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**Working Paper**

## The GATS turns ten: A preliminary stocktaking

WTO Staff Working Paper, No. ERSD-2004-05

**Provided in Cooperation with:**

World Trade Organization (WTO), Economic Research and Statistics Division, Geneva

*Suggested Citation:* Adlung, Rudolf (2004) : The GATS turns ten: A preliminary stocktaking, WTO Staff Working Paper, No. ERSD-2004-05, World Trade Organization (WTO), Geneva, <https://doi.org/10.30875/f4795f5f-en>

This Version is available at:

<https://hdl.handle.net/10419/90660>

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**World Trade Organization**

Economic Research and Statistics Division

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**THE GATS TURNS TEN: A PRELIMINARY STOCKTAKING**

**World Trade Forum 2004**

Rudolf Adlung: WTO

Manuscript date: August 2004

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# THE GATS TURNS TEN: A PRELIMINARY STOCKTAKING

Rudolf Adlung<sup>1</sup>

## Abstract:

*The paper discusses the experience to date with the implementation and application of the General Agreement on Trade in Services (GATS), some ten years after its entry into force. One striking observation is the smooth functioning of the Agreement, which has created far less tensions and frictions, including at Ministerial Meetings, than its difficult negotiating history might have suggested. This is due in large part to a high degree of flexibility at several levels: Members have more scope than under the GATT to depart from common horizontal obligations, in particular the MFN principle; they are able to adjust the breadth and depth of their trade commitments (market access and national treatment) to particular sector conditions; and they face less constraints, if any, in the use of trade-related policies such as subsidies, export restrictions, or domestic regulatory interventions. An additional source of flexibility is the uncertainty still surrounding a few core concepts of the Agreement and their sometimes daring application in individual schedules. While the ongoing negotiations also provide an opportunity for technical corrections of scheduling problems, the basic (built-in) flexibility elements of the Agreement - including the bottom-up approach of undertaking sector commitments and the possibility of inscribing limitations under individual modes - will, of course, persist. (Their actual relevance may, nevertheless, differ significantly between 'old' Members and countries negotiating their accession to the WTO.) Given the broad reach of of the Agreement in terms of membership, sector application, and modal coverage, flexibility may be considered a *conditio sine qua non*. There is little reason to believe that a more rigid structure would have been acceptable to Uruguay Round participants and, even if so, that it would have proven stable and resilient over time. However, flexibility may come at a cost: lack of meaningful obligations across a reasonably broad range of service sectors. Vested interests may find it far easier than under the GATT to defend their privileges and defy more rational and harmonized trading conditions. While the paper discusses formula-based approaches that have been proposed to improve the quantity and/or quality of sector commitments within the existing framework of GATS, there should be no illusion about the scope for technical solutions to what constitutes a political and institutional challenge.*

JEL classification: F02, F13, H70

Keywords: WTO, Trade in Services, Rules, Liberalization

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<sup>1</sup> Trade in Services Division, WTO Secretariat. An earlier version of this paper was presented at the World Trade Forum 2004 (Bern, Switzerland); a conference volume is under preparation. Philippe Borel deserves particular credit for his helpful comments.

## I. INTRODUCTION

The creation of a trade agreement for services and its integration into the multilateral system proved one of the most controversial issues in the run up to and during the early stages of the Uruguay Round.<sup>2</sup> Somewhat surprisingly, the Agreement that ultimately emerged from the negotiations has functioned very smoothly since. The GATS, and services trade in general, have generated less tension and friction than any comparable area within the remit of the WTO. Contrasting with a lot of public excitement, services have not created difficulties at any of the post-Marrakesh Ministerial Meetings, including in Seattle and Cancún. The services parts of the draft declarations prepared in Geneva have been submitted to Ministers without substantive problems requiring a decision on their part.<sup>3</sup> In the same vein, services have given rise to very few trade disputes over the past ten years. Only two of the more than 100 Panel cases brought under WTO Agreements - United States and Mexico over telecommunication services, Antigua/Barbuda and United States over gambling and betting services - have centred exclusively on the interpretation of obligations assumed under the GATS.

The apparent success of the Agreement or, at least, the absence of major problems to date may be attributed to at least three factors:

First, the novelty of a number of core elements involved and the need, within individual governments, to coordinate with ministries and agencies that had not previously been exposed to concepts of international trade. Many Members may thus have hesitated to undertake commercially significant obligations and/or to defend their rights out of ignorance or fear of unintended repercussions. Such effects are likely to fade over time, however.

Second, the lack of stringent, non-modifiable trade obligations. There are virtually no requirements that individual Members might find difficult to meet or, otherwise, elude under relevant exemptions. The GATS offers more scope for departures from most-favoured-nations (MFN) treatment - one of the few horizontal obligations that apply across virtually all services - than is the case under relevant GATT Articles. Moreover, traditional building blocks of the GATT, including the prohibition of quantitative restrictions and the automatic guarantee of national treatment with regard to domestic rules and regulations, are negotiable under the GATS.<sup>4</sup>

Third, the absence of fully fledged counterparts to some - important and controversial - GATT rules. In particular, the GATS does not contain any export-related provisions that would constrain a Member's ability to restrict or promote supplies under any of the four modes of supply, nor are there trade remedy mechanisms (safeguards, countervailing duties, and anti-dumping measures) that could be invoked by affected trading partners. And the rules governing domestic regulations are comparatively weak. For example, Member governments would not be prevented at present from operating excessively restrictive standards or licensing and certification systems.<sup>5</sup> The GATS provides for further negotiations in some of these areas, but there has been little progress in almost ten years.

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<sup>2</sup> Croome (1999).

<sup>3</sup> The only open issue to be decided in Cancún was the date by which improved offers of specific commitments should be submitted. The target date for the submission of initial offers, contained in the Doha Ministerial Declaration of November 2001, was end-May 2003. Thirty-eight WTO Members, including the EC as a whole, had submitted such offers prior to the Cancún Ministerial in September 2003.

<sup>4</sup> Members assume market access and national treatment obligations only in sectors they have listed in their national schedules ('bottom-up' scheduling) and only to the extent that they have not inscribed limitations or specific exclusions under one or more of the four modes of supply: cross-border trade (mode 1), consumption abroad (mode 2), commercial presence (mode 3) and presence of natural persons (mode 4). For more details see, for example, WTO (2001a), Chapter IV.

<sup>5</sup> The commercial value of similar market access and national treatment commitments may thus vary significantly across sectors and Members.

The flexibility of the GATS, its track record to date and its implications for trade policy making, are a natural starting point for a preliminary stocktaking. Given the Agreement's basic structural features, as outlined above, it may be useful to distinguish three axes along which flexibility can be exercised:

- "Horizontal" (across WTO Members): Use of MFN exemptions, recognition measures and other possible departures from MFN treatment (e.g. regional integration, general exceptions, prudential measures in financial services);
- "Vertical" (across sectors and modes of supply): Variations in breadth and depth of market access and national treatment obligations; free choice of policy instruments;<sup>6</sup>
- "Diagonal" (across policy disciplines): Non-harmonized use of domestic regulations (e.g. services standards, licensing and certification systems); free determination of export-related policies; exclusion of so-called governmental services.<sup>7</sup>

Further, given the vagueness of some core provisions and the (current) absence of authoritative interpretations, Members may feel less constrained in the use of trade measures than under a long-tested agreement.

While the following section focuses on the status of the MFN principle and related possibilities for club formation in services trade (in addition to 'conventional' preferential trade agreements), the third section briefly describes current patterns of access obligations assumed by Members. The fourth section provides an overview of certain conceptual and interpretational problems, their effects on the application of core provisions (MFN, market access and national treatment), and the ensuing scope for clarification. It is followed by a brief discussion of the long-running negotiations in four rule-making areas: domestic regulations, emergency safeguards, government procurement, and subsidies. The question is raised whether 'variable geometry' would offer a solution. A final section provides a brief assessment and outlook of the ongoing services round.

## **II. MFN TREATMENT: CORNERSTONE WITH FUZZY EDGES**

The MFN requirement is the only core obligation that has a similar status in both GATT and GATS. However, in addition to 'traditional' exceptions, such as for regional integration projects, the GATS contains a sweeping exemption for all MFN-inconsistent measures that Members listed at the end of the Uruguay Round or, if later, the date of accession. Moreover, in possible response to the Agreement's broad modal coverage and the dearth of international standards in services, the drafters of GATS provided more scope for (discretionary) recognition of foreign standards, licences and certificates than exists under the GATT.

### **1. Article II (MFN) Exemptions**

The role of the MFN principle within the framework of GATS and, closely related, the question of sector coverage were hotly debated up to the final stages of the Uruguay Round.<sup>8</sup> Should MFN be granted horizontally across all services, or only in sectors subject to a Member's access commitments? The former option appeared elusive for various reasons, including concerns about potential free-riders in sectors such as financial services; vested interests in perpetuating entrenched

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<sup>6</sup> Article XX:1 of the GATS contains only one basic obligation governing the assumption of specific commitments in services: each Member is required to submit a schedule. There is no further guidance concerning the number of commitments, let alone the product scope, modal coverage, or level of access.

<sup>7</sup> Services that are "supplied neither on a commercial basis nor in competition" are explicitly exempt from the definitional scope of the Agreement (Article I:3).

