The GATS and developing countries
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The GATS and developing countries – At the service of development?¹

I. What is trade in services?

The service sector encompasses a wide and disparate array of economic activity, ranging from traditional sectors such as transport, communications, finance, energy and tourism to new and dynamic areas such as software development, environmental and educational services. The share of services in worldwide economic activity has expanded markedly in recent years. Services dominate the economic landscape of advanced economies, accounting for close to 70 percent of production and employing close to four-fifth of workers in the OECD area. In many developing countries, services today constitute over 50 percent of economic activity, significantly more than traditional sectors such as agriculture or manufacturing.²

Services have been the fastest growing component of cross-border trade and investment activity over the past decade. Total measurable trade in services, as defined by the four types of transactions subject to multilateral disciplines (see Box 1), stood at some USD 2.3 trillion at the end of 2001. This represents 7.6 percent of world output and over a quarter of total trade in goods and services.³ The service sector accounts for almost half of the global stock of foreign direct investment (FDI) and some two-thirds of annual FDI flows have been directed towards service industries in recent years.⁴ What’s more, services are where more than four of five barriers to international investment are found.⁵

¹ This note was written by Pierre Sauvé, Director of Studies, Groupe d’Economie Mondiale, Institut d’Etudes Politiques de Paris, October 2003.
² Research on 20 least developed countries found that only three of them had a larger share of output from agriculture than from services. Further, for seven of these countries, services were the main source of export revenue (OECD, 2003).
³ WTO (2002).
⁴ UNCTAD (2003).
⁵ Sauvé (2002).
Such figures attest to the economic and commercial significance of the sector and of negotiations aimed at progressively rolling back impediments to trade and investment in it.

Although developed countries dominate global trade and investment in services, developing countries are often highly specialised in – and dependent on – services exports as a source of foreign exchange earnings. The services exports of developing countries grew four-fold over the past fifteen years. As a result, there has been broad convergence in the share of services in the total exports of developed and developing countries.

Long hesitant to commit significantly to market opening in services, a growing number of developing countries are today active demandeurs in WTO and regional negotiations. This is especially true in areas where they enjoy strong comparative advantages, such as in tourism, construction, computer, shipping and a host of labour-based services (see Box 2). To some extent, such a trend also reflects the strong recent rise in services trade between developing countries in sectors as diverse as audio-visual, maritime transport, health, telecommunications and a host of business services.6

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**Box 1. Classifying services transactions**

In contrast to merchandise trade, services are often intangible and are often produced and consumed at the same time. The need for proximity between the consumer and the producer typically implies that one of them must move to make an international service transaction possible. Such factor mobility is a hallmark of trade in services. Since the traditional definition of trade – where a product crosses a border – would miss out on a whole range of international service transactions, it is now customary to define “trade in services” as comprising four “modes of supply”. These are:

(i) cross-border supply – analogous to trade in goods, such trade arises when a service crosses a national frontier, as in the case of an international long-distance call; (ii) consumption abroad, when consumers travel to the territory of the service supplier, for instance for educational or tourism purposes; (iii) commercial presence, which involves physical establishment in a foreign market, such as the foreign branch or subsidiary of a bank; and (iv) movement of service suppliers, which occurs when individual service providers or employees of a firm temporarily move to another country, as when a Swedish architect oversees the design and construction of a museum in South Africa.

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6 OECD (2003).
II. How does the General Agreement on Trade in Services (GATS) operate?7

The conclusion of the General Agreement on Trade in Services, bringing services trade into the multilateral framework of trading rules, was one of the most significant achievements of the Uruguay Round.

The GATS, which entered into force in January 1995, offers for services trade the same stability that arises from mutually agreed rules, binding market access and non-discriminatory commitments that the GATT has provided for goods trade over the last five and a half decades.

However, liberalisation of services trade is quite different from trade in goods, given the salient characteristics of services, most notably the need for movement of factors of production—capital and labour—and the highly developed regulatory frameworks in place in many service industries.

A framework agreement that features several of the fundamental principles of the GATT—national treatment, most-favoured nation (MFN) treatment, transparency in domestic regulation, fair application of laws, the GATS covers in principle international trade in all services except those supplied in the exercise of governmental authority (so-called “public services”) and, in the air transport sector, traffic rights and all services directly related to the exercise of such rights.

