

# trade hot topics

## Supporting the Development of Trade in Services in Small States and Low-income Countries

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### Background

Small states and low-income countries (LICs) face significant challenges in their efforts to export services. They are primarily interested in supplying services from one country to another (also referred to in WTO jargon as ‘Mode 1’ or ‘cross-border supply’) and individuals travelling from their own country to supply services in another (referred to as ‘Mode 4’ or ‘temporary movement of natural persons’). However, Mode 1 and Mode 4 commitments are often linked to situations where a foreign company sets up subsidiaries or branches to provide services in another country (referred to as ‘Mode 3’ or ‘commercial presence’), which puts access out of reach of their small suppliers who lack the resources to invest abroad.<sup>1</sup> Even where not linked to Mode 3, Mode 4 access is usually limited to highly-skilled individuals, not the lower-skilled where the small states and LICs have a competitive advantage.

This issue of *Commonwealth Trade Hot Topics* outlines certain preferential measures in the context of both regional and multilateral trade arrangements that may help small and low-income countries develop and expand their services trade. This discussion is preceded by a description of the types of preferential treatment that currently exist

with respect to trade in services and their possible effect, as well as the difficulties in measuring the effect of the impact of removing regulatory barriers to trade in services.

### Existing SDT in services trade

The term ‘Special and Differential Treatment’ (SDT) is used to describe preferential treatment given to developing and least-developed countries (LDCs) in multilateral trading arrangements under the auspices of World Trade Organization (WTO) agreements. In most of these agreements, SDT for developing and least-developed countries takes the form of less rigorous obligations and/or additional time for implementation of commitments, as well as technical assistance. The General Agreement on Trade in Services (GATS), by contrast, imposes the same general rules and obligations (such as Most-Favoured Nation — MFN — and Domestic Regulation) on all WTO members developed and developing, and gives no additional time to developing countries for implementation of those obligations. SDT under the GATS takes other forms.

<sup>1</sup> Even where small countries have formal access to other markets, their service suppliers may not have the resources to investigate foreign market opportunities, and they often lack government support. The suppliers may not have adequate human or technical resources, and they often pay high costs for basic services, such as financial credit and access to the internet.

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First, the *architecture* of the agreement provides unlimited negotiating flexibility to members as to the extent to which they open their service markets. Thus, each member is free to determine how many sectors in which to make binding commitments and how quickly to implement those commitments. It may also place limitations on its commitments, such as on the number of foreign service suppliers that may enter its market. The GATS uses the 'positive list' approach, under which each member's schedule only lists those sectors in which it has made market-opening commitments. The Doha Development Round (DDA) follows the same approach, as do many regional trade agreements (RTAs), including all of those signed by the European Union, Association of Southeast Asian Nations (ASEAN) members and China. Other RTAs, such as the North American Free Trade Agreement (NAFTA), use the 'negative list' approach, under which all services sectors are fully opened except to the extent set out in a schedule of non-conforming measures. This approach also gives a good deal of flexibility, though arguably less than in the case of positive-list agreements. This format is followed by the USA and by most of its trading partners in the Western Hemisphere and elsewhere.

The GATS also contains provisions acknowledging that the developing countries are not expected to provide *reciprocity* in terms of the number of commitments, and various documents produced during the DDA reiterate this principle. LDCs were to be given even more flexibility, and the Hong Kong Ministerial Declaration explicitly stated that they were not expected to make any new services commitments. Even though the GATS recognises the need to allow flexibility for developing countries entering RTAs, very few RTAs contain provisions explicitly acknowledging that need. In practice, however, developing country parties to RTAs have generally made many fewer commitments than developed country parties in the case of positive-list RTAs and have taken more exceptions in the case of negative-list agreements.

The *negotiated outcomes* of the GATS show that on average the developing countries made many fewer commitments than the developed countries. However, as noted above, many of the Mode 1 and Mode 4 commitments by developed countries are linked to Mode 3, which makes them of little value to the smaller countries, which do not generally have service suppliers large enough to invest abroad. Also, Mode 4 commitments by developed countries are mostly limited to highly-skilled

individuals. RTAs exhibit a similar asymmetry of outcome, with developed countries making many more commitments in the case of positive-list agreements, or scheduling fewer non-conforming measures in the case of negative-list agreements, than the developing country members. However, as in the case of the GATS, Mode 1 and Mode 4 commitments may be linked to Mode 3, and Mode 4 commitments are usually limited to highly-skilled personnel.

