Patrick Messerlin, Eric van der Marel

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PATRICK MESSERLIN
ERIK VAN DER MAREL

G | M | F The German Marshall Fund of the United States
STRENGTHENING TRANSATLANTIC COOPERATION

The German Marshall Fund of the United States
1744 R Street, NW
Washington, DC 20009
T 1 202 683 2650
F 1 202 265 1662
E info@gmfus.org

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The Dynamics of Transatlantic Negotiations in Services

Economic Policy Paper Series

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By Patrick Messerlin and Erik van der Marel[1]

[1] Groupe d'Economie Mondiale at Sciences Po (GEM): http://gem.sciences-po.fr. This text is an updated version of a document published in July 2009. We are grateful to Jennifer Hillman, Joe Guinan, Alejandro Jara, and Bruce Stokes for extremely useful comments and discussions.

Executive Summary

Tough times are expected in the year(s) to come, but focusing entirely on public and private budget cuts is not a politically sustainable policy. On top of its direct impoverishing impact, austerity has an indirect impact, which is very corrosive in the long run for consumers. It induces producers of goods and services to retreat to their home markets, reducing the level of competition in the markets they left behind.

There is thus an urgent need to build a pro-growth agenda, for which the services sector is the best candidate, since it accounts for 60-70 percent of the G20 GDP. Such an agenda means reforms: in order to take the right decisions when redesigning their strategies, service providers need clarity and predictability on how their markets will operate. History shows that introducing pro-growth domestic reforms is hugely bolstered by opening — or reopening — domestic markets to foreign competitors.

This is why a "sleeping" Doha is not a reason for not starting negotiations *now* on how to improve market access in services. This paper argues that the two largest world economies, the United States and the EU, should launch bilateral negotiations on services. The expected gains for consumers and the opportunities for service providers are huge in both sides of the Atlantic because their services sectors are likewise huge and because the protection still prevailing in many services areas is still high. Potential gains come from three sources:

- cutting the currently applied barriers on market entry;
- lowering the U.S. and EU bound commitments on services liberalization dating from the Uruguay Round to the level of the (much) lower barriers actually in force today, a source of invaluable certainty in a crisis plagued by so much uncertainty; and
- "defragmenting" the EU internal market by opening the markets of the most protectionist EU Member States to competition from the United States *and* from the other EU Member States — and vice-versa for the U.S. "internal market."

In this context, this paper gives a sense of the services for which some "willingness to negotiate" could be targeted for moving ahead.

Transatlantic negotiations on services are likely to generate dynamics that will go beyond the United States and the EU. It would be relatively costless and highly beneficial to extend these talks to roughly 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 because these eight additional countries have a service sector equal to the size of the EU or U.S. markets, with a level of protection similar or higher.

These powerful dynamics justify the complications inherent in extending bilateral transatlantic services negotiations to include a limited number of other countries because such a move would reduce the risk of distortions that a purely transatlantic deal would create, and because, ultimately, such an initiative would open the door to multilateral negotiations in services when the time comes.

The United States and the EU are the "obvious" candidates to launch a liberalization process. This may not be necessarily the case, however. Alternatives are emerging from transpacific initiatives in services to East-Asia initiatives to

Asia-Europe initiatives. All these options share one common feature: as soon as one of these dialogs takes off, dynamic forces will induce the nonparticipating largest economies to join the ongoing talks. In other words, the starting point of the whole negotiating process may be different, but the dynamic effects will be the same. This is not so surprising. After all, it echoes very well the history of the last two centuries of international trade liberalization.

Introduction

The world economy is at a critical juncture. On the one hand, the persistent crisis is taking a growing toll on consumers and producers. Public and private budget cuts are generating impoverished consumers. Moreover, these cuts have a very corrosive and too much neglected, long-term impact: they induce producers of goods and services to retreat to their home markets, reducing the level of competition in many markets to the detriment of consumers, and generating *de facto* a creeping "de-globalization."

On the other hand, the United States and the EU give no sign of adopting the much needed pro-growth agenda that would counter-balance the recessionary effects of the budget cuts and make them more politically sustainable. This silence may be due to the fact that such an agenda means reforms — a perspective that petrifies current politicians. But, if producers and service providers want to take the right decisions when redesigning their strategies, they need clarity and predictability on how their markets will operate in the future.

The best candidates for a pro-growth agenda are services, if only because they account for almost 70 percent of the GDP of the G20 countries. As history shows, pro-growth domestic reforms are both buttressed and boosted by opening — or reopening — domestic markets to foreign competitors. The fact that the Doha Round is not an option for several years to come should not be an excuse for inertia: not opening domestic markets to foreign competitors would run the risk of stalling the implementation of domestic reform agendas.

