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TRADE IN SERVICES AND DEVELOPMENT IMPLICATIONS

Note by the UNCTAD secretariat*

Executive summary

The main challenge facing developing countries in the services area is strengthening domestic supply capacity, maximizing its contribution to economic growth and reconciling economic, social and development considerations. Liberalization of trade in services is expected to enhance global welfare through increased efficiency and competition, lower prices and greater choice for consumers. It should contribute to improving access to basic services and achievement of the MDGs. A number of issues and concerns on the potential effects of services sector reform on the achievement of legitimate developmental objectives still remain to be addressed, among them the appropriate pace and sequencing of reform and liberalization. Quantitative assessment has produced only indicative results concerning the impact of liberalization, and available methods of quantifying barriers seem inadequate. Lacking a complete picture of the overall impact of services liberalization on sustainable development, a customized approach to each country's condition seems in order. Assessment of trade in services, with increased emphasis on the policy options available to developing countries related to strengthening of their domestic services capacity and its efficiency and competitiveness, is a critical step for taking informed policy decisions.

* The document was submitted on the above-mentioned date as a result of processing delays.

I. INTRODUCTION

1. Strengthening domestic supply capacity and its efficiency and competitiveness is the main challenge that developing countries face in the area of services, as they seek to maximize their contribution to economic growth and attain social and development policy objectives. A number of issues and concerns need to be addressed concerning the potential impact of reform, technological change and liberalization on domestic stakeholders, and on legitimate national developmental objectives, especially given that reforms tend to reach into areas previously considered to be the exclusive domain of the public sector.

2. Assessment of trade in services undertaken so far at the national and international levels has followed different approaches. Quantitative analysis and econometric modelling has been used to assess the effect of the elimination/reduction of trade barriers in services on market prices; on the availability of services and the quality of these services; and on overall welfare. Another approach is sustainability impact assessments, which aim to help policymakers and trade negotiators achieve outcomes that are consistent with, and promote, sustainable development. It is based on public consultations with technical analysis to evaluate potential social, economic and environmental effects of trade liberalization. Finally, sector-specific case studies can be made of individual countries, aiming to present a range of experiences on how the performance of different countries in those sectors has brought about expected results and attained the policy objectives sought.

3. There seems to be a convergence of views on the fact that the existing ‘knowledge gap’ on services and trade in services in developing countries, as well as the potential effects of trade liberalization, constitutes an obstacle to effective participation in trade negotiations by developing countries and also affects their ability to define and implement pro-development domestic policies. As a result of comprehensive assessment, a list of options and approaches could be established to demonstrate where liberalization must be complemented by policies to attain development objectives, and what form these policies could take.

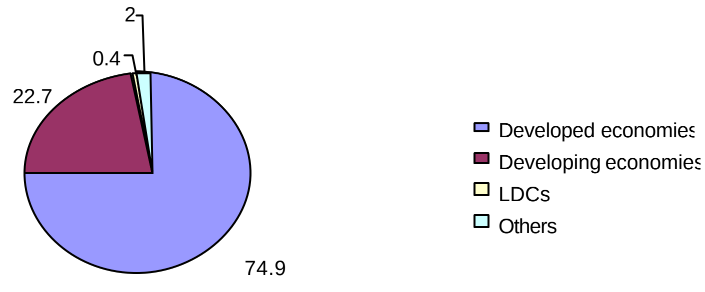
II. SERVICES AND DEVELOPMENT

A. Dynamics of trade in services and developing countries

4. World exports of commercial services amounted to US$ 2,125 billion in 2004. Trade in services is still concentrated in developed countries as can be seen in figure II.1. Developing countries' share of total world services exports is nevertheless gradually increasing. The most dynamic segment of trade in services is that of ‘other commercial services’.[1] They represent 47 per cent of total world exports and have experienced double digit growth rates – up to 16 per cent – in recent years. India and China account for nearly 8 per cent of total exports of these services.

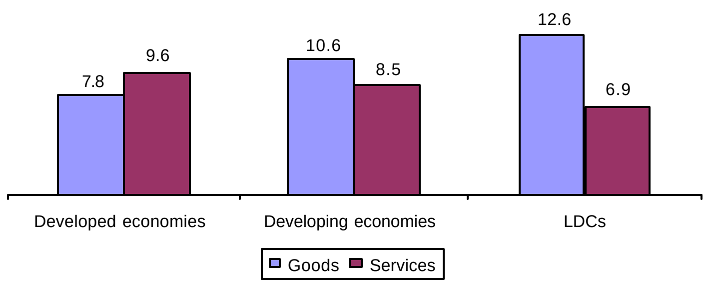
[1] Includes construction, insurance, financial, computer and information services, personal cultural and recreational services, other business services, and royalties and licenses fees.

Figure II.1. Percentage shares of global services exports, 2004



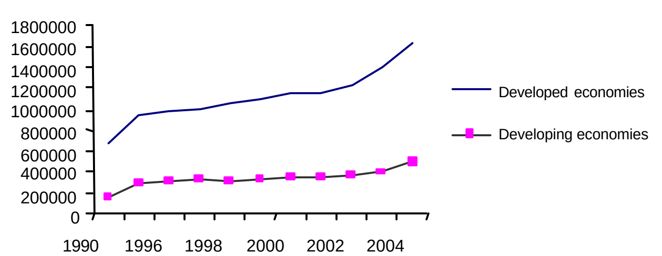
5. Developing countries that have successfully attracted FDI are increasingly participating in trade in dynamic services and have also been able to reap benefits from merchandise trade; there is a high and growing concentration of trade in both goods and services originating in such developing countries. However, as can be seen in figure II.2, growth in merchandise exports exceeds growth in services exports for developing and least developed countries. The 12 leading exporters of services among developing countries account for over 70 per cent of the total services exports of these countries.

