

Reflections on the Nature of Preferentialism in Services Trade

Pierre Sauvé and Anirudh Shingal
World Trade Institute
University of Bern

The Path Ahead for World Trade: Free Trade Agreements and the
Multilateral Trading System in 2020

An academic workshop and roundtable on the occasion of
EFTA's 50th Anniversary

Graduate Institute of International and Development Studies
Geneva, 22 November 2010

Services PTAs: A factsheet

- Before the year 2000, only 6 of the 55 WTO-notified PTAs covered services
- Since then, more than half of the 150+ PTAs have involved services
- 70 PTAs address both goods AND services; 6 are services-only PTAs
- 62% of services PTAs feature an OECD Member; 13% are N-N, 49% N-S and 38% are S-S – yet 74% of services trade is N-N (no EU-US PTA in services)
- Such trends broadly mirror specialization patterns in services trade

Broad results from literature

- Even as the Vinerian approach to estimating the welfare effects has lesser analytical relevance...
- ...there are lower costs of trade diversion from preferential access than in the case of goods trade
- However, the sequence of liberalization may matter more in services trade esp. in sectors with network externalities...
- ...because location-specific sunk costs of production are important so that even temporary privileged access for an inferior supplier can translate into durable longer-term market advantage deterring future market contestability

We know little about preferences and their possible erosion in services trade...but preference margins are real (if possibly theoretical)

- The scope for – and political economy of – preference erosion in services trade is understudied and hard to gauge
 - Do PTAs entrench regional preferences or facilitate WTO commitments? (This remains an important empirical question to which the end of the DDA will provide measurable answers)
 - There is considerable “water” both in GATS commitments and the latest DDA offers (This may be entirely tactical and linked to the DDA’s state of play on agriculture and NAMA)



GATS vs PTAs: Modal Differences in Levels of Liberalization and Margins of Preference

| | GATS | DDA Offer | PTAs | GATS/PTA | DDA/PTA | PREF. |
|--------------------|------|------------|------|----------|---------|-------|
| MARGIN | | (0 to 100) | | % | % | % |
| Total score | 27 | 34 | 63 | 38 | 54 | 46-62 |
| Mode 1 | 24 | 30 | 59 | 41 | 51 | 49-59 |
| Mode 3 | 30 | 38 | 67 | 45 | 57 | 43-55 |
| OECD | | | | | | |
| Mode 1 | 43 | 51 | 59 | 73 | 86 | 14-27 |
| Mode 3 | 53 | 59 | 67 | 79 | 88 | 12-21 |
| Non-OECD | | | | | | |
| Mode 1 | 18 | 23 | 60 | 30 | 38 | 62-70 |
| Mode 3 | 23 | 32 | 67 | 34 | 48 | 52-66 |

Source : Author calculations based on Marchetti and Roy (2008).

Comparing the level of services trade and investment liberalization across sectors

| Sector | GATS | DDA (0 to 100) | PTA | GATS/PTA % | DDA/PTA % | Pref. Margin % |
|---------------------|------|-------------------|-----|---------------|--------------|-------------------|
| Professional | 30 | 39 | 67 | 44,8 | 58,2 | 41,8 – 55,2 |
| Computer | 55 | 74 | 93 | 59,1 | 79,6 | 20,4 – 40,9 |
| Postal/Courier | 14 | 20 | 53 | 26,4 | 37,7 | 62,3 – 73,6 |
| Telecom | 51 | 58 | 80 | 63,8 | 72,5 | 27,5 – 36,2 |
| Audio-visual | 17 | 20 | 50 | 34,0 | 40,0 | 60,0 – 66,0 |
| Construction | 40 | 46 | 75 | 53,3 | 61,3 | 38,7 – 46,7 |
| Distribution | 32 | 41 | 76 | 42,1 | 53,9 | 46,1 – 57,9 |
| Education | 18 | 25 | 57 | 31,6 | 43,9 | 56,1 – 68,4 |
| Environmental | 20 | 30 | 62 | 32,3 | 43,4 | 56,6 – 67,7 |
| Financial | 36 | 40 | 53 | 67,9 | 75,5 | 24,5 – 32,1 |
| Health | 8 | 11 | 34 | 23,5 | 32,4 | 67,6 – 76,5 |
| Tourism | 51 | 61 | 83 | 61,4 | 73,5 | 26,5 – 38,6 |
| Maritime | 12 | 23 | 57 | 21,1 | 40,4 | 59,6 – 78,9 |
| Rail | 14 | 20 | 52 | 26,9 | 38,5 | 61,5 – 73,1 |
| Road | 16 | 18 | 56 | 28,6 | 32,1 | 67,9 – 71,4 |
| Auxiliary transport | 21 | 24 | 58 | 36,2 | 41,4 | 58,6 – 63,8 |

