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TRADE IN SERVICES AND DEVELOPMENT IMPLICATIONS*

Note by the UNCTAD secretariat

Executive summary

The services economy has been gaining in importance and dynamism, including in its contribution to economic growth and human development. As developing countries play an increasing role in services trade, this creates the need to ensure that the development gains from liberalization will materialize. While there is a potential for development-enhancing services trade, there is need for judicious domestic policy reform and careful international commitments for this potential to materialize. Recent trends from which developing countries could benefit include increasing FDI in services and the rise of dynamic new sectors such as outsourcing and infrastructure services. Mode 4 continues its prime role in light of developing countries' comparative advantage in labour-intensive services. Challenges remain in implementing reforms to truly promote economic growth and human development gains through trade in services. A number of preconditions have to be met to overcome developing countries' supply constraints and to guarantee universal access to basic services. The assessment of services trade and policy options available can help in this respect. Regional integration increasingly covers services trade, presenting both challenges and opportunities for developing countries. GATS could reinforce increasing participation of developing countries in services trade by delivering commercially meaningful commitments and underpinning them through the elaboration of disciplines on GATS rules, including domestic regulation but in a manner that preserves the right to regulate in the public interest. This would contribute to the achievement of the Millennium Development Goals and to the objective of the Millennium Declaration and the São Paulo Consensus of an open, equitable, rule-based, predictable and non-discriminatory multilateral trading system.

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I. TRENDS IN THE GLOBAL SERVICES ECONOMY

Economic trends

1. Over the last two decades, the services economy in all countries has gained in importance and contributed a growing share to gross domestic product (GDP) and employment. Services are a fundamental economic activity, with a key role in infrastructure building, competitiveness and trade facilitation. They also have important implications for poverty reduction and gender equality. Most service firms are traditional employers of women, and this includes government, which retains its essential function in providing services in developing countries. There are, however, differences in the development of the services economy and infrastructural services across countries and regions. In 2002, services accounted, on average, for 49 per cent of GDP in developing countries, while for developed countries this share was 72 per cent. For the period 2000-2003, trade in services[1] represented 16 per cent of the total trade of developing countries, expanding at the same pace as their trade in goods. While the share of workers employed in service activities is about 30 per cent in developing countries as a group, it has reached 53 per cent in some developing economies and hovers around 70 per cent in most developed countries. The informal services sector plays an important role in developing countries.

2. The share of developing countries in world total exports of services was 22 per cent in 2003, while their share in imports was 24 per cent. Contrary to previous years, world total services trade increased less rapidly (13 per cent) than merchandise trade (16 per cent) in 2003. This nonetheless represents by far the strongest increase since 1995.[2] Developing countries generally remained net importers of commercial services in 2003,[3] and their services trade has been below global averages. Overall, there has been a surge in the growth of services exports. Average annual growth rates for service exports of developed countries increased from 4 per cent during the period 1995-2000 to over 7 per cent during the period 2000-2003. For developing countries, this latter figure was 4 per cent, compared to 3 per cent for the previous period, or 13 per cent for the 1990 – 1995 period.

3. Trends in services imports broadly mirror those in exports, but there are some differences. Compared to past years, in 2000-2003 service imports accelerated in developed countries, matching the trend in services exports. This was due to strong services import growth in Europe, Australia and New Zealand. For the period 1995-2002, service imports in developing countries remained mostly flat, with 3 per cent annual growth, followed by 8 per cent growth from 2002 to 2003. Excluding China, there was a general slowdown in growth of service imports by developing countries, mirroring a lower growth rate in their exports. As a result their share in global imports of services has dropped from 24 per cent in 2000 to 21 per cent in 2003.

4. Trends in the services trade balance varied. Europe almost doubled its surplus in 2000-2003. North America's surplus more than tripled in the 1990s, peaking at nearly US$ 70 billion in 2000, but decreased fast thereafter to less than US$ 40 billion by 2003. Sub-Saharan Africa's deficit continues at roughly US$ 10 billion annually. In Latin America and the

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[1] According to the GATS, services can be traded in four modes: from the territory of one Member into the territory of any other Member (Mode 1); in the territory of one Member to the service consumer of any other Member (Mode 2); by a service supplier of one Member, through commercial presence in the territory of any other Member (Mode 3); by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member (Mode 4).
[2] UNCTAD, *Handbook of Statistics, 2004*.
[3] *Participation of the developing economies in the global trading system*, WT/COMTD/W/136.

Caribbean and Asia, services trade deficits have shown positive signs of reducing over the past decade, whereas in the Middle East and the transition economies deficits have grown. Least developed countries (LDCs) have continued to build up export capacities in both goods and services, which grew at an average annual rate of 7 per cent and 3 per cent respectively from 2000 to 2003. Nevertheless, they still face substantial difficulties in participating in services trade, and their exports are particularly vulnerable to external shocks. In 2003, LDCs accounted for 0.4 per cent of world trade in services, mostly transport and travel services. LDCs' comparative advantage is in exports of labour-intensive services.

5. There is a paucity of disaggregated and internationally comparable statistics on the direction of international services trade and on South-South trade in particular. Nonetheless, figures confirm the increasing significance of South-South services trade. A new trend shows a growing concentration of trade in some developing countries. In 2003, 12 leading exporters of services among developing countries – including China, India, the Republic of Korea, Malaysia, Thailand, Mexico, Egypt and Brazil – accounted for 71 per cent of service exports of all developing countries, compared to 66 per cent in 1998. Data on mergers and acquisitions (M&As) point to South-South trade through commercial presence.[4]

6. While these figures may be helpful in indicating how countries can harness services trade for development, developing countries remain particularly vulnerable to external shocks over which they have no control, given their over-dependence on a limited number of service activities. The impacts of the heightened security measures due to terrorist threats and the recent natural disaster in South-East Asia have implications for infrastructural services, tourism and Modes 3 and 4.

The shift of FDI to services[5]

7. FDI in services has expanded, with the world's inward stock of FDI in services quadrupling (1990 to 2002) and the share of services in the world's FDI stock rising from one quarter in the 1970s to about 60 per cent in 2002. Developed countries remain the main source of outward FDI, while developing countries' share has also grown (from one per cent in 1990 to 10 per cent of global outward FDI services stock in 2002). On the inward side, developing countries' FDI has been increasing (to 25 per cent of inward FDI stock in services), though developed countries remain the main recipients. In 2002, services accounted for about 55 per cent of the total stock of inward FDI in developing countries and some 85 per cent of outward FDI stock for developing countries. FDI flows in services between developing countries are growing faster than flows between developed and developing countries. By 2010, more than one-third of the FDI in developing countries will originate in other developing countries, with India, China, Brazil and South Africa being among the main players.

8. This shift of FDI towards services has allowed the services sector to benefit from the related transfer of capital, technology and managerial know-how and facilitated the development of skills and reorganization of firms in recipient countries. There can, however, be costs. These include the crowding out of domestic service suppliers, potential effects on the balance of payments, and negative cultural and environmental externalities. Given that services now account for the largest share of FDI flows into many countries and that this trend is likely to continue, it is crucial to put in place policies that maximize benefits and minimize costs.