<sup>8</sup> Croome (1999).

bilateral regimes and reciprocity conditions (not least in transport); and sector-related sensitivities in Europe and elsewhere (e.g. with regard to audiovisual services). Nevertheless, the Agreement that ultimately emerged from the negotiations covers virtually all sectors, with the only wholesale exclusion applying to large segments of air transport, and is based on the MFN principle.<sup>9</sup> On the other hand, Members were permitted, pursuant to Article II:2 of the GATS, "to maintain a measure" inconsistent with MFN treatment provided it had been listed at the entry into force of the Agreement. (However, the relevant lists subsequently submitted by individual Members contain not only existing measures, as the above language seems to imply, but also a few exemptions that might prove necessary in future, for example, in the context of advancing regional integration projects.)

The Annex on Article II Exemptions stipulates that exemptions should not exceed ten years "in principle", are subject to a first review after no more than 5 years, i.e. in 2000, and are to be negotiated in any subsequent trade round.<sup>10</sup> There is thus no possibility for WTO Members to seek new exemptions under these provisions, not even for existing measures that had escaped their attention during the Uruguay Round or, in the case of recent Members, the accession process. The only - relatively onerous - option would be to negotiate a waiver under Article IX:3 of the WTO Agreement. However, during the period under review, from January 1995 to end-July 2004, no such attempts were made for MFN-inconsistent measures.

An overview produced at the time of the first MFN review in 2000 lists over 420 exemptions, involving more than two-thirds of the WTO Members (counting the EC as one).<sup>11</sup> Most exemptions, some 55 per cent, relate to inter-governmental agreements and are thus not apparently associated with unilateral policy initiatives. Not surprisingly, the sector focus is on services that have attracted relatively few commitments, in particular the various transport sectors (35 per cent) and audiovisual services (20 per cent).<sup>12</sup> The vast majority of the exemptions, over 90 per cent, are intended by the Member concerned to apply for an open-ended ("indefinite", "unspecified", etc.) time period. This needs to be set, however, against the timeframe provided for in the Agreement - maximum duration of ten years "in principle"- and the commitment to negotiate the removal of exemptions in subsequent trade rounds.

## 2. Recognition Measures

The need to provide scope for recognition measures, despite their tension with the MFN requirement, appears particularly pressing in the context of a services agreement that covers not only product flows, but extends to factor movements. Conformity with prevailing standards and other regulatory requirements is a core determinant of foreign products/producers being permitted to

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<sup>9</sup> An Annex to the GATS exempts measures affecting air traffic rights and services directly related to the exercise of these rights for all but three specifically listed services from the Agreement's cover. This exemption is to be reviewed at least every five years; the first review, terminated in November 2003, did not produce any results. In maritime transport, where sector-specific negotiations were extended beyond the timeframe of the Round, but remained inconclusive, the MFN requirement applies only to those (sub-)sectors that a Member has inscribed in its schedule of commitments. Negotiations continue, however, within the framework of the current round. Further, as noted before, the Agreement explicitly excludes from cover services that are supplied in the exercise of governmental authority.

<sup>10</sup> In conducting the review, the Council for Trade in Services is mandated under the Annex to "examine whether the conditions which created the need for the exemption still prevail; and determine the date of any further review". The first review was conducted at Council meetings in May, July and October 2000 (WTO documents S/C/M/44, 45 and 47); the second review was to begin no later than June 2004 (S/C/M/53, section A).

<sup>11</sup> The overview was prepared by the OECD Secretariat (OECD, 2001) on the basis of an informal document by the WTO Secretariat.

<sup>12</sup> The existence of a specific commitment guarantees the indicated (minimum) level of treatment vis-à-vis all Members. In turn, this implies that whenever a binding has been assumed for a particular mode, the Member concerned has relinquished the possibility of listing MFN exemptions that would qualify the scheduled level of treatment. See WTO document S/L/92 of 28 March 2001 ("Scheduling Guidelines"), para. 21.

compete. Article VII of the GATS is intended to provide legal cover for the autonomous or mutually agreed recognition of qualifications, licences, certificates etc. obtained in another country. If there are parallel, but not necessarily similar, WTO provisions in the area of goods, they are to be found in the Agreement on Technical Barriers to Trade (TBT) and the Agreement on Sanitary and Phytosanitary Measures (SPS). Yet Article VII is weaker and contains no explicit encouragement, let alone requirement, to recognize equivalent foreign regulations, but merely provides a procedural framework.<sup>13</sup>

Recognition measures are neither subject to review or sunset provisions, nor to disciplines comparable to those governing economic integration agreements under Article V of the GATS (substantial sector coverage, etc.). However, recognition must not constitute "a means of discrimination between countries" in the application of standards etc. or "a disguised restriction on trade in services" (Article VII:3). Interested Members shall be afforded adequate opportunity to negotiate their accession to such agreements or, in the event of autonomous recognition, to demonstrate that their education, licences, etc. should be recognized as well (Article VII:2). In short, Article VII provides an exception from the MFN requirement under Article II:1 for an indefinite period of time, balanced with procedural disciplines that are designed to prevent recognition measures from being used "to dilute entirely the MFN obligation".<sup>14</sup>

It appears, however, that these provisions have been rarely used since the GATS' entry into force. Between January 1995 and July 2004, Members submitted no more than 42 notifications under Article VII:4, covering some 120 agreements or measures. (The precise figures are subject to an element of uncertainty since it is not possible, given differences in terminology, to infer from all notifications whether they cover agreements also notified by other parties.)<sup>15</sup> About two-thirds of all notifications relate to 'old' agreements, which predate the GATS or the relevant Member's accession to the WTO; some date even back to the late 19<sup>th</sup> century, in particular in Latin America. About 105 of the notified 120 initiatives are bilateral, while an additional ten involve more than two countries. Only a handful of the measures/policies covered are autonomous in nature and not directly associated with (reciprocal) accords, although it is not precluded that reciprocity considerations may have played a role in these cases as well.<sup>16</sup> The general focus of the measures/agreements seems to be on advanced educational degrees in engineering and other professional services, rather than on more mundane qualifications (driving licences, etc.). In some ten cases, accountancy and/or auditing services are involved.

There have been very few advance indications of the opening of negotiations, as provided for under Article VII:4(b), that would have allowed interested Members to seek participation in the drafting process. Defensive policy considerations - the perceived need to protect recognition measures from possible challenges under the MFN obligation (Article II:1) - appear to have prevailed over other considerations, including the possible use of notifications for promotional purposes vis-à-vis other Members. In the same vein, most signatories to integration agreements seem to hold the view that related recognition measures are covered by Article V, thus obviating the need for notification under Article VII.<sup>17</sup> This interpretation offers at least two 'advantages' for the governments involved: no obligation to afford third countries an opportunity to negotiate

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<sup>13</sup> Trachtman (2003).

<sup>14</sup> Nicolaïdis and Trachtman (2000).

<sup>15</sup> OECD (2003) provides an overview of existing notifications without attempting to eliminate the overlap.

<sup>16</sup> For example, one Member has indicated that it does not maintain measures within the meaning of Article VII:4(1), but accords recognition autonomously (WTO document S/C/N/30 of 30 October 1996). No further explanation is given, nor have autonomous recognition measures been subsequently notified by the government concerned.

<sup>17</sup> By end-July 2004, there was only one notification under Article V:7(a), from Australia and New Zealand, that had been submitted "also in recognition of any notification requirements under Article VII:4" (WTO document S/C/N/66 of 21 October 1997). For a brief discussion of the relationship between the two Articles and for further references see OECD (2003).

participation, and no automatic extension of the relevant benefits to third-country nationals that carry degrees, certificates, etc. issued by institutions within the integration area. While Article V:6 requires participants in an integration agreement to extend "the treatment granted under such agreement" (possibly including recognition measures) to juridical persons of other Members that are constituted under their laws and engage in substantive business operations in their territory, there are no equivalent provisions applying to natural persons of other Members supplying services within the relevant area.

The scarcity of notifications under Article VII is, of course, not necessarily a reliable indicator of the absence of recognition initiatives beyond the possible reach of Article V.<sup>18</sup> Other reasons are conceivable as well. For example, some Members or, rather, their competent bodies may have been unaware of the notification requirement; generally lax notification disciplines may have proved contagious; and/or the officials involved may have opted for a generous interpretation of the (non-)application of Article VII to arrangements concluded by private associations.<sup>19</sup> Yet there are also objective impediments that could have discouraged the use of recognition measures to deepen market integration: absence of effective coordination links between the administrations directly involved - e.g. sector ministries, government-mandated private bodies - with the trade ministries coordinating WTO-related initiatives; lack of incentive due to the persistence of formal access barriers (discretionary licensing etc.) and the absence of effective regulatory disciplines under Article VI; fears about perceived losses of regulatory sovereignty; concerns about the credibility and integrity of foreign licensing and certification bodies; incompatibilities of the relevant education, training and licensing systems; incumbent suppliers' interest in retaining discretion in the licensing processes; high cost of negotiating recognition schemes and monitoring their operation over time; and absence of suitable blueprints.<sup>20</sup> While, in May 1997, WTO Members agreed on - voluntary, non-binding - guidelines for mutual recognition agreements in the accountancy sector to ease the negotiation of, or accession to, such agreements, there have been no further such initiatives since.<sup>21</sup>

### **III. FLEXIBILITY OF THE GATS: DIVERSITY OF ACCESS CONDITIONS**

#### **1. Distribution of Commitments across Members**

Access obligations in merchandise trade under the GATT may be termed one-dimensional. Relevant concessions refer to only one type of transaction (cross-border imports) and one legitimate instrument of protection (tariffs). In contrast, commitments under the GATS cover a far broader spectrum of services transactions and, even more so, permissible trade barriers, including six types of market access restrictions and a virtually unlimited range of conceivable departures from national treatment. This implies, in turn, that it is very difficult to provide a reasonably accurate picture of the obligations undertaken by individual Members under the Agreement.

