

AN ASYMMETRIC APPROACH TO SERVICES LIBERALIZATION: THE EUROPEAN UNION-MERCOSUR CASE

Sherry Stephenson and Patricio Contreras*
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1. Introduction

The vast number of agreements for the liberalization of trade in services that has been implemented both at the multilateral and bilateral levels has shed light on the negotiating strategies that might be considered by governments in order to obtain the full benefits of liberalization. The main conclusion arising from these experiences is that no specific recipe can be prescribed for negotiating the liberalization of trade in services, but that, whatever the negotiating modality chosen, it should take into account the speed with which the economies of participating countries are able to open their markets to international trade ¹ and the degree to which the agreement is capable of conveying credibility. The legitimacy of an agreement will depend upon how it is structured, while the ability of members to implement the commitments to be undertaken will depend to a considerable extent on their level of development and particularly on the sophistication of their regulatory instruments.

How best to liberalize services and how to structure a services agreement are two key issues that have been addressed through different and creative mechanisms in the various economic integration agreements that have been negotiated over the past several years. Although different models for achieving similar objectives have been designed, no one agreement can be considered as an optimal model for all situations. Many contain elements that, in the light of experience, may be improved upon.

The purpose of this paper is to provide a framework for discussion of various approaches to crafting a services agreement that might be considered by the European Union (EU) and Common Market of the South (MERCOSUR) members. This discussion builds on past experiences, but, at the same time, suggests ways in which the liberalizing potential of a future agreement could be enhanced through improving upon the generally recognized deficiencies of earlier agreements, particularly in terms of building the national capacity of the participating members to implement required regulatory reforms that must precede the liberalization of services trade.

The paper is organized in five sections. Sections two and three present the critical elements to be contained in a services trade agreement and assess alternative negotiating modalities. Section four suggests a negotiating approach that EU and MERCOSUR members may wish to consider to advance in their interregional liberalization efforts and section five concludes.

2. Principal elements of a services agreement

Three principal elements relevant for consideration in a services trade agreement are: coverage, liberalization principles, and depth of commitments.²

2.1 Coverage

The coverage of the liberalizing commitments is two-dimensional and comprises the modes of supply ("cross-border" and "cross border plus commercial presence") on the one hand, and the number of service sectors included under the trade disciplines on the other. Cross-border trade includes trade from the territory of one party to the territory of the other party; trade by a person of a party (in the territory of that party), to a person of the other party; and trade by a national of a party in the territory of the other party. Cross-border trade plus investment includes all of the above, plus commercial presence in the form of foreign direct or portfolio investment. Investment in services activities may be treated as a mode of supply, as in the WTO GATS, or set out as an individual chapter of a comprehensive agreement covering trade in goods and services, such as the NAFTA and the NAFTA-type agreements have done.³

Two issues must be kept in mind when using modes of supply for scheduling purposes. First, the difficulty of separating trade in services as between the four modes of supply⁴ renders ambiguous the distinction between modes, and particularly between modes 1 and 2. For instance, in the context of cross-border telecommunication or financial services, a transaction may be equally classified as mode 1 or mode 2 depending upon the territory in which the transaction is deemed to have originated. The confusion arises from the fact that the physical presence of the consumer does not determine the location of the transaction.⁵ A related problem arising from the modal ambiguity is that of establishing whether the legal jurisdiction applies to the country of the supplier or to the country of the consumer.

The second problem originating from a modal approach to scheduling commitments regards the possibility that such an approach allows to discriminate as between the supply of a service by modes of delivery. For instance, commitments under GATS are usually more liberal for mode 2 and 3 than for mode 1. And commitments under mode 4 are often tied to those made under mode 3. This may be the case as well for cross-border commitments under mode 1 that are made dependent upon a commercial presence.

In NAFTA-type agreements no modes are mentioned per se as commitments are not scheduled. However, the modes of service supply are encompassed within the agreement under separate chapters – for investment covering both goods and services (mode 3), for cross-border services trade (modes 1 and 2) and an annex on the mobility of business persons (partial coverage of mode 4). However, mode 4 under the NAFTA-type agreements is virtually excluded, with the exception of the temporary movement of certain categories of professional service providers.

Discriminating between the modes of service supply in this manner not only biases the commitments in favor of a particular mode of supply, but it also undermines the credibility of the commitments made as the existence of unbound modes removes the ability of the service provider to choose the most efficient means of providing the service and thus undermines the competitiveness of the market for a particular

service.

With regard to the number of sectors included in services agreements, one approach focuses on individual sectors within which commitments to liberalize are limited to specific sectors or sub-sectors of an industry, mutually agreed upon by countries that are party to the agreement. Sectoral agreements with regard to air, land and sea transportation are typical examples of this method.⁶ Alternatively, the focus can be on universal sectoral coverage, as under the GATS and all of the services agreements subsequently concluded in the Western Hemisphere. Notwithstanding the successful conclusion of the sectoral agreements on basic telecommunications and financial services under the WTO GATS in 1997, crosscutting negotiations with comprehensive sectoral coverage are usually considered more successful because interests in other sectors that stand to gain from liberalization offset the opposition of vested interests in any one sector (see Feketekuty, 2000). Additionally, the conditions set out in GATS Article V to ensure the compatibility of economic integration agreements with the multilateral trading system require that such agreements have “substantial sectoral coverage” understood in terms of number of sectors, volume of trade affected and modes of supply. The article further states that in order to meet this condition, agreements should not provide for the a priori exclusion of any mode of supply.

When the option of universal sectoral coverage is adopted there are essentially two mechanisms by way of which liberalization can be carried out: the bottom-up or “positive list” approach and the top-down or “negative list” approach. Under a positive list approach, countries undertake national treatment and market access⁷ commitments specifying the type of access or treatment offered to services or service suppliers in scheduled sectors. The alternative top-down approach is based upon negative listing, whereby all sectors and measures are to be liberalized unless otherwise specified by reservations or non-conforming measures. This is the so-called “list-or-lose” technique. GATS, for instance, follows a positive list approach for sectoral coverage and a negative list approach for limiting market access and national treatment commitments in respect of sectors listed in schedules (with the qualification that even here, the GATS allows for entries that are “unbound”, that is where no commitment at all are made for a particular mode of supply under a given sector). NAFTA-type agreements, on the other hand, rely on a negative list approach, and any exceptions to liberalization are contained in reservations to the agreements set out in annexes.

GATS-type negotiations focus on the bilateral negotiation of market-access and national treatment commitments on an item-by-item basis, across all services sectors. NAFTA-type agreements commit to provide market access and national treatment as general obligations for all service sectors on a horizontal basis, subject to a negotiated list of reservations set out in lists of non-conforming measures (with respect to existing laws, administrative decrees and regulations). Measures applying to sectors included in these list of reservations can be either indefinitely retained, unilaterally dismantled, or subject to future negotiations for removal.

2.2 Liberalization principles

Two basic non-exclusive approaches can be adopted in applying the principles that

guide efforts to open services markets: establishing liberalizing principles as general obligations (as is the case of the NAFTA-type agreements) or as part of the specific commitments. In the case of GATS, some of the obligations, including most-favored-nation (MFN), are of a general nature, whereas others (such as national treatment and market access) are part of the specific commitments. It is important to point out however, that the choice of the application of the liberalizing principles is not necessarily tied to the choice of a negotiating approach or modality. For instance, in the MERCOSUR Protocol on Services, the liberalizing principles are all of general application, unlike the GATS, although both agreements follow the positive list approach to carrying out liberalization.

