Global Trade in Services & GATS: An Overview

Majid Ali Wajid

I. Introduction

The term "Services" covers a wide range of heterogeneous products and activities of industries that typically dominate absolute output and employment in most countries. It encompasses both intermediate services (communications, transport, financial, construction and business services) and final demand services (tourism and travel, recreation, education, health and environmental services). According to a definition a service is an economic activity that adds value either directly to another economic unit or to a good belonging to another economic unit. Consequently, services have as a defining feature the requirement for direct interaction between producers and consumers (firms or households) before the service can be rendered. The trade in services can be distinguished from trade in goods in that they are intangible and invisible. Furthermore, services unlike goods cannot be stored, that is they are often produced and consumed at the same time.

Until 1995, no multilateral agreement existed on rules for the trade in services. This was largely due to a lack of knowledge about the services trade itself. However, the initiatives taken by certain private-sector groups in the developed world successfully led their governments to insist on the inclusion of international services in the Uruguay Round of negotiations which ultimately resulted into the General Agreement on Trade in Services (GATS) of the WTO (World Trade Organization).

The GATS is an inter-governmental agreement to establish a multilateral framework of principles and rules for trade in services. The principal aim is the expansion of services trade under conditions of transparency and progressive liberalization and as a means of promoting the economic growth of all trading partners and the development of developing countries. The GATS covers almost all commercially traded services in any services sector except those supplied in the exercise of governmental authority. It addresses both services and service suppliers.

II. World Trade in Services: At a glance

Global trade in services has grown in the past few years especially because of reduction in transport costs and enhancement of technological innovations – telecommunications and information technology. Services currently represent two thirds of World Gross Domestic Product (GDP). The share of services value added in GDP tends to rise significantly with the countries' level of income, standing at 69% on average in high income countries (73% in the United States), against 55% and 44% respectively in middle and low income countries. Even in the latter group, the production of services is generally a core economic activity, whose contribution to GDP is above that of both industry and agriculture. Significant differences exist however between countries within the same group, as is the case for example between India and Nigeria – two low-income countries whose respective shares of services in GDP are 48% and 28%.

The current importance of services' value added follows decades of sustained growth of services' contribution to GDP, which is also mirrored in employment statistics. Looking at developments over the 1990-2000 period, a significant shift of employment from the agriculture and industry sectors to the services-producing sector has been observed.

World exports of commercial services (i.e. excluding government services) amounted to USD 2,127 billion in 2004, after growing on average at around 7% per year in value terms since 1980. Trade in commercial services grew faster than trade in goods during this period, increasing its share in total world trade. Services, at present, account for approximately 20% of total world trade.

The share of services in world trade contrasts with the central contribution of services production in domestic economies. As a matter of fact, due to their intangible nature, trade in services is inherently subject to more constraints than trade in goods. While a (tangible) good may be produced, stored, moved and consumed at different places and times, the delivery of a (intangible) service is seldom dissociated from its production and its consumption, requiring the proximity of the supplier and the customer. For instance, hairdressers and their clients need to be physically close for a haircut, and doctors generally need to be in direct contact with their patients for a consultation.

The need for proximity for supplying many services has led providers to export their products through developing a commercial presence in consuming countries, i.e. the establishment of foreign affiliates. This form of international trade in services was estimated at around USD 2,000 billion in 1998, that is, substantially more than "conventional" trade in services.

In merchandise trade negotiations, statistics on tariffs and trade have been extensively used to identify priorities, to formulate negotiating strategies, to evaluate and exchange commitments, and to assess the benefits of liberalization. These types of statistical needs are, in principle, the same for services negotiations. However, the challenge posed to statisticians is much more difficult to meet in the case of services, as systems to measure international trade in services are not as developed as for merchandise trade, and due to the broad definition of services trade.

III. Developing Countries and Services Trade

When the GATS was being negotiated in the Uruguay Round, the initial reaction of the Developing Countries was that this was principally an area of interest to industrialized economies. This view is no longer generally held. The importance of effective services sectors for development is now widely accepted.

Services liberalization is vital to economic growth in developing countries. Reforms in sectors such as financial services, telecommunications and transport facilitate growth and economic efficiency. In particular, the availability of infrastructure and financial services attracts investment and supports export industries. Improvements in health and education are necessary to build human capital. The challenge for developing countries is to negotiate services liberalization that leads to the transfer of technology and capacity-building. According to certain analysts, the priority sectors are movement of persons, construction and energy services.

