessens the direct exposure of service sector workers to trade-related job displacement. Third, and perhaps most importantly, owing to a lower degree of sector-specific professional specialisation and above-average educational levels, service sector employees in many fields will tend to display greater overall labour market mobility. The latter characteristic may explain the observed tendency for displaced workers in non-manufacturing activities to experience shorter peri-

ods of unemployment, higher overall re-employment rates, and smaller earnings losses on average upon re-employment than workers in manufacturing. ■

How does the GATS operate?

Services trade encompasses a disparate array of economic activity, and brings together a similarly wide scope of issues, institutions, and interests. The conclusion of the GATS, bringing services trade into the multilateral framework of trading rules, was one of the most significant achievements of the Uruguay Round. The GATS offers for services trade the same stability that arises from mutually agreed rules and binding market access and non-discriminatory commitments that the GATT has provided for goods trade over the last five and a half decades. However, liberalisation of services trade is quite different from trade in goods, given the characteristics of services and the highly developed regulatory frameworks in place in many service industries. Much of the current public debate over the alleged downsides of services trade and investment liberalisation is rooted in misunderstandings arising from the complex geometry of the GATS and of trade in services more generally.

A framework agreement that features several of the fundamental principles of the GATT – national treatment, most-favoured nation treatment (MFN), transparency in domestic regulation, fair application of laws – the GATS covers in principle international trade in all services except those supplied in the exercise of governmental authority and, in the air transport sector, traffic rights

and all services directly related to the exercise of such rights.

The GATS consists of three major elements: the framework which lays out the general obligations for services trade, in much the same way as the GATT does for trade in goods; a number of annexes on specific sectors as well as the schedules of commitments submitted by WTO Members. Due to its structure and its voluntary, “bottom-up”, approach to liberalisation, the GATS allows WTO Members to select the sectors, modes of supply (i.e. cross-border trade; movement of consumers; commercial presence and movement of suppliers) and regulatory conditions in which liberalisation commitments are made. Or indeed to make no commitments at all by leaving entire sectors out of their schedules. Such flexibility, and the emphasis in GATS on the progressive, voluntary, nature of liberalisation, help explain why the GATS is arguably the most “development-friendly” of all Uruguay Round Agreements.

The preamble to the Agreement sets out key considerations that underlie its continued negotiation. These include:

- The belief that a multilateral framework of rules and principles that aim to progressively liberalise services trade will assist the growth of international trade in services and contribute to economic development world-wide
- Acknowledgement that the liberalisation process must respect the needs and rights of governments to regulate in order to pursue national policy objectives
- Acknowledgement that the integration of developing countries

into the multilateral trading system must be facilitated through a reinforcement of the capacity, efficiency and competitiveness of their domestic service industries.

Critiques of the GATS are often based on the erroneous belief that the Agreement must inevitably bring any and all service sectors within its liberalising scope, and these will be wholly and irretrievably “lost” to the regulatory protections of national governments. The GATS permits member countries to undertake the progressive opening of service sectors and integration into the multilateral trading system at their own pace and in accordance with their national priorities and objectives. Indeed, the Agreement establishes a series of means through which countries can limit, condition, or even suspend the commitments that they make.

The GATS offers the following options to a WTO Member that wishes either to exclude a service sector from its GATS commitments; restrict their extent; justify a breach of those commitments; or opt out of the multilateral trading system altogether:

- *It can simply decline to make any commitments.* Nothing in GATS compels member countries to bind or liberalise any specific sector, and a country could indefinitely choose to keep a sector outside the scope of its commitments. In this respect, the sectoral coverage of liberalisation commitments under the GATS is much less complete than that of goods under the GATT. While the majority of WTO Members have bound most or all of their goods tariffs, many have thus far left a large number of their service sectors “unbound”.
- *The country is free to qualify its commitments in any given sector or sub-sector.* For each of the four modes of supplying services covered by the GATS, a WTO member can either specify that it is “unbound” (i.e., the country has made no commitments in that sector for that mode of supply) or make a more specific reservation. A WTO Member can also bind less than the regulatory *status quo* or commit to future liberalisation, allowing incumbent suppliers to prepare for new market conditions and for necessary regulatory regimes to be established.
- *The country can apply horizontal limitations to all services.* For example, many countries have listed so-called “horizontal” limitations applicable to all sectors on the commitments for movement of persons or on those governing investment (commercial presence) in service activities. For instance, some WTO members maintain the right to review all inward FDI flows above a certain value threshold or to restrict temporary entry to certain types of service providers (i.e. highly skilled).
- *A country can invoke GATS Article XII (Restrictions to Safeguard the Balance of Payments) provisions* to suspend a commitment in the event that it is found to cause adverse effects on its balance of payments.
- *A country can invoke the various general exceptions in GATS Article XIV (General Exceptions) to justify existing regulations, or to enact new ones, in pursuit of legitimate public policy concerns.* Such exceptions can be invoked where governments deem it necessary to protect major public interests, including safety, human, plant or animal life or health, national security or public morals.
- *A country could ultimately withdraw from GATS and the WTO altogether, though it bears recalling in this regard that no WTO members have to date done so and that countries have been queuing to join – rather than leave – the Organisation.* ■

Addressing the GATS critique

Critical assessments of the GATS typically find their origin in the broader context of backlash against globalisation and the commercialisation that it brings to some activities previously insulated from the market. Claims of threats to the provision of public services, such as education or health services, or to services with strong public goods connotations, such as water or electricity distribution, are among the most commonly voiced concerns associated with the GATS and with the very idea of services trade and investment liberalisation (including that pursued at the regional level).

A paradox of the anti-GATS campaign is that much of it is rooted in the OECD area, where the share of services in employment and standards of living are highest, and where the benefits of regulatory reform and of trade and investment liberalisation in services have arguably generated the greatest gains in consumer welfare and allocative efficiencies. Not surprisingly, the public policy debate on services in OECD countries has tended to centre not so much on disputing the economic case for open markets.

Rather, the debate over GATS has generally focused on the respective roles that the market and the state (as both regulator and direct purveyor of services such as education and health) should be assuming, as well on the threat to national regulatory sovereignty allegedly posed by trade and investment rule-making.

GATS and the right to regulate

Threats to a country's sovereign right to regulate, or the alleged transfer of regulatory authority from national governments to a supranational body such as the WTO, is a central plank of the anti-GATS critique. Agreements to accept a framework of rules, whether bilateral, plurilateral or multilateral, by definition entail some curtailment of sovereignty, although the decision to enter into such an agreement is itself an exercise of sovereignty. Over 140 governments have chosen through membership of the WTO to participate in a package of multilateral agreements because they recognise the overall net economic and social benefits that accrue from a rules-based trading system.

The progressive liberalisation, not deregulation, of services trade is the goal of the GATS, and of periodic negotiating rounds. A common misconception in the public policy debate over GATS is to use the terms "liberalisation" and "deregulation" interchangeably, as if they were literal synonyms. They are not, and it is simply wrong to assimilate regulations to trade restrictions. Services liberalisation, indeed, often necessitates regulation or re-regulation. But that is not to say that regulation, whether for economic or social purposes, cannot be designed, implemented or enforced in more transparent and efficient ways, with

positive overall effects in terms of democratic governance.

The principal concern linked to loss of sovereignty is the consequent loss of a nation's freedom to regulate its service sectors in the manner it deems appropriate. Many service sectors are highly regulated in order to protect consumers, the environment and, in the financial services sector, to protect a country's financial stability. Governments are understandably cautious when agreeing to subject themselves to common rules. Such regulatory precaution is reflected in the provisions of the GATS, which uphold the fundamental right of a government to regulate in order to pursue national policy objectives. The Agreement's preamble recognises, *inter alia*, "*the right of Members to regulate, and to introduce new regulations, on the supply of services within their territories in order to meet national policy objectives*".

