DOMESTIC REGULATION AND TRADE IN SERVICES: LOOKING AHEAD

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Background considerations

This volume of essays has explored one of the most important and difficult issues in international trade today: the relationship between trade and investment liberalization and domestic regulatory autonomy. While regulatory autonomy is required to allow domestic rules to respond to local conditions, there may be times when such autonomy leads to trade friction, either unintentionally or as disguised protectionism.

The interface between international trade and domestic regulatory conduct has been the object of a growing body of rules and jurisprudence in relation to trade in goods but is new in the realm of services. Given the pervasive influence that domestic regulatory conduct exerts on trade and investment conditions, it should come as no surprise that the above tensions, and the attendant policy sensitivities to which they give rise, should have become so prominent in GATS negotiating circles.

A paradox of the body of rules governing trade in services at the multilateral level is that the disciplines dealing with the centrally important issue of domestic regulation and its impact on market access rank amongst its weakest elements. Article VI (Domestic Regulation) of the GATS remains to this day provisional in nature. A central question confronting the multilateral community, and to which the essays in this volume have attempted to provide some answers, is how best to strengthen GATS disciplines without unduly curtailing national regulatory freedom. Of related interest are the questions of determining the extent to which government regulations in the services field can be based on principles of economic efficiency and good governance and the degree to which regulatory principles can, amidst considerable sectoral diversity, be pursued through the creation of meaningful horizontal (i.e. non sector-specific) disciplines.

This concluding essay draws on the body of analysis contained in this volume in identifying a set of issues to which services negotiators and regulators will need to devote closer attention in the coming years. From a forward-looking perspective, six key themes appear to warrant closer analytical scrutiny.

First, the rationales for regulation, and the reasons for collective action at the multilateral level, are similar across service sectors. There can be little doubt that further experimentation on this policy interface will need to be conducted along sectoral lines, not least of which for the purpose of nurturing greater GATS “buy-in” on the part of sectoral regulators. Still, the argument can be made that a horizontal approach to disciplines on domestic regulation is possible under GATS. Horizontal rules may in fact emerge (in future) from sectoral experimentation.
Second, before new disciplines on domestic regulation can be contemplated, it is important that a fuller understanding of the scope of existing GATS disciplines be achieved. This concerns most centrally Articles III (Transparency) and XVII (National Treatment). As it happens, much can be achieved by making the process of rule-making more transparent and striving for non-discrimination in rule design and enforcement. This is a centrally important conclusion of the essays by Keiya Iida and Julia Nielsen and by David Leebron.

However, while strengthened transparency disciplines over and above those currently found in Article III may be desirable as a means to promote good governance and efficient regulation, the design of any new disciplines in this area must be informed by a careful assessment of potential benefits and costs, particularly enforcement costs. The latter may be non-trivial in developing country settings.

Meanwhile, there can be little doubt that the non-discrimination (both de jure and de facto) disciplines found in Articles II (MFN) and XVII (National Treatment) of the GATS already exert powerful discipline on domestic regulatory conduct in the services area. Yet, as several of the essays in this volume suggest, there may still be a need for a variety of reasons to create deeper disciplines to protect the rights of foreign producers and consumers.

Third, in so far as non-discriminatory access to or control of essential facilities is a problem, market-opening commitments on trade and investment will typically need to be complimented by pro-competitive regulatory disciplines. This emerges in the essays on telecommunications by Daniel Roseman, transportation by Richard Janda, energy by Peter Evans and, a somewhat surprisingly (given his characterization of the industry’s increasing “commoditization”), in the chapter on financial services by Stijn Claessens.

Fourth, in so far as regulations like licensing and qualification requirements are impediments to trade, market-opening commitments may need to be supported by the right to challenge trade-impeding or needlessly burdensome regulation. This emerges most clearly in the essays on accountancy by John Hegarty and Claude Trolliet and on health services by David Luff as well in the essay on financial services standards by Joel Trachtman. Recognition of this challenge is what lies behind the Article VI:4 work program on the development of possible new disciplines on regulatory conduct (beyond those already agreed for accountancy services). However, as is discussed in greater detail below, opinions diverge quite significantly on the form any new possible disciplines might take – indeed, over the very feasibility of reaching agreement on such disciplines.