Figure II.2. Comparing annual average growth rates of exports, 2000-2004 (Percentage)



6. Developing countries currently account for approximately 25 per cent of total world exports in business services. The assessment of trade in services needs to address the conditions for enhancing developing country competitiveness in dynamic services, particularly in business services and computer and information services, which offer the promise of significant developmental gains. Figure II.3 clearly shows that developing countries have not been able to fully exploit their services export potential.

Figure II.3. Export of services (millions of US$)



7. Another issue that deserves attention is the importance for developing countries of South-South trade in dynamic services. In most cases, regional markets are the main importers of these services from developing countries, in particular business services. Measures are needed at the regional level to enhance developing country export opportunities. Another effect of increasing regional trade is developing countries' strengthened ability to venture into international markets.

Box II.1. Assessment of trade in services in COMESA and SADC

COMESA and SADC have adopted a common approach to assessment within a coordinated framework to underpin their regional negotiations. The first part of the assessment is meant to provide countries with an overview of the regulatory framework in which trade in services occurs, while the second part provides information relating to the actual status of supply and trade in services through such concrete indicators as the share of individual countries in regional trade in services, their competitive position, and the average level of liberalization achieved in different services sectors. The inventory of all measures includes laws, rules and regulations affecting trade in services at the horizontal and sectoral levels. This will be useful in the context of both the negotiations and work on harmonizing laws and regulations in the region. The format would allow for the categorization of measures in three groups: measures that constitute barriers to market access and to national treatment, and non-discriminatory measures. Finally, the modes of supplying a service that are affected by each measure would be established. The questionnaires prepared divide the information into three sections: policy, market structure and performance of the sector. National assessment studies are to be undertaken for individual countries to assess the structure and behaviour of services markets, the regulatory framework and the future direction of economic reforms, followed by a regional assessment study. These findings will help in identifying competitiveness of sectors, the most tradable services regionally, as well as barriers to trade. UNCTAD is assisting COMESA and SADC in this assessment.

B. Policy considerations for developing countries

8. In most developing countries the development of the services economy appears to have a number of specificities with important implications for policy formulation: (i) the shift toward services is taking place at significantly lower levels of per capita income than in the case of developed countries; (ii) traditional, non-tradable, low-productivity services with reduced capital accumulation potential account for the significant share of services in GDP and in total employment; (iii) there is no observable positive symbiotic relationship between services and manufacturing, and there is a limited externalization process taking place; (iv) the expected increase in the share of services in GDP with income growth did not happen in a number of developing countries.

Box II.2. How are services different in developing countries?

In Latin America as a whole 46.3% of total non-agricultural employment in 2001 was accounted for the informal sector, which had increased its share from 42.8% since 1990. In some countries the proportion is significantly higher, e.g. in Honduras (60.7%), Peru (59.5%), Ecuador (57.4%), Colombia (55.6%) and Venezuela (49.2%). In Colombia, 8 out of 10 services workers are in the informal sector. In only three out of a total of 12 Latin American countries does employment in the informal sector as a proportion of total non-agricultural employment fall below 40%: in Panama (37.3%), Chile (38.0%) and Mexico (39.6%). In many developing countries, Governments seem to account for a significant proportion of services' contribution to GDP, higher than that observed in developed countries: in Caribbean countries governments account on average for 12.2% of GDP; in Brazil – 15.2% of GDP, in Bolivia – 11.5%, Panama – 11.1%, Haiti – 17%. In OECD countries, with some exceptions, Governments represent below 7% of GDP, with 5.1% in the United States, 3.9% in Australia, 5.4% in Japan, and 5.6% in Italy. For developing countries financial services, telecommunications, and business services account for a relatively small proportion of total GDP: in low income developing countries it is 5% of GDP, and in middle and upper-income developing countries between 7.5 and 10%. In developed countries these services represent about 20% of GDP. The expected increase in the share of services in total GDP with income growth has not been confirmed by the experience of many African countries: of 51 countries, 56% had their services share in GDP decline during 1990-2001.

9. Concerns and questions about the effect of services trade liberalization have been raised in national assessment studies, *inter alia* regarding the following: (i) the possible impact of liberalization on access to essential services, especially for the least favoured segments of the population; (ii) the extent to which liberalization can affect social policy objectives, e.g. in areas such as education, health, and culture; (iii) the magnitude of short-term adjustment costs and how to address them; (iv) the effect on the development of domestic supply capacity, and SMEs, considering that some services activities may require a certain degree of protection before achieving international competitiveness; (v) the distributional impact of services trade liberalization within and between countries; and (vi) the impact of FDI on development.

10. A number of questions are related to how best to undertake trade reform in services. The issues of the pace and sequencing of reforms and the impact of regulatory frameworks on the final outcome of trade liberalization have received increased attention as they seem crucial for assuring development gains from services trade liberalization. There is also a need to identify flanking policies to strengthen domestic capacities in services. Trade liberalization alone does not guarantee that services needed for growth and development will automatically emerge in developing countries. There is widespread recognition that the gains from reform will not materialize or will be seriously undermined if a competitive environment is not assured. A strengthened regulatory framework and the institutional development of competition and other regulatory authorities often represent preconditions for meaningful liberalization. The impact of the structure of global markets on the outcome of services trade liberalization needs to be assessed. Given the increasing concentration of many services industries worldwide, there is a real risk that reform in developing countries could fall short of producing the expected beneficial outcomes because of the external trading environment and the dominant market position of global service suppliers. In this connection, difficulties surrounding the regulatory framework and institution building in developing countries need to be taken into account.

C. Assessing gains from trade liberalization

11. Economic theory suggests that developing countries can expect, under certain conditions, to reap significant gains from liberalization of trade in services, both in terms of the static welfare and income effects resulting from specialization and factor utilization, as well as from the dynamic effects on capital formation and technology dissemination. Services trade liberalization, through important spillovers to 'downstream' user activities, increases the expected static and dynamic effects of trade liberalization on income and welfare.