It has been argued that it is difficult to make policy generalizations across different service sectors. This has been pointed out as the main argument in favor of a sector-specific approach for the application of liberalizing principles. Alternatively, the argument for the general application of liberalizing principles is that the economic and social reasons for regulatory intervention should be independent of the particular characteristics of a service.⁸ Furthermore, a general approach would not only take advantage of economies of scale in rule-making but would also add to the credibility of the agreement by lessening the influence of vested interests.

Four liberalizing principles for trade in services are usually taken into consideration in developing a services agreement:

i) Most-favored nation. This is one of the fundamental principles to secure non-discrimination in international trade. The principle obliges members to give the most favorable treatment accorded to any of their trading partners, to all the other members immediately and unconditionally. Exemptions to the MFN requirement may be included within the provisions of the agreement.⁹

ii) National treatment. This principle stipulates that services and service providers from another party to the agreement be accorded treatment no less favorable than that accorded to like services and service providers of national origin. Violations to national treatment in the area of trade in services include a wide variety of situations ranging from nationality or permanent residence requirements to discriminatory practices with regard to fiscal measures, access to local credit and foreign exchange practices, and limitations of the type of services that may be rendered by foreign suppliers.

iii) No local presence requirement. Many countries frequently require a local presence (that is, an established trade presence) as a condition for foreign individuals or juridical persons wishing to provide services within their territory. This is usually the case with services that require close supervision to guarantee better consumer protection. A local presence requirement may hinder international trade because it may impose higher costs on foreign service suppliers than those incurred under other modes of supply, given the capital necessary to carry out an investment.

iv) No quantitative non-discriminatory restrictions. Technical considerations or market-size may induce governments to establish quantitative non-discriminatory restrictions on the rendering of given services. Such is the case in the allocation of radio and television frequencies, the number of banks allowed to operate in a given

market or the number of telecom companies authorized to provide cellular and basic telephony services in a given region within the country. These restrictions may also be associated with unfair business practices that may limit competition and allow for open discriminatory actions in favor of a limited number of suppliers.

An important issue regarding the liberalizing impact of the above principles regards the strength or weakness of the domestic regulatory framework. The key point here is that trade can be inhibited even by non-discriminatory qualitative regulations, like certain standards and licensing requirements, and by inadequate regulation or by over-regulation. Take for instance a horizontal commitment to MFN treatment. Such a commitment may be rendered economically meaningless for those services industries for which the regulatory systems vary greatly among countries in the cases where these systems act as 'de facto' barriers to trade.

The case of inadequate regulation applies in those cases where the market fails to allocate resources efficiently. Consider the case of a natural monopoly (in telecommunications services, for instance) that is not adequately regulated. In such case the monopolist has the ability to impede access to the market even if the country does not require local presence, does not impose quantitative non-discriminatory barriers and is committed to (horizontal) national treatment.¹⁰ The development of pro-competitive regulation as a component of a market-opening strategy is an important step to take in eliminating this possibility and in permitting the agreed services liberalization to have the desired impact on the domestic market.

2.3 Depth of the Commitments

The depth of the commitments undertaken in a trade agreement on services may vary substantially. An important determinant of the depth of commitments is the extent to which an agreement is binding. Most provisions in GATS and the provisions in the regional economic integration agreements in the Western Hemisphere are binding; however, cooperation groupings such as APEC, are based on voluntary, unilateral and non-binding commitments.

Members to a services agreement have at their disposal several instruments to achieve different levels of commitments. The most important of these are presented below and organized from lower to higher levels of commitments:

i) Transparency. This is normally the most basic or minimal level of commitment included within a services trade agreement. It requires all members to the agreement to either directly inform the other parties about national measures that may affect trade in services with respect to the disciplines within the agreement, or to set up national "enquiry points" to facilitate access to all the existing measures, at the level of the central or federal government and of state, provincial or local governments.

Lack of transparency in the design and enforcement of regulations constitutes one of the main impediments to services trade. Foreign investors, particularly those that are seeking to establish a commercial presence in the domestic market, are unlikely to commit resources in countries where it is unclear how the design and enforcement of regulation will affect their business activities.

ii) Ceiling Binding. A long established practice in merchandise trade agreements, the setting of a ceiling binding is also used for the adoption of commitments in trade in services. For instance, in the GATS scheduling of commitments, countries may set up or indicate conditions and limitations to market access and national treatment that are not part of the existing legal or regulatory measures within the respective country. An example of such a ceiling binding could involve setting up maximum screening quotas for foreign audiovisual programs, expressed as a cap on the daily percentage of programs, where the country involved reserves the freedom to operate above, or at a less restrictive level, than the stated quota.

The practice of binding at a more restrictive level than the regulatory status quo introduces a significant degree of uncertainty into the decisions of foreign service providers to contest a foreign market through cross-border trade or commercial presence. At the same time, governments engage in this practice because it provides them not only with the flexibility to adjust their regulatory frameworks in the event of unforeseen circumstances (e.g. financial crises), but also with significant negotiating coinage in future services negotiations.[11](#)

iii) "Freeze" or "standstill" on existing non conforming measures. This commitment involves freezing the existing regime and measures up to a given date and undertaking a commitment not to make such measures more non-conforming in the future. This commitment, known as a "grandfather" clause, is used in agreements on trade in goods and in some agreements on trade in services (as in NAFTA, at federal and provincial levels, and in GATS with regard to some MFN exemptions that have been scheduled). A grandfather clause tends to discriminate against new investors as it normally freezes a regime that is more favorable to investors currently operating in the market than to new entrants.

iv) Ratcheting. In addition to the commitment to freeze existing measures, a moving floor of commitments can also be established. If a party amends its legal framework in a way that eliminates or reduces restrictions on a service sector or activity, the ratchet clause obligates the party to offer this higher degree of liberalization to the other members as well. This mechanism makes it impossible for the party to revert to a less liberal policy for trade in the respective sector and prevents countries from "backsliding" with respect to any unilateral liberalization implemented after the effective date of the standstill. This type of commitment, present in NAFTA-type agreements (sometimes only effective at the federal level, other times at both the federal, state and provincial levels), is likely to have a positive effect on trade and investment in the members to the agreement adopting this type of discipline, as it signals to foreign service providers the commitment not to introduce sudden regulatory changes that could reverse previous liberalization.

v) "List or Lose." This type of commitment supplements the "transparency" commitment and serves to speed up the process of liberalization. In the context of a negative list or top-down approach, the parties undertake the obligation to list all non-conforming measures to the provisions of the agreement. Failure to include any non-conforming measure in the list is understood to eliminate the measure in question with respect to the other parties to the agreement. This is the approach adopted by NAFTA members with regard to the existing non-conforming measures at federal or national level. However, such approach failed to be implemented at the state or

provincial level for those same countries and thus these measures were ‘grand-fathered’.

vi) Future Liberalization. This type of commitment involves establishing procedures and deadlines to advance towards greater or complete liberalization of services trade among member countries. A pre-commitment of this type is a powerful mechanism to signal the unwillingness of a country to protect national suppliers to perpetuity, while providing a time buffer for specific sectors to meet the conditions for enhanced competition. Various types of modalities may be envisaged for carrying out future liberalization, including the deepening of sector-specific disciplines, or the negotiation of the removal of restrictions on a request-and-offer basis, or the adoption of clusters, and so forth.