The number of sectors inscribed in schedules - regardless of their economic importance and the existence of limitations - may, nevertheless, provide a cursory indication of Members' propensity to bind access conditions under the GATS. Table I suggests a relatively clear relationship with the level of development, despite wide variations within individual country groups. With the exception of post-Uruguay Round accession cases, developing countries have, on average, scheduled far less sectors than developed Members, thus apparently availing themselves of the flexibility afforded by

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<sup>18</sup> India has raised doubts about Members' principle compliance with the notification requirement under Article VII and perceived information gaps in the notifications actually made in several meetings of the Council for Trade in Services in 2003 (WTO documents S/C/M/67, 68 and 69 of 17 September, 28 November and 15 December 2003).

<sup>19</sup> Although Article I:3(a)(ii) extends the scope of the GATS to non-governmental bodies acting in the exercise of delegated powers, uncertainties may have remained.

<sup>20</sup> See also OECD (2003).

<sup>21</sup> WTO document S/L/38 of 28 May 1997.



the architecture of the Agreement which, in turn, is also reiterated in various development-related provisions (Articles IV and XIX:2).<sup>22</sup>

**Table I: Commitments by country group, March 2004**

Countries	Average number of sub-sectors committed per Member	Range (Lowest/highest number of scheduled sub-sectors)
Least-developed economies	20	1 – 110
Developing & transition economies	54 (106)*	1 – 154 (58-154)*
Developed countries	108	87 – 117
Accessions since 1995	106	37 – 154

\* Transition economies only.

Total number of sub-sectors: ~160; total number of Members: 146.

Source: WTO Secretariat

Concerning the levels of access committed, available evidence suggests that most Members have confined themselves to locking in status quo access conditions, or even less, at the time of the negotiations.<sup>23</sup> This may be due to several factors, including the structural complexity of the GATS, which does not certainly facilitate sweeping liberalization initiatives across countries and sectors; hesitations associated with the novelty of many of the terms and concepts involved; and time constraints at late stages of the Uruguay Round. Services liberalization may presuppose profound institutional reforms that are difficult to negotiate, both domestically and among WTO Members, within a relatively short time window. Moreover, the resource implications, including government internal consultation and co-ordination needs, tend to be higher than those associated with traditional tariff negotiations, and so are the risks arising from over-ambitious commitments that are not in tune with the regulatory and institutional capacity of the country concerned.

The picture for Members that recently acceded to the WTO, in particular several transition economies in Eastern Europe and Central Asia, is conspicuously different. Not only have they scheduled as many, and sometimes even more, sectors than large developed Members, a closer look also reveals that the quality of bindings, i.e. the share of commitments without limitations ('full commitments'), is higher than in any other group. For example, more than one-third of the market access commitments undertaken by accession economies under mode 3 are without limitations, which is almost three times the share for developed countries.<sup>24</sup> This 'imbalance' may be attributed to several factors.

First, the new Members may have seen the accession process as an opportunity to establish a reputation as open and reliable trading partners and, in the context of mode 3, as safe locations for foreign direct investment. Second, many recent accessions involve transition economies, which have been undergoing profound structural and institutional changes. In such an environment, negotiators may encounter less internal coordination needs and/or resistance to change than within long-established administrations. Third, acceding countries tend to be confronted with high external expectations. Requests from current Members, which have more time and resources to pursue their claims than in normal trade rounds, may prove particularly challenging. Fourth, the political and economic stakes are higher as well. Given that there is virtually no 'safety net' in accession negotiations, failure tends to be more embarrassing - denial of WTO membership and the associated benefits - than inconclusive trade negotiations among current Members. The accession process is possibly the only context in which services negotiators have little alternative, but to organize

<sup>22</sup> Whether additional policy discretion contributes to promoting trade, investment and growth is a completely different issue, of course. See, for example, the discussion in World Bank (2002).

<sup>23</sup> Hoekman (1996), and Dobson and Jacquet (1998).

<sup>24</sup> Hoekman, Mattoo and English (2002), Chapter 27.

combinations of commitments across service sectors and modes that are attractive for broad groups of Members, or otherwise to accept continued non-membership.<sup>25</sup>

In order to put this process on a more economically objective footing, it has been proposed to allow a panel of independent experts to ascertain the WTO compatibility of the applicant country's trade regime and propose reasonably achievable adjustments.<sup>26</sup> (The proponents admit, however, that the prospects of current Members tying their hands are very remote.) Alternatively, one could also think of the accession schedules being used, in following trade rounds, to benchmark the commitments sought from existing Members at comparable and, even more so, advanced levels of economic development. Still more ambitiously, long-standing Members could be invited, at regular intervals, to contribute some sort of membership fee in the form of a minimum number of new commitments modelled on those undertaken by recently acceding countries. However, although potentially stimulating, there is little point in further pursuing such thoughts. They are certainly not more realistic than the proposed expert panel and might be dismissed in WTO fora as incompatible with relevant guidelines and provisions (section IV.5(b)).

## **2. Distribution across Sectors**

Not surprisingly, tourism has drawn the highest number of commitments among all large service sectors. Given the traditionally open regimes in many countries, the sector is an obvious candidate for 'painless' commitments. Otherwise, current schedules are largely dominated by producer-related services, i.e. services that perform infrastructural functions for a broad array of downstream users. Many of the commitments concerned are attributable to the extended - sector-specific - negotiations on basic telecommunications (concluded in February 1997) and financial services (December 1997). In contrast, health and education have apparently proved far less popular. While the sector pattern displayed in Chart I essentially reflects the scheduling decisions of developing countries, which account for 80 per cent of the WTO membership, health and education are also among the few sectors that have been shunned completely by a significant number of developed economies.<sup>27</sup>

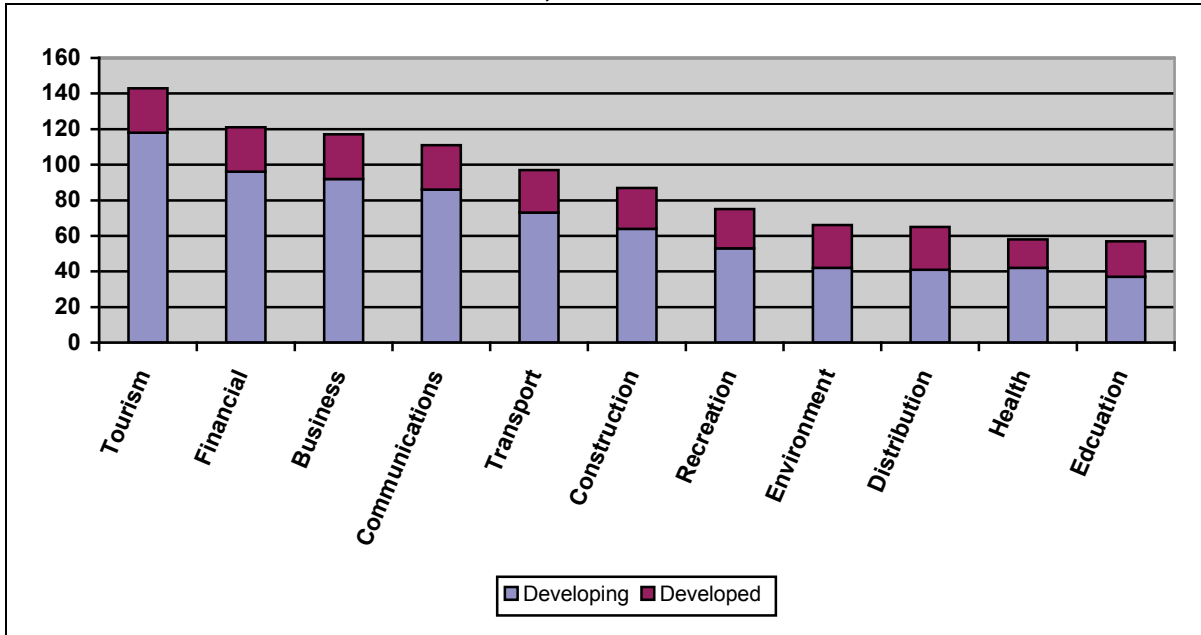
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<sup>25</sup> A Decision of the General Council, in January 2003 (WT/L/508), is intended "to facilitate and accelerate" the accession of least-developed countries. Members are held to "exercise restraint" in seeking commitments from these countries, "taking into account the levels of concessions and commitment undertaken by existing WTO LDCs' Members". As shown in Table 1, however, current LDC Members have scheduled between one and 110 sectors. No similar decision exists for developing and transition economies.

<sup>26</sup> Grynberg, Ognivtsev and Razzaque (2002).