It is certainly true that, as with any other legally bound undertaking in the WTO (or any other international treaty), the GATS can affect the regulatory conduct of member countries. Yet countries accept such disciplines because they deem them necessary to reaping the full benefits from international co-operation in a rules-based system. The GATS affords WTO members considerable flexibility in this regard. For only those sectors, sub-sectors and modes of supply where a WTO member agrees to schedule liberalisation commitments and where exceptions from the most-favoured-nation treatment obligation have not been taken, what that country ultimately accepts to do under GATS is to not make its regulatory regime more restrictive in future (subject to trade concessions or

retaliatory measures of commercially equivalent effect if a country decides, as it always can, to renege on its commitment). In scheduling commitments, WTO members may also opt, at their discretion, to treat foreign services and service providers in a non-discriminatory manner. That is, extend national treatment to the latter, now or in the future. And they can decide, if they so desire, to eliminate, immediately or progressively, quantitative restrictions that impede access to their services markets. Each one of those decisions – like that of not scheduling commitments – remains the sovereign prerogative of WTO members to make.

Commitments under the GATS to grant market access do not entail any changes – and certainly not compromises – to regulatory standards or preferences. Those in force for the protection of the public, or to achieve universal access, e.g. in telecommunications or water supply, continue to apply regardless of the nationality of the supplier. Governments may also choose to impose additional requirements on foreign suppliers, something they typically do for instance in the case of professional licensing in medical services.

The specific obligations concerning domestic regulation in the GATS framework aim at requiring Members to regulate those service sectors in which they have made commitments in a reasonable, objective and impartial manner. Article VI of GATS on Domestic Regulation aims to create more transparent domestic regulatory decision-making, implementation and administration. There is explicit recognition of the right of service suppliers to information on regulatory and adminis-

trative decisions and to judicial and administrative review and appeals processes. In both respects, the GATS champions principles of good governance.

The work programme foreseen under Article VI(4) of the GATS, on which discussions have continued since the end of the Uruguay Round, has provoked some of the strongest anti-GATS sentiments. Work in this area is designed to address the fact that non-transparent, unfair or unduly burdensome regulations at the national level can potentially undermine the value of market access commitments freely entered into by a WTO member. Article VI(4) calls for the development of any necessary new disciplines to ensure that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary trade barriers. No so-called “necessity test” has yet been developed under the Article VI(4) work programme. Discussions have proceeded slowly, reflecting the cautious attitude of governments in this area.

Disciplines relating to domestic regulation have however been developed specifically for the accountancy sector. These draft disciplines, which were adopted in December 1998 and are due to be integrated into the GATS at the conclusion of the current negotiations, would only apply to those countries that made commitments on accountancy services. Critics have argued that the incorporation of such disciplines in the GATS could infringe upon governments’ sovereign right to regulate by imposing a set of global standards on WTO members. However, the draft disciplines do not focus on the substan-

tive content of qualifications in accountancy but seek to ensure procedural transparency in matters of licensing and qualification. The WTO is not a standards-making body, nor is it mandated to assess the content of national standards, be they technical or professional. The Article VI(4) work programme concerns itself with the *means* that countries choose to pursue public policy objectives, and not the objectives *per se*.

The GATS and public services

A variety of claims are made describing the GATS as a threat to the provision of public services: that it forces governments to privatise and allow competition in public services, that it obliges them to open them up to foreign trade and investment, and that it puts in danger the assurance of basic public services such as education, water distribution or health services. However, GATS rules do not dictate any specific role for the public and private sectors; countries are free to decide for themselves what sectors will be reserved for the state or state-owned enterprises. And they remain entirely free to decide whether or not to open such sectors to outside competition and to make (or not) binding commitments in such sectors in their GATS schedules. It is incorrect to suggest that the GATS forces governments to privatise or open up public services to competition, as the Agreement features no such obligations.

An important element in the debate over the GATS and public services is the fact that services supplied in the exercise of governmental authority are specifically excluded from the scope of the Agreement. GATS Article I.3(b) defines “services” to

include “any service in any sector except services supplied in the exercise of governmental authority.” This exception is further clarified in Article I.3(c), which specifies that “a service supplied in the exercise of governmental authority” means “any service, which is supplied neither on a commercial basis, nor in competition with one or more service suppliers.”