The GATS calls for *technical assistance* to be given to the developing countries, but unlike many of the WTO agreements, specifies that it should be provided, not by the developed countries, but by the WTO itself. In practice, however, a good deal of assistance has been provided by members as well as by the WTO and other international organisations, although the amount of assistance given with respect to services has been relatively low. Various documents produced during the DDA reiterate the need for technical assistance to be given to the developing countries. Some of the more recent RTAs, especially those signed by the EU and the USA with developing partners, contain provisions calling for the supply of technical assistance. These are not, however, contractually binding.

The GATS does not give members *additional time* for implementation of the general obligations, although the negotiating flexibility built into the Agreement allows countries to delay implementation of their commitments. A significant number of such pre-commitments were made by developing countries in the telecommunications sector, although it has rarely been used for other sectors. A few RTAs give the smaller countries additional time for implementation, though in some cases these are limited to a few sub-sectors.

The GATS and various DDA documents contain a number of hortatory, '*best-endeavour*' type provisions for stimulating the services exports from developing countries and allowing them greater market access opportunities. These have proved to be of little value to developing countries. A few RTAs contain similar statements.

### Assessing the impact of SDT

It is difficult to assess the overall impact of SDT in services, and it appears that no-one has attempted to measure its value as a whole to the developing countries. Certain types of SDT — technical assistance, and additional time for implementation

of commitments — clearly benefit the smaller, poorer countries. So does the aspect of non-reciprocity that allows greater access to developed country markets. However, the other side of non-reciprocity, allowing the developing countries to keep their service markets more closed, may in fact be harmful to them in the long run. As discussed in the next section, there is a substantial body of work that demonstrates that barriers to service trade can be extremely costly, and that removing them can raise GDP significantly. Service activities are critical components of all economic output. The positive effects of removing service trade barriers, both external and internal, are felt throughout the economy in increased efficiency, since greater competition results in lower intermediate costs for manufacturers and agricultural producers as well as for service suppliers. Opening more service sectors should likewise benefit smaller and less developed countries, although this should be done with great care, to ensure that local service suppliers are not crowded out by foreign competitors. In particular, it is essential to set up effective regulatory structures and train officials in regulatory expertise before liberalising. For this, both time and technical assistance are needed.

### Assessing the impact of services trade liberalisation

Assessing the impact of services trade liberalisation is an important but difficult task for economic researchers. The methodologies are still being developed and the data are inadequate, particularly in small and low-income countries. Also, services are highly heterogeneous in their characteristics, ranging from essential infrastructure services, such as telecoms, transport and distribution, to consumer services, such as healthcare and education. However, considerable progress has been made over the past decade in modelling the impact of liberalisation on services trade. Economists have attempted to estimate these impacts through four different types of approaches. The first approach focuses on the firm level and measures changes in total factor productivity (TFP). The second uses economy-wide computable general equilibrium (CGE) models to assess the overall impact of liberalisation on services trade through incorporating all of the channels through which services may impact national economies. The third ‘frequency’ approach involves the examination of restrictive policies applied to service sectors and a conversion of these into frequency indicators (i.e., the more measures

applied, the higher the frequency), then used in impact regressions. Similarly, the fourth ‘gravity’ approach relies upon indirect methods through gravity regressions to estimate what trade flows should be in a certain services sector and then estimate the tariff equivalent of policies from the difference between estimated and observed flows.

The results of these modelling approaches suggest that barriers to services trade appear to be substantial, especially for Modes 3 and 4. However, the approaches are still fraught with difficulties and drawbacks, such as the lack of availability of universally accepted measures of restrictions on services that can be converted into cost and price wedges in these various modelling frameworks. Despite their shortcomings, estimates from these quantitative impact approaches do provide a rough indication of the relative magnitude of prevailing barriers as well as the distribution of the gains to be realised from increasing competition in services markets for income and welfare. Across the board, the research suggests that potential gains from liberalisation may be quite large because of the numerous linkages between services and the rest of the economy.

### Suggested pro-development SDT arrangements and measures in RTAs

Our proposals for SDT arrangements in RTAs that would help Commonwealth small and low-income countries expand their access to the service markets of other countries fall into two main categories: negotiated outcomes and technical assistance.

