# 'Leading with Services': The Dynamics of Transatlantic Negotiations in Services

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## Executive summary


Services providers are busy re-designing their strategies to cope with the global economic crisis. In order to take the right decisions, they need clarity and predictability on future market access in services. Meanwhile, consumers impoverished by the current crisis would greatly benefit from more open markets. Starting negotiations *now* on how to improve market access in services would deliver predictability to firms and economic gains to consumers, and would be facilitated by the fact that the last months have witnessed growth or resilience in a substantial number of services. That said, how could this be done when negotiating market access in services is so notoriously difficult?

We begin by exploring the option of launching bilateral negotiations on services between the two largest world economies, the U.S. and the EC. For both economies, expected gains for consumers and opportunities for services providers are huge because the size of the services that remain substantially protected is equivalent (at least) to their respective manufacturing sectors as a whole. Moreover,

- being on average the more open partner, the U.S. has a strong interest in cutting EC barriers that are bound by commitments dating from the Uruguay Round, or even in reducing these bound barriers to their current (lower) applied level.
- being on average the less open partner, the EC may be less sanguine. However, it has a strong additional motive: to use the Transatlantic talks as a way to "deepen" its Internal Market by opening the markets of the most protectionist EC Member States (ECMS) to competition from the U.S. *and* from the other EC Member States (as was done for goods in the Kennedy Round).

We do not stop at an analysis of the costs and benefits of Transatlantic negotiations on services. We also examine the dynamics of such talks. We show that it would be relatively costless, and highly beneficial, to extend these talks to eight countries, a group small enough to keep negotiations manageable and large enough to ensure that more than 80 percent of world production in services would be covered in the negotiations. Shifting from bilateral to such plurilateral negotiations would be attractive for all the participants, although not exactly for the same reasons:

- For the U.S., such a shift would roughly double the deal that could be concluded with the EC.
- For the EC, such a shift would open the services markets of these eight countries which are often as protected as the most protected ECMS markets.
- The eight additional countries would enjoy, *mutatis mutandis*, the same gains as the EC.

These powerful dynamics justify the risk of starting bilateral Transatlantic negotiations. In fact, sticking to a Transatlantic deal in services is unlikely to be optimal. As economic analysis shows, bilateral preferential liberalizations are costly for the negotiating partners because they distort trade flows in an inefficient manner. Extending the Transatlantic talks to the eight countries would massively reduce the risk of such distortions.

We conclude by revealing a "willingness to negotiate" that can be tapped for moving ahead, especially in the growing or resilient services sectors. If successful, such extended talks ultimately could (and ideally should) be "repatriated"—explicitly or implicitly—into the Doha negotiations, giving them the final boost that was missing in July 2008 in order to conclude them successfully.


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## "LEADING WITH SERVICES"
## THE DYNAMICS OF TRANSATLANTIC NEGOTIATIONS IN SERVICES

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### Introduction

During the last decade, the relations between business people and trade negotiators have not been easy. Business people lost interest or grew disenchanted with the Doha Round negotiations at the World Trade Organization (WTO), while trade negotiators complained that they could not conclude the Round without the active support of business, which was notably lacking. Two recent events might change this picture, and both of them involve services.

First, the collapse of the Doha talks in July 2008 clearly revealed that no decisive progress in the Doha Round could be made in agriculture and industry without an initiative capable of extracting trade negotiators out of their entrenched positions regarding these sectors. The only source for an initiative powerful enough to do so is the services sector—which amounts to two-thirds of world output, is the fastest growing sector in the current world economy, and has proved to be the most resilient in the face of the current economic crisis. Moreover, once perceived as being of interest only to developed countries, services have gained considerable importance for emerging economies.

Second, the global economic crisis is offering unexpected opportunities to well-run and dynamic firms, particularly in the services sectors that have been showing sustained growth, such as computer and related services, telecommunications or insurance (Mattoo and Borchert 2009). In order to seize upon these opportunities, services providers need to re-assess their strategies, which requires greater certainty regarding their future access to foreign markets. All this occurs precisely at a time when market opening in services would bring vast benefits to consumers impoverished by the current crisis.

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[2] Groupe d'Economie Mondiale at Sciences Po (GEM): http://gem.sciences-po.fr. We are grateful to Jennifer Hillman and Joe Guinan for their extremely useful comments.

In short, the time is ripe for starting negotiations on better market access in services. The key question then is whether such negotiations could also help jump-start a renewed effort to concludethe Doha Round, since negotiating services liberalization is notoriously difficult, with the difficulties increasing more rapidly than the number of the parties sitting at the negotiating table.

One option is to launch bilateral negotiations on services between the two largest world economies. This note thus explores the costs and benefits of Transatlantic talks on services liberalization. But it does not stop there. It also reveals the dynamics of such talks by showing that it would be relatively costless, and highly beneficial, to extend these talks to a handful of other countries, thus reaching more than 80 percent of the world production in services. This share is large enough to provide huge gains for consumers and massive new opportunities for services providers. Such extended talks could then be "repatriated"—whether explicitly or implicitly—into the Doha Round of negotiations, giving them the final boost that was missing in July 2008 in order to speed them towards a successful conclusion.

## Section 1: An EC-U.S. bilateral in services

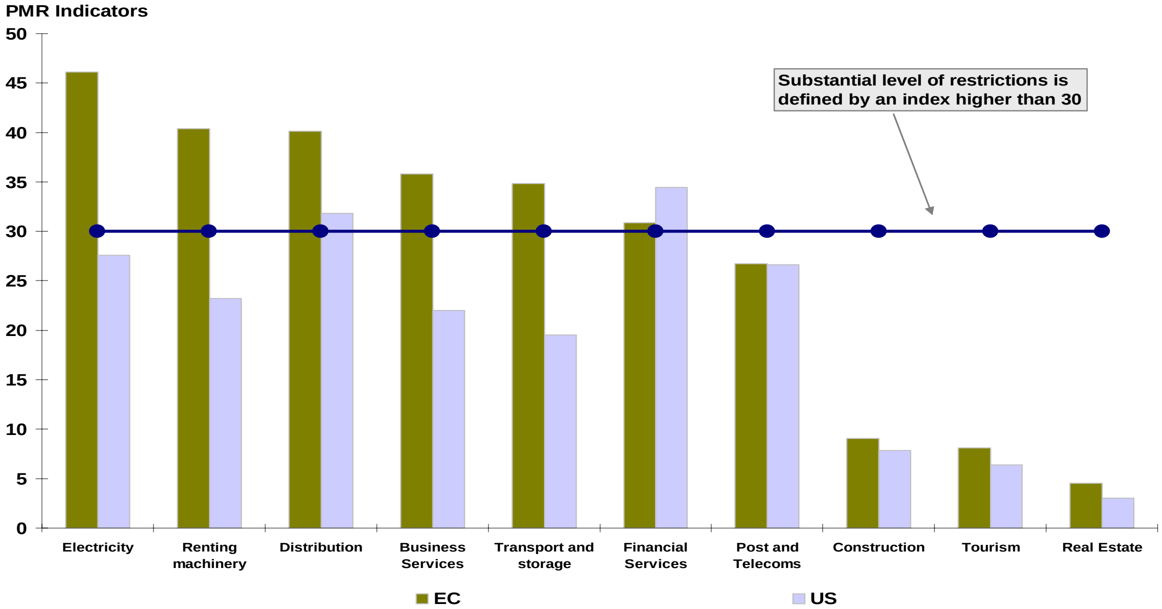
Would Transatlantic negotiations on services liberalization raise enough interest among U.S. and European services providers? This question has two answers, and not just one.