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[4] During the period 1987-2002, the largest cross-border service M&As in Bolivia involved, *inter alia*, Argentina (oil and gas, audiovisual), Brazil (oil and gas, electricity and transport) and Chile (banking). In 2001, the largest foreign services affiliates in Uganda included two South African companies (telecom, banking).

[5] UNCTAD, *World Investment Report 2004. The Shift Towards Services,* New York and Geneva, 2004.

9. National FDI policies for services will have to be reflective of the country's domestic services industry, its overall economic conditions and its development objectives. This entails a process of trial and error, to identify those policy options that best suit the country's specific level of development. National policy-making is increasingly taking place within the framework of international agreements for services FDI. This, in turn, creates a complex process of interaction between international and national service policies. Countries continue to sign bilateral and regional agreements covering services FDI and have entered into Mode 3 commitments under the GATS. They do so partly in the hope of attracting much needed services FDI. However, it has not been possible to empirically demonstrate a causal relationship between such agreements/commitments and an increase in services FDI.

Outsourcing

10. The outsourcing of services, one of the most dynamic sectors of the world economy, is giving rise to new trade opportunities for developing countries, with global outsourcing expenditures expected to grow to US$ 827 billion in 2008. Such opportunities can arise either from outsourcing, i.e. outsourcing a service to a third party service provider abroad, or from captive offshoring, i.e. producing the service internally through the establishment of a foreign affiliate abroad. The volume of outsourcing should increase by 30 to 40 per cent each year over the next five years, reflecting the fact that, after large transnational companies (TNCs), small and medium-sized enterprises (SMEs) are likely to begin outsourcing.

11. Outsourcing is used, among others, by enterprises seeking to take advantage of low-wage countries. Focussing on core activities in fewer locations is another source of saving costs. Outsourcing some operations also allows significant productivity gains ranging from 15 to 25 per cent, access to additional skills, and improvements in the quality of the services provided. Some studies have attempted to assess the implications of outsourcing on a sector- and country-specific basis. In the case of professional services, an industry study conducted for the United States shows that, of the approximately $1.45-1.47 of value derived from every dollar spent offshore, US firms receive $1.12-1.14, while supplying firms receive 33 cents of the value.[6]

12. The fear that continuing growth of services outsourcing may lead to employment losses in developed countries has given rise to protectionist tendencies. However, in addition to the increased competitiveness of their firms, importing countries could enjoy additional benefits, for example moving up the value chain to higher-value activities or increasing their exports. The US economy is expected to generate 22 million new jobs by 2010, of which 10 million will not be filled by domestic workers.

13. Outsourced services range from simple, low-value-added activities (e.g. data entry) to more sophisticated, high-value-added activities (e.g. architectural design, financial analysis, software programming, human resource services and R&D). Overall, the trade of outsourced services is taking place between developed and developing countries, as well as within each group, with developing countries strongly involved in the rise of outsourcing. One prime example is that of business process outsourcing (BPO) services, where developing countries' participation is expected to grow. Given that BPO services range from lower-end or basic business process outsourcing to more integrated, expert-based services that are web-enabled, there are a number of possibilities for moving up the value-chain.

14. The gains for receiving countries could be enormous, given that the export earnings derived from outsourcing are often accompanied by a number of related advantages, including

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[6] Chamber of Commerce of the United States, “Jobs, trade, sourcing and the future of the American workforce”, April 2004.

FDI, human capital formation and knowledge spillover. However, companies also face difficulties associated with outsourcing of services, such as communication problems due to cultural and language differences, inappropriate infrastructure levels, inconsistent quality of products, or different time zone management issues. In order to capture the new trading opportunities from outsourcing, developing countries can implement a number of domestic policies, relating *inter alia* to: (i) infrastructure development; (ii) improvement of the legal and regulatory framework; (iii) human resource development; (iv) research and development, (v) quality standards, and (vi) privacy. International policies can also help. In the case of the GATS, the careful negotiation of specific commitments for Mode 1 (specifically in telecommunication, business and computer services) would be a step in this direction. Commitments could range from substantial liberalization to commitments binding existing regimes. In addition, a moratorium could be placed on any restrictive policies relating to outsourcing (e.g. government procurement). In all these areas, there is need to explore options for the best way to arrive at meaningful liberalization.

Movement of natural persons to supply services

15. World welfare gains from liberalization of the movement of workers could amount to $US 156 billion per year if developed countries increase their quota for the entry of workers from developing countries by 3 per cent.[7] Another study computed gains of some $200 billion annually if a temporary work visa scheme is designed and adopted multilaterally.[8] Gains could be larger than the total gains expected from all the other negotiating items in current WTO negotiations. Recent figures show an increasing trend towards relaxing entry conditions for foreign workers in OECD countries, mainly to bridge the skill shortages found in most of them.[9] The United Kingdom, Japan and the United States serve as examples.[10] While a significant portion of movements is from developing to developed countries, there is also a considerable movement of workers between developing countries (Arab oil-producing and some Asian countries) and some movement from developed to developing countries, including movement not linked with commercial presence.

16. Remittances from workers are a major, stable source of capital inflows for many developing countries, but they are nevertheless subject to shocks. In 2003, remittances to developing countries amounted to $US 93 billion, nearly double the amount of official development assistance (ODA). The total amount of resources remitted may, however, be two or three times higher, since a large number of transactions are realized through informal channels. For many low-income countries, remittances as a share of GDP and imports are larger than in the case of middle-income countries. For example, in commodity-dependent and resource-strapped Lesotho, remittance receipts represented about 27 per cent of GDP in

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[7] Alan Winters et al., *Negotiating the Liberalization of the Temporary Movement of Natural Persons*, Commonwealth Secretariat, March 2002. See also, UNU/WIDER, *Efficiency Gains from the Elimination of Global Restrictions on Labour Mobility*, 2003.

[8] See Dani Rodrik, *Centre for Economic Policy Research*, 2002; skilled and unskilled workers from developing countries would be allowed employment (quota set at 3 per cent of developed countries' labour force) in developed countries for 3-5 years and be replaced on their return.

[9] UN Department of Economic and Social Affairs (DESA), *World Economic and Social Survey 2004: International Migration*, November 2004.

[10] The United Kingdom increased its work permit application approvals from 85,600 in 2000 to 115,700 in 2001 (versus 58,200 in 1999), mainly in sectors such as education, health care and computer technology. In Japan, the number of foreigners (mostly entertainers) obtaining residence for employment reasons in 2001 was 142,000, an increase of 9.3 per cent over 2000 and 39 per cent over 1998. In the United States, the quota of highly qualified temporary visas (H1B), which had been raised to 195,000, was not used up entirely in 2001, but more than 163,000 permits were distributed, representing an increase of more than 40 per cent from the previous year. Temporary unskilled labour in the non-agricultural sector (H2B visas) increased by 50 per cent in 2000 and reached 72,400 in 2001, double the number in 1999.

2001. Remittances improve countries' ability to finance development objectives, the foremost of which are poverty reduction and improvement of human capital. Their positive role is particularly pronounced for the LDCs. Middle- and lower-skill workers tend to remit a higher proportion of their income. Policies are needed to support technology transfer that facilitates remittances or investments by making such transfers less costly. Transaction costs can reach 10 to 15 per cent of the total value, with the global business totalling US$ 6 to 7 billion annually.

