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THE RELATIONSHIP BETWEEN REGIONAL TRADE AGREEMENTS AND THE MULTILATERAL TRADING SYSTEM

SERVICES

This paper forms part of a broader study on the relationship between Regional Trade Agreements and the Multilateral Trading System. Together with other chapters and an overall assessment, it will be incorporated into a consolidated document to be submitted to the Trade Committee on 28-30 October 2002.

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THE RELATIONSHIP BETWEEN REGIONAL TRADE AGREEMENTS AND THE MULTILATERAL TRADING SYSTEM: SERVICES

I. Key points emerging

- 1. The last decade and a half witnessed strong growth in the number of regional trade agreements featuring disciplines on trade and investment in services. Such agreements offer tangible proof of heightened policy interest in the contribution of efficient service sectors to economic growth and development and a growing appreciation of the gains from trade and investment in services.
- 2. Such developments have paralleled efforts at framing services disciplines in the World Trade Organisation (WTO) under the aegis of the General Agreement on Trade in Services (GATS). Because they have typically been negotiated in a concurrent fashion, regional and multilateral efforts at services rule-making have tended to be closely intertwined processes, with much iterative learning by doing, imitation, or reverse engineering. Experience gained in developing the services provisions of RTAs has built up significant negotiating capacity in participating countries, providing expertise available for deployment in a multilateral setting.
- 3. The proliferation of regional initiatives has provided governments with significant policy space in which to experiment with various approaches to rule making and market opening in the area of services trade. In particular, the regional route has afforded governments the ability to pursue policy approaches differing from those emerging from the incipient multilateral framework under the GATS. Because the GATS itself remains incomplete, with negotiations pending in a number of key areas (e.g. emergency safeguards, subsidies, government procurement, domestic regulation), such regional experimentation has generated a number of useful policy lessons in comparative negotiating and rule-making dynamics.
- 4. This paper addresses a range of issues arising from the treatment of services trade in selected regional agreements and their possible relevance to multilateral rule making. While the paper makes a number of comments about the results achieved by some of the RTAs reviewed in it, its immediate purpose, as with all the other chapters of the overall RTA study, is to compare provisions found in the RTAs with those in the WTO. The following key points arise from the analysis¹:
 - RTAs tend to show broad commonality, both among each other and vis-à-vis the GATS, as regards the standard panoply of disciplines directed towards the progressive opening of services markets.

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It bears noting that the stylised facts summarised here depict broad trends. Such trends may obtain even as the treatment of specific rule-making issues and/or the degree of liberalisation achieved in specific sectors or with regard to particular modes of supplying services may show greater variance. The large number of RTAs covering services and the even greater number of individual sectors such agreements encompass obviously complicates attempts at making broad analytical generalisations. For instance, one can note the tendency for NAFTA Members, particularly Canada and the United States, to take on liberalisation commitments broadly in line with what was being contemplated (and would later be bound) under the GATS in a majority of sectors even as particular sectoral liberalisation initiatives, for instance in the fields of land transportation (bus and truck services) or specialty air services, were being pursued exclusively within the regional compact.

In some instances, however (e.g. non-discriminatory quantitative restrictions, domestic regulation), GATS disciplines go further than those found in a number of RTAs.

- Starting with the NAFTA in 1994, an increasing number of RTAs have in recent years sought to complement disciplines on cross-border trade in services (modes 1 and 2 of the GATS) with a more comprehensive set of parallel disciplines on investment (both investment protection and liberalisation of investment in goods- and services-producing activities) and the temporary movement of business people (related to goods and services trade and investment in a generic manner).²
- RTAs featuring comprehensive or generic investment disciplines typically provide for a right of non-establishment (i.e. no local presence requirement as a pre-condition to supply services) as a means of encouraging cross-border trade in services. Such a provision, for which no GATS equivalent exists, might prove particularly well suited to promoting e-commerce.
- With very few exceptions (of a mainly sectoral nature), RTAs covering services typically feature a liberal "rule of origin"/denial of benefits clause, i.e. extend preferential treatment to all legal persons conducting substantial business operations in a member country. In practice, the adoption of a liberal stance in this regard implies that the post-establishment treatment of what in many instances represents the most important mode of supplying services in foreign markets investment is non-preferential as regards third country investors.
- RTAs covering services tend to follow two broad approaches as regards the modalities of services trade and investment liberalisation. A number of RTAs tend to replicate the use, found in GATS, of a positive list or hybrid approach to market opening, whereas others pursue a negative-list approach. While both approaches can in theory generate broadly equivalent outcomes in liberalisation terms, as a practical matter a negative list approach can be more effective and ambitious in producing liberalisation. As well, the process of "getting there" tends to differ, with a number of good governance-enhancing features associated with negative listing, most notably in transparency terms.
- A number of governments participating in RTAs, particularly those adopting a negative list approach to liberalisation, have shown a readiness to subsequently extend regional preferences on an MFN basis under the GATS. This may reflect both a realisation that preferential treatment may be harder to confer in services trade (and is indeed perhaps economically undesirable with regard to investment) and that multilateral liberalisation may offer greater opportunities of securing access to the most efficient suppliers, particularly of infrastructural services likely to exert significant effects on economy-wide performance.
- RTAs have generally made little progress in tackling the rule-making interface between domestic
 regulation and trade in services. Indeed, many RTAs feature provisions in this area that are no
 more fleshed out and, in some instances, weaker or more narrowly drawn (i.e. focusing solely on
 professional services) than those arising under Article VI of the GATS (including the Article VI:4
 work programme).

For a fuller account of the treatment of investment and the movement of labour in RTAs, see OECD (2002), "The Relationship Between Regional Trade Agreements and the Multilateral Trading System: Investment", TD/TC/WP(2002)18 and OECD (2002), "Labour Mobility in RTAs", TD/TC/WP(2002)16.