### *A first source of opportunities and gains*

A first source of opportunities for services providers and gains for consumers consists in reducing or cutting the current *applied* barriers to trade in services. For getting a sense of the magnitude of these barriers, this note uses the comprehensive and internationally comparable OECD Product Market Regulation (PMR) indicators which measure the degree to which policies, such as state control of business enterprises, legal and administrative barriers to entrepreneurship, etc., inhibit or promote competition (OECD 2008). In order to reflect the regulatory nature of these barriers, the note refers to them as "regulatory constraints."

Figure 1 presents the available PMR indicators for the EC and U.S. regulatory constraints in services on a scale from 0 to 100, with 0 standing for a completely open market and 100 for a completely closed market.[3] These indicators are not equivalent to tariffs, but are mere estimates produced by experts on the services sector. But, the manner in which they are generated suggests that PMR indicators higher than 30 may be considered as "substantial" barriers.

**Figure 1: Level of applied regulatory constraints in services: the Transatlantic case**




Sources: OECD (2008), OECD (2006). Authors' calculations.

Notes: OECD Product Market Regulation (PMR) indicators vary from 0 (markets considered as open) to 100 (markets considered as closed). The EC level of regulatory constraints in a service is the average of PMR indicators by ECMS weighted by the output shares of the corresponding ECMS service sectors. Only data for EC15 countries (excluding Luxemburg) are available. All shares are based on output data from the National Accounts (input-output tables) for the year 2000. A "substantial" level of protection is defined as a PMR indicator higher than 30.

Figure 1 provides three key results.

- The output of the services with a substantial level of protection represents roughly 20 percent of EC and U.S. GDP respectively—that is, about the combined output of the manufacturing and agricultural sectors in the U.S. and the EC.[4] In other words, opening markets in these services would have the same potential economic impact as all the liberalization undertaken during the last fifty years covering only industrial and agricultural goods (assuming a successful Doha Round).
- The range of services with a higher level of protection is almost the same on both sides of the Atlantic. Negotiators could thus work on deals within services as well as

[3] The scale of PMR indicators is 0 to 6 from least to most restrictive (Conway, Janod and Nicoletti 2005). We use a larger range (0 to 100) in order to have a presentation more similar to tariff rates. The PMR indicators do not cover all the services. For instance, they are not available for education, health or social services. The services with PMR indicators shown in Figure 1 represent two-thirds of the entire U.S. and EC service sector.

[4] Or 25 to 29 percent of the output of all the services for which PMR indicators are available.

deals between services, hence expanding the scope of possible concessions since it may be easier to exchange concessions on services pertaining to the same broad service sector than to exchange concessions between two different broad service sectors.

- U.S. services look, on average, less protected than EC services. This has two important consequences. First, it means that the U.S. has a strong negotiating interest in such bilateral talks, a feature that, once combined with reports on growing services in the U.S., should change the current negative mood in the U.S. Congress and should allow the U.S. to take a more active role in trade negotiations. Second, this result also means that the EC should have some additional incentives to negotiate with the United States. A first incentive is the substantial economic gains to EC consumers from reducing or eliminating EC regulatory constraints. Another incentive would flow from the second source of opportunities and gains examined immediately below.

***A second source of opportunities and gains***

Any trade liberalization offers a second—often neglected—source of opportunities for services providers and gains for consumers if *applied* barriers are lower than *bound* barriers. Bound barriers are those imposed by the legal commitments taken by countries in the WTO. In services, most EC and U.S. commitments date from the conclusion of the Uruguay Round in 1995. However, since then, the EC and the U.S. have had ample time to adopt and to apply lower regulatory constraints—all the more because these two large and complex economies rely on federal or quasi-federal political structures allowing a different level of regulatory constraints among their member states.[5]

As a result, a second source of gains from Transatlantic trade talks consists in reducing *bound* regulatory constraints to their applied level—i.e., in eliminating "water" in protection in services.[6] Such water is dangerous because it means that reversion to higher protection can be fast (no fear of breaching WTO obligations), massive (when bound protection is much higher

[5] Gootiiz and Mattoo (2008) presents a similar analysis based on indicators not yet publicly available.

[6] A detailed analysis of the notion of water in protection in services is beyond the scope of this paper. It is more complicated than the parallel notion in goods (the difference between bound and applied tariffs). This is because a country's schedule in a specific service is defined by eight entries (four modes in market access and four modes in national treatment). However, it is recognized that the "*elements of the schedule operate exactly in the same way as a GATT binding*" since "*they represent bound commitments that, when the service concerned is supplied by the specified mode, it will receive treatment no less favorable than is stated in the schedule*" (WTO Secretariat 1999, page 182).

than applied protection), and wide (when there are many large countries with water). Recently, some parts of the business community have begun to realize, with the global economic crisis, the high costs that are associated with the uncertainty generated by water in protection in the industrial sector.[7] We will use the term "value of binding" when referring to this second source of gains.

Figure 2 illustrates the existence of water in protection within the EC as the information on regulatory constraints is only available on an EC Member State (ECMS) basis. No equivalent available data for the U.S. states exist. However, evidence from U.S. GATS commitments (with their exceptions by U.S. state in insurance, financial and legal services and, to a lesser extent, engineering, accounting and bookkeeping) and from the business community suggests that similar water in protection in services also exists within the United States.

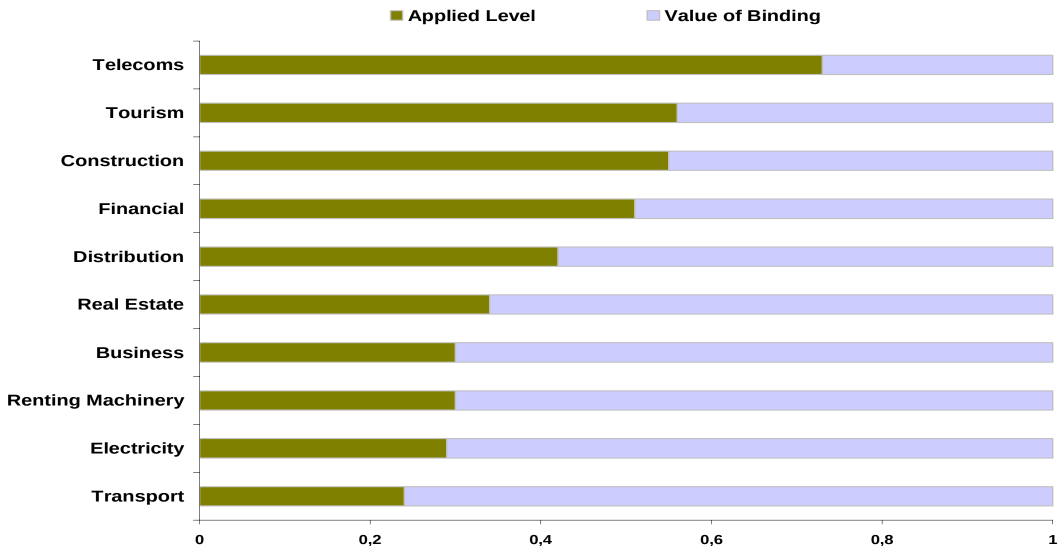
Figure 2 assigns an index of 1 to the ECMS with the highest level of applied restrictions in a given service, and it assumes that such an ECMS abides by the bound commitments taken by the EC as a whole at the Uruguay Round. In other words, an index of 1 means that the level of applied barriers in the ECMS in question is equal to the level of the EC bound barriers. Any ECMS exhibiting an index lower than 1 has an applied level of protection lower than the bound level protection defined by the EC Uruguay commitment. As a result, figure 2 displays opportunities for valuable binding to lower applied levels. For instance, France is set to 1 in telecommunications because it shows the highest level of applied regulatory constraints in this service. If one assumes that France abides by the EC bound level of constraints in telecommunications, reducing the EC bound level to the lowest applied level of regulatory constraints (0,7 in the Netherlands) across the EC telecommunications would reduce the water in protection in all the other ECMS—hence generate a value of binding in terms of commitments across the EC Internal Market.