17. Sending countries face the risk of losing some scarce resources – not only in terms of skilled workers but also in terms of public investment in the training and education of these workers. Empirical studies suggest that there is an "optimal level of migration" that stimulates pursuit of higher education at home and spurs economic growth. Moreover, economic costs for the individual and the home economy are likely to be minimal owing to scarce employment opportunities at home and the limited capacity for collecting income taxes. In addition, other factors, including investment, increases in financial capital and new trade opportunities, including those created by expatriates may more than offset this cost to the home economy. Recent trends suggest that "brain circulation" is a more appropriate term to describe the exchange of skills in international trade in services.[11] In the host economy, where Mode 4 trade is spurred *inter alia* by a lack of nationals interested in filling certain jobs or qualified to do so, wages are not likely to decline, as foreign service providers will probably not be perfect substitutes for national ones.

18. Multilateral liberalization of temporary movement through commercially meaningful GATS commitments could be one of the best ways to attenuate permanent or illegal migration and maximize gains for sending and receiving countries. It would also contribute to balance, predictability and equity in the multilateral trading system.

II. ISSUES IN INFRASTRUCTURE SERVICES

19. The existence and quality of infrastructural services are key determinants of trade: services such as transport and logistics, but also distribution, telecommunications, financial and business services, are crucial to the competitiveness of economies. Transport, logistics and distribution services are crucial for moving goods and services from one country to another, while business, telecommunications and financial services reduce transaction costs and support trade. In many developing countries, transport and distribution services contribute an important percentage of GDP (as high as 30 per cent) and account for a large share of employment. Moreover, these sectors are particularly relevant for developing countries, as they do not require highly skilled workers. The characteristic of services as inputs to other sectors of the economy is clearly demonstrated in these sectors. High transportation and distribution costs can render sections of an economy uncompetitive. The challenge is to determine how best to ensure the provision of transport and distribution services to the economy. Options range from subsidizing these sectors to opening them to participation by domestic and foreign firms.

20. The situation is similar in the case of those infrastructural services that are in the public interest. Ensuring access to essential services is acknowledged as the principal means by which to achieve the Millennium Development Goals. Indeed, some of these services are essential for human life itself (e.g. health or the provision of water), and Governments need to ensure their adequate provision, including to the poor and marginalized. This function has

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[11] For example, in Australia, the non-return rate of temporary entrants, including persons from developing countries, fell to 2.2 per cent in 2001. A survey of 1,500 Chinese and Indians working in Silicon Valley in the United States found that 50 per cent of them went back home at least once a year and 5 per cent returned at least five times. In addition, 74 per cent of Indian and 53 per cent of Chinese respondents intended to start a business back home.

traditionally fallen within the public domain, with the last decades seeing a trend towards opening up essential service sectors to foreign or domestic competition. Privatization and liberalization have produced mixed results, either increasing prices for the poor or entailing other adjustment costs (e.g. loss of employment). It has been recognized that liberalization and privatization have to be accompanied by appropriate regulatory measures and have to be carefully managed, and mixed experiences are considered the result of regulatory failures. If the transition process had been adequately managed and regulated, it would – in theory – have been possible to reap the benefits of liberalization and privatization in full. However, even for countries with strong and sophisticated institutional and regulatory frameworks, there is no guarantee of success in privatization processes. The mixed experiences of the United Kingdom (railway) and California (energy) are cases in point.

21. Research revolves around proposals to better manage and regulate such transition processes. Most proposals suggest a delicate combination of competition and regulation: there is a need not only to increase competition, but also to make it work (e.g. through regulation to remedy inadequate consumer information) and, finally, to complement it with regulations with a social purpose. Non-discriminatory universal service obligations or various forms of vouchers are examples. Indeed, some countries have successfully experimented with regulations to ensure universal services, with subsidy schemes or universal service obligations being possible options. Chile, in the case of telecommunications, has adopted a scheme involving several elements: a universal service levy (one per cent) to generate finances, and a competitive bidding process to allocate funds. The latter should encourage operators to adopt the best technology and cost-saving practices. Ultimately, this system has allowed Chile to significantly increase the number of household telephones with a minimum level of subsidies.[12]

22. Given the particular constraints faced by developing countries, not all options may be practical to implement. India's experience in telecom highlights the difficulties that can arise when implementing universal service obligations for private sector providers. While targets were set and stipulated in the various license agreements, it has not been possible to meet them. Inadequate enforcement mechanisms and overly ambitious targets are among the reasons for failure. While analysis of such experiences is increasing, to date there is still a lack of understanding about the functioning of the various policies, and there is even less understanding about the ways in which these options may play out in different economic and social scenarios. In order for privatization and liberalization to deliver their expected benefits, there is a need for more analytical work on types of flanking policies (which are in themselves not cost-free), their pros and cons, the range of situations in which they produce desirable results, and their potential for failure (their costs and who pays the costs). Finally, relying on flanking policies to make privatization and liberalization work may – in certain cases – foreclose the more fundamental question about whether or not private-sector and foreign operators' involvement is the most suitable option in the first place. Even in developed countries there are sensitivities, particularly in respect of health, education and water services. All these complex issues need to be taken into consideration prior to deciding on whether or not privatization is the best option.

Box 1: South Africa's challenge in reforming infrastructure services and utilities[13]

To unleash significant economy-wide gains, South Africa has adopted a careful approach to the liberalization of key services, largely due to concerns regarding unemployment, poverty alleviation and universal access to basic services, as well as to the recent establishment of regulatory and competition authorities. Utilities came under scrutiny in the mid-1990s, as many of the sectors lacked investment,

[12] Aaditya Mattoo, *Economics and Law of Trade in Services*, 2004, World Bank.
[13] Ian Steuart and Rashad Cassim, *Opportunities and risks of liberalizing trade in services: Country study on South Africa*, ICTSD, forthcoming.

relied on outdated technology, provided erratic and unreliable services, and left large areas under-serviced. The Government's strategy for services is linked to the country's privatization strategy. Today, most key producer services are owned by the state, with some partially privatized (telecommunications are largely privatized, while transport and energy remain public). Recognizing the challenges of introducing competition, the Government has set up regulatory agencies in the communications and energy sectors. South Africa has begun to develop an institutional infrastructure in response to competition and the privatization of various services and utilities. One of the major challenges is the independence and credibility of these institutions in ensuring fair competition in the sector. Another important challenge is the role of competition policy. Though there are gains to be made from liberalization of key infrastructural sectors that have significant downstream effects and in which, historically, protection has resulted in considerable inefficiency costs to society, the extent to which these services can be liberalized depends largely on the progress made in laying the institutional foundations for reforming regulations.

23. Business services are among the most dynamic service sectors. In the OECD, they have been the fastest growing sectors in terms of employment since 1980. They range from data processing services and professional services to labour recruitment services. Many of these services were initially performed in-house by firms but are now regularly purchased from or outsourced to outside providers. This allows for cost savings and has been made possible by the emergence of suppliers specialized in almost each function relating to the performance of modern business. Business services are knowledge-intensive, allow for technology diffusion and are an important source of productivity growth. Their outsourcing is particularly important for SMEs, as it allows them to focus their limited internal resources on core functions.

