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Negotiating Trade in Services: Lessons From Autonomous Liberalisation

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Greater trade openness in services is central for new trade agreements to boost trade and economic growth. A sector often neglected in past trade agreements, services are now part and parcel of bilateral trade negotiations like TTIP and subject to negotiations over a services-alone plurilateral agreement, the so-called TISA. Yet, to date, most of the liberalization in services has been carried out autonomously, independent from the WTO or other trade agreements. So what can be learnt from autonomous liberalisation when new trade agreements on services are negotiated? And what explains this incentive of countries to liberalize on a unilateral basis?

Since the creation in 1995 of the General Agreement on Trade in Services (GATS), a WTO agreement, world-trade patterns have changed dramatically. New technology has introduced novel opportunities for how we trade whilst new business practices have sophisticated the management and fragmentation of production, leading, among other things, to the rise of global supply chains. All these changes have direct implications for services. Technological innovation has made many services thought of as non-tradable to become tradable, creating new patterns of comparative advantages for countries. Modern management practises have focused on efficient services inputs and optimised delivery of produces. As the focal point for trade negotiations has shifted from traditional barriers to regulatory barriers, of which there are many in services, there is also an extra push now for freeing up services trade.

Trade policy in services takes place at three different levels: multilaterally in the GATS, preferentially through Preferential or Free Trade Agreements, and autonomously on the basis of applied or real policy liberalization. Generally, applied policy restrictions are for most countries more than two times less restrictive than policy commitments made in GATS. In other words, there is much "water" between applied and bound levels of openness. What lessons can be derived from autonomous liberalisation that can help current trade negotiations on services carried out?

First, it is important to recognize that services liberalization spans a wide variety of sectors that are highly heterogeneous. No country is likely to have comparative advantages across the full range of services; such advantages are rather sector-specific for the simple reason that services are very different from each other. Tourism for instance is totally different from a consultancy service. Unsurprisingly, such differences influence the dynamics of trade negotiations in services.

There are huge differences across countries and sectors in terms of applied restrictions. For instance, Albania's life insurance market is still completely closed for cross-border trade through Mode 1 (cross-border supply), but is already entirely open for imports stemming from investments made through Mode 3 (commercial presence). Similarly, although major restrictions still remain in Professional services in the EU for both Mode 1 and 3, cross-border banking services only have some minor restrictions, whilst trade of banking services through Mode 3 is completely free. The U.S. has still some restrictions in banking services through Mode 3 whereas no restrictions exist in Mode 1 for this service.

Second, the great diversity of services means that trade-offs are not only to be found across sectors, but also along modes of supply. This could make negotiations more complex, but also create room for more subtle negotiation strategies. For instance, the TISA negotiations include many developed but also developing countries such as Pakistan and Peru. These countries are very likely to have different comparative advantages in services sectors compared to richer countries, which means that there are larger complementarities between the two types of trading partners. On the other hand, the TTIP negotiations are between two developed economies where complementarities are less obvious. In such circumstances, trade-offs could perhaps be better linked to modes cross-cutting various sectors.

Third, the most important lesson that can be drawn from the dynamics of autonomous liberalisation is about well-informed policy-makers and negotiators. A country's comparative advantage is in large part the chief determinant of its ambitions and preferences in trade policy. There is, however, often great uncertainty for many policy-makers what comparative advantages in services they and their partner countries' have. This limits an economy's trade and trade-policy potential. Trade negotiators that are better informed about a countries' comparative advantages will also have a better understanding of how negotiations can close successfully and, at the same time, give better reform momentum in domestic policy.

Generally, richer countries show somewhat greater openness in terms of applied openness in services. But there are other factors related to a country's endowments rather than affluence that play a role. For instance, a greater amount of skilled workers is positively associated with greater levels of liberalization in Mode 3 which is generally intensive in the usage of skilled labour. Likewise, businesses connected to ICT technology and the Internet tend to be associated with liberal cross-border trade policies in Mode 1.

The explanation is that a country that has a large pool of skills or a greater ICT base are economies which attract firms that intensively need these endowments for their production. This makes firms more productive since there is a good "match", which can subsequently reduce opposition to more trade openness: firms become strong enough to compete with foreign providers and reduce the demand for protection. In other words, the good "fit" between what a country can provide and what a firm needs can constitute one important channel though which trade policy in services can be altered.

Surprisingly, however, the opposite holds true for institutions. Countries with stronger institutions are less likely to liberalize in sectors which tend to need strong domestic institutions most. Services that require strong institutions are often very complex. Examples include Professional services such as accounting, auditing or lawyers that are traded through Mode 1. These services are usually exported by rich OECD countries like EU member states. Presumably, institutional-intense sectors in developed regions are still subject to comparatively high trade restrictions and these professional services providers are less willing to liberalize.

Finally, countries have in the meantime also implemented new commitments in services through preferential trade agreements. Just like in the case of applied policy, these commitments often go beyond what has been liberalized in GATS. But, these commitments are legal bindings and can be regarded as bound levels of restrictiveness in services. Awareness of this gap between multilateral and preferential commitments, and between applied and bound commitments, should be kept in mind by negotiators as a reduction of this discrepancy gives firms certainty about policy conditions for trade and investment, which boosts investment and trade volumes.

However, one problem with commitments undertaken in an agreement is that they may in fact not be implemented in domestic law. Commitments made in an agreement are one thing; passing new regulatory rules through parliaments is another. Hence, what really matters is what countries have in terms of applied policy.