- RTAs tend to be viewed as offering greater scope for making speedier headway on matters relating to regulatory co-operation in services trade, notably in areas such as services-related standards and the recognition of licences and professional or educational qualifications. Despite the greater initial similarities in approaches to regulation and greater cross-border contact between regulators that geographical proximity can afford, progress in the area of domestic regulation has been slow and generally disappointing even at the regional level.
- With a few exceptions, RTAs have similarly made little headway in tackling the key "unfinished" rule-making items on the GATS agenda. This is most notably the case of disciplines on emergency safeguards and subsidies for services, where governments confront the same technical challenges or political sensitivities at the regional level as they do on the multilateral front. More progress has however been made at the regional level in opening up procurement markets for services, though such advances have tended to be made in procurement negotiations rather than in the services field.
- With the notable exception of land transportation issues, where physical proximity stands out as a determinative facilitating feature, RTAs have generally made little progress in opening up those service sectors that have to date proven particularly difficult to address at the multilateral level (e.g. air and maritime transport; audio-visual services³; energy services). In the key infrastructural areas of basic telecommunications and financial services, the GATS has in fact achieved a higher level of bound liberalisation than that on offer in most RTAs. The latter result suggests that, in some sectors, the political economy of multilateral bargaining, with its attendant gains in critical mass, may help overcome the resistance to liberalisation arising in the narrower or asymmetrical confines of regional compacts.

II. Key features of the General Agreement on Trade in Services (GATS)⁴

- 5. The General Agreement on Trade in Services (GATS) for the first time extends internationally agreed rules and commitments, broadly comparable with those of the GATT, into a huge and still rapidly growing area of international trade. All WTO Members are subject to the disciplines of the GATS and have assumed specific commitments in individual services sectors.
- 6. The GATS applies in principle to all services, except those relating to air traffic rights and services supplied in the exercise of governmental authority. Article I(3) of the GATS defines the latter as services not provided on a commercial basis or in competition with other suppliers. This carve-out includes the activities of central banks and other monetary authorities, statutory social security and public retirement plans, and public entities using government financial resources. The GATS distinguishes between four modes of supplying services: cross-border trade, consumption abroad, commercial presence, and presence of natural persons.⁵

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While such a result obtains within the great majority of RTAs, some agreements, notably the Chile-Mexico FTA, the Chile-MERCOSUR FTA or the US-Jordan FTA, did achieve some measure of liberalisation in audio-visual services.

For a fuller depiction of how the GATS operates, see OECD (2002), *GATS: The Case for Open Services Markets*, Paris: OECD, pp. 57-63.

The latter two modes of supply recall how factor mobility is an essential defining characteristic of services trade. They are also illustrative of how rule-making initiatives in the sector encompass a significantly wider range of policy domains, including areas, such as the regulation of foreign investment or the treatment of immigration-related matters, that can arouse particular sensitivities.

7. GATS obligations contained may be categorised into two groups: general obligations which apply directly and automatically to all Members, regardless of the existence of sectoral commitments; and specific commitments whose scope is limited to the sectors, sub-sectors and/or modes of supply where a Member has undertaken market access and/or national treatment obligations.

a) General obligations

- MFN treatment: Under Article II, Members are held to extend immediately and unconditionally 8. to services or services suppliers of all other Members "treatment no less favourable than that accorded to like services and services suppliers of any other country". Derogations are possible in the form of so-called Article II-Exemptions. Members were allowed to list such exemptions before the Agreement entered into force. New exemptions can be granted only to new Members at the time of accession or, to current Members, by way of a waiver under Article IX:3 of the WTO Agreement. All exemptions are subject to review; they should in principle not last longer than 10 years.
- 9. Transparency: GATS Members are required, inter alia, to publish all measures of general application and establish national enquiry points mandated to respond to other Members' information requests.

b) Specific commitments

- Market access: The granting of market access is a negotiated commitment undertaken by individual Members in specified sectors. It may be made subject to one or more of six types of limitations enumerated in Article XVI(2). For example, limitations may be imposed on the number of service suppliers, service operations or employees in a sector, the value of transactions, the legal form of the service supplier, or the participation of foreign capital.
- 11. National treatment: In any sector included in its schedule of specific commitments, a WTO Member is obliged to grant foreign services and service suppliers treatment no less favourable than that extended to its own like services and service suppliers, subject to the terms and conditions specified in its schedule. In this context, the key requirement is to abstain from measures which are liable to tilt the conditions of competition in favour of a Member's own services or service suppliers.
- The GATS does not impose the obligation to assume market access or national treatment commitments in a particular sector. In scheduling commitments, Members are free to tailor the extent of the commitments they schedule in accordance with national policy objectives. The scheduling of specific commitments triggers further (conditional) obligations concerning, inter alia, the objective administration of domestic regulations and the avoidance of restrictions on international payments and transfers.
- Each WTO Member is required to have a schedule of specific commitments, which identifies in a positive manner those service sectors, sub-sectors, or modes of supply subject to market access, national treatment, and additional commitments. Under the GATS' hybrid approach to liberalisation, in areas subject to commitments, WTO Members must list negatively any non-conforming measures they wish to maintain. Most schedules consist of both sectoral and horizontal sections. In sectors where WTO members

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However, Article XIX stipulates a common obligation of WTO Members to enter into successive rounds of trade negotiations with a view to achieving a progressively higher level of liberalisation.

The "Horizontal Section" contains limitations that apply across all sectors included in the schedule. They often refer to a particular mode of supply, notably commercial presence and the presence of natural persons. The "Sector Specific Section" contains limitations that apply only to the particular sector, sub-sector or mode of supply to which they refer.

voluntarily undertake specific commitments, measures are subject to the disciplines of Article VI on **domestic regulation**. Members thus need to ensure, *inter alia*, that they are administered in a reasonable, objective and impartial way and do not constitute unnecessary barriers to trade.

- 14. Recognising the great diversity of service sectors, the GATS features several **sectoral annexes** that complement the framework provisions and/or specify its scope of application in particular sectors. The two most prominent areas where sectoral rules have been developed lie in the area of basic telecommunications, where negotiations were successfully concluded in February 1997, and financial services, where talks were successfully completed in mid-December 1997. In both sets of negotiations, Members achieved significantly improved commitments with a broader level of participation that that on offer at the end of the Uruguay Round.
- 15. The GATS sets out a work programme normally referred to as the "built-in" agenda. On the rule-making front, various GATS Articles provide for issue-specific negotiations intended to define possible rules and disciplines for domestic regulation (Article VI), emergency safeguards (Article X), government procurement (Article XIII), and subsidies (Article XV). These negotiations have been under way since 1995.
- 16. In looking at the GATS agreement, as well as at the significance of the specific services commitments undertaken by WTO members, it is worth pointing out how the evolution of multilateral disciplines can coexist with, be informed by, and at times supersede (as is most evidently the case in basic telecommunications) disciplines or liberalisation outcomes obtaining at the regional level. As with many RTAs covering trade and investment in services, the GATS is still incomplete. The process of filling the gaps will likely require several more years of negotiations, and experience will no doubt show a need to improve or modify some of the existing rules. Each WTO Members' schedule of commitments for trade in services is also only a first step, comparable not so much with its GATT schedule of 1994, but rather with the initial limited tariff cutting undertaken when the GATT was launched in 1948. Among the most important elements in the GATS package is that successive further rounds of negotiations will be undertaken to continue to open up world trade in services in a progressive manner.