Fifth, as regards the promotion of regulatory harmonization (or at the very least greater doses of regulatory convergence) and the conclusion of mutual recognition agreements (MRAs), greater participation by developing countries in the development of international standards in services is clearly desirable. Where such standards do exist, the likelihood of disguised or needlessly restrictive impediments to trade and investment may be significantly lower to the extent that such standards reflect best practice policies. Multilateral disciplines under the GATS should, accordingly, create a stronger
presumption in favor of genuinely international standards in services trade. Moreover, because of the potential of MRAs to create trade and investment distortions, bilateral or plurilateral recognition agreements should respect the non-discrimination principle, as mandated by Article VII of GATS. Such agreements should not, as a rule, be notified under Article V of GATS (Economic Integration) but rather be open to all eligible participants under the potentially less trade-restrictive terms of Article VII.

Sixth, developing countries have much to gain from strengthened multilateral disciplines on domestic regulation. This is so for two important reasons. First, the development of such disciplines can play a significant role in promoting and consolidating domestic regulatory reform efforts. Second, such disciplines can help developing country exporters to address potential regulatory barriers to their exports in foreign markets. A central challenge confronting developing countries is thus how best to harness multilateral rule-making efforts with a view to promoting sound regulatory institutions and practices at the national level.

1. Understanding the rationales for – and possible trade effects of – domestic regulation

The service economy comprises an extraordinarily rich variety of economic activities. Such diversity – and the rule-making challenges it poses in international negotiations - is one of the defining characteristics of the GATS. Are services sectors so different that each will need a distinct approach? Or are there certain basic general principles that can be applied across sectors - and will remain relevant over time in a world of changing technology and policy?1

The great diversity of services sectors, the difficulty of making policy-relevant generalisations in the midst of rapidly changing regulatory environments, and the regulatory precaution associated with the sheer novelty of trade negotiations in the services field, have all tended so far to impart a certain degree of sectoral specificity to discussions of the GATS-domestic regulation interface. However, as several of the essays in this volume bring out quite vividly, even though services sectors differ greatly, there is considerable similarity in the underlying economic and social reasons for regulatory intervention: monopolies in network-based services (e.g. telecommunications, transportation and energy services), externalities and asymmetric information in knowledge and intermediation-based services (e.g. financial and professional services), and the desire to ensure universal access in essential services (e.g. health and education services). These rationales, and a range of possible GATS- and domestic policy-based responses thereto, are presented in Table 1 below. Focusing on these rationales may provide the basis for determining the desirability and feasibility for answering one of the

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1 The existence under GATS of a multilateral framework of disciplines of generic application, coupled with a series of annexes addressing sectoral specificities, suggests that no single answer can be given to the above tensions. The policy tensions arising from sectoral diversity appear to require flexible (and dual) rule-making responses.
key issues confronting services negotiators under the Article VI:4 work program: choosing between horizontal and sectoral disciplines.

Table 1. Dealing with domestic regulations at the multilateral and national levels

<table>
<thead>
<tr>
<th>Market failures</th>
<th>Services sectors</th>
<th>Possible GATS response</th>
<th>Possible national policy responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monopoly/</td>
<td>Network services: telecommunications; transport (terminals and infrastructure),</td>
<td>Generalising key disciplines in telecommunications reference paper to ensure cost-based access to essential facilities, such as roads, rail tracks, terminals, sewers, networks or pipelines. Strengthened disciplines to deal with anti-competitive conduct.</td>
<td>Developing pro-competitive regulation to protect consumer interests where competitive market structures do not exist.</td>
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<tr>
<td>Oligopoly</td>
<td>environmental services (sewage) and energy services (distribution networks).</td>
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<td></td>
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<tr>
<td>Asymmetric information</td>
<td>Intermediation and knowledge based services: financial services, professional services, etc.</td>
<td>Non-discrimination and possible application of a &quot;necessity&quot; test.</td>
<td>Strengthening domestic regulation to remedy market failure in an economically efficient manner.</td>
</tr>
<tr>
<td>Externalities</td>
<td>Transport, tourism, etc.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Social objectives:</td>
<td>Transport, telecommunications, financial, education, health</td>
<td></td>
<td>Devising economically efficient means of achieving social objectives in competitive markets.</td>
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<td>Universal service</td>
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In the current GATS talks, negotiators will be considering whether and how such disciplines could be applied to a variety of other network services, including transport (terminals and infrastructure), environmental services (sewage) and energy services (distribution networks), with a view to ensuring, inter alia, that any major supplier of essential facilities provides access to all suppliers, national and foreign, at cost-based rates and does not abuse its dominant position in markets.
2. Transparency