<sup>27</sup> Canada, Finland, Iceland, Sweden, Switzerland, Liechtenstein, New Zealand and Norway have not committed on any sub-sector of health-related and social services. In addition, Canada, Finland, Iceland and Sweden have omitted all educational services.

**Chart I: Sector focus of current schedules, March 2004**



*Note:* The vertical axis displays the number of Members that have scheduled at least one sub-sector out of the eleven large service sectors, listed on the horizontal axis. The sub-sectors are those referred to Table 1. EC Members are counted individually.

Source: WTO Secretariat

### 3. Distribution across Modes

The diversity of access conditions - or, at least, of bound levels of access - across sectors is reflected in a similar diversity across modes. Overall, commitments on *mode 2*, consumption abroad, tend to be the most liberal. On average, about one-half of all entries for both market access and national treatment under that mode do not carry any limitations.<sup>28</sup> However, the relevance of these commitments may be limited insofar as mode 2 transactions are economically important only in a few sectors, including tourism and, increasingly, health and education, and governments may have few instruments in any event to prevent their nationals from moving abroad or to influence their consumption habits once they have left the country. While the share of full commitments ("none") under *mode 1* is in the order of one-third, even more entries under that mode provide for continued policy discretion ("unbound"). The absence of bindings may not be attributable in many cases to particular policy intentions, but to the perceived impossibility of supplying services over distance (e.g. hotel or restaurant services, hospital or social services). Otherwise, mode 1 transactions are subject to a multitude of limitations, many of which seem intended to protect domestic monopolies, e.g. in telecommunications, or tight regulatory regimes, e.g. in insurance and many professional services, from being circumvented or undermined.

However, the delimitation between modes 1 and 2 may not be entirely clear in all circumstances. The relevant definition in Article I:2 of the GATS builds on the territorial presence of supplier and consumer at the time of supply, without explicitly requiring that, in the context of mode 2, the consumer be physically present in the territory of the foreign supplier. This may lead to questions in the case of electronic transmissions, such as call back or calling card services, but also financial transactions conducted via the internet. Second, the supply of a service is defined in Article XXVIII(b) of the GATS to include production, distribution, marketing, sale and delivery. It is thus conceivable that the execution of one single services transaction embraces elements that, at subsequent stages, fall under different modes.<sup>29</sup>

<sup>28</sup> WTO (2001a), Chapter IV.

<sup>29</sup> A significant number of Members, which have exempt mode 1 from their commitments in sectors such as hotel, restaurant or hospital services ("unbound"), have added a footnote explaining that cross-border

*Mode 3*, commercial presence, is the most economically important mode of supply, representing some 50 to 60 per cent of all trade falling under the GATS.<sup>30</sup> About four-fifths of all entries under this mode guarantee some degree of access, subject to various limitations which are sometimes difficult to interpret (Chart II and section IV.4).<sup>31</sup> Virtually all commitments on *mode 4*, presence of natural persons, are very tightly circumscribed. Starting from an "unbound", most Members have scheduled undertakings with regard to a limited number of categories, normally higher-level employees and/or intra-corporate transferees, that are permitted access for limited periods of stay. Even these undertakings are frequently subject to tight numerical ceilings or discretionary economic needs tests.<sup>32</sup>

#### IV. CONCEPTUAL OVERLAPS AND UNCERTAINTIES

To discuss the operation of the GATS over its first ten years, and ensuing challenges for the ongoing negotiations, it is useful to consider the role and structural relationship of its main building blocks. Like in other trade agreements, there are at least four core issues to be considered in this context:

- compliance with MFN principle (→ determining, *inter alia*, the scope for club formation among like-minded countries);
- use of quantitative limits on market entry and/or market participation (→ reflecting, *inter alia*, the role of government-mandated exclusivity rights);
- extension of national treatment (→ determining a country's scope for trade-protective action in individual sectors); and
- status of regulatory barriers in the pursuit of public policy and other objectives (quality, safety, reliability, social and regional equity, etc.).

At first glance, these elements have clearly defined functions within the Agreement's overall architecture. Departures from MFN are prohibited in principle (Article II:1), subject to the qualifications referred to above; under mutually independent provisions (Articles XVI and XVII) Members may assume market access and/or national treatment obligations in selected sectors with the possibility of inscribing mode-specific exclusions or limitations; and regulatory interventions are governed by a separate set of provisions, rudimentary at present, that aim to protect government's ability to pursue legitimate policy objectives while avoiding 'unnecessary' trade effects. However, the actual role of and relationship between these concepts, in particular between market access and national treatment, may leave scope for interpretation; and actual scheduling practices have not certainly helped to avoid confusion.

It thus proves difficult at times to draw a clear borderline between: (i) quantitative restrictions and other barriers falling under the market access provisions of Article XVI of the GATS; (ii) departures from national treatment pursuant to Article XVII; (iii) domestic regulatory interventions that may be maintained, even in fully liberalized markets, for quality and other

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supplies of such services are not technically feasible. The question arises, however, given the definition of supply in Article XXVIII(b), whether this is actually the case. While these explanatory footnotes have no legal implications ("unbound" means "unbound" regardless of any further explanations), they may fuel doubts surrounding the distinction between modes 1 and 2.

<sup>30</sup> Karsenty (2002).

<sup>31</sup> WTO (2001b), Chapter 22. Reasons for the relatively low share of full commitments are discussed, for example, in Sauv e (2000) and WTO (2001a).

<sup>32</sup> Carzaniga (2003).

regulatory purposes; and (iv) the status of certain such measures under the most-favoured-nation requirement of Article II. In view of already existing studies,<sup>33</sup> a few examples may suffice.

## 1. Uncertainties Surrounding the MFN Requirement

There are in particular two groups of questions that arise in connection with the MFN principle. The first touches on the difficulties *per se* of operating quota regimes in an MFN-consistent way. Consider, for example, a government-mandated telecom or insurance monopoly that is in the hands of a private foreign supplier. Could the relevant arrangement, possibly concluded many years earlier, be challenged under the MFN provision if it had not been advertised and awarded, e.g. via auction, on a non-discriminatory basis? Another potentially sensitive area relates to domestic standards, such as zoning laws, building codes or safety requirements, which are normally modified over time. In such situations, to what extent would the MFN requirement oblige administrations to subject existing foreign-owned operations to the same standards as new start-ups? The implications could be absurd, in particular if high sunk costs are involved.

It may be argued in both cases that the MFN principle is time-bound. Accordingly, governments would simply need to ensure that all potential investors, regardless of nationality, have the same opportunities at any particular point in time. The MFN obligation would thus not prevent already established foreign suppliers from being treated differently from new foreign entrants. Doubts linger, nevertheless. For example, would situations in which historical privileges could be removed at little or no cost to the government concerned - e.g. the exemption of an early entrant from subsequently introduced regulatory standards (opening hours, etc.) or commercial conditions (equity ceilings, etc.) - need to be distinguished from cases in which legal entitlements and potentially costly compensation claims are involved? And, from a slightly different perspective, could it be argued that the MFN rule requires at least a minimum degree of stability and consistency in the application of laws and regulations, including economic needs tests, to like services and service suppliers over time?<sup>34</sup>

## 2. Scope of the National Treatment Obligation

The national treatment standard of Article XVII hinges on whether a particular measure would modify the conditions of competition to the detriment of like foreign services or service suppliers. This obviously needs to be assessed case-by-case. For example, while other Members might be ready to follow Iceland's example and schedule a language requirement for veterinarians as a national treatment limitation, very few, if any, governments would inscribe a similar requirement under professional services (e.g. translation services) for which command of the national language is a core qualification requirement.<sup>35</sup> However, views may differ in individual cases.

An additional factor enters the equation if cross-modal implications of the national treatment obligation are taken into account. The relevant disciplines of Article XVII focus on the detrimental effects of a measure on like foreign services and service suppliers without putting these effects into a modal context.<sup>36</sup> Depending on whether like services are supplied cross-border (e.g. medical diagnosis, retailing services) or consumed abroad (e.g. hospital treatment, higher education),

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<sup>33</sup> See, for example, Low and Mattoo (2000), and Mattoo (2000a).

<sup>34</sup> Article VI:1 might also provide an element of stability. It requires each Member to ensure that "all measures of general application affecting trade in services are administered in a *reasonable, objective and impartial* manner." However, the scope of core terms and concepts (italicized) has remained undefined.

<sup>35</sup> For example, the so-called Accountancy Disciplines (WTO document S/L/64, see footnote 51 below), adopted by the Council for Trade in Services in December 1998, list language skills among the potentially relevant qualification requirements for accountants.

<sup>36</sup> The Panel *Canada – Certain Measures Affecting the Automotive Industry* found it "reasonable to consider for the purposes of this case that services [wholesale trade services of motor vehicles] supplied in Canada through modes 3 and 4 and those supplied from the territory of other Members through modes 1 and 2 are 'like' services" (WTO document WT/DS139/R of 11 February 2000).

production subsidies and other support schemes for domestic producers, although free of nationality criteria, may thus have national treatment implications under modes 1 or 2. While some Members have provided cover for potentially relevant situations, e.g. by inscribing subsidy-related limitations for all modes of supply, others may have failed to consider these implications and/or embraced a different concept of likeness.