24. Recently, total exports of business services have been increasing at an average annual rate of about 8 per cent. Although OECD countries remain the principal players in terms of exports and imports, some developing countries, led by India, have emerged as important exporters. Half of world trade in commercial services consists of business services, which includes professional services such as accounting, legal, health and advertising services. Trade in these services could offer important opportunities for developing countries given their comparative advantage in labour-intensive services. The market for business services requires a sufficient pool of skills and a market size that can sustain a highly diversified business services sector, which makes it more prevalent in developed and middle-income countries than in low-income developing countries.

Box 2: Computer and related services

Computer and related services (CRS) are among the fast-evolving business services. They consist of (i) consultancy services related to the installation of computer hardware, (ii) software implementation services, (iii) data processing services, and (iv) data base services. Providers of CRS increasingly offer packages of related services. WTO Members have submitted proposals that aim mainly at increasing liberalization of these services. The proposals range from clustering commitments (as opposed to taking subsector-specific commitments) and harmonizing all commitments for this sector to developing an 'understanding' on the scope of commitments under CRS. The main difficulties that the proponents of further liberalization in CRS are facing are: (a) the need to distinguish between CRS and the services that they enable (i.e. services relating to content such as banking), as this would allow for more complete commitments for CRS, (b) the need to ensure that the classification used reflects market reality (i.e. taking into account technological advances), (c) the need to address the overlap between certain CRS and value-added telecommunications services, and (d) the need to address the online delivery of CRS, including in light of the distinction between the different modes of supply of GATS. Determining whether the electronic delivery of a service constitutes delivery under Mode 1 or Mode 2 is key and needs to be addressed not only in the services negotiations but also in the context of WTO work to examine all trade-related issues arising from electronic commerce.

25. Developing competitive professional services in developing countries is particularly important given their contribution to furthering development and good corporate governance (e.g. accounting). Developing countries need to establish adequate regulatory frameworks for professions and support the role of professional bodies through which Governments could shape and influence a profession, its evolution and its future competitiveness. Developing countries have a clear export interest in professional services through the movement of people, and more recently have taken advantage of increasing outsourcing opportunities. In facilitating the movement of professionals, issues need to be addressed in connection with economic needs tests (ENTs), burdensome administrative procedures relating to entry (visas and work permits) and the lack of transparency of regulations (steps could be taken to encourage their publication or make them readily available in consolidated form, including electronically). As recognition is crucial to facilitating such movement, appropriate means should be found to facilitate developing countries' accession to mutual recognition agreements (MRAs). Countries should also progress towards the establishment and eventual adoption of common international standards and criteria for recognition, as well as international standards for the practice of professions, which fully take into account the realities in and interests of developing countries. As a means of trade facilitation, limited licensing systems for foreign professional service suppliers could be promoted.

26. The challenge confronting many developing countries is identifying professional services in which they could benefit from further liberalization commitments among the WTO members and defining the kind of specific commitments, both horizontal and sector-specific, and additional commitments under Article XVIII needed to achieve the objectives of Article IV of the GATS. Commercially meaningful multilateral commitments in the areas of export interest to them, particularly Mode 4 and Mode 1, would serve to increase their participation in services trade. Current negotiations for disciplines on domestic regulation, particularly in respect of qualification requirements and procedures, offer an opportunity to render market access commitments effective for developing countries.

III. POLICY REFORMS IN THE SERVICES SECTOR

27. Developing countries' main challenge is how to strengthen domestic supply capacity and reconcile trade, development, social and equity considerations. Liberalization of trade in services has become a concern for many stakeholders, particularly when reform reaches into areas previously considered the public sector domain. An assessment of policy options and the implications of commitments under the GATS and other international agreements can contribute to gaining a better understanding of how to achieve developmental objectives, which is crucial if reforms are to support the MDGs. The choice of policies ranges from preserving the role of the Government in public goods to full privatization and liberalization of a sector. All these may be viable depending on the prevailing economic and social conditions in a country and in the international markets. At the same time, commitments under bilateral, regional, and multilateral trade negotiations on services limit certain policy options. In making such commitments, developing countries need clarity and an assurance that these are the best development options. The ultimate effect of public policies largely depends on the underlying characteristics of the markets. A better understanding of the structure and behaviour of service markets in developing countries (overall and for individual sectors) and in the international economy is necessary to develop policy options and to assess the possible impact of alternative policies on growth and sustainable development, as well as on different stakeholders. A fundamental development challenge is to address the multiple characteristics of service sectors ranging from the provision of public goods (water/sanitation, health or education) to those where commercial delivery is more widespread (retail, transport, telecommunications) but where complex issues remain, e.g. competition, universal access, networks, their maintenance and expansion.

Box 3: Lessons drawn from national assessments of domestic reforms[14]

China's assessment of reforms in its banking sector is that increasing participation of foreign banks improved the financial system and provided more advanced services to consumers. However, domestic banks are losing market shares with the shift of high-end consumers and capable executives to foreign banks. In the distribution sector, Chinese SMEs found it difficult to develop their business in the face of competition from big foreign competitors (e.g. China's biggest retailer had a sales volume of less than 1 per cent of that of the biggest retailer from the United States). After China's accession to the WTO, 28 new foreign-invested retail chain stores have been established. Though customers may enjoy better services and cheaper merchandise, many small local retailing stores collapsed. The challenge is now how to deal with such situations, since these firms are crucial to employment and economic dynamics. China's conclusion is that liberalizing gradually is key.

Thailand has gradually liberalized its retail trade since the late 1980s. Starting from 1997, and as a reaction to the financial crisis, FDI in retail services increased remarkably. This brought benefits and costs. Some retailers offered cheaper products and more varieties, improved their distribution networks and inventory control, and generated employment. But the closing down of many small traditional shops (several thousands a year) and the disappearance of traditional middlemen led to a negative reaction in a large segment of the population. In response, the Government undertook regulatory action to prevent further negative ramifications, especially for small, traditional retailers.

28. The experience of developing countries reveals that, for positive outcomes to result, liberalization must proceed at a speed that is not too rapid for local actors, the regulatory framework and social safety net must be adequate, and there must be a competitive business environment and suitable accompanying policies to ensure that economies enhance their capacity to integrate beneficially into the world economy. The importance of sequencing reforms is well established in theory, but the specific content of this sequencing is less clear, and having a number of benchmarks on how to proceed would facilitate decision-making. It should be recognized that there is no "one size fits all" policy framework, either across services sectors or across countries. The challenge is to elucidate what policy framework should be used for what sectors and under what national and international conditions services' contribution to economic growth and sustainable development will be enhanced.