III. Rules for Services in RTAs

a) Key disciplines: convergence and divergence

17. While RTAs covering services come in many different shapes and sizes, they tend to feature a common set of key disciplines governing trade and investment in services that are also found in the GATS, albeit with differing burdens of obligation (see Table 1). Areas of greatest rule-making convergence between the multilateral and regional levels relate to the agreements' scope of coverage (where carve-outs in respect of air traffic rights and public services tend to define the norm); disciplines on transparency, national treatment, most-favoured nation treatment, as well as disciplines on payments and transfers, monopolies and exclusive service providers, and general exceptions. Considerable similarities also exist between the multilateral and regional levels as regards the need for sectoral specificity (i.e. sectors requiring special treatment in annexes). Lesser convergence (and more limited regional progress) can be observed in areas of rule-making that have posed difficulties in a GATS setting. This includes issues such

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This programme of work reflects both the fact that not all services-related negotiations could be concluded within the time frame of the Uruguay Round, and that Members have already committed themselves, in Article XIX, to successive rounds aimed at achieving a progressively higher level of liberalisation.

as non-discriminatory quantitative restrictions (market access in GATS-speak), domestic regulation, emergency safeguards and subsidies.

- 18. The principles of **most-favoured nation** and **national treatment** constitute two of the most basic building blocks to any agreement on services, just as they do in the goods area. As with the GATS, very few RTAs set out such principles in unqualified form⁹, regardless of whether they are framed as general obligations (which is the case for MFN in virtually all agreements and for national treatment in agreements pursuing a negative list approach to liberalisation) or as obligations that apply solely in sectors where liberalisation commitments are positively undertaken.
- 19. As may be expected given the regulatory intensity of services trade, **transparency** disciplines are common to all RTAs covering services. These typically stipulate, as is the case under GATS, an obligation to publish relevant measures and notify new (or changes to existing) measures affecting trade in services and to establish national enquiry points to provide information on measures affecting services trade upon request. One innovation over the GATS is the provision that some RTAs, particularly in the Western Hemisphere, make for members to afford the opportunity (to the extent possible) for prior comment on proposed changes to services regulations.
- While RTAs covering services typically address **non-discriminatory quantitative restrictions** that impede access to services markets (addressed under Article XVI of the GATS), many agreements, particularly those concluded in the Western Hemisphere and modelled on the NAFTA, are weaker than the GATS, committing parties solely to making such measures fully transparent in annexes listing non-conforming measures and to a best endeavours approach as regards their progressive dismantling in future. In contrast, under GATS, WTO members undertake policy bindings in sectors, sub-sectors and modes of supply against which market access commitments are scheduled. Many other RTAs, such as MERCOSUR and the various RTAs to which EU Members are party, introduce a prohibition on the introduction of new non-discriminatory QRs on any scheduled commitment and sector, mirroring a similar requirement under the GATS.
- 21. The argument has been made that RTAs in the services field provide scope for creating "optimum harmonisation areas", the presumption being that the aggregate adjustment costs of regulatory convergence and policy harmonisation are likely to be smaller when foreign regulatory preferences are similar and regulatory institutions broadly compatible. Both sets of conditions are likelier on balance to obtain among countries that are "closer" in physical and/or cultural/historical terms. ¹⁰ In practice, however, it is notable how the broad intersect between **domestic regulation** and services trade has tended to prove intractable (just as it has under the GATS) even among the smaller subset of countries engaging in RTAs.

Only the Mercosur Protocol and Decision 439 of the Andean Community provide that no deviation from MFN and national treatment be allowed among members to the two integration groupings.

See Fink, Carsten and Aaditya Mattoo (2002), "Regional Agreements in Services: Some Conceptual Issues", mimeo, Washington, D.C.: The World Bank.

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Table 1: Key disciplines in RTAs covering services

Agreements	MFN Treatment	National Treatment	Market access (N-D QRs)	Domestic Regulation	Emergency Safeguards	Subsidy Disciplines	Government procurement	Rule of origin (denial of benefits)
GATS	Yes	Yes	Yes	Yes	Future	Future negotiations	Future negotiations	Yes
NAFTA	Yes	Yes	Yes	Yes*	No	No	Separate chapter	Yes
Canada – Chile	Yes	Yes	Yes	Yes*	No	No	No	Yes
Chile – Mexico	Yes	Yes	Yes	Yes*	No	No	No	Yes
Bolivia-Mexico	Yes	Yes	Yes	Yes*	Future	No	Separate chapter	Yes
Costa Rica – Mexico	Yes	Yes	Yes	Yes*	Future	No	Separate chapter	Yes
Mexico – Nicaragua	Yes	Yes	Yes	Yes*	No	No	Future negotiations	Yes
Mexico – Northern Triangle ¹	Yes	Yes	Yes	Yes*	Future	No	No	Yes
Central America – Dominican Republic	Yes	Yes	Yes	Yes*	Future	Future negotiations	Separate chapter	Yes
Central America - Chile	Yes	Yes	Yes	Yes*	No	No	Separate chapter	Yes
Group of Three	Yes	Yes	Yes	Yes*	No	No	Separate chapter	Yes
MERCOSUR	Yes	Yes	Yes	Yes	No	Future negotiations	Future negotiations	Yes
Andean Community	Yes	Yes	Yes	Yes*	No	No	No	Yes
CARICOM	Not specified	Yes	Not specified	Yes*	Yes	No	No	Yes
CARICOM – Dominican Republic	Yes	Yes	Yes	Yes*	Future	No	Separate chapter	Yes
Central American Economic Integration	Not specified	No general article	No	No	No	No	No	Not specified