From an economic perspective, the broad cross-modal interpretation of likeness may have unintended ramifications: it could further increase the tendency among governments to favour producer over consumer subsidies. According to the Scheduling Guidelines, Article XVII does not require the extension of national treatment to suppliers located abroad, since there is no obligation on a Member to take measures beyond its territorial jurisdiction. In contrast, virtually all benefits extended under consumer-focused regimes (scholarships, social insurance entitlements) are due within the jurisdiction of the government concerned. National treatment problems may thus arise if residents are discouraged, e.g. through denial of otherwise available public support or insurance cover, from consuming services abroad. Potentially relevant areas are educational services, including distance learning, and health services.<sup>37</sup> In the absence of national treatment limitations, a system change towards consumer-oriented support, while potentially widening the scope for individual choice and enhancing competition at least in the national market, might therefore require a modification of scheduled commitments, against compensation, under Article XXI.

### **3. Relationship between Articles XVI (Market Access) and XVII (National Treatment)**

Contrasting with Article XVII, the definition of Market Access in Article XVI is based on an exhaustive list of six types of measures that, in the absence of relevant limitations, Members are not allowed to operate. Of these, four are defined in terms of quota limits (e.g. restrictions on the number of suppliers, value of transactions, number of operations, number of natural persons), while two relate to institutional or ownership restrictions (limitations on the form of incorporation, including joint venture requirements, and limits on foreign equity participation). While the former four limitations may, or may not, be operated on a national-treatment basis, joint venture requirements and foreign equity ceilings (under Articles XVI:2(e) and (f), respectively) are discriminatory by nature. Possibly with a view to facilitating the scheduling process, Members are held, nevertheless, to inscribe all measures inconsistent with Article XVI, including those with discriminatory elements within the meaning of Article XVII, in the market access column only. Article XX:2 ensures that scheduling of these measures under market access provides a qualification with regard to national treatment as well.<sup>38</sup>

Normally, it should not matter whether measures inconsistent with Articles XVI and XVII are inscribed separately in the two respective columns or, in keeping with Article XX:2, only in the market access column. However, this presupposes that the single entry under market access is as clear, concerning any national treatment implications, as a separate entry under Article XVII might have been. Can this reasonably be assumed in all cases? Second, there are also problems of legal interpretation. For example, if a Member has undertaken no bindings under market access ("unbound") and full commitments on national treatment under the same mode, three options are conceivable. The Member may be permitted to operate: (i) all types of measures falling under the

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<sup>37</sup> For example, six of the over 50 Members that have undertaken commitments on various health services have scheduled limitations on insurance portability under mode 2. See Adlung and Carzaniga (2001).

<sup>38</sup> The prescription contained in Article XX:2 might protect Members from unintended national treatment obligations that may arise from market access restrictions under Article XVI. While quotas and other measures under Article XVI are relatively easy to associate with individual modes (e.g. modes 3 or 4), the attendant national treatment implications may be more difficult for the scheduling Member to locate. For instance, a prohibition to employ foreign drivers would not only be inconsistent with full market access and national treatment commitments on road transport under mode 4, presence of natural persons, but could also raise national treatment problems under mode 1, cross-border trade (foreign truck operators would need to change drivers at the border). Article XX:2 provides that all such national treatment implications, regardless of mode, are covered if the measure is properly described in the market access column (in this case, under mode 4).

market access provisions of Article XVI:2(a)-(f), regardless of any discriminations that may be implied; (ii) all types of market access restrictions in their non-discriminatory form, except those that are discriminatory by nature (joint venture requirements and foreign equity ceilings); or (iii) only non-discriminatory market access restrictions, thus precluding the use of the two latter categories. Recent discussions in the Council for Trade in Services suggest that each option enjoys some support.

Another interesting ramification of the - somewhat complicated - relationship between Articles XVI and XVII arises in the context of Article V (Economic Integration). Article V:1 provides for the absence or elimination "of substantially all discrimination, in the sense of Article XVII, between or among the parties" to an integration agreement in the sectors concerned. Although there is no explicit reference in this context to the discriminatory measures listed under Article XVI:2, i.e. joint venture requirements and foreign equity ceilings, these are likely to be covered as well ("in the sense of"). Nevertheless, a clear structural distinction between the two Articles would have precluded even the vaguest doubt.

#### **4. Imprecise Scheduling**

A significant number of Members have scheduled limitations, in particular under market access, that cannot be clearly associated with relevant GATS provisions. Imprecise entries may be explained in part by government's lack of experience, coordination problems between ministries, and a traditional bureaucratic preference for risk minimization. Thus, rather than screening a law for possible inconsistencies with Article XVI, it might have been tempting for the officials concerned to simply inscribe its title in the relevant column. However, the implications are difficult to anticipate.

Article XVI:2 clearly refers to six types of "measures" that a Member would need to schedule and, in the same vein, Article XX:1 stipulates that each schedule shall specify the "terms, limitations, and conditions on market access, ..." In the event of a dispute, would a panel consider the reference to a particular law as sufficient? What would the situation be if the law was subsequently changed in scope and restrictiveness? Other entries under market access merely indicate the existence of (non-specified) licensing and qualification requirements. What is their legal status, given that licensing requirements may be used simply for quality or safety purposes? Would such entries also provide cover for trade restrictions that might be implied?<sup>39</sup> Finally, some limitations are couched in the form of positive undertakings - commitments not to introduce or maintain certain measures in specified areas - which may have been sought by, and prove reassuring for, sceptical trading partners. Again, however, what is the legal value?

Chart II provides an overview of the limitations scheduled under market access for mode 3, the commercially most relevant mode of supply. The Chart features the six types of measures provided for under Article XVI:2, complemented by two residual categories covering imprecise or even flawed entries.<sup>40</sup> Disturbingly, these are the two largest categories.

The interpretation of existing commitments may suffer from additional uncertainties related to individual Members' use of ill-defined terms and concepts. A particular source of concern are commitments on mode 4 whose coverage, very limited in virtually all schedules, tends to be further

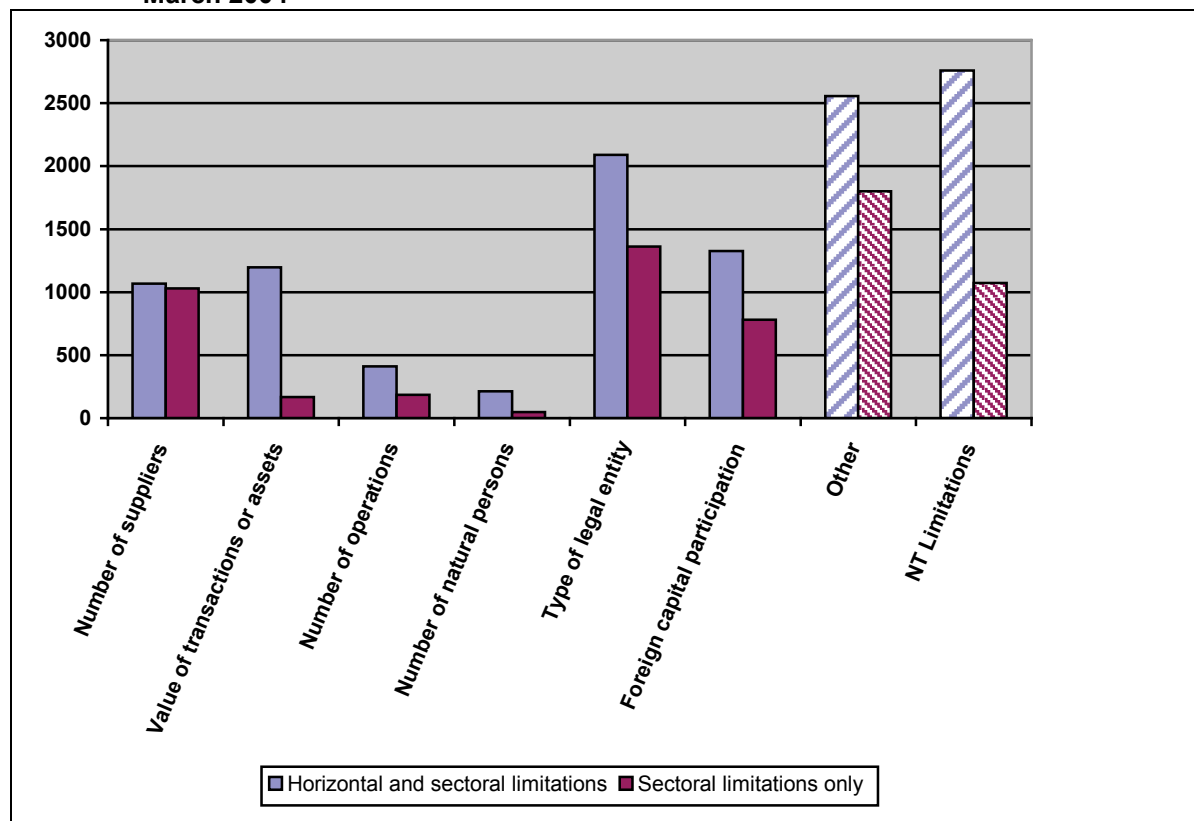
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<sup>39</sup> Interestingly, the Panel *Mexico – Measures Affecting Telecommunications Services* found a requirement scheduled under market access, that commercial agencies obtain permits and that these permits be based on regulations, not to constitute a market access limitation within the meaning of Article XVI:2(a). See WTO document WT/DS204/R of 2 April 2004.