12. It is worth noting that the proposition of the market-based competition model for the liberalization of trade in services is based on the same theoretical assumptions that are applied in the realm of trade in goods. Benefits are expected to result from more competition, lower prices and wider choice, faster innovation and greater FDI and enhanced technology transfer. Liberalizing trade in services entails the movement of factors of production: the effects of FDI liberalization in services on the development prospects of developing countries constitute an integral aspect of the needed assessment. There is widespread recognition that FDI inflows could bring benefits to the recipient economies in the form of capital inflow, technology spillovers, human capital development, international trade integration and overall enhancement of enterprise development. However, determining exactly how FDI affects development has proven to be remarkably elusive. There is growing recognition that benefits might not be automatic, and that under certain conditions FDI could even produce negative effects on market structure and could lead to crowding out of domestic enterprises, as well as generating other adverse social impacts. Therefore, government policies are needed to enhance the benefits and minimize the costs of FDI. Concerning services, most attention has been given to assessing the effects of FDI in the telecommunication and financial services sectors; efforts are, however, needed to assess the potential effects on economic growth and development of FDI in other services activities.

13. The results of different studies estimating worldwide welfare gains from multilateral trade liberalization in services differ significantly, though all of them show an overall positive impact. Estimations of the welfare effect range from US$ 90 to 688 billion, depending, among other things, on the depth of reduction of trade barriers and gains being distributed between developed and developing countries in proportion to their GDP. There is a general recognition that, because of uncertainty in the modelling data and assumptions, the results of these studies should be heavily qualified. After reviewing a number of them, the OECD concluded, for example, that quantitative modelling is valuable in providing an order of magnitude to estimate the effects of multilateral liberalization, but that quantification of services barriers is unlikely ever to be sufficiently accurate to be used directly in the conduct of negotiations, and the results should therefore only be taken as indicative.

14. Attempts have been made through quantitative analysis and econometric modelling to assess the effect of the elimination/reduction of trade barriers in services on market prices, on the availability and quality of services, as well as on the overall economy of a country. These attempts mainly seek to estimate the 'tariff equivalent' of barriers to trade in services, in order to single out suitable market responses to those changes.

15. There are a number of studies aimed at quantifying, at the sectoral level, the restrictiveness of measures affecting trade in services and at assessing their effects on welfare and on the growth path of specific countries. Research on the effect of services liberalization on average predicts modest static welfare gains of less than 1 per cent of GDP, even though some country studies show larger gains, and the dynamic effects provide considerably greater

long-term benefits. A study on Tunisia estimates, for example, that full services liberalization would raise welfare by 5.3 per cent, with investment liberalization accounting for 75.5 per cent of the gains. Studies that assess the growth effect of the liberalization of financial and telecommunications services show that countries which opted for an open regime are growing at a higher rate – 1.3 to 1.6 percentage points higher – than countries that limit competition in these sectors. The growth effect of liberalizing financial services is found to be more significant than that of liberalizing telecommunication services. A positive relation has also been found between the openness of a sector to FDI, external trade and private ownership and respective sectoral growth rates. A review of different quantitative studies assessing the effects of services trade liberalization in developing countries concludes that in many countries the potential GDP gains from liberalizing services imports are considerable, especially if compared with the liberalization of merchandise imports. However, the potential benefits are highly country-specific, and sectoral priorities for liberalization need to be established on a country-by-country basis.[2] Some recent analytical work suggests that liberalization in some services might not always yield gains for developing countries.[3]

16. The main difficulty facing quantitative approaches to assessing the effects of services trade liberalization is lack of data, leading to the need to make assumptions and approximations. Moreover, results depend on the way trade barriers are quantified and on the specifications of different models. Concerning the quantification of trade barriers, it has been observed that even the best available methods are inadequate. An additional difficulty is in isolating the effects of trade liberalization from the effects of other intervening variables, as in many cases reforms in different policy areas take place simultaneously. In assessing the effects of services trade liberalization, it is necessary to take into account the specific features of individual services, as well as the differing impact of trade according to the different modes of delivery. These issues are not usually addressed in the research that was reviewed. Considering that quantitative analysis provides important insights into the effects of services trade liberalization, the need exists to refine estimation techniques and modelling to capture the specificities of trade in services. There is an equally urgent need to improve data on services as the basis for formulating policy recommendations to developing countries.

III. ASSESSMENT ON A SECTORAL BASIS

17. A set of preliminary findings based on national assessments in selected services sectors conducted by UNCTAD is discussed below. The findings suggest that each country should carefully assess the costs and benefits associated with liberalization resulting in, *inter alia*: employment displacement versus employment creation, skill transfer and transfer of technology; efficiency gains versus effects on the informal sector and employment; local sourcing versus imports and effects on the balance of payments; raising quality standards to facilitate market access versus market entry barriers posed by standards; development of infrastructure versus pressure on existing resources; and positive FDI spillover effects versus crowding out by FDI.

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2 Lucke, M and Spinanger, D (2004), *Liberalizing International Trade in Services: Challenges and Opportunities for Developing Countries*, Kiel Discussion Papers 412, Institut Fur Weltwirtschaft Kiel, July.

3 Whalley, John (2003), *Assessing the Benefits to Developing Countries of Liberalization in Services Trade*, NBER Working Paper Series Working Paper 10181, National Bureau of Economic Research, December.

A. Construction and related engineering services

18. The construction sector remains a low-margin, highly regulated and high-risk activity. It is among the most cyclical economic sectors in many countries and nearly 50 per cent more volatile than the manufacturing sector. Construction services are labour-intensive and provide jobs at all skill levels. Small and medium-size enterprises (SMEs) and the informal sector play an important role in the construction services sector. Developing countries, while according access to international firms, are striving to promote utilization of the local labour force and productive resources as a way of building their supply capacity and developing private markets. The role of government procurement is particularly important in this respect.