As a result, there is an urgent need to start international negotiations in services that would give service providers the new and clear market opportunities they need to grow their businesses. The firms that have used this crisis to get in better shape will grab these opportunities, in particular in the services sectors that have been resilient during the three last years, such as computer-related services, telecommunications, and insurance (Mattoo and Borchert 2009).

This paper explores the costs and benefits of transatlantic talks on services liberalization. As the United States and the EU are still the largest markets in services — though probably for no more than a decade or two more — it makes sense to start with transatlantic negotiations. This paper then reveals the powerful dynamics of such talks by showing that it would be relatively cost-free and highly beneficial to extend these talks to roughly eight countries, hence to cover 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 to service providers. Ultimately, the results of such extended talks could then be reinjected into multilateral negotiations when the time comes.

1 Transatlantic Talks: Internal Negotiating Dynamics

Would transatlantic negotiations on services liberalization raise enough interest among the U.S. and EU service providers? Yes, for three reasons:

- They will cut the currently relatively high level of applied barriers that still prevail in many services sectors,
- They will increase certainty — a crucial tool for fighting crises — in other services by lowering the barriers that were bound fifteen years ago by the United States and EU in the Uruguay Round to the (much) lower level of barriers that the United States and EU currently apply,
- They will "defragment" the U.S. and EU internal markets that remain fragmented because most regulations in services are designed *and* implemented by the U.S. states (USSs) or by the EU Member States (EUMSs).

The fact that there are three sources of gains suggests the existence of strong potential internal (in the United States and in the EU) negotiating dynamics at work. This section provides some sense of the relative magnitude of these three sources of gains.

Cutting Applied Protection

A first source of gains for consumers and opportunities for service providers consists of reducing or cutting the currently *applied* barriers to trade in services. A sense of the magnitude of the applied barriers imposed by the EU and the United States is provided by the internationally comparable OECD Product Market Regulation (PMR) indicators (OECD 2011). PMR indicators measure the degree to which competition is inhibited or distorted by regulatory barriers, such as legal and administrative barriers to entrepreneurship, state control of business enterprises, sector-specific anti-competitive regulations, etc.

Table 1 presents the available PMR indicators of the EU and U.S. regulatory barriers in key services for the years 2003 and 2007 (the last year for which there are available data). The indicators range from 0 to 100, with 0 indicating a completely open market and 100 a completely closed market.[1] It should be stressed that the PMR indicators are not equivalent to tariffs: they are mere estimates of the existing regulatory barriers in the service sectors covered.

Table 1 provides four key results:

- There are clearly two groups of services, one still substantially protected and one with low or moderate regulatory barriers.
- The range of services with a substantial level of protection (PMRs equal to or higher than 20) is almost the same on both sides of the Atlantic. This feature is important because it allows negotiators to work on deals within services as well as between services. Exchanging concessions on services pertaining to the same broad service sector is usually seen as much easier than exchanging concessions involving two different broad service sectors.
- If one looks at average protection, U.S. services look less protected than EU services, though not by much.
- This difference between the U.S. and EU level of protection has decreased between 2003 and 2007, mirroring unilateral liberalization measures taken by the EU — in fact mostly by the EUMS, as shown below.

[1] The initial range of the PMR indicators used 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 services with PMR indicators shown in Table 1 represent two-thirds of the entire U.S. and EU service sectors.

Table 1: Applied regulatory barriers in U.S. and EU selected services (2003 and 2007)

	Level of applied regulatory barriers (PMR indicators)										
	Electricity	Construction	Distribution	Tourism	Transport	Post & telecoms	Financial services	Real estate activities	Renting of machinery	Professional & Business Services	All services
	1	2	3	4	5	6	7	8	9	10	11
2007											
United States	30.6	4.7	22.4	4.2	19.5	19.2	25.3	2.6	17.0	14.9	16.0
EU-14 [a]	23.5	7.0	29.3	6.3	24.1	19.5	22.1	3.0	24.6	23.9	18.3
EU-18 [b]	23.5	7.2	27.6	7.0	24.0	20.9	25.7	3.4	25.7	25.0	19.0
2003											
United States	38.3	4.7	22.5	4.3	19.5	19.6	25.3	2.7	17.0	15.0	16.9
EU-14 [a]	31.7	7.5	29.8	6.8	29.2	23.9	22.4	3.1	25.0	24.3	20.4
EU-18 [b]	31.7	7.9	28.5	7.8	30.7	25.1	26.1	3.8	26.2	25.6	21.3

Sources: OECD (2011). Authors' calculations.

