Symposium: The First Five Years of the WTO

"General Agreement on Trade in Services"

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It now seems clear that the Congress showed some prescience in the process of enacting objectives for the Uruguay Round began in 1982. At that time, "services" accounted for about 70 percent of the U.S. economy, but the fear for many members of Congress was that the U.S. industrial economy was in the process of "hollowing out." Nevertheless, the Congress decided to press for foreign market access for services, which they knew would accelerate the restructuring of the economy of this country.

Since then, the U.S. economy has made a vast adjustment. Our industrialized sectors have become globally competitive, and yet we also have a strong services economy. Indeed, we also now have what is called an information economy, defined by rapid rates of change; wide, deep and sensitive capital markets; redundant, fast and stable telecommunications; and a premium on knowledge-based workers. The Congresses of the mid-1980's could not have predicted this development, but they did encourage it, in part by mandating services negotiations.

The basic mandate for the U.S. negotiators in the Uruguay Round is found in the Trade Act of 1988. Section 1101(a)(9) contained two basic objectives with respect to services: Gaining market access for services exports and establishing an international system of services agreements. The latter

objective eventually ripened into the General Agreement on Trade in Services, or GATS. My assignment today is to evaluated the first 5 years under GATS and perhaps indicate some work for the future.

I do not propose to do this in any detail in the 10 minutes I've been allocated. The Coalition of Service Industries, CSI, has already done the work anyway, when it responded in detail to USTR's request for comments in preparation for the Seattle Ministerial meeting last August. CSI commented specifically by sector, as well as outlining four overarching issues: structural issues (such as the services classification system, which is still evolving); regulatory reform; electronic commerce; and a special concern, government procurement. While I plan to touch on the first two of these issues, I want to look over this first 5 years and the future from a somewhat broader perspective.

The first issue such broad issue is the actual and perceived value of what has been negotiated. For all the effort that has gone into multilateral services negotiations over the last 15 years, there is surprisingly little market interest in these commitments.

I do not mean that American companies have failed to support the negotiations; quite the contrary. The services business community has devoted a substantial amount of money and executive time to these negotiations.

Nor do I mean that there would not have been some harm if these negotiations had failed, although I doubt it would have affected the services industries themselves so much as the assumptions for progress of the entire trading system.

What I mean is that if we were to look at middle income countries with roughly similar levels of development and resource endowments, but with widely dissimilar levels of GATS commitments, capital markets would not propose a significantly lower risk premium for the one with the greater services commitments. The reason for this lack of discrimination in favor of GATS bindings is that so far services negotiations have basically put into international commitments obligations that do not significantly open markets compared to what would have happened in those markets anyway. Moreover, since the opening of these markets was driven by the demand for capital or technology or both, the transformation to a more open environment is not likely to be

reversed. Therefore, as far as capital markets are concerned, GATS bindings don't change much, at least for now.

This should not be surprising. Economic history is replete with examples of the increase of trade without trade agreements. In the 19th century, unilateral reduction of barriers to trade in goods occurred not mainly through trade agreements -- indeed, most market opening was unilateral in those days -- but because transportation costs were falling. At the turn of the century, these costs were about one-quarter what they were at mid-century. Barriers to services are falling today for similar reasons. Our trade negotiations are to a great extent milestones in a path already broken by technology.

Nonetheless, trade commitments such as those in GATS are potentially beneficial, even in their current form. There was eventually a reaction to the rapid rates of change in the 19th Century, and a rapid increase in trade isolation, which hurt economies everywhere. These days, we can see the beginnings of a reaction to globalization in many countries, especially in developing countries. GATS commitments will help cope with that reaction. However, so far, capital markets don't seem to put much of a value on safety nets at the level of current practice.

Perhaps this analysis suggests that what we need to do is to move forward, toward commitments that really change current practice in developed and middle income countries. Without question, some such effort is advisable, and no doubt the built-in agenda process will eventually begin that effort. CSI has spoken to the details. But I believe there is another, perhaps more important, agenda item.

There are today regions of the world and countries where greater commitment probably would make a difference to capital markets, that is, where GATS commitments are likely to increase imports of capital and thereby improve chances for growth. These are the regions and countries of the least developed, where about 1/3 of humanity resides.

The trading system needs to think of the development of the least developed not as a question of granting uncompensated concessions but as a kind of tough love, where countries grow faster precisely because they do take on committments. In order to do this, we must realize that a new paradigm for

trade negotiations has developed, which we can cultivate for the mutual advantage of both developed and developing countries.

Services negotiations, particularly the tough ones like telecommunications and financial services, do not mainly invoke the classic paradigm of trade negotiations, in which countries exchange concessions in order to get access to each other's markets for their most competitive exports. In services negotiations, especially those where neither side makes concessions beyond current practice, developed and developing countries are seeking different but complementary objectives. The developed countries are, indeed, seeking market access. The developing countries, however, are seeking capital, service market development, and other inchoates that help build a competitive infrastructure.