The degree of government funding for public services varies widely across countries, depending on social and political preferences as to the role of the state in the provision of those services. The regulatory landscape in the education and health fields in most countries, developed and developing, is one in which public and private suppliers typically co-exist. The advantage of the GATS in this regard lies once more in its flexibility. It can accommodate a wide spectrum of positions with regard to services provided by the government and those supplied under competitive market conditions or by private entities on a not-for-profit basis. Over and above the specific GATS carve-out for services supplied in the exercise of governmental authority, it is important to recall that the Agreement allows WTO members to:

- regulate their service sectors in accordance with national policy objectives (subject to the limitations noted above in respect of areas where liberalisation commitments are undertaken);
- refrain from taking liberalisation commitments in any particular sector, sub-sector or mode of supply;
- maintain or designate monopolies; and

- retain the ability to subsidise service activities in their territories (see below).

It also bears noting that not a single country proposal to liberalise the provision of health services under the GATS has been formulated to date. Moreover, the three WTO members that have tabled negotiating proposals on trade in education services have all sought to clarify their circumscribed nature. These proposals generally seek non-discriminatory treatment for those who provide education and training services on a commercial basis and meet the regulatory requirements of the host country. The United States, which submitted one of the proposals, has noted that it explicitly does not cover primary and secondary education and that a country's subsidies for higher education should not be made equally available to foreign providers. All proposals emphasise the central importance of preserving the ability of countries to apply regulatory measures necessary to achieve education policy objectives, including in respect of public funding.

The GATS and investment

Services trade through foreign direct investment (FDI) is particularly important given the need for proximity between suppliers and consumers of services and the need to tailor service offerings to host market conditions. It is the area where by far the largest amount of liberalisation commitments were undertaken by WTO members in the Uruguay Round. This suggests the importance countries attach to reaping the positive benefits – high paying jobs, human resource training, technology transfers, quality upgrading – typically associated

with greater doses of foreign direct investment whilst also retaining the freedom to regulate such activity.

The argument is often heard that the GATS is principally an investment agreement, designed to promote the interests of large multinationals. While the GATS can be described as a multilateral agreement that covers FDI in the services trade context, it is not an agreement on investment *per se* and cannot be portrayed, as many GATS opponents have alleged, as a means of resurrecting the Multilateral Agreement on Investment (MAI).

While WTO members may, via their GATS commitments, accord market access to foreign investors, they are not obliged to do so. In addition, governments are free, if they choose to make commitments on commercial presence, to maintain existing discriminatory or quantitative restrictions. The Agreement affords no automatic right of establishment to foreign investors. The only obligations of WTO members are to schedule any existing restrictive measure they wish to maintain in sectors where liberalisation commitments are voluntarily undertaken, and to ensure freedom of payments and transfers relating to investments in such sectors.

Governments can use the GATS selectively to encourage investment in sectors of their choice, subject to the conditions they wish to impose or retain, including with respect to technology transfers and the employment of local workers. The Agreement also permits governments to maintain foreign ownership restrictions in sectors where they have made commitments. The GATS promotes greater predictability through the permanency of commitments, an important element in

attracting investment for developing countries.

The GATS, subsidies and public procurement

Two allegations often raised by GATS' critics relate to the presumption that the Agreement forces members to grant governmental subsidies, notably in the fields of public health and education or cultural industries, to all comers on a non-discriminatory basis; and that it obliges countries to open up public procurement markets, including at the sub-national level. The areas of subsidies and government procurement are ones where WTO Members agreed at the end of the Uruguay Round to pursue negotiations with a view to developing any necessary new multilateral disciplines. No such disciplines currently exist in the services area, nor has any firm deadline been set to complete ongoing discussions in both areas.