Table 1: Key disciplines in RTAs covering services

Agreements	MFN Treatment	National Treatment	Market access (N-D QRs)	Domestic Regulation	Emergency Safeguards	Subsidy Disciplines	Government procurement	Rule of origin (denial of benefits)
EU	Yes	Yes	Yes	Yes	No	Yes (covered under competition disciplines)	Yes	Yes
Europe Agreements	Yes	Yes	No	Yes	No	Yes (covered under competition disciplines)	No	Beneficiaries specified through definition of "undertakings"
EU-Mexico	Yes	Yes	Yes	No (provisions on regulatory carve- out and recognition)	No	No	Separate chapter	Yes
EFTA – Mexico	Yes	Yes	Yes	Yes	No	No	No	Not specified
EFTA-Singapore	Yes	Yes	Yes	Yes	No	Requests for consultations to be given sympathetic consideration	Separate chapter	Yes
Japan – Singapore	No	Yes	Yes	Yes	No	No	Separate chapter	Yes
ASEAN Framework Agreement on Services	Yes	Yes	Yes	Not specified	Yes	No	No	Yes
Australia – New Zealand Closer Economic Relations trade Agreement	MFN for excluded sectors	Yes	Yes	Yes	No	Export subsidies prohibited Other subsidies excluded	No	Yes
US - Jordan		Yes	Yes	Yes	No	Future negotiations	Yes	Yes

^{*} Rules on domestic regulation are set out more narrowly (in most cases they apply only to the licensing and certification of professional services suppliers)

1 Honduras, Guatemala and El Salvador

- 22. In many instances, RTAs address domestic regulation in a manner analogous to that found in Article VI of the GATS, i.e. with a focus on procedural transparency and ensuring that regulatory activity does not lead to disguised restrictions to trade or investment in services. With the exception of the EU itself and of agreements reached between the EU and countries in Central and Eastern Europe in pre-EU accession mode, no RTA has to date made tangible progress in delineating the possible elements of a necessity test aimed at ensuring broad proportionality between regulatory means and objectives (as is potentially foreseen under the GATS' Article VI:4 mandate). Similarly, with few exceptions (e.g. in the EU context as well as the ANZCERTA), little significant tangible progress been registered in regulatory harmonisation. It is notable that neither the NAFTA nor the many NAFTA-type agreements reached in the Western Hemisphere contain an article on domestic regulation per se in their services chapters. Rather, such agreements feature more narrowly drawn disciplines relating to licensing and certification of professionals. 11 Moreover, even though a number of RTAs, notably those concluded in the Western Hemisphere, call on Members to recognise, at times on the basis of explicit timetables (as in the NAFTA in the case of foreign legal consultants and the temporary licensing of engineers), foreign educational credentials and professional qualifications in selected professions, progress in concluding mutual recognition agreements has proven slow and difficult, particularly when pursued between countries with federal systems.
- 23. The experience to date with regulatory convergence and co-operation at the regional level does not provide clear-cut evidence in support of the argument advanced on optimum (regional) harmonisation areas. Given that any attempt at reaching MRAs in the services area (as with goods-related MRAs) is almost by definition likely to involve a limited number of participating countries, it is not altogether clear that RTAs offer a superior alternative to that available to WTO Members under Article VII of the GATS.¹²
- 24. With few exceptions, RTAs have similarly made little headway in tackling the key "unfinished" rule-making items on the GATS agenda. This is most notably the case for disciplines on an emergency safeguard mechanism (ESM) and subsidies for services, where governments confront the same technical challenges or political sensitivities at the regional level as they do on the multilateral front. It is interesting to note for instance that the countries of Southeast Asia, which have been amongst the most vocal proponents of an **emergency safeguard mechanism** in the GATS, have not adopted such a provision within the ASEAN Framework Agreement on Services (AFAS). To date, only members of CARICOM (in Protocol II) in the Western Hemisphere, have adopted (but not yet used) such an instrument, and questions remain as to the operational feasibility of an ESM in services trade. Elsewhere, the NAFTA has provided one example of sectoral experimentation (in financial services) with safeguard-type measures.¹³ On

Whereas similar GATS language states that the measures in question should not be a restriction to the supply of a service under any of the four GATS modes, the NAFTA-type agreements narrow this requirement to the cross-border supply of a service. No comparable provision can be found in these agreements' investment chapters. Meanwhile, in the Australia-New Zealand Closer Economic Relations Agreement, language on licensing and certification is not legally binding but rather hortatory in nature.

Indeed, Article VII of GATS arguably allows greater initial selectivity in the choice of partners in regulatory harmonisation, whereas RTAs allow for convergence between countries whose regulatory fit may not always be optimal. There is, of course, one important difference between RTAs and the GATS insofar as preferential treatment (including in regulatory matters) can be fully protected under Article V of the GATS; whereas WTO Members must be prepared under Article VII to extend recognition privileges to all Members willing and able to satisfy national regulatory requirements.

Under the terms of the NAFTA's chapter on financial services, Mexico was allowed to impose market share caps if the specific foreign ownership thresholds agreed to – 25 and 30 percent respectively for banks and securities firms – are reached before 2004. Mexico may only have recourse to such market share limitations once during the 2000-2004 period and may only impose them for a three-year period. Under no circumstances may such measures be maintained after 2007. It bears noting that Mexico has not to date made use of such provisions even as the aggregate share of foreign participation in its financial system is today significantly

subsidies, with the exception of the EU (including its pre-accession agreements with countries in Central and Eastern Europe) and of ANZCERTA, the adoption of regional disciplines in the services area has proven elusive, particularly in countries with federal political systems given the extent of sub-national policy activism in this area. Whereas a number of RTAs (e.g. MERCOSUR) replicate the call, made in GATS, to develop future disciplines on subsidies in services trade, others, notably the NAFTA and numerous NAFTA-type agreements in the Western Hemisphere, specifically exclude subsidy practices from coverage.¹⁴

More progress has been made at the regional level in opening up **government procurement** markets for services, though this has tended to be achieved through negotiations in the area of government procurement *per se* (as with the WTO's Government Procurement Agreement or GPA) rather than addressed in services negotiations.¹⁵ The approach taken in RTAs is for the most part very similar to that adopted in the WTO, i.e. non-discrimination among members within the scope of scheduled commitments and procedures to enhance transparency and due process. RTAs whose members are all parties to the GPA, such as EFTA and the Singapore–Japan FTA, specifically mention that the relevant GPA articles apply and most agreements concluded in the Western Hemisphere basically replicate GPA disciplines at the regional level. However, it bears noting that unlike the GPA, which applies in principle to purchases by both state and sub-national governments, many RTAs provide for binding government procurement disciplines at the national level only.¹⁶

higher than the thresholds described above. See Sauvé, Pierre (2002), "Completing the GATS Framework: Safeguards, Subsidies and Government Procurement", in Hoekman, Bernard, Aaditya Mattoo and Philip English, eds., *Development, Trade and the WTO: A Handbook*, Washington, D.C.: The World Bank, pp. 326-335.