The GATS consists of three major elements: (i) the framework which lays out the general obligations for services trade in much the same way as the GATT does for goods trade.

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7 A fuller discussion of the structure of the GATS, its modus operandi and future challenges in services rule-making can be found in Chanda (2002) and OECD (2002).
trade in goods; (ii) a number of annexes that respond to some of the unique characteristics of individual service sectors; and (iii) schedules of liberalisation commitments undertaken by WTO Members.

Due to its voluntary, “bottom-up”, approach to liberalisation, the GATS allows WTO Members to select the sectors, modes of supply and regulatory conditions in which market opening commitments are made. Such flexibility, and the emphasis in GATS on the progressive nature of liberalisation, help explain why the Agreement is often described as the most “development-friendly” of all Uruguay Round agreements.8

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

- Belief that a multilateral framework of rules and principles that aim to progressively liberalise services trade will assist the growth of international trade in services and contribute to economic development world-wide;
- Acknowledgement that the liberalisation process must respect the needs and rights of governments to regulate in order to pursue national policy objectives;
- Acceptance that the integration of developing countries into the multilateral trading system must be facilitated by reinforcing the capacity, efficiency and competitiveness of their domestic service industries.

Services negotiations at the WTO typically proceed on the basis of bilateral requests and offers: countries request market opening measures from their trading partners and the latter respond with offers. Agreement is reached, and the best bilateral deal on offer extended to all WTO Members on an MFN basis, once all Members are satisfied with the total package on the table (which may include considerations linked to negotiated outcomes outside of services).

The relative novelty and greater overall complexity of services trade resulted in a limited initial harvest of liberalisation commitments in the Uruguay Round.9 Most attention was indeed focused on the development of a framework of rules governing the progressive liberalisation of services markets.10

Negotiations under the GATS resumed in January 2000 as part of the Uruguay Round’s built-in agenda. The talks have subsequently been integrated into the Doha Development Agenda and are subject to the same deadlines as all other areas under negotiation.

Pursuit of services liberalisation has generated a fair share of public controversy in recent years, especially in developed countries. Criticisms of the GATS are often based on the belief that the agreement must inevitably bring any and all service sectors within its liberalising scope, and these will be

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8 OECD (2002).
9 An indication of the work that lies ahead for securing more meaningful market access commitments may be gleaned from a calculation of the share of commitments where no restrictions are maintained on market access and national treatment. For high-income countries, the share is about 25 percent of all services; for other Members less than 10 percent (Hoekman and Mattoo, 1999).
10 Outstanding rule-making negotiations under GATS are proceeding in four areas: emergency safeguards; domestic regulation; subsidies and government procurement of services.
wholly and irretrievably “lost” to the regulatory protections of national governments.\(^{11}\)

In fact, the GATS allows member countries to undertake the progressive opening of service sectors and integration into the multilateral trading system at their own pace and in accordance with their national priorities and objectives. Indeed, the agreement establishes a series of means through which countries can limit, condition, or even suspend the commitments that they make. The limited liberalisation commitments made to date suggest that WTO Members enjoy considerable policy flexibility under the GATS.

Several of the agreement’s provisions focus specifically on the particular needs and constraints faced by developing countries in services trade. For instance, the Preamble to the GATS recalls the particular need developing countries may have to regulate their services markets in accordance with national policy objectives. Article IV focuses attention on the practical means of enhancing the participation of developing countries in world trade in services, notably through improved access to information networks and distribution channels.

Similarly, Article XIX, on which the modalities governing the current set of multilateral negotiations are based, provides that “there shall be appropriate flexibility for individual developing country members, and especially least developed countries, to open fewer sectors, liberalise fewer types of transactions, extend market access in line with their development situation and attach conditions aimed at strengthening their domestic services capacity and competitiveness”.

Crucially, the GATS also calls on developed countries to lift restrictions in sectors and modes of supply of export interest to developing countries (see Box 3). Developing countries rightfully complain that little has been done to date to meet the above challenges. Finding the appropriate means of doing so will be an important litmus test of the Doha Round if it is to fulfil its stated development promise.