3. Negotiating strategy

To date services negotiations have followed two basic approaches to liberalization: horizontal negotiations for the bilateral exchange of requests and offers covering all sectors, and plurilateral or multilateral negotiations focused on individual sectors (such as financial services or basic telecommunications). These approaches have also been combined, such as in the GATS and in the NAFTA-type agreements where specific annexes (in the former case) or chapters (in the latter case) exist for selected service sectors in which deeper disciplines and often an alternative negotiating modality have been agreed upon. For instance, both GATS and NAFTA-type agreements contain annexes for the temporary entry of business persons, while in NAFTA-type agreements separate chapters are written for services sectors such as financial services and telecommunications. In the GATS, the agreement on basic telecommunications contains generally-applicable pro-competitive regulatory principles for this sector, while the Memorandum on Financial Services set out an agreement among signatories on how to schedule commitments on financial services.

The differing negotiating mechanisms reflected in the above approaches suggest that achieving the goals of a services agreement, i.e. to improve social welfare by means of liberalization of trade, poses an important challenge for negotiators. In deciding the appropriate mix of the elements that compose a services agreement - coverage, liberalization principles, and depth of commitments - negotiators are challenged not only by factors affecting their own domestic markets, but also those affecting the markets of their trading partners. Such factors as the degree of development and contestability of domestic markets, as well as the relative strength or weakness of the domestic regulatory framework in comparison to that of the country’s trade partners are all important in determining the approach to liberalization. Similarly, the lack of expertise of negotiators, the resources available to carry out a negotiation, and the political power of domestic interest groups are likely to challenge the commitment to liberalize trade and should consequently be addressed directly when opting for a negotiating strategy.

The experience accumulated so far suggests that four major questions must be answered by national negotiators in order to fashion a negotiating strategy while addressing the elements that constrain the effective liberalization of services trade: (1) the review of domestic regulation and the undertaking of regulatory reform in the

context of a services agreement; (2) the degree of precision and transparency to be afforded by the agreement to service providers; (3) the architecture of the agreement with respect to the treatment of those disciplines that would apply to both goods and services; and (4) the liberalizing modality and its operability in function of a decision for more immediate or more progressive liberalization.

3.1 Review of domestic regulation and regulatory reform

It is critical to begin the process of review of domestic regulation and the accompanying regulatory reform that must go hand-in-hand with services liberalization under any given approach. It is a common understanding that services liberalization involves essentially the removal of discriminatory regulation, whether in quantitative or in qualitative form, while nondiscriminatory restraints are a matter of domestic regulation. This distinction allows countries to tackle the reduction of barriers to services trade, on the one hand, and the reform of domestic regulation, on the other.¹² Making this distinction also allows for the identification of those services sectors that can be subject to horizontal liberalization and those that should be negotiated on a case-by-case basis, in particular those services where trade can be inhibited even by non-discriminatory qualitative regulations and by the absence of pro-competitive regulation. However, it is important to keep in mind that services liberalization and domestic regulatory reform must go forward in a parallel and interrelated manner, so that liberalization does not run forward faster than required regulatory reform in service sectors subject to specific types of market failure.

In the case of network industries, such as telecommunications, energy services, and air and maritime transport, the economic characteristics of these services justify a review of the adequacy of current regulations in view of the need to implement an accompanying pro-competitive regulatory structure as liberalization is undertaken. These sectors also may be the object of an attempt at regulatory harmonization at the sectoral level. One of the main features of a network industry regards the tendency to anti-competitive behavior of incumbent operators. This results in markets being highly uncontestable unless some kind of pro-competitive regulation is put in place. The experience accumulated so far in the GATS context provides a good guideline on how to proceed in this regard. The Reference Paper developed for basic telecommunications establishes a common set of pro-competitive regulatory rules, which not only enhance market access, but also increase social welfare through imposing a more efficient and a more socially oriented behavior on incumbents.¹³ The Reference Paper is a good example of a “target or formula” approach within which qualitative targets serve as negotiating guidelines against which national policies are compared.¹⁴

More contestable services industries – those subject to externalities or asymmetries of information - such as financial services and professional services - can be more directly addressed through the adoption of international standards, complemented by either mutual recognition agreements or necessity tests.¹⁵

3.2 Degree of transparency to be provided by a services agreement

Clear commitments with respect to the treatment of Foreign Service providers reduce legal uncertainty, enhance the credibility of trade agreements and thus generate more

effective economic integration. The imprecision and lack of transparency of commitments made under the different services agreements have been widely discussed. This discussion has centered on the degree of clarity for service providers that is set out in a positive vs. a negative list approach to services liberalization. It has been suggested that a negative list approach provides for a high degree of precision and transparency of commitments. Alternatively, it could also be argued that the precision and transparency of a positive list approach could be enhanced by improvements in scheduling techniques, as well as the inclusion of deeper and more binding disciplines within the structure of an agreement. These could include, among others, the following:

- the obligation to bind at the level of application or the level of 'status quo';
- the obligation to attach specific legislative references to the commitments included;
- the requirement to separate discriminatory from non-discriminatory measures when scheduling commitments.

Feketekuty (2000) has pointed out that there is not much difference between leaving a whole sub-sector unbound under a positive list approach on the one hand, or reserving it and thus preserving it from liberalization under a negative list approach, on the other hand, if the applicable law or regulation is not specified. The important issue should then be with regard to the precision with which countries spell out their limitations on national treatment and market access or their reservations and the precise provisions of the laws and regulations that cover these limitations.

3.3 Architecture of an agreement

There are many disciplines that can be applied horizontally to both goods and services. This is the case, for instance, of competition policy, where uncompetitive behavior can arise equally from suppliers of goods or services. It is also the case of dispute settlement mechanisms, which may be required for arbitration and resolution of disputes involving both goods and services suppliers. A further example is government procurement, in which case bidding procedures need not differ for many goods and services acquisitions. Likewise, disciplines for standards and technical regulations may be cast to cover standards used in the production of both goods and services. A more critical example is direct investment, where despite the type of investment (in goods or services), rules for investment protection including those guaranteeing related payments and transfers or the recognition of certificates and licenses should be granted in order to guarantee market access.

Many free-trade agreements have recognized the benefits of developing common disciplines for trade in goods and services. Current negotiations of GATS on transparency in government procurement, for instance, apply to both goods and services. NAFTA-type agreements have addressed investment in the context of a separate chapter covering both goods and services, rather than as a mode service supply within a services chapter. These agreements also have separate chapters on government procurement and on standards and technical regulations that apply comprehensively to both goods and services.

The development of common disciplines applying horizontally to goods and services has many advantages. It adds to the consistency and coherence of the architecture of a

trade agreement. This in turn facilitates negotiations and clarifies the scheduling of commitments or reservations. In addition, common disciplines may make negotiators less subject to sectoral pressures and allow for economies of scale in the negotiation of agreements and in the dismantling of barriers to trade.

Several integration groupings have gone the route of deepening their integration arrangement through the addition of various issue-specific protocols or decisions (relating to services, investment, government procurement, competition policy, etc.) rather than integrating these within a comprehensive single agreement. This choice requires that careful attention be paid to the consistency of these individual protocols and the way that the disciplines of each interrelate to each other.