Figure 2 shows the frequent occurrence and large magnitude of water in protection among the ECMS across other services. The mere reduction or elimination of water in protection would therefore provide large opportunities to U.S. services providers. Furthermore, however, it would deliver opportunities to the EC services providers in the least protected ECMS which are facing difficulties with access in the most protected ECMS (which are likely to have high

[7] Among others, see Messerlin (2007, 2008), Bouët and Laborde (2008), Achard, Rupp and Jomini (2008).

barriers with respect to all competitors, be they from other ECMS or from the U.S.) and it would generate welfare gains for EC consumers and investment security for businesses in the most protected ECMS. This conclusion is reinforced by the fact that, in most services, the highest applied regulatory constraints (index of 1 in Figure 2) are implemented by a large ECMS representing a large part of the entire EC market.

**Figure 2: The Value of Binding in Services: Water in Protection across EC Member States**




Sources: OECD (2008), OECD (2006). Authors' calculations.
Notes: An index of 1 assumes that the highest level of regulatory constraint of an ECMS in the EC is equal to the bound level of regulatory constraints committed in the GATS. Figure 2 shows the maximum difference between applied regulatory constraint compared with the EC bound level for each service across the ECMS and hence therefore reveals the maximum value of binding.

Combining Figures 1 and 2 shows strong incentives for Transatlantic talks on both sides of the Atlantic. Being on average more open, the U.S. has a strong interest in cutting bound barriers and reducing water in protection. Being on average less open, the EC may at a first glance look to have less of an interest in this if it adopts a narrow negotiating approach—but, as has been argued above, economic analysis shows that the true beneficiaries of improved access to EC markets are EC consumers. Furthermore, the EC has an additional and powerful motive which is to use the Transatlantic negotiations to deepen its own Internal Market. Such an EC "deepening" motive for Transatlantic talks is not new. It was a key force behind the 1964-67 Kennedy Round. During the mid-1960s, the most protected ECMS were reluctant to reduce their highest tariffs to the lower agreed level of the Common External Tariff. Improved market access to the U.S. and to other GATT industrial Members was an attractive price for these reluctant ECMS to implement the Common External Tariff. All these incentives are consistent with the fact that, in 2005, the EC tabled offers more encompassing than those of the United States (see Section 3, Table 2 below).

Finally, such a limited forum may be conducive to more trust, giving a crucial "qualitative" dimension to these bilateral talks. In particular, the two parties may be more inclined to adopt, as often as possible, a "negative" list approach when defining reservations (that is, all the measures not explicitely listed are covered by the negotiated agreement, and only the listed reservations exempt existing measures from the disciplines of the agreement). Similarly, the two parties may be more inclined to adopt, as often as possible, a ratchet provision (that is, if a reserved measure were changed or eliminated, the reservation would disappear) limiting the building up of water in protection (contrary to what happened after the Uruguay Round).

## Section 2: Expanding Transatlantic talks to other countries

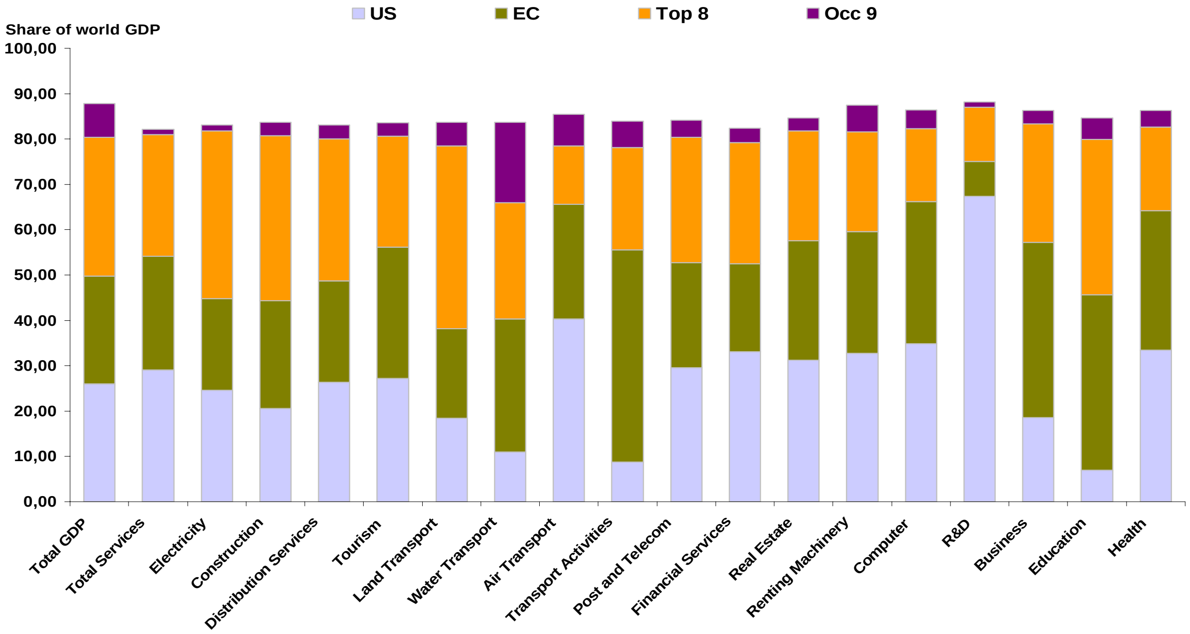
Going beyond Transatlantic talks and shifting to plurilateral ones depends on two factors.

### *The low costs of expanding*

First, would such a shift be relatively costless? The answer depends largely on the number of additional countries to be involved in the negotiations. Reducing such a number is acceptable as long as the negotiating parties represent a "critical mass" of the world economy—a size often mentioned is 80 per cent of world trade. As a criterion based on trade shares is not appropriate in services which are not yet traded as routinely as goods, a better criterion is the output ("value added" in the National Accounts parlance) produced in services. Figure 3 provides the cumulated shares of the output produced in 17 services, based on the OECD normalized Input-Output tables.