We need to find ways to demonstrate that this tradeoff actually works in practice, because developing countries are unlikely to see developed countries as markets for their services at this stage, with some interesting but economically minor exceptions. The key, I believe, is to persuade countries that are traditionally marginal players to take the risk of real commitment. If we can see meaningful, practical GATS commitments begin to grow in south Asia, Africa south of the Sahara, in the Arab states, central Asia and the Former Soviet Union, then we can make capital markets notice. There can be no more important mission for the trading system in the next five years than to convince the governments in these regions that commitments are worthwhile, and then also to make our responsibility to convince the capital markets to reward those governments with lower risk premiums.

Which brings me to my second issue: The rule of law.

It is by now commonplace that every services negotiation is about two basic issues: domestic regulation and investment. These issues are also the critical issues on the question of attracting capital. In setting objectives for services negotiations in 1988, the Congress said that U.S. negotiators should take account of legitimate U.S. domestic objectives such as health, safety, security, environmental, consumer or employment opportunity interests and the laws and related regulations. The heart of the matter for us as well as our trading partners, in both developed and developing countries, is to find ways to serve these legitimate public objectives, while still introducing foreign investment, technology, and competition into our own and other markets.

In developed countries, such as Europe and even to some extent Japan, this is an issue of deciding to make laws work differently. Once Europe decided to encourage competition in telecommunications, or Japan decided to encourage competition in financial services, the difficulties were not over. But at least the issue was one of enforcing a law.

In many developing countries, there is a prior question: What is law? Open competition, especially competition involving foreigners, requires not less but greater enforcement of law: Real law, law that can bite. Impartial law, transparent law, law applicable to everyone, law with consequences. In some sectors, financial services for example, it is positively dangerous to allow foreign competition without adequate regulatory and supervisory control. Of the last 25 banking crises in the world, 18 were preceded by financial market liberalization. A nation cannot open its market to services if its concept of law requires that the Prime Minister's brother-in-law own the principal service supplier, because the regulator cannot punish the Prime Minister's brother-in-law for violating the rules.

This means that an essential prerequisite of future progress in services negotiations, particularly in the large, least developed areas of the world where these negotiations can have the greatest impact, is that nations somehow learn to do law. For their part, developed countries should resist making uncompensated trade concessions to countries that refuse to establish the rule of law. Instead, they need to make a major, unilateral effort to establish the domestic rule of law in developing countries as part of their development goals for 2015.

The foundation for this effort by developed countries already exists in the GATS. Articles III and VI of the GATS are a virtual Administrative Procedure Act for services. Article III requires publication or some other form of public notice of any "measure" relevant to the operation of the GATS. Article VI requires Members, in sectors where they have specific commitments, to make review of administrative decisions affecting foreign service suppliers; a statement to foreign applicants of decisions that affect them; and most of all that "all measures of general application affecting trade in services are administered in a reasonable, objective and impartial manner."

Whatever the legal impact of Articles III and VI, the idea that domestic regulation has to exist and that it has to be impartial and regular is new to much

of the world. It is hard to see how this language constrains the United States, but it is at war with bribery, with insider information, with keiretsus and star chambers. There is no telling what it means when applied to Japan and Singapore, much less to those nations on the WTO's doorstep, such as China, Russia and Saudi Arabia. Indeed, the fundamental question about these articles is whether they will quickly become dead letters because they are so far from the experience of the world at large. If we allow that to happen, we are condemning several billion potential customers to poverty, if not war, well into the next century. We must insist that these provisions be put into place, but we must realize the necessary skills cannot be learned in a day. Russia make take a quarter of a century more to learn the skill; China may be 50 years away from it. Without it, there must be a substitute.

We have some precedents for substitutes for domestic law, but they are not hopeful. One is pre-shipment inspection by private companies as a substitute for domestic customs procedures, which (as Ambassador Strauss once said of another bad idea) sounds good, if you say it fast. We need to work with developing countries to find alternatives. One might be regional mechanisms, where an elite and public-minded bureaucracy might be more easily developed. Another might be to create special channels of review or external but compulsory arbitration mechanisms until domestic legal developments catch up. Many businesses use these now. Whatever the right answer, the search for substitutes should begin in earnest now, together with a real developed country commitment to funding the training and discipline that will be needed ultimately.

The third issue is the need to address the overwhelming uncertainty about the meaning of the provisions of the GATS. The CSI paper discusses these uncertainties in some detail, but perhaps a few examples will highlight the problem in the GATS.

Virtually every normative provision of the GATS is interesting and even novel. Some of these provisions are so obviously problematic that they cry out for substantive re-negotiation. For example, Article V, on economic integration, weakens the comparable provision of the WTO. On the one hand, it appears (in a footnote) to outlaw the European practice of partial free trade agreements by providing that agreements "should not" provide for the *a priori* exclusion of any mode of supply. However, this is implicitly written out of the text by

paragraph 2, which requires that "consideration . . . be given" to the relationship of the FTA or a "wider process of economic integration," an obvious reference to the EU's policies. By permitting partial FTAs for services, the GATS will permit the EU to eventually achieve just what commenters have feared of FTAs, that they will effectively raise barriers to those not parties to them. This should obviously changed, as should indeed the European policy of partial FTAs for goods.

