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# Rethinking Services in a Changing World

Policy Options Paper



The **E15** Initiative

STRENGTHENING THE GLOBAL TRADE AND  
INVESTMENT SYSTEM FOR SUSTAINABLE DEVELOPMENT

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# Rethinking Services in a Changing World

Patrick Low

on behalf of the E15 Expert Group on Services

January 2016

## Note

The policy options paper is the result of a collective process involving all members of the E15 Expert Group on Services. It draws on the active engagement of these eminent experts in discussions over multiple meetings as well as an overview paper and think pieces commissioned by the E15Initiative and authored by group members. Patrick Low was the author of the report. While a serious attempt has been made on the part of the author to take the perspectives of all group members into account, it has not been possible to do justice to the variety of views. The policy recommendations should therefore not be considered to represent full consensus and remain the responsibility of the author. The list of group members and E15 papers are referenced below.

The full volume of policy options papers covering all topics examined by the E15Initiative, jointly published by ICTSD and the World Economic Forum, is complemented with a monograph that consolidates the options into overarching recommendations for the international trade and investment system for the next decade.

The E15Initiative is managed by Marie Chamay, E15 Senior Manager at ICTSD, in collaboration with Sean Doherty, Head, International Trade & Investment at the World Economic Forum. The E15 Editor is Fabrice Lehmann.

## E15Initiative

Jointly implemented by the International Centre for Trade and Sustainable Development (ICTSD) and the World Economic Forum, the E15Initiative was established to convene world-class experts and institutions to generate a credible and comprehensive set of policy options for the evolution of the global trade and investment system to 2025. In collaboration with 16 knowledge partners, the E15Initiative brought together more than 375 leading international experts in over 80 interactive dialogues grouped into 18 themes between 2012-2015. Over 130 overview papers and think pieces were commissioned and published in the process. In a fast-changing international environment in which the ability of the global trade and investment system to respond to new dynamics and emerging challenges is being tested, the E15Initiative was designed to stimulate a fresh and strategic look at the opportunities to improve the system's effectiveness and advance sustainable development. The second phase of the E15Initiative in 2016-17 will see direct engagement with policy-makers and other stakeholders to consider the implementation of E15 policy recommendations.

## E15Initiative Themes

- Agriculture and Food Security
- Clean Energy Technologies
- Climate Change
- Competition Policy
- Digital Economy
- Extractive Industries\*
- Finance and Development
- Fisheries and Oceans
- Functioning of the WTO
- Global Trade and Investment Architecture\*
- Global Value Chains
- Industrial Policy
- Innovation
- Investment Policy
- Regional Trade Agreements
- Regulatory Coherence
- Services
- Subsidies

\* Policy options to be released in late 2016

For more information on the E15Initiative:

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# Abstract

Services have needed rethinking for a long time in a changing world. The role of services in production, consumption, and trade has evolved dramatically in the last few decades. Information-related and transport technologies have splintered production locationally and facilitated the separation of production and consumption over greater distances. At the same time, they have greatly shrunk space and time, providing a platform for the explosive growth of international trade and investment. By taking advantage of recently available data sets measuring trade in value-added instead of in gross terms, valuable new insights have emerged on the multiplicity of services entering trade and on the networked nature of economies. The world of policy has been trying to catch up with the evolution of services and servicification in the global economy where services are increasingly recognized as a prominent source of value creation, employment and growth. However, questions arise about the adequacy of arrangements for cooperation in this domain, and, in particular, whether the General

Agreement on Trade in Services (GATS) and preferential services agreements are fit for purpose. Following analysis of the background and dynamics to international cooperation in services, the present paper examines issues and outlines related recommendations under six specific categories: services and digitization; small and medium-sized enterprises and services trade; the role of “soft law” in international agreements; regulatory cooperation; coherence issues arising in relation to the separate rules governing goods and services; and, modifications to the GATS related to temporary presence and also scheduling disciplines. Twelve policy options are put forward for government action to develop an international services regime that addresses today’s economic and regulatory challenges, while fostering international cooperation and competition. Their unifying characteristic is that they are all recommendations that could change the framework for future trade policies and negotiations.

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Abbreviations	
APEC	Asia-Pacific Economic Cooperation
API	application program interface
ASEAN	Association of Southeast Asian Nations
BIT	bilateral investment treaty
CFTA	Continental Free Trade Area
CPC	Central Product Classification
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GVC	global value chain
HS	Harmonized System
ICT	information and communications technology
ITA	Information Technology Agreement
MFN	most favoured nation
OECD	Organisation for Economic Co-operation and Development
PTA	preferential trade agreement
RCEP	Regional Comprehensive Economic Partnership
RTA	regional trade agreement
SME	small and medium-sized enterprise
SPS	sanitary and phytosanitary
TBT	technical barriers to trade
TFA	Trade Facilitation Agreement
TFTA	Tripartite Free Trade Area
TiSA	Trade in Services Agreement
TPP	Trans-Pacific Partnership
TPRM	Trade Policy Review Mechanism
TTIP	Transatlantic Trade and Investment Partnership
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

# Executive Summary

Technology, the growing “servicification” of production, and increased trade dependency, accompanied by income growth associated with economic development and increased productivity, have all combined to make services an ever larger part of global economic activity. Yet for historical reasons services have been neglected both in academic work and policy discourse. This neglect has not only meant that the value contribution of services has been understated, but the various functions of services in production, trade and consumption have also been overlooked, along with the contribution of services to innovation and productivity growth. The invisibility of services and some of the ways in which they are produced and consumed have added a layer of complexity, and contributed to a paucity of data on services.

The unabated evolution of technology and international markets requires national policy-makers to rethink approaches to services in the context of trade competitiveness. National economies cannot function without access to competitive global networked services and trading platforms, all of which are powered and supported by trade in services—including computer, internet and digital services, telecoms services, delivery services, and financial services.

Against this backdrop, the E15 Expert Group on Services, convened by ICTSD in partnership with the World Economic Forum and supported by Sweden’s National Board of Trade, has engaged in critical analysis and forward-thinking on issues relating to a deeper and more comprehensive regime for services in the global economy. The experts explored new thinking and put forward fresh ideas on opportunities for reform and reinvigoration of international services regimes, especially at the multilateral level. The Group has striven to arrive at a set of viable and pragmatic policy options for trade officials, trade policy-makers and other stakeholders to consider, including for the WTO post-Nairobi agenda.

Policy-makers will benefit from the paper’s compilation of ideas and information for rethinking services trade in the context of today’s global economy. A broad array of topics is presented, concerning governments at all levels of development, from the digitized economy to regulatory cooperation in the evolving architecture for international trade in services.

## Background

The paper confirms that much more work is required in the area of trade in services, and suggests paths forward to address services at a multilateral and plurilateral level that may incubate new disciplines and approaches to negotiations.

By taking advantage of recently available data sets measuring trade in value-added instead of in gross terms, valuable new insights have emerged on the multiplicity of services entering trade. Much of this services-generated value addition tended to be mis-specified as value attributable to goods or misclassified within the services sector when data were only presented in gross terms.

It was not until the 1980s that serious systematic consideration was given to the institutional setting for international cooperation in services. This started in a multilateral setting and eventually resulted in the establishment of the General Agreement on Trade in Services (GATS). The GATS has been progressively complemented by preferential trade agreements (PTAs) in services, some of which have innovated with interesting variations on the currently prevailing structure of GATS schedules. The PTAs have often gone further in market opening than the GATS. This has not always been the case, however, as in certain instances PTAs have subtracted from GATS commitments. In many ways, refining international treaty frameworks—in the goods realm as well as services—and ensuring that they are relevant in a rapidly changing economic and business landscape will always be a work in progress.

The Doha Round negotiations in services have not progressed significantly, not least because some members have traded off a lack of what they regard as progress elsewhere with any effort to address a services agenda. This has resulted in the TiSA negotiations, which are currently taking place outside the WTO among countries that represent 70% of world trade. The systemic consequences of this unprecedented development, in terms of size and scope, remain uncertain and opinion is divided among observers as to how TiSA should be viewed. The final verdict will depend to a degree where the results ultimately sit in relation to the GATS and the multilateral framework.



## Policy Options

The Expert Group decided to focus particularly on a set of issues for which it commissioned think pieces by authors from within the Group. These were on services and digitization, small and medium-sized enterprises and services trade, the role of “soft law” in international agreements, regulatory cooperation, and coherence issues arising in relation to the separate rules governing goods and services. These papers were discussed by the Group and policy recommendations developed in relation to the written analysis and the discussion of it.

In addition, the Expert Group engaged in detailed discussions on temporary access of people supplying services in host markets, scheduling techniques for recording specific commitments on market access and national treatment, the use of standardized nomenclatures for recording commitments and approaches to addressing the gap between what governments commit to with their trading partners and what policies they actually pursue in practice. Each of these areas is also subject to policy recommendations.

Twelve policy options related the above issues are put forward for government action to develop an international services regime that addresses today’s economic and regulatory challenges, while fostering international cooperation and competition. Some of these options may seem rather technical in nature, when gauged against the need for a comprehensive response to the huge changes that are taking place in the global economy. However, their unifying characteristic is that they are all recommendations that could change the framework for future trade policies and negotiations.

## Next Steps

The options are presented over an indicative time horizon. Short-term options are mostly related to analytical and exploratory work that can be undertaken immediately whereas longer-term options are of more substantive nature and might require significant effort and consensus building. The task facing governments and other stakeholders is to find ways of rendering regimes for the regulation of services as relevant and supportive as possible to the challenges facing the global economy. Such arrangements must be equitable to gain acceptance, and contribute to sustainability, development and growth.

# 1. Introduction: What is this report about?

Services play an increasingly important role in the global economy. Propelled in no small measure by technological developments in information and communications technology (ICT), their contribution to value continues to grow alongside the internationalization of economic activity and rising global income. Services play a multifunctional role in production, trade and consumption. The complexities that underlie the role of services, linkages between services and goods, and economic outcomes are often not fully understood.

Mounting awareness of the evolving importance of services in the global economy has focused attention on the need for international cooperation to develop compatible and mutually advantageous agreements on services. Yet international regime building has been relatively slow, incomplete, and fragmented.

At the multilateral level, the General Agreement on Trade in Services (GATS) was negotiated in the Uruguay Round of multilateral trade negotiations (1986-1994) and came into force in 1995. The Agreement identified areas for further rule-making negotiations, including on the question of safeguards, subsidies, procurement and domestic regulation. This remains the case today with no tangible results in any of them. The multilateral regime currently governing services trade predates the digital revolution. Not surprisingly, many suggestions have been made on how to improve and adapt the GATS to evolving technological and policy realities.

In the fourteen years since the launch of the Doha Round in 2001, very little progress has been made on services.<sup>1</sup> Rising frustration at what many regarded as the relative neglect of the subject in the negotiations, as well as the insistence of some members for results in agriculture ahead of services, recently prompted a group, currently comprising 23 members representing 52 economies and 70% of global services trade, to pursue the negotiations on a plurilateral basis outside the WTO. This subgroup of like-minded WTO members embarked upon a negotiation aimed at establishing a Trade in Services Agreement (TiSA). The implications of this development are explored in section 2.3 below.

The services sections forming part of preferential trade agreements (PTAs) vary in approach and detail. They make up a criss-crossing mosaic that is sometimes complementary to the GATS, and sometimes less so. In certain instances they go further than GATS, or depart from the currently prevailing structure of GATS schedules, or contain provisions more reflective of services markets today and could show the way for an improved multilateral approach (Latrille and Lee 2012; Mattoo and Sauvé 2011; Roy 2011). In other cases they detract from GATS and have even been dubbed “GATS-minus” (Adlung and Miroudot 2012).

In more recent years, a push has taken place to develop mega-regional PTAs. These include the Trans-Pacific Partnership (TPP), the Regional Comprehensive Economic Partnership Agreement (RCEP), the Transatlantic Trade and Investment Partnership (TTIP), the Tripartite Free Trade Area (TFTA), the Continental Free Trade Area (CFTA) and the Pacific Alliance.<sup>2</sup> None of these ongoing negotiations have been completed to date and the likely contents of pending agreements have yet to be made publicly available.<sup>3</sup> But between them the mega-regionals account for the bulk of the global economy and the world’s population. They could have a profound influence on global trade and investment governance.

