15th PECC General Meeting

Brunei Darussalam

Focus Workshop on Trade

September 1, 2003
Room J-3
International Convention Centre

PECC Perspectives on WTO and APEC Services Agendas

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PECC Trade and Investment Issues in WTO and APEC Study Group on Services

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Presented to the Trade Workshop, 15th PECC General Meeting
Brunei Darussalam
1st September 2003

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The PECC Services Study Group has carried out work during 2003 in the area of domestic regulation that is directly relevant to both the WTO and APEC Services Agendas. This work has been inspired in part by the support that the PECC has provided over the past five years to the APEC Group on Services in the form of the project on the *Menu of Options for Voluntary Liberalization, Facilitation and Promotion of Economic and Technical Cooperation in Services Trade and Investment*. The third and final phase of this project was completed this August at the SOM III meeting of the APEC Group on Services in Phuket, Thailand. Work during this final phase focused in large part on the two questions of how to improve services regulation and how to deepen regulatory disciplines at the multilateral level in the context of the ongoing GATS negotiations.[1]

The work of the PECC Services Study Group has taken the issue of domestic regulation one step further to look at how useful and/or beneficial it might be to develop regulatory disciplines for specific service sectors. This work is particularly relevant at the present time, since it has proven extremely difficult to advance towards deeper horizontal disciplines at the multilateral level. Indeed, a more fundamental and heavyweight subject would be hard to find in the Doha Round Agenda since domestic regulation directly involves the issues that are at the heart of national sovereignty.

[1] The finalized document of the APEC Group on Services, *Menu of Options for Voluntary Liberalization, Facilitation and Promotion of Economic and Technical Cooperation in Services Trade and Investment* (2001) and its further extension through the elaboration of *Additional Elements for the Menu of Options* (2003) can be found at the official APEC web site under the Group on Services – www.apec.org.

Discussions on deepening disciplines for domestic regulation in the WTO Working Party on Domestic Regulation have become more sensitive rather than less sensitive, as the years have passed since the conclusion of the Uruguay Round. In the WTO General Agreement on Trade in Services, Article VI on Domestic Regulation sets out principles and rules for disciplines on non-quantitative, non-discriminatory domestic regulations "relating to qualification requirements and procedures, technical standards and licensing requirements". The Article mandates that disciplines be further developed to deal with regulatory measures not addressed by GATS Articles II (MFN), XVI (Market Access) and XVII (National Treatment). Aside from the difficulty of defining the specific types of measures that would be encompassed within a strengthened Article VI, there is no consensus at present among members of the world trading system that deeper horizontal disciplines would be either useful or desirable, given the diversity of regulatory practices and the sensitivity surrounding the perceived encroachment of the multilateral system and its officials on the ability of governments to design and implement the level and type of regulatory structure they desire at home. Governments are fearful that such multilateral disciplines would be able to subordinate domestic regulatory prerogative to trade policy objectives.

Many WTO members are also resisting an intermediate step which would be the generalized application of the current level of discipline that is specified by Article VI.4, namely that:

> "…..measures relating to qualification requirements and procedures, technical standards and licensing requirements are, *inter alia*:
>
> (a) based on objective and transparent criteria, such as competence and the ability to supply the service;
> (b) **not more burdensome than necessary to ensure the quality of the service;**
> (c) in the case of licensing procedures, not in themselves a restriction on the supply of the service."

At present this discipline is only applicable to scheduled service sectors contained in national Schedules of Commitments and not to all service sectors.

A well-known international services expert and former services negotiator for the United States (Dick Self), reflecting the views of several WTO members, has stated that :

> "….the question of 'burdensomeness' is in the eye of the beholder …",
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> and "…in the GATS over the past five years…..WTO members have made no progress in an effort to develop general disciplines that would apply to all services sectors under Article VI:4. This effort has gone nowhere and it will go nowhere."[2]

Given the lack of consensus to date on deepening horizontal disciplines for domestic regulation, the focus at present in the WTO GATS negotiations is on transparency and defining administrative procedures with more precision so that these do not serve as masked barriers to trade. However, the two questions that form the heart of the domestic regulation issue, namely whether the legitimacy of government aims enshrined in legal measures can be challenged under the WTO dispute settlement mechanism, and how to apply the necessity test to legitimate regulatory measures in order to ensure that these do not represent disguised barriers to trade, or unnecessarily burdensome regulations on service suppliers, have yet to be fully debated.