- The EFTA-Singapore FTA requires that sympathetic consideration be given to requests by a party for consultations in instances where subsidy practices affecting trade in services may be deemed to have injurious effects. The Japan-Singapore New Partnership Agreement features generic provisions on subsidies applicable to both goods and services trade.
- Still, it bears recalling that despite notable progress in RTAs, government procurement practices continue in most instances to be the province of discriminatory practices. In the case of NAFTA, for instance, despite the fact that the scope of covered purchases was quadrupled when compared to the outcome of the 1987 Canada-United States FTA, covered entities only represented a tenth of North America's civilian procurement market at the time of the Agreement's entry into force. See Hart, Michael and Pierre Sauvé (1997), "Does Size Matter? Canadian Perspectives on the Development of Government Procurement Disciplines in North America", in Hoekman, Bernard and Petros Mavroidis, eds., Law and Policy in Public Purchasing, Ann Arbor: University of Michigan Press, pp. 203-221.
- For a fuller discussion of the treatment of government procurement in RTAs, see OECD (2002), "The Relationship Between the Multilateral Trade System and Regional Trade Agreements: Government Procurement", TD/TC/WP(2002)24, (15 April).

b) The treatment of investment in services: establishment and non-establishment rights

- 26. Starting with the NAFTA in 1994, an increasing number of RTAs have in recent years sought to complement disciplines on cross-border trade in services (modes 1 and 2 of the GATS) with a more comprehensive set of **parallel disciplines on investment** (rules governing both the protection and liberalisation of investors and their investments in goods- and services-producing activities) and the **temporary movement of business people** (related to goods and services trade and investment in a generic manner).¹⁷
- 27. One important difference in approaches to services trade as between (and among) RTAs and the GATS concerns the interplay between cross-border trade and investment in services. At the multilateral level, the GATS (and the WTO more broadly) does not contain a comprehensive body of investment disciplines (the GATS is silent for instance on matters of investment protection) but incorporates investment in services ("commercial presence" in GATS-speak) as one of the four modes of service delivery (see Table 2).
- 28. A GATS-like approach has been followed in a number of RTAs, notably by MERCOSUR members and many RTAs concluded outside the Western Hemisphere (e.g. ASEAN Framework Agreement on Services, US-Jordan FTA). This approach contrasts with that taken by NAFTA and the NAFTA-type RTAs, where investment rules and disciplines covering both matters of investment protection (as typically treated under bilateral investment treaties, or BITs) and liberalisation (typically with respect to both pre- and post-establishment matters), combined with investor-state and state-to-state dispute settlement provisions, apply in a generic manner to goods and services in a separate chapter. The latter agreements thus feature services chapters that focus solely on cross-border delivery (modes 1 and 2 of GATS), complemented by separate chapters governing the movement of capital (investment) on the one hand, and the temporary entry of business people on the other. A number of RTAs, such as the Japan-Singapore FTA, CARICOM as well as the EFTA-Mexico and EFTA-Singapore FTAs, address investment in services both under the commercial presence mode of supply (in their services chapters) as well as in separate chapters dealing with investment, the right of establishment or the movement of capital (see Table 2).
- 29. As Table 2 indicates, RTAs featuring generic investment disciplines typically provide for a **right of non-establishment** (i.e. no local presence requirement as a pre-condition to supply a service, subject to the right to reserve and list existing non-conforming measures) as a means of encouraging greater volumes of cross-border trade in services. While such an obligation, for which no GATS equivalent exists¹⁹, were initially crafted (starting with the NAFTA) before the Internet became a tangible commercial reality, they may nonetheless prove particularly well-suited to promoting e-commerce and encouraging countries to

For a fuller account of the treatment of investment and the movement of labour in RTAs, see OECD (2002), "The Relationship Between Regional Trade Agreements and the Multilateral Trading System: Investment", TD/TC/WP(2002)18 and OECD (2002), "Labour Mobility in RTAs", TD/TC/WP(2002)16.

Such movement is usually defined as comprising four distinct categories to which preferential temporary entry privileges are bestowed: business visitors, traders and investors, intra-company transferees, and professionals.

It could be argued that such a provision is somewhat implicit in the GATS insofar as the Agreement only allows Member countries to maintain local presence requirements in scheduled sectors (under modes 1 and 2) to the extent that such non-conforming measures are explicitly inscribed in their schedules. No such discipline, however, applies to sectors that do not appear in Members' GATS schedules or in those modes of supply where WTO Members remain unbound. In contrast, the right to non-establishment is a general obligation under the NAFTA, against which reservations to preserve existing non-conforming measures can be lodged.

adopt less onerous restrictions on cross-border trade whilst achieving legitimate public policy objectives (e.g. prudential supervision, consumer protection).

- 30. With very few exceptions (of a mainly sectoral nature), RTAs covering services typically adopt a liberal "**rule of origin**" (via a provision on denial of benefits), i.e. the benefits of RTA treatment are typically only denied to juridical persons that do not conduct substantial business operations in a member country. In practice, the adoption of a liberal rule of origin implies that the post-establishment treatment of what in many instances represents the most important mode of supplying services in foreign markets investment is non-preferential for third country investors as regards liberalisation commitments. Stated differently, under a liberal rule of origin for services and investment, third country investors can in most instances take full advantage of the expanded market opportunities afforded by the creation of a RTA by establishing within the region. ²¹
- 31. The above consideration may to some extent explain the observed readiness that a number of governments participating in RTAs have shown to subsequently extend (either immediately or in a progressive manner) regional preferences on an MFN basis under the GATS. This may reflect both a realisation that preferential treatment may be harder to confer in services trade (and may indeed be economically undesirable with regard to investment/mode 3) and that multilateral liberalisation may offer greater opportunities of securing access to the most efficient suppliers, particularly of infrastructural services likely to exert significant effects on economy-wide performance. A readiness to extend RTA preferences on an MFN basis in GATS (or to extend such preferences in RTAs concluded with other countries) is most noticeable amongst countries of the Western hemisphere, the majority of which have tended to lock-in the regulatory *status quo* prevailing in their investment regimes by virtue of adopting a negative list approach to liberalisation in the RTAs to which they are party (see below).