The task facing governments and other stakeholders is to find ways of rendering regimes for the regulation of services as relevant and supportive as possible to the challenges facing the global economy. Such arrangements must also be equitable to gain acceptance, and contribute to sustainability, development and growth.

Against this backdrop, experts in the E15 Expert Group on Services engaged in critical analysis and forward thinking on issues relating to a deeper and more comprehensive regime for services in the global economy. The experts have explored new thought and put forward fresh ideas on opportunities for reform and reinvigoration of international services regimes, especially at the multilateral level. The Group has striven to arrive at a set of viable and pragmatic medium and long-term policy options for trade officials, trade policy-makers and other stakeholders to consider, including for the post-Bali Doha Round agenda.

<sup>1</sup> The waiver permitting the preferential treatment of the trade of least developed countries, agreed at the Bali Ministerial Meeting in December 2014, stands out as an element of progress in services.

<sup>2</sup> The TPP comprises 12 economies on both sides of the Pacific. RCEP includes 10 ASEAN states and an additional 6 major Asian economies. The TTIP is a bilateral between the EU (with its 28 member states) and the United States. The TFTA involves 26 African countries and the African Union has also launched the CFTA. The Pacific Alliance implicates Chile, Colombia, Mexico and Peru.



In order to advance its work, the Group commissioned a number of thematic papers covering areas it considered of particular relevance to its task. These papers provided useful insights upon which to build a policy options narrative on services. The papers did not, however, cover all aspects of what the Group considered in terms of the more comprehensive approach envisaged in this exercise.

The commissioned papers looked at the changing context in which services should be analysed, the digitization of global commerce, small and medium-sized enterprises (SMEs) in services, the use of soft law in international rules, regulatory cooperation, and the relationship and possible integration of rules on goods and services in the context of international trade rules.

The Expert Group's discussion has led to a series of recommendations listed in section 3 of this report. Some of these may seem rather technical in nature, when gauged against the need for a comprehensive response to the huge changes that are taking place in the global economy. Their unifying characteristic is that they are all recommendations for action that could change the framework for future trade policies and negotiations. These policies and negotiations, as TheCityUK (2015) has underlined, "have tangible commercial value, and so are vital for business. They are core instruments for giving freer rein to comparative and competitive advantage in global trade and the creation of new markets, opportunities and access."

National policy-makers can benefit from the paper's analysis on this topic of increasing relevance to all national economies and to the global economic system. As the European Commission has emphasised (European Commission 2013), trade "has become an important means of achieving much needed growth and creating jobs without drawing on public finances." But for trade to perform this function, trade policy needs to be effective, sustainable over the long term, enable business to prosper and contribute to growth and wealth-creation. It is this objective that underlies the Expert Group's recommendations.

<sup>3</sup> After five years of negotiations, the TPP negotiations were closed on 5th October 2015. Ratification is now required by all signatories and this will be a contested process. Official summaries indicate that it contains provisions on e-commerce and free data flows as well as on opening up services markets.

# 2. Background to International Cooperation in Services

## 2.1. The Evolution of Services in the Global Economy

Services have needed rethinking for a long time in our changing world. Classical economic thought assigned zero value to services because they could not be accumulated. One consequence of this is the absence of historical data on services. Later thinking considered services devoid of scope for productivity growth and feared that their increasing dominance as a source of income would spell relative economic decline. Matters have been made no better by the invisible or intangible character of services and the difficulties of identifying and measuring them.

Greater appreciation of the contribution of services to economic activity began to take hold in the 1970s. It was not until the 1980s that governments saw the need to craft a multilateral agreement on services akin to the regime that had regulated goods since the late 1940s. Burgeoning preferentialism in trade relations from the early 1980s onwards saw the establishment of a growing number of PTAs containing provisions on trade in services, although most preferential services agreements were concluded post-Uruguay Round.

Economic growth and globalization, spurred on by technological advances, brought services into a new prominence as sources of income, trade, jobs and development (Rentzhog and Anér 2014). Key technological developments in information and communications technology and in transport, along with evolving business models, have driven the internationalization of production. Trade and foreign investment have worked in tandem, spreading value networks producing both goods and services across multiple economies. This process has intensified dependency on services, growing its share of value in production. A related development, also enabled largely by technology, has been the application of services innovation to facilitate growing customization of production in ever more complex and differentiated markets. This too has intensified the services components of production.

Through reducing the costs and barriers to cross-border exchange, technological advances in ICT, in particular, have greatly increased the number of firms engaged in trade via Internet platforms. Many of these firms are small but can serve a large customer base in multiple economies. The involvement of multiple firms in cross-border exchange—unconstrained by scale as a barrier to entry, logistical challenges and administrative burdens—represents an important structural change in the global economy driven predominantly by services. Relative to manufacturing operations, the minimum efficient scale of operations

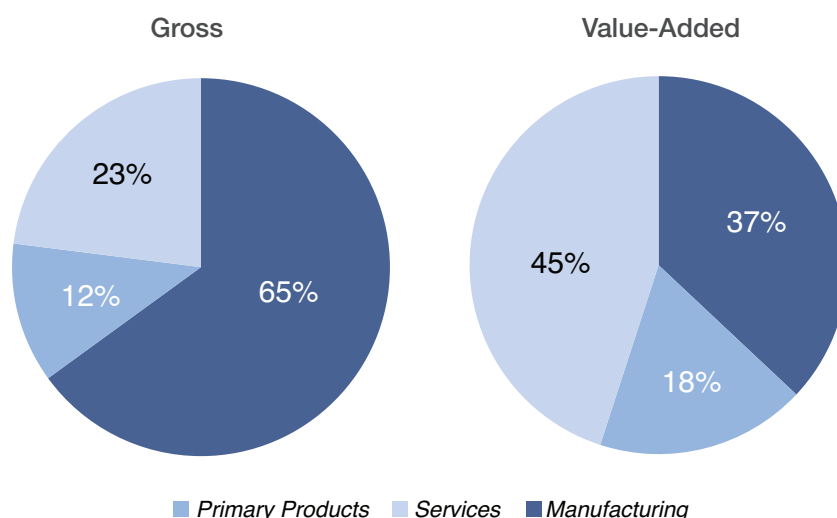
for service providing firms often tends to be smaller and less intensive in the use of physical capital. In some service sectors, this can offer significant catching up and technological leapfrogging opportunities for service suppliers from developing countries.

The consumption side of the story of growing services dominance in the global economy is also important. As people become richer, they spend proportionately more of their incomes on services. In this sense, economic development will always bias growth towards services, augmented in today's economy by the digital revolution and other technological advances. Moreover, the old neoclassical precept that the consumer is king has become truer than it ever was. The digital world of the Internet and social media has armed consumers with levels of information they never had before and rendered them more discerning and demanding. This has fed technology-enabled product differentiation across a swathe of consumer goods, and further stimulated services components in production.

The recently improved procedure of measuring trade in terms of value-added has also raised a hitherto dormant awareness of the importance of services in trade flows. Thanks to the work of various international agencies, governments and academic institutions, the use of international input-output matrices to capture value-added in traded products has led to a re-estimation of the services component of trade. Essentially, what the value-added measure of trade does is to net out the import component of exports in each economy, allowing a proper attribution of value to the location where it was generated. This addition in accuracy changes our understanding of the true nature of trade relationships in important ways. Bilateral trade balances no longer look the same when imports are netted out from exports. The technology content of bilateral trade flows can be very different in cases where, for example, complex products are assembled in an economy that reports the exports gross instead of netting out the hi-tech imports that go into exports. The true nature of the interdependent trade relationship between country pairs is thus more fully revealed.

When trade was only measured in gross terms without any consideration of the input breakdown and sourcing of traded products, the services component of cross-border trade was regularly reported as somewhat less than 25% of total value. The figure now is some 45% (Figure 1). This remains an underestimate on account of difficulties in measuring some services flows via the balance-of-payments accounts, and to the extent that services inputs into manufactures that are supplied in-house without any

**Figure 1: Sectoral Contributions to Trade, Gross and Value-Added Measures (2008)**



recorded arm's-length transactions will still be counted in the trade statistics as manufactures. One could make the same argument in respect of manufactures embedded in output identified as services exports, but this occurs far less frequently in practice. It should also be noted that the data used in these calculations pertain to 2008 and does not capture the degree of servicification that has occurred since.

The extension of a value-added measure from the traditional GDP calculation to trade flows has also reinforced awareness of the networked nature of economies—how putatively different markets are linked and what the true content is of traded products. A revelation emerging from the value-added approach is that all services entering the production of goods or services for export are in principle tradable. Services that are non-tradable if supplied in isolation can be “bundled” with goods (or other services) and traded as a composite offering. Take factory cleaning services as a simple example, where a factory produces footwear for export. Those cleaning services represent part of the value incorporated in the exported shoe and are therefore traded. As a stand-alone service, factory cleaning obviously cannot be traded, but this changes when that service is bundled with other sources of value generated in the production process. If all producer services can potentially be traded, this may raise questions about the sources of national comparative advantage and the scope for specialization. It is also a reminder that policies affecting one activity have ramifications for lots of other activities comprising joined-up production structures.

In terms of the GATS definition of services transactions, a more accurate accounting of the content of products in the context explained above would lead to the identification of more Mode 1 transactions.<sup>4</sup> Within the GATS definitional framework, access to foreign markets can, of course, also be secured through factor flows (Modes 3 and 4).

As noted briefly in introduction, the role of services in production, consumption and trade has evolved dramatically in the last few decades. Information-related and transport technologies have splintered production locationally and facilitated the separation of production and consumption over greater distances. At the same time, they have greatly shrunk space and time, providing a platform for the explosive growth of international trade and investment.

Innovation in services is also a significant factor in explaining the growing prominence of the sector (Miles 2006). Spontaneous networks of producers, consumers and entrepreneurs have combined technology and knowledge to generate innovative processes and products. Innovation and productivity gains in services are harder to pin down and measure than R&D-generated innovation in the goods sector. This is because innovation is more incremental and integrated in the production process as opposed to being undertaken by a designated R&D department.

A greater level of political willingness of governments to open markets to international trade and investment—as compared to the first half of the twentieth century—completed the mosaic upon which the world has globalized over the last six decades. In short, internationalized production and consumption, combined with changes in patterns of consumer behaviour have been the proximate causes of growing services-intensity in the global economy.

<sup>4</sup> The definition of services trade under the GATS is four-pronged, depending on the territorial presence of the supplier and the consumer at the time of the transaction. The GATS covers services supplied (a) from the territory of one Member into the territory of any other Member (Mode 1 - Cross-border trade); (b) in the territory of one Member to the service consumer of any other Member (Mode 2 – Consumption abroad); (c) by a service supplier of one Member, through commercial presence, in the territory of any other Member (Mode 3 - Commercial presence); and (d) by a service supplier of one Member, through the presence of natural persons of a Member in the territory of any other Member (Mode 4 - Presence of natural persons). From: WTO Trade in Services Division. 2013. The General Agreement on Trade in Services: An Introduction.

## 2.2. Servicingation

The growing reliance on services as a source of economic activity led to the coining of the term “servicingation” by economists at the Swedish National Board of Trade, and the term has assumed common usage in the literature (Rentzhog and Anér 2014). A parallel branch of literature referred to as “service science” (Low 2013) focuses on the same phenomenon, as does work by the OECD on “knowledge-based capital (OECD 2011, 2012). The definition given by Rentzhog and Anér (2014) of servicingation — “a process whereby non-services sectors (both agricultural and non-agricultural) in the economy buy and produce more services, and also sell and export more services, often as a package deal with the good” — describes a core driver of the increasing share of services-generated value in the economy.

However, the demand for services must not be seen only as derived from other activities in the non-services and services sectors. Services themselves are directly consumed (e.g. travel, tourism, personal insurance and other financial services, business services, retail distribution, and so on) and a combination of growing customization and rising global incomes has vastly increased demand for services in these sectors as well.