3.4 Liberalizing modality

It is important to keep in mind when considering the negotiation of a services agreement that the choice of a liberalizing modality, as well as the type and depth of disciplines to include in an agreement, are both separate questions from that of architecture of an agreement. The choice of a negotiating modality (positive or negative list approach) should be distinguished from the organizational structure given to the agreement. Too often these questions are considered as entwined into a joint, and related, decision but this is not the case. It is in fact entirely possible to develop an overall free trade agreement characterized by an architecture wherein separate chapters contain comprehensive disciplines for goods and services as described above, with the selection of either a positive or a negative list approach to carry out the actual market access liberalization. It is even conceivable that differing liberalizing modalities be chosen for different chapters of the agreement.

Designing the architecture for a free trade agreement thus requires that the need for a coherent framework be uppermost in the minds of negotiators so that no aspect of trade liberalization slips beneath the cracks through a disjointed coverage of respective areas under the agreement. The most critical relationship in this context to resolve coherently is that between services and investment given the overlap of investment in services as commercial presence (mode 3).

4. EU-MERCOSUR Negotiations

In the discussion above it was pointed out that market and regulatory asymmetries between trading partners are key elements that need to be taken into account when designing and implementing a free-trade agreement. The case of the European Union (EU) and the Common Market of the South (MERCOSUR) constitutes a clear example of trade partners subject to such asymmetries.

4.1. Market asymmetries

Table 1
Services Output
(% of GDP)

Countries	1995	1999
East Asia & Pacific	40	41
Europe & Central Asia	52	56
European Monetary Union	70	71
Latin America & Caribbean	58	62

Mercosur (average)	58	60
Argentina	66	67
Brazil	54	61
Paraguay	49	45
Uruguay	62	67
Middle East & North Africa	45	--
South Asia	45	47
Sub-Saharan Africa	50	55
United States	72	--

Source: *World Development Indicators* database.

Table 1 shows that both the EU and MERCOSUR areas are highly specialized in the production of services. In the EU, services output accounts for the highest share of GDP among the different regions in the world. The MERCOSUR figure is slightly lower than the overall figure for Latin America and the Caribbean, which ranks second among world producers of services. In terms of international trade in services (Table 2), the EU is clearly more specialized than MERCOSUR¹⁶ as it not only accounts for the largest share of world services exports (nearly 40 per cent), but it also shows a degree of specialization in such exports which is six times higher than that of MERCOSUR (measured in terms of the ratio of services exports to GDP).¹⁷

Table 2
Trade in Services Statistics
(year 2000)

Region	Value of services exports (billions of dollars)	Share of World total (percent)	Degree of specialization		
			Services exports/ Merchandise exports (percent)	Services exports/ GDP (percent)	Services exports/ GDP (percent)
Mercosur	14.7	1.04	17.4	1.2	2.2
European Union	580.2	39.55	25.0	7.2	7.1

Source: OAS Trade Section calculations, based on official data.

The greater specialization of the EU in the production and exports of services should indicate a higher degree of development and sophistication of EU services markets relative to those of MERCOSUR. It is likely that MERCOSUR's lower relative specialization in services partly responds to a probable regulatory disadvantage of MERCOSUR's services markets (see next section), although this hypothesis can be contested by arguments such as factor specialization, consumer tastes or plain statistical inaccuracies (Box 1).

The fact that MERCOSUR is a net importer of services, as shown by its ratio of services imports to GDP in comparison to its ratio of exports to GDP (table 2), and largely dependent from FDI (mostly from the USA) for the development of its internal service production,¹⁸ imply that the main benefits of an immediate

into a reduction in import prices and a probable increase in foreign direct investment in those services sectors in which regulatory asymmetries and relative expertise are most favorable to EU members (i.e. those sectors in which EU members have the greatest comparative advantage). Longer-term benefits such as increased services exports would depend on the liberalizing strategy followed by MERCOSUR members. This issue is addressed in section 4.3.

Box 1: Assessing Regulatory Asymmetries

The type of statistics on trade flows in services used in this study tells us little if anything about the impact of regulatory reform on services trade flows or about regulatory asymmetries between trade partners. Only an impact analysis would allow us to determine the extent of the correlation between regulatory reform and increased trade in services. Similarly, the extent of the regulatory asymmetries may be assessed by examining the degree of pro-competitiveness fostered by a particular regulatory framework. Indicators of the latter may be:

- Number and type of sectors regulated in each market
- Number and type of market distortions prevailing in each services sector (e.g. barriers to the supply/supplier and consumption/consumer of a service)
- Existence of independent regulatory agencies
- Level of application of pro-competitive regulatory standards (e.g. GATS Reference Paper on Telecommunications, Basle Committee Accord on Banking Regulation, IASC and OSCO International Accounting Standards, etc.)

4.2. Regulatory asymmetries

Strong regulatory asymmetries between the EU and MERCOSUR characterize these two regions. In the EU the establishment of the Single Market has fostered profound changes in national regulations of virtually all services sectors and extensive harmonization of regulation across countries. MERCOSUR, on the other hand, is in a much earlier stage of integration of services markets, characterized by ongoing and far-reaching reforms of national regulations in specific services sectors and scarce regulatory harmonization across countries. A brief description of the regulatory standing of services sectors in these two trade groupings will clarify this point.

The MERCOSUR area

Up to date regional efforts in the MERCOSUR area seem to have focused on the reduction of discriminatory barriers to services trade, while deregulation and regulatory reform (non-discriminatory barriers) efforts have been addressed mainly, and with different intensity, at the national level. The reduction of discriminatory barriers has been pursued mainly within the WTO-GATS framework, although the

by Mercosur governments in December 1997 but not yet ratified or legally in force) should bring forward enhanced reduction of intra-regional discrimination, as shown by the schedules of commitments attached to the Protocol.

As regards domestic regulation of services sectors in MERCOSUR members, the situation varies from sector to sector. In the energy sector, Argentina de-linked its electricity sector from its natural gas sector, increased the competitiveness of electric generation and, to a lesser extent, oil production and natural gas production and promoted the establishment of spot and future markets in wholesale markets for electricity and natural gas. Also, and in parallel fashion to the restructuring and privatization of the energy sector, Argentina introduced measures to restrict ownership and prevent discrimination and market power of incumbents. Brazil, on the other hand, has followed a more conservative approach in the opening of its energy sector, by means of which reforms are being implemented gradually and as a function of the interests of the different states that compose the Federation (Lutz 2001). The European Commission has described this diverse panorama of regulatory frameworks for energy in the following terms:

In electricity and natural gas services the regulatory frameworks of MERCOSUR party states are subject to the following asymmetries that prevent a further integration of these markets: “i) different competition regimes in generation, transmission/transport and distribution, ii) different levels of involvement of the governments in the provision of the service, iii) different market mechanisms, iv) problems of compatibility between bi-national agreements and the system of authorization of exports with the criteria set forth in a regional common market (EC 1999 in Lutz 2001).[19](#)

Another example of regulatory asymmetries within the MERCOSUR region is land transport services. In this sector, the more significant pro-competitive changes have also taken place in Argentina, particularly in long-distance passenger transport by road. In Brazil, on the other hand, state regulation is still the same as it was 20 years ago and there seems to be little willingness to modify this situation in the near future (Thomson, 2001).[20](#) The situation seems to be no different in Latin America as a whole:

“In the present situation, there are more and more of the following: a) private enterprises created by the sale or concession of publicly-owned companies which had previously controlled a transport market, and b) transport sub sectors where regulations which had previously been imposed on private operators have been abolished or are considered restrictive and in need of reform” (CEPAL 1998).