In this controversial context, members of the PECC Services Study Group chose to examine whether, in light of the difficulties encountered in pursuing deeper horizontal disciplines, it would be possible instead to develop deeper regulatory disciplines targeted at specific service sectors. With the blockage at the WTO level on moving forward on horizontal disciplines, the work of the Services Study Group was designed to stimulate discussion as to the value of an alternative approach. Rather than examining the twelve major service sectors one by one to see the relevance of specific disciplines, the PECC Services Study Group approached the issue by grouping service sectors according to their underlying characteristics and the reasons that justify regulatory intervention. The rationale behind this approach is that service sectors displaying similar underlying characteristics can be viewed as requiring similar types of regulatory disciplines.

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[2] Quoted in the paper by Julian Arkell on "The Prospects for Liberalisation in Services" presented at the Wilton Park Conference, 27-30 May 2003.

Moreover, these characteristics are likely to present themselves in the same sectors across all economies. This approach has also been followed in recent publications by international services experts.[3]

In spite of the large diversity of services sectors, the basic rationale behind government action is remarkably similar depending upon the underlying economic and social reasons present for regulatory intervention. There are basically four reasons behind a government's decision to regulate:

1) the presence of monopolies in network services (e.g. telecommunications, transportation and energy services);
2) the presence of asymmetric information applying to knowledge and intermediation-based services (e.g. financial and professional services);
3) the presence of externalities associated with services supply (e.g. transport, tourism); and
4) the desire to ensure social objectives and universal access in essential services (e.g. health and education services).

Additionally, the mode in which services are delivered may affect the type of regulation that can be or should be developed. The challenge of the growing number of services supplied through cross-border means is a particular case in point.

Members of the PECC Services Study Group addressed the feasibility and desirability of developing sectoral disciplines for services under two of the above considerations. The authors of the policy notes find in general that developing regulatory disciplines requires an understanding of the economic properties of the services industry as well as an appreciation of the social objectives that it satisfies. To the extent that an industry displays the same economic properties across markets and societies share universal social objectives, then a set of common regulatory principles can be developed

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[3] See publication edited by Christopher Findlay (2001) on *Towards Improving Regulation for Services*, conference proceedings, chapter 1, and the chapter by Aaditya Mattoo and Pierre Sauve in the forthcoming volume that they co-edit (2003) on *Domestic Regulation and Trade in Services.*

for service sectors within the multilateral trading system. However, this involves a delicate balance in trying to ensure the effectiveness of such sectoral regulatory disciplines within the multilateral framework, while avoiding over-prescribing a regulatory regime that may not accommodate the diversity of national social and economic environments, institutional frameworks and legal infrastructures. In this context, the PECC services experts suggest that one way forward is to have a mix of a binding and non-binding regulatory framework where WTO members may be bound by general sectoral regulatory principles, with more detailed implementing rules and regulations subject to specific commitments.

A fourth policy note looks at the question of "Investment Issues and their Interface with Services" in light of the imminent WTO Cancun Ministerial Meeting. This note attempts to tie in the services and investment components of the PECC Trade Forum work in a cross-cutting fashion. The following provides a summary of the findings of the various experts.

I. Developing Regulatory Disciplines for Network Services

The policy note by Deunden Nikomborirak and Ramonette Serafica examines the reasons behind, and the implications for, developing regulatory disciplines for network services, or those services which are characterized by the tendency to natural monopoly through the presence of both economies of scale and economies of scope. WTO members have already achieved a precedent in this regard in the form of the 1997 Reference Paper on Basic Telecommunications. The Reference Paper elaborates pro-competitive regulatory disciplines in several areas that ensure access to essential telecommunications infrastructure and that are consistent with good governance. Such disciplines are meant to reinforce market access commitments in the telecom area. Although the Reference Paper is voluntary, once accepted by WTO members, it becomes binding. Nikomborirak and Serafica believe that for other network services that display market characteristics similar to that of telecommunications, some form of additional

regulatory disciplines are a prerequisite for market liberalization. They suggest that a similar set of disciplines to that of the Reference Paper could be extended to other network-based services such as transportation, water and electricity, which also typically contain monopoly elements that require government intervention to protect consumers and ensure availability of these essential services.