Notes: PMR indicators vary from 0 (markets considered as open) to 100 (markets considered as closed). [a] Simple average of the PMR indicators for 18 EUMS, including four Central European EU Member States. [b] Simple average of the PMR excluding the four Central European EU Member States.

This picture offers two important lessons in political terms. First, it suggests that the United States has a clear interest in transatlantic talks (it will gain by more open EU markets), a feature that would hopefully counter-balance the current negative political mood on trade matters among some in the U.S. Congress.

Second, a more protected EU could be seen as more hesitant to open services markets than the United States. However, two powerful forces will counterbalance the possible EU hesitations. The economic gains for consumers from reducing or eliminating regulatory barriers will be greater in the EU than in the United States (the EU barriers being higher than the U.S. ones). Indeed, achieving such gains drove the unilateral EU liberalization between 2003 and 2007, and such a motive could be stronger in a crisis period characterized by a growing number of impoverished consumers. Also, what follows shows that the two other benefits that can be drawn from transatlantic negotiations — cutting bound protection and "defragmenting" the internal market — are particularly strong in the EU's case.

Cutting Bound Protection

Bound regulatory barriers are those defined by the commitments taken in the WTO by countries. They are the only ones enjoying legal force. *Applied* regulatory barriers can be lower (but not higher) than the corresponding bound barriers. Indeed, as most EU and U.S. commitments in services date from the conclusion of the Uruguay Round in 1995, the EU and the United States have had ample time to adopt and to apply (much) lower regulatory barriers — all the more because these two large and complex economies rely on federal or quasi-federal political structures allowing their member states to adopt more or less open regulations and to implement them in a more or less open manner.

When applied barriers are lower than bound barriers, trade liberalization offers a second — often neglected — source of gains for consumers and opportunities for service providers: lowering the *bound* regulatory barriers to their *applied* level eliminates the so-called "water in protection" in services.[2] Water in protection looks innocuous. It is not. It is highly toxic, particularly in a crisis period, because differences between applied and bound rates allow governments to resort to higher protection that can be:

- fast since there is no fear of breaching WTO obligations, hence of being obliged to compensate or to face retaliations as long as, once increased, the applied level of protection remains lower or equal to the bound level;
- huge in the sectors where bound protection is much higher than applied protection; and
- widely spread since there are many large sectors with water in protection.

The recent months have made some parts of the business community aware of the high costs associated with the uncertainty generated by water in protection in the industrial sector.[3]

The "value of binding" — cutting bound barriers to their applied levels, hence to ban the possibility of reversals — is thus a second source of gains from the transatlantic negotiations in services. Table 2 gives a crude sense of the magnitude of water in protection in the EU services. It provides this information only for the EU simply because there are no equivalent available data for the USSs. However, evidence from U.S. GATS commitments (with their USS-specific exceptions in insurance, financial and legal services and, to a lesser extent, engineering, accounting and bookkeeping, and, more indirectly, in public procurement) and from the business community itself suggests that similar water in protection in services also exists within the United States.

Table 2 provides the highest and lowest PMR indicators for the 18 EUMS covered by the OECD study for the years 2003 and 2007. It gives a sense of the value of binding if one assumes that the applied PMR for the most protected EUMS is close to the level of protection in this service that the EU has bound under the Uruguay Round — a reasonable proposition. Two estimates of the value of binding can be calculated for each service sector:

- the difference between the highest and lowest PMR in 2007; and
- the difference between the highest PMR in 2003 and the lowest one in 2007.

[2] 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).

[3] For more detail on such costs, see Messerlin (2007, 2008), Bouët and Laborde (2008), Achard, Rupp and Jomini (2008), Productivity Commission (2010), OECD-WTO UNCTAD Report (2011).

Table 2: The value of binding: water in protection across EUMS, 2003 and 2007

	PMR 2003		PMR 2007		Value of binding in 2007 based on	
	Highest EUMS	Lowest EUMS	Highest EUMS	Lowest EUMS	2003	2007
Electricity	60.0	0.0	41.7	0.0	60.0	41.7
Construction	12.8	4.0	12.2	3.6	9.2	8.6
Distribution	41.5	13.0	40.9	12.7	28.8	28.2
Tourism	16.5	3.8	13.2	3.4	13.1	9.8
Transport	55.8	11.2	43.8	9.1	46.7	34.7
Post & telecoms	32.6	15.8	27.8	12.0	20.6	15.8
Financial services	46.8	10.9	45.9	10.5	36.3	35.4
Real estate activities	9.5	1.6	7.6	1.5	8.0	6.1
Renting of machinery	42.4	10.9	42.0	10.5	31.9	31.5
Prof. & business services	41.3	10.4	40.8	10.0	31.3	30.9

Sources: OECD (2011). Authors' calculations.