According to the World Bank, services generally account for over 50% of GDP in developing countries, and services are the fastest growing sector in many of the least-developed economies. The benefits to developing economies from liberalizing trade in services are immense.

Tourism and construction are important domestic and export industries in many developing countries. Expansion of services industries creates jobs. As economies expand, services sectors become the largest providers of jobs. Countries such as India have already experienced benefits from exporting information technology-related services, such as data entry and call centre services, to large firms in the United States and elsewhere.

Liberalization of services has strategic importance for other sectors such as agriculture and manufacturing, for which services are inputs. Competitive services industries such as telecommunications, banking and transportation are critical if other sectors of national economies are to be competitive.

Efficient and competitive services not only provide a direct benefit to consumers but provide vital support for overall economic development. Lower transaction costs, more transparent regulations and more reliable access to services also benefit consumers and attract longer-term investment. Services trade offers low-income countries the opportunity to innovate faster by gaining new skills, technology and information through technology transfer and foreign direct investment.

Liberalization provides an opportunity for officials to advance commitments to permit competition from foreign providers of services which advance reform of the domestic economy. In effect, the General Agreement on Trade in Services (GATS) offers developing countries the only enforceable global framework for growing their services trade opportunities in the future.

The majority of WTO Members are developing countries. Though their share of international trade, and in particular of trade in services, is still relatively small they have a major interest in services trade, both as exporters and importers of services. The GATS recognizes their special needs in two ways. First, it is accepted that the pace of liberalization by any country may reflect its level of development and national policy objectives. Developing countries are therefore not expected to liberalize as quickly or as extensively as developed countries.

Developing Countries have already shown that they do have some comparative advantage in service and are able to export a broad range of services effectively. Labour intensive sectors such as construction have a clear comparative advantage for developing countries, but trade has been limited by trade barriers, including the reluctance of most countries to extend to the less-skilled occupations the permissible temporary movement of people to deliver a service. Developing countries are, however, also active in sectors that are more intensive users of human capital or of physical capital. The best-known example is software services exports, which is now a multi-billion dollar industry. Other examples of information technology – related services include back-office processing and call centers.

Interestingly, despite their smaller size and more limited resources, many services firms in developing and transition countries are already successful exporters. Although government officials in these countries often focus primarily on tourism and the movement of labour, their private-sector services firms report a wide range of profitable export activities.

IV. Services Sectors in South Asia

South Asia has a fast and growing trade in services. Large numbers of South Asians cross each other's borders as tourists, pilgrims, professionals, students and health care seekers as well as providers. Nepal, Maldives, Sri Lanka and India are major tourist destinations both globally and within the region. India is a major attraction for students and health care seekers while Indian nurses and doctors are much in evidence in a number of hospitals in Bangladesh, Nepal, Maldives and Bhutan. Managers and professionals from India are in service in Nepal and Bhutan just as Indian and Pakistani managers are running textile mills in Bangladesh while Bangladeshi cooks and waiters are ubiquitous in Maldivian tourist resorts. With the enhancement in the quality of service delivery across the region this trade in services will grow and may do so exponentially, since this is an area where South Asia has some comparative advantage.

There is, however, no reason why the market in services should be monopolized by India. Pakistan, Sri Lanka and Bangladesh can invest in their education and health-care sector to attract service seekers from within the region as well as globally. Pakistan already has some excellent hospitals and institutions of educational excellence which attract clients from overseas. It would not take much effort to upgrade such service sectors in these countries to serve a regional and even global market.

India is now emerging as one of the major exporters of IT services at the global level. There is an expectation that this could grow to US$ 50 billion. Pakistan, Bangladesh and even Maldives have the potential to share in the fast growing IT market.

However, SAARC initiatives in the service sector have not moved beyond some consultations related to the tourism sector. Much more work, again possibly at the level of civil society, needs to be done to estimate the extent and nature of this market as well as its underlying dynamics. Such studies can then be used to open up dialogue at the official level to see how the issue of services should be integrated into the SAFTA process. Since much of this trade in services is informal and hence unrecorded, this trade will continue to expand through the play of market forces. It may be counterproductive for SAARC to interfere with the market but the SAARC process should be used to explore ways to enhance the export capacity in services of the weaker SAARC member countries.

V. Liberalization of Trade in Services: Significance

Trade Liberalization involves providing greater market access to foreign firms by lowering barriers to trade. Trade liberalization is consistent with countries' continuing to regulate industries for the purposes of consumer protection, prudential management of economy, control of natural monopolies, or the achievement of social goals. Services have a significant impact on growth and efficiency across a wide range of user industries and overall economic performance. For instance, sectors such as transport, telecommunications and financial services are key determinants of the conditions in which persons, merchandises, services and capital flow.