The experts feel, however, that the present provisions of the Telecom Reference Paper are insufficient. They therefore suggest adding the additional elements below to a network-services regulatory template in order to ensure the effectiveness of regulatory disciplines for other network-based sectors. These include:

a) the requirement to clearly specify the regulatory objective in order to promote transparency in administration and implementation of the regulation;
b) the inclusion of a provision to address the abuse of a dominant position in a market to foreclose competition (for example, the potential abuse of a dominant position by a national airline into related activities, or of large international shipping companies);
c) the inclusion of a provision to ensure that standards (such as safety and environmental regulations in the transportation sector) are reasonable and administered in a transparent, non-discriminatory and neutral manner and are not more burdensome than necessary (in a manner similar to that required under GATS Article VI.4).
d) the requirement to ensure that an industry is not over-regulated (e.g., it should not be necessary to regulate very small-scale producers, such as small electricity generating companies);
e) the inclusion of a provision concerning cross-border anti-competitive business practices that may be beyond the reach of domestic regulations or competition laws and that will allow those affected to have an international recourse (e.g. international maritime shipping cartels).

Lastly, the experts advocate the recourse to peer reviews and the use of codes and standards as mutually reinforcing mechanisms at the multilateral level that could be used to strengthen compliance of regulatory disciplines at the sectoral level. They suggest including a regulatory review for specific service sectors as part of the current WTO Trade Policy Review mechanism.

II. Developing Regulatory Disciplines for Professional Services

The policy note by Patricio Contreras examines the case for regulating professional services, due to the presence of asymmetries of information which arise in this sector as consumers are unable to assess the quality of the service provided. Contreras distinguishes between accredited professions, such as accountants, architects, doctors, engineers, lawyers, veterinaries and teachers, from other professional services such as consulting or advertising. For the former, the quality of service provided is critical for the consumer and such professions are subject to accreditation. Their quality tends to be observable, though in most cases only ex-post. For the non-accredited professional services, the quality of the service is either less critical or less observable, and therefore Contreras suggests that the development of regulatory disciplines should encompass the accredited professional services only.

Government intervention through regulation is almost always necessary in the area of professional services as market-based mechanisms (such as reputation, contractual guarantees of performance quality, performance bonds, or third-party accreditation) are not adequate for consumer protection. Contreras points out that many of the regulations (or sometimes their absence) that are put in place for professional services pose impediments to competition and international trade. While certain regulations are overtly protectionist (such as nationality or residency requirements), others (such as professional certification/ entry requirements) may restrict competition and trade more than is necessary, raising the price and limiting innovation. Asymmetries in regulatory regimes – both requirements and procedures - between countries may also

constitute barriers to trade in professional services. At present very few mutual recognition agreements have been concluded that overcome these barriers.

One way to mitigate the barriers posed to international trade in professional services is to negotiate common multilateral regulatory disciplines. WTO members have already developed a precedent in this regard in the form of the Disciplines on Domestic Regulation in the Accountancy Sector, adopted by the Working Party on Professional Services in November 1998. The Accountancy Disciplines contain provisions on transparency requirements, administration of licensing requirements, qualification requirements and procedures, and technical standards for the accountancy profession. A key provision of the Disciplines is the general requirement that regulations "are not more trade-restrictive than necessary to fulfill a legitimate objective. Legitimate objectives are, *inter alia,* the protection of consumers, the quality of the service, professional competence, and the integrity of the profession." Although the Accountancy Disciplines have not yet come into force, the intention of WTO Members is to bring them into effect and make them binding at the conclusion of the Doha Development Round.

Contreras believes that for other professional services that display market characteristics similar to that of accountancy, some form of additional regulatory disciplines similar to those mentioned above are a prerequisite for stimulating international trade. He suggests that whether the existing regulatory provisions for accountancy can be extended to other professions depends on the magnitude and impact of the information asymmetry and how this differs between professions and between countries and concludes that :

1) The deeper disciplines on transparency, licensing requirements and procedures, qualification requirements and procedures set out in the Accountancy Disciplines, can be applied to all accredited professional services, though some variation in specialized provisions may be needed;
2) The stronger version of the 'necessity' test set out in the Accountancy Disciplines can be applied to all accredited professional services, as

consumer protection should be a common regulatory objective to all professions;

3) Mutual recognition agreements may be recommended for those professional services where it is more possible to observe quality ex-post (such as legal services, engineering services, medical services). For those services where it is not possible to observe such quality easily (such as accountancy or auditing), it is preferable to develop internationally harmonized and recognized standards.