Many other normative provisions raise questions that are more subtle, but which could still be embarassing for the United States. However, so little is know about their origin and intention that it may be years before we discover the impact of these provisions.

But it gets worse. There is another half to the GATS commitment system, the specific sectoral commitments, which are contained in special schedules, and the provisions that surround them, called annexes. In general, the annexes are attempts to extend the general rules of the GATS to the specifics of sectoral regulation, whereas the schedules set out the obligations of governments, spread across a scheduling matrix bounded by subsector and by what are called modes. Modes are a scheduling convention which causes governments to list limitations on free access by how the service is supplied, i.e., cross-border, through investment, by visiting personnel, etc.

The main difficulty with these provisions is the difficulty of reading them, much less interpreting them. Goods tariff schedule reading and writing was always something of an art, but the service schedules make this skill less art than fetish. Supposedly, the staff of USTR and the interested U.S. agencies have refused to allow their political superiors to accept language which would needlessly bind the U.S. or give foreign governments too much room to squirm out of solemn obligations. We do not yet know whether this system has worked in this highly technical enterprise.

I do not advocate pausing in the movement forward to accomplish some kind of ecclesiastical exercise of figuring out what these provisions mean. That can only aid and abet those who want to frustrate progress. However, I think the United States in particular needs to begin to develop its capabilities to use the committee process, and introduce the Congress and the business community to the uses of these processes.

One of the great untold accomplishments of the WTO is to create an organization with legal personality. This arcane fact means that the committees and subcommittees of the WTO can decide themselves to undertake work without the creation of special negotiation instruments, such as "rounds." The Services Council already has a number of such committees, and the United States should now lend its efforts to using these bodies to clarify, if necessary through a system of commentaries on the GATS, those provisions which are not clear. We cannot leave this effort to the dispute settlement process, which is our inclination as a common law country. The GATS and indeed the WTO is much too fragile to take that kind of stress. We need to move forward through developing consensus in a committee process, rather than mainly through dispute settlement.

This brings me to my last issue, which is where to go from here? We have, in five years, brought up and got running a shaky but workable system of international rules. We have shown the capacity to negotiate under difficult circumstances, although the jury is out on whether these agreements are really enforceable or even meaningful in terms of market opening.

At this point, we do not have the benefit of the national consensus on direction given to U.S. negotiators in the Trade Act of 1988. However, based on that 12-year-old enactment, we know market access and a system of rules that does not pretermit legitimate domestic regulatory interests in the basic direction. Whether it is enacted this year or not, thoughtful people in Congress and business should now sketch out further marching orders. They will eventually be enacted.

One question that interests many in this regard is the role of competition policy moving forward. On this issue, I will close.

For reasons I don't have time to explain here, this issue is not one of general competition policy, however much the European Commission would like it to be. The domestic political objective of increasing the power of the Commission vis-a-vis the Member States is or should be irrelevant to the international issue.

The international issue is whether, in regulated industries, the GATS must in some way achieve a pro-competitive overlay on existing regulation in order to assure market access for foreign service suppliers. Market access cannot be had

by undermining or even limiting legitimate domestic regulatory objectives, such as the safety and soundness of financial institutions or the security of networks. Indeed, market access can only be expanded if it is a better way of achieving those objectives than the alternative. Countries do what is in their interest.

Moreover, much depends on what the alternative is. It is not discriminatory, and therefore should not be the subject of trade negotiations, to mandate that suppliers provide universal service, regardless of whether they are domestic or foreign. However, if the existing system is a monopoly that is supposed to, but does not, provide universal service, and competition would do a better job, then a pro-competitive overlay may be necessary, just to keep the monopoly from undoing any benefit of trade concessions.

This is theory that was applied in basic telecommunications, a sector where obligations and therefore the test of these types of provisions is only now coming into play. There are other state monopolies, such as healthcare, where the idea might be interesting, but politically difficult. Finally, there are many service sectors, such as construction, engineering, professional services, banking and others, where lack of competition is not the problem. In those cases, pro-competitive agreement provisions are more difficult to imagine.

Conclusions

The WTO membership has at least recognized the importance of the service sector in international commerce. It has developed a shaky, cumbersome but potentially workable framework of rules, procedures and obligations. While the obligations largely represent current practice, this is a good beginning. Detailed direction now needs to come from governments, but a key objective should be to increase least developed country participation as a way to promote the infrastructures and investments these countries will need to grow, using as appropriate their interest in access to capital and market development. Developed countries need, in this regard, to press for the rule of law in developing countries, especially the least committed and least developed.

Beyond this, an effort should be made through the GATS committee system to clarify the normative provisions and scheduling conventions of the GATS. Finally, in the special regulatory area of pro-competitive regulation, there may be some room for transferring the Basic Telecom rules to other sectors, but it is more important that GATS is not the path to general agreement

on international competition rules. That subject is nowhere near ready for international discussion, let alone negotiation.