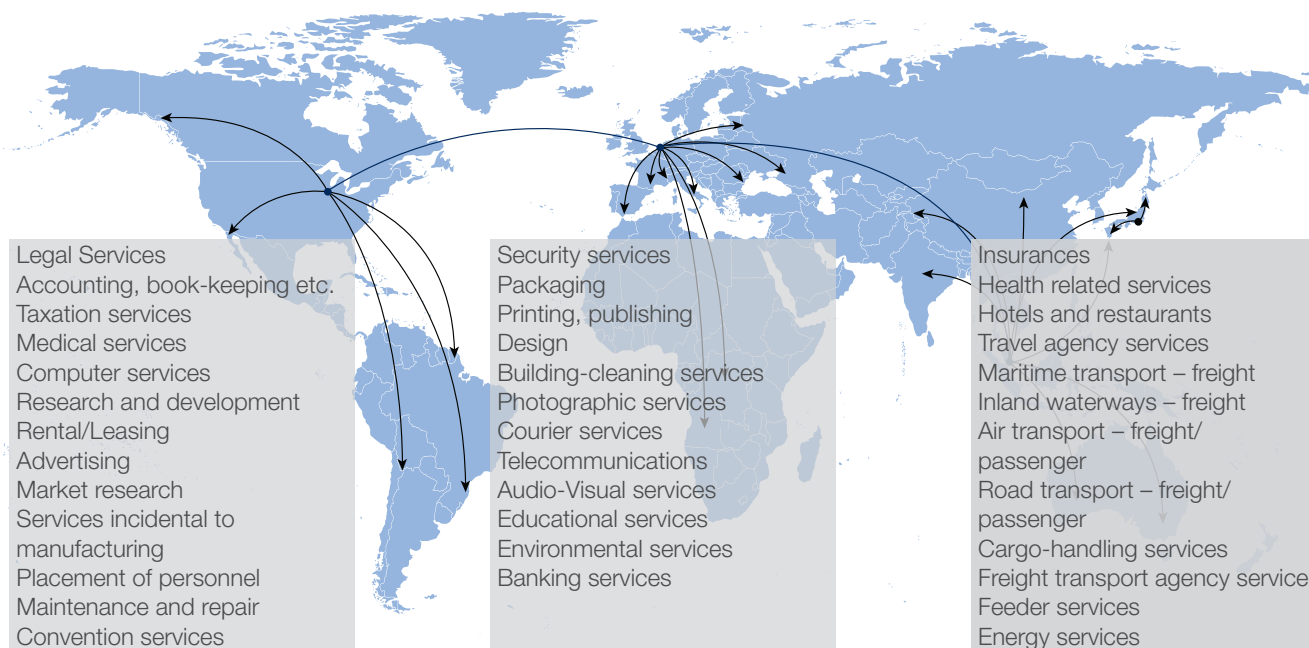
The distinction here is between producer services and consumer services. The difference between the two can depend both on the nature of the service as well on the place in the value chain of the source of demand for a service. Leisure services, for example, would in most cases be consumption services. They do not enter production. Insurance services, on the other hand, can be producer services if they are inputs into a production process. Alternatively, insurance for household goods, for example, forms part of a consumption package and has nothing to do with production.

In the case of production inputs, services are multifunctional. They may simply be the glue that holds value chains together, conveying products or people over distances. These services may include transport, logistics and various ICT products. Secondly, they may be ancillary services that allow production to occur. Repair and maintenance services, management services, and various back-office services are examples. Finally, some services may be directly consumed in production, such as production monitoring or cleaning and refuse disposal. These distinctions may be heuristically helpful, but a proper enumeration of services along a value chain does not rely on them. Services entering production represent value regardless of their function.

Notwithstanding the distinction between production and consumption services as sources of value, a good part of the growing demand for services through a servicingation process is associated with production dedicated to goods for final consumption and in that sense is derived. This applies regardless whether the final output of a value chain is a good or a service. Rentzhog and Anér (2014) report on a study by Sweden’s National Board of Trade (Kommerskollegium 2010) of a company called Sandvik Tools that consumes over 40 different services to sell and ship their products (Figure 2). That number would be even greater if all the services entering into the manufacture and post-sales maintenance of the tools were also counted in the value chain.

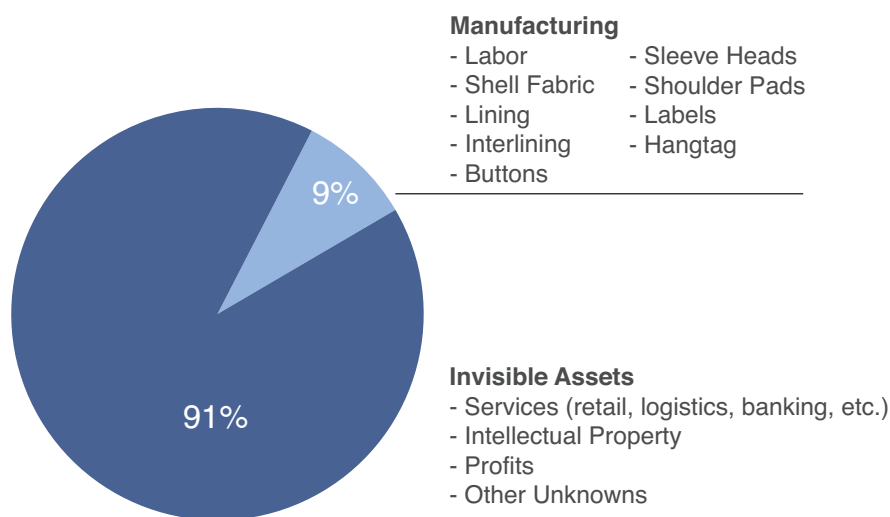
A range of other studies indicate similar outcomes. Low (2013) reports on the services component of the manufacture of a jacket (Figure 3). The share of the jacket attributable to physical inputs is only 9%. All the rest is comprised of invisible assets, including services and profits.

**Figure 2: Services Needed by Sandvik Tooling to Sell and Ship a Product**



Source: Swedish National Board of Trade 2010

**Figure 3: Manufacturing Cost and Invisible Assets of a Jacket**



Source: Low (2013)

The evolution of services and servicification in the global economy has resulted in a new world where services are recognized as a prominent source of economic activity and value creation—in production, trade, consumption, investment, employment, growth and innovation—and will continue to expand those contributions over time. The world of policy is trying to catch up. Improvements in data availability have demystified services to a degree, but there is a long way to go. Questions arise about the adequacy of arrangements for international cooperation in this domain. In particular, there is the question whether the GATS and preferential services agreements are fit for purpose in a rapidly changing world. These are the issues to be taken up in the rest of the paper.

### 2.3. International Cooperation in Services

Much has been written about international cooperation in services. Analyses have tended to focus on the GATS, but there is also considerable literature on what PTAs have been doing in services.<sup>5</sup>

The GATS was influenced in no small measure by the GATT and adopted parts of its legal structure. However, the GATS also incorporated some important additional features to address perceived differences between goods and services. Among the important differences were the inclusion in GATS of alternative means of trading services, involving cross-border movement of products, consumers, and factors of production. On the product market side, suppliers could send their services to consumers across frontiers just as in the case of goods, or consumers could cross frontiers themselves to consume foreign-supplied services. In factor markets, both investors and individuals crossing frontiers to supply services also came under the GATS umbrella.

Another important contrast with the GATT relates to the asymmetric treatment of rules on non-discrimination, particularly in regard to national treatment. While the most-favoured-nation (MFN) principle of non-discrimination among non-resident suppliers or suppliers applies (with exceptions) in GATS as in the GATT, the national treatment principle is negotiable in GATS while it is an *ex ante* across-the-board requirement in GATT. This difference reflects the multi-modal approach to trade transactions adopted in the GATS, the absence of tariffs as the prime instrument of border protection, and the relative insignificance of the border as a locus of regulation in services markets.

The GATS has also been criticized for a lack of clarity in regard to some provisions and definitions, which could have had a dampening effect on the willingness of governments to undertake obligations. Many GATS commitments were benchmarked at levels of access above those prevailing at the time the commitments were made. In the absence of further negotiations, over time the value of GATS commitments has been further diluted through autonomous liberalization or liberalization under regional initiatives. Gaps today between commitments and actual policies can be large (Miroudot and Pertel 2015). They detract from predictability in trade relations. The same phenomenon exists in the GATT.

As noted in the introduction, a subset of participants in the Doha Round have initiated negotiations on a separate Trade in Services Agreement. So far, TiSA is the only initiative outside the WTO to be launched with the specific purpose of substituting for a WTO negotiation. Assuming a successful completion of the negotiations, this could have serious implications not only for services negotiations in the WTO, but for the overall balance of the multilateral

<sup>5</sup> The issues touched on in what follows were discussed by the Expert Group. Useful insights emerged, with varying levels of convergence among members, but the group did not seek to negotiate and no explicit consensus was attempted among the views expressed. For this reason there is limited specific attribution to the Expert Group collectively. Where relevant, the paper has drawn heavily on the think pieces prepared for the group.



negotiating agenda. On the other hand, TiSA could also point the way to progress in negotiations under the GATS. Systemic concerns will largely evaporate if TiSA establishes a successful pathway towards multilateralization. The Council for Trade in Services is kept informed by TiSA participants on developments in the negotiations.

One view of TiSA is that its architects consider it open to all members, and the intention is to bring the agreement within the WTO and apply it on a non-discriminatory basis. This could be achieved by incorporating the results into the GATS schedules of the members concerned, taking on the form of a critical mass agreement like the post-Uruguay Round results on telecommunications and financial services. If this is the approach, a question that could arise is how any rule changes agreed in TiSA would be enshrined. Perhaps the Additional Commitments (Article XVIII) column in Members' schedules of commitments could serve the purpose. This presupposes, however, that the respective obligations add to and do not detract from currently existing GATS disciplines. Whether a critical mass approach is indeed the intention remains unclear, but it is noteworthy that China's request to join the TiSA in 2013 was not supported by all participants. An alternative is that TiSA will not be multilateralized, but be notified as an Economic Integration Agreement governed by Article V of GATS.

Whether or not TiSA succeeds, and whatever the form it takes, any future consideration of how to improve multilateral governance in services would benefit considerably from examining the provisions and experiences of PTAs that incorporate services provisions. The picture is mixed and complicated. Some evidence suggests that market access commitments have on average been far higher in services PTAs than in the GATS (Mattoo and Sauvé 2011; Roy 2011).

In contrast, Adlung and Miroudot (2012) found that most of the services-related 66 PTAs contained in an OECD database included GATS-minus provisions. These often take the form of "horizontal" (cross-sectoral) exclusions that go further than those contained in the respective GATS schedules, for example on such matters as national treatment for subsidies. These GATS-minus provisions are more frequently encountered with the so-called "NAFTA-type" PTAs as opposed to the "GATS-type" PTAs. A major difference between these two genres is that the former adopts a negative list approach starting from the assumption of full liberalization across all sectors and modes of supply unless restrictions are explicitly indicated. Under a GATS-type "hybrid" approach, each member only lists the sectors in which it undertakes access commitments in order then to specify departures from full liberalization under the mode(s) concerned. The implications of this difference will be taken up in the next section, but for present purposes it may be supposed that if everything not listed is covered by the provisions of the PTA, a precautionary measure would be to reserve the right to grant discriminatory subsidies across-the-board. Again, this creates a lot of uncertainty concerning the actual conditions of access to and participation in the respective markets.

Latrille and Lee (2012) undertake a comprehensive survey of some 84 PTAs containing services provisions to consider how divergent the PTAs were among themselves and from the GATS, and also how innovative or experimental the PTAs were. The authors employ the NAFTA-type and GATS-type distinction and find similar numbers of agreements adopting each approach, complemented by a smaller group of agreements containing NAFTA-type as well as GATS-type elements. They find that the NAFTA-type agreements treat investment provisions for both goods and services in a single set of provisions. They also observe some evidence of agreements going further than GATS, for example, by extending domestic regulation disciplines across the board, regardless of whether a sector is subject to market access commitments. In contrast, Article VI:4 calls for further work to establish or develop regulatory disciplines for services—including in respect of objectivity, transparency, and a least-trade-restrictive standard. Pending the completion of this work, the Agreement states that in sectors where specific commitments have been undertaken, these standards must be observed. The implication seems to be that a best endeavours approach to regulation is adopted in the interim for services not incorporated in a schedule of commitments.