Box III.1. Trade liberalization in construction services in Jordan

Positive outcomes:

- Flow of regional investments in real estate and construction projects;
- Advent of large-scale service suppliers;
- Revival of the housing, transportation and telecommunications sectors;
- Increasing educational and awareness programmes to attract local manpower to engage in these sectors;
- New business partnerships in the contracting profession;
- More professional disciplines in the certification and qualification of contractors;
- Considerable increase in the number of certified companies in vertical sub-sector specializations.

Concerns with liberalization:

- Advent of profit-oriented foreign ownership of service enterprises that does not have any interest in developing local expertise or supply capacity;
- Increased property prices and increased cost of small-scale construction services;
- Liberalizing the sectors does not promise ‘sustainable’ foreign exchange revenue sources from these sectors for the Jordanian economy;
- Foreign participation did not lead to technological capacity building in these sectors in Jordan;
- The number of local construction contracting firms forced out of the market for lack of competitive resources has been increasing since 2002;
- Foreign companies employing foreign workers are paying less than the national average, which forces Jordanian workers out of the job market;
- Projects funded by international donors are implemented by foreign contractors and service providers, who at times do not abide by the local regulations on licensing, registration and certification;
- Foreign contractors are not totally committed to joining the engineering association or the construction contractors’ association as a formal gateway to providing services in Jordan.

Source: UNCTAD Services Assessment in Jordan, 2005.

19. The preliminary findings of the assessment suggest that there is a limit to the extent to which growth and development could be achieved exclusively through internal reform processes. The impact of multilateral funding and bilateral aid in construction may contribute to upgrading physical infrastructure, but the recipient country's construction sector may play a marginal role, mostly through subcontracting from foreign firms. Local companies retain low technology and small contracts, affecting the growth of the domestic industry. Building SME capacity is essential, and the role of government in ensuring a level playing field is vital.

Box III.2. Construction services in Indonesia

Government financing accounts for more than 57 per cent of all construction projects. The number of firms is estimated at 97,000, of which close to 90 per cent are small companies. Large construction companies contribute about 40 per cent of the total value of construction. The major weakness of domestic suppliers is limited access to capital and technology. Domestic construction players do not have sufficient capability for high-tech infrastructure projects. The problem of access to capital is evident for domestic players wishing to expand operations abroad. Overseas projects require high-value collateral (tender bonds, advanced-payment bonds or performance bonds). Bank references are also a problem, since most Indonesian banks are not recognized abroad. High interest rates at home also imply higher capital costs for domestic players. Indonesia can export services through Mode 4 in the form of construction workers and professionals. The main demand in this respect comes from the Republic of Korea and Malaysia, and opportunities exist in developed countries.

Source: UNCTAD Services Assessment in Indonesia, 2005.

B. Telecommunication services

20. Telecommunication services are the main drivers of the global tradability of goods and services, as well as the means for offshoring a wide range of IT-enabled services (ITES) and business process outsourcing. However, liberalization and privatization of this sector have to be carefully managed to prevent anti-competitive behaviour, ensure universal coverage and affordable pricing, and widen access to all types of services. The case study in Kenya referred to in box III.3 shows why the gradual liberalization process in the telecom market faces difficulties in attracting private and foreign investments; it also shows how the expected immediate negative impact on employment has made reforming the sector particularly difficult, as well as how important it is to put in place policies promoting SMEs, especially in creating new employment opportunities.

Box III.3. Telecommunications: Challenges facing Kenya

Following the telecommunications reforms, a decision was taken to privatise TKL in 2003 by selling 49 per cent of its equity to a strategic partner who was expected to invest in the modernization of the network. The price offered by the highest bidder was so low that the Government did not go ahead with the process. There has been poor growth in fixed-line connectivity and access due to capital constraints, associated with an unsustainable wage bill, and management problems at TKL. Two companies were licensed in cellular telephony services and are expected to reach a combined subscriber base of 4 million by 2005, while the cost of connection and handsets has declined. In spite of the adoption of universal access policies and the introduction of the mobile/cellular services, the rural sector coverage still remains deficient.

The cost of deeper reforms to rationalize the workforce at TLK and restructure the company to make it profitable and streamline operations is a major challenge. Mobile telephony has directly created a little over 1,000 new jobs, and while the figures for indirect employment are difficult to calculate, it is evidently substantial. Jobs are being created in distribution and agency business and support services. Reform also demonstrated the positive impact of measures in favour of SMEs. A number of market segments requiring minimal investment were preserved for local SME investors through, for example, minimum local equity participation requirements.

Source: UNCTAD Services Assessment in Kenya, 2005.

21. The lessons learned in the assessment relate to policies that need to be put in place to ensure success in telecommunication services reform, including: (i) development and expansion of national and regional infrastructure, and inviting private sector investment and financial support from development partners; (ii) the establishment of the Universal Service Fund to facilitate extension of telecommunication services to rural areas, where government investments and partnerships continue to be important; (iii) improvement of the business environment to facilitate new investments and to expand existing ones; and (iv) ensuring ICT human resource development, promoting e-commerce and e-government, and establishing enabling policy and legislative frameworks.