III. Developing Disciplines for Cross-Border Electronic Trade in Services

The policy note by Alexandra Sidorenko and Christopher Findlay discusses the problems posed for regulators by cross-border electronic trade in services, known under the GATS as mode 1, or cross-border supply of services via the mail or the internet (and at times undistinguishable from mode 2 of services trade, or consumption abroad). The note focuses on how e-commerce issues have been treated to date in the WTO, asking broadly the following questions:

1) Do the existing core agreements (GATT, GATS and TRIPS) apply to electronic commerce? Should disciplines for electronic commerce be developed within any of these three areas, or should a new horizontal approach be adopted?
2) Is there a need for specific trade-related regulatory guidance in areas like consumer protection and data privacy, and should this be under the purview of the WTO or other bodies?
3) What further liberalization would support the growth of the Internet and foster electronic commerce?

In answer to the first question the Sidorenko and Findlay point out that how the existing WTO agreements apply to e-commerce is still under question. To a large extent the answer to this question depends upon whether an e-commerce transaction is defined

exclusively as a service (the preference of the EU) or as either a good or a service, depending upon the form it can acquire (the preference of the US). Adopting the former approach would sit electronic transactions squarely within the GATS, while opting for the second would blur the lines.

The outcome of this debate will have significant consequences on what type of liberalizing impulse may be given to e-commerce under multilateral trade rules. The national treatment discipline under GATT (applying to goods) is a general obligation but applies only to internal measures like taxes or regulations and not to border measures like tariffs. Under the GATS (applying to services), national treatment applies to all measures affecting services supply but it is not a general obligation and only applies to sectors which have been scheduled. Thus if a sector has not been scheduled, foreign service suppliers could be subject to discriminatory internal or differential taxes. Also, the GATT contains a general prohibition of quantitative restrictions, but these are only prohibited or subject to bound ceilings in the GATS in sectors where specific commitments have been made. Thus items can be treated differently if they are categorized as a good or a service. The implications for e-commerce transactions are significant in that treatment under the GATS could be less liberal than under the GATT. The authors suggest following the recommendation of an e-commerce expert, requiring governments to adopt the more liberal treatment when relevant. However, this would necessitate a specific decision by all WTO Members.

While some international trade experts argue against an entirely new horizontal discipline for internet trade on the grounds that existing rules can accommodate these transactions, others underline that many issues remain unresolved because of the classification problems around electronic trade. No initiative has been taken to date to develop a 'horizontal text or a WTO Annex on Pro-competitive Regulation and Open Markets for E-Commerce'. The risk is that by following a piecemeal approach, new barriers will emerge through government application of new regulations, which will then take time to dismantle. One way forward suggested by the authors is to adopt a cluster

approach to negotiating liberalization of e-commerce which would encompass both goods and services, something not yet attempted in the WTO/ GATT context.[4]

Sidorenko and Findlay suggest that it would be useful to consider the development of multilateral regulations to apply to e-finance, since consumer protection remains a major issue of cross-border trade in financial services. Asymmetry of information between providers and consumers of these services necessitates regulation of the sector, and the cross-border aspect of the relationship adds on the complication of multiple jurisdictions. Another possibility for addressing electronic transactions in a holistic manner would be to consider impediments to particular modes of supply and to develop model schedules for commitments and necessary disciplines for e-commerce transactions under mode 1. The project on e-APEC is particularly relevant in this context.

IV. Investment Issues and their Interface with Services: the Road to Cancun

The policy note by Pierre Sauve and Maryse Robert provides a cross-cutting analysis of the interface of investment and services issues. The experts underline the unequal treatment accorded to investment under the current structure of multilateral rules. While a phenomenal number of bilateral and regional trade agreements have covered investment within binding obligations, the current multilateral regime remains very limited in scope, primarily confined to performance requirements in the WTO Agreement on Trade-Related Investment Measures (TRIMS), which covers goods only, and to modes 3 and 4 of the supply of services under the GATS through commercial presence and the movement of natural persons associated with a foreign direct investment. The experts argue that at present the WTO framework suffers from a clear imbalance and lacks “modal neutrality”. Whereas the WTO includes disciplines on trade in goods and

[4] The core e-commerce goods and services which would be included in this cluster include: telecommunications basic infrastructure, value-added and support services; telecommunications and IT equipment and support services; Internet access, hosting and design services; online payment processing systems; delivery (post and courier) services; transport services; distribution services; and other services (legal, advertising, market research, photographic).

services, it has yet to cover comprehensive investment rules and guarantees of investor protection for goods and services.