Latrille and Lee (2012) also found evidence of a more open approach to mutual recognition of qualifications in some PTAs, which is not altogether surprising considering the likelihood that this occurs where the preferential partners are similar or more geographically proximate economies (Sauvé and Shingal 2014). On the other hand, Latrille and Lee identified various GATS-minus "framework" provisions in certain PTAs, including a redefinition of the governmental service carve-out and the omission of the nullification and impairment test relating to the provisional application of regulatory standards (GATS Article VI:5) in respect of services subject to specific commitments.

A final observation, previously noted briefly, is that since the time when the GATS came into force 20 years ago, the world of services has changed dramatically, for all the reasons previously discussed, such as developments involving the Internet and multiple services platforms for international transactions. At the same time, the GATS-mandated negotiations to progressively liberalize services markets and fill certain gaps in the rule-making agenda are making very little, if any, progress, leaving a number of issues unaddressed.



# 3. Policy Options: Rethinking Services Trade

This section focuses on the issues raised in the Expert Group's discussions and the think pieces the group commissioned to highlight matters of particular concern and possible recommendations for future action by governments. The discussion below draws heavily on these think pieces, which cover the digitization of global commerce (Bieron and Ahmed 2014), small and medium enterprises (SMEs) in services (Nordas 2015), the use of soft law in international cooperation (Low 2015), regulatory cooperation (Mattoo 2015), and the relationship and possible integration of WTO rules on goods and services (Sauvé 2015; and Drake-Brockman 2015). The related policy options are put forward for consideration at the end of each subsection.<sup>6</sup>

## 3.1. Services and the Digitization of Commerce

The digital revolution has been deeply transformative, but the policy response from governments has often been confused and contradictory. The digital revolution has reduced transactions costs in a variety of ways, raised productivity and contributed strongly to growth. It is a key driver of innovation and has brought about new products and new ways of producing and consuming old ones. It has reshaped business models and injected an unprecedented level of inclusiveness into commerce. The smallest enterprises can today aspire to serve markets worldwide. At the same time, large multinational firms have also relied increasingly on the Internet to do business, coordinate physically disperse operations and exchange information. Digitized commerce in its multiple forms will remain a key source of growth for decades to come, but is threatened by services nationalism, with particular implications for smaller competitors that rely on open trading platforms and global scale.

Digitized commerce relies very heavily on services, but also requires the physical assets of logistics providers, such as express delivery companies, to complete transactions where the output is physical. Bieron and Ahmed (2014) aptly refer to a Global Empowerment Network, comprising a combination of the Internet, platform services and logistics providers. Firms engaged in these activities can be of varying sizes, as there are limited barriers to entry.

On the policy front, measures that might hinder the smooth operation of Internet-based business raise questions going well beyond a concern for market access through cross-border transactions. They may relate to government concerns about security and privacy, or to the erosion of the tax base. Moreover, the integrated nature of Internet-based business involving goods also requires that logistics providers have a physical presence to supply their services. This implicates a different range of policies relating to investment, labour markets, transport, customs administration, and other regulatory measures bearing on access and the costs of doing business within and across borders.

Because of the decentralized architecture of the Internet and the absence of unifying top-down controls, governments and citizens—sometimes in quite different ways—are concerned about security, surveillance and privacy. Recent revelations about official access to private information, justified by governments on security grounds, have created discord among governments and upset individuals who feel their privacy can all too easily be intruded upon.

This has created pressures for finding ways of regulating and at times curtailing access to digitized information. One response has been to insist upon the localization of data processing and data storage at the national level. Many actors in the sector believe that such requirements can be costly and negatively impact on growth without advancing the goal of protecting personal data. Yet an appropriate level of access to information is a legitimate public concern that needs addressing, so a solution must be found. The GATS may be an effective instrument, particularly through its MFN and national treatment provisions, as well as the Annex on Telecommunications, for addressing many of the policy issues surrounding the digitized economy. However, the social and public policy aspects of security and privacy concerns may be beyond the capacity of a law-based international agreement like GATS to address adequately, thus reinforcing the need for information sharing and for developing best practices that address privacy-related concerns without unduly restricting the economic potential of trade in services delivered digitally.

<sup>6</sup> The policy options have been divided into issues that might be addressed in the short, medium or long term. The recommendations are predicated on discussions among the Expert Group in three meetings held in 2014-15 and should be read in conjunction with the thematic think pieces where these are available.

If technology and policy work together, viable solutions can be found to achieving balance between public policy concerns and the manifold benefits flowing from the digitized economy. A “hands-off” message to governments is not the answer. Instead, governments must understand the capabilities of the technologies used by business and leverage them to address their needs and cooperate more closely on such matters as information exchange, best practices to address social and political concerns, and improving encryption. In the longer-term, governments might negotiate a more comprehensive multilateral agreement on data flows and related privacy concerns.

In summary, the signal and growing importance of digitized commerce creates a strong interest among governments and other stakeholders in ensuring that data flows are as unencumbered and free as possible, subject to legitimate public policy concerns regarding privacy, law enforcement, taxation and national security. These latter concerns should be accommodated through international cooperation and understandings among the relevant authorities, and with a view to inflicting minimum costs on users of digitized means of communication and exchange.

**Policy Option 1: Short to medium term:** Using existing disciplines, institutional trade forums and ongoing bilateral and multilateral negotiations, governments should establish guidelines for regulating cross-border data flows, bearing in mind public policy concerns relating to law enforcement, privacy and national security. In this context, governments should:

- Clarify existing GATS provisions, including MFN, national treatment and the Annex on Telecommunications in terms of their application to cross-border data flows;
- Call upon WTO members to step up their efforts in deliberating those issues in the context of the WTO Work Programme on E-Commerce;
- Explore means of enhancing information exchange among governments, international organizations, services suppliers, consumers and other global stakeholders;
- Consider the possibility of adopting best practices relating to privacy, developed by agencies such as the OECD or Asia-Pacific Economic Cooperation (APEC), as part of an effort to draw a regulatory line between privacy and state access;
- Promote a maximum degree of interoperability internationally of privacy regimes;
- Agree on establishing adequate controls over the bulk collection of personal data;
- Focus on improving encryption and developing best practices to enhance the security of cross-border digital transactions;
- Engage in a process to assess the implications of requirements for data localization and cross-border restrictions on data flows in terms of their efficiency costs and effectiveness in attaining their stated objectives, including economic development, privacy protection and national security.

**Policy Option 2: Long term:** Consider the development of regulatory disciplines, the elements of which could be used multilaterally or in regional trade agreements (RTAs), on international trade in services delivered digitally and data flows that would confirm existing disciplines or establish new ones and encourage digital trade.

### 3.2. Services and SMEs

According to Nordas (2015), systematic data on small firms supplying and trading services are scarce. Standard information available from firm-level studies suggests that exporting firms—whether they sell goods or services—tend to be large and more productive than firms that do not export. They are also more likely to pay higher wages and be foreign-owned. Smaller firms are less likely to trade through investing abroad, but rather rely more on cross-border transactions.

This profile, however, obscures a good deal about SMEs supplying services and the extent of their engagement in trade. This is because the firms are too small to have much of an impact on averages. As also pointed out by Bieron and Ahmed (2014), a large and growing number of small and innovative services firms, whose core asset is human capital, maintain an active trading presence on the Internet. These firms have at their disposal a range of business models. They may sell and deliver online, or sell online and deliver offline. They may combine online and offline activities that require both cross-border sales and a commercial presence in the destination market. Many SMEs are likely to engage indirectly in trade, for example by securing a franchise with a foreign company to sell locally or supply after sales services. Or they may trade indirectly by providing services as inputs to lead firms who export directly.

Against the background of a flourishing digitized economy that has opened up new opportunities for SME services firms to enter global markets, Nordas poses the question of whether action is needed on the policy front to address obstacles to these activities. Before looking at specific policies, she observes that while SMEs account for a dominant share of employment in most economies, the popular image of SMEs as key creators of jobs is not borne out by the empirical evidence. Rather, it is new firms that create jobs and tend to innovate, and most new firms start small before growing into something larger, or failing. Some successful firms stay small as a matter of choice.

Entering export markets is costly and the larger a firm’s revenue from exporting, the easier these costs are to absorb. This restrains entry of SMEs into exporting unless they are particularly productive. In the absence of a situation in which export activity carries benefits for the economy at large, additional to those accruing from domestic market operations, support targeted at export activities by SMEs will not yield positive social benefits.

Instead, Nordas (2015) argues, governments should focus on removing obstacles to market entry, which can weigh disproportionately on small firms. Policies should not, however, be targeted on eligibility criteria that define SMEs, as this may encourage firms to stay small. Removing

obstacles to firm entry benefits all firms, regardless of whether they become exporters. An exception to this would be when a government assumes a role in facilitating information about foreign market conditions. This can be seen as an intervention that will benefit all exporters. Other broad-based policies should focus on reducing transactions costs, increasing flexibility in terms of the legal form that foreign establishments can take (foreign branches or representative offices rather than subsidiaries), eliminating unnecessary administrative burdens, facilitating entry by refraining from protecting incumbents, allowing freer data flows, protecting intellectual property rights adequately, and facilitating market exit when needed (bankruptcy).

Succinctly, advances in information and communications technologies in recent years have opened up numerous opportunities for SMEs to engage in international commerce. Yet because these enterprises are small, they are disproportionately affected by trade costs associated with processes, procedures, regulations and other technical burdens associated with cross-border trade.

**Policy Option 3: Short term:** Bearing in mind the new opportunities offered SMEs by the digitization of trade, consider the following actions to ensure that these opportunities can be realized:

- Call upon countries to provide comprehensive, online, single points of enquiry for cross-border services providers to learn about host country regulatory, licensing and other administrative requirements;
- Recruit another international organization or an independent agency to rate and annually report on the progress of each country in this effort;
- Call upon countries implementing the Trade Facilitation Agreement to adopt interoperable, digitally-enabled single windows for customs and border compliance, and release open application program interfaces (APIs) to allow developers to create digital platforms to services to seamlessly link SMEs to large numbers of country single windows;
- Encourage the establishment of online single windows for cross-border services providers in need of licenses, permits and other administrative requirements and explore the provision of Aid for Trade to implement this project in developing countries;
- Encourage the establishment of higher standardized *de minimis* customs levels to facilitate cross-border flows of small packages supplied by Internet-enabled retail services providers, especially SMEs;
- Explore the integration of national postal services into an interoperable, global, package-shipping network.

### 3.3. The Role of Soft Law

The notion of “soft law” seeks to capture gradations in the level of commitment to cooperation among parties. The lightest form of joint action might take the form of dialogue unaccompanied by any commitment beyond talking. From there cooperation could graduate to firmer undertakings, starting with information exchange, then moving on to consultation, comity and other forms of cooperation or understanding, and culminating in justiciable

legal undertakings. The distinction between soft and hard law turns on whether undertakings are enforceable through legal action. Interest in soft law arises from the idea that soft law can be a pathway to deeper understanding that ultimately can lead to the establishment of robust hard law. A second reason for thinking about soft law is that in some areas of cooperation, a more flexible and less binding form of cooperation may produce better results than contested hard law. Finally, the issues at hand, or prevailing realities, may be such that soft law represents the maximum level of attainable cooperation.

One definition of soft law in contrast to hard law is “normative provisions contained in non-binding texts” (Shelton 2000). The essential contrast here is between justiciability and non-justiciability. The precise meaning behind this definition depends on what is understood by the words “normative” and “provisions.” In considering the role for soft law in international agreements, Low (2015) has opted for a wide interpretation of these words. A normative provision is assumed to exist in all situations where governments have agreed to a non-binding form of words in a formal or legal text, or to a process or procedure, that may be interpreted as reflective of a shared aspiration rather than a legally enforceable one.

The justification for embracing such wide scope in meaning is two-fold. First, a catch-all definition accommodates multiple forms of exchange—modalities which can be identified in existing provisions and practices in the WTO and other international institutional arrangements today. Second, in practical terms an attempt to distinguish among degrees of softness in different non-justiciable provisions and processes does not seem a practical proposition in the absence of clear and broadly accepted metrics for doing so.