c) Modalities of liberalisation: negative vs. positive list approaches

32. Two major approaches towards the liberalisation of trade and investment in services have been manifest in RTAs and in the WTO: the positive list or "bottom-up" approach (typically a hybrid approach featuring a voluntary, positive, choice of sectors, sub-sectors and/or modes of supply in which governments are willing to make binding commitments together with a negative list of non-conforming measures to be retained in scheduled areas), and the negative list or "top-down/list it or lose it" approach. While both negotiating modalities can produce (and indeed have in some instances produced) broadly equivalent outcomes in liberalisation terms, the two approaches can be argued to generate a number of qualitative differences of potential significance from both a domestic and international governance point of view²³. While the debate over these competing approaches appears settled in the GATS context, it may still

Indeed, the aim of attracting greater volumes of FDI, including from third country sources, is often a central objective of RTAs. For this reason, there are generally few instances in which the benefits of an RTA in the investment field are restricted to juridical persons that are owned or controlled by nationals of a member country. Among the RTAs reviewed in this note, only the MERCOSUR and the Andean Pact feature such restrictions.

It bears recalling, however, that a number of economic factors (e.g. the scale economies arising from a larger regional market) and policy variables (e.g. the maintenance of discriminatory sectoral rules of origin within an RTA), can affect global patterns of investment, as discussed in TD/TC/WP(2002)18.

See Sauvé, Pierre (2000), "Making Progress on Trade and Investment: Multilateral vs. Regional Perspectives", in Sherry M. Stephenson, ed., *Services Trade in the Western Hemisphere: Liberalisation, Integration and Reform*, Washington, D.C.: Trade Unit of the Organisation of American States and Brookings Institution Press, pp. 72-85.

The purpose of the ensuing discussion is to note such differences without advocating any implicit hierarchy of policy desirability. Both approaches have strengths and weaknesses. The governance-enhancing aspects of

be useful to recall these differences as governments contemplate the scope that may exist in the current negotiations for making possible improvements to the GATS architecture.

- 33. Under a GATS-like, **positive (or hybrid) approach to scheduling liberalisation commitments**, countries agree to undertake national treatment and market access commitments specifying (through reservations in scheduled areas) the nature of treatment or access offered to foreign services or foreign service suppliers. ²⁴ Under such an approach, countries retain the full right to undertake no commitments. In such instances, they are under no legal obligation to supply information to their trading partners on the nature of discriminatory or access-impeding regulations maintained at the domestic level. A related feature of the GATS that tends to be replicated in RTAs that espouse a bottom-up approach to liberalisation is to afford countries the possibility of making commitments that do not reflect (i.e. are made below) the regulatory or statutory *status quo* (a long-standing practice in tariff negotiations that was replicated in a GATS setting).
- 34. The alternative, "top-down" approach to services trade and investment liberalisation is based upon the concept of **negative listing**, whereby all sectors and non-conforming measures are to be liberalised unless otherwise specified in a transparent manner in reservation lists appended to an agreement. Non-conforming measures contained in reservation lists are then usually liberalised through consultations or, as in the GATS, periodic negotiations. It is interesting to note that despite the strong opposition that such an approach generated when first mooted by a few GATT Contracting Parties during the Uruguay Round, the negative list approach to services liberalisation has in recent years been adopted in a large number of RTAs covering services. Canada, Mexico and the United States pioneered this approach in the NAFTA in 1994. Since the NAFTA took effect, Mexico played a pivotal role in extending this liberalisation approach and similar types of disciplines (i.e. right of non-establishment) on services to other RTAs it has signed with countries in South and Central America. ²⁵

negative listing have, however, been noted by several observers. See, in particular: Sauvé, Pierre (1996), "Services and the International Contestability of Markets", in *Transnational Corporations*, Vol. 5, No. 1, (April), pp. 37-56; Snape, Richard and Malcolm Bosworth (1996) "Advancing Services Negotiations", in Schott, Jeffrey, ed., *The World Trading System: Challenges Ahead*, Washington, D.C.: Institute for International Economics, pp. 185-203; World Trade Organization (2001), *Market Access: Unfinished Business – Post Uruguay Round Inventory*, Special Study No. 6, Geneva: World Trade Organization; and Stephenson, Sherry (2002), "Regional Versus Multilateral Liberalisation of Services", in *World Trade Review*, Vol. 1, No. 2, (July), pp. 187-209.

- Members of MERCOSUR adopted one slightly different version of the positive list approach with a view to liberalising services trade within the region. According to MERCOSUR's Protocol of Montevideo on Trade in Services, annual rounds of negotiations based on the scheduling of increasing numbers of commitments in all sectors (with no exclusions) are to result in the elimination of all restrictions to services trade among the members of the group within ten years of the entry into force of the Protocol. The latter has yet to enter into force. See Sherry M. Stephenson (2001), "Services", in Salazar-Xirinachs, Jose-Manuel and Maryse Robert, eds., *Toward Free Trade in the Americas*, Washington, D.C.: Trade Unit of the Organisation of American States and Brookings Institution Press, pp. 163-185. See also Pena, Maria-Angelica (2000), "Services in MERCOSUR: The Protocol of Montevideo", in Sherry M. Stephenson, ed., *Services Trade in the Western Hemisphere: Liberalisation, Integration and Reform*, Washington, D.C.: Trade Unit of the Organisation of American States and Brookings Institution Press, pp. 154-168.
- The Andean Community has adopted a somewhat different version of the negative list approach. Decision 439 on Trade in Services specifies that the process of liberalisation is to begin when comprehensive (non-binding) national inventories of measures affecting trade in services for all members of the Andean Community are finalised. Discriminatory restrictions listed in these inventories are to be lifted gradually through a series of negotiations, ultimately resulting in a common market free of barriers to services trade within a five-year period set out to conclude in 2005.