IV. ECONOMIC INTEGRATION AND SERVICES

29. The last years have seen a growth of RTAs covering services trade. These agreements differ in their approach towards market opening (e.g. the GATS-type positive-list approach[15] or the NAFTA-inspired negative-list approach[16]), in their content (e.g. substantial liberalization or standstill status) and in their signatories (developed and/or developing countries). While some RTAs in part mirror the GATS (e.g. domestic regulation or recognition issues), others go beyond it (e.g. *a priori* transparency, GATS plus[17]) or fall short of it (e.g. excluding the local level from the coverage).[18] Multiple negotiating processes have resulted in a complex and overlapping network of rules with different obligations. This creates challenges for the signatory countries, in particular the developing ones. Their

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[14] Communications from the respective countries to the WTO.
[15] E.g. MERCOSUR, ASEAN or the EU-Mexico FTA.
[16] E.g. ANZERTA or the Andean Community.
[17] Negative list agreements may serve as an example.
[18] Some agreements allow countries to exclude whole sectors from their coverage (while the GATS allows no *a priori* exclusion), while others tend to contain sectoral exclusions that are wider than those in the GATS. Also, RTAs have generally made little progress in developing disciplines on non-discriminatory domestic regulation potentially affecting trade in services, and also on addressing safeguards and subsidies.

difficulties range from managing multiple negotiating processes to complexity of rules, as well as assessing particular negotiating scenarios. North-South RTAs, for example, might frequently entail liberalization that is deeper and faster than the one achieved at the multilateral or regional (South-South) level. This may put particular pressure on developing countries' domestic regulatory frameworks.

30. Developing countries may also use RTAs proactively with a view to furthering their developmental objectives and allowing for lessons learnt for the multilateral trading system. In the Andean Community, certain regulations concerning transport and financial and telecommunications services are being harmonized. The movement of natural persons (MNP) might serve as an example for North-North (ANZERTA), South-South (CARICOM, the Andean Community) and North-South (NAFTA) RTAs.[19]

31. North-South RTAs can be helpful if they are pursued with clear developmental objectives (in the case of economic partnership agreements, the goal is to contribute to the sustainable development of ACP countries) and result in the negotiation of operational, development-oriented obligations (e.g. to increase the production and supply capacity of Eastern and Southern African countries). South-South RTAs can enhance cooperation (e.g. cooperation between regulators or for infrastructural, competition- or trade facilitation-related purposes).

Box 4: Regional integration in Eastern and Southern Africa (ESA) and EC economic partnership agreements

Sixteen members[20] of the 19-country Common Market for Eastern and Southern Africa (COMESA) have agreed to negotiate an economic partnership agreement (EPA) with the European Communities. They expect that their regional initiative will allow them to benefit from shared resources and opportunities and facilitate the creation of regional industries that are capable of penetrating new markets and competing globally. The ESA-EPA negotiations provide an opportunity to undertake an overall and comprehensive assessment of the state of their services economies (e.g. the extent of liberalization, the state of their regulatory environment and the performance of selected sectors). National assessments benefiting from UNCTAD support will start by focusing on a selection of sectors and Mode 4. The assessments aim to determine the benefits of services liberalization in these countries and whether it is in their interest to negotiate further with the EC. Notwithstanding the fact that the ultimate decision to negotiate services in the ESA–EC EPA remains open, any agreement will most likely mirror the GATS, granting flexibility to developing countries (e.g. in opening up fewer services sectors and retaining the freedom to regulate trade in services in line with their national policy objectives). Negotiations need to be underpinned by the principles of special and differential treatment. Specific areas where ESA countries might benefit from an EPA include freer mobility of people and the development of infrastructural services and technical expertise in the areas of telecom, financial, and transport services.

32. RTAs may also entail challenges, particularly for developing countries. Imbalances in negotiating strength and capacities may create pressures and result in far-reaching obligations that may not reflect a developing country's development priorities. With respect to rule

[19] In the case of ANZERTA, Australia and New Zealand have practically integrated their markets for natural persons providing services. CARICOM aims at achieving full labour market integration and is progressively implementing the free movement of people. The Andean Community services regime (Decision 439) contains a commitment to facilitate the free transit and temporary presence of certain individuals, with the Andean Labour Migration Instrument creating a step in this direction. Finally, in the case of NAFTA, Chapter 16 facilitates the cross-border movement of four categories of businesspersons, albeit without precluding the requirement for temporary workers to meet certain licensing or certification requirements and without altering central aspects of a member country's general immigration provisions.

[20] These are Burundi, Comoros, Democratic Republic of the Congo, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Uganda, Zambia and Zimbabwe.

making, several RTAs include provisions for prior comment on proposed changes to services regulations on either a "best endeavour" or an obligatory basis, an aspect that goes beyond the GATS.[21] RTA negotiations following a negative list approach, which automatically includes new services, may result in developing countries binding their market opening at a stage that is more liberal than their multilateral GATS commitments. This may happen without them having a comprehensive understanding of the potential implications thereof. Economic implications of deeper commitments may be even more far-reaching if they are negotiated between a developed country and a South-South regional grouping, with the former only slowly realizing its own integration process. Such circumstances could impede South-South trade, which may be overtaken by North-South imports.

33. Thus, whether, how and with whom services liberalization should be pursued in a regional context remain crucial decisions that need to be taken carefully and on the basis of a regional group's specific economic, social and developmental circumstances.

V. THE WTO SERVICES NEGOTIATIONS

Overview of the GATS negotiations

34. WTO Members have high stakes in the GATS negotiations. Estimates suggest that, for developing countries alone, liberalization could provide up to US$ 6 trillion in additional income. However, such figures have to be viewed with caution, as supply constraints and other limiting factors may ultimately impede benefits for developing countries. Article XIX provides some specific guiding principles for the negotiations (e.g. progressive, step-by-step liberalization; specific flexibility for individual developing countries; and giving priority to sectors and modes of interest to developing countries). The GATS, the Negotiating Guidelines and the Modalities for Special Treatment for LDCs constitute the yardsticks against which the success of the negotiations will need to be measured. An adequate balance within the services negotiations, as well as transparent and inclusive processes, is also crucial for achieving the development objectives of this Round.

35. While the Doha Ministerial Declaration provides indicative timelines for the submission of initial requests and offers, many developing countries were not able to submit their requests and/or offers within these timelines. Indeed, identifying sectors and modes of economic interest and the trade barriers to be removed is not an easy task in the absence of adequate data on the services sector. The WTO General Council Decision adopted on 1 August 2004 provided for a new timeline for the tabling of revised offers (May 2005), calling for a high quality of offers, particularly in sectors and modes of export interest to developing and especially least developed countries.[22] To date, the number of initial offers submitted is 50, counting the EC as one. Some Members consider that this is still insufficient[23] and call on their trading partners to make high-quality offers. The question from a developing country's perspective is not simply to seek comprehensive offers but rather offers that pay special attention to sectors and modes of supply of export interest to them.

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[21] Note, however, the relevant best endeavour elements in the accountancy disciplines.
[22] *Doha Work Programme, Decision Adopted by the General Council on 1 August 2004*, WT/L/579.
[23] Communication from Australia, Canada, Chile, EC, Hong Kong (China), Iceland, India, Japan, Mexico, New Zealand, Norway, Republic of Korea, Singapore, Switzerland, the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu, and the United States, *Joint Statement on Market Access in Services*, JOB(04)/176.