Clearly implementing appropriate regulation is the issue in both cases. However the lack of monitoring to determine the extent to which privatized or publicly-owned companies given in concession still maintain market power is also an area of concern (Thomson 2001). In MERCOSUR this issue is made more critical by the fact that only two members have competition laws, Argentina and Brazil, and the regional provisions are not yet operational (Tavares 2001).

The regulatory situation in the telecommunications sector in the MERCOSUR area is quite similar. Brazil, Paraguay and Uruguay, for instance, have not yet signed the WTO-GATS Reference Paper on Telecommunications. Brazil, however, has

implemented many of the pro-competitive principles established therein. Paraguay, on the other hand, still maintains a state-monopoly in domestic and long distance telephone services originating in Paraguay, and ANTELCO (the state run telephone company) has been accused of shutting down and seizing the equipment of companies alleged to have been offering call back services (USTR 2001). Uruguay still maintains a state monopoly in domestic and long distance telephone services.

In financial services, the four MERCOSUR Party States have introduced significant reforms to their regulatory frameworks in the past years. In the banking sector, for example, reform in the banking sector of Argentina seems to be moving faster than in the other MERCOSUR Members States. Argentina is currently undergoing a process of privatization and closure of most provincial banks, the aim of which is to reduce public sector presence in the economy and to induce compliance with the government's broader financial sector policies. At an earlier stage of reform, Paraguay is concerned with strengthening supervision and enhancing transparency of financial information, as well as establishing standards for capitalization and allowances for credit risks that are in line with international standards. Similarly, authorities in Uruguay are taking measures to make the institutions in the financial intermediation system more efficient and to strengthen the oversight machinery to keep the system solvent. The program includes financial legislation, regulation and supervision activities (IDB 2001).

In sum, the regulatory situation of services sectors in the MERCOSUR region can be summarized as follows: 1) members are at different stages of deregulation and reform, with privatization having taken place faster than deregulation in most service sectors and most countries; 2) a low degree or no regulatory harmonization is present in regulated service sectors; and 3) members display considerable differences in the ability to make regulatory reforms operational, and to monitor and exercise authority in this regard.

The European Union

The EU has gone a long way in deregulating certain services sectors and putting in place pro-competitive regulations in others, as well as in integrating its internal market by means of promoting a higher degree of regulatory harmonization. In particular, the elimination of discriminatory barriers to services trade coupled with the establishment of common regulatory frameworks and the application of the principle of mutual recognition brought forward by the introduction of the Single Market has modified the conditions of competition in individual EU Member States, leading to changes in market structures and to an intensification of price and cost competition, affecting practically all services (banking, insurance, road freight, air transport, telecommunications, TV broadcasting, distribution and advertising) (EC 1996). The current competitive and regulatory standing of the services sector in the EU area is by no means free of limitations. However, the experience accumulated so far provides valuable insights for MERCOSUR in its process of integration.

The EU experience has shown that although a well-designed regulatory framework is a necessary condition for trade liberalization and integration, it is far from being a sufficient condition. At least two additional sources of inefficiency have arisen in the EU Single Market: market concentration and market fragmentation. In network

industries, for instance, the EU has recognized that the existence of substantial up-front fixed costs may limit competition creating a serious risk of market failure and knock-on effects further along the economic chain. This may be the case in utility industries, such as gas, electricity and railway. In solving this problem the EU Member States have implemented sector-specific regulations and applied horizontal competition policies to promote more competitive behavior. However, the EU has also recognized that increased competition in these industries may hinder market concentration as a response to merger and acquisition activity. This dampens the positive impact from opening network industries to competition and hence requires careful monitoring.

The EU has also seen that regulatory bans or limitations on particular types and forms of services applied at the national level fragment the single market. In financial services, for instance, the EU reports that there is clear evidence that product restrictions hamper the cross-border supply of services, in particular in retail banking. Similarly, in the advertising sector, the EU has pointed out that the muddle of disparate national rules creates obstacles for companies wanting to offer standardized services across national borders and also affects development in distributive trades who are the main end-users of such trade. In mobile telecommunications differences in international roaming charges are not consistent with a fully integrated market and competitive market behavior.

In response to this issue, the EU adopted a pro-active approach to increase market integration by means of increasing regulatory harmonization focusing on areas such as: the elimination of restrictions on the content or form of specific services; the conditions to ensure fair competition; and the elimination of fiscal distortions (EC 1996). Regulatory harmonization has taken the form of sector-specific rules spelled out in Community Directives²¹ and competition policies to be applied horizontally to the relevant sectors. Community Directives establish economic-based minimum common requirements aimed at leveling the playing field for business. Community Directives have been issued for many of the services sectors, namely: financial services (Banking Directive, Pension Funds Directive), energy services (Electricity Directive and Gas Directive), telecommunications services (Open Network Provision Directive and leased lines Directive), television and broadcasting (TVWF Directive and Cable and Satellite Directive), etc.

A particularly valuable lesson obtained from this approach regards the adequate use of the principle of mutual recognition to identify those cases where regulatory harmonization is both feasible and desirable. According to the European Commission, having this type of secondary legislation implemented in national law clearly identifies the areas in which mutual recognition must be accepted. Moreover, the principle of mutual recognition plays a key part in opening the Single Market in all the sectors which have not been the subject of harmonization measures at the Community level or which are covered by minimal or optional harmonization measures.

The existence of a more advanced market and regulatory treatment of services sectors of EU members relative to MERCOSUR members presented in this and the previous section, provides the basis for identifying a negotiating strategy for a future EU-MERCOSUR trade agreement. This is done in the following sections.

4.3. Addressing market and regulatory asymmetries

A negotiating strategy for the liberalization of services trade in a context of asymmetric economic conditions is one that progressively and asymmetrically eliminates discriminatory (quantitative and non-quantitative) barriers to trade in all or the majority of services sectors. The purpose of the asymmetric component is to make the schedule of progressive liberalization and binding a function of a process of regulatory review and reform, tied to the economic conditions of each member of the agreement. The negotiating strategy suggested is as follows:

Phase I: Identification of (potential) “sensitive” sectors and liberalization of “non-sensitive” sectors

During the fifth meeting of the European Union-MERCOSUR Bi-regional Negotiations Committee that took place during 2-6 July 2001 in Montevideo, Uruguay, the EU tabled a proposal for the substantial liberalization of all services sectors upon entry into force of the agreement. In this form, the EU proposal would not seem to address the need for differential treatment of the asymmetries prevailing in certain services sectors of the EU and MERCOSUR.

Identifying services sectors for which liberalization would be the most difficult to achieve and those that would need to be subject to sector-specific treatment should be the primary task of MERCOSUR negotiators in the drafting of a free trade agreement with the EU.²² Such sectors are commonly subject to economic and social reasons for intervention, like the existence of market failure or the need for income redistribution. They may also be characterized by the absence of political will to liberalize (due to excessive political power of interest groups, for instance) or by the perpetuation of transitory non-competitive practices (e.g. subsidies or lax regulation).

Once these sectors have been identified it is key to assess the extent of the prevailing intervention, the feasibility of liberalization and/or the need for regulatory reform and/or the need for revised or new regulation. An essential tool in assisting the former would be a complete inventory of regulatory measures affecting services trade, including all those that are discriminatory as well as certain measures that are non-discriminatory but that may nonetheless restrict trade.