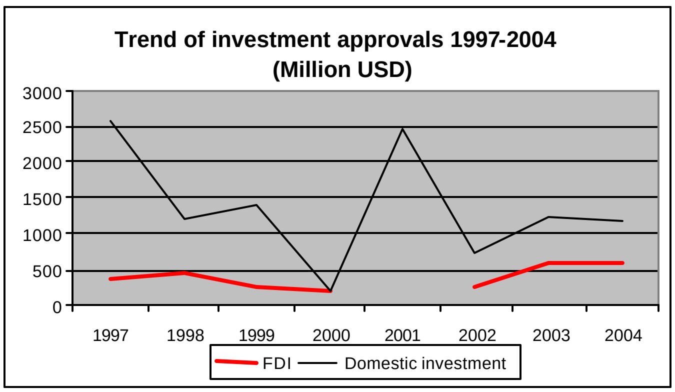
C. Tourism services

22. Tourism is among the top five export revenue generators for 75 countries, regardless of their level of development. For 45 of them, tourism is the top generator, including for 17 LDCs. The experience of many developing countries, and in particular LDCs and small economies, shows the growing importance of tourism as the main and sometimes the only driver of economic and social development on a sustainable basis. Tourism is probably the most liberalized sector in international trade in services.

Box III.4. Approaching tourism reform in Indonesia

Development of the tourism sector in Indonesia has undergone three major shocks in recent years, resulting in the travel trade surplus dropping by half in 1998 in the wake of the Asian financial crises and a 10 per cent decline in tourism income due to the bombing of nightclubs in Bali and the tsunami. Still, tourism continues to be an important contributor to exports and continues to absorb labour and support economic growth, providing 10 million jobs in 2004. In addition, 8 per cent of the poor are working in trade, hotels or restaurants. The output multiplier for the restaurant sub-sector was 1.97 and for hotels 1.68, meaning that if final demand in restaurants increases by 1 billion Rupiah, the output of the whole economy would increase by 1.97 billion Rupiah.

In 2003 only 9 per cent of 10,435 hotels had star ratings. The hotel industry is dominated by medium and small players. The tourism business is segmented, and foreign suppliers aim mainly at the upscale market. Competition is often tough in all segments, and the ability of any particular firm to dominate the market, therefore, is limited. Increasing FDI in the tourism sector has not been accompanied by a systematic decline in domestic FDI, as seen from fluctuations in domestic investment approvals in the graph below. This indicates that FDI and domestic investment are not substitutes for each other.



Other concerns include excessive ownership of land and buildings by foreign investors, who have the capacity to buy land and displace local players from potential tourist destinations, and monopolistic practices applied by large foreign suppliers. For liberalization to proceed successfully, it would need to be supported by complementary policies designed to help domestic SMEs to compete in the market. Other policies may also need to be put in place to promote competition and minimize the adjustment cost of land, assets, and employment displacement.

Source: UNCTAD Services Assessment in Indonesia, 2005.

23. Benefits from the domestic liberalization of tourism, as reflected in country assessments, depend, among others, on the degree of integration of domestic sector tourism, global business practices, competitive conditions in foreign markets, access to distribution networks, and the degree of leakage. An important factor is the high degree of vulnerability to external shocks and volatility, especially of international tourism flows. Public policies in favour of SMEs are particularly important in tourism. Assessments also underline that there are significant market access and national treatment barriers in developed country markets,

mainly with respect to restrictions on movement of professionals who supply tourism services and restrictions on some forms of tourism business that developed countries need to ease or remove, including in the trade negotiations by undertaking commercially meaningful commitments on Mode 4.

D. Distribution services

24. Distribution services are at the core of the logistics chain. They play a critical role in ensuring the efficiency of domestic markets, enhancing consumer welfare, and linking the domestic home economy with the rest of the world. Modernization of distribution services and the entry of foreign firms into developing country markets are likely to enhance welfare through increased productivity and efficiency gains and lower prices, provide a greater choice of products and increased competition, and create better-quality jobs. Large international retailers operating in the domestic market can become an avenue for increasing exports as domestic suppliers are incorporated into the global procurement network.

25. Developing countries may find it difficult to advocate reform in distribution services, since in most developing countries, particularly LDCs, traditional players dominate the distribution industry, and its modernization could entail significant short-term adjustment costs, including displacement of small retailers and consequent employment effects. They are also concerned with the leading position of global retailers on the domestic market, who may acquire dominant market and buyer's power.

Box III.5. Regulation and liberalization: Distribution services in Ecuador

Legislation on distribution services in Ecuador is in trade terms ‘non-restrictive’ with no market access restrictions applied or advantages given to local providers. The distribution sector in Ecuador is not regulated in terms of specific regulations on establishment or concerning operations, e.g. opening hours, zoning regulations, establishment of large outlets, pricing or promotional sales, or protection of SMEs. However, this may not be sufficient to promote development of the market in an open trading environment.

In distribution services it is important to avoid a market situation in which the product or service of several sellers is sought by only one buyer – a trend that emerged in wholesale services in Ecuador. Liberalization under these conditions would simply mean that a domestic monopoly provider would be replaced by a foreign one. On the other hand, removing all trade barriers to market entry in the retail market has not led to the establishment of large foreign chains or their domination of the markets. It seems that retail services do not provide sufficient competitive space for foreign players to grow, given the small size and high degree of competitiveness of most markets in the Andean countries. For example, in Colombia Carrefour is only the fourth largest player, and Ahold operations in Peru were recently taken over by a local company.

To change such market outcomes, more laws, including antitrust legislation, may be necessary. Trade liberalization in services should be seen not simply as efforts towards elimination of ‘restrictive’ legislation, but also in terms of ‘correcting’ market failures. Fewer regulations may not result in more competitive markets.

Source: UNCTAD Assessment of Services in Ecuador, 2005.

26. Not all developing countries and LDCs that seek to attract foreign investment to develop their retail services sector are successful, as developing countries are generally speaking low-value markets, and a sufficient volume of sales must be available to attract FDI. While countries commit themselves to encouraging modern retailing to benefit consumers, farmers, manufactures and other services providers, there is no one-size-fits-all solution for implementing reform in the distribution sector and for maximizing development benefits.