The essay by Keyia Iida and Julia Nielsen provides a comprehensive review of existing transparency provisions in national, regional and WTO agreements, and the options for enhancing transparency under the GATS. Transparency is, however, rather like the trade policy equivalent motherhood and apple pie. Few would question its innate desirability. However, two issues arise in the context of strengthening transparency disciplines. First, while transparency can help to reduce concealed protectionism, it cannot alone eliminate the more persistent and the more deeply embedded inefficiencies. Second, while it is important to recognize the many benefits of enhanced transparency, it is also important to acknowledge that its pursuit in greater quantities may also be costly. Accordingly, any new multilateral disciplines on transparency must be based on a careful assessment of the benefits and costs, both globally and nationally.

For instance, *ex ante* transparency, in the form of obligations providing for consultations with all interested parties prior to the enactment of a new law or regulation, will almost certainly have a higher administrative cost than *ex post* transparency, whereby new regulations and regulatory decisions are made public once taken. Proponents of strengthened transparency disciplines, notably through prior notification requirements, point to the greater political legitimacy likely to be attached to laws and regulations deriving from broad public consultations, and the attendant scope for lessening protectionist capture and the risk of inefficient regulatory design.

It is, nonetheless, plausible to assume that greater transparency can be associated with diminishing marginal benefits and increasing marginal costs. And that there is an optimal level of transparency that equates the two at the national level. The question then is why the national optimal may not necessarily be the global optimal. Simply put, why are multilateral rules on transparency needed? One possibility is that domestic transparency may not translate into transparency for foreign providers – e.g. calls for tender in the local language press or consultations with local suppliers do not engage foreign providers. More generally, national transparency may be a global public good the full benefits of which are not fully internalized by each national government. In any case, if multilateral rules do create deeper transparency obligations, there must be some way of ensuring that these rules do not place an excessively costly administrative burden, especially on poorer countries. There is, accordingly, a great need for empirical investigation of the costs and benefits of increased transparency disciplines, and how the choice of optimal levels is today made at the national level.

3. Monopoly

The problem of monopoly has two dimensions in services trade: the impact on conditions of access to markets and essential facilities for foreign producers and the impact on consumers. The essays in this volume have focused for the most part on the former issue, but we also make some comments about the latter problem.
Market failure due to natural monopoly or oligopoly may create trade problems because dominant incumbents can impede access to markets through their control of essential facilities. Because of its direct impact on trade, this form of market failure will typically need to be addressed directly by multilateral disciplines, lest market-opening commitments be nullified or impaired.

The relevant GATS provision, Article VIII dealing with monopolies and exclusive service providers, is in its current shape fairly limited in scope. As a consequence, and as the essay by Daniel Roseman describes, a reference paper featuring a number of pro-competitive regulatory principles was developed in the context of the telecommunications negotiations in order to ensure that monopolistic or dominant suppliers would not undermine market access commitments. A number of essays in this volume conclude that in the current set of GATS talks, negotiators should consider whether and how such disciplines could be usefully applied to a variety of other network services, including transport (terminals and infrastructure), energy services (distribution networks), and financial services (payment systems) with a view to ensuring, *inter alia*, that any major supplier of “essential facilities” provides non-discriminatory conditions of access and use to all suppliers, national and foreign.

The effects of rules dealing with issues such as "reasonable" and “cost-oriented” conditions of access to networks and pricing of services are considerably more complex and will require more careful consideration. They are also likely to show considerable variance and raise highly technical issues across various sectors. In such instances, generic disciplines may prove inadequate, a conclusion Daniel Roseman (telecommunications) and Peter Evans (energy) both draw.

One issue that the essays in this volume do not deal with, but which may be important, concerns the possible need for international rules to protect consumers. Market power can be an issue even in the absence of government restrictions on entry. For despite changes in technology, it is far from clear that consumers in small markets will necessarily secure access to competitively-priced supplies of telecommunications, transport and financial services even if all barriers to entry are eliminated. In some sectors, anti-competitive practices are likely to be a problem.