Figure 3 presents these data for the 19 largest economies (except Hong Kong, which is missing for the reporting year 2000). These economies can be divided into two groups. The "Top 8" group includes Japan, China, India, Brazil, Russia, Canada, Korea and Mexico. This group represents roughly 80 percent of world production in almost all services. It clearly represents the inner circle of countries to be involved in extended negotiations.[8] As it is a small number of countries, the costs of such an extension appears quite manageable from a negotiating perspective. For a broader view, Figure 3 also presents the "Occasional 9" economies that play a notable role in some services sectors—in particular, Turkey, Taiwan and Australia. This second group could constitute a broader circle of negotiating partners to be involved in extended negotiations in services (for more detail, see Annex 1).

**Figure 3: Shifting to plurilaterals: how many additional countries?**




Source: OECD (2006)
Notes: Total services includes public administration and defence, health and social services, private households services which are not shown separately in Figure 3.

### *The huge benefits of expanding*

Second, what would be the benefits of shifting to plurilateral negotiations for the EC and the United States? Figure 3 shows that the Top 8 and Occasional 9 groups represent a substantial share of the services sectors—it often amounts to an additional market the size of the U.S. or EC for most of the services. Shifting to a plurilateral deal thus expands substantially the size of the markets generating gains for consumers and offering opportunities to firms.

[8] Most countries have reporting year 2000 for the input-output tables. Mexico shows reporting year 2003 and Turkey 1998. However, Mexico largely outperforms Turkey in all economic sectors, hence leaving no doubt about Mexico as a member of the Top 8 group.

What about the level of regulatory constraints of the Top 8 group? As the information is relatively limited, Table 1 presents both the applied and bound regulatory constraints. It shows several key results when focusing on applied regulatory constraints:

- Canadian and Japanese services with substantial barriers represent a similar or larger share of the goods sector (or GDP) than the EC and U.S. corresponding services.
- The level of regulatory constraints in the Top 8 group is often higher than or as high as the EC level.
- As barriers are concentrated in the same services sectors, negotiators could work on deals within broad service sectors as well as deals between broad service sectors.

Table 1 presents also the level of bound regulatory constraints, although it is not directly comparable to the level of applied regulatory constraints. The information is nevertheless interesting because it is available for all the countries of the Top 8 group (except Russia, not yet a WTO Member).

**Table 1: Extending the negotiations to the Top 8 group**

| | Applied Regulatory Constraints | | | | Bound Regulatory Constraints | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | U.S. | EC | Canada | Japan | U.S. | EC | Brazil | Canada | China | India | Japan | Korea | Mexico |
| Business Services | 22 | 36 | 40 | 35 | 38 | 40 | 96 | 50 | 62 | 97 | 56 | 63 | 72 |
| Communication Services | 27 | 27 | 29 | 29 | 29 | 59 | 98 | 52 | 56 | 88 | 55 | 51 | 77 |
| Distribution Services | 32 | 40 | 33 | 58 | 13 | 43 | 74 | 39 | 63 | 100 | 31 | 51 | 48 |
| Construction & Related Engineering | 8 | 9 | 9 | 11 | 31 | 57 | 84 | 29 | 63 | 96 | 56 | 44 | 84 |
| Transport Services | 20 | 35 | 24 | 29 | 70 | 84 | 94 | 70 | 78 | 100 | 77 | 84 | 94 |
| Financial Services | 34 | 31 | 38 | 30 | 48 | 28 | 92 | 37 | 45 | 94 | 38 | 80 | 83 |
| Educational Services | -- | -- | -- | -- | 89 | 43 | 100 | 100 | 58 | 100 | 75 | 100 | 46 |
| Tourism and Travel Related Service | 6 | 8 | 8 | 12 | 13 | 46 | 83 | 34 | 28 | 82 | 54 | 47 | 56 |
| Health and Social Services | -- | -- | -- | -- | 83 | 76 | 100 | 100 | 100 | 94 | 87 | 100 | 64 |
| Real Estate | 3 | 5 | 2 | 3 | -- | -- | -- | -- | -- | -- | -- | -- | -- |
| Renting Machinary | 23 | 40 | 40 | 37 | -- | -- | -- | -- | -- | -- | -- | -- | -- |
| Electricity | 28 | 46 | 53 | 37 | -- | -- | -- | -- | -- | -- | -- | -- | -- |
| Shares of services with a substantial level of restrictions (>30%) | | | | | | | | | | | | | |
| Share of GDP | 20 | 19 | 23 | 24 | 29 | 45 | 34 | 41 | 31 | 38 | 52 | 45 | 52 |
| Share of All Goods | 113 | 82 | 82 | 130 | 164 | 194 | 107 | 149 | 53 | 84 | 285 | 139 | 184 |
| Share of All Services | 25 | 24 | 31 | 29 | 34 | 59 | 49 | 57 | 74 | 71 | 64 | 67 | 73 |

Source: OECD (2008), OECD (2006), World Bank (World Trade Indicators). Authors' calculations.

Notes: For both bound and applied regulatory constraints indicators vary from 0 (markets considered as open) to 100 (markets considered as closed). The EC level of regulatory constraints in services are averages weighted by the output shares of the EC services sectors. All shares are based on output data from the National Accounts (input-output tables) for the year 2000. The share of services covered (last row) is the output of the services for which there is information on the levels of barriers as a share of output in all the services. Note that for Education the share of output in R&D is included following input-output tables.

Table 1 reveals the EC and U.S. clear interest in extending their bilateral talks to the Top 8 group—illustrating the gains to expect from "additive" regionalism (Harrison, Rutherford and Tarr 2002). Such a shift would vastly expand the size of the markets involved in the liberalization package since the Top 8 group represents altogether a market equivalent to between half and double the market size of the EC or U.S., depending on the service sector at stake (Figure 3). And it would also bring down severe impediments to market access since the Top 8 group exhibit relatively high levels of protection (Table 1).

What would then be the interest of each member of the Top 8 group to join such negotiations? First, and foremost, it would be the enormous welfare gains to their own consumers from such a liberalization. Second, it would help sharpen the comparative advantages of emerging services providers in the Top 8 group. Last but not least, not joining the EC-U.S. negotiations would have a high price in the case of services. As services are regulation-intensive, leaving the EC-U.S. negotiators in a *tête-à-tête* would raise the risk that these two largest economies would set international regulatory norms tailored exclusively to their own interests. Such a situation could be costly for late-comers who would not make their voices heard in time. In this crucial respect, negotiations in services are quite different from those in goods where joining later does not generally raise the same high risks in terms of norms and standards.

These dynamic forces that should induce the EC and the U.S. to extend their Transatlantic talks to less than a dozen of countries are essential because they justify the risk of initiating bilateral (Transatlantic) talks. Taking such a risk is necessitated by the current debilitating lack of appetite for WTO negotiations, notably in the United States. But economic analysis shows that sticking to a purely Transatlantic deal would not be optimal: it shows that preferential (bilateral) liberalizations are costly for the negotiating partners because they distort trade flows in an inefficient manner.[9] The dynamic forces pushing for extending the Transatlantic talks to the Top 8 group would therefore considerably reduce the risks of such distortions.