The “dos and don’ts” of non-justiciable exchanges may be implicit. They may entail different forms of learning interaction that lead to modified behaviour, voluntary compliance or evolving shared (and possibly binding and enforceable) commitments of a more explicit nature. Or they may be forms of words involving something that is still aspirational, or a best endeavours undertaking, but nevertheless specific. Sometimes these block-building elements of cooperation never become justiciable—perhaps because it would simply be impractical for that to be the case—and in other instances they may be pathways to hard law.

The experience of APEC in this context would be worthwhile examining. APEC has launched numerous initiatives over the years—not always implicating all 21 economies represented in APEC—to explore issues of mutual interest, exchange experiences, report on their own policies, and subscribe voluntarily to the monitoring of shared or self-declared targets. What eventually became the WTO Information Technology Agreement, for example, started out as an APEC initiative. Similarly, work on the definition of environmental goods and services in APEC has spurred further efforts to address these issues in the WTO. APEC initiatives are sometimes difficult to assess in terms of specific outcomes, but by embracing voluntary processes, relying on peer pressure, and avoiding a decision-making

formality that allows the exercise of a veto by one or more parties, the institution can deliver concrete results.

This is what might be termed the positive face of soft law. But soft law outcomes may also be less constructive and arguably undesirable if they lead to misaligned expectations or reflect incapacity to agree. In the interests of global governance, it might sometimes be better if undertakings, procedures or processes with unconstructive characteristics eventually take the form of hard law or if the soft law accommodation is eliminated altogether in the longer term. At the margin disagreements may arise as to an appropriate categorization among soft law manifestations.

Different instances of soft law can be found in the GATS, the WTO and other international agreements and texts. Provisions calling for notifications and consultations take the form of both hard law and soft law in WTO agreements, depending on whether they are designed more for the transparency end or the surveillance and monitoring (i.e. compliance) end of the spectrum. In all cases, rendering information more symmetrical and generally available is an essential ingredient of international cooperation, whatever form it takes.

Sometimes exhortatory or best endeavours language finds its way into hard law provisions, introducing a degree of non-justiciability in that context. Examples abound of such less-than-specific obligations. In GATS Article III, which deals with transparency, for example, Paragraph 4 provides that parties “shall respond promptly” to all requests by another party for information. The word “promptly” may be interpreted in different ways and the underlying notion could have been couched in terms of a time limit. In other cases, such as GATT Part IV, the Generalized System of Preferences and special and differential treatment provisions, the language is of a best endeavours nature. Provisions like these have arguably become a source of misaligned expectations and hampered cooperation in a broader sense.

On the other hand, best practice texts, guidelines and voluntary standards are likely to have tempered behaviour and perhaps in some cases allowed for the development of additions to hard law. The WTO’s Trade Policy Review Mechanism (TPRM) is an example of a soft law process that may be seen as a means of fostering better mutual understanding of national perceptions, constraints and aspirations. For some WTO members, reports generated by the TPRM process provide a clearer view of their own policy frameworks. It might be hoped that the Transparency Mechanism for Regional Trade Agreements will contribute in the same way as the TPRM, but its history is one of retreat from earlier efforts at setting hard rules on exceptions to non-discrimination principles for preferential trade deals. Many would argue things would have been better if movement had been in the opposite direction—that is, towards precise rules that could be used more readily to assess compliance with clear obligations.

Many observers, including some members of the Expert Group, have taken the view that one way of addressing the difficulties encountered by the WTO in recent years to advance agendas through negotiation is by deepening dialogue among governments. This has been variously referred to as a “missing middle” (Lamy 2007; Evenett 2009) and a “deliberative deficit.” The WTO Secretariat could be given a role to explore ways that governments may lessen the deliberative deficit through processes that may lead to better mutual understanding, the augmentation, clarification or removal of soft law, or its transformation into hard law. Any such exercise should draw on the experience of other international institutions and preferential trade agreements. Where best endeavours provisions are used, they would be less prone to misaligned perceptions and expectations if they were accompanied by accountability duties explaining how they had been used.

On the broader question of the role of soft law in the context of hard law frameworks, many participants in the Expert Group considered that trade in services, to a far greater extent than trade in goods, brings into prominence the question of how to articulate global rules with the sovereign right of governments to regulate. It is unlikely that all aspects of such jurisdictional sovereignty can be brought within the ambit of hard law based on binding international agreements. To that extent, it is probable that there will always be a need for some degree of soft law (in Shelton’s sense of “normative provisions contained in non-binding texts”) to cover those situations in which different countries wish to convey a shared objective of respecting each other’s positions but cannot commit to renouncing or pooling sovereignty through treaty obligations that would rigidly fetter their jurisdictional freedom. In turn, however, this raises the question of how to develop an enhanced approach to soft law, allowing it to function as means of catering for those issues without creating ambiguities or “papering over” real differences of view that need to remain clearly understood and respected.

Broadly defined, soft law can thus take many forms. It can foster dialogue on issues relevant to services and the trading system more generally without any presumption that it is a precursor to hard law. Such dialogue can increase mutual appreciation of multidimensional issues and contribute to more productive cooperation. It might take the form of best endeavours provisions that can encourage certain kinds of beneficial but essentially voluntary actions, or it can cover for disagreements and become a source of misaligned expectations. Best endeavours provisions may also establish a path towards hard law.

**Policy Option 4: Short term:** Within the limits of its mandate, encourage the WTO Secretariat to contribute in reducing the “deliberative deficit” by addressing current topics, suggesting areas for discussion, proposing ways of approaching issues, disseminating analysis and information, and developing dialogue with other international organizations dealing with relevant matters, including in the field of services. In this context, soft law developed outside the WTO should be studied to ascertain how it might inform domestic regulatory processes affecting trade in services.



**Policy Option 5: Medium term:** The WTO membership should explore ways of ensuring that best endeavours clauses play a positive role in international agreements:

- Where best endeavours provisions—or commitments calling for a lower level of discipline—reflect a process of moving towards hard law commitments, the nature of the economic or other conditions justifying a soft law approach should be spelled out, and in appropriate cases technical assistance should be a component in a transition away from soft law towards hard law;
- Best endeavours commitments should be accompanied by accountability duties, involving specific notification and monitoring provisions, especially if they risk creating misaligned expectations as to the effect of commitments contained in soft law texts.

### 3.4. Regulatory Cooperation

One reason why multilateral and regional services trade negotiations have not delivered a higher level of real liberalization is because they have followed the goods negotiating model of focusing almost exclusively on reciprocal market opening. Mattoo (2015) argues that this model did not work because countries are unwilling to risk opening many of their services markets unless the regulatory preconditions for successful liberalization have been fulfilled. These conditions include not just the existence of adequate national regulatory capacity but also a framework for international regulatory cooperation.

Consider why. Since services are intangible and many of them are consumed at the same time as they are produced, unlike goods they cannot be physically inspected at borders and their conformity with standards ensured before they are consumed. Regulators respond to the problem of national market failure in services by regulating their service providers. But efficiently regulating foreign services providers is a challenge because their operations can lie completely (in the case of cross-border trade or consumption abroad) or partially (in the case of commercial presence) outside the jurisdiction of a national regulator. As Mattoo (2015) puts it “for services to be globalized, regulation cannot remain national.”

Trade negotiators have not ignored domestic regulation, but seen it primarily through the lens of securing access to markets. Thus, the goal has been to ensure that the presence of prudential regulation or the absence of pro-competitive regulation in importing countries does not become a trade barrier. Where market failure due to informational problems—for example, in areas such as financial and professional services—prompts national regulators to impose licensing, qualification, and other requirements, rule-making has sought to ensure that these requirements do not unduly burden foreign providers. Where market failure due to monopolies—for example, in network-based services such as telecommunications and transport—allows incumbent firms to frustrate entry and competition, international rules have required national regulation to ensure fair access to essential facilities.

There are two problems with this market access-centred approach. The first is that existing international trade rules and commitments are hard to enforce and have uncertain value. It has always been difficult to strike a balance between allowing scope for the legitimate use of domestic regulation and preventing its protectionist abuse. Leaving the balance to be struck by the importing country's authorities risks allowing either less regulatory discretion than is politically acceptable domestically, or more regulatory discretion than is consistent with internationally predictable market access.

The second problem with this approach is that it does not facilitate new market opening and international commitments by helping national regulators deal with international market failure. A country will be reluctant to open its financial markets, for example, unless it is confident that it can prevent financial instability and loss for its consumers. The same applies to its data processing markets unless it can protect its citizens' privacy, or its transport and Internet-based services markets if it is afraid that the gains from liberalization will be appropriated by international oligopolies. Similarly, a country will demur at allowing entry to individual foreign service providers unless it is confident that they will not threaten its security. In some cases, such as the supply of services through locally incorporated subsidiaries, the importing country can in principle deal unilaterally with market failure because the provider is in its jurisdiction. But doing so requires adequate regulatory capacity and could lead to higher costs of trade by fragmenting markets (for example, by requiring local capital adequacy or the use of local servers). In other cases, such as cross-border banking, transport, or data-processing services, addressing market failure efficiently requires the cooperation of the regulator in the exporting country. This challenge is accentuated by the degree of heterogeneity that exists among jurisdictions in terms of institutions and social preferences.

Mattoo (2015) also identifies a “hold-back” problem. This can occur if stringent or discriminatory regulation inhibits specific market access and national treatment commitments. Adequate regulatory cooperation is crucial for continued market opening. Where this is absent, regulatory spillovers among jurisdictions can elicit trade restrictions. In the case of goods, the terms for entering a market can be separated from the regulatory assessment of whether acceptable product standards are met. With services, the greater need to focus on the supplier rather than the product will feed a reluctance to open the market.

Mattoo (2015) argues that greater regulatory cooperation can help address these problems. One dimension of such cooperation involves the assumption of obligations not just by importing countries but also by exporting countries when negative externalities are transmitted via exports of services. These exporter commitments need not be in the context of trade agreements, but could be secured in other existing or new forums for international regulatory cooperation. What matters is that market access commitments by importing countries would be transparently and predictably conditional on the fulfilment of specific conditions by exporting countries. Importing country regulators would then be

reassured that exporting countries will cooperate to protect their consumers' privacy, financial security, and well-being from the consequences of international market failures.

Another requirement is for regulatory assistance to support liberalization commitments by developing countries. Developing country policymakers would then know that any regulatory inadequacies that could undermine the benefits of liberalization will be diagnosed and remedied before any market-opening commitments take effect. This will yield better results rather than having market-opening negotiations take their course, as at present, with only ad-hoc links to international assistance for regulatory reform.

But even where regulatory cooperation prospers, a risk arises of exclusion. If cooperation occurs through harmonization and standards are too stringent, the costs for some countries, especially developing countries, may be prohibitive. If cooperation takes place through mutual recognition, exclusion arises through rules of origin. Here there is clearly a need to minimize the risk of exclusion. A part of this problem results from a tendency for members to notify mutual recognition agreements (MRAs) under the "closed" GATS Article V exception for regional agreements rather than under the "open" GATS Article VII on recognition. This may reflect an attempt to share these gains on a limited reciprocal basis by avoiding the obligation to extend recognition more widely. Aspects of the exclusion issue could be addressed through Aid for Trade activities or other technical assistance initiatives at both the multilateral and regional levels.

Discussions in the Expert Group also touched on aspects of the provisions in GATS Article VI on domestic regulation. Two issues in particular appeared to be of concern. One was the absence of a clear and comprehensive necessity test in GATS Article VI (the subject of a long-standing negotiating mandate under Article VI:5) in contrast to both the Agreement on Technical Barriers to Trade (TBT) and the Agreement on the Application of Sanitary and Phytosanitary (SPS) Measures. The necessity test under the two goods-related Agreements refers to the requirement to ensure that regulatory measures are only applied to the extent necessary to meet underlying public policy objectives, and should not constitute a disguised restriction on trade. Although some WTO members have expressed reservations about the inclusion of a necessity test in the field of services, and have failed to integrate even the currently applicable disciplines under Article VI:5 in their RTAs, such a provision would strengthen international regulatory discipline in both a multilateral and regional context.