#### (1) *Negotiated outcomes*

As explained above, service suppliers in small countries which are by definition small and possibly medium-sized enterprises, are primarily interested in Mode 1 and Mode 4 access. They are unlikely to have the resources to be able to invest abroad (Mode 3), and few countries restrict Mode 2 (consumption abroad).

(a) *Mode 1 access.* With respect to Mode 1, the developing countries should seek to have their developed country partners bind Mode 1 for all sectors or across-the-board, without any linkage to Mode 3. This would be important to ensure modal neutrality and the possibility for the most cost-effective means of service delivery.

(b) *Mode 4 access.* For political and security reasons, it is unrealistic to expect the developed countries to grant Mode 4 access for broad categories of

workers, especially those on the lower-skilled spectrum. However, a number of incremental improvements would be helpful:

- Mode 4 commitments should not be solely linked to commercial presence (i.e., investors and intra-corporate transferees), but should be expanded to include contractual service suppliers, independent professionals, trainees, technicians and semi-skilled workers.
- Workers granted access should be allowed to bring their spouses, and the issue of pension portability should be considered.
- Elements from bilateral labour agreements, such as those allowing entry of a limited number of low-skilled workers on a seasonal basis, should be incorporated into RTAs, under more flexible types of arrangement, to be reviewed annually.
- More effective approaches to address measures inhibiting Mode 4 market openings for service suppliers from developing countries should be formulated, including ways to more effectively address Economic Needs Test (ENT) measures. These could include the development of binding rules and conditions spelling out criteria for their use in services schedules, as well as mechanisms for periodic review.
- The negotiation of Mutual Recognition Agreements (MRAs) should also be encouraged, although this is a challenging undertaking among countries of different levels of development.

In addition, smaller and poorer countries should be given access to government procurement opportunities on a non-reciprocal basis, and they should be given longer time-frames for the implementation of commitments.

## *(2) Technical assistance*

Recent RTAs negotiated by the USA establish Committees on Trade Capacity Building that are tasked with overseeing all aspects of technical assistance, including helping to prioritise projects, requesting assistance from international organisations and others, and monitoring and assessing trade capacity-building projects. This seems to be a promising approach, but it is too early to assess how effective it has been. Another approach is exemplified by the 'Hub and Spokes' project of the Commonwealth Secretariat, which places experts in the trade ministries of the recipient countries. A mid-term review of the

project found that it was efficient and practical and had had a positive effect on capacity-building in the recipient countries.

Technical assistance could also be benchmarked, with respect to both the implementation of commitments, and the setting up of the regulatory structures that should accompany liberalisation. The smaller countries should seek to link their liberalisation commitments to the provision of technical assistance and the establishment of regulatory rules and structures for services that require intensive regulatory principles in order to ensure a pro-competitive market for suppliers, following the precedent of the DDA negotiations on trade facilitation. They should also seek to have the offers of technical assistance transformed from hortatory to mandatory provisions, so that failure to supply the specified assistance would provide a basis for resorting to dispute settlement.

## **Approaches to advancing SDT in a multilateral context**

While there is a great deal of hortatory language in the GATS and in various DDA documents about the importance of providing SDT to developing countries, it does not seem to have had the desired effect. The development of a reference paper on SDT that would set out the guidelines under which developed WTO members would provide SDT treatment to developing ones, and that would be open to adoption by WTO members would be useful. The content of the SDT Reference Paper, once accepted, would be binding in nature, similar to the binding character of the Telecommunications Reference Paper.<sup>2</sup> Such a reference paper would serve to correct the imbalance in other trade agreements whereby 'best endeavour' clauses for technical assistance are traded off against obligatory commitments for liberalisation on the part of developing countries. The binding commitments of the SDT Reference Paper, once accepted, would link the provision of training and other forms of technical assistance, particularly with the development of rules and expertise in the regulatory area, to the implementation of commitments by developing countries in specific service sectors.

Another approach that seems to have considerable merit is the proposal under discussion in the WTO

<sup>2</sup> The Telecommunications Reference Paper was adopted by many WTO members as part of their GATS commitments with respect to telecommunications. It imposes a series of principles designed to ensure that former monopoly operators do not impede the access of new suppliers to the market.

Services Committee that the developed countries be granted a waiver from the MFN obligations of the GATS, to enable them to establish a generalised system of preferences (GSP)-type programme in favour of LDCs with respect to services. This waiver proposal for services was a part of the interim package for the Doha Development Round proposed by WTO Director-General Pascal Lamy.