In determining the feasibility of liberalization the constraints on policy reform should be ascertained (e.g. the degree of social sensitivity of certain service sectors, the existence of vested interests, the use of discriminatory intervention as part of a development strategy, etc.) along with the mechanisms that would be needed to lift (if ever) such constraints.²³ The need for regulatory reform should stem from an assessment of the market structure of the different services sectors and should give rise to a schedule of reform policies consistent with more open markets to be implemented in conjunction with the actual liberalization of trade. Whether or not the regulatory reform process should precede or be implemented in parallel to the market-opening process should depend on the speed with which the domestic economy is capable of adjusting to a more contestable market. The different levels of development of MERCOSUR economies and, in many cases, the absence of political will to liberalize suggest that regulatory reform be implemented first. This practice

would provide an economic-based, built-in mechanism for the implementation and monitoring of reform.

In order to achieve the objective of comprehensive and progressive liberalization while taking into consideration the economic asymmetries prevailing between the EU and MERCOSUR, all sectors not identified as sensitive or in need of regulatory review or reform should be scheduled for immediate and unconditional liberalization and binding.²⁴ All other sectors should be liberalized in a ten-year period equally divided into a regulatory reform/review phase and progressive liberalization phase.²⁵

Phase II: Regulatory reform/review and political consensus

Services sectors considered subject to economic or social reasons for intervention should be the object of enhanced technical cooperation leading to a process of progressive regulatory reform to be implemented during the first five years of entry into force of the agreement. This would allow MERCOSUR members to benefit from the more sophisticated regulatory frameworks prevailing in the services sectors of the EU.²⁶ Such regulatory reform would allow for a schedule of pre-commitments to be established in a parallel manner in order to ensure progressive liberalization of the sector in question.

Sectors not subject to justifications for intervention, but where political will for immediate liberalization and reform is absent (e.g. sectors in which excessive regulation is a response to regulatory capture) should be made the object of pre-commitments for a well-defined schedule of progressive liberalization. The transition period should allow for building the necessary political consensus to underpin reform through providing time for service suppliers in politically sensitive sectors to implement the necessary adjustments for enhanced competition.

Phase III: Progressive liberalization

Once regulatory reform/review has been implemented and political consensus for liberalization achieved, the process should focus on the actual liberalization of trade by means of progressively lifting all discriminatory restraints to trade in services (ideally). A schedule of progressive liberalization should specify clearly the level of liberalization to be achieved by the end of the third phase.²⁷ In sectors in which there is no case for intervention, the non-discriminatory measures should also be progressively examined to see if they could be harmonized or brought into closer alignment as between the participating countries. In order to make the liberalization process credible and transparent, the regulatory regimes of member countries of the agreement should be made subject to a “freeze” or “standstill” on all remaining restrictions which do not conform to either a national treatment or MFN obligation with binding at the level of application by the end of the third phase.

4.4 Final considerations

A series of considerations need to be stressed when considering the liberalizing strategy presented above.

(all frontier and internal discriminatory measures) and market access (all frontier and internal non-discriminatory measures)²⁸ are key to enhancing the liberalizing impact of a free trade agreement.²⁹ General application of these principles is likely to reduce the number of limitations/reservations in an agreement. This, however, does not eliminate disparities in protection (that distort resources away from their most efficient use) that arise when limitations/reservations are not scheduled in a consistent or neutral manner among all sectors/modes of supply.

- The adoption by the EU and MERCOSUR of a three-phase liberalizing approach for services that departs from the GATS definition of modes of supply raises the question of whether or not such an approach is compatible with MERCOSUR's 'positive list' approach based on taking commitments by modes of supply. Needless to say, an overlap between these two approaches would imply increased liberalization within MERCOSUR should MFN treatment be applied strictly. An overlap of this kind could be avoided if the EU-MERCOSUR agreement initiated its progressive liberalization phase once the ten-year period established for full liberalization within MERCOSUR under the Montevideo Protocol was finalized (end-2007). However, even if the liberalization schedule between MERCOSUR and the EU were initiated after this ten-year period (i.e. no overlap), inconsistencies may arise should national treatment and market access receive different treatment (as regards services sectors or modes of supply) in the two agreements. For instance, should NT be of general application in an EU-MERCOSUR agreement, this would render discrimination against MERCOSUR suppliers in sectors/modes of supply where national treatment was made subject to limitations within the MERCOSUR agreement.
- Pre-commitment to reform and liberalization is the backbone of the three-phase liberalizing strategy presented above. On the one hand, the motivation of the EU to enter into a technical assistance process stems from MERCOSUR's pre-commitment to bind at the level of practice during the second phase. Regardless of whether or not further liberalization takes place in the sectors under consideration during the third phase, the regulatory reform implemented in phase II guarantees the EU a higher degree of national treatment and, possibly, market access. On the other hand, protected services suppliers within the MERCOSUR area will more favorably view regulatory reform if progressive liberalization were pre-committed to occur during the second phase of the process. Reform of the regulatory framework would be a key element in their preparation for future enhanced competition.
- An essential element of the liberalizing strategy outlined is the fact that the burden of increasing the contestability of the services sectors in the MERCOSUR area rests essentially on domestic regulatory reform/review (not the elimination of all existing regulation), whose rationale stems from economic considerations emanating both from efficiency objectives and social objectives, and from the exchange of technical cooperation between MERCOSUR and the European Monetary Union. In addition, this strategy is likely to promote a certain degree of regulatory harmonization (or at least facilitate mutual recognition of regulatory standards), while providing a sound justification for the remaining non-discriminatory restrictions to market access.

5. Conclusion

The EU has placed a high priority on the successful conclusion of the negotiations

with MERCOSUR, in part to obtain a foothold into the Americas. The outcome of the services negotiations between the EU and MERCOSUR should be a substantial component of the resulting agreement and should result in an accord to liberalize services trade that goes further than what has been achieved to date in the GATS and even possibly than what has been achieved among MERCOSUR members themselves.

Appropriate, pro-competitive domestic regulatory reform should be viewed as a desirable outcome to be obtained from negotiations. This is particularly important in the case of MERCOSUR, where domestic politics have put at stake the viability of finally implementing a common market.³⁰ The negotiating strategy spelled out in this study provides a credible built-in mechanism for sound reform in a context of political challenge, that despite the level of interregional services trade liberalization obtained, should promote a more efficient functioning of intraregional markets. For MERCOSUR this should also mean a higher degree of regulatory harmonization and possibly a stimulus to further speed up its process of services liberalization.

The negotiating strategy spelled out in this study is subject to some strong assumptions. If not met, the outcome of the agreement (in terms of liberalization of services trade and regulatory reform) may be limited. These assumptions are: (1) technical expertise and/or resources to carry out the assessment of the existing regulatory structures and the need for regulatory reform of the various services sectors is made available through technical cooperation that is both timely and adequate, and (2) government officials are in a strong position and capable of inducing political will for reform.

Annex I

EU Free Trade Agreements on Services

This annex presents a brief description of the main provisions included in the free-trade agreements put in place by the EU and Mexico and by the EU and Central and Eastern European countries seeking accession to the EU (CEEC).³¹ The aim is to present experiences that may prove useful in the drafting of an EU-MERCOSUR services agreement.