An efficient services infrastructure is a precondition for economic success. Services such as telecommunications, banking, insurance and transport supply strategically important inputs for all sectors, goods and services. Without the spur of competition they are unlikely to excel in this role – to the detriment of overall economic efficiency and growth.

There is strong evidence in many services, not least telecoms that liberalization leads to lower prices, better quality and wider choice for consumers. Such benefits, in turn, work their way through the economic system and help to improve supply conditions for many other products.

A country's commitments in its WTO services schedule amount to a legally binding guarantee that foreign firms will be allowed to supply their services under stable conditions. This gives everyone with a stake in the sector—producers, investors, workers and users—a clear idea of the rules of the game. They are able to plan for the future with greater certainty, which encourages long-term investment.

The use of FDI as the preferred means of delivery makes services liberalization unique in terms of the additional gains it provides to developing countries. Imports of services through FDI bring with them inflows of physical, capital, human capital and technology – factors important for overcoming some of the main development constraints that poor countries face.

Furthermore, because foreign entrants employ significant numbers of the local work force, this process results in a period of sustained development of the human capital of the local labour force involved. Technology transfer may well be enhanced via spill overs from use of local suppliers and employee turnover. The demonstration effect of using new technology and management techniques also improves their adoption by domestic firms. Finally, many services make use of common inputs.

Increased trade in services will bring much-needed investment to poor countries, as well as services that are greatly lacking. Development has been slowed by poor access to services, and would be much improved through expanded trade. Expanded trade in services also implies greater technology transfer to developing countries through private enterprise.

Consumers in poor countries have long been stifled by government monopolies, which often hardly provide, or do not at all provide, services such as electricity, clean water or healthcare. Local businesses and entrepreneurs are also stifled, because they rely on such services as inputs to their production, but are unable to afford them. They are also stifled by extremely bureaucratic rules and regulations, and corruption. Services competition in any form means more access, cheaper and more reliable provision, and most importantly, more – not less – choice for consumers.

Through GATS, more professionals (doctors, especially) may be able to provide services on a temporary basis in other countries, rather than permanently immigrating to other countries. Moreover, they may be able to more effectively provide those services in their own countries.

VI. GATS: Framework for Liberalization

The Members through membership of the World Trade Organization (WTO), have taken on the obligations of the GATS. This agreement, which came into force in 1995, sets out a framework of legally-binding rules governing the conduct of world trade in services. It is supported by a number of schedules of specific commitments undertaken by individual WTO Members. These commitments bind Members not to introduce more restrictive rules which could have an adverse effect on trade. The aim of the Agreement is to get members to apply common rules on how foreign services providers can deliver services in national economies and also to reduce over time the barriers to the provision of those services. The idea is that greater competition in the delivery of services will increase competitiveness in the economy and improve the quality of services provided.

The GATS has nothing to do with the deregulation or privatization of industries. In fact, the Agreement excludes from its coverage all services provided in the exercise of governmental authority. In addition, governments have an unqualified right in the WTO to refuse to open particular service industries to foreign competition. They have a right to maintain protection of particular industries under WTO rules, and most do. The GATS therefore makes a distinction between trade barriers that distort competition and restrict access to markets on the one hand, and regulations which are necessary to pursue legitimate policy objectives and ensure the orderly functioning of markets on the other hand.

The GATS categorizes services according to the way in which they are provided. Four modes of delivery are laid down: cross border supply, consumption abroad, commercial presence, and movement of natural persons.

The principal obligation in the GATS is to guarantee non-discriminatory treatment to foreign service providers as markets are opened. National treatment is not an automatic right. Members are invited to grant national treatment in the process of progressive liberalization of services markets. GATS also has a general obligation to ensure that national laws governing the provision of services are transparent.

Scheduling Commitments

As with the General Agreement on Tariffs and Trade (GATT), in GATS members list their commitments in national schedules. The commitments show what restrictions have been removed and which industries remain reserved for national providers. The aim of successive rounds of negotiations is to progressively remove restrictions on foreign suppliers of services and to extend national treatment to foreign providers.

Each Member of the WTO is required to have a schedule in which it registers its commitments to provide market access and national treatment to services and service suppliers of other Members. When making a commitment, a Member binds the level of market access and national treatment specified in the schedule and undertakes not to impose any new measures that would restrict entry into the market or discriminate in favour of services or services suppliers of national origin. Commitments can only be withdrawn or modified after negotiation and agreement with other Members on a compensatory adjustment through which the modifying Member offers alternative commitments. However, new commitments and improvements to existing ones can be added at any time.

