Regionalism in Services

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Examples of RTAs in services

- Early agreements:
  - EU
  - NAFTA

- Newer agreements:
  - MERCOSUR
  - ANDEAN Pact
  - ASEAN
  - US bilateral FTAs (Chile, Jordan, Singapore, Vietnam)

- More agreements are being negotiated
What do international negotiations offer?

- Foster deeper liberalization at home and abroad through reciprocity-based market access negotiations
- Enhance credibility of
  - current trade regime
  - commitment to future reforms
- Promote regulatory cooperation

Key Q: Are these gains best realized in a regional or multilateral context?
Will there be trade preferences? Do RTAs achieve speedier results?

Protection

Time

PG
PF
PM

MERCOSUL

GATS

FTAA

T1

T2

T3
Are preferences in services feasible?

Measures affecting services trade are typically not tariff-like instruments, but:

- Limitations on entry of firms
- Foreign equity limitations
- Quotas on outputs and foreign service workers
- Requirements regarding the legal form of establishment
- Non-discriminatory regulatory measures

Can there be exclusionary rules of origin?
Example of preferences in services

- Bilateral air service agreements: preferential allocation of output quotas
- Preferential relaxation of foreign equity limitations (e.g., NAFTA)
- Preferential access to certain regions within a country (e.g., Hong Kong-China FTA)
- Preferential recognition of foreign qualifications (e.g., EU mutual recognition)
Welfare effects of trade preferences

Lesson from goods trade:
- Trade creation: consumers gain from lower prices
- Trade diversion: loss of fiscal revenue, possibly loss of quota rents

Preferential liberalization in services is more likely to lead to welfare gains:
- Little or no (static) cost of trade diversion, as measures typically do not generate benefits (revenues) for the importing country
- E.g. excessive formalities, local content and ownership restrictions, unnecessary re-qualification, licensing and local establishment requirements
But purely on efficiency grounds, MFN liberalization is preferable

- Offers access to the most competitive (x-efficient) service providers
- Reduces complexity for negotiators, implementing administrations and businesses
- Other gains from trade (economies of scale, more intense competition, knowledge spillovers) are likely to be bigger if liberalization is non-discriminatory
And trade diversion can be costly in a different way

Due to the importance of location-specific sunk costs in services:

- second-best providers may benefit from first mover advantages
- sequence of liberalization matters, benefits from eventual MFN liberalization may be smaller if RTAs lock in less efficient first movers
- are South-South RTAs in services more prone to such concerns?
Why then negotiate regionally?

- Political imperative
- More efficient bargaining
  - Negotiations may be less complex
  - Less scope for free riding on MFN principle
- Certain forms of regulatory cooperation are more feasible and desirable within a smaller and/or geographically proximate group of countries (regulatory convergence, mutual recognition).
- Learning-by-doing/gradualism (infant industry protection before MFN liberalization under GATS)
Regulatory cooperation involves trade-offs

- Between realizing the benefits of economies of scale in regulation and the costs of delegating regulation to a more remote regulator.

- Weighing the benefits of an integrated market against the potential risks subscribing to locally inappropriate standards.

- Essential that developing countries participate in the development of international standards.
Rules of origin (denial of benefits)

- From an economic perspective a liberal rule of origin is to be preferred, but then regional liberalization approaches MFN liberalization.

- Possible approaches:
  - Local incorporation
  - Local incorporation and substantial business operation
  - Domestic ownership and control
Regional agreements in services: a preliminary conclusion

- Weaker case for agreements that grant explicit preferences

- Stronger case for regulatory cooperation

  - but not necessarily/always in a narrow regional context
Lessons from the practice of regionalism in services trade

- 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
  - Scope/coverage (similar carve-outs – e.g. air transport, public services)
  - Core disciplines are also typically similar
  - In some cases, stronger WTO disciplines on non-discriminatory quantitative restrictions (i.e. market access)
Architectural divergences

Essentially two competing models, with few attempts at reconciliation

RTAs covering services either:

- replicate the GATS approach (e.g. Mercosur), including in terms of approaches to liberalization (hybrid scheduling) or
- follow an approach first developed in the NAFTA, including through scheduling on the basis of negative lists of non-conforming measures
Architectural divergences

Under the NAFTA model, services disciplines address issues of cross-border trade (modes 1 and 2), complemented by generic (i.e. non-services specific) disciplines on investment and the temporary entry of business people.