Table 2: Key features of RTAs covering services

Agreements	Scope/ Coverage	Negotiating modality	Treatment of investment in services	Right of non establishment	Ratchet mechanism	
GATS	Universal*	Positive list approach	Covered as "commercial presence" (mode 3)	No	No	
NAFTA	Universal*	Negative list approach	Separate chapter	Yes	Yes	
Canada – Chile	Universal*	Negative list approach	Separate chapter	Yes	Yes	
Chile – Mexico	Universal*	Negative list approach	Separate chapter	Yes	Yes	
Bolivia-Mexico	Universal*	Negative list approach	Separate chapter	Yes	Yes	
Costa Rica - Mexico	Universal*	Negative list approach	Separate chapter	Yes	Yes	
Mexico - Nicaragua	Universal*	Negative list approach	Separate chapter	Yes	Yes	
Mexico – Northern Triangle ¹	Universal*	Negative list approach	Separate chapter	Yes	Yes	
Central America – Dominican Republic	Universal*	Negative list approach	Separate chapter	Yes	Yes	
Central America - Chile	Universal*	Negative list approach	Separate chapter	Yes	Yes	
Group of Three	Universal*	Negative list approach	Separate chapter	Yes	Yes	
MERCOSUR	Universal*	Positive list approach	Separate Protocols	No	No	
Andean Community	Universal*	Negative list approach	Covered as "commercial presence"	No	No	
CARICOM	Universal*	Negative list approach	Covered as "commercial presence" and in separate chapters (on right of establishment and movement of capital)	No	No	
CARICOM -	Universal*	Negative list approach	Separate chapter	Yes	No	
Dominican Republic						
Central American Common Market	Construction services	Positive list approach	Not specified	No	No	

Table 2: Key features of RTAs covering services

Agreements	Scope/ Coverage Negotiating modality		Treatment of investment in services	Right of non establishment	Ratchet mechanism	
EU	Universal*	Negative list approach	Treated as freedom to establish	Yes	No	
Europe Agreements	Universal*	Negative list approach	Separate chapter	Yes	No	
EU-Mexico	Universal*	Standstill (+ future	Covered as	No	No	
	(audio-visual	negotiation of	"commercial presence"			
	services explicitly	commitments à la	and under a separate			
	excluded)	GATS)	investment chapter			
EFTA – Mexico	Universal *	Positive list approach	Covered as	No	No	
			"commercial presence"			
			and under a separate			
			investment chapter			
EFTA – Singapore	Universal*	Positive list approach	Covered as "commercial	No	No	
			presence" and under a			
			separate investment			
			chapter			
Japan - Singapore	Universal *	Positive list approach	Covered as "commercial	No	No	
			presence"			
			and under a separate			
			investment chapter			
ASEAN Framework	Universal*	Positive list approach	Covered as "commercial	No	No	
Agreement on Services			presence" and under a			
			separate investment			
			chapter			
Australia – New	Universal*	Negative list approach	Covered as "commercial	Yes	No	
Zealand Closer			presence" but no			
Economic Relations			common disciplines on			
trade Agreement			investment			
US - Jordan	Universal*	Positive list approach	Covered as "commercial	No	No	
			presence"			

^{*} Air transport and in certain cases cabotage in maritime services is excluded

Honduras, Guatemala and El Salvador

- 35. A number of distinguishing features of negative listing can be identified. For one, such an approach enshrines and affirms the up-front commitment of signatories (subject to reservations) to an overarching set of general obligations. This is currently the case under the GATS solely with respect to the Agreement's provisions on MFN treatment (Article II, with scope for one-time exceptions) and transparency (Article III), with all other disciplines applying in an à la carte manner to sectors and modes of supply on those terms inscribed in members' schedules of commitments. 26 A second, and perhaps more immediately operational, defining characteristic of negative listing lies in its ability to generate a standstill, i.e. to establish a stronger floor of liberalisation by locking-in the statutory or regulatory status quo. Such an approach therefore avoids the GATS pitfall of allowing a wedge to arise between applied and bound regulatory or statutory practices.²⁷ An important governance-enhancing feature arising from the adoption of a negative list approach is the greater level of transparency it generates. The information contained in reservation lists will be important to prospective investors, who value the one-stop shopping attributes of a comprehensive inventory of potential restrictions in foreign markets. They are also likely to benefit home country negotiators, assisting them in establishing a hierarchy of impediments to tackle in future negotiations. Such information can in turn lend itself more easily to formula-based liberalisation, for instance by encouraging members to agree to reduce or progressively phase out "revealed" nonconforming measures that may be similar across countries (e.g. quantitative limitations on foreign ownership in airlines).²⁸ The production of a negative list may also help to generate a useful domestic policy dialogue between the trade negotiating and regulatory communities, thereby encouraging countries to perform a comprehensive audit of existing trade- and investment-restrictive measures, benchmark domestic regulatory regimes against best international practices, and revisit the rationale for, and most efficient means of satisfying, domestic policy objectives.
- 36. A further liberalising feature found in a number of RTAs using a negative list approach to liberalisation consists of a **ratchet mechanism** (see Table 2), whereby any autonomous liberalisation measure undertaken by an RTA member between periodic negotiating rounds is automatically reflected in that member's schedule of commitments or lists of reservations. Such a provision typically aims at preventing countries from backsliding with respect to autonomously decreed policy changes. It may also facilitate the provision of negotiating credit for autonomous liberalisation, an issue currently under discussion in the GATS context. A provision of this type has been argued to exert positive effects on the investment climate of host countries by signalling to foreign suppliers the latter countries' commitment not to reverse the (liberalising) course of policy change.²⁹

It bears noting however that most RTAs that employ a negative list approach to liberalisation feature so-called "unbound" reservations, listing sectors in which Members wish to preserve the right to introduce new non-conforming measures in future. In many RTAs, particularly those modelled on the NAFTA, such reservations nonetheless oblige member countries to list existing discriminatory or access-impairing measures whose effect on foreign services or service suppliers might in future be made more burdensome.

The suggestion has been made that WTO Members could address this issue in GATS without revisiting the Agreement's negotiating modality by agreeing to a new framework provision whose purpose would be to encourage governments to reflect the statutory or regulatory *status quo* in their scheduled commitments (whilst keeping with the voluntary nature of such commitments). See Sauvé, Pierre and Christopher Wilkie (2000), "Investment Liberalisation in GATS", in Sauvé, Pierre and Robert M. Stern, eds., *GATS 2000: New Directions in Services Trade Liberalisation*, Washington, D.C.: Centre for Business and Government, Harvard University and the Brookings Institution Press, pp. 331-363.