Two considerations would seem relevant in determining whether a regulatory response may be necessary and, if so, what form it should take. One such consideration derives from whether the national market is segmented or not from the international market. If cross-border delivery is feasible, then services trade resembles goods trade and the size of the national market may be largely irrelevant in determining competitive conditions. However, the cross-border delivery of services will in many instances be difficult, either for technological reasons or because of the nature of consumer and/or regulatory preferences. For instance, fixed line local telecommunications services may be difficult to supply without some form of commercial presence, and consumers will often be reluctant to buy life insurance or enter into other types of retail financial services transactions with overseas firms. In these cases, national market structures assume critical importance.
A second consideration is whether the minimum efficient scale of operation is large relative to the size of the market – or whether sunk costs are important, if market contestability (i.e. the credible threat of new entry) is deemed to be the relevant benchmark. In basic telecommunications, banking, as well as air and maritime transportation services, despite changing technologies that have greatly reduced both the optimal scale of operation and the importance of sunk costs, the answer to both questions is likely to be positive for some time.

Concerns about consumer interests and how they may be affected by monopolistic and other anti-competitive types behavior are addressed in principle by GATS Articles VII and IX, but these provisions provide only for information exchange and consultation. Strengthened multilateral rules may be needed to reassure small countries with weak enforcement capacity that the gains from liberalization will not be appropriated by international cartels.²

4. Regulatory impediments to trade: is a necessity test necessary?

When market failure is attributable to informational problems or externalities, multilateral trade disciplines need not address the problem per se, but rather ensure that domestic measures to deal with the market failure do not serve unduly to restrict trade. The same may be said of measures designed to achieve social objectives, to the extent that they may be covered by GATS rules and subject to scheduled commitments. Such trade-restrictive effects can arise from a variety of technical standards, prudential regulations, and qualification requirements in professional, financial and numerous other services; as well as from the granting of monopoly rights to complement universal service obligations in services like health, transport and telecommunications.

One means that has been suggested for disciplining the trade- and investment-inhibiting effects of this entire class of regulations is to complement the national treatment and market access obligations with the development of a so-called "necessity" test. Such a test essentially leaves governments free to deal with domestic economic and social objectives provided that any measures taken are no more burdensome than necessary to achieve the relevant objective. Such a test, for which a trade in goods equivalent is found in the Agreement on Technical Barriers to Trade (TBT) and the Agreement on Sanitary and Phyto-Sanitary measures (SPS), has long been in use as a legal standard within the European Community. A necessity test also forms part of the accountancy disciplines agreed to by WTO Members in 1998 and described by Hegarty and Trolliet in this volume.

² An important reason for developing a first-best international response to these practices is to prevent recourse to an inferior national response. It bears recalling in this regard that the costly cargo-sharing schemes imposed by many developing countries in the maritime sector were primarily a reaction to the perceived power of maritime conferences.
In principle, a necessity test could be used to encourage the adoption of economically efficient policy choices in remedying market failures and in pursuing non-economic objectives. For instance, in the case of professional licensing, a requirement to re-qualify could be deemed unnecessarily burdensome, since the problem - inadequate information about whether individual practitioners possess the required skills - could be remedied by a less burdensome test of competence (which is – and should be - the main rationale of professional licensing regimes).

Important unanswered questions remain about the feasibility and desirability of embedding a necessity test for services trade under the GATS. These include: how might “necessity” be defined - or whether further definition is necessary; whether “necessary to ensure the quality of the service” is sufficiently broad to allow for a host of regulatory objectives; and how other elements, such as the reasonable availability of alternative measures (or the lack thereof), should be taken into account in the resolution of possible trade disputes.

It is, however, difficult to see how even the basic GATS disciplines of MFN and national treatment can be enforced without the application of some similar test. In such instances, a necessity test may be more than a mere Article VI add-on.

Consider first the national treatment obligation, which requires that foreign services and service suppliers receive no less favorable treatment than the like national services and suppliers. Applying the traditional GATT/WTO two-step approach of first establishing likeness and then determining whether “like” foreign suppliers are receiving less favorable treatment, one can easily end up in a legal cul-de-sac.