The latter RTAs also tend to provide for a right of non-establishment (no local presence requirement as a pre-condition to supply services).
**Hybrid vs Negative listing**

- Both approaches can be made to yield similar liberalization harvests.
- Negative list approach promotes gains in transparency, locks-in the *status quo* in bound sectors and may encourage a domestic regulatory audit of service sector regimes.
- Downsides: administratively burdensome; may deprive policy space for future measures.
- Non-binding lists of non-conforming measures a good-governance compromise?
Rules of origin

- Majority of RTAs covering services opt for a liberal (i.e. substantial business operation) rule of origin, with a view to promoting third country FDI inflows into the integrating area.

- But some evidence of more restrictive rules aimed at limiting benefits to insiders (e.g. Mercosur, China-Hong Kong FTA, Andean Pact).
Does regional liberalization facilitate subsequent multilateral commitments?

- Some supporting evidence in the Western Hemisphere, where a number of RTAs predated or coincided with the establishment of GATS

- More difficult to ascertain for more recent RTAs, little evidence in Doha Round initial offers; but more in negotiating proposal terms, i.e. greater engagement by developing countries may reflect regional learning by doing between WTO rounds
On rules, RTAs more often than not face GATS-like difficulties

- Little progress to date in RTAS in developing disciplines on non-discriminatory regulatory conduct (e.g. necessity test)
- Little progress to report on the unfinished agenda of GATS (emergency safeguards – even within ASEAN; subsidies; more positive advances on services procurement)
Similar challenges arise in liberalization terms

- Progress on Mode 4 trade uneven and generally limited even in RTAs
- Sensitive sectors tend to remain the same across negotiating settings (e.g. maritime, aviation, audio-visual services, despite limited advances in some agreements)
- Some sectors (e.g. land transport) lend themselves more readily to RTA liberalization
But some evidence of liberalization synergy between RTAs and the WTO

- In some instances, WTO has gone further because timing was right or because bargaining dynamics were favorable (e.g. basic telecoms, finance)
- RTAs allow progress to be made in areas where regulatory conditions evolve rapidly or where new pro-liberalization constituencies arise (i.e. e-commerce/digital trade; express delivery, environmental services)
- Iterative nature of market opening advances illustrates RTA-WTO complementarities
Do RTAs facilitate regulatory convergence?

- Evidence is mixed; harmonization and mutual recognition are challenging even among a limited subset of partners.
- EU-NAFTA experience attests to such difficulties, but RTAs have registered some progress, especially in professional licensing.
- RTAs promote regulatory dialogue, the benefits of which may be reaped outside of trade agreements but in a manner that nonetheless facilitates and promotes trade and investment.
Multilateral Disciplines on RTAs in Services: Article V of GATS

Like Art. 24 of GATT, Article V imposes three conditions on economic integration agreements for the latter to be deemed WTO-compatible:

- “substantial sectoral coverage" (not the same as "substantially all sectors" as in Art. 24 of GATT)
- eliminate existing discriminatory measures and/or prohibit new or more discriminatory measures (a standstill is thus sufficient)

In both respects, GATS disciplines are weaker than those governing preferential liberalization of goods trade

- RTAs are not to result in higher trade and investment barriers against third countries (to be determined on a sectoral basis)
Special flexibility for RTAs between developing countries

Article V:3(b) allows developing countries additional flexibility in according more favorable treatment to firms and services that originate in parties to an integration agreement.

Is such policy space being used? Is it conducive to the development of world efficient service providers?
Why weaker WTO disciplines on RTAs in services?

- Novelty of subject matter (incites regulatory and negotiating precaution)?

- Recognition of the difficulty of achieving comprehensive liberalization of services markets, even at the regional level

- Policy preference of a number of important WTO members that were negotiating (or contemplating future) RTAs in services at the time that GATS Article V was being drafted
Looking to the future: elements of value-adding RTAs in services

- RTAs can offer services negotiators policy space to experiment with new and/or improved rules and achieve deeper liberalization than that on offer at the WTO level
Issues to consider in RTAs

- The relationship between cross-border trade in services, investment and the movement of people

- Pros and Cons of:
  - Producing a negative list of non-conforming measures and performing a comprehensive audit of service sector regulations
  - Locking in the regulatory status quo
Issues to consider (2)

- How best to strengthen intra-regional labor mobility, including for medium- and lower-skilled worker categories (e.g. non-professional essential personnel)

- How best to strengthen regulatory transparency (binding vs hortatory approaches; need for technical assistance)
Issues to consider (3)

- Developing disciplines on trade-inhibiting measures flowing from non-discriminatory conduct

- Experimenting with pro-competitive regulation in sectors subject to location-specific sunk costs and/or prone to market dominance (e.g. energy; environmental services; distribution)
Issues to consider (4)

- Assessing the scope for procurement liberalization in services
- Paying attention to the design of rules of origin for investment in services
Thank you!