\(^{11}\) OECD (2002) and WTO (2001). A common misunderstanding in the policy debate over GATS is to use the terms “liberalization” and “deregulation” interchangeably, as if they were literal synonyms. They are not, and it is simply wrong to assimilate regulations to trade restrictions. Services liberalization, indeed, often necessitates regulation or re-regulation.
III. Why is trade in services important from a development perspective?13

An inefficient service sector acts like a prohibitive tax on a national economy. For this reason, the economic cost of protecting inefficient service sectors is arguably of greater overall significance than that flowing from protectionism in the goods sector. A direct policy corollary is that the payoff from sound reforms and market opening commitments in services can be substantial. Indeed, in virtually every country, the performance of the service sector can make the difference between rapid and sluggish growth.14

There is increasing evidence suggesting that services trade liberalisation may yield significant long-term effects on growth and development.15 A number of key

Box 3. Securing a better deal on labour mobility under the GATS12

A key area for many developing countries under the Doha Development Agenda is to see some liberalisation of the right of workers to move temporarily to provide services there. Such movement is not to be confused with migration, for such workers will remain long-term residents in their home countries. But the ability to harvest crops, clean streets, care for the elderly, design software, operate ships or engage in construction work at (or near) American, European or Japanese wages would immeasurably increase the incomes of mobile workers, including those of lower-skilled workers in developing countries.

Mode 4 of the GATS concerns the temporary movement of natural persons linked to the supply of services, from one Member of the WTO to another Member. Mode 4 is by far the smallest mode of service delivery in terms of both trade flows and the level of scheduled commitments made in the Uruguay Round. The limited commitments made to date under Mode 4 refer almost exclusively to higher-level personnel, and especially to intra-corporate transferees, whose mobility is essentially an adjunct of investment liberalisation. Most existing commitments thus have limited significance for developing countries since their comparative advantage lies primarily in low- and medium-skilled labour-intensive services.

The very essence of international trade, be it of goods or services (including factors of production), is to exploit differences in relative prices flowing from diverging factor endowments. The larger such differences, the greater the likely gains from opening up international trade. In the case of Mode 4 trade, potentially very large returns from liberalisation could be reaped if medium- and less-skilled workers, who are relatively abundant in developing countries, were allowed to move and provide their services on a temporary basis in developed countries (or indeed in higher income developing countries, as has been the case most notably in South-east Asia and the Gulf States). Indeed, studies show that the gains from even a modest liberalisation of Mode 4 trade could exceed those expected to flow from a full elimination of barriers to merchandise trade.


12 For a fuller depiction of the development promise and negotiating challenges in the area of labour mobility, see World Bank (2003, chapter 4).
13 For a comprehensive discussion of the contribution of service sector reforms to the development process, see World Bank (2001).
15 Estimates suggest that, after controlling for other determinants of growth, countries that fully liberalized trade and investment in finance and telecommunications grew on average 1.5 percentage points faster than other countries over the past decade. See Mattoo, Rathindran and Subramanian (2001).
service sectors – energy, transport, telecommunications, finance – clearly possess growth-enhancing properties. A competitive and well-regulated financial sector leads to the efficient transformation of savings to investment, ensuring that resources are channelled into areas that will yield the highest returns while facilitating better risk-sharing in the economy.

Improved efficiency in the provision and cost of telecommunications generates economy-wide benefits, as this service is a vital intermediate input and also crucial to the dissemination and diffusion of knowledge. Similarly, business services such as accounting and legal services are important backbones in helping firms reduce their transaction costs. And education and health services are crucial in helping societies build up the stock of human capital, a key ingredient in long-run growth performance.

Thus, regardless of where a country’s comparative advantage may lie – and for many developing countries it may be outside of services, it has every interest in ensuring that its service infrastructure underpins, rather than inhibits, its capacity to take advantage of world markets.

Furthermore, the import of foreign factors of production, particularly through investment (under Mode 3 – commercial presence – of GATS) that characterises services liberalisation is likely to encourage the transfer of technology, managerial know–how and product and process innovation. All of these can lead to additional growth-enhancing gains.