The other issue relates to the extent to which agreements such as the GATS should rely on existing international standards. References to international standards in GATS (Article VI:5(b)) are minimal compared to the relevant TBT and SPS provisions. The GATS provision offers a weak incentive to apply such standards and only with respect to licensing and qualification requirements and technical standards. Other domestic regulations such as prudential measures and data protection may not be covered. This restrained use of the work of other standardizing bodies contrast with the TBT and SPS Agreements. Not only are

standards developed by other international bodies explicitly recognized, but there is a rebuttable presumption of compliance with the necessity test for measures conforming to international standards, guidelines or recommendations.

Moreover, the use of the word "standards" in GATS (in contrast to the TBT and SPS Agreements) does not accommodate the growing body of principles, guidelines and recommendations that have become internationally recognized benchmarks (for example, the Basel Committee's Core Principles for Effective Banking Supervision or the OECD's Guidelines on the Protection of Privacy and Transborder Flows of Personal Data). A similar case could be made for some standards developed by non-governmental organizations (for example, World Wide Web Consortium (WC3) standards or the Internet Engineering Task Force).

Greater consideration, accommodation and reliance in relation to the work of other international bodies would provide an opportunity to tap into a flourishing alternative regulatory machinery that can deliver regulatory outputs more responsive to market needs and quicker to adapt to change. This would make for a faster and more effective response to regulatory challenges arising from the internationalization of services transactions.

To summarize, regulation and market access obligations both affect the conditions of competition in markets. Regulatory cooperation is essential not only for facilitating trade, but also for reassuring negotiators and regulators that the consequences of liberalization commitments will be predictable in terms of policy outcomes. In order to secure progress in liberalization, national regulatory institutions may need to be strengthened and mechanisms created for international regulatory cooperation. Since such cooperation will often take place between a subset of countries, it is also important to watch out for the excluded countries. More could also be done to strengthen international norms on regulation in the area of services.

**Policy Option 6: *Medium term:*** Undertake the following work programme under WTO auspices and other relevant international and regional organizations.

- Identify the services sectors where weak national regulation can undermine the benefits of liberalization and establish mechanisms for diagnosing and remedying regulatory inadequacies in these services sectors, especially in developing countries. Develop country- and sector-specific recommendations on the appropriate sequence of regulatory reform and liberalization, as well as credibly commit assistance for the former where necessary.
- Identify the services sectors where the absence of adequate international regulatory cooperation can undermine the benefits of liberalization. Ensure greater coherence between international regulatory forums and trade negotiations, and that technical support and training is available to permit the participation of developing and least-developed countries in regulatory cooperation activities. Develop country- and sector-



specific recommendations on the appropriate sequence of international regulatory cooperation and liberalization.

These initiatives should build on existing arrangements in areas like financial, telecommunications and transport services, in order to establish a framework for mechanisms that ensure meaningful international cooperation in services sectors.

**Policy Option 7: *Medium term:*** Address the risk of exclusion created by regulatory cooperation among small groups of countries through a reaffirmation of relevant WTO provisions, a relaxation of exclusionary rules of origin and appropriate technical support to close gaps in standards between developing and developed countries.

**Policy Option 8: *Medium term:*** Institute processes in the WTO and elsewhere to consider ways of strengthening regulatory provisions in services, along the lines already established in the TBT and SPS Agreements and some preferential agreements, including through greater reliance upon the work of other international standardizing bodies.

### 3.5. Towards Greater Compatibility between Rules Governing Goods and Services

The rise of global value chains (GVCs) has increased co-dependency between goods and services and raised concerns about parallel structures of rules for global trade and investment governance. Virtually all arm's-length transactions in modern economies consist of bundled offerings, frequently of both goods and services. In this environment disconnected or stand-alone rules covering goods and services separately can raise costs, frustrate commerce and distort market outcomes.

This line of reasoning has led to suggestions for fusing the GATT and the GATS. Sauv  (2015) has raised four key questions in this regard. The first is whether the current contrasted and separate architecture for goods and services is compatible for a world in which GVCs are a significant feature of the economic landscape. Second, do existing rules offer a "coherent and predictable environment" for business? Third, how feasible would it be to fuse the two sets of rules? Finally, what other approaches might improve alignment between the two regimes?

The only one of the four questions to which Sauv  (2015) gives an unequivocally negative answer is the third. He believes the systematic fusion of rules for goods and services into a unified structure is neither possible nor desirable, although he does see possibilities for greater coherence in the manner in which goods and services are treated in certain areas of negotiation. He notes that not only are the rules in the two domains quite different but within both rule sets there is also considerable variety designed to accommodate diversity.

Sauv  (2015) argues that a number of fundamental differences between goods and services make diverse rule sets inevitable. First, he refers to intangibility. Other characteristics that distinguish goods and services are non-storability, the multiple ways in which services are delivered,

contrasting political economies of non-discrimination, reliance on quantity-based regulation in services, the degree of regulatory intensity affecting services, and the demonstrated lack, including in PTAs, of a negotiating appetite for rules on subsidies, safeguards and trade remedies in services.

Not all the contrasts are stark. On storability, modern technology has made a range of services storable when bundled with goods. Moreover, some perishable goods, like particular kinds of cuisine, have to be consumed as soon as they are made, and in very close proximity.

As for multiple delivery modes, the picture is again mixed. In a world of bundling, there are no longer any services entering production that are by definition non-tradable if they are bundled with other products—usually goods—that are exported. Similarly, if we define a Mode 3 for goods-related investment to parallel Mode 3 for services investments, we also have greater modal compatibility. The same could be said of a Mode 4 for workers in manufacturing and primary industries.

Mode 2 has always confounded some commentators because it is an undertaking by an importing party guaranteeing its own consumers the option of consuming in the territory of another party—that is, the exporter of the service. All the other modes are about access for supplies or suppliers. Nevertheless, one might envisage a similar Mode 2 purely for the consumption of goods.

The emphasis on quantitative restrictions as opposed to price-based interventions is more intense in services, and is in any case largely outlawed in the goods domain—save in exceptional circumstances. Why are services so regulation-intensive? Part of the reason, noted above, is technical, having to do with the intangibility of services and the tendency for them to be highly customized. This is an important difference with goods—service suppliers have to be regulated, whereas with goods the product itself can be the focus. Goods producers nevertheless have to be regulated, for example, in terms of environment, health and safety conditions in factories. The problem with regulation, of course, is that it lends itself to various forms of inefficiency and capture more readily than price-based instruments, and is likely to carry additional deadweight costs as a result.

Fusion of regulations on goods and services is not rendered impossible merely because regulatory targets are diverse and of different relative intensity. If greater uniformity were to be advantageous, it would need to be in terms of regulatory principles, standards set, and the procedural aspects of regulatory regimes. Without more work in this area, it is unclear what in practical terms such fusion would actually look like.

Drake-Brockman (2015) has attempted to assess the potential benefits of addressing the kinds of economic distortions likely to arise at the firm level from differences, disconnects and gaps in the rules affecting trade in goods and services in a world of increasing servicification. She sees potential opportunities for a more horizontal approach to addressing generic gaps in the rules on both goods and

services, for example with respect to issues such as cross-border data flows and e-commerce, which have arisen in the context of trade in services but which evidently also affect all other sectors.

The thrust of the above arguments is that closer integration of goods and services regimes may not be as technically infeasible, nor the differences between goods and services as stark, as is sometimes argued. Further work would be needed to tease out the details of what fusion would amount to in practice and what advantages would flow from it.

Current differences in the rules governing trade in goods and trade in services can also change incentives for firms to produce either “goods” or “services.” They may be induced to make future ownership, structural or locational decisions in what for them would otherwise be a non-optimal, cost inefficient manner. The possibility of safeguards, anti-dumping actions and countervailing duties under GATT but not GATS might, for example, incentivize a manufacturer to outsource assembly operations on a contract basis to entities that are legally independent of the producer (and owner) of the respective components (Adlung and Zhang 2012).

Drake-Brockman (2015) argues that, at their root, such situations raise economic questions, and the paucity of empirical research leaves them largely theoretical at present. When the international economics of servicification becomes more fully understood, Drake-Brockman suggests that new trade rules, as well as new soft law tools, will inevitably be needed in order to level the playing field between goods and services firms presently affected by dissimilar regulatory regimes. From this perspective, delay in international consideration of the prospects for “fusion” risks leaving the door open to new protectionist action, taking advantage of gaps, disconnects and differences.

Equally important, however, is whether the conditions exist for attempting significant architectural experiments. Sauv  (2015) recalls that the willingness and ability of governments to sit down and work on such an endeavour is certainly in doubt. Furthermore, this would need to take place against a domestic policy backdrop that aims at greater coherence across goods, services and investment. This leads to the conclusion that given uncertainty as to what the economic advantages would amount to, the need for further policy research, and the deep challenge of marshalling political support for such an effort, the pursuit of a “radical” fusion agenda may not be worthwhile in the foreseeable future. What could be worthwhile, however, is an exploratory exercise among governments, as well as other stakeholders, of arguments for augmenting compatibility between the two policy sets and practical ways this could be brought about.

A cluster approach to addressing fractured rules has also been mooted. This would mean dividing activities along sectoral or activity-specific lines and establishing an integrated rule-set around the cluster. The biggest problem with this approach is that in a world where everything is networked, defining the cluster boundaries would have an element of arbitrariness about it. This could fracture the policy regime in a broader sense and introduce distorting and costly discontinuities.

As Sauv  (2015) argues, however, the rejection of such an agenda does not mean there is nothing to be done about increasing compatibility between rules on goods and services in international agreements on certain cross cutting areas. A first area for serious consideration is investment. Global value chains rely crucially on foreign direct investment. Sales of multinational corporation foreign affiliates amount to more than US\$30 trillion a year (UNCTAD 2014). That is significantly in excess of global trade flows at around US\$24 trillion (WTO 2014). We have investment rules for services in GATS, albeit partial ones that cover market access and national treatment, but not investor protection in a comprehensive manner. The GATT does not contain rules on investment. Multilateralizing the thousands of bilateral investment treaties that have grown in number over the years and building a global investment regime would be politically challenging but would remove a significant distortion from the system.

In addition, Drake-Brockman (2015) and Sauv  (2015) argue that if investment rules could be brought together, the same logic should be made to apply to the movement of labour. Such an idea would probably be met with strong opposition, although some authors have suggested that one way to promote labour mobility for temporary stays would be for the labour-supplying economy and the labour-importing economy to work together to manage the flow. Other ways of doing this involve an examination of, and agreed procedures and time frames for processing work permits and visas for the temporary presence of natural persons. Ideas might also be gleaned from the experience of regional initiatives, such as the introduction of the APEC Business Travel Card. A volume edited by Mattoo and Carzaniga (2003) contains several contributions on what cooperation between supplying and receiving countries could mean in different jurisdictions.

Sauv  (2015) further highlights three areas where more comprehensive, consolidated, rules could pay dividends. These are, first, the inclusion of services in the Information Technology Agreement. Second is the possible inclusion of the logistics/transport/border administration cluster of services into the Trade Facilitation Agreement. In a sense, they are already there, for example, in the provisions on the use of customs agents. The third suggestion is to bring environmental services more explicitly into the current work on environmental goods. This is under active consideration in APEC and also has the support of the European Union within the ongoing WTO talks. The last two of these may encounter the problem of defining borders mentioned above in relation to activity or sectoral clusters, but all three of these ideas would certainly be worth exploring further.

As noted earlier, the present negotiating atmosphere militates against this kind of creativity, but this may not always be so. In all the cases suggested above for considering new approaches to bringing rules on goods and services closer together, careful attention would need to be paid to the details of making closer integration happen. But political pushback and technical challenges should not be allowed to head off further exploration in the future.

One way of addressing these issues—where there are likely to be significant gains from greater coherence but where both technical and political alignment among governments are essential—would be to establish a Working Group open to all WTO members, or some other mechanism if a WTO Working Group were considered premature, to examine the issues and make recommendations.