Liberalizing principles

The application of basic principles differs substantially between the two types of agreements. The EU-Mexico agreement applies general provisions – market access, most-favored-nation treatment and national treatment – horizontally to the four modes of supply (explicitly defined) and all services sectors not excluded from the agreement, whereas EU-CEEC agreements specify most-favored-nation treatment only as a general principle. Modes of supply are not explicitly defined in this case, however they are implicitly addressed in specific chapters. For market access, the EU-

Mexico text explicitly excludes non-discriminatory quantitative restrictions (Article 4, Decision 2/2001), while EU-CEEC agreements remain silent on this point. In both cases commitments reflect the status quo.

Harmonization of regulation

Regulatory requirements differ substantially between the two types of agreement as well. CEEC are required to (Chapter III, Title V of EU-CEEC agreements) gradually approximate their existing and future legislation to that of the European Community in areas such as: banking law, company accounts and taxes, financial services, rules on competition, technical rules and standards, transport, telecommunications, etc. Mexico, on the other hand, is not required to modify its domestic regulations, except for the application of international regulatory standards. In addition, the agreement promotes the future recognition of requirements, licenses and other regulations.

Transparency

It is not possible to determine the degree of transparency achieved by EU-CEEC and EU-Mexico integration agreements at this stage. Both contain provisions establishing the need for listing reservations and justifying temporary discriminatory or non-discriminatory practices implemented during a 10-year transitional period (see below), however these provisions will be subject to continuous revision during this period. Only when definitive lists of reservations are scheduled and discriminatory practices are fully or partially eliminated will a transparency assessment procedure be relevant.

Architecture of the agreements

Chapters with specific provisions applying to both goods and services are contained in both agreements. In the EU-Mexico agreement this type of provisions exist for investment and related payments, government procurement and intellectual property rights. EU-CEEC agreements add to these provisions others on competition policy and public aid.

As regards sector-specific treatment the two agreements follow different approaches. In the EU-Mexico agreement, specific chapters are devoted to maritime transport and financial services. The EU-CEEC agreements, although they do address specific sectors, they do only in terms of particular provisions within more general chapters. For instance, Article 56, Chapter III (Supply of services), Title IV of the Agreement between the European Community and Hungary, on international maritime transport, provides for unrestricted access to the market and traffic on a commercial basis. Such a provision replaces a more restrictive clause applying to trade in other services set out in Article 55.

EU-Mexico and EU-CEEC agreements also establish specific provisions for the different modes of supply. For instance, investment and related payments are given specific treatment and considered independently from commercial presence or establishment in both types of agreements. Local presence is not required in either agreement, although this is not explicitly stated either of them. The EU-CEEC agreements devote a complete chapter to “Establishment” (Chapter II, Title IV) and

contain a specific clause regarding establishment for modes one and two (Article 52.1 of the EU-Latvia agreement for instance). The EU-Mexico agreement directly addresses the right of establishment in the definition of commercial presence (Article 3) and indirectly by means of listing measures (quantitative and non-quantitative) that a party should not adopt in order to ensure market access. Also, commercial presence is explicitly defined in the context of maritime transport and financial services.

A standstill clause applies on commercial presence (establishment) and investment in the EU-CEEC agreement, although, in the case of Central and Eastern European countries, the former covers the complete transitional period, whereas the latter covers the second half of the transitional period. The EU-Mexico agreement establishes a standstill clause horizontally to measures affecting all modes of supply (including investment) as of the entry into force of the agreement.

Mode four, movement of natural persons, is subject to deeper liberalization under EU-CEEC agreements than under the EU-Mexico agreement. Under Article 3.c.i, Decision 2/2001, the latter allows for the movement of managerial or set up personnel exclusively in conjunction with investments (established business in the territory of the other party). In addition to this benefit, EU-CEEC agreements entitle beneficiaries of the right of establishment in the foreign market, or their subsidiaries, to employ key personnel. This concept is broader than set up and managerial personnel, as it also encompasses persons who possess high or uncommon qualifications or knowledge. The residence and work permits of such employees shall only cover the period of such employment. As regards the cross-border supply of services, EU-CEEC agreements also allow for the temporary movement of natural persons related to the provision of the service, however prohibits that they engage in making direct sales to the general public or in supplying the service themselves.

Although both type of agreements undertake less liberal commitments under mode four than under alternative modes, they do address the need for further liberalization of mode four. This is accomplished by explicitly establishing the need for taking the necessary steps to provide for the mutual recognition of qualifications (Article 46 in EU-Hungary agreement for instance, and Article 9, Decision 2/2001, in the EU-Mexico agreement). For Central and Eastern European countries this issue is further addressed in the European Commission Accession Papers, whereby it is established that a mid-term objective in relation to movement of persons is the complete alignment of mutual recognition of diplomas.[32](#)

Liberalizing modality

As regards the liberalizing modality, both types of agreement adopt a progressive liberalization of trade based on a negative list approach, although this is not made explicit in the EU-Mexico text. Both cases provide for a transitional period of 10 years subject to lists of reservations or non-conforming measures and a calendar of liberalization, however their final aim differs. The EU-CEEC agreements aim at nearly full liberalization and coverage of substantially all trade between the Parties to the agreement to be achieved after the 10-year transitional period. The EU-Mexico agreement, on the other hand, is less clear in this respect as it stipulates that after three years of entry into force of the agreement parties should establish the level of liberalization they agree to grant each other following the 10-year transitional period

(Article 7.3). During the transitional period parties are permitted to temporarily impose overly restrictive provisions on specific sectors or modes of supply on the grounds of particular “weaknesses” affecting such sectors or their regulatory frameworks.

Technical cooperation

Technical assistance plays an important role in EU-CEEC agreements.³³ Chapter III, Title V stipulates that the EU shall provide technical assistance to the Central or Eastern European country for the implementation of measures in specific sectors, which may include inter alia: the exchange of experts, the provision of early information especially on relevant legislation, the organization of seminars, training activities, and aid for the translation of Community legislation in the relevant sectors. Moreover, a separate title (Title VI) is entirely devoted to economic cooperation aimed at contributing to the development and growth potential of Central or Eastern European country, incorporating issues such as environmental considerations and harmonious social development. The relevant article explicitly states that cooperation should focus in particular on policies and measures related to relevant sectors. For instance, according to Article 71.3 contained in the agreement between the EU and the Republic of Estonia, service sectors of interest are energy, transport, telecommunications, postal services and broadcasting; banking, insurance and other financial services and tourism. Cooperation in, say, Banking and financial services (Article 68) is to focus on:

- the improvement of efficient accounting and audit systems in Estonia based on international rules and European Community standards,
- the strengthening and restructuring of the banking and financial systems,
- the improvement and harmonization of supervision and regulation system of banking and financial services,
- the preparation of glossaries of terminology,
- the exchange of information in particular in respect of laws in force or being drafted,
- the preparation and translation of Community and Estonian legislation.

Cooperation is also an integral component of the EU-Mexico agreement. Title VI (of document L/276, 28.10.00 of the Official Journal of the European Community) on cooperation establishes the institution of a “...regular dialogue in order to intensify and improve cooperation...” which, as regards economic matters, shall focus on the analysis and exchange of information, in particular on the macro-economic aspects, in order to stimulate trade and investment. Service sectors such as financial services, energy, transport, tourism, audiovisual, information and communication and health are given specific treatment. Cooperation in these sectors takes the form of exchange of information on regulations and business environments and, in some cases, training programs.

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[*] The authors are trade policy specialists with the OAS Trade Section and support the analytical and technical work of the FTAA Negotiating Group on Services. Comments on this draft are welcome at: sstephenson@oas.org and pcontreras@oas.org.