**Box 1: Shifting from bilateral to plurilateral: the case of air transport**

Air transport offers a recent illustration of a beneficial shift from bilateral to plurilateral agreements. The case is all the more interesting because it challenges several preconceptions in

[9] If the barriers imposed by the EC and the U.S. on imports of services from the rest of the world are as high as those they impose on each other's imports (a likely assumption) EC and U.S. services providers can charge high prices in their partner's markets—and they are inclined to do it either by necessity (if they are less efficient than services providers located in the rest of he world) or by lucrative rent-seeking (if they are as efficient). As a result, the EC and U.S. consumers could not get the gains to be expected from more competitive markets. Rather, they will have to *de facto* "subsidize" the inefficient services providers of the trading partner or to pay high rents to the efficient services providers on the other side of the Atlantic. Sometimes, it is argued that the capacity of bilateral agreements in services to be really discriminatory (that is, to open a market to the signatory of the bilateral and to close the same market to all the other countries) is limited. That may be the case (it is a matter of judgment or depends on the circumstances), but it does not eliminate the potential risks described above.

trade policy in services: it consists in an effort of stand-alone liberalization led by a business-based international institution (IATA) in a sector so far impervious to a multilateral framework.

After five years of negotiations (2003-2008), the EC and the U.S. are enforcing their "Open Skies" agreement which has notably increased the level of competition on transatlantic routes. A sense of the improvement is provided by the changes in the airline liberalisation indicators (ALIs, designed by the WTO 2006, 2007). ALIs range from 0 (completely closed markets) to 50 (totally open markets). ALIs on transatlantic routes have increased from a (weighted average) level of 24 prior to the EC-U.S. Open Skies agreement to a level of 32 after it.

In June 2008, the International Air Transport Association's (IATA) Summit resolved to go further in market opening by launching the Istanbul Process (Jomini, Achard and Rupp 2009). Officials from fifteen economies (including Australia, Brazil, Canada, India and Singapore, in addition to the EC and to the U.S.) made proposals for expanding the commercial freedoms of airlines that would increase the ALIs to the level 34 for all the participants to the Process.

Depending on the technical assumptions upon which the calculations are based (for details, see Jomini et al., 2009) the additional number of passengers on the EC-U.S. routes would range from 1.2 to 4.1 millions under the Open Skies agreement alone. Shifting to the plurilateral Istanbul Process would add 0.1 to 0.7 more million passengers on such routes. Including China, Japan and Korea (which are not yet participants in the Istanbul Process) would add roughly 1.6 to 4.9 more million passengers.

## Section 3: Any appetite for negotiations?

Improving market access would offer the new opportunities that services providers need for redesigning their strategies, and the gains that consumers need for coping with an economic crisis that is causing considerable hardship. But, beyond these economic reasons, is there any appetite for such negotiations? Table 2 tries to "reveal" the willingness to negotiate in services by combining two sources of information.

The most recent source is the July 2008 "Signalling Conference" held under the aegis of the Doha Round negotiations. In the course of a day, negotiators from 31 countries (the EC, the U.S. and all the countries of the Top 8 group were present, except Russia) signalled their offers to open domestic services markets, and their requests to get better market access to foreign services. The Conference was unanimously considered a success, many participants showing an unexpectedly strong appetite for negotiating improved market access in services. The Chairman's Report does not give any precise information on the offers and requests and does not even mention the names of the countries specifically interested in each service.

However, it sheds some qualitative light on the intensity and scope of the services to be liberalized among WTO members which is summarized in the two first columns of Table 2.

Column 1 gives a sense of how many participants manifested a serious interest in negotiations during the Signalling Conference. Column 2 focuses on the interest shown for two modes: mode 3 on the right of establishment and mode 4 on the movement of natural persons. These two modes were the most contentious during the Uruguay Round negotiations (WTO Secretariat 2000) and, during the Doha Round negotiations, services providers have repeatedly underlined their crucial role. The two columns reveal a willingness to negotiate, with a high number of participants interested in each service, a high occurrence of offers and requests on mode 3, and even a willingness to include mode 4 (by far, the most contentious aspect of any international negotiation in services because it is often misperceived as a possible source of illegal immigration).

Columns 3 and 4 rely on an older source of information, namely the EC and U.S. offers tabled in 2005 before the Hong Kong WTO Ministerial. These offers were notoriously limited, reflecting the highly uncertain state of negotiations in manufacturing and agriculture at this time. However, even if these offers do not provide adequate information on the magnitude of the offers tabled in 2008, they are useful because they give a first sense of the services in which the EC and the U.S. were already ready to move in 2005. This is particularly the case for the EC offers which tabled notable additional commitments, be it in terms of widening (binding the most recent ECMS at the level of EC 1995 commitments) or deepening (offering new commitments for the EC as a whole in terms on market access or national treatment).[10] The U.S. offers present a less clear picture, with no notable proposals for two-thirds of the services sectors, as shown by column 4. Two reasons explain this situation. First, as noted above, U.S. services tend to be more open on average. Second, in 2005, the U.S. was focusing its efforts on the manufacturing and agricultural negotiations because of its strong offensive interests in agriculture (whereas the EC approach to agriculture was largely dominated by its defensive interests, its offensive farm and food interests having been unable to make their voice heard). Finally, it should be underlined that the market opening moves in

[10] For providing the information in columns 3 and 4, we calculated indicators measuring how much the EC and the U.S. were willing to move (in terms of widening and deepening and for the four modes of supply) for each service listed in their offers (WTO 2005a and 2005b). Weights have been given to each mode of supply by service in order to reflect their relative economic importance when aggregating the various modes. These weights are those used by the World Bank's World Trade Indicators for calculating the bound level regulatory constraints (see Table 1).

columns 3 and 4 do not necessarily occur in the corresponding entire broad sector: they may be observed in some sub-sectors only (see Annex 2).

**Table 2: Revealing the willingness to negotiate**

| Services | Signalling Conference 2008 | | 2005 offers: market opening moves | | Size of sectors (US$ bn) | Crisis resilience |
|---|---|---|---|---|---|---|
| | Nbr WTO Members | GATS mode underlined | EC | US | | |
| | 1 | 2 | 3 | 4 | 5 | 6 |
| Business Services | Virtually all | 4 | yes | no | 4918 | High |
| Communication Services | Substantial | 3 | yes | yes | 737 | High |
| Distribution Services | Substantial | 3 | yes | no | 3809 | -- |
| Environmental Services | Substantial | 3 | some | no | -- | -- |
| Construction & Related Engineering | Substantial | 3 & 4 | some | no | 1715 | High |
| Transport Services | Substantial | 3 | some | some | 1282 | Low |
| Financial Services | Notable | 3 | yes | small | 1770 | Low to High |
| Educational Services | Notable | 3 & 4 | no | yes | 1444 | -- |
| Tourism and Travel Related Services | A few | | yes | no | 774 | Low |
| Health and Social Services | A few | 3 & 4 | no | no | 1483 | -- |
| Recreational, Cultural & Sporting | -- | -- | small | no | 1217 | -- |
| Energy | Substantial | 3 | -- | some | -- | -- |

Source: Columns 1 and 2: TNC Chairman's Report of 30 July 2008; Column 3: WTO (2005a); Column 4: WTO (2005b); Column 5: OECD (2006); Column 6: Mattoo and Borchert (2009).

Notes: Column 1 reports the number of WTO Members having expressed interests in negotiating the service mentioned. The TNC Chairman's Report includes a separate paragraph for audiovisuals, with two WTO Members expressing interest. Column 2 reports the explicit mention of modes 3 and 4 for the service at stake. Columns 3 and 4: see text. Column 5 gives the total size in billions of US$ (PPP) in the U.S., EC and Top 8 group markets by service. Note that Recreational services includes the Personal, Community and other Social sector, while Educational services include R&D services. Column 6 reports the resilience of services to the current economic global crisis as reported by Mattoo and Borchert. Crisis resilience is low in financial services, and high in insurance.