IV. STATE OF PLAY IN THE GATS NEGOTIATIONS

27. With the WTO's Sixth Ministerial Conference in Hong Kong, negotiations to liberalize services trade have entered their final phase. However, with a little less than a year remaining until the expected end of this round of negotiations, questions still exist on: the significance of results in both the market access and the rules aspects; the extent to which the negotiations will secure an overall balance of rights and obligations among Members; and whether the negotiations will meet the objectives of their development-oriented mandate.

28. The Hong Kong Ministerial Declaration on the Doha Work Programme addresses services in both the main text and in its Annex C. The text of this Annex had been presented by the Chair of the CTS Special Session, and, until the last day of the Conference, the reference to it in the main text was 'bracketed' – i.e. no consensus had been reached.[4] The main text, in paragraphs 25 to 27, recalls the overall objectives of the negotiations and the objectives and principles set out in the GATS, the Doha Declaration, the Negotiating Guidelines, the LDC Modalities and the 2004 July Package. While urging all Members to participate actively towards achieving a progressively higher level of liberalization, it also refers to appropriate flexibility for individual developing countries, and states that negotiations shall have regard to the size of economies of individual Members (both overall and in individual sectors). The Declaration recognizes the particular economic situation of LDCs and the difficulties they face, and acknowledges that they are not expected to undertake new commitments. According to paragraph 27, Members are determined to intensify the negotiations and, in that context, give particular attention to sectors and modes of export interest to developing countries; however pro-development outcomes remain to be realized in the negotiations.

29. Annex C adds new dimensions as regards modal objectives, with differentiated levels of ambition for each mode. It sets out more detail on plurilateral approaches for negotiating services commitments and establishes that Members to whom plurilateral requests have been made are to consider such requests in accordance with paragraphs 2 and 4 of Article XIX and paragraph 11 of the Negotiating Guidelines (which refer respectively to the flexibility for developing countries in opening their markets and to the progressivity of liberalization and affirm the request-offer approach as the main method of negotiation). Annex C also sets out specific timelines for outstanding initial offers (to be submitted as soon as possible); plurilateral requests (to be submitted by 28 February 2006, or as soon as possible thereafter); a second round of revised offers (to be submitted by 31 July 2006); final draft schedules of commitments (to be submitted by 31 October 2006); and appropriate mechanisms for according special priority to LDCs (to be developed before the end of July 2006).

[4] Prior and during the Ministerial, the G-90 and some ASEAN countries put forward an alternative text on Annex C, to address their important concerns. Some other developing countries proposed to delete all of Annex C.

30. The need for targeted technical assistance, including for analysing statistical data, for assessing interests in and gains from services trade, and for building regulatory capacity (particularly for those services sectors where liberalization is being undertaken by developing countries), is recognized in Annex C of the Hong Kong Declaration. In addition, the Negotiating Guidelines have turned assessment into a standing agenda item of the CTS and require that negotiations be adjusted in the light of the results of the assessment. So far, this has not taken place.

A. Market access issues and offers

31. As of December 2005, 69 initial offers and 30 revised offers had been submitted. Less than half of the offers include improvements to horizontal commitments on Mode 4, and those who have made changes have not included categories of natural persons of interest to developing countries. New sectors/sub-sectors committed contain limitations that act as barriers to entry. Some “backtracking” can also be observed in Members' offers. Some 400 MFN exemptions still remain, and if the proposed improvements in offers were to come into force, the number of MFN exemptions would be reduced by less than 10 per cent.[5]

32. This limited progress gave rise to a debate about a possible crisis in the negotiations. It was argued that the bottom-up approach to scheduling commitments, together with the bilateral request/offer negotiating method, was not enough to ensure sufficiently ambitious results and a critical mass of commitments and new commercial opportunities. As a response, a series of developed countries put forward suggestions, including cross-sectoral and modal formula-type approaches, establishing ‘quantitative’ and ‘qualitative’ criteria to which individual Members’ market opening offers should correspond, sometimes to be complemented with more ambitious plurilateral initiatives and – ultimately – a continuation of the bilateral request/offer process. According to the proponents, however, combining a collectively agreed level of ambition with certain flexibilities would ensure a successful outcome in negotiations.

33. As stated by a large number of developing countries, this is a problematic combination. In the Trade and Development Board in October 2005, developing countries emphasized that the complementary approaches would reverse the logic and spirit of the GATS and the Negotiating Guidelines. Developing countries fear that the adoption of complementary approaches would lead to a substantial loss of current built-in flexibilities and a consequent reduction of development flexibility. It was emphasized that developmental provisions of GATS Articles IV and XIX, the Negotiating Guidelines and the LDC modalities should remain the benchmark for the negotiations.

34. Ultimately, the idea of establishing specific, mandatory quantitative targets for the negotiations was dropped owing to lack of consensus. However, the Ministerial Declaration sets out modal objectives and emphasizes plurilateral approaches. While the specific language referring to the plurilateral approach was subject to intense negotiation, overall concerns of developing countries with the approach – namely that it might result in higher levels of commitments and sectoral initiatives – remain.

35. The deeper reasons that may lie behind the rather limited quality and number of offers is the lack of understanding about the impacts of services trade liberalization. Given

[5] WTO (2005), Report of the Meeting Held on 27 and 30 June and 1 July 2005, Note by the secretariat, TN/S/M/15, paragraph 161.

that services trade assessments are still at their initial stages, developing countries would enter into liberalization commitments without sufficient data, statistics and information to anticipate their implications. Developing countries lack the resources and technical capacity to carry out such assessments and subsequently to submit their offers within the various indicative deadlines set. The situation is similar with respect to requests. This has particularly been the case for LDCs, but developed countries are also facing challenges. The fact that recent WTO jurisprudence points to the difficulty of foreseeing the potential implications of scheduled commitments (e.g. *US - Gambling*) may induce Members to proceed with care and to strive – to the extent possible – for informed choices in the negotiations.