<sup>40</sup> In accordance with the scheduling conventions of Article XX:2, Chart II includes market access restrictions that are also inconsistent with national treatment. "Other limitations" are made up mainly of the three categories referred to above: references to laws and regulations; listing of non-specified licensing and authorization requirements and similar entries whose relevance under Article XVI is unclear; and positive undertakings, e.g. commitments to refrain from operating certain measures.

undermined by frequent inscriptions of non-specified economic needs tests;<sup>41</sup> scheduling of professional categories such as 'managers' or 'specialists' whose definition may vary widely between Members; or vague references to maximum periods of stay, such as 'short-term' or 'temporary', which provide little guidance.

**Chart II: Types of Market Access Limitations Scheduled by WTO Members under Mode 3, March 2004**



Note: Horizontal limitations apply across all sectors included in a schedule and, thus, might reflect broader policy objectives and constraints than the limitations inscribed for individual sectors.

Source: WTO Secretariat

## 5. Possible Solutions in the New Round

### (a) Technical improvements and more liberal commitments

The ongoing services round is likely to promote legal clarity and certainty for at least three reasons. First, the envisaged liberalization of existing commitments and renegotiation of MFN exemptions will result in currently scheduled measures being scaled down or eliminated altogether; a variety of interpretation problems are thus bound to disappear. Second, Members' familiarity with the Agreement may have increased sufficiently over time to prevent them from repeating old mistakes in sectors they decide to schedule for the first time. Third, the preparation and submission of new schedules also provides an opportunity for technical amendments that do not alter the scope of existing commitments, but present them in 'new clothes'. The initial offers submitted to date do contain a good number of such (proposed) technical changes.

A note of caution may be necessary, however. The interpretation of what constitutes a technical change and what would downgrade an existing commitment may differ among Members.

<sup>41</sup> The only advantage of such tests for trading partners, as compared to non-bindings, may be the fact that a commitment, regardless of content, automatically triggers certain horizontal disciplines, including additional transparency obligations (Article III:3) and a prohibition on international payment restrictions in the areas covered (Article XI:1).



For example, a government whose predecessors had scheduled the country's Investment Act of 19[...], might hold the view that the restrictions provided for in the Act, including those whose introduction is at the discretion of the administration, as well as any later legislative changes, are covered by the entry. However, other interpretations are reasonably conceivable as well. For example, from a purist's perspective, the entry might have been obsolete from the outset since it did not specify a measure and its inconsistency with Article XVI:2 (see above). Anything less than a full commitment might thus be viewed as a deterioration. The fact that there are skeletons in a good number of cupboards may, however, help to promote a sense of pragmatism.

(b) More harmonized and streamlined scheduling practices, policy approaches and instruments

A range of proposals have been made in recent years to harmonize scheduling practices, clarify frequently used terms and concepts, and ensure that scheduled liberalization measures actually translate into improved access. This may include in some cases the development of sector-specific or mode-specific policy frameworks modelled on the Reference Paper in basic telecommunications.<sup>42</sup> Other initiatives have been aimed more directly at promoting more liberal and/or commercially meaningful commitments.

Most of the proposals listed in Table II appear compatible *per se* with the 'bottom-up' approach of GATS and, thus, with the Negotiating Guidelines of March 2001. Rather than substituting for request-offer negotiations, they could serve as guidelines or reference points. From the perspective of an individual Member, use of such formulae or models offers various benefits: improved efficiency of the negotiating process, enhanced transparency and consistency of the results, and reduced risk of unintended legal consequences, including over-ambitious commitments. However, not all areas (sectors, modes, policy issues) are equally amenable to formula-type solutions.

*Sector-specific approaches*

Potential initiators will certainly weigh the expected benefits with the resource implications of developing new formula or model approaches. Will these help to produce broader, deeper and/more predictable commitments?

It may be more than mere coincidence that existing examples - Reference Paper (RP) in telecommunications, Model Schedules for Maritime Transport and for Telecommunications, and Understanding on Commitments in Financial Services - focus on areas where at least some large participants have active trade interests. Services such as health or education are unlikely to attract similar attention any time soon. In a similar vein, the work programme under Article VI:4 - development of regulatory disciplines for standards, licensing and qualification requirements and procedures - prioritized the accountancy sector rather than, for example, medical, educational or construction services.

*Cross-sectoral recommendations or obligations*

From an economic perspective it would be preferable, of course, to encourage countries to move towards more uniform trading conditions. Greater uniformity would not only help to improve economic efficiency, but to avoid political precedents for special treatment in an ever increasing number of circumstances.<sup>43</sup> There are thus good arguments in favour of more sweeping initiatives that would promote or protect liberal trading conditions across a broad range of sectors, measures and Members. Relevant proposals include the liberalization of all trade under modes 1 and 2; the assumption of full commitments across all internet- or telecommunication-based sectors; or the

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<sup>42</sup> See also Thompson (2000).

<sup>43</sup> Hoekman and Messerlin (2000).

wholesale elimination of particularly restrictive economic needs tests.<sup>44</sup> Again, however, there are likely to be limits.

**Table II: Horizontal approaches to improve quantity and/or quality of commitments within the GATS framework**

Proposal	Basic Principle	Example/Model	References
Common definitions	Standard definitions of frequently used terms in schedules	Persons covered by mode 4 commitments ('managers', 'specialists', etc.), standard periods of stay, etc.	Self and Zutshi (2003); World Bank (2004); Negotiating Proposals of WTO Members (e.g. India: S//CSS/W/12 of 21 November 2000); Tuthill (1997).
Standard policy instruments or concepts for (voluntary(?)) adoption	Streamlined/harmonized mechanisms or disciplines to improve commercial relevance of commitments	Creation of 'GATS visa' for movements under mode 4; one-stop information or contact points for interested groups; competition disciplines in basic telecommunications; proposed Reference Paper for Economic Needs Tests.	
Framework undertakings	Members refrain from operating and/or scheduling measures considered to be particularly restrictive or distortive.	(i) Undertaking not to impose duties on electronic-transmissions. (ii) Proposals to exclude specified transactions from economic needs tests, to review the role of nationality requirements, foreign equity ceilings, etc.	Ministerial Declaration on Global Electronic Commerce (25 May 1998). Communications from WTO Members.
"Standstill"-type obligations	Members bind currently applied regimes in scheduled sectors (or across the board).	Understanding on Commitments in Financial Services.	Communications from WTO Members in preparation of the 1999 Ministerial Conference.
Model schedule	Members undertake standardized commitments in individual sectors, technology areas or modes (mode 4).	Understanding on Commitments in Financial Services; Draft Schedule for Maritime Transport Services; Model Schedule for Basic Telecommunications; proposed model schedules of: (i) mode 4; (ii) information technology and business process outsourcing.	WTO Secretariat Informal Note of 15 April 1996 (NGMTS, 1872); Hatcher (2003); Mattoo and Wunsch (2004); Chaudhuri, Mattoo and Self (2004).
Cluster approach	Commitments are not assumed for individual sectors but, where relevant, for clusters of related sectors.	Proposals to encourage complementary commitments on: courier and related transport services (e.g. road freight transport); various environmentally important services; health care and health insurance services; and multimodal transport services (maritime transport and related road and waterways transport).	WTO (2001b, Chapters 12, 14, 16, and 17); OECD (2000).
Minimum sector coverage		Proposals to achieve more comprehensive coverage of strategically/economically important services (e.g. business process outsourcing, telecommunications, financial services) and/or to liberalize services that are transmitted electronically.	
(i) "Qualitative" approach	Obligation to include certain core sectors in all schedules.		Feketekuty (1998); Mattoo and Wunsch (2004).
(ii) "Quantitative" approach	Obligation to include a minimum number of sectors in all schedules.	Members agree to commit at least X sectors (with variations depending on level of development).	Adlung (2000).

Mere best-practice recommendations may not carry sufficient weight in governmental-internal consultations to prompt sector ministries (and lobbies) to forego their scope for discretion. Tellingly, although there is an unambiguous recommendation in the Scheduling Guidelines to specify the criteria used in economic needs tests, about 100 out of some 250 tests do not indicate any

<sup>44</sup> For example, it has been discussed that full commitments on modes 1 and 2 (cross-border trade and consumption abroad) across virtually all sectors might help to ensure continued, unfettered expansion of computer-based services (Mattoo and Wunsch, 2004). A range of exemptions might be required, however, to provide cover for 'sensitive' products/markets or policy intentions. Also, given the aversion of various Members against international policy bindings, such a proposal may need to be developed by a critical mass of countries, comparable to the Information Technology Agreement, rather than by the WTO membership as a whole.

criterion.<sup>45</sup> Non-specified tests were even deemed acceptable in recent accession cases. In contrast, stringent horizontal disciplines may prove difficult to negotiate in the first place, given the diversity of sector-interests, institutional conditions, as well as political and economic cultures among WTO Members. Reticent governments have strong language in the Agreement and the current Negotiating Guidelines to refer to: Liberalization shall take place “with due respect for national policy objectives and the level of development of individual Members, both overall and individual sectors” (Article XIX:2 of the GATS), and the negotiations shall respect “the existing structure and principles of the GATS, including the right to specify sectors in which commitments will be undertaken and the four modes of supply” (Negotiating Guidelines).<sup>46</sup>

The crucial challenge facing the drafters of the Agreement - to find a reasonable balance between economically meaningful disciplines and their broad application across sectors, modes and Members - has not vanished since. Tight rules or broad reach? While the almost comprehensive coverage of the GATS offers more scope in principle for mutually beneficial trade-offs (“reciprocal exchange of concessions”) than a narrow sector agreement, it was achieved by conceding Members an virtually unlimited flexibility in the use of trade measures, pursuit of regulatory objectives, etc. Although proponents of flexibility (or ‘sector-specificity’) may have a hidden defensive agenda, like their counterparts in agriculture and elsewhere, they are also able to point out incompatibilities between institutional structures and regulatory cultures in ‘sensitive’ sectors, possibly including financial, legal, health, educational and transport services, that may defy common formulae.