For instance, consider the hypothetical case of a medical doctor from Greece arriving in Canada with a view to practicing medicine there. Imagine that the Canadian licensing authorities ask him to re-qualify from scratch in his new country of adoption. Would such a requirement be inconsistent with national treatment? The Canadian licensing authorities could legitimately allege that a doctor trained in Greece is not “like” a doctor trained in Canada. What would a WTO panel say? If it said that a Greek medical doctor was like a Canadian doctor, then Canada would not have the right to impose even a slightly greater burden on the Greek doctor. This is hardly sustainable, and could with some justification be seen as a threat to regulatory autonomy. If, on the other hand, a Greek doctor is not deemed to be “like” a Canadian doctor, the national treatment discipline simply does not apply, and the Canadian (provincial) licensing authorities are given a free rein to do whatever they want. This is also likely to be an unsatisfactory outcome.

The most reasonable argument would be to ask: what is it that the Canadian licensing authorities really need to do to ensure that foreign doctors do not constitute a threat to the health of Canadian citizens? Under such an approach, anything that strayed unduly from competence-based reasons for licensing (which can quite legitimately include a demonstrable command of local languages) should be deemed inconsistent with national treatment. But this is precisely a variant of the necessity test.
Some WTO Members have raised the fundamental question of whether a necessity test is itself "necessary" given the scope for addressing problems via other means (such as transparency) and the concerns raised about the potential for such a test to limit the full scope of possible government action to regulate service sectors. Indeed the very discussion of this issue has generated considerable controversy in regulatory and civil society circles, particularly in the OECD area.\(^3\) Intractable and politically sensitive as these questions may be, it is doubtful that WTO Members will be able to bring closure (in one way or another) on the Article VI:4 work program without a more thorough airing of the challenges arising from the possible adoption of a necessity test for services trade.

If policy sensitivities arise when necessity-type arguments are invoked in dealing with overtly discriminatory (i.e. national treatment-inconsistent) regulatory measures, the application of a necessity test to measures that satisfy non-discrimination disciplines tends to be even more controversial. This is so because a necessity test could under such circumstances be seen as suggesting that domestic regulatory conduct should somehow be subordinated to trade policy imperatives in light of its possible trade- or investment-impairing effects.

The possible new disciplines called for under the Article VI:4 work programme are to deal with regulatory measures not addressed by Articles II (MFN), XVI (market access) and XVII (National Treatment) of GATS. Identifying the specific types of measures to which Article VI:4 disciplines would apply has long bedevilled WTO Members. Indeed, the empirical (and commercial) significance of strictly non-discriminatory trade-impeding measures has yet to be satisfactorily established. Moreover, even if such measures did matter, how they should be dealt with under the GATS remains to this day quite unclear.

A deliberately far-fetched example helps to highlight some of the challenges negotiators would need to contend with in developing a necessity test applicable to non-discriminatory regulatory measures. Imagine that a WTO member required that all taxi drivers should be certified cardiologists because it is simply socially unacceptable in that country for people to die of heart attacks while trapped in traffic jams. This would seem on the face of it an excessively burdensome regulatory requirement. It is, however, strictly non-discriminatory and so the question is, should WTO rules prohibit it? Would such a prohibition not be considered unduly intrusive? David Leebron’s depiction of the tentativeness of US judicial rulings on challenges to non-discriminatory measures is a sobering reminder of the political difficulties encountered in making rules in this area. Moreover, it remains unclear that non-discriminatory measures other than quantitative restrictions (i.e. other than those addressed by Article XVI of GATS in scheduled sectors) are important sources of trade or investment friction, or that they are comparable in economic significance to de facto discriminatory measures.

\(^3\) See OECD (2002), *GATS: The Case for Open Services Markets*, Paris: OECD, for a further depiction of the public policy controversy surrounding the GATS and its alleged effects on the right to regulate the supply of services.
A central challenge facing those WTO Members in favor of embedding a necessity test in GATS will be to give more precise meaning to the notion of necessity and the conditions under which such a discipline would be triggered. At a minimum, it would seem necessary to err on the side of permissiveness to make any such new disciplines politically acceptable. A balance would indeed need to be struck between political concerns about the intrusiveness of multilateral rules and the need to ensure that protectionist or needlessly burdensome regulation does not undermine market access commitments.