Notes: The value of binding is defined as (i) the difference between the highest and lowest PMR in 2007, or as (ii) the difference between the 2003 highest PMR and the 2007 lowest PMR. The highest PMR are taken as proxies of the bound regulatory protection. The proposition that the 2003 highest PMR is the closest from the Uruguay Round bound level of protection seems reasonable. [a] These two services are among the best candidates for liberalization negotiations according to the signaling exercise (see Section 3).

The second estimate captures the unilateral liberalization undertaken by the various EUMS since the Uruguay Round. Indeed, the wide range of PMR within the EU strongly suggests that such liberalizations remain largely driven by individual EUMS decisions.

Table 2 suggests four main observations on the value of binding (remembering that PMRs are mere indicators, not tariff-like figures):

- It is huge in absolute terms for the most protected services, even if one values water in protection on the basis of the 2007 PMRs.
- It is huge in relative terms for the most open services.
- It has increased substantially between 2003 and 2007, reflecting EUMSs' unilateral liberalizations.
- It is high for those services that the WTO's 2008 signaling exercise has suggested as best candidates for negotiations: business services, communication services, and distribution (see Section 3 below).

In short, reducing or eliminating water in protection in the EU and in the United States would therefore provide large opportunities to U.S. and EU service providers and huge benefits to their consumers.

"Defragmenting" the EU and U.S. Internal Services Markets: Internal Negotiating Dynamics

The approach in terms of water in protection reveals a third source of benefits from opening markets that is also largely ignored. Table 3 presents the same information as Table 2, but it specifies the EUMS with the highest PMR, the EUMS among the four largest EUMS with the highest PMR, the number of EUMSs having a PMR within the range of the two previous PMRs, and the EUMS with the lowest PMR. The information on the large EUMS and on the number of EUMSs having a PMR within the range of the two previous PMRs is key for having a sense of the political weight of EUMS vested interests opposed to liberalization.

Table 3 reveals how much the "EU internal market" for any service covered is "fragmented," a point confirmed by a rigorous analysis (Miroudot and Shepherd 2011). If it were possible for U.S. firms to export their services from a relatively open EUMS to the most protected EUMSs, then U.S. service providers would establish their activities in the most open EUMS and operate from it toward the most protected ones (the rest of the EU). In such a case, keeping high barriers would make little

Table 3. Fragmented internal markets: the EU case (2007)

	A: Highest PMR		B: Highest PMR in large EUMSs [a]		Number of EUMS between the A and B	C: Lowest PMR	
	PMR	EUMS	PMR	EUMS		PMR	EUMS
Electricity [c]	41.7	Sweden	33.2	France	3	0.0	Britain
Construction	12.2	Belgium	10.0	Italy	0	3.6	Sweden
Distribution [d]	40.9	France	40.9	France	0	12.7	Sweden
Tourism	13.2	Slovakia	7.6	Italy	3	3.4	Sweden
Transport	43.8	Greece	28.9	Italy	3	9.1	Denmark
Post & telecoms	27.8	Slovakia	24.2	France	2	12.0	Netherlands
Financial services	45.9	Slovakia	29.4	Italy	2	10.5	Ireland
Real estate	7.6	Poland	4.3	Germany	3	1.5	Greece
Renting of machinery	42.0	Austria	39.2	Germany	0	10.5	Sweden
Prof. & business services [d]	40.8	Austria	38.5	Germany	0	10.0	Sweden

Source: OECD (2011). Notes: [a] The "large" EUMSs are Britain, France, Germany and Italy. [b] Number of EUMSs with a PMR within the range of PMRs in the two previous columns. [c] No PMRs are available for the Central European EUMSs. [d] These two services are among the best candidates for liberalization negotiations according to the 2008 WTO signaling exercise (see below section 3).

sense for the most protected EUMS. The survival of high PMR across EUMS is thus the sign that the EU internal market remains very fragmented. Of course, the same story could probably be told for the United States, the only question being whether the range of the value of binding among the USSs would be similar or lower than the one among the EUMS.

This observation has a crucial consequence in terms of transatlantic negotiating dynamics. It implies that U.S. service providers *and* the service providers from the most open EUMS have converging interests: to build a coalition for opening the markets of the most protected EUMSs. As once again a symmetrical story is likely to prevail in the United States, transatlantic negotiations in services could thus trigger very interesting coalitions between the most open USSs and EUMSs against the most protected USSs and EUMSs on both sides of the Atlantic in every service with significant water in protection (in relative terms). Such coalitions have the power to deliver substantial deals.