Box 5: Mode 4 and tourism offers: Evaluation of progress[24]

Only about a quarter of offers make Mode 4-related improvements (e.g. new categories of natural persons, broadened sectoral application of commitments on contractual service suppliers, extended duration of stay, clarified application of economic needs tests (ENTs), and removal of residency/nationality requirements). Mode 4 offers do not address major issues raised by developing countries, including the inclusion of categories pertaining to semi- and less-skilled service providers. Most of the additional categories pertain to intra-corporate transferees (ICTs) (tied to Mode 3) and highly skilled professionals. The length of stay allowed for ICTs, compared to contractual service suppliers and independent professionals, is more generous. Some offers on contractual service suppliers (both as employees of juridical entities and as independent service suppliers) may be of interest, but these are limited in terms of sectoral coverage and have restrictive criteria on educational and professional qualifications. In an initial assessment of offers, a group of 18 developing countries maintained that current offers do not represent significant improvements over existing Mode 4 commitments. Few offers include new semi- and less-skilled categories, remove horizontal and sectoral limitations or address work permit and visa procedures (GATS visa).

For tourism, a group of nine developing countries have indicated that current offers by developed countries are still far from containing improvements. Many still contain limitations and others make no improvements at all. Other important issues are: the facilitation of MNP and the recognition of qualifications, and the elimination of anti-competitive practices and of requirements for commercial presence, nationality or residency.

36. In the perception of developing countries, a preliminary analysis of initial offers by the major trading partners reveals a number of things. Several offers seem to go back on previous commitments or lack real change in the level of commitment, despite modifications. This is done either by redefining the sector/subsector to which a commitment applies or by going from one partial commitment to another one. Initial offers often use new classifications (even with respect to sectors that are not officially part of the WTO classification list) that have received no multilateral approval and are still under discussion. This leads to uncertainty as to what exactly a country is offering. Also, offers seem to indicate that some countries are not abandoning any MFN exemptions, but rather introducing new ones. This can be cause for concern, as the impact of even the existing exemptions has not yet been assessed. Offers also appear to concentrate on certain industries, mostly bypassing certain sensitive sectors, for example health, audiovisual or labour-intensive services, particularly those supplied through Mode 4 and at lower skill levels, where developing countries have their comparative advantage. Finally, certain offers refer to the notion of reciprocity. While the GATS request-offer process naturally builds upon bargaining and exchange processes, flexibility should be maintained for developing countries.

37. The review and evaluation of progress in negotiations pursuant to paragraph 15 of the Negotiating Guidelines allow for regular reporting of Members to the Council for Trade in Services (CTS) on the progress in the negotiations, including bilateral negotiations. In line with the Negotiating Guidelines, some developing countries have reiterated that the main benchmarks for evaluating progress should be the extent to which the negotiations are achieving the objectives of the GATS, as stipulated in Article IV (Increasing Participation of Developing Countries) and Article XIX (Progressive Liberalization). The review of negotiations is crucial, as it should feed into the Sixth Ministerial Meeting of the WTO (Hong

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[24] Communication from Bolivia, Brazil, Chile, China, Colombia, Cuba, Dominican Republic, Ecuador, Egypt, Guatemala, India, Indonesia, Mexico, Nicaragua, Pakistan, Peru, Philippines and Thailand, *Review of Progress as established in Paragraph 15 of the Guidelines and Procedures for the Negotiations on Trade in Services (S/L/93),* TN/S/W/19, and Communication from Brazil, Colombia, Dominican Republic, El Salvador, India, Indonesia, Nicaragua, the Philippines and Thailand, *Review of Progress in Negotiations, Including Pursuant to Paragraph 15 of the Guidelines for Negotiations,* TN/S/W/23.

Kong, China, in December 2005) by means of a report of the CTS to the Trade Negotiations Committee, including on possible recommendations.

The GATS rules negotiations

Emergency safeguard measures[25]

38. Negotiations on possible emergency safeguard measures (ESM) have been identified as an area of prime developmental importance, albeit characterized by lack of consensus on the key issues of the desirability and feasibility of such measures. The ASEAN Members' draft ESM agreement provided the main impetus for discussions. The main difficult areas were included in an annex to this document, which raised such issues as the possibility of applying safeguard measures to established foreign suppliers (Mode 3), the definition of domestic industry, the impact of a safeguard measure on national treatment and most-favoured-nation treatment, and acquired rights. More recently, and in reaction to the feedback and questions from other Members, this group of countries has submitted some new elements for discussion. Discussions have focused on the description and analysis of specific situations potentially justifying the use of ESM. The proponents of ESM have suggested several scenarios where they feel an ESM would be needed. Members are currently discussing the merits of each case.

39. There are several grounds on which to justify ESM in services. The nature of services trade renders it prone to unforeseen developments, and a safety belt could assist countries in their liberalization efforts. It could also help address adjustment costs. Safeguard measures are an important political tool that can make the difference for Governments in terms of appeasing the potential "losers" of liberalization and reform, while disciplining Governments to restructure within a particular window of time. There nonetheless remain concerns to be addressed. These include: fears of abuse, the fact that Mode 4 is possibly the easiest "target", and the risk of creating an overly burdensome mechanism. Moreover, any ESM should contain S&D for developing countries.[26]

Subsidies

40. Subsidies can have a detrimental effect on international trade, in particular exports of developing countries. Negotiations for disciplines to address trade-distortive effects of subsidies currently focus on examples of services-related state support measures. While some WTO Members have offered information on their subsidies, discussions have to rely mainly on information contained in Trade Policy Reviews. Discussions also focus on definitions and principles, where Members seek to draw on the Agreement on Subsidies and Countervailing Measures and the Agreement on Agriculture, while keeping in mind the specificities of services.

41. Many Governments subsidize services sectors such as air, maritime and public railway transport, telecommunications, utilities (water and electricity) and public-good-type services (education and health).[27] Measures can be grouped according to the intended beneficiaries: (i) support measures whose intended beneficiaries are households or consumers; (ii) those whose intended beneficiaries are service suppliers; and (iii) those intended to benefit

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[25] UNCTAD, *Emergency safeguard measures in the GATS: Beyond feasible and desirable*, forthcoming.

[26] Examples of S&D: preventing the number of suppliers from developing countries from decreasing below a certain level or average level from a recent representative period if a quantitative restriction is imposed on mode 4 suppliers and granting the right to seek an extension of an ESM application period only to developing countries.

[27] *Subsides and trade in services*, S/WPGR/W/9.

society as a whole. From the perspective of Article XV, those subsidies whose intended beneficiaries are service providers are obviously most relevant, and the exchange of information obligation is limited to them. However, the trade impact and the extent to which a measure with other intended beneficiaries also benefits service suppliers cannot be discarded *a priori* and requires further assessment.

42. There is evidence that in many cases countries provide either general or sector-specific export support to their services suppliers. In the case of Australia, between 1997 and 2002, assistance to services exporters amounted to $1.35 billion. This assistance was granted to almost every services sector through direct financial assistance, funding to institutions and tax expenditures available to exporters. The amount involved represented almost 30 per cent of all support to services reported during the same period.[28] Developing and developed countries differ in their use of export subsidies, the former tending to rely on a more selective approach and the latter tending to use, *inter alia*, export promotion regimes, export financing and export guarantees.[29] To the extent that export support programmes provide below-market rates or allow prices that are inadequate to cover operating costs, they could entail an export subsidy. Other horizontal measures could also qualify as export subsidies.