Several models exist as a starting point for discussions along these lines in a GATS setting. One such model is offered by the wording of necessity tests already found in the GATT’s TBT and SPS Agreements as well as in Article XX (Exceptions), which draw attention to the need for regulatory measures to be “the least trade restrictive alternative reasonably available to achieve the regulatory goal”. A second model comes from the proportionality tests codified under EU law and applied in a number of rulings by the European Court of Justice on the internal trade effects of regulatory measures maintained by EC member countries. Proportionality has tended to include least-trade restrictive analysis, but also other tests, notably with regard to desirability (means-end rationality), cost-benefit analysis and feasibility. A third model stems from proposals calling for the development of necessity-based criteria creating a presumption in favor of economically “efficient” regulations and regulatory outcomes. Whatever model (if any) is ultimately adopted in GATS, one rule of thumb may well be to avoid creating rules whose enforcement would require judicial decisions to be rendered on highly delicate policy matters. Rather, the rules should mainly serve to target truly egregious regulatory measures. Perhaps it would be sufficient to ensure that a non-discriminatory measure is “not obviously unnecessary” to secure compliance with a legitimate public policy objective. Following the example of the accountancy disciplines, it may also be desirable to attempt to provide guidance to prospective WTO panelists by drawing up an illustrative list of legitimate public policy objectives to which presumptions of regulatory immunity would *prima facie* apply.

### 5. Harmonization and Recognition

Harmonization and mutual recognition can be seen as complements of, rather than substitutes for, multilateral rules on domestic regulation. Three core questions arise under this cluster of issues. First, where is it feasible and desirable to develop international standards for services trade? Second, what should the link be between the GATS and international standards? And third, how should the GATS deal with plurilateral or bilateral mutual recognition?

The pessimism that calls for regulatory harmonization typically generate is based on the absence of widely accepted international standards in services. Where such standards do

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exist, as in financial services (banking, securities and insurance) or maritime transport, meeting them often tends to be seen as a first step towards acceptability, rather than as a sufficient condition for market access. The GATS, like the GATT, does not specifically require the use of international standards. It generally provides weaker incentives for the use of such standards than the SPS or the TBT Agreements, and does not provide a presumption of compliance as do the latter two agreements.\(^5\)

It is unlikely that meaningful international standards for most services will be developed any time soon. Still, it bears noting that in those areas where global standards do exist, the likelihood of disguised or needlessly restrictive impediments to trade and investment may be significantly lower. In part, this may owe to the fact that internationally-agreed norms can more easily reflect best practice regulatory policy. The existence of such standards may also significantly facilitate trade and investment. This is likely to be particularly the case of cross-border trade, as international standards may help overcome the various forms of information asymmetries that hold such trade – and its commensurate liberalization under GATS - back.

Accordingly, efforts should be directed to ensuring that the GATS creates a stronger presumption in favor of genuinely international standards in services trade. As with recognition agreements (see below), efforts at developing international standards for services trade are likely to require greater doses of technical assistance and capacity building. This may be usefully done at the national and regional levels (particularly as proximity, both geographic and historical/cultural, may be expected to facilitate regulatory convergence).

At the multilateral level, efforts to promote the adoption of international standards will invariably be carried out outside the WTO framework. The WTO, it must be recalled, is not in the business of making regulatory standards. Rather, its remit lies in how such standards are formulated and implemented if and when they impact on trade. The relevant institutions for promoting international standards for services are to be found in various specialized regulatory institutions, such as the Bank for International Settlements for banking standards, the International Telecommunications Union for telecommunications, the International Civil Aviation Organization for air transport services, as well as the International Standardization Organization (ISO) for various categories of services (including the means of producing and supplying them).

Another concrete example of forward movement in international standardization involving developing countries is provided by the IMF-World Bank Comprehensive Financial Sector Adjustment Programs, which are helping many jurisdictions to assess their compliance with international standards in the financial sector with the aim of addressing any underlying weaknesses. Carried out in a voluntary and participative manner outside of the trade policy framework, such regulatory cooperation may

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\(^5\) Such a presumption can be found in Article 2.5 of the TBT Agreement and Article 3.2 of the SPS Agreement.
nonetheless be expected to facilitate the progressive, orderly, pursuit of liberalization of trade and investment in financial services.

As regards mutual recognition agreements (MRAs), three observations seem in order. First, such agreements cannot be made to happen. Secondly, they do not seem to be happening – at least not on any major trade-influencing scale. Often touted as a desirable transaction cost-reducing alternative to regulatory harmonization, there are in practice relatively few examples of successful, operative MRAs in services trade.6 Thirdly, even if MRAs were to happen in greater numbers, it is unclear whether they would always be desirable.