In fact, such a "defragmenting" motive for transatlantic talks is not a new story. It was already at work in the EU during the Kennedy Round. In the early 1960s, the most protected EUMSs became reluctant to reduce their highest tariffs to the (much) lower level of the Common External Tariff. Improved market access to the United States and to other GATT industrial country members was attractive enough for these reluctant EUMS to implement the Common External Tariff.

Negative Lists and Ratchet Provisions

These balanced potential gains from liberalization favor the introduction of two negotiating devices that would strengthen the quality of the services agreements from both a static and a dynamic dimension.

First, potential balanced gains make easier the use of "negative lists" that name only the services to be exempted from the disciplines of the agreement. Such a device offers a much clearer view of what is effectively liberalized — everything except what is listed as nonliberalized at the signature of the agreement. This is the static dimension. This is in sharp contrast with "positive lists" that name the services to be liberalized. Positive lists often require that service providers have a deep knowledge of what has not been liberalized but is crucial for taking advantage of the agreed liberalization measure. As a result, positive lists impose high costs on newcomers and tend to considerably weaken the pro-competitive effect of the liberalization measures.

Second, potential balanced gains also make easier the introduction of ratchet provisions that would specify the conditions locking in any new liberalization measure so that this measure could not be revoked or nullified over time, be it in part or in totality. This is the dynamic dimension.

2 Expanding Transatlantic Talks: External Negotiating Dynamics

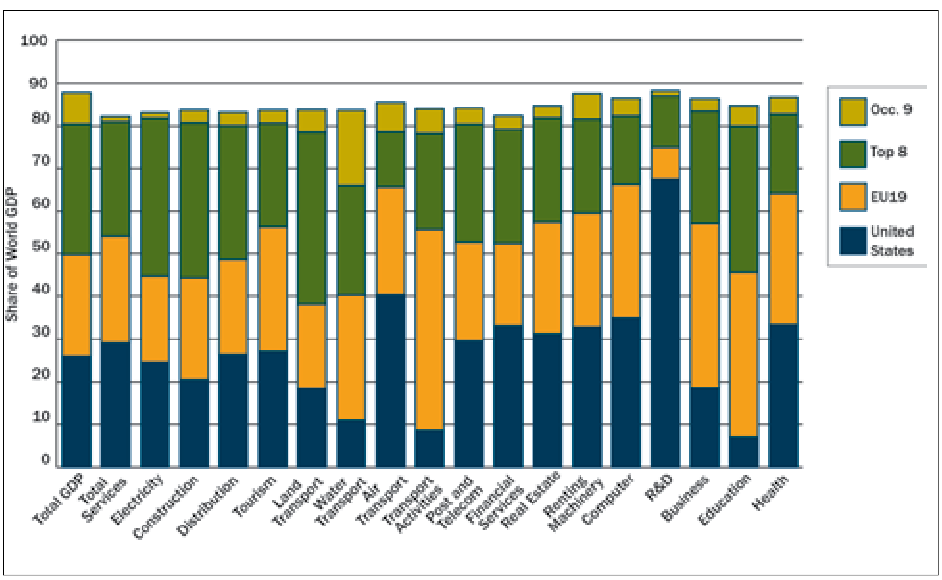
Transatlantic talks in services will also be subjected to *external* negotiating dynamics, that is, they will induce other countries to join them. "Plurilaterals" (agreements among several countries) in services are often suggested as the way to solve the difficult problems of negotiating services liberalization that the WTO has been unable to solve. However, such a proposal assumes that a dozen or so countries will suddenly find the energy and willingness to negotiate in services after having failed to do so in the WTO during more than ten years — a not-so convincing proposition.

This section suggests a more plausible process for generating plurilaterals in services. The most likely scenario is that two countries decide to initiate bilateral negotiations. If they are large enough — as the United States and the EU are — and if the prospect of a successful outcome is high enough, then there will be strong dynamic forces that will induce these bilateral negotiations to become plurilateral, and ultimately multilateral. That said, shifting from a bilateral to a plurilateral forum depends on two factors: the costs and benefits from expanding the negotiations.

Keeping the Cost of Expansion Low

The costs of negotiations are likely to remain low if the number of countries willing to join the EU-U.S. negotiations is limited. But, at the same time, limiting the number of participants is optimal only as long as the negotiating parties represent a "critical mass" of the world service sector in question. The needed "critical mass" that is often mentioned in the WTO is 80 percent of world trade. But, a criterion based on trade shares is not appropriate in services that are not yet traded as routinely as goods (if only because of all the remaining barriers). A much better criterion

Figure 1: Shifting to Plurilaterals: How Many Additional Countries to get a Critical Mass?