Some of the approaches developed in the RTA context would also be helpful to consider implementing multilaterally, including a collective decision by the WTO members to delink commitments on Mode 1 access from commercial presence so as to ensure modal neutrality for service suppliers; various incremental improvements to Mode 4 access that would benefit service providers from developing countries; and the granting of non-reciprocal access for developing country service exporters to the government procurement markets of the developed countries.

## Conclusion

Although the developed countries made many more market-opening commitments than the developing

countries in their GATS schedules and in RTAs covering services, these are often of little value to the small and low-income countries. Few of the latter have service suppliers large enough to be able to make Mode 3 investments. The Mode 1 and Mode 4 commitments by the developing countries are frequently linked to Mode 3 investments and therefore are also out of reach for the low-income countries. And Mode 4 commitments are generally limited to highly-skilled individuals, rather than the lesser-skilled where the poorer countries have an advantage. In future GATS and RTA negotiations, therefore, the small and low-income Commonwealth countries should focus on obtaining from the developed countries across-the-board Mode 1 commitments that are delinked from Mode 3, and should push for a broadening of Mode 4 commitments in ways that provide them with realistic access to the developed-country markets. In addition, it would be helpful to link market-opening commitments by the low-income countries to the receipt of adequate technical assistance in a binding manner, such as could be done possibly through the development of a reference paper on SDT.

# International Trade & Regional Co-operation Section at the Commonwealth Secretariat

This Trade Hot Topic is brought out by the International Trade and Regional Co-operation (ITRC) Section of the Economic Affairs Division (EAD) of the Commonwealth Secretariat, which is the main intergovernmental agency of the Commonwealth — an association of 54 independent states, comprising large and small, developed and developing, landlocked and island economies — facilitating consultation and co-operation among member governments and countries in the common interest of their peoples and in the promotion of international consensus-building.

ITRC is entrusted with the responsibilities of undertaking policy-oriented research and analysis on trade and development issues and providing informed inputs into the related discourses involving Commonwealth members. The ITRC approach is to scan the trade and development landscape for areas where orthodox approaches are ineffective or where there are public policy failures or gaps, and to seek heterodox approaches to address those. Its work plan is flexible to enable quick response to emerging issues in the international trading environment that impact particularly on two highly vulnerable Commonwealth constituencies — least developed countries (LDCs) and small states.

## Scope of ITRC Work

ITRC undertakes activities principally in three broad areas:

- It supports Commonwealth developing members in their negotiation of multilateral and regional trade agreements that promote development friendly outcomes, notably their economic growth through expanded trade.
- It conducts policy research and consultations increase understanding of the changing of the international trading environment and of policy options for successful adaptation.
- It contributes to the processes involving the multilateral and bilateral trade regimes that advance the more beneficial participation of Commonwealth developing country members, particularly small states and LDCs.

## ITRC Recent Activities

ITRC's most recent activities focus on assisting member states in the WTO Doha Round and the Economic Partnership Agreement (EPA) negotiations involving the African, Caribbean and Pacific countries (ACP) the European Union (EU), undertaking analytical research on a range of trade policy and development issues, and supporting workshops/dialogues for facilitating consensus-building on issues of Commonwealth members' interest, exchange of ideas, and disseminating results from informed analysis.

## Selected Recent Meetings/Workshops supported by ITRC

9 March 2011: Consultative Meeting on Trade Effects of Rules on Procurement for Commonwealth ACP members held in London, UK.

8 March 2011: Consultative Meeting on Making Trade in Services Supportive of Development in Commonwealth Small and Low-Income countries, held in London, UK.

16-18 February 2011: Conference on Regional Integration titled 'Caribbean Community and the Commonwealth: Collective Responsibility in the Twenty First-Century', held in Kingston, Jamaica.

17-19 December 2010: 3rd South Asian Economic Summit titled, Regional Economic Integration, Climate Change and Food Security Agenda for the Decade 2011-2020, held in Kathmandu, Nepal.

25-26 November 2010: Regional Seminar on Trade Policy for Commonwealth Caribbean Parliamentarians, held in St. Kitts & Nevis.

24-26 November 2010: International Dialogue titled, Exploring a New Global Partnership for the LDCs in the Context of the UN LDC IV, held in Dhaka, Bangladesh.

15-17 November 2010: Workshop on Competitiveness Strategies with Special Reference to African and Indian Ocean Small States, held in Port Louis, Mauritius.