IV. Handle with care: managing the opening of services markets

While studies indicate that there are substantial gains from liberalising key services sectors, it would be wrong to infer that such gains can be realised in a simple, mechanical, manner by simply opening up services markets to greater foreign competition or private supply. Indeed, poorly designed reform programs in services can substantially undercut the benefits of liberalisation.

Three types of challenges seem particularly important. First, there may be a reluctance to fully open service markets to private sector-led competition before an appropriate regulatory framework is established. Regulation is needed in many service sectors to address a variety of market failures, ranging from public monopolies in transportation and telecommunications, to information asymmetries in the provision of financial and professional services or the need to ensure universal access in education or health services.

Full market opening in the absence of adequate regulation may reduce the gains from liberalisation and may even lead to adverse outcomes – as demonstrated, for example, by the Asian financial crisis. Once more, care must be taken in getting the sequence of reform efforts right, so as to ensure that domestic regulatory reform efforts are compatible with concurrent or subsequent external liberalisation efforts.

Second, there may be concerns that liberalisation could adversely affect access to services by the poor. A common
concern in many developing countries is that new market entrants may primarily focus on rich and urban market segments, to the detriment of poor and remotely located consumers. The application of universal service obligations on a non-discriminatory basis is one means available to host governments to ensure that foreign service providers satisfy a range of social policy objectives in a liberalising policy environment.

Third, liberalising trade in services invariably changes the structure of service markets, with a common pattern being the entry of foreign firms and the exit or consolidation through mergers and acquisitions of domestic service providers. Many of the benefits flowing from greater market openness may take time to materialise. In contrast, the costs associated with the rationalisation of service industries will appear early on under the guise of changes in the structure of industry ownership and possibly labour displacement. Opposition from affected workers, incumbent firms (domestic or foreign) and bureaucracies, who will often perceive liberalisation as a threat to employment, profitability or rent-seeking behaviour, add to the complexity of liberalisation efforts with respect to services. Such adverse effects need to be adequately anticipated and managed, through the phasing in of reforms and complementary labour market policies (e.g., unemployment benefits, re-training of workers, assistance with job or worker relocation).

V. What can WTO engagement help achieve in the services field?

Governments face the difficult task of designing services reforms such as to generate sustainable gains in overall economic performance while minimising adjustment costs to avoid social hardship and promoting pro-poor outcomes in terms of access to essential services.

While achieving successful outcomes remains, first and foremost, a domestic policy challenge, engagement in multilateral services negotiations can nonetheless help support domestic policy reform efforts. It can do so in five distinct manners:

First, reciprocity-based bargaining can help governments overcome domestic opposition to reform. Pursuit of reforms and further liberalisation can be easier to implement if a government can demonstrate that its exporters will gain from improved market access negotiated in other areas of a WTO round. Because many developing countries have fewer internationally competitive service sectors than do industrial countries, this may limit reciprocal bargaining within services under the GATS. The WTO offers scope for cross-sectional trade-offs — which may indeed be necessary to ensure an ‘equitable’ exchange of market access concessions.

Second, domestic reforms cannot address barriers in foreign markets. The only feasible means of doing so is by pursuing reciprocal liberalisation opportunities with one’s key trading partners.

Third, a multilateral commitment that is binding under international law and therefore more difficult (and costly) to reverse in future can strengthen the credibility of domestic policies, contributing to an improved investment climate. Locking-in current policy under international law or progressively closing the gap between existing policies and international commit-
ments, can send a potentially powerful signal to investors that a government is committed to opening its services markets and to safeguarding such openness. The credibility-enhancing properties of multilateral commitments rank among the most important features of the GATS and of WTO rule-making more broadly.

Fourth, the GATS framework offers the possibility of pre-committing to future liberalisation with a view to instilling a greater sense of urgency to needed domestic regulatory reforms whilst promoting orderly adjustment. A scheduled commitment to future liberalisation may be more credible than a purely domestic reform announcement, particularly in countries saddled with higher risk premia. All stakeholders in a given sector would face a clear, irrevocable, deadline to prepare for a reformed policy environment.16