Source: OECD (2011, 2006)

Notes: Total services includes public administration and defense, health and social services, private households services which are not shown separately in Figure 1.

appears to be the output ("value-added" in the National Accounts parlance) shares in services.

Figure 1 provides the cumulated shares of the value-added produced in 17 services, based on the OECD normalized Input-Output tables. It presents these data for the 19 largest economies (except Hong Kong for which there is no data; for more detail, see Annex 1).

Figure 1 shows that the additional economies needed for reaching a significant critical mass can be divided into two different groups (leaving aside the United States and the EU). First, there is the "Top 8" group, which includes Japan, China, India, Brazil, Russia, Canada, Korea, and Mexico. This group, plus the United States and the EU, represents roughly 80 percent of world value-added (production) in almost all services. All these core countries are likely to be interested in a plurilateral agreement. As it is quite a small number of countries, the costs of such an extension appears quite manageable from a negotiating perspective.

A second group, called the "Occasional 9" economies, play a notable role in some services sectors — in particular, Taiwan, Turkey, and Australia. They can thus provide an additional coverage of the world value-added and constitute a broader circle of negotiating partners to be involved in extended negotiations in services if some of the Top 8 countries are initially reluctant to join the negotiations.

The Benefits of Expanding: Huge

What would be the benefits of shifting to plurilateral negotiations for the EU and the United States? Figure 1 shows that the Top 8 and Occasional 9 groups represent a substantial share of the world services sectors: they amount to an additional consolidated market often larger than the U.S. or EU markets. Shifting to a plurilateral deal would thus very substantially increase the gains for European and U.S. consumers and the opportunities for their firms.

These benefits depend also on the level of regulatory barriers of the Top 8 and Occasional 9 groups. Table 4 presents the applied regulatory barriers for the six countries for which the OECD is calculating the PMRs (four of the Top 8 group, and two for the Occasional 9 group). It suggests three main results:

- Some of these countries have undertaken unilateral liberalizations in some services between 2003 and 2007: Japan in electricity, Korea and Mexico in transport.
- Australia exhibits a level of protection roughly similar to the United States and EU. If one leaves aside electricity (because of a lack of data), Korea and Mexico exhibit an average level of protection similar to that of the EU.
- Canada and Japan are more complicated to interpret. Both seem to have services that are more protected than those of the EU. But, the EU PMRs are simple averages of the EUMS PMRs. It happens that Japan and Canada are almost always less protected than the most protected EUMSs in most services [Messerlin 2012]. This situation generates additional coalitions interested in "defragmenting" the EU (U.S.) Internal Market.

All these results suggest the EU and the United States have a clear economic interest in extending their bilateral talks to the Top 8 (and Occasional 9) group — illustrating the gains to be expected from "additive" regionalism (Harrison, Rutherford and Tarr 2002).

Table 4: Extending the Negotiations to the Top 8 and Occasional 9 Groups

	Level of applied regulatory barriers (PMR indicators)										
	Electricity	Construction	Distribution	Tourism	Transport	Post & telecoms	Financial services	Real estate activities	Renting of machinery	Professional & Business Services	All services
	1	2	3	4	5	6	7	8	9	10	11
The Top 8 Group											
	2007										
Japan	26.9	10.3	45.2	11.2	28.0	23.6	24.0	2.9	30.1	29.4	23.2
Canada	55.6	6.9	24.4	6.5	24.5	26.5	29.9	3.6	31.4	30.2	23.9
Korea	(na)	5.7	14.1	5.0	31.2	26.1	30.1	4.4	22.2	21.6	--
Mexico	(na)	5.5	20.2	5.3	23.5	27.5	29.1	2.0	21.5	21.6	--
	2003										
Japan	35.0	10.4	45.3	11.5	26.9	25.6	24.1	2.9	30.2	29.6	24.2
Canada	55.0	6.9	24.3	6.4	23.0	25.6	29.8	3.6	31.4	30.1	23.6
Korea	(na)	5.8	14.2	5.1	34.9	26.4	30.2	2.5	22.3	21.7	--
Mexico	(na)	5.7	20.3	5.4	28.6	27.6	29.2	2.0	21.6	21.7	--
The Occasional 9 Group											
	2007										
Australia	25.0	4.3	15.9	5.8	13.8	21.0	29.8	3.2	21.5	20.4	16.1
Turkey	(na)	10.5	33.9	10.1	48.6	32.0	27.7	2.7	32.7	32.4	--
	2003										
Australia	25.0	4.6	16.3	6.2	16.2	23.6	29.9	3.4	21.9	20.8	16.8
Turkey	(na)	10.3	33.9	10.0	42.5	44.2	27.9	2.7	32.7	32.4	--

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

Notes: For both bound and applied regulatory barriers indicators vary from 0 (markets considered as open) to 100 (markets considered as closed). The EU level of regulatory barriers in services are averages weighted by the output shares of the EU 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.