A Working Group on the Relationship between Trade and Investment was established at the First WTO Ministerial Conference in Singapore in 1996 and this work was intensified in the Doha Ministerial Declaration in 2001 (paragraph 22) which instructed the Working Group to focus on the clarification of seven issues: (i) scope and definition, (ii) transparency; (iii) non-discrimination; (iv) modalities for pre-establishment based on a GATS-type positive list approach; (v) development provisions; (vi) exceptions and balance-of-payments safeguards; and (vii) consultation and the settlement of disputes. Since then some WTO members have argued that this list is not closed and should also allow for discussion of performance requirements, investment incentives and/or investment protection.[5]

Major controversies within the Working Group have revolved around a number of key issues, such as the breadth of the definition of "investment" and "investors" and the implications thereof; the extent of transparency obligations, notably in respect of prior notification requirements, the degree and form of technical assistance required to help developing countries; the operational modalities of development provisions governing the trade and investment interface in a possible WTO investment framework; the desirability of replicating a GATS-like approach to scheduling liberalization commitments; and the links between foreign direct investment and technology transfer.

Sauve and Robert underline, however, that the question of developing multilateral disciplines on investment following the Cancun Ministerial, should WTO Members decide to do so, are deeper and more far-reaching than what has been discussed to date in the Working Group. These involve looking at the WTO system itself and how investment rules would be "accommodated" into the current four-pillar structure of the

[5] Paragraph 22 also requires that the "special development, trade and financial needs of developing countries and least-developed countries should be taken into account as an integral part of any framework, which should enable members to undertake commitments and obligations commensurate with their individual needs and circumstances."

WTO where disciplines are separated in their application (one pillar for goods under Part I, one pillar for services under Part II, one pillar for intellectual property under Part III, and one pillar for the dispute settlement mechanism under Part IV). Given that investment covers activities encompassing goods, services and intellectual property (and that generally these are indistinguishable in practice given the integrated nature of output and the use of services as intermediate inputs into all final products, whether they be goods or services), the current structure of the WTO would need to be rethought and possibly recast for it to be "trade relevant" in the modern context of international trade.

The experts point out that reaching an agreement on a generic non-discriminatory regime for investment under the WTO extending to all areas covered by WTO rules (i.e. goods, services and intellectual property) would constitute a significant achievement. They see this as a possible intention of Paragraph 22 of the Doha Development Agenda. However, they emphasize that incorporating a generic set of investment rules into the WTO framework would entail significant systemic consequences through significantly expanding the scope of WTO coverage to a range of "inside the border" measures. This would also imply a degree of architectural overhaul that WTO members have not yet begun to address in earnest.

Questions that an architectural overhaul would elicit include the following:

1) Are WTO members prepared to contemplate a GATS covering solely cross-border trade in services (as is done in the NAFTA and other free trade agreements that have adopted a similar structure)?
2) Could a case be made in such circumstances to also treat labor mobility issues (mode 4 of the GATS) in a generic fashion, thus affirming the equivalence between movements of capital and labor within the trading system? Would a stand-alone WTO agreement on labor movement be of sufficient potential benefit in mobilizing meaningful commitments in this area to enlist support by developing countries for the launch of a negotiation on investment disciplines?

In the absence of answers to a systemic overhaul, questions raised by inclusion of investment disciplines into the *current* WTO structure include the following:

3) How would existing WTO disciplines relate to any new set of investment rules? Would the TRIMS Agreement be incorporated by reference? Would its scope of prohibited measures be modified, expanded, clarified?
4) How would the treatment of commercial presence (mode 3) in the GATS co-exist alongside a generic set of new investment disciplines? In particular, how would the definition of commercial presence contained in the GATS (focusing on matters of both pre- and post-establishment) be made coherent with the adoption of a possibly narrower definition in a new WTO investment accord?

Sauve and Robert feel that, given the numerous complexities raised by the questions above, placing the investment liberalization agenda in *existing* WTO agreements – namely the GATS – may be a more promising approach. In this case the focus would be on improving market access commitments under mode 3. Without prejudice to the evolving discussions in Geneva, the authors set out the core elements that may likely feature in a future multilateral framework on investment, suggesting that the hard core disciplines on investment protection will remain within the context of regional and bilateral trade agreements.

List of Papers prepared by members of the PECC Services Study Group for the work carried out during 2003

1. *Developing Regulatory Disciplines for Network Services*
   Deunden Nikomborirak (Thailand) and Ramonette Serafica (Philippines)

2. *Developing Regulatory Disciplines for Professional Services*
   Patricio Contreras (Chile)

3. *Developing Regulatory Disciplines for Cross-Border Electronic Trade in Services*
   Alexandra Sidorenko (Australia) and Christopher Findlay (Australia)

4. *Investment Issues and their Interface with Services*
   Pierre Sauve (Canada) and Maryse Robert (Canada)