At present, for those services where a WTO Member has made market access commitments, it can maintain the ability to subsidise national service suppliers on a discriminatory basis by listing such limitations on national treatment in its schedule of commitments. It retains, moreover, full freedom to subsidise service activities in sectors in which it has not made commitments and which appear on its list of exemptions from MFN treatment. Meanwhile, disciplines on public procurement, including for services and construction, continue to be governed by the WTO's Government Procurement Agreement (GPA), whose membership is currently limited to 27 signatories (mostly from OECD countries). Like the GATS, the GPA affords sig-

natories full freedom to decide where and under what conditions to undertake market opening commitments for covered entities, including with regard to purchases by sub-national governments.

The GATS and dispute settlement

The WTO's Dispute Settlement Understanding (DSU) inspires some of the most extreme claims by opponents of trade liberalisation. Critics often portray the DSU as a tool by which countries' laws might be overturned. In fact, WTO members retain the sovereign right to establish their own laws. Neither the DSU nor any other international body has the authority to invalidate the laws of sovereign states. The most that the DSU can do, in the event that it finds a country's laws to be incompatible with its obligations under the GATS, is to give that country a choice among three alternatives. The preferred outcome is that the country brings its laws into compliance with the obligations that it has undertaken. Failing that, the country can either compensate its trading partners (e.g., by liberalising trade in some other area), or be subject to retaliation (of commercially equivalent effect) on the part of those countries whose interests have been injured. The retaliatory option is the least preferred outcome. It is also the least used in practice. But in the absence of WTO rules, where "might" would likely supplant "right", retaliation would probably be the one most frequently employed by parties to a dispute, typically on a unilateral basis and to the benefit of the most economically or politically powerful countries.

The DSU does not operate under the often alleged principle that trade

rules trump all other considerations. As with WTO rules governing trade in goods, the GATS establishes exceptions (in Article XIV) that extend special treatment to measures affecting national security, human, animal or plant life and health, public morals, governmental activity, and other legitimate considerations of public policy. The Agreement also allows members to introduce restrictive measures in instances where liberalisation commitments may be shown to induce adverse effects on a country's balance of payments (in Article XII). The contention that a measure is justified by one or more of the above exceptions or restrictions remains however a refutable proposition that can be challenged by another WTO member and decided by a dispute settlement panel.

It bears recalling, moreover, that the GATS offers WTO members full freedom to limit their commitments, or exclude entire sectors from their liberalisation schedules. The DSU does not override such protections. Indeed, WTO members cannot be accused of breaching specific commitments they have not undertaken. ■

Reaping the benefits of open services markets: still a long way to go

Services represent an area where the potential gains from international cooperation and multilateral rule making are large and where the benefits of such cooperation have barely begun to be tapped. The primary goal of the Uruguay Round in the services field was to put in place the GATS framework, through which liberalisation would be achieved on

a progressive basis in successive negotiating rounds.

Little real liberalisation – understood as implying a rolling back of existing discriminatory or market access impairing measures – was locked-in (i.e. made legally binding) in the first negotiating round. Most Members made commitments that bound the statutory and regulatory *status quo* (in some cases significantly less) and the sectoral coverage of commitments in many Members' schedules is quite limited. An indication of the work that lies ahead for securing more meaningful market access commitments may be gleaned from a calculation of the share of commitments where no restrictions are maintained on market access and national treatment. For high-income countries, the share is about 25 per cent of all services; for other Members less than 10 per cent. ■

Looking ahead: future challenges

Liberalisation of services markets is already well underway with or without the GATS, and is being propelled both by new technological applications and by the autonomous – and typically pro-liberalising – policy decisions of national governments. Reform in services markets has been and will likely continue to be driven primarily by domestic priorities. Reform efforts are almost inherently more sustainable in political and economic terms if they are pursued out of recognition of national self-interest, rather than at the behest of foreigners.

Left to domestic discretion, however, experience shows that reform may never be undertaken in any

systemic way. New negotiations in the GATS should help codify the high level of *de facto* liberalisation that has been achieved in recent years, including in the short period since the end of the Uruguay Round. It should also encourage countries to go farther by exchanging mutually beneficial commitments to further open their markets.