Negotiating Dynamics

That said, would there then be any interest among members of the Top 8 (and Occasional 9) group to join the U.S.-EU negotiations? The answer is yes for three reasons:

The consumers of these countries would benefit from the enormous welfare gains associated with such a wide liberalization.

Expanding the negotiations would reveal the comparative advantages of emerging service providers in the Top 8 (and Occasional 9) group. There is no reason to believe that emerging economies would have comparative advantages in goods only. They will almost necessarily have comparative advantages in some services. The earlier these advantages are revealed, the better it is for the Top 8 (and Occasional 9) countries. And, the better it is also for the United States and EU: the United States and the EU have no interest in building up or expanding services in which they have no comparative advantages, if only to avoid costly adjustment processes in the years to come.

Last, but not least, not joining the EU-U.S. negotiations would impose a substantial cost on nonparticipants. As services are regulation-intensive, leaving the EU-U.S. negotiators in a *tête-à-tête* would raise the risk that these two largest economies would set international regulatory norms tailored closely 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 on tariffs imposed on goods, where joining later does not raise such risks.

These dynamic forces that should induce the EU and the United States to extend their transatlantic talks to roughly a dozen of countries are essential because they justify the risk of initiating bilateral (transatlantic) talks soon. Leading by example is necessitated by the current debilitating lack of appetite for WTO negotiations, notably in the United States. But economic analysis shows that a strictly transatlantic deal is unlikely to be optimal because it risks distorting trade flows.[4] The dynamic forces pushing for extending the transatlantic talks to the Top 8 group would considerably reduce such risks.

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[4] If the barriers imposed by the EU and the United States 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), EU and U.S. service providers can charge high prices in their partner's markets — and they are inclined to do it by necessity (when they are less efficient than service providers located in the rest of he world) or by lucrative rent-seeking (when they are as efficient). As a result, EU and U.S. consumers could not get the gains to be expected from more competitive markets. Rather, they would de facto "subsidize" the inefficient service providers of the trading partner or to pay high rents to the efficient service 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.

3 Is there Any Appetite for Plurilateral Negotiations?

The most recent indication of the willingness to negotiate in services remains the July 2008 "Signaling Conference" held under the aegis of the Doha Round negotiations. In the course of only one day, negotiators from 31 countries (including the EC, the United States, and all the countries of the Top 8 group, except Russia) signaled their offers to open domestic

Table 5: Revealing the Willingness to Negotiate: The State of the World, July 2008

Services	Signalling Conference 2008		Size of sectors [b] (US$ bn)	Crisis resilience [c]
	Number of WTO participants [a] 1	GATS mode underlined 2	3	4
Business Services	Virtually all	4	4918	High
Communication Services	Substantial	3	737	High
Distribution Services	Substantial	3	3809	--
Environmental Services	Substantial	3	--	--
Construction & Related Engineering	Substantial	3 & 4	1715	High
Transport Services	Substantial	3	1282	Low
Financial Services	Notable	3	1770	Low to High
Educational Services	Notable	3 & 4	1444	--
Tourism and Travel Related Services	A few		774	Low
Health and Social Services	A few	3 & 4	1483	--
Recreational, Cultural & Sporting	A couple	--	1217	--
Energy	Substantial	3	--	--

Source: TNC Chairman's Report of 30 July 2008; OECD (2006); Mattoo and Borchert (2009).

Notes: [a] 31 WTO Members participate to the Signaling Conference. [b] Data cover the United States, EU and Top 8 group. [c] As reported by Mattoo and Borchert.

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.

Unfortunately, the Chairman's Report does not give any precise information on the offers and requests. It 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.

Table 5 summarizes this information in the two first columns. Column 1 gives a sense of how many participants manifested a serious interest in negotiations during the Signaling 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 issues during the Uruguay Round negotiations, and, during the Doha Round negotiations, service providers have repeatedly underlined the necessity to include them in the negotiations. 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 provide important information from an economic perspective. Column 3 gives the total (United States, EU, and Top 8 group) market size of the services listed in US$ billions 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 $8 trillion gives a sense of the size of the services market, compared to the rest of the economy.