A multilateral agreement like the GATS cannot mandate countries to conclude MRAs – just as any provision such as Article V of GATS (Economic Integration) or Article XXIV of GATT cannot make regional integration agreements happen. As in the case of regional agreements, multilateral disciplines can be more or less permissive with regard to mutual recognition.

This in turn raises a key question: where and how strong are the incentives to conclude MRAs? The practice of MRAs suggests that their scope is quite limited; they are invariably concluded between very similar countries. Even in a region with as strong an integrationist dynamic as the European Union, and despite a significant level of prior and/or complimentary (minimal) regulatory harmonization, the effect of MRAs has been limited by the unwillingness of many host country regulators to cede full control.7 It should come as no surprise that MRAs have yet to exert significant effects on services trade.

Such an outcome in turn raises the question of the benefits and costs of MRAs. The analogy with regional integration agreements is here again useful, as MRAs can be likened to sector-specific preferential arrangements. In instances where regulatory barriers are prohibitively high - one can imagine autarky as the ultimate example - then recognition can only be trade creating. But if they are not, then selective recognition can have discriminatory effects and lead to trade diversion. The result may well be to create trade according to a pattern of mutual trust rather than on the basis of the forces of comparative advantage. For instance, one can readily observe OECD countries making progress (albeit limited) towards MRAs in professional services, but avoiding such agreements with countries such as India, Egypt or the Philippines.

Article VII (Recognition) of the GATS strikes a delicate balance by allowing such agreements, provided third countries have the opportunity to accede or demonstrate

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equivalence. Thus, Article VII has a desirable open-ended aspect that Article V (dealing with integration agreements) does not. This makes it particularly worrisome that many MRAs have been notified by WTO Members under Article V rather than Article VII.

The key concern for any multilateral agreement should be not how those who enjoy preferential access are treated, but how those who do not enjoy such access are treated. Somewhat ironically, the only line of defense on the rights of third countries could well come from a necessity test aimed at ensuring that such countries would not be subject to unnecessarily burdensome regulation even if they were not parties to an MRA.

Because of the potential of MRAs to create trade and investment distortions, bilateral or plurilateral recognition agreements should respect the non-discrimination principle, as mandated by Article VII of GATS. Such agreements should not, as a rule, be notified under Article V of GATS (Economic Integration) but rather be open to all eligible participants under the terms of Article VII.

6. Regulatory reform and development

Developing countries have much to gain from strengthened multilateral disciplines on domestic regulation. This is so for two main reasons. First, the development of such disciplines can play a significant role in promoting and consolidating domestic regulatory reform efforts. The experience in telecommunications in many developing countries is a powerful example of this possibility.\(^8\)

Secondly, such disciplines can help developing country exporters to address potential regulatory barriers to their exports in foreign markets. For example, unless disciplines are developed to deal with potentially restrictive licensing and qualification requirements for professionals, market access commitments on the movement of natural persons may have limited commercial meaning. The adoption of best regulatory practices or adhesion to international standards may similarly help developing countries overcome regulatory hurdles in foreign markets.

It is however important to note that there are limits to what can be achieved at the multilateral level, as many key regulatory challenges, particularly in the realm of building credible and independent regulatory institutions, must still be addressed at the national level. This is so because multilateral trade rules are often primarily designed to ensure market access, and not directly to promote economic efficiency or social welfare.

For developing country negotiators, an important question is how best to harness multilateral rule-making efforts with a view to promoting sound regulatory institutions and practices at the national level. Attention must be given in this context to the need for a proper sequencing of regulatory reform and liberalization efforts. Technical assistance

for the development of regulatory capacity in developing countries is bound to be a crucial accompaniment to future services trade liberalization.

Advancing our understanding of the interface between domestic regulation and services trade remains critically dependent on the quality of policy dialogue between the trade and regulatory communities. The GATS has been instrumental in promoting a much needed *rapprochement* between these two communities, promoting mutual learning and helping dispel misunderstandings. Much remains to be done to enhance the quality and depth of such a dialogue. Absent such dialogue, which in today’s more politically charged negotiating environment must also involve broad participation by civil society organizations, it will be difficult to make much headway on this difficult policy interface. While probably more acute in the OECD area, such a challenge is equally important for developing countries as the latter acquire a greater stake in services liberalization and the multilateral trading system more generally.