43. Negotiations on subsidies disciplines must pay attention to the special concerns of developing countries, e.g. subsidies aimed at building competitiveness in priority service sectors and meeting social and development objectives and the priority removal of trade-distorting subsidies of developed countries. This would contribute to a more equitable and non-discriminatory multilateral trading system. Notification of developed countries' subsidy programmes, including those implemented under regional integration schemes, must be encouraged.

Government procurement

44. GATS MFN, market access and national treatment obligations do not apply to government procurement (GP) by governmental agencies for governmental purposes and not with a view to commercial resale or with a view to use in the supply of services for commercial sale. Negotiations are being conducted under GATS Article XIII, but a major stumbling block for progress in this area is the lack of clarity on the mandate and particularly on whether market access issues are covered or not. A recent EC communication proposes a framework for services GP – basically providing for commitments on GP to be taken within the framework of schedules of specific commitments, listed in a fifth column on limitations on GP.[30]

45. Developing countries are hesitant to open up their markets for GP to international tendering because they fear that foreign suppliers will crowd out local firms and the latter will at the same time be unable to gain access to foreign GP markets because of lack of competitiveness and the complexity of the tendering process. Concerns have also been raised on the implications of transparency disciplines on market access and developing countries' use of GP as a tool to pursue social and development objectives. However, in light of the potential beneficial effects of competition (allowing Governments wider choices in terms of quality and price of services, resulting in savings that could be channeled to other productive activities)

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[28] S/WPGR/W/25/Add.4, page 7.
[29] E. Brau *et al., Officially Supported Export Credits: Developments and Prospects*, IMF, 1995; IMF, *World Economic and Financial Surveys*, 1995. In the case of the United States, the Department of Commerce lists 161 export programmes administered by different agencies. The situation is similar in the EC and other OECD countries, which employ multiple programmes. OECD, *Export Credit Financing Systems in OECD Member and Non-Member Countries*, 2002 Supplement.
[30] Communication from the European Communities, *Government Procurement Services*, S/WPGR/W/48.

on growth and development, more analysis should be undertaken to identify the costs and benefits of these different options.

Domestic regulation

46. Article VI.4 of the GATS mandates the development of necessary disciplines to ensure that measures relating to qualification requirements and procedures, technical standards and licensing requirements and procedures do not constitute unnecessary barriers to trade in services. When pursuing this mandate, there is a need to establish a balance between preserving the right to regulate and ensuring that legitimate measures are not applied in an arbitrary manner or as a disguised barrier to trade. The right to regulate is of particular importance for developing countries, as many of them do not yet have an optimal regulatory and institutional framework in place. Recent contributions address measures relating to administrative procedures for obtaining visas or entry permits, experiences with disciplines on technical standards and regulations, issues related to transparency and the relationship between future VI.4 disciplines and market access and national treatment. Qualification requirements and recognition issues have also figured prominently.[31]

47. There are discussions about what specific measures could fall under Article VI.4 and their relationship with measures falling under Articles XVI and XVII. The WTO Secretariat compiled an expanded list of examples of measures falling under Article VI.4. Members' contributions focus also on problems of delineation (see above)[32] or on specific areas of regulations (e.g. measures relating to visa applications or entry permits and licensing and other administrative procedures). With respect to visa procedures, there is interest in discussing whether administrative procedures relating to visas could be part of possible Article VI.4 disciplines, or what alternatives exist (transparency being one such option).[33] Given their potential to export via MNP, questions relating to where and how effectively visa issues are dealt with are particularly important for developing countries. Ultimately, however, any rules on these issues will deliver their broader benefits only in conjunction with meaningful market access commitments.

48. Another aspect is possible disciplines on transparency, where some view the concept as going beyond publishing, or making readily available, information on measures pertaining to services trade, to include also prior notification and comment procedures.[34] While the original text of the GATS does not contain any provisions to that effect,[35] other international agreements, at the bilateral or regional level, contain variations of such rules. At the same time, such an expanded concept of transparency – particularly when materializing in legally binding rules – may create administrative burdens and costs for developing countries. Indeed, many developing countries’ legal systems do not provide for such consultations. Likewise, developing countries are concerned about any undue influence that foreign companies and

[31] Communications from Colombia (July 2004), Mexico (September 2004), the United States (September 2004), Hong Kong (March 2004) and Australia (June 2004). Previous communications were from India, for example in September 2003.
[32] The suggestion has been made to incorporate an element of national treatment in regulatory disciplines which indicates that countries should ensure the non-discriminatory application of regulatory measures unless and to the extent that any elements of inconsistency have been scheduled as national treatment restrictions under Article XVII.
[33] In the case of professionals as service providers, some countries have suggested making readily available in a consolidated form (possibly electronically or on websites) details of all measures pertaining to the movement of natural persons, including relating to visa and work permit requirements and procedures.
[34] Allowing for prior comment would require WTO members to notify proposed laws and regulations and to solicit comments from interested parties and take such comments into account.
[35] See, however, the relevant best endeavour elements of the accountancy disciplines.

Governments could exert on their domestic regulatory processes. Careful consideration of such a broadened notion of transparency is needed.

49. Necessity is seen as a concept to strike a balance between the right to regulate and the requirement not to unduly restrict trade. Thus, developing countries need to ensure that any possible future disciplines do not prejudge their flexibility to undertake regulatory and institutional reform and their ability to meet public policy objectives.[36] Disciplines could ultimately opt for an open-ended list (like the Accountancy Disciplines), or use the term “national policy objectives”. The latter would leave the determination of such objectives to individual countries, and it already appears in the GATS preamble.[37]

50. Technical standards, including standards at the international level, are also being discussed (including definitional questions of technical and international standards, and how harmonization with international standards should be linked to the fulfilment of the objectives of VI.4). In addition to addressing the possible ways of granting S&D, any work on international standards would have to bear in mind the particular difficulties of developing countries in participating effectively in international standard-setting bodies and processes.

51. Mutual recognition agreements (MRAs) have mostly been negotiated between developed countries and between countries with close cultural and historical linkages. There is a need to facilitate developing countries' accession to existing MRAs and negotiation of new ones. Also, MRAs are frequently negotiated by professional associations, which often do not operate under delegated, governmental authority. This raises uncertainties about the status of such agreements under the GATS.

52. Two final, structural issues concern the overall way of dealing with issues pertaining to the VI.4 agenda. First, in terms of approaching future disciplines, some Members appear to prefer a horizontal approach, while others would prefer to move on a sector-by-sector basis, or a combination thereof. Second, some countries have included certain domestic regulation aspects in their requests – possibly in an attempt to progress on critical issues in the bilateral rather than the multilateral context. Developing countries have clearly expressed their preference for addressing such issues in the multilateral rather than the bilateral context – in accordance with the GATS.

53. Specific consideration may need to be given to: developing countries’ need for flexibility and ways to implement it (e.g. regarding the concepts of transparency, less trade restrictiveness, or national policy objective); the creation of S&D obligations and ways to ensure their effectiveness (e.g. regarding technical assistance in the context of regulatory reform, and ways to facilitate developing countries’ effective participation in international standardizing bodies); and the overall context of any future disciplines. Ultimately, to maximize developmental gains, future disciplines on domestic regulation should facilitate exports of developing countries, particularly through MNP.