Combining tables 4 and 5 suggests attractive matches between the declared willingness to negotiate and the economic forces at work. In particular, it reveals three services sectors — business services, communications, and distribution — as a rich potential source of negotiating successes: these sectors are large and relatively highly protected.

4 Conclusion

The total output of the three services that benefit from a clear willingness to negotiate — business services, communications services, and distribution — in the ten largest countries is *larger* than the entire output of agricultural and industrial goods in these countries. In other words, liberalizing these services sectors is an endeavor equivalent to the entirety of global trade liberalization of the past 50 years.

Thus, a transatlantic initiative on services expanded to include less than a dozen countries offers the prospect of considerable gains for consumers and opportunities for producers on both sides of the Atlantic and in the world. This encouraging conclusion raises two questions.

First, how to manage the expansion of the negotiating process? There are several options [Cooke 2011]:

- The EU-U.S. initiative could be MFN-based from its start
- It could be based on benefits confined to participants until it reaches some threshold (for instance, 80 percent of world GDP) and then become MFN-based; or
- It could be based on benefits confined to participants.

The choice is crucial for two reasons. It will define the level of trust among the "willing" — hence, the more or less intensive use of a "negative lists" approach (only the listed services are exempted from the disciplines of the agreement). It will also determine the intensity of the use of ratchet provisions (reservations would automatically disappear if a reserved barrier were reduced or eliminated) that is the best way to limit the creation of water in protection.

Second, this paper is based on the proposition that the United States and the EU are the "obvious" candidates to launch a liberalization process. This may not be necessarily the case, however. Alternatives are emerging: Transpacific initiatives in services (APEC or TPP), East-Asia initiatives, and Asia-Europe initiatives. All these options share one common feature: as soon as one of these dialogs takes off, the dynamic forces evoked above will induce the nonparticipating largest economies to join the ongoing talks. In other words, the starting point of the whole process may be different, but the dynamic effects will be the same.

This last observation is not so surprising. After all, it echoes very well the history of the last two centuries of international trade liberalization.

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6 Annex

Table A1: "Top 8" and "Occasional 9" Groups 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
Transatlantic Partners	USA	26.0	17.3	29.1	27.5	24.6				20.5	26.4	27.2	18.4	11.0	40.3
	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
Top 8	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
	China	7.4	16.0	4.2	5.0	13.9			13.0	8.4	4.0	5.3	9.1		
	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
	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
	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
	Russia	2.6	3.3	2.3	2.8	3.5	30.2			3.1	6.3		7.7		
	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
	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
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
	Indonesia	1.3	2.6					5.8				1.5		4.7	
	Taiwan	1.1						1.1			1.4			3.4	1.9
	Australia	1.0					2.5		3.5	1.1					2.7
	Argentina	0.7					2.0		1.2						
	South Africa	0.7							1.3				1.4		
	Switzerland	0.6													
	Norway	0.4												4.7	
	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
	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
	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

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 defense; Compulsory social security; Other community, social & personal services; Health & social work; Private households with employed persons & extra-territorial organizations & 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.

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	46 Health & social work	47 Other community, social & personal services	48 Private households & extra-territorial organisations	
8.7	29.6	33.1	31.3	32.8	34.9	67.4	18.6	40.1	7.0	33.4	42.7		USA
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	EU19
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	Japan
	6.5	5.2	1.6				7.4	2.6	5.2	1.2		0.5	China
1.4	2.2	3.6	1.6		2.2		0.3	2.8	4.8	0.9	1.8		India
2.9	3.0	1.2	3.0	2.5	0.1		4.0	1.5	4.8	1.8	1.3	5.0	Mexico
2.8	2.9	2.4	3.6	0.3	1.1		1.5	5.5	2.1	0.6	1.1	8.8	Brazil
		2.7				2.0	0.3			2.7	1.8		Russia
2.3	2.2	2.2	2.6	1.9	2.3		2.7	2.0	3.3	1.1	1.7	1.7	Canada
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	Korea
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	Turkey
1.4				0.5		0.4						0.6	Indonesia
	1.3	1.6	1.3	0.4	0.9	0.5	0.6		1.8	0.7	1.1	2.9	Taiwan
3.0	1.4		1.5		2.1		1.1		1.7	1.2	1.3		Australia
							0.7		1.1	0.6	1.0	4.3	Argentina
								1.4					South Africa
				5.0	0.9	0.1				0.7		1.5	Switzerland
						0.1							Norway
													Israel
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	Transatlantic
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	Top 8
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	Occ 9

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