Fifth, additional commitments on transparency and regulatory principles can be important complements to the removal of explicit services trade barriers under the GATS. Such good governance disciplines assure foreign traders and investors that liberal market access commitments will not be nullified or impaired by the imposition of regulatory barriers to services trade or the non-transparent and discretionary implementation of service sector regulations (such as the allocation of licenses). In addition, commitment to multilaterally agreed principles on transparency and domestic regulation could promote the adoption of “best practice” or “pro-competitive” regulation at home – as has happened in the telecommunications sector.17

VI. What role for trade-related technical assistance and capacity building?

The Doha Development Agenda is full of references to capacity-building, none of which however are legally binding. To guard against the very real risk that the absence of technical assistance may stymie needed reforms and unduly hold back liberalisation commitments, consideration could be given to establishing a more formal link between enhanced market access commitments by developing countries and additional assistance on the part of developed countries. Such a link could lend greater credibility to both liberalisation and technical assistance programs.

The question naturally arises of where additional assistance should be directed. Developing countries face two central challenges in undertaking service sector reforms: first, that of identifying the elements of good (i.e. economically sound) services policy; second, assessing how the choice of good policy at the domestic level can be supported by multilateral (or regional) negotiations.

None of the above is easy, and many developing countries are at a distinct disadvantage in meeting such challenges.18 There is much therefore that properly-targeted trade-related technical assistance and the strengthening of institutional and regulatory capacities can do to help developing coun-

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16 With the exception of a significant number of pre-commitments in the 1996 Agreement on Basic Telecommunications, WTO members have so far not made extensive use of pre-commitments under the GATS. It is widely expected, however, that such a practice will become more widespread in future for countries that seek to engage more resolutely in the negotiations but may still be unwilling or unable to liberalize fully or immediately.

17 See Mattoo and Sauvé (2003).

18 OECD (2002a).
tries harness the full potential of service sector reforms.

WTO Members cannot participate meaningfully in services negotiations without first understanding how domestic reform is best pursued. This requires careful analysis informed by two-way dialogue between national stakeholders, country negotiators and independent researchers. A stocktaking exercise to consider national and cross-country experience with services reform could help identify areas where reforms can be fast-tracked and those where uncertainties suggest greater doses of regulatory precaution.

An assessment of the effects of services liberalisation is foreseen under GATS. The donor community could lend credibility to such an assessment by setting up a group of internationally-recognised experts to lead and direct such work. An initiative of this type could help ensure that WTO commitments reflect sound economic policy rather than the dictates of domestic or foreign pressure groups.19

Much capacity-building efforts in services has so far focused on helping negotiators and policy officials master the legal provisions of the GATS. A more pressing need, and one that is arguably more conducive to harnessing the pro-development potential of the GATS, is that of acquiring the analytical tools to determine a country’s readiness to liberalise; develop government-wide negotiating strategies; and help domestic service providers take full advantage of the market access opportunities arising from regional and multilateral liberalisation efforts.

Technical assistance directed to the above needs deserves greater attention on the part of multilateral agencies and the donor community. For the most part, this entails the dissemination of knowledge on best practice initiatives in countries – developed and developing – that have been successful reformers. Invariably, these countries will tend be those that have developed efficient communication channels with the multiplicity of stakeholders that services negotiations entail.

Another area where technical assistance can make a difference concerns the strengthening of regulatory agencies in developing countries. Regulatory institutions can be costly and require staff with sophisticated legal and economic skills. Yet sound domestic regulation is critical to realising the full benefits of open service markets and responding to its potential downsides.

Helping developing countries improve domestic standards and qualifications for services, notably by strengthening their participation in regional or global standard-setting initiatives, is another area where more focused capacity-building efforts can yield strong development dividends. Low standards and related inadequacies in domestic regulation can frustrate access of developing country services and service providers to foreign markets. It can also legitimise existing trade and investment barriers directed against such exports.

A final candidate for enhanced assistance relates to help in designing reforms that properly factor the impacts of liberalisation on the

19 Mattoo (2003).
poor and improve their access to essential services. Such services run the gamut from sanitation to transport, health, telecommunications, small-scale finance, education and health.

While most of these complimentary policy challenges lie outside the realm of GATS negotiations, getting them right can help build needed support for reform efforts. However, implementing such policies in an economically sound manner can present numerous challenges to weak bureaucracies, and many developing countries, particularly least-developed countries, will require outside support in meeting them.
References


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