There are thus good reasons to assume that the economic implications of the GATS will prove more selective than those of the GATT. Vested interests will find it easier to defend traditional privileges and defy broad-based liberalization.<sup>47</sup> However, are there credible alternatives? Would a more rigid structure prove resilient enough to accommodate some 160 sectors, close to 150 Members, and four modes of supply? Possibly not.

#### *Potential ramifications*

An additional issue to be considered is the wider policy context within which liberalization formulae would be applied. Given the particular structure of the Agreement, and still existing voids, over-ambitious initiatives might have unintended ramifications and/or risk backlash in related areas.

One point to be considered is the absence of policy constraints on a government's use of export subsidies and other measures to promote (or restrict) domestic supplies under any of the four modes. Affected trading partners would have no legal remedies under the Agreement to challenge such measures, not even under the MFN obligation;<sup>48</sup> nor are there instruments they could use for compensatory action. The GATS does not currently contain any equivalent to the trade remedy mechanisms available under the GATT - safeguards, countervailing duties, and anti-dumping measures - that are (abundantly) used in merchandise trade. In turn, the absence of export-related disciplines and of potential remedies, while understandable in view of the conceptual and technical difficulties involved, could expose governments to domestic pressure they might find difficult to

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<sup>45</sup> WTO document S/CSS/W/118 of 30 November 2001.

The Scheduling Guidelines were adopted by the Council for Trade in Services in 2001 (WTO document S/L/92 of 28 March 2001); however, the recommendation to specify the criteria on which economic needs tests are based was already contained in an explanatory note circulated by the then GATT Secretariat in 1993 (MTN.GNS/W/164/Add.1 of 30 November 1993).

<sup>46</sup> The Guidelines and Procedures for the Negotiations on Trade in Services are contained in WTO document S/L/93 of 29 March 2001.

<sup>47</sup> Adlung (2004).

<sup>48</sup> The MFN rule requires a Member, in the extension of export subsidies, not to discriminate between foreign-owned companies established within its jurisdiction, but it would not impose constraints on the targeted use of such subsidies *vis-à-vis* some, but not all trading partners.

resist.<sup>49</sup> Consequently, since honouring ambitious access commitments could prove more politically demanding than under the GATT, Members might be keen in sensitive areas to retain some scope for trade protective action.

Given the absence of vocal complaints to date about emergency trade situations in services, this position may appear excessively cautious. On the other hand, however, there are also good reasons not to simply extrapolate past trends into the future. As noted before, the shares of full commitments, i.e. commitments that guarantee unfettered access, have remained rather limited for all modes, except mode 2 (section III); and these shares do not even capture the high number of sectors which Members have not scheduled at all. Broader and deeper commitments may create a more economically and politically challenging environment.

A second point of concern is the present weakness - or, more bluntly: the virtual absence - of disciplines on domestic regulation. The GATS thus offers wide scope for the excessive use of regulations, including the non-recognition of foreign educational degrees, licences, and certificates, to cushion the trade effects associated with the reduction of formal barriers falling under Articles XVI and XVII. Non-availability of 'official' trade remedy instruments does not certainly allay the risk of excessive regulatory restrictions. These restrictions may prove particularly virulent in trade under modes 1 and 4, cross-border trade and presence of natural persons, but may also be used to exclude consumption abroad from coverage under domestic support schemes (scholarships, public health insurance).<sup>50</sup> In turn, apart from undermining the commercial value of specific commitments, such attempts could also hamper progress in the ongoing negotiations on regulatory disciplines under Article VI:4.<sup>51</sup>

## V. WTO RULE-MAKING: MARATHON OR TREADMILL?

In four rule-making areas - domestic regulation, emergency safeguard measures, government procurement, and subsidies - the drafters of the GATS essentially confined themselves to providing for continued negotiations. The relevant mandates are contained, respectively, in Articles VI:4, X, XIII, and XV.<sup>52</sup> The only area that is currently subject to some - weak - disciplines is domestic regulation, where Article VI:5 establishes sort of a regulatory standstill, pending the entry into force of the disciplines to be negotiated under Article VI:4.<sup>53</sup> Even in this area, however, where the relevant mandate is most closely circumscribed, no particular outcome is envisaged. Theoretically at least, it is not precluded that Members, adopting the view that no new rules are necessary for the time being, decide to terminate or suspend one or more of these negotiations.

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<sup>49</sup> Article XV:2 of the GATS merely calls on Members to give "sympathetic consideration" to requests for consultations from other Members that consider themselves to be adversely affected by a subsidy. In the absence of a satisfactory outcome, the remaining option for an affected Member would be to invoke Article XXI in order to introduce, through re-negotiation of its schedule, access limitations in the sector concerned. In other words, when scheduled services are involved, the importing country might need to 'pay compensation' in order to protect its industry, at least on the home market, from what could be considered to be 'unfair' trade.

<sup>50</sup> Commercial presence (mode 3) seems to be less affected since investors do not carry their (foreign) regulatory profiles with them, but adjust almost automatically to host-market requirements once they set up or buy a domestic company.

<sup>51</sup> The accountancy sector is a special case in so far as particular set of disciplines has already been agreed upon; it was put on hold until the conclusion of the current services round (WTO documents S/L/63 and S/L/64 of 15 and 17 December 1998, respectively). Trollet and Hegarty (2003) opine that the existence of these disciplines has made the undertaking of specific commitments in accountancy more onerous for Members.

<sup>52</sup> For a discussion of various options in the latter three areas, see Sauv e (2002).

The Negotiating Guidelines for Services (S/L/93, op.cit.) provide that Members "shall aim to complete" the negotiations under Articles VI:4, XIII and XV prior to the conclusion of the negotiations on specific commitments. Concerning the negotiations under Article X on "the question of emergency safeguard measures", a more recent Council Decision (WTO document S/L/159 of 17 March 2004) envisages that, subject to the outcome of the mandate, the results shall enter into effect not later than the date of entry into force of the results of the current services negotiations.

<sup>53</sup> See, for example, Trachtman (2003).

Such an outcome would still leave space for country-specific solutions: safeguard-type provisions could be attached, case-by-case, to new commitments on market access; additional commitments on the use of domestic regulations or subsidies, beyond existing MFN and national-treatment disciplines, could be assumed under Article XVIII (e.g. obligations to comply with specified international standards or to limit the levels of financial assistance); and procurement-related commitments could be undertaken under the Plurilateral Agreement. However, such solutions might not lead very far. First, they may not help small countries, without negotiating leverage, to solve access problems, caused by excessive regulation or subsidization, in major markets. Further, the trade ministries concerned, even if potentially interested, will find it more difficult internally to overcome the resistance of organized interests against self-bindings than would be possible under a broader-based approach. And, finally, wider participation would also help to contain asymmetries in negotiating experience among Members and provide some sort of insurance against mal-specification. (Avoidance or, if need be, correction of collective errors tends to be less costly than the renegotiation of individual 'over-commitments' under Article XXI.) Finally, a coordinated approach would add less layers of additional rights and obligations to an already complex jigsaw of commitments.

However, these considerations appear quite hypothetical at present. Neither outcome - agreement to create a particular set of new rules or to terminate the negotiations on one or more issues - appears easily attainable. This is particularly true for the three rule-making mandates (emergency safeguards, procurement, and subsidies) within the remit of the Working Party on GATS Rules.

Are there halfway options between the individual (country-specific) and the comprehensive (horizontal) approach? One such option could consist of a core group of interested Members developing disciplines that, comparable to the RP in telecommunications, would then be left for adoption by individual Members as additional commitments under Article XVIII. Not all issues are equally suited, however.

- In the area of *domestic regulation*, an RP-type model might appear attractive for a vanguard of countries, if any, that are prepared to go beyond what is acceptable to the membership in general. However, an open-ended group of countries would still be able to elude any stringent disciplines, possibly yielding to the entrenched influence - with wide variations across Members and sectors - of producer associations on the domestic political process.<sup>54</sup> A reference paper might thus not obviate the need for a horizontal (minimum) accord, whose precise scope, in addition to transparency and procedural obligations, would remain to be explored.<sup>55</sup>
- Concerning *government procurement*, a precedent already exists under the GATS. Members that have adopted the Understanding on Commitments in Financial Services, some 30 at present, are committed to according all domestically established suppliers MFN and national treatment in their public entities' procurement of financial services. The extension of such an obligation across more sectors, while possibly unacceptable for some Members, should not prove too difficult for others, as a first step at least.<sup>56</sup> Quite a number of governments are

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<sup>54</sup> For further discussion see, for example, Mattoo (2000b).