3 November 2010: Pre-LDC IV African Civil Society Forum, held in Arusha, Tanzania.

16 September 2010: WTO Public Forum Session on Africa in international trade: impediments and opportunities, in Geneva, Switzerland.

28 June 2010: Consultation Meeting on WTO Accession, held in Brussels, Belgium

26 June 2010: Workshop on Policy Barriers in Intraregional Trade in South Asia, held in Dhaka, Bangladesh

## Selected ITRC Publications

Collier, P. (2011). *Catching Up: What LDCs Can Do, and How Others Can Help*, London: Commonwealth Secretariat.

Calì, M., Razzaque, M. A. and Te Velde, D. W. (2011). *Effectiveness of Aid for Trade in Small and Vulnerable Economies*, Economic Paper No. 91, London: Commonwealth Secretariat.

Calì, M with Kennan, J (2010). *The Global Financial Crisis and Trade Prospects in Small States*, Economic Paper, London: Commonwealth Secretariat.

Milner, C., Morrissey, O. and Zgovu, E. (2010). *Policy Responses to Trade Preference Erosion: Options for Developing Countries*. London: Commonwealth Secretariat.

Jones, E., Deere-Birkbeck, C. and Woods, N. (2009). *Maneuvering at the Margins: Constraints Faced by Small States in International Trade Negotiations*. London: Commonwealth Secretariat.

Razzaque, M. A. (ed) (2009). *Trade, Migration and Labour Mobility*. London: Cameron May.

Srinivasan, T N (2009). *LDCs, Landlocked Developing Countries and Small States in the Global Economic System*. London: Commonwealth Secretariat.

Stevens, C et al. (2009). *The CARIFORUM and Pacific ACP Economic Partnership Agreements: Challenges Ahead?*, Economic Paper No. 87, London: Commonwealth Secretariat.

Winters, L A et al. (2009). *An EU-India Free Trade Agreement: Reflections on the Implications for Excluded Countries*. London: Commonwealth Secretariat.

Calì, Massimiliano and te Velde, Dirk Willem (2008). *'Towards a Quantitative Assessment of Aid for Trade'*. Economic Paper, London: Commonwealth Secretariat.

Grynberg, Roman and Newton, Samantha (eds) (2008). *Commodity Prices and Development*. Oxford University Press.

Milner, Chris (2008). *Trading on Commonwealth Ties: A Review of the Structure of Commonwealth Trade and the Scope for Developing Linkages and Trade in the Commonwealth*. London: Commonwealth Secretariat.

Turner, L (2008). *'Quantifying Aid for Trade: A Case Study of Tanzania'*. Economic Paper, London: Commonwealth Secretariat.

Qalo, Veniana (ed) (2008). *Bilateralism and Development: Emerging Trade Patterns*. London: Cameron May.

Grynberg, Roman and Bilal, Sanoussi (eds) (2007). *Navigating New Waters: A Reader on ACP-EU Trade Negotiations*. London: Commonwealth Secretariat.

Razzaque, Mohammad A and Laurent, Edwin (eds) (2007). *Global Rice and Agricultural Trade Liberalisation: Poverty and Welfare Implications for South Asia*. London: Commonwealth Secretariat.

## Selected Ongoing Policy Research Projects

- Aid for trade in small states and Sub-Saharan Africa
- Trade and climate change issues for LDCs
- Rise of emerging developing countries and implications for Sub-Saharan Africa and small vulnerable economies (SVEs)
- Commonwealth Investment Framework Agreement
- Trade effects of Government Procurements on developing countries
- Development issues under EPAs
- Development aspects of trade-related issues and trade in services
- Regional trading arrangements in South Asia and their implications
- Trade in services issues for small states and low-income countries
- Fiscal implications of Pacific trading arrangements
- Issues in the context of the Fourth UN Conference on LDCs
- The development impact of the Doha Round on least developed countries (LDCs)
- The impact on small vulnerable economies (SVEs) of the Doha negotiations on agriculture, non-agricultural market access (NAMA), trade in services and development issues
- Non-tariff barriers in South Asia and Sub-Saharan Africa
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- Global value chains and the impact on growth in developing countries
- LDCs and SVEs in South-South trade



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hot topics

ISSN: 2071-8527 (print) ISSN: 2071-9914 (online)

Series editor: Dr Mohammad A Razzaque

Produced by the Economic Affairs Division of the Commonwealth Secretariat

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