Columns 5 and 6 provide important information from an economic perspective. Column 5 gives the total (U.S., EC and Top 8 group) market size of the services listed in billions of US$ at the purchasing power parity exchange rates. Market sizes are a key factor determining the magnitude of consumers' welfare gains and of firms' opportunities, hence the likelihood and magnitude of the negotiation success. That the size of the agricultural and industrial markets for the ten countries amounts to roughly US$7,900 billion gives a good sense of the size of the market at stake in services.

This willingness to negotiate is confirmed by the collective requests in services tabled in the aftermath of the 2005 Hong Kong Ministerial. Out of the two dozen or so of such requests, seven deal with services matching the sectors of Table A1, making possible to quantify the outputs at stake. First, these seven services (construction, distribution, air transport, financial services, computer services, maritime transport and education) represent a third of the total world output in services. Second, for the five first of these sectors, requests have been tabled by countries representing two third of the world output in the services sector in question (up to 85 percent in computer services) and representing more than half of the world output in maritime transport and 10 percent in (private) education. Third, the U.S. and the EC are involved in all these requests (except the U.S. in transport) while half of the Top 8 countries are also active members of these requests, underlining the "igniting" power of the U.S-EC bilateral and of the plurilateral including the Top 8 countries.

Combining tables 1 and 2 suggests attractive matches between the declared willingness to negotiate and all the economic forces at work. In particular, three services sectors—business services, communications and distribution—emerge as a particularly rich potential source of negotiating successes. This final observation suggests a few conclusions.

**Conclusion: A strategic success**

The total output of the three services—business services, communications and distribution—with a clear willingness to negotiate amounts to US$9 trillion in 2000 in the 10 largest world economies, almost *one-third* of world GDP. This is *larger* than the entire output of agricultural and industrial goods in these 10 countries—meaning that liberalizing these services sectors is a task potentially equivalent to the entirety of the trade liberalization of the past fifty years. Last but not least, these services also show a substantial level of protection among the ten countries (Table 1), substantial opportunities associated to the value of binding (Figure 2), and growth or resilience to the global economic crisis (Table 2).

A significant success in these three broad services between the ten countries in question thus has the capacity to open unexpected opportunities *beyond* these services and the ten countries.

- It could "mellow" the negotiating positions of the ten largest countries in services other than the three sectors mentioned. Such an evolution sheds an interesting light on the issue of "sensitive" services (see Annex 2).
- It would induce other countries to join the group of the ten largest countries. In particular, it could open the door to repatriate, and ultimately plurilateralize or multilateralize such an initiative (with little concern about "free riders") at the World Trade Organization, unlike other bilateral initiatives that are sometimes discussed.

A Transatlantic initiative on services holds out the prospect of considerable gains and opportunities for consumers and producers on both sides of the Atlantic at a time of considerable economic challenges. "Leading with Services" is also a winning strategy for concluding the Doha Round, given the magnitude of the economic gains that could be unleashed. Services could effectively be put in the driving seat of the WTO negotiations, where they belong, and not held hostage to agriculture and manufacturing, which is a major reason for the defensive tactics that have plagued the talks for years. The United States and the EC have the power of initiative in this regard. Together, they should take it.