Multilateral rule-making and liberalization efforts can help countries overcome domestic resistance to change by offering compensatory bargains in sectors of priority export interest. Trade agreements also perform the useful function of allowing countries to periodically lock-in past reform efforts. By giving greater permanency to reform efforts, and establishing a floor of openness under conditions of heightened regulatory transparency, legally bound commitments in the services area can send powerful signals to domestic and foreign service suppliers alike. Such signals are likely on balance to generate greater inflows of foreign investment, given the importance of commercial presence as a means of competing in services markets.

The GATS can also serve a central adjustment-enabling function, by allowing WTO Members to pre-commit to future liberalization in an orderly, progressive, manner. Once again, this will tend to send strong signals to incumbents about the need to prepare for a more competitive environment, and to regulatory authorities to put in place a proper regulatory framework to accompany liberalization efforts and address potential downsides.

The GATS allows WTO Members considerable flexibility as regards the pace, sequence, and nature of trade and investment liberalization

efforts they seek to bind under it. Such flexibility, and the emphasis in GATS on the progressive character of market opening efforts, may be of considerable importance in helping countries anticipate, mitigate, or avoid potential downsides flowing from liberalization.

The multilateral community faces a dual challenge in the current GATS round. A first challenge consists of responding credibly to the rising chorus of criticisms levelled at the GATS. There can be little doubt that even as such concerns are legitimately felt and expressed, they are in many instances greatly exaggerated and belie a misunderstanding of the aims and operation of the GATS. The ongoing negotiations provide a ready-made opportunity for governments to inform concerned constituencies about the GATS and how it affects national economic and social goals.

A second challenge is to build support amongst all WTO members, and especially developing countries, for wider and more commercially meaningful GATS commitments. Liberalization under GATS will nonetheless remain progressive in character, and will in many instances require concomitant efforts at capacity building in education, training, institutional and regulatory matters. To make a success of the GATS negotiations, efforts will also be needed to progressively open up areas of export interest to developing countries, notably in sectors such as construction, tourism, computer software development and transportation, as well as in respect of the movement of service suppliers, so-called “mode 4” trade in services.

In stating the case for open markets, it matters that the relative contribu-

tion of trade and investment liberalization to ongoing structural change be properly understood, and set against other forces, chief among which technology, that are reshaping the world’s economic landscape. Trade and investment liberalization are means of helping societies and individuals cope with change and take advantage of the opportunities afforded by closer economic integration. Liberalization is never, nor should be, an end in itself. At the same time, stakeholders in the public debate over market openness should guard against the tendency to expect – and at times promise – more than trade and investment liberalization can realistically be expected to deliver. Just as unhelpful however is the tendency to ascribe to trade and investment policy a greater influence on countries’ destinies than is warranted relative to more purely domestic or independent forces and the exercise of sovereign policy choices.

The above considerations do not, of course, take away from the positive overall effects of open services markets on the welfare of nations and the pocketbooks of citizens. Because they are the backbone of a vibrant market economy, the case for open services markets is just as strong – if not more – than that for goods trade. It matters greatly therefore that governments be able to communicate the case in favour of open services markets. It is essential that they make clear what is and is not subject to trade disciplines and negotiations. Above all, governments must communicate why and how a sustained commitment to international cooperation and to open markets more often than not forms part of the answer to the concerns of their citizens, rather than being their root cause. ■

Further Reading

- **Open Services Markets Matter** (*forthcoming*)
- **The Development Dimensions of Trade** (*forthcoming*)
ISBN: 92-64-19675-7, 30 euros, 137p.
- **Trade in Services: Negotiating Issues and Approaches, 2001**
ISBN: 92-64-19522-X, 35 euros, 135p.
- **OECD Economic Studies: Special Issue: Regulatory Reform, No. 32, 2001/1**
ISBN: 92-64-19004-X, 45 euros, 275p.
- **Innovation and Productivity in Services, 2001**
ISBN: 92-64-18609-3, 35 euros, 156p.
- **Open Markets Matter: The Benefits of Trade and Investment Liberalisation, 1998**
ISBN: 92-64-16100-7, 19 euros, 116p.

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