<sup>55</sup> In early 2003, Japan proposed to create, and circulated a draft outline of, an Annex on Domestic Regulation. It has since been discussed at various meetings of the Working Party on Domestic Regulation; reports are contained, for example, in WTO documents S/WPDR/M/22 of 22 September 2003 and S/WPDR/M/23 of 27 November 2003.

<sup>56</sup> The legal form of implementation may need to be further examined, however. Since Article XIII expressly exempts government procurement of services from the application of Articles II (MFN), XVI (Market Access) and XVII (National Treatment), but not from Article XVIII, the latter may appear as an appropriate vehicle for the adoption of disciplines. However, the question arises whether the Article can effectively be used to extend the reach of the MFN requirement, i.e. of a horizontal obligation under the GATS, that otherwise applies across the board. Members that have scheduled their financial services commitments in accordance with the Understanding have stated this upfront, in the form of a headnote, in the relevant section of their schedules.

prevented in any event, under national legislation, from discriminating among domestically incorporated companies on the grounds of ownership.

- Although no comparable precedent exists for *subsidies*, there seem to be no insurmountable technical problems that could prevent Members from developing RP-style disciplines. However, possibly reflecting the (social, regional, etc.) sensitivities involved, and given the absence of any particular frictions to date, this issue has not drawn much enthusiasm either. Although Article XV:1 provides for an exchange of information on all subsidies related to trade in services, very few Members have made relevant submissions.<sup>57</sup>

After ten years of post-Uruguay Round rule-making negotiations, like-minded countries may want to explore, nevertheless, the scope for common initiatives. The initial focus could be, for example, on a reference paper that would discipline certain types of subsidies (e.g. 'export subsidies' under mode 1) or an understanding on government purchasing from domestically-established suppliers under mode 3. In any event, the door would remain open for the gradual expansion of country participation and, at later stages, the creation of additional and/or tighter obligations. Many issues, including the question of sector coverage, would still need to be discussed, however. It would make little sense, for example, if a Member's future disciplines on export subsidies remained confined to sectors for which it has assumed market access and national treatment obligations.

Emergency safeguards appear unsuited for such an approach. The initial concept, at least from the proponents' perspective, is not aimed at strengthening or developing disciplines, but creating an additional instrument, apart from scheduled limitations and other potentially relevant escape clauses in the Agreement, that could be used in particular circumstances to qualify the level of access obligations.<sup>58</sup> In turn, the existence of such an emergency mechanism may be expected to instil confidence and prompt more liberal commitments than would otherwise be the case.<sup>59</sup> Hypothetically, it is also conceivable that a group of interested Members undertakes to clarify core parameters of a safeguards provision that might then be attached, in suitable cases, to market access commitments undertaken in the current round. However, what would be gained by creating such a mechanism, given that a similar instrument, economic needs tests, already exists? Or would Members

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A recent proposal by the European Communities (WTO document S/WPGR/48 of 11 May), is far more ambitious. It would extend the conventional schedule of commitments by a fifth column in which procurement-related obligations could be inscribed under all four modes of supply, possibly subject to limitations concerning threshold values or preferences for national suppliers. A new GATS Annex on Government Procurement would allow Members to list procurement-related MFN exemptions for existing preferential arrangements. Benefits extended under the Plurilateral Agreement on Government Procurement would be exempt from the MFN requirement.

<sup>57</sup> Hong Kong, New Zealand, Norway, and Poland (as of July 2004).

<sup>58</sup> Like the GATT, the GATS allows Members to ignore existing commitments and other obligations in specified circumstances, such as balance-of-payments problems, threats to life and health (Article XIV), and protection of essential security interests (Article XIV***bis***).

<sup>59</sup> In 2000, the ASEAN countries presented a concept paper with elements of a comprehensive safeguard mechanisms in services (WTO document S/WPGR/W/30 of 14 March 2000) that would be horizontally applicable across all Members, sectors, and modes. Core parameters (surge in imports, injury, causality; temporary application; etc.) are inspired by the Agreement on Safeguards. Under such a horizontal mechanism, a Member would still be able, pursuant to Article XVIII, to forego application in individual cases (sectors and/or modes) or across all scheduled sectors. Of course, the political momentum would have changed, and a higher number of sectors would possibly be made subject to a safeguards mechanism than in an alternative scenario where it is inscribed sector-by-sector. Would this potentially more restrictive effect actually be compensated by higher-quality commitments, i.e. would Members feel encouraged to undertake deeper obligations across a broader range of services? And what would be the (remaining) value of such obligations if the possibility of future protective action is taken into account?

be ready to swap certain types of economic needs tests, in particular non-specified tests, for a more clearly defined safeguards clause that could be inscribed in schedules?<sup>60</sup>

There have been no attempts to put the safeguard discussion in a wider context and discuss situations of 'unfair' trade in services, involving 'dumping' or 'subsidization', for which no remedies exist as well. Although Article XV would require Members also "to address the appropriateness of countervailing procedures", no particular thought has yet been given to the need for, and technical feasibility of, such procedures. It is obviously difficult to conceive of a GATS equivalent to relevant GATT provisions, given the particular nature of many services transactions (intangible, customized, etc.) and the wide scope of the Agreement.

## VI. ASSESSMENT AND OUTLOOK

Services negotiations under a multi-dimensional agreement such as the GATS are difficult to organize. There is no common coordination system, comparable to tariff-controlled merchandise trade, that could be used to define a single negotiating target and the appropriate approach(es). The diversity of trading conditions, permissible trade restrictions and regulatory strategies across sectors makes it far more difficult for governments internally to overcome entrenched positions than in tariff negotiations under the GATT. The scope for reciprocal exchanges in which the export interests of some sectors might be mobilized against the defensive interests of others, is far more limited. Progress depends strongly on Members' ability to provide "a dose of unilateralism".<sup>61</sup>

The conditions, however, are not necessarily favourable. Coordination and implementation of liberalization programmes in services tend to be more time-consuming and resource-intensive than in merchandise trade. Access improvements cannot normally be achieved via administrative decrees, comparable to tariff reductions, but may presuppose profound institutional and regulatory changes: the abolition of monopoly regimes, enactment of new licensing rules and procedures, creation of supervisory bodies, etc. The changes need to be prepared in time in order to be negotiable (or 'committable') at decisive stages of a round. In-house cooperation and coordination within a Department of Trade and Industry might no longer suffice; many other ministries and agencies, possibly unfamiliar with international trade rules, may need to be involved and persuaded. Regional sensitivities might complicate this task if the relevant competencies are not concentrated at federal government level.

On the other hand, there are circumstances where services liberalization has proven virtually irresistible. Technical progress, not least the ascent of new communication technologies, has created new alternatives to long entrenched regimes and/or rendered them unenforceable. Telecom reform, to an extent, consisted of many governments simply recognizing and adjusting to what was happening in reality. And users' patience has not been unlimited. Information about liberalization policies abroad has led to telecom ministries being held accountable for performance deficits (higher charges, lower penetration, non-availability of advanced services, etc.) and be swayed to budge. Threats of industrial relocation may have added a sense of urgency, especially in cases where new technologies allow cross-border trade to gradually substitute for local presence. And there has been less internal resistance to change in rapidly expanding services than in agriculture, steel or mining, where specific skills and expertise may be lost for good. In such circumstances, the ongoing round will certainly help to accelerate and, within limits, modify reform projects that are already under consideration and, on entry into force, protect the new regimes from slippages and reversals.

Reciprocal bargaining situations may not be the rule, but could nevertheless arise in particular circumstances. Potential candidates are areas where common conceptual frameworks and 'negotiating

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<sup>60</sup> A WTO Secretariat study has raised the idea that, if some sort of a safeguards mechanism was to be introduced, this could be combined with an undertaking to do away with non-specified economic needs tests (WTO, 2001a).

<sup>61</sup> Hoekman and Messerlin (2000).

currencies' (market shares, number of suppliers, etc.) can be developed and used. Somewhat surprisingly, this may include mode 4 where different groups of Members have articulated interests. While some claims might be dismissed as negotiating tactics, others are obviously underpinned by serious domestic shortages, including in the health and social service sectors of a number of developed countries.<sup>62</sup>

Yet in order for mode 4 commitments to be economically relevant, it may be equally important to advance technical work, including on regulatory disciplines under the mandate of Article VI:4, and to stimulate recognition initiatives under the provisions of Article VII. Both areas are mutually linked, but there has not been much enthusiasm to date. Rather, sector lobbies may have found it more convenient to use their influence on the regulatory process as a brake, rather than openly confronting the easing of formal access restrictions. (Again, this militates for caution *vis-à-vis* ambitious liberalization initiatives in the absence of complementary efforts to defuse excessive regulation.) An additional element of uncertainty is the recent proliferation of preferential agreements in services and apparent tendencies to confine harmonization and recognition initiatives to participating countries.

Two crucial questions thus remain: How to ensure compatibility between deeper integration initiatives among sub-groups of Members and broad-based moves - across sectors, modes, and policy instruments - at multilateral level? And, in the latter context, how to promote economically meaningful results within the architecture of GATS?

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<sup>62</sup> Recent research may have helped to popularize the economic benefits while allaying some of the fears associated with the temporary presence of foreign service suppliers. See, for example, Winters (2003) and other contributions in Mattoo and Carzaniga (2003).



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