B. Developing countries' export interests

36. Without going into specificities for countries/regions and sectors, various studies have identified Modes 1 and 4 as those modes of supply where developing countries and the LDCs have significant export opportunities. For developing countries, these gains could also translate into means to achieve the MDGs, with the eradication of poverty being prime amongst them. For Mode 4, realizing these gains requires developed countries (as major markets of interest for developing country service providers) to allow for the movement of broader categories of service suppliers, including less skilled categories. Horizontal commitments on Mode 4 (identifying categories of natural persons) need to be complemented by sector-specific commitments with meaningful market openness. Facilitating administrative and visa requirements for temporary entry of service providers, simplifying qualification procedures or facilitating the accession of sending countries to mutual recognition arrangements are important.

37. Mode 1 service delivery (spurred by the modernization of technology and the increasing reliance of firms on outsourcing) offers opportunities to developing countries that are able to provide quality services at lower costs. Again, a comprehensive and balanced assessment, including the impact of increasing Mode 1 trade, could help alleviate the concerns in respect to market opening.

38. The Ministerial Declaration calls for commitments to be made for Modes 1 and 2 at existing levels of market access and sets out specific types of commitments for Mode 3. Many developing countries consider the objectives established for Mode 4 to be of a lower level of ambition. They call for new or improved commitments on the categories dealing with contractual services suppliers, independent professionals, others (de-linked from commercial presence), intra-corporate transferees and business visitors. This was done to reflect, *inter alia,* the removal or substantial reduction of economic needs tests and an indication of prescribed duration of stay and possibility of renewal, if any.

C. LDCs' interests

39. The importance of services for development turns services negotiations into a key issue for LDCs.[6] LDCs have actively participated in the negotiations and have sought to obtain full and meaningful implementation of the LDC Modalities and commercially

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[6] See Lakshmi Puri (2005), *Towards a New Trade "Marshall Plan" for Least Developed Countries: How to Deliver on the Doha Development Promise and Help Realize the UN Millennium Development Goals?,* Trade, Poverty and Cross-cutting Development Issues Study Series No.1, UNCTAD, United Nations, 2005. The paper suggests that enhanced market access for LDCs, including in the services sector, is an essential component of the Marshall Plan for LDCs, aimed at assisting poorest countries escape the poverty trap.

meaningful Mode 4 commitments and the operationalization of GATS Article IV. However, effective implementation of the Modalities remains absent.

Box IV.1. LDC issues and concerns

LDC contributions have included: (1) a Group request on Mode 4, which sought access for skilled services providers (e.g. doctors, engineers, lawyers), as well as less-skilled providers (carpenters, tourist guides, hotel managers, hairdressers or waiters). However, developed WTO Members showed little inclination to go beyond the liberalization of professionals. Moreover, commitments are frequently subject to onerous qualification or other requirements; (2) suggestions for a mechanism to grant preferential access to LDCs, including providing full market access on a non-reciprocal basis through specific commitments in sectors and modes of export interest to LDCs; removing limitations in sectors and modes of export interest to them; undertaking further commitments only in favour of LDCs, and assigning priority to imports from LDCs; and providing LDCs with technical and financial assistance to carry out continuous assessments of their domestic services economies; (3) a suggestion for a reporting mechanism (in the CTS) to monitor any progress on the implementation of the mandates stated in the GATS and the LDC Modalities.

40. The Hong Kong Ministerial Declaration, in paragraph 47, states that Members shall implement the LDC Modalities and give priority to sectors and modes of supply of export interest to LDCs, particularly with regard to movement of service providers under Mode 4. It is hoped that this will induce a positive response to the LDC Model Request. Annex C specifies that Members shall, in the course of negotiations, develop methods for the full and effective implementation of the LDC Modalities, including: developing appropriate mechanisms for according special priority, including to sectors and modes of supply of interest to LDCs; undertaking commitments, to the extent possible, in sectors and modes of supply identified by LDCs that represent priority in their development policies; assisting LDCs to enable them to identify sectors and modes of supply that represent development priorities; providing targeted and effective technical assistance and capacity building for LDCs; and developing a reporting mechanism to facilitate the review requirement of the LDC Modalities. While this specific language has been hailed as a major achievement, its concrete implementation and the realization of the attendant benefits remain a challenge, as much of the current language is on a best endeavour basis. Country- and sector-specific assessments could assist LDCs in identifying specific methods for implementing LDC modalities and improving the knowledge base upon which policy decisions – at both national and international levels – are to be made.

D. Assessment in the GATS

41. A comprehensive and thorough assessment could further the objectives of current services negotiations in all areas. So far, the assessment has consisted mainly of the exchange of information among WTO Members on their own national assessment of the impacts of past liberalization of services. No multilateral conclusions have been drawn from this exercise.

42. Assessment-related presentations by Members and ensuing discussions noted that: (1) the assessment process is useful and should be an ongoing process; (2) countries need

technical assistance and capacity-building to undertake national assessments; (3) data collection and the methodology used to aid the assessment process and allow for comparability of results needs to be improved; (4) results of initial assessments have pointed to the need for flanking policies and regulatory and institutional preparedness, as well as for boosting developing countries' supply capacity and competitiveness to ensure gains from liberalization; and (5) there is a need to address adjustment costs of liberalization, in particular with respect to impact on employment.