u^b

Source: Author calculations based on Marchetti and Roy (2008)

But what about rules of origin?

- The restrictiveness of rules of origin determines the extent to which non-members can benefit from trade preferences negotiated in agreements
- Given that a majority (62%) of WTO-notified agreements involve a developed country member, the majority of PTAs covering services adopt the most liberal (i.e. substantial business operation) rule of origin, with a view to promoting third country FDI inflows into the integrating area and extending the benefits of integration to all investors that are established in one of the PTA Parties. **In such instances, the preferential liberalization of Mode 3 largely approximates MFN liberalization**
- **South-South PTAs make increasing use of the space afforded them under Article V.3** to adopt more restrictive rules of origin aimed at limiting benefits to insiders
- Rules of origin targeting cross-border supply (Mode 1) remain largely unaddressed (and weakly enforceable), and rules dealing with Mode 4 trade tend to be highly restrictive, typically bestowing temporary entry benefits only to citizens or permanent residents of PTA Parties

So do preferences really matter? Are they more theoretical than real?

- Feasibility constraints in enforcement-poor regulatory settings – many developing and most least developed countries do not have the regulatory means to enforce preferences
- Practicality of maintaining parallel regulatory regimes
- Tepid advances on MRAs in most PTAs
- Preferences appear weakly enforceable for many Mode 1 transactions and are of least relevance for Mode 2 trade
- Article V.6 all but multilateralizes preferential liberalization for Mode 3 for N-N and N-S PTAs (accounting for the bulk of services trade)
- Preferences are most feasible where the border matters, such as for Mode 4 trade (but this concerns the smallest share of trade and of commitments, <5%) —

Moreover, some issues are thorny still for PTAs

- **Sensitive sectors tend to be the same across negotiating settings** despite the fact that in almost all instances, PTAs have generated forward movement (especially true of N-S PTAs and those involving the US)
- **Progress on Mode 4 trade remains uneven and generally limited even in PTAs**, though the possibility to contain MFN leakage helps to raise comfort levels at the trade-migration interface (also treated in non-trade deals, especially for lower-skilled movement)
- **Sectors such as land transport/logistics, MRAs in professional services lend themselves more readily and easily to “neighbourhood” approaches**

Bottomline

- Even as the potential downsides of preferential services liberalization may be less ominous...
- ...preferential access does result in significant first-mover advantages, which can be used to deter entry for more efficient third-party suppliers
- Also, PTAs are here to stay...
- ...even though one cannot deny that the gains from multilateral liberalization are likely to be larger

Multilateralizing services preferentialism

- Notifying MRAs to the WTO under Article VII of the GATS
- Making preferences in services trade time-bound
- Showcasing PTAs with liberal denial of benefits provisions as best practice accords
- Negotiate voluntary best practice guidelines for services agreements



Thank you!

Pierre Sauvé

pierre.sauve@wti.org

Anirudh Shingal

anirudh.shingal@wti.org

www.wti.org

www.nccr-trade.org

—