To recapitulate the ideas presented above, in a real world context where business decision-making involves joined up treatment of interdependent elements of trade and investment activities, questions arise as to the wisdom and utility of today's parallel legal and institutional treatment of rules on trade and investment in goods and services. To a greater or lesser degree, this issue arises in both multilateral and preferential rule-making settings, though most explicitly in the WTO setting. Should governments try to rationalize fractured rule sets in order to render them more relevant and less distorting? Certain pointers as to where such action would be both feasible and useful are suggested here. While arguments regarding the technical or legal difficulties or willingness and interest among governments of acting on such an agenda must be taken seriously, they should not constitute an embargo on deliberation.

**Policy Option 9:** *Short term:* Call upon governments, with the assistance of the WTO, World Bank, UNCTAD and OECD, to engage in analytical work, aiming at better understanding and raising awareness of the imperative of policy coherence across the areas of trade in services, trade in goods and investment.

**Policy Option 10:** *Medium term:* Constitute a Working Group open to all WTO members or some other mechanism to examine the desirability and feasibility of reducing distortionary parallelism in separate rule sets affecting goods and services in the domains of both trade and investment. This exercise should take account of possible lessons from alternative approaches adopted by preferential trade agreements. Such a Group might start its work by considering the following possibilities:

- Identifying areas of trade law where the playing field might not be level between goods and services firms;
- Bringing together international rules on investment in goods and services, as well as rules on the movement of people, taking into consideration the implications this would have in terms of extending multilateral disciplines to investment and people movement beyond those existing for services under GATS;
- Bearing in mind possible risks associated with splintering trade rules along sectoral lines, consider the possibility—as has already emerged in the procurement field—of including both goods and services in some stand-alone agreements such as the Information Technology Agreement, the Trade Facilitation Agreement, and an agreement dealing with environmental products as well as in possible future agreements in areas like cross-border data flows and e-commerce.

### 3.6. Other Suggestions for Modifications to the GATS

The rich discussion in the Expert Group cannot be fully captured here, but a number of ideas emerged that are helpful in scoping policy options. Interesting discussions took place on the origins of the GATS and how it has evolved. Various members of the Expert Group identified further areas where improvements to existing rules could usefully be contemplated. Some of these are covered in the above discussion of the thematic papers. A selection of additional issues is mentioned here for inclusion in the listing of policy options.

#### 3.6.1. Improving access for the temporary mobility of people

Mode 4 of the GATS dealing with the movement of people is the most sensitive and least yielding in terms of commitments of all the modes. This is unsurprising considering the nature of contemporary economic and socio-political realities in this area. Sensitivities also arise concerning the length of stay of non-resident service suppliers, the equivalence of professional qualifications and capabilities, and employment and learning opportunities for local service providers. One or other of these concerns is present in virtually all economies. Without ignoring the worries of governments, more could be done to clarify GATS provisions and those found in preferential agreements. More could also be done to render more transparent and streamlined procedures associated with working visas and permits for temporary presence. In addition, regulatory cooperation between source and host countries on such matters as pre-screening, acceptance and facilitation of returns, controls over illegal immigration, and where appropriate, the operation of agencies responsible for recruiting and managing transfers of cross-border service suppliers, can all be strengthened.

Improvements in these areas could considerably reduce the costs of doing business. The temporary presence of non-residents who enter foreign markets to supply services has grown in importance with the internationalization of production. Global value chains require a continuing stream of people across frontiers to enable flows of goods, services and knowledge. The growing importance of digitized commerce that requires elements of expertise from non-resident suppliers of services also argues for improvements in temporary presence regimes. The bundling of goods and services to create value has increased complementarities and strengthened the case for an integrated “Mode 4 approach” that also encompasses manufacturing activities. The need for a larger bargain on Mode 4 trade is also rooted in underlying global demographics and chronic skills shortages in a number of sectors.

Opportunities thus exist for reaping greater benefits from trade involving the temporary movement of natural persons across frontiers to provide services. Realizing these benefits does not require any modification to nationally determined public policy priorities with respect to such activities. Rather they rely on greater legal clarity and procedural efficiency, combined with closer regulatory cooperation among governments.

**Policy Option 11: Short term:** Launch a process to examine ways of accruing greater benefits from temporary cross-border movement of people supplying services. The experience of preferential agreements covering temporary movement of persons should also be taken into account. Specifically, consideration should be given to:

- Call upon WTO members to clarify GATS provisions in relation to how the Agreement covers processes and procedures related to visas and work permits;
- Improving transparency in relation to national conditions, procedures and processes for issuing visas and work permits;
- Strengthening regulatory cooperation between governments for managing the entry and stay of natural persons for the supply of services.

### 3.6.2. The use of negative lists for scheduling

It might be argued that in identifying a party's commitments under an agreement, listing commitments assumed (positive list) or exceptions taken (negative list) ultimately amounts to the same thing. Although this may be true in a technical sense, the dynamics of each approach differ and are likely to result in different outcomes in terms of the coverage of scheduled commitments. If exceptions from commitments are listed, by implication everything else is covered. That default has properties lacking in the positive list approach. In our rapidly changing world, where new services emerge with a certain frequency, commitments would apply to all new services, unless a party explicitly excludes new services from automatic inclusion arising as a result of the negative listing dynamic. This has occurred in some negative list agreements, which weakens arguments contrasting the two approaches. Where exceptions are not taken, the negative list will lock in the regulatory *status quo* rather than introducing a gap ("water") between commitments and actual policy. Experience so far with GATS points to a lot of water in commitments, which significantly diminishes their commercial value to business users.

The political economy implications of drawing up comprehensive negative lists of non-conforming measures may deter members from taking exceptions that are not of paramount importance. This suggests that a higher level of binding commitments would be forthcoming. Still, the exercise of sifting through the entire services sector to identify exceptions can build awareness on policy opportunity costs and can represent a valuable exercise in transparency, inter-agency cooperation and dialogue, and the promotion of good governance.

Many consider the case for a negative list approach to be strong, suggesting that this is why it has been used in a number of preferential agreements and bilateral investment treaties (BITs). It should be noted, however, that BITs tend only to cover national treatment and not market access. This may make it easier to accept a negative list (and for that matter a "ratchet"—see below) than in a situation when both national treatment and market access are covered. The case for a negative list approach is less convincing for

others, both in terms of a propensity in some jurisdictions to carve out large exceptions whichever approach is used, and the challenges implied for regulators, especially in developing countries. There would doubtless be some technical issues to be addressed in switching from positive to negative listing under the GATS, and it would have to be an incremental process complemented as appropriate by technical assistance. Another potential concern with the negative listing approach is that capacity-constrained developing countries with limited resources may end up with unintended commitments—surely not a desirable outcome. Adlung and Mamdouh (2014) question the need to adjust the GATS itself in order to accommodate negative listing. They argue that the GATS is written in a manner that precludes nothing in terms of decisions by individual governments to choose their scheduling methodology. Whether this flexibility is deployed to strengthen the level of commitments is a matter of political preference rather than technical limitations embodied in scheduling methodology. The real question, however, is whether a joint decision to make a negative list approach mandatory would be desirable—assuming agreement were even possible—as a means of strengthening levels of commitments. Governments might consider what would be possible and desirable in this area.

### 3.6.3. Nomenclature

It has long been argued that the absence of a standard nomenclature in GATS schedules was a source of confusion. The Secretariat's W/120 nomenclature has served as a guideline for many in describing the services listed in their schedules of commitments. The product breakdown is highly aggregated and in any event nothing obliges WTO members to follow that nomenclature. The more disaggregated United Nations Central Product Classification (CPC), upon which the 160 categories identified in W/120 are based, was not acceptable to all WTO members as the basis for classifying services. This situation is different from that in goods trade, where the Harmonized System Description and Coding System (HS) is a common classification system for goods, which is comparable internationally for around 5,000 products at the 6-digit level.

A relevant question, especially in the age of servicification, is how far it makes sense to pursue a goods-like uniformity for scheduling in the domain of services. The Scheduling Guidelines developed in the GATS context recommend the establishment of a concordance with the CPC or otherwise to give a sufficiently detailed definition of a product to avoid any ambiguity in relation to the scope of a commitment. A question to consider, however, is how far uniformity in nomenclature is important in disputes when a panel has to determine the scope of a commitment. The question of uniformity in nomenclature would seem to be a matter worth further reflection on the part of governments, keeping in mind the difficulties of converting numerous existing commitments into a new nomenclature.



#### 3.6.4. Elimination of “water” in commitments and a “ratchet” clause

It has long been observed that the value of bound commitments, whether in the sphere of goods or services, is greatly diminished if bindings do not represent the prevailing level of openness. In GATS, the bulk of commitments, particularly those of some developing country participants in the Uruguay Round, fall short of actual practice (“*status quo*”)—the gap being the “water” in the schedules. Eliminating the water would make an important contribution to predictability and the level of market access disciplines assumed by parties to the agreement.

In addition, it has been suggested that maintaining *status quo* bindings—that is, bindings reflecting the actual level of permitted market access—in a dynamic sense could be assured through a ratchet clause. This clause would ensure that parties would be bound by any subsequent improvements in the terms of access at the time of their introduction. If a negative list approach to scheduling was adopted, the need for ratcheting would arise for items inscribed in reservation lists. In the case of measures not included in such lists, all obligations in the agreement would automatically apply. A ratcheting provision would, of course, also apply to positive list scheduling.

The embrace of a ratcheting provision may embody technical complications and monitoring challenges. More importantly, a ratcheting requirement could introduce a reluctance on the part of members to assume commitments. On the other hand, a similar provision (although not called a “ratchet” at the time) was stipulated in the Protocol of Provisional Application of the GATT (1947) and has proven useful over the years in locking in regulatory changes in the direction of greater conformity with treaty obligations.

As presented above and in the two preceding subsections, the Expert Group discussed a range of issues and options relating to GATS disciplines on scheduling and how to improve procedures and techniques in order to increase the consistency, depth, and clarity of scheduled commitments. As with many other aspects of the Group’s discussions, no firm shared conclusions were reached. Nevertheless, the issues warrant further reflection.

**Policy Option 12: *Medium term*:** Call upon WTO members to examine various aspects of scheduling practices in the GATS, as well as alternatives deployed under preferential agreements, with a view to considering possible ways of improving existing arrangements. Areas to assess the desirability of change include:

- Progressively switching to the adoption of negative listing in GATS schedules of specific commitments;
- Working on a more standardized system of nomenclature for the scheduling of specific commitments;
- Establishing a “roll-back and standstill” negotiating modality that could be applied horizontally to align items listed in schedules of specific commitments with *status quo* policy in order to eliminate “water” in commitments.

# 4. Next Steps and Conclusion

As a result of the contemporary evolution of services and servicification, as well as improved awareness and measurement of services as a source of value creation, the concept of trade in the early 21<sup>st</sup> century may need to be understood differently. This report, arising from a vibrant and forward-looking expert dialogue process, seeks to provide a comprehensive overview of a set of critical issues related to international cooperation in services where progress has either been achieved or is dormant, and offers guidance on a set of present and future priority areas for analysis, negotiation and policy intervention.

These priority areas include work on identifying frameworks in the WTO and elsewhere that could better integrate rules on trade in goods, trade in services and investment, examining positive approaches to services disciplines developed in different institutional settings, promoting an enhanced approach to soft law in the articulation of rules for services, creating mechanisms for improved international regulatory cooperation while addressing the risks of exclusion, and more structured policy responses to the profound transformations brought about by the digital revolution.

The policy options are presented over an indicative time horizon. The short-term options are mostly related to analytical and exploratory work that can be undertaken immediately whereas the medium and long-term options are of a more substantive nature and might require significant effort. It should be noted that members of the Expert Group did not always agree on the primacy of certain recommendations or on where the institutional locus of responsibility should lie in pushing the options forward.

Nevertheless, the main objective is to sow the seeds of ideas that will feed into the decision-making process so that trade policy can perform its function as an important means of achieving growth, employment and sustainable development. Policy-makers and other stakeholders from countries at all levels of economic development can benefit from the paper's analysis and policy proposals.



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The papers commissioned for the E15 Expert Group on Services can be accessed at <http://e15initiative.org/publications/>.