Each Member first identifies the service sectors in which it is willing to make commitments. Then the Member states the conditions under which it will allow services and service suppliers' access to its market. These obligations are negotiated on a sector-by-sector basis and are inscribed on Member's schedule of commitments.

When the first schedules of commitments were prepared, members were required to list restrictions that applied "horizontally", that is, across all service sectors. Most common restrictions were those on foreign investors and on the movement of personnel.

Members were also required to list restrictions according to the mode of supply and to what extent national treatment was afforded to foreign service suppliers. Finally they were required to list what services were “unbound” that is, where no commitments to remove barriers have been made.

The schedules of commitments thereby contain “positive” lists of commitments indicating what restrictions have been removed and “negative” lists showing services where no restrictions have been removed. The process of negotiations to remove barriers in the Doha Round and in future will effectively be aimed at expanding the positive list and reducing the negative list.

VI. Progressive Liberalization through Negotiations under GATS

Under successive rounds of negotiations, aimed at progressive liberalization, Members individually choose in which sectors to make binding commitments, and in which not to. Negotiations proceed on the basis of requests and offers; that is, countries request each other to consider liberalization in particular sectors, and respond with offers. Agreement to liberalize is not reached until all participating Members – including developing countries – are satisfied with the total package being offered. There are no plans to change this approach. This does not prevent any country from making commitments unilaterally at any time.

Governments are always free to liberalize unilaterally without making commitments in the GATS. However, GATS commitments have real value in providing secure and predictable conditions of access to markets, which benefits traders, investors, and, ultimately, all of us as consumers. This is why so many Governments have chosen to make binding commitments in the GATS framework, where they are intended to be legally secure.

The processes for negotiating reductions of barriers to services under the General Agreement on Trade in Services (GATS) are derived from those employed in the General Agreement on Tariffs and Trade. The nature of restraints on the provision of services has so far ruled out general formula or targets to secure across the board cuts in protection. The basic reason is that it is very difficult to quantify the value of restraints on services.

A round of negotiations on GATS started in the year 2000 as a built-in-agenda of the main agreement. The negotiation has two components, i.e. negotiation on market access and negotiation on rule making. The first part of the negotiation is known as the request-offer process that starts as bilateral and concludes as multilateral.

Negotiations are organized as “request/offer” negotiations. Members are invited to table what cuts they would like to see other make. These are requests. Then members are invited to indicate what restrictions they are prepared to remove. These are offers. Once both sets of proposals are on the table, the process of negotiation to arrive at a package begins.

The Doha Development Agenda decided that member countries of the WTO should submit their initial request for specific commitments by 30 June 2002 and initial offers by 31 March 2003. All these deadline have passed and there is no substantial achievement on GATS negotiations. Subsequently, the July Package of 2004 asked members who had not yet submitted their initial offers to do so by May 2005 but even this deadline has not been properly adhered to.

Interestingly, negotiations on services trade liberalization under the Doha Round have generated less tension and friction than any other comparable area within the ambit of the WTO. However, the situation is not going to remain the same. WTO members who have significant interests in services trade liberalization want to see progress on services at par with agriculture and non-agricultural market access. Developing country members need to become proactive as it holds an immense potential in terms of further expansion of world trade.

VIII. Pakistan and GATS

Pakistan has made commitments under the GATS in the service sectors relating to Business, Communication, Construction and Engineering, Financial, Health, Tourism and Travel. While making commitments in these sectors, Pakistan has placed horizontal restrictions across all the service sectors, which are uniformly applied to all the sectors. To quote some restriction as examples, it may be mentioned that the foreign firms can have up to a maximum of 51% equity in their local business in Pakistan and 50% of the executives or specialists in any company could be the foreigners. Some other examples of these limitations are that the local commercial offices of the foreign firms are required to meet their local expenses by remittances from abroad. The acquisition of real estate is subject to authorization on case-to-case basis.

As an illustration of Pakistan's sectoral commitments, it may be mentioned that the licenses granted in banking sectors are on the basis of reciprocity i.e. only to the banks of the countries that also grant license to Pakistani banks. Pakistan also gives favorable treatment to the banking institutions established as joint venture under the ECO framework and Islamic financing. Pakistan has made more commitments allowing foreign companies/firms to establish their subsidiaries in Pakistan because this serves as an incentive for foreign direct investment. In computer and related services, Pakistan has adopted liberal approach in allowing consumption of services in other countries and has granted permission to foreign companies to establish their affiliates in Pakistan. In construction and related services, foreign firms are required to have partnership and/or joint venture with Pakistan companies. In health services, Pakistan has imposed no restrictions in consumption of services in other countries and has allowed foreign service suppliers to establish their commercial presence subject to regulations of Pakistan Medical & Dental Council (PMDC).