See Sauvé, Pierre (1996), "Services and the International Contestability of Markets", in *Transnational Corporations*, Vol. 5, No. 1, (April), pp. 37-55.

See Hoekman, Bernard and Pierre Sauvé (1994), *Liberalising Trade in Services*, World Bank Discussion Paper No. 243, Washington, D.C.: The World Bank and Stephenson, Sherry (2001), *Deepening Disciplines for Trade*

37. Two **potential pitfalls** arising from the use of negative listing have been identified. First, that such an approach may be administratively burdensome, particularly for developing countries. Such a burden may however be mitigated by allowing for progressivity in the completion of members' negative lists of non-conforming measures.³⁰ The costs of compliance must also be weighted against some of the benefits in governance and best regulatory practices described above. A second concern relates to the fact that the adoption of a negative list implies that governments ultimately forgo the right to introduce discriminatory or access-impairing measures in future, including in sectors that do not exist or are not regulated at the time of an agreement's entry into force. To assuage the latter concerns whilst promoting the transparency-enhancing properties associated with the use of negative listing, the suggestion has been made to encourage countries (including possibly in the WTO context) to exchange (as they have in the Andean Community and are considering doing within MERCOSUR) comprehensive, non-binding, lists of non-conforming measures.³¹

d) Limits to gravity? Assessing the depth of regional vs. multilateral liberalisation in services trade

- 38. With the notable exception of land transportation issues, where physical proximity stands out as a determinative facilitating feature, RTAs have generally made little progress in opening up those service sectors that have to date proven particularly difficult to address at the multilateral level. Most RTAs have tended to exclude the bulk of air transportation services (with the notable exception of the EU for intra-EU traffic) from their coverage. Limited progress has similarly been achieved at the regional level in sectors where particular policy sensitivities arise, such as maritime transport or audio-visual services, or where the scope for meaningful liberalisation was limited at the time of RTA negotiations, such as in the case of energy services until recently.
- 39. Similarly, advances in regulatory harmonisation and mutual recognition in services, while a common objective of many RTAs, continue to prove difficult to achieve at the regional level. There have, of course, been a number of instances of tangible forward movement in the RTA context, notably within the E.U. and ANZCERTA (where, however, progress has been slow for instance with regard to the recognition of professional qualifications- even in the context of common labour market policies or integrated single markets³²), as well as in North America (where MRAs have been concluded in a number of professions, notably accountancy, architecture and engineering but with variable degrees of compliance by sub-national licensing bodies). Moreover, while a number of RTAs have gone beyond the GATS as regards the treatment of mode 4 trade (for instance as regards the broader range of professional categories

in Services, OAS Trade Unit Studies: Analyses on Trade and Integration in the Americas, Washington, D.C.: Organisation of American States, (March).

In the NAFTA, for instance, sub-national governments were initially given an extra two years to complete their lists of non-conforming measures pertaining to services and investment. The NAFTA parties subsequently decided not to complete the lists at the sub-national level, opting instead for a standstill on existing non-conforming measures. Compliance with the production of negative lists has similarly been problematic elsewhere in the Western Hemisphere, as a number of agreements were concluded without such lists being finalised and without firm deadlines for doing so. The inability of "users" to access the information contained in the negative lists to such agreements deprives the latter of an important good-governance promoting feature.

^{31.} See Sauvé and Wilkie (2000), *op. cit.* for a fuller depiction of such a proposal.

For a detailed analysis of problems encountered in realising the European Union's single market programme for services, see Commission of the European Communities (2002), "The State of the Internal Market for Services - Report from the Commission to the Council and the European Parliament", presented under the first stage of the Internal Market Strategy for Services, COM(2002)41 Final, Brussels, (30 July).

benefiting from temporary entry privileges under the NAFTA as compared to the GATS) and, in the process, drawn much needed policy attention to the essential trade facilitating role that labour mobility provisions can play alongside trade and investment liberalisation, they have nonetheless been prone to encountering many of the political sensitivities on display at the multilateral level in the area of labour mobility.

- 40. In some instances, it appears that RTAs may simply have been overtaken by events at the multilateral level. Thus, in the key infrastructural areas of basic telecommunications and financial services, the GATS has achieved a higher level of bound liberalisation than that on offer in most RTAs.³³ In part, this may simply reflect timing issues. For instance, the conditions required to contemplate far-reaching liberalisation in basic telecommunications services were generally not ripe at the time that the NAFTA was completed in 1993,³⁴ whereas the required constellation of forces in political, regulatory and technological terms obtained at the time the GATS Agreement on Basic Telecommunications (ABT) was concluded in 1997.
- 41. Experience under both the ABT and the Financial Services Agreement (FSA) also suggests that, in some sectors, the political economy of multilateral bargaining, with its attendant gains in critical mass, may help overcome the resistance to liberalisation arising in the narrower or asymmetrical confines of regional compacts.

Negotiations in the GATS on financial services, and notably the development of the GATS Understanding on Commitments in Financial Services, took advantage of insights gained in addressing financial market opening at the regional level. This was particularly the case under the NAFTA, whose Chapter 14 addressed (in 1993) a range of issues that would feature prominently in negotiations of the WTO's 1997 Financial Services Agreement. See Sauvé, Pierre and Brenda Gonzalez-Hermosillo, (1993), "Implications of the NAFTA for Canadian Financial Institutions", in *C.D. Howe Institute Commentary*, No. 44, Toronto: C.D. Howe Institute (April); see also Leroux, Eric (1995), *Le libre-échange nord-américain et les services financiers*, Collection Minerve, Montréal: Editions Yvon Blais; and Sauvé, Pierre and Karsten Steinfatt (2001), "Financial Services and the WTO: What Next?", in Litan, Robert E., Paul Masson and Michael Pomerleano, eds., *Open Doors: Foreign Participation in Financial Systems in Developing Countries*, Washington, D.C.: The World Bank Group, the International Monetary Fund and the Brookings Institution Press, pp. 351-386.

For instance, EU member countries had not yet put in place the pro-competitive regulatory framework required to achieve an integrated market for telecommunication services.