## Annex 1: “Top 8” and “Occasional 9” Groups

### Table A1: Shifting to plurilaterals: how many additional countries?

| | | Total Value Added (GDP) | Total Goods | Total Services (a) | Total Services (b) | 26 Electricity | 27 Gas | 28 Steam and hot water supply | 29 Collection and distribution of water | 30 Construction | 31 Wholesale & retail trade; repairs | 32 Hotels & restaurants | 33 Land transport; transport via pipelines | 34 Water transport | 35 Air transport | 36 Supporting and auxiliary transport activities | 37 Post & telecommunications | 38 Finance & insurance | 39 Real estate activities | 40 Renting of machinery & equipment | 41 Computer & related activities | 42 Research & development | 43 Other Business Activities | 44 Public admin. & defence; compulsory social security | 45 Education (c) | 46 Health & social work | 47 Other community, social & personal services | 48 Private households & extra-territorial organisations |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Transatlantic | USA | 26,0 | 17,3 | 29,1 | 27,5 | 24,6 | | | | 20,5 | 26,4 | 27,2 | 18,4 | 11,0 | 40,3 | 8,7 | 29,6 | 33,1 | 31,3 | 32,8 | 34,9 | 67,4 | 18,6 | 40,1 | 7,0 | 33,4 | 42,7 | |
| | EU19 | 23,8 | 20,6 | 25,0 | 24,6 | 20,1 | 6,5 | 39,4 | 33,9 | 23,8 | 22,3 | 29,0 | 19,8 | 29,3 | 25,3 | 46,9 | 23,2 | 19,3 | 26,3 | 26,8 | 31,3 | 7,6 | 38,6 | 19,8 | 38,7 | 30,8 | 22,2 | 41,5 |
| Top 8 (d) | Japan | 7,6 | 5,2 | 8,5 | 8,8 | 6,4 | 17,9 | 18,3 | 16,2 | 9,5 | 8,9 | 8,8 | 7,9 | 14,1 | 4,0 | 10,6 | 8,2 | 7,0 | 9,7 | 14,9 | 10,1 | 8,1 | 7,7 | 5,6 | 11,1 | 8,7 | 8,7 | 4,7 |
| | China | 7,4 | 16,0 | 4,2 | 5,0 | 13,9 | | | 13,0 | 8,4 | 4,0 | 5,3 | 9,1 | | | | 6,5 | 5,2 | 1,6 | | | | 7,4 | 2,6 | 5,2 | 1,2 | | 0,5 |
| | India | 3,5 | 6,0 | 2,6 | 2,7 | 4,0 | 4,7 | | 4,6 | 3,6 | 3,6 | 1,3 | 5,5 | 5,9 | 1,2 | 1,4 | 2,2 | 3,6 | 1,6 | | 2,2 | | 0,3 | 2,8 | 4,8 | 0,9 | 1,8 | |
| | Mexico | 2,8 | 2,9 | 2,7 | 2,9 | 1,5 | 6,3 | | | 3,2 | 3,5 | 3,2 | 5,4 | 1,0 | 1,2 | 2,9 | 3,0 | 1,2 | 3,0 | 2,5 | 0,1 | | 4,0 | 1,5 | 4,8 | 1,8 | 1,3 | 5,0 |
| | Brazil | 2,7 | 3,2 | 2,5 | 2,4 | 3,4 | 4,8 | | 5,5 | 4,1 | 1,5 | 1,8 | 1,3 | 0,7 | 2,2 | 2,8 | 2,9 | 2,4 | 3,6 | 0,3 | 1,1 | | 1,5 | 5,5 | 2,1 | 0,6 | 1,1 | 8,8 |
| | Russia | 2,6 | 3,3 | 2,3 | 2,8 | 3,5 | 30,2 | | | 3,1 | 6,3 | | 7,7 | | | | | 2,7 | | | | 2,0 | 0,3 | | | 2,7 | 1,8 | |
| | Canada | 2,1 | 2,2 | 2,1 | 2,2 | 2,4 | 6,8 | | | 1,9 | 2,3 | 2,0 | 1,9 | 1,3 | 2,7 | 2,3 | 2,2 | 2,2 | 2,6 | 1,9 | 2,3 | | 2,7 | 2,0 | 3,3 | 1,1 | 1,7 | 1,7 |
| | Korea | 1,9 | 2,3 | 1,8 | 1,9 | 1,9 | 3,9 | 23,1 | 2,6 | 2,5 | 1,2 | 2,0 | 1,5 | 2,6 | 1,7 | 2,6 | 2,6 | 2,4 | 2,1 | 2,3 | 0,2 | 1,8 | 2,1 | 1,3 | 2,8 | 1,6 | 0,7 | 1,9 |
| Occasional 9 | Turkey | 1,4 | 1,9 | 1,2 | 1,3 | 1,3 | 1,4 | | 3,2 | 1,8 | 1,7 | 1,6 | 3,9 | 4,9 | 2,4 | 1,4 | 1,1 | 1,6 | 0,0 | 0,0 | 0,2 | 0,0 | 0,5 | 1,5 | 0,2 | 0,4 | 0,5 | 14,2 |
| | Indonesia | 1,3 | 2,6 | | | | | 5,8 | | | | 1,5 | | 4,7 | | 1,4 | | | | 0,5 | | 0,4 | | | | | | 0,6 |
| | Taiwan | 1,1 | | | | | | 1,1 | | | 1,4 | | | 3,4 | 1,9 | | 1,3 | 1,6 | 1,3 | 0,4 | 0,9 | 0,5 | 0,6 | | 1,8 | 0,7 | 1,1 | 2,9 |
| | Australia | 1,0 | | | | | 2,5 | | 3,5 | 1,1 | | | | | 2,7 | 3,0 | 1,4 | | 1,5 | | 2,1 | | 1,1 | | 1,7 | 1,2 | 1,3 | |
| | Argentina | 0,7 | | | | | 2,0 | | 1,2 | | | | | | | | | | | | | | 0,7 | | 1,1 | 0,6 | 1,0 | 4,3 |
| | S-Africa | 0,7 | | | | | | | 1,3 | | | | 1,4 | | | | | | | | | | | 1,4 | | | | |
| | Switzerland | 0,6 | | | | | | | | | | | | | | | | | | 5,0 | 0,9 | 0,1 | | | | 0,7 | | 1,5 |
| | Norway | 0,4 | | | | | | | | | | | | 4,7 | | | | | | | | 0,1 | | | | | | |
| | Israel | 0,2 | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Summary | Transatlantic | 49,8 | 37,9 | 54,1 | 52,1 | 44,8 | 6,5 | 39,4 | 33,9 | 44,3 | 48,7 | 56,2 | 38,2 | 40,3 | 65,6 | 55,6 | 52,8 | 52,4 | 57,5 | 59,6 | 66,2 | 75,0 | 57,2 | 59,9 | 45,6 | 64,2 | 65,0 | 41,5 |
| | Top 8 | 30,6 | 41,1 | 26,8 | 28,7 | 37,0 | 74,6 | 41,5 | 41,8 | 36,4 | 31,4 | 24,4 | 40,3 | 25,6 | 12,9 | 22,6 | 27,6 | 26,7 | 24,3 | 22,0 | 16,0 | 11,9 | 26,1 | 21,3 | 34,3 | 18,5 | 17,2 | 22,6 |
| | Occ 9 | 7,4 | 4,5 | 1,2 | 1,3 | 1,3 | 5,9 | 7,0 | 9,3 | 3,0 | 3,1 | 3,0 | 5,3 | 17,7 | 7,0 | 5,8 | 3,8 | 3,2 | 2,8 | 6,0 | 4,2 | 1,2 | 3,0 | 2,9 | 4,7 | 3,6 | 3,8 | 23,6 |

Source: OECD (2006).

Notes: (a) This column shows the widest definition of services (codes 26 to 48). (b) This column shows a narrower definition (codes 26 to 43 and 45, hence excluding the following services: Public administration and defence; Compulsory social security; Other community, social & personal services; Health & social work; Private households with employed persons & extra-territorial organisations & bodies. (c) Note that many U.S. educational services are included in Research and Development services. (d) The Top 8 economies are the largest economies in terms of GDP, ranked by decreasing order. (e) The 9 Occasional economies are the subsequent largest economies in terms of GDP, ranked by decreasing order.

## Annex 2. About "sensitive" services

Bitter fights over "sensitive" sectors can threaten large-scale trade negotiations, as illustrated by the fierce French opposition to the inclusion of the audiovisual sector during the Uruguay Round negotiations, or the similarly adamant U.S. opposition on gambling services in a recent dispute settlement case. Could the negotiations described above fall victim to a similar such situation?

Despite the heated rhetoric, the notion of "sensitive" sectors appears rather elusive, as illustrated by audiovisuals and gambling. In both cases, the issues have been sensitive internally at least as much as externally. Most ECMS did not share the French views on audiovisuals during the Uruguay Round, and many U.S. states wondered why the U.S. federal government spent so much negotiating capital for defending the interests of few U.S. states. In addition, over time, apparently intractable conflicts have been dissolved by technological progress and new strategies on the part of the major firms involved. For instance, in the late 1990s, U.S. audiovisual firms have been highly supportive of French efforts to fight digital piracy of movies. More recently, ECMS have increasingly made their audiovisual subsidies available to U.S. filmmakers—and this move includes France (under the form of a tax break yet to be enforced).

The audiovisual example gives an important lesson. If opening audiovisual markets is still not on the EC agenda, there is a slow, but very substantial, erosion of the barriers on an ECMS basis, with quiet bilateral negotiations in "WTO-parallel" bilaterals. A similar conclusion is suggested by the air transport case (see Box 1 above) which shows a sector traditionally impervious to multilateral negotiations being attracted by a "WTO-parallel" plurilateral shaped by the services providers themselves.

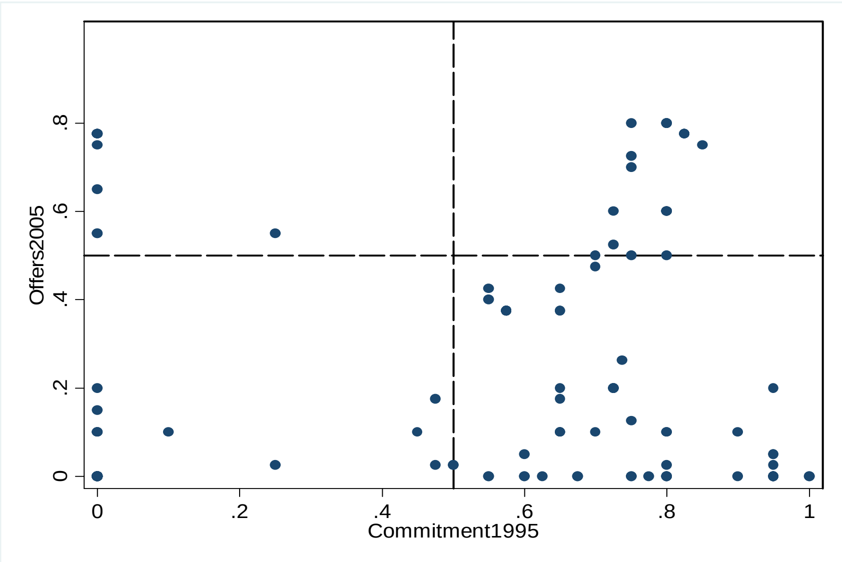
In sum, the notion of "economic fundamentals" strong enough to determine intrinsically "sensitive" services looks questionable. Sensitivity seems more a product of the existence, at a specific time, of aggressive coalitions on both sides of the border. If correct, this view suggests a continuum of services with, at one end of the range, clear candidates for mutual concessions in a multilateral framework and, at the other end, increasingly unlikely candidates. Such a continuum is relatively fluid in two ways. First, the dynamics of the negotiations on the clear candidates can be strong enough to engulf initially unlikely candidates within the reach of the final agreement. Second, sectors which remain "sensitive" in the multilateral forum may not be sensitive in other fora, such as WTO-parallel bilaterals or plurilaterals.