Initial Requests made to and by Pakistan

Pakistan, till recently, had received initial requests from certain countries for liberalization in almost all the sectors. The requests as and when received from other countries were shared with the stakeholders in order to solicit their considered views.

Pakistan also had sent requests to countries in different sectors/sub sectors under Modes 3 and 4, for elimination of restrictions on market access and national treatment. These initial requests made by Pakistan to other countries were made on the basis of certain assumptions. The selection of sectors and sub-sectors was based on the strengths Pakistan currently has in the services sector or in sectors in which it has the potential to become a service exporter. Pakistan has so far made requests to countries from which it has received requests as well as to some additional countries, which are good potential markets for export of Pakistani services.

Factors to be considered before Liberalization

In the context of the offers that would be made by Pakistan, a number of factors are to be kept in mind. Firstly, Pakistan has already made some binding commitments in the services sector during the Uruguay Round followed by additional commitments in the financial and telecom sector in 1998. Secondly, whatever offers that might be made by Pakistan in response to the requests received or otherwise would automatically be available to all WTO members on most favored national (MFN) basis. Thirdly, decision making involves an examination as to whether on a balance, would Pakistan be better off going for maximum possible liberalization or alternatively adopt a defensive posture and liberalize to the minimum extent in order to afford maximum protection to Pakistani service providers in the domestic context.

While dealing with liberalization of services, Pakistan needs to guard against the possible dangers of going for maximum liberalization. However, it would be also appropriate to recognize that there may be much greater benefits than losses in adopting the liberalization option.

Recent Developments

Pakistan has recently submitted its conditional initial offers list to the WTO Secretariat envisaging opening up almost all major sectors and sub-sectors to foreign services providers (FSPs). This offer is conditional to the market access Pakistan receives in other areas of negotiations as well. Pakistan has the right to add, remove or modify any element of the offer until a final agreement that meets its objectives is reached. Under the new developments, Pakistan has now made 10 liberalization commitments out of 12 sectors under the GATS. These include business services, communications, construction/engineering services, financial services, health and tourism, veterinary, education, accounting and legal services.

Following the submission of the conditional initial offer lists to the WTO, Pakistan has now started bilateral negotiations with other WTO member countries for getting offers of their interest before finalizing the final list for submission. The share of services in the GDP of Pakistan is now around 52 per cent, whereas the share of services in GDP of developed countries is about 75 per cent.

IX. Conclusion

Multilateral trade liberalization, under the aegis of the WTO has thrown open opportunities for its members to exploit the vast potential of trade in services. Developing countries do recognize the potential benefits of liberalization in trade in services. However, gains from services liberalization have not been realized much because of limited access in modes and sectors of export interest to developing countries and/or supply-side constraints. Often they are difficult to identify as most of these barriers do not occur at the border but emanates from regulatory framework of national governments.

Liberalization of services entails adjustment costs. Adjustment has to be made by both developed and developing countries. Developed countries need to show more flexibility by providing better market access to service providers from developing countries. Developing countries, on their part, besides trying to overcome external barriers, need to bring necessary policy changes at the domestic level to harness their natural competitive advantage. An effective regulatory framework is required to channelise the gains from services trade expansion to a desired direction.

For Pakistan, in undertaking liberalization in services, it is necessary to lay the institutional foundations for reform, identify coherent strategy that maximizes the gains while minimizing the adjustment costs, and manage the political consequences of reform to keep the process on track.

The institutional foundations for liberalization can include understanding the current trade stance, establishing the governmental process for trade negotiations, and creating the institutions to manage liberalization. Once the foundation for liberalization has been laid, the next step would be to devise a trade liberalization strategy aimed at maximizing the gains and minimizing the adjustment costs. The strategy needs to set out in detail the sequence and timing of liberalization across the different sector, the modes of supply, and the two groups of barriers (market access and national treatment).

The government needs to broaden the decision making process to include trade and industry department, which represents industrial users, and any other line departments whose users are affected. Outside the government, industry associations and consumer groups can provide vocal support for reform. Choosing sectors that offer rapid delivery of benefits from liberalization is a means of quickly building widespread support.