MFN exemption review

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[36] For example, the obligation to choose the least trade-restrictive measure among other available options has been mentioned as potentially problematic for developing countries. In fact, for them, selecting the “least-trade restrictive” measure would need to be done in the light of different development priorities and taking into account different additional administrative burdens.

[37] “National policy objectives” also has the added advantage of having been interpreted quite broadly in relevant Panel and Appellate Body decisions.

54. Opinions differ on the scope of the MFN exemption review.[38] There is a need to strike a balance between ensuring that the MFN principle is not rendered void of any meaning, while allowing countries exceptions without which their engagement in the negotiations would be in question. In the recent MFN review, responses showed that many MFN exemptions were considered necessary because of regional and bilateral investment, labour and other agreements that Members had entered into. It was also stated that the conditions that had created the need for MFN exemptions mostly still existed. Overall, there is a need to better understand the developmental and systemic implications of MFN exemptions.

Classification

55. Since 1996, discussions in the Committee on Specific Commitments (CSC) have aimed to ensure that the classification used reflect commercial realities of today's service industries and their trade. In parallel with discussions in the CSC, WTO Members have engaged in bilateral and plurilateral discussions on technical issues regarding classification (including within informal "Friends' Groups" of countries seeking further liberalization in a specific services sector). Some Members have also included new classifications in their initial requests and offers. This could lead to a situation where Members negotiate their mutual concessions on the basis of different understandings of the various sectors. In all, some 17 services sectors and subsectors are affected by discussions relating to classification, including energy, computer-related, environmental, legal, transport (maritime and air transport), education and distribution services.

Assessment of trade in services in the GATS negotiations

56. The assessment of trade in services, an ongoing exercise to be used at a later stage to adjust the negotiations, continues to be a main concern for developing countries.[42] Lack of assessment and information is one of the main impediments to their more active participation in the service negotiations. It seems timely to multilaterally draw conclusions of submissions and discussions relating to assessment.

57. More broadly, however, lack of assessment also prevents the elaboration of sound domestic policies aimed at spurring the services sector's contribution to the overall development of developing countries. For now, only rough, partial or sector-specific assessment exists. More efforts need to be devoted and more resources allotted to elaborating and testing assessment methodologies that would finally allow developing countries to gain a better understanding of the main characteristics, strengths and shortcomings of service markets. Thus far, the assessment has shown that: (a) an overall balance of rights and obligations has not been attained under the GATS, (b) the increase in developing countries' world service exports has been small, (c) the objectives of Article IV have not been achieved (because of export barriers, supply constraints and lack of commercially meaningful commitments), (d) benefits of privatization and liberalization are not automatic, (e) there is a need for policy flexibility and proper sequencing of liberalization, (f) priority attention is needed to ensure access to essential services, and (g) there is need for assistance for nascent service sectors and SMEs in developing countries.

Dispute settlement cases relating to services

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[38] I.e. should its only objective be to determine whether the conditions for the exemptions still prevail or should it attempt to achieve a decrease in the number of exemptions?

[42] Both because of its role as an input to the GATS negotiations and as a means for them to better understand and develop their domestic economy.

58. There have been several WTO dispute settlement cases on services. Two cases[39] are particularly crucial, as they relate exclusively to the GATS. The Telmex dispute is about whether Mexico's laws and regulations for the supply of public telecom services are consistent with its commitments under the GATS. The main issues are whether provision by Telmex (major supplier) of interconnection to US basic telecom suppliers is based on cost-oriented and reasonable rates, terms and conditions; whether Telmex is engaging in anti-competitive practices; and whether Mexico has failed to ensure that US basic telecom suppliers have access to, and use of, public telecom networks and services. The Panel ruled that in determining whether interconnection costs are reasonable, only the actual costs of interconnection are to be taken into account (excluding infrastructure construction and maintenance costs), that Mexico had not taken appropriate measures to prevent Telmex from engaging in anti-competitive practices, and that Mexico had an obligation to provide access to and use of private circuits. While the Panel emphasized that its findings in no way prevent Mexico from pursuing development objectives, this case nonetheless points to the difficulty in formulating commitments in a manner that truly safeguards development options. The second case relates to cross-border gambling services. Here the United States claimed – unsuccessfully – that it had intended to exclude Internet gambling from its commitments. The ruling covers a number of important issues relating to the supply of services through Mode 1, specific commitments of Members and how they are to be interpreted, and the measures that need to be taken before any unilateral modification of specific commitments, including prior consultations with affected parties. The ruling also provides an interpretation of the general exceptions clause of the GATS (Article XIV), indicating that, in invoking Article XIV, Members have an obligation to consult with the other party or parties to find a least trade-restrictive measure. It also exposes the systemic difficulty for smaller countries to oblige their trading partners (particularly major players) to comply with rulings against them. Both the Telmex and the Gambling case highlight the difficulty of foreseeing the potential implications of scheduled commitments (even for countries with considerable experience in the negotiation of international trade agreements) and the need to carefully schedule the intended commitments. They flag the risk that panels and the Appellate Body may interpret schedules of specific commitments in a manner different from what the scheduling country had intended.

CONCLUSION

59. Developing a thriving services sector is vital for all countries. Infrastructural and other dynamic sectors can contribute to poverty alleviation and human development, thereby furthering the achievement of MDGs. New export opportunities for developing countries, including through outsourcing, need to be supported and facilitated. Preconditions for ensuring development gains include measures aimed at the appropriate sequencing of reform, domestic supply capacity building and increased competitiveness, and universal access by all, especially the poorest, to essential services. Services trade can create employment opportunities and promote poverty alleviation and human development. Adopting a participatory multi-stakeholder approach in the formulation of policies and appropriate regulatory frameworks and involving trade negotiators, regulators, legislators, professional associations and civil society would ensure that their particular concerns, including opening the market to foreign competition, are taken into account. It must be recognized that regulatory reform entails adjustment costs and necessitates regulatory capacity and institution building, technical assistance and capacity building in this regard. Assessment of trade in services and policy reform can help developing countries to improve their national policy framework and to negotiate more effectively at the international level. Given that development is at the heart of the Doha Work Programme, and in order to implement the MDGs, GATS negotiations should seek to ensure better prospects for developing countries in

[39] WT/DS204/R, WT/DS285/R.

terms of a more balanced and equitable distribution of benefits from trade liberalization. Liberalization in Mode 4 and sectors of particular interest to developing countries will be the litmus test. The review and evaluation of the services negotiations – which is to determine the extent to which Article IV is being implemented – will also prove crucial for assuring development gains.

60. The São Paulo Consensus strengthened UNCTAD's role in the area of services in all three pillars of its work. In particular, it provided for identifying dynamic sectors where developing countries can gain, including outsourcing and Mode 4; assistance to developing countries to harness the challenges and proactively use RTAs to further their developmental objectives (e.g. by assessing implications and providing negotiating and technical assistance); assistance in multilateral trade negotiations on services; and support for national and regional assessments of the services economy and policy reforms. Finally, research and analysis by UNCTAD on trade-related development benchmarks in the area of services was stressed.