# Annex 1: Summary Table of Main Policy Options

Policy Option	Timescale	Current Status and Gaps	How to get there
<b>Services and the digitized economy</b>			
<b>1. Establish guidelines for regulating cross-border data flows.</b>	Short to Medium Term	<ul style="list-style-type: none"> <li>- WTO Reference Paper on Telecommunications concluded in 1996 before Internet and cross border data flows became prominent in international trade.</li> <li>- WTO Programme on E-Commerce has been unable to make recommendations on cross border data flows or to reach a definition on e-commerce.</li> <li>- Regional organizations and bodies have been able to go further and develop understandings on data privacy, but this has not been taken up at the multilateral level.</li> <li>- There is little interoperability of privacy regimes for data internationally, which acts as a deterrent to trade flows.</li> <li>- There is also no agreement on controls over the collection of personal data.</li> <li>- Varying methods for data encryption exist between countries, complicating cross border digital transactions.</li> <li>- Several countries have recently enacted regulations for the localization of data servers, which restricts cross-border data flows and impedes international trade in efficiency terms.</li> </ul>	<ul style="list-style-type: none"> <li>- Clarify existing GATS provisions, including MFN, national treatment, and the Annex on Telecommunications in terms of their application to cross-border data flows.</li> <li>- Call upon WTO members to step up their efforts in deliberating those issues in the context of the WTO Work Programme on E-Commerce.</li> <li>- Consider the possibility of adopting best practices relating to privacy, developed by agencies such as the OECD or Asia-Pacific Economic Cooperation (APEC), as part of an effort to draw a regulatory line between privacy and state access.</li> <li>- Promote a maximum degree of interoperability internationally of privacy regimes.</li> <li>- Agree on establishing adequate controls over the bulk collection of personal data.</li> <li>- Focus on improving encryption and developing best practices to enhance the security of cross-border digital transactions.</li> <li>- Engage in a process to assess the implications of requirements for data localization and cross-border restrictions on data flows in terms of their efficiency costs and effectiveness in attaining their stated objectives, including economic development, privacy protection and national security.</li> </ul>
<b>2. Consider the development of disciplines on trade in services delivered digitally and data flows.</b>	Long Term	<ul style="list-style-type: none"> <li>- The digital revolution has been deeply transformative but the policy response has often been confused and contradictory.</li> <li>- If technology and policy work together, viable solutions can be found to achieving a balance between public policy concerns and the benefits flowing from the digitized economy.</li> </ul>	<ul style="list-style-type: none"> <li>- Build on the above.</li> <li>- The elements of regulatory disciplines could be used multilaterally or in RTAs.</li> <li>- Confirm existing disciplines or establish new ones and encourage digital trade.</li> </ul>

Policy Option	Timescale	Current Status and Gaps	How to get there
<b>Services and SMEs</b>			
<b>3. Ensure that new opportunities offered SMEs by the digitization of trade can be realized.</b>	Short Term	<ul style="list-style-type: none"> <li>- There is no single point of enquiry for cross border services providers and the national enquiry points envisaged by the GATS are designed for use by government officials and not by services providers.</li> <li>- To date, only 17 countries have ratified the Trade Facilitation Agreement (TFA). The lack of digital enabling single window for customs and border compliance currently disadvantages SMEs services providers to trade via Mode 1. The more countries that commit to this technological step, the more opportunities it would offer for SMEs from developing countries to export services.</li> <li>- There are many different levels of <i>de minimis</i> customs levels for small packages in international trade. This varies country by country and discourages digitally enabled electronic commerce, especially from SMEs.</li> </ul>	<ul style="list-style-type: none"> <li>- Call upon countries to provide comprehensive, online, single points of enquiry for cross-border services providers to learn about host country regulatory, licensing, and other administrative requirements.</li> <li>- Recruit another international organization or an independent agency to rate and annually report on the progress of each country in this effort.</li> <li>- Call upon countries implementing the TFA to adopt interoperable, digitally-enabled single windows for customs and border compliance, and release open application program interfaces (APIs) to allow developers to create digital platforms to services to seamlessly link SMEs to large numbers of country single windows.</li> <li>- Encourage the establishment of online single windows for cross-border services providers in need of licenses, permits and other administrative requirements and explore the provision of Aid for Trade to implement this project in developing countries.</li> <li>- Encourage the establishment of higher standardized <i>de minimis</i> customs levels to facilitate cross-border flows of small packages supplied by Internet-enabled retail services providers.</li> <li>- Explore the integration of national postal services into an interoperable, global, package-shipping network.</li> </ul>
<b>The role of soft law</b>			
<b>4. Encourage the WTO Secretariat to contribute in reducing the “deliberative deficit.”</b>	Short Term	<ul style="list-style-type: none"> <li>- WTO members traditionally emphasized deliberation through negotiation, with limited exchanges outside of this. This has stymied the ability of the WTO to advance understanding and discussion on key trade issues, including those involving services and regulatory processes.</li> </ul>	<ul style="list-style-type: none"> <li>- Address current topics, suggest areas for discussion, propose ways of approaching issues, disseminate analysis and information, and develop dialogue with other international organizations dealing with relevant matters, including in the field of services.</li> <li>- Soft law developed outside the WTO should be studied to ascertain how it might inform domestic regulatory processes affecting trade in services.</li> </ul>

<b>Policy Option</b>	<b>Timescale</b>	<b>Current Status and Gaps</b>	<b>How to get there</b>
<b>5. Explore ways of ensuring that best endeavours clauses play a positive role in international agreements.</b>	Medium Term	- The WTO currently has no mechanism for assessing the relationship between best endeavours provisions and hard law obligations.	- Where best endeavours provisions reflect a process of moving towards hard law commitments, the nature of the economic or other conditions justifying a soft law approach should be spelled out, and in appropriate cases technical assistance should be a component in a transition from soft law towards hard law. - Best endeavours commitments should be accompanied by accountability duties, involving specific notification and monitoring provisions, especially if they risk creating misaligned expectations as to the effect of commitments contained in soft law texts.
<b>Regulatory cooperation</b>			
<b>6. Undertake a work programme to identify services sectors where the benefits of liberalization might be undermined by (i) weak national regulation, and (ii) inadequate international cooperation.</b>	Medium Term	- These initiatives should build on existing arrangements in areas like financial, telecommunications, and transport services in order to establish a framework for mechanisms that ensure meaningful international cooperation in services sectors. - The work programme should be undertaken under the auspices of the WTO and other relevant international and regional organizations.	- Establish mechanisms for diagnosing and remedying domestic regulatory inadequacies in these sectors, especially in developing countries. Develop country- and sector-specific recommendations on the appropriate sequence of regulatory reform and liberalization, and credibly commit assistance for the former where necessary. - Ensure greater coherence between international regulatory forums and trade negotiations, and that technical support is available to permit the participation of developing countries in regulatory cooperation activities. Develop country- and sector-specific recommendations on the appropriate sequence of international regulatory cooperation and liberalization.
<b>7. Address the risk of exclusion created by regulatory cooperation among small groups of countries.</b>	Medium Term	- If regulatory cooperation occurs through harmonization and standards are too stringent, the costs for some countries, especially developing countries, may be prohibitive. - If cooperation takes place through mutual recognition, exclusion arises through rules of origin. Part of this problem results from a tendency for members to notify mutual recognition agreements under the “closed” GATS Article V exception for regional agreements rather than under the “open” GATS Article VII on recognition.	- Reaffirmation of relevant WTO provisions, relaxation of exclusionary rules of origin and appropriate technical support to close gaps in standards between developing and developed countries. - Aspects of the exclusion issue could be addressed through Aid for Trade activities or other technical assistance initiatives at both the multilateral and regional levels.



<b>Policy Option</b>	<b>Timescale</b>	<b>Current Status and Gaps</b>	<b>How to get there</b>
<b>8. Institute processes to consider ways of strengthening regulatory provisions in services.</b>	Medium Term	<ul style="list-style-type: none"> <li>- There is an absence of a clear and comprehensive necessity test in GATS Article VI.</li> <li>- References to international standards in GATS are minimal.</li> <li>- The GATS provision offers a weak incentive to apply such standards and only with respect to limited areas.</li> </ul>	<ul style="list-style-type: none"> <li>- This could be done along the lines already established in the TBT and SPS Agreements and some preferential agreements, including through greater reliance upon the work of other international standardizing bodies.</li> </ul>
<b>Greater compatibility between rules governing goods and services</b>			
<b>9. Engage in analytical work on policy coherence across the areas of trade in services, trade in goods and investment.</b>	Short Term	<ul style="list-style-type: none"> <li>- WTO rules were created with separate bodies of rules for goods and services and a lack of multilateral disciplines on investment. This structure does not reflect how businesses invest, produce and trade in the 21<sup>st</sup> century.</li> </ul>	<ul style="list-style-type: none"> <li>- The WTO, World Bank, UNCTAD and OECD should provide assistance to governments in this analytical work aimed at the understanding and awareness of the imperative of policy coherence.</li> </ul>
<b>10. Constitute a working group (or other mechanism) to examine the desirability and feasibility of reducing distortionary parallelism in separate rule sets affecting goods and services in the domains of trade and investment.</b>	Medium Term	<ul style="list-style-type: none"> <li>- Closer integration of goods and services regimes may not be as technically infeasible, nor the differences between goods and services as stark, as is sometimes argued. Further work is needed to tease out the details of what fusion would amount to in practice and what advantages would flow from it.</li> <li>- The conditions may not exist for attempting significant architectural experiments; however, an exploratory exercise among governments, as well as other stakeholders, of arguments for augmenting compatibility between the two policy sets and practical ways this could be brought about would be worthwhile.</li> <li>- This exercise should take account of possible lessons from alternative approaches adopted by preferential trade agreements.</li> </ul>	<p>The working group might start its work by considering the following possibilities in which there is an identified gap:</p> <ul style="list-style-type: none"> <li>- Identifying areas of trade law where the playing field might not be level between goods and services firms.</li> <li>- Bringing together international rules on investment in goods and services, as well as rules on the movement of people, taking into consideration the implications this would have in terms of extending multilateral disciplines to investment and people movement beyond those existing for services under GATS.</li> <li>- Bearing in mind possible risks associated with splintering trade rules along sectoral lines, consider the possibility – as has already emerged in the procurement field – of including both goods and services in some stand-alone agreements such as the ITA, the TFA, and an agreement dealing with environmental products as well as in possible future agreements in areas like cross-border data flows and e-commerce.</li> </ul>

Policy Option	Timescale	Current Status and Gaps	How to get there
<b>Other suggestions for modifications to the GATS</b>			
<b>11. Launch a process to examine ways of accruing greater benefits from temporary cross-border movement of people supplying services.</b>	Short Term	<ul style="list-style-type: none"> <li>- GATS rules on the temporary presence can be strengthened.</li> <li>- Currently, temporary movement of persons under Mode 4 has not been the object of liberalizing commitments to the same degree as the other three modes. Governments have been reluctant to touch upon issues such as visas and work permits in the framework of a multilateral trade organization.</li> <li>- The experience of PTAs covering temporary movement of persons should be taken into account.</li> </ul>	<ul style="list-style-type: none"> <li>- Call upon WTO members to clarify GATS provisions in relation to how the Agreement covers processes and procedures related to visas and work permits.</li> <li>- Improve transparency in relation to national conditions, procedures and processes for issuing visas and work permits.</li> <li>- Strengthen regulatory cooperation between governments for managing the entry and stay of natural persons for the supply of services.</li> </ul>
<b>12. Call upon WTO members to examine various aspects of scheduling practices in the GATS with a view to improving existing arrangements.</b>	Medium Term	<ul style="list-style-type: none"> <li>- Improvements can be made on issues relating to GATS disciplines on scheduling as well as procedures and techniques in order to increase the consistency, depth, and clarity of scheduled commitments.</li> </ul>	<p>Areas to assess the desirability of change include:</p> <ul style="list-style-type: none"> <li>- Progressively switching to the adoption of negative listing in GATS schedules of specific commitments.</li> <li>- Working on a more standardized system of nomenclature for the scheduling of specific commitments.</li> <li>- Establishing a “roll-back and standstill” negotiating modality that could be applied horizontally to align items listed in schedules of specific commitments with <i>status quo</i> policy in order to eliminate “water” in commitments.</li> </ul>

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recommendations expressed in the policy options paper are not attributable  
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## International Centre for Trade and Sustainable Development

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