Box IV.2. Assessment in Rwanda: The case of an LDC

At the CTS meeting in September 2005, Rwanda presented the results of its services trade assessment, which was conducted with the assistance of UNCTAD. It highlighted the country's supply-side constraints and the weakness of its legal, regulatory and institutional frameworks. Other key issues included: (1) the low contribution of the services market to the overall economy and employment; (2) the country's high deficit in trade in services; (3) the fact that most services trade was South-South oriented; (4) the fact that services were not yet playing a significant role in the economy; and (5) the fact that Rwanda's Uruguay Round commitments had not yet produced the expected benefits (particularly in Mode 3). Although an in-depth analysis of the Rwandan services economy was still being undertaken, the very low capacity of Rwandan institutions and the absence of a sound regulatory framework suggested that Rwanda's current commitments do not necessarily correspond to its national development objectives in services. Rwanda highlighted the need for more assistance to improve its supply capacity and regulatory and institutional frameworks; the need for policy space and flexibilities; as well as the need for assistance for institutional capacity-building in order to participate more meaningfully in the services negotiations.

E. GATS rules

43. An emergency safeguards mechanism (ESM) would allow countries to address import surges and unforeseen developments as a result of services liberalization, as well as to facilitate adjustment, thereby encouraging deeper commitments. Negotiations on an ESM involve complex regulatory issues and are characterized by a divergence in views about the desirability and feasibility of ESM rules. An ESM would need to find the right balance between flexibility (e.g. allowing Members to define certain concepts at the national level) and rigidity (e.g. strict notification/transparency requirements and the concept of a 'limited window') of the rules so as to allow for adequate discretion for each country to invoke the measures while avoiding abuse.

44. Negotiations on subsidies are not progressing. Members continue discussing how to move forward on information exchange and how to sequence this with the search for a definition of trade-distortive subsidies. State support for services appears to be widespread, and its distortive effects on services trade cannot be discarded. The role of subsidies in development programmes and the particular need of developing countries for flexibility in this area require particular attention.

45. As regards government procurement, Members continue to disagree on the mandate, including whether or not the negotiating mandate (Article XIII) covers market access issues, and on the impact of the 2004 July Framework (suspending discussions on government

procurement) for the respective services negotiations. The EC has called for a framework on government procurement, but a specific reference to its respective proposals was ultimately deleted from Annex C of the Ministerial Declaration.

F. Domestic regulation

46. In the past months, negotiations on domestic regulation (mandated by GATS Article VI:4) have gained momentum, and Members in the Working Party on Domestic Regulation agreed upon a series of "elements" for the future disciplines. For developing countries, the challenge is to navigate between the need to preserve domestic policy flexibility and achieving clear/specific disciplines to secure market access. As Members strive to avoid undue limitations on Governments' right to regulate, they would benefit from a comprehensive regulatory assessment, giving insights about the various types of domestic regulations, their objectives, the design of such regulations and their implementation. Particular emphasis could be given to determining the pacing and sequencing of regulatory reform and liberalization on a sectoral basis, as well as the possible trade-distortive impact of domestic regulations.

47. Regulatory assessment could prove useful for efforts to build institutions and to strengthen regulatory and policy frameworks in developing countries – some of the key challenges identified for developing countries in that context. From a negotiators' perspective, it would allow informed decisions when devising the specific elements of the future disciplines on domestic regulation. More broadly, the assurance that important policy choices are made in an informed manner would also assuage domestic stakeholders, who are voicing concern about the possible impact of future regulatory disciplines.

48. For developing countries, allowing for development flexibilities is of utmost importance. Issues that may warrant attention include: the recognition of their particular development needs to exercise the right to regulate; the phased introduction of laws affecting developing countries' services exports; longer time frames in the application of the future disciplines; and more broadly capacity and institution building.

G. Implications

49. The Hong Kong Ministerial Declaration offers guidance on intensifying negotiations and, ultimately, achieving expanded sectoral and modal coverage of commitments. It accelerates the pace of negotiations by establishing modal objectives, emphasizing plurilateral negotiations and setting timelines. Against this backdrop, it is important to ensure that the actual negotiations will not erode the flexibility, the development-friendly architecture and the concept of progressive liberalization enshrined in the GATS and the Negotiating Guidelines. In terms of enhancing developing countries' export opportunities, real progress on Mode 4 and on sectors of export interest to developing countries are still absent. The specific attention given to LDCs in the Ministerial Declaration needs to take the form of concrete development outcomes, including appropriate mechanisms for giving special priority to them.

50. A review of progress as set out in paragraph 15 of the Negotiating Guidelines could help achieve implementation of the GATS development provisions. Similarly, multilateral discussions on assessment, with contributions of national assessments, together with a proper

adjustment of the negotiations in light of the results of the assessment (as suggested in paragraph 14 of the Negotiating Guidelines), are central for realizing development benefits.

V. CONCLUSIONS

51. Liberalization of trade in services, within appropriate regulatory and policy frameworks, is expected to contribute to enhancing global welfare through increased efficiency, lower prices, greater choice and increased domestic competition. There are only a limited number of assessment studies on the development implications of trade in services liberalization in developing countries. Quantitative assessments have produced inconclusive results. The assessments have emphasized the need for a cost and benefit analysis of reform and liberalization by developing countries. Preliminary findings from national sectoral assessments have highlighted concerns and questions about the effect of services trade liberalization.

52. The establishment of flanking policies and domestic regulatory frameworks is a necessary precondition for liberalization to yield development-oriented results. This is particularly true for infrastructure services, where fair and transparent conditions for competition need to be put in place. Phased and appropriate sequencing in reform and liberalization of services is also a key aspect for building competitiveness and efficiency of domestic supply capacity. Public policies supporting and promoting, among others, SMEs, technology and innovation, access to capital and financing, building of human capital and ensuring essential access are of critical importance. Studies have shown that market liberalization may result in different outcomes depending on the services sector and country/region at stake. The conclusion from available evidence is that a ‘one-size-fits-all’ approach is inappropriate in dealing with services trade liberalization.

53. GATS negotiations could provide an opportunity to take forward interests of developing countries in the area of their export and development interests, in particular Mode 4. There is a need to intensify the assessment work in order to ensure that the negotiations reflect development policy objectives of developing countries, contribute to the achievement of MDGs and result in a win-win situation for all.

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