In light of this lesson, what follows aims at giving a sense of the relative degree of sensitivity (from low to high) among EC services (the EC being richer in terms of information). It relies on the assumption that relative sensitivity depends less on economic fundamentals than on the capacity of the representatives of the services providers to capture or to miss the economic opportunities brought by trade liberalization. In this context, combining the information on the EC 1995 commitments and on what the EC was willing to offer in 2005 (in short, the EC 2005 offers) for each of the 150 service sub-sectors of the GATS nomenclature allows to define four main situations in Figure A2.

- 24 services (North-East quadrant) are more open than the EC average entire service sector both in 1995 and in 2005. These services are clearly at the forefront of EC service liberalization.

- 64 services (South-East quadrant) are more open than the EC average entire service sector in 1995, but less open than the average in 2005. This situation is harder to interpret: there is little left to liberalize, or there is a slowdown in market opening.
- 13 services (North-West quadrant) are less open than the EC average entire service sector in 1995 and more open than the average in 2005. This is a very interesting case: these services could have been considered as sensitive in 1995, but they are at the forefront of the EC services liberalization ten years later.
- 49 services (South-West quadrant) are less open than the EC average entire service sector both in 1995 and in 2005. These services could be considered as potential "hard core" sensitive sectors.

**Figure A2: EC Service Sub-sectors: Commitments in 1995 and Offers in 2005**




Source: Hoekman (1995), WTO (2005a). Authors' calculations.

Notes: Data for commitments 1995 are drawn from Hoekman (1995). Calculations for the indicators on the EC 2005 offers are explained in footnote 10. Both indicators take into account market access and national treatment and apply similar weights across modes of supply for each services sector. Each indicator ranges from 0 (unbound or no commitment) to 1 (completely liberalized). Note that one point in figure A2 may represent several sub-sectors that exhibit the same indicators.

Table A2 aims at shedding some additional light based on more detailed information. In particular, column 1 presents the 49 services located in the South-West quadrant, that is, those which could include the potential "hard core" sensitive sectors. It suggests that:

- Multilateral negotiations (be they WTO-based or not) seem of little relevance for 13 services, namely inland waterways, rail and road transports because all these services are largely regional by nature, at least viewed from the EC (as a whole) perspective.
- Out of the remaining 36 services, it has already been mentioned that nine are under "WTO-parallel" bilaterals (the six audiovisual services) or plurilateral (three out of the five air transport).

That leaves open the question of the relative sensitivity of the remaining 27 services—a small percentage (less than one-fifth) of the services universe (150 sub-sectors). Examining in more detail these services would be very interesting, but is beyond the scope of this note.

**Table A2. Ranking EC services by likelihood of sensitivity**

| | | South West | South East | North West | North East | Total |
|---|---|---|---|---|---|---|
| | | 1 | 2 | 3 | 4 | 5 |
| 1. Business services | A. Professional Services | | 10 | | | 10 |
| | B. Computer and Related Services | | | | 5 | 5 |
| | C. Research and Development Services | 2 | | | 1 | 3 |
| | D. Real State Services | | 2 | | | 2 |
| | E. Rental/Leasing Services without Operators | 1 | 4 | | | 5 |
| | F. Other Business Services | 2 | 10 | 1 | 7 | 20 |
| 2. Communication services | A. Postal Services | | | 1 | | 1 |
| | B. Courrier Services | | | 1 | | 1 |
| | C. Telecommunication Services | | | 8 | 7 | 15 |
| | D. Audiovisual Services | 6 | | | | 6 |
| 3. Construction & related engineering services | A. General Construction Work for Buildings | | 1 | | | 1 |
| | B. General Construction Work for Civil Engineerin | 1 | | | | 1 |
| | C. Installation and Assembly Work | 1 | | | | 1 |
| | D. Building Completion and Finishing Work | 1 | | | | 1 |
| 4. Distribution services | A. Comission Agent's Services | | | | 1 | 1 |
| | B. Wholesale Trade Services | | | | 1 | 1 |
| | C. Retailing Services | | | | 1 | 1 |
| | D. Franchising | | 1 | | | 1 |
| 5. Educational services | A. Primary Education Services | | 1 | | | 1 |
| | B. Secondary Education Services | | 1 | | | 1 |
| | C. Higher Education Services | | 1 | | | 1 |
| | D. Adult Education | | 1 | | | 1 |
| 6. Environmental services | A. Sewage Services | | 1 | | | 1 |
| | B. Refuse Disposal Services | | 1 | | | 1 |
| | C. Sanitation and Similar Services | | 1 | | | 1 |
| 7. Financial services | A. All Insurance and Insurance-related Services | 1 | 3 | | | 4 |
| | B. Banking and Other Financial Services (Excl. ins | 6 | 12 | | | 18 |
| 8. Health related & social services | A. Hospital Services | | 1 | | | 1 |
| | B. Other Human Health Services | 1 | | | | 1 |
| | C. Social Services | | 1 | | | 1 |
| 9. Tourism & travel related services | A. Hotels and Restaurants (Incl. Catering) | | 1 | | | 1 |
| | B. Travel Agencies and Tour Operators Services | | | | 1 | 1 |
| | C. Tourist guides services | | 1 | | | 1 |
| 10. Recreational, cultural & sporting services | A. Entertainment Services (incl. theatre, live bands | 1 | | | | 1 |
| | B. News Agency Services | | 1 | | | 1 |
| | C. Libraries, Archives, Museums and Other Cultur | 1 | | | | 1 |
| | D. Sporting and other recreational services | | 1 | | | 1 |
| 11. Transport services | A. Maritime Transport Services | 3 | 1 | 2 | | 6 |
| | B. International Waterways Transport | 6 | | | | 6 |
| | C. Air Transport Services | 3 | 2 | | | 5 |
| | D. Space Transport | 1 | | | | 1 |
| | E. Rail Transport Services | 4 | 1 | | | 5 |
| | F. Road Transport Services | 3 | 2 | | | 5 |
| | G. Pipeline Transport | 2 | | | | 2 |
| | H. Services Auxiliary to all Modes of Transport | 2 | 2 | | | 4 |
| | I. Other Transport Services | 1 | | | | 1 |
| All services | | 49 | 64 | 13 | 24 | 150 |

Source: Hoekman (1995), WTO (2005a). Authors' calculations.

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