[1] In exploring the current account implications of alternative speeds of liberalization, Edwards and Van Wijnbergen (1986) find that in a framework where a country faces a borrowing constraint, a gradual liberalization of trade is to be preferred to an immediate approach. However, this question is one that has often been debated in the economic literature and no universally agreed conclusion exists with respect to the optimum speed of undertaking trade liberalization, whether for goods or services.

[2] The core of this section is extracted from Stephenson and Prieto (1999).

[3] See Stephenson and Prieto (1999) for a comparison of the different types of services agreements.

[4] Trade in services is defined in GATS in terms of four modes of supply: cross border supply (mode 1), consumption abroad (mode 2), commercial presence (mode 3), and movement of natural persons (mode 4).

[5] In the context of GATS, Mattoo (1997) proposes merging modes 1 and 2 for the telecommunications and financial services sectors.

[6] It should be noted that agreements on specific service sectors would not meet the conditions set out in Article V of the GATS, particularly with respect to the necessity for any preferential agreement to include "substantially all sectors," and thus probably would not be deemed compatible with WTO requirements. See footnote 9.

[7] See next section for a definition of these terms.

[8] The economic rationale for regulation of sector services arises from three different types of market failure: natural monopoly or oligopoly, externalities, and asymmetries of information.

[9] An important question arising in the context of the MFN principle is how to treat the nexus between regional and multilateral initiatives aimed at liberalizing trade in services. Thus far, GATS has dealt with this nexus through a very general standard—embodied in Article V—that establishes the requirements preferential trading arrangements must meet in order to be deemed consistent with the GATS.

Specifically, Article V stipulates that an agreement providing for preferential, discriminatory treatment on trade in services: have “substantial sectoral coverage” (in terms of number of sectors, volume of trade and modes of supply); provides for the elimination of “existing discriminatory measures;” and not result in “new or more discriminatory measures.” However, the difficult questions of interpretation raised by the requirements contained in GATS Article V, coupled to the constraints on the availability of adequate data on services, make the implementation of Article V very difficult. For a detailed analysis of GATS Article V, see Stephenson (2000).

[10] The same kind of argument can be made when the market fails due to the presence of externalities and asymmetric information.

[11] Bosworth (2001) argues that this argument is fundamentally flawed. His point is that since multilateral commitments are negotiated on ‘bound’ measures whereas unilateralism reduces actual measures, unilateral action to reduce trade barriers does not undermine negotiating coinage. Indeed, unilateral decisions that accelerate liberalization ahead of multilateral commitments are likely to strengthen, not weaken, a country’s negotiating position, since it can negotiate from the stronger position of being able to offer greater cuts to bound levels knowing full well that this would not require any further reductions in applied measures.

[12] This issue has been extensively discussed in the context of the classification of market access and national treatment commitments under GATS. See Feketekuty (2000), Low and Mattoo (2000), and Stephenson (2000).

[13] Note though that the sole threat of competition enhances a more efficient behavior of incumbents.

[14] For a discussion of formula approaches on both a sector-specific and cross-sectoral basis, see Thompson (1999).

[15] See Low and Mattoo (2000) for further discussion on mechanisms to strengthen domestic regulation.

[16] Figures for 2000 presented in table 2 are basically unchanged with respect to 1995.

[17] Measured in terms of the ratio of services exports to merchandise exports, the EU is only 1.4 times as specialized in services as MERCOSUR. See Contreras (2000) for an analysis of the degree of specialization in trade in services of countries in the Western Hemisphere.

[18] Direct investment from the EU in MERCOSUR for the period 1990-96 was more than 6.500 million ECU with services representing between one-third and two-thirds of this total, concentrated in sectors such as banking, insurance, telecommunications, sea and air transport and engineering. Business services are also a growing component of direct EU investment in MERCOSUR. The European Commission (1998).

• Statistics on trade in services provided by the International Monetary Fund

(Balance of Payments Manual) contain considerable flaws that both underestimate services trade and complicate time-series and cross-section comparisons. Figures are provided for cross-border trade of “commercial services”, comprised of shipping, tourism, and remittances, while excluding other forms of supply such as sales through foreign affiliates and movement of natural persons. In addition, services transactions resulting from foreign direct investment are not included. Dissagregation may be limited in some cases due to inconsistencies in the reporting methods used or simply due to lack of reporting. In many cases data are stated in net rather than gross values (exports minus imports).

[19] Most of these issues have been addressed in the “Memorandum of Understanding on Electricity Exchange and Electric Integration of MERCOSUR”, approved by Decision 10/98, however it is not yet operational. Similarly, discussions on a “Memorandum of Understanding on Gas Exchange and Gas Integration of MERCOSUR” are likely to extend in time given the important economic and political implications of this sector, particularly in Argentina.

[20] For instance, at the beginning of 2001, the Brazilian Congress had tabled proposals to maintain the exclusivity rights granted to providers of long-distance passenger transport by road for 15 additional years, without engaging in a new bidding process and, apparently, in contradiction to article 15 of the Constitution (Lycurgo, 2001 in Thomson 2001).

[21] A directive is a provision that is binding upon each Member State to which it is addressed. However, the choice of form and method for achieving the mandated result is left to the national authorities of the Member States.

[22] Technical co-operation regarding the identification of non-tariff obstacles to trade has been a major concern of the EU-MERCOSUR negotiations, however since co-operation activities seem to focus on goods rather than services (see footnote 30) it is likely that a similar criterion is being applied for non-tariff obstacles (see “Final Conclusions,” Second Meeting of the EU-MERCOSUR Biregional Negotiations Committee, http://europa.eu.int/comm/external_relations/mercosur/ass_neg_text/concl_bnc2.htm).

[23] An application of the concept of tariff variation (Pahre 2000) to services suggests that looking at variation in the level of protection of different services sectors points toward differences in each sector’s domestic political strength. In contrast, looking at variation by a service’s country origin points to general foreign policy issues.

[24] The EU-Mexico agreement follows a more conservative approach as progressive liberalization is allowed in both “sensitive” and “non-sensitive” sectors. The agreement also establishes a standstill horizontally to all modes of supply. See annex.

[25] It is important to note that a separation of services sectors of this type may lead to transitory worsening of protection disparities.

[26] The Madrid, 1995 cooperation agreement between EU and MERCOSUR addresses political dialogue, co-operation and trade issues. As regards cooperation in regulatory reform, at present its focus seems to be on goods (customs harmonization,

veterinary and phytosanitary rules, technical norms and standards and statistical harmonization) rather than on services (see The European Commission, 1998). In fact, only three services sectors plus investment are specifically addressed (energy, transport and telecommunications and information technology) and emphasis is put on enhancing transparency rather than on reform or harmonization of legislation. See annex for an analysis of this issue in the context of EU-Mexico and EU-Central and Eastern European countries agreements.

[27] The EU-Mexico agreement does include a clause of this sort, however in its actual drafting it makes uncertain whether or not it will lead to considerable and transparent liberalization of services. See annex.

[28] See Mattoo (1999) for a discussion of inconsistencies in the definition of NT and MA in GATS. Also note that NT is defined broadly in NAFTA to cover all discriminatory measure, and the term ‘market access’ is generally avoided (Bosworth 2001).

[29] Discriminatory and non-discriminatory measures are to be understood as encompassing both quantitative and, when feasible, non-quantitative restrictions. The latter are not listed under GATS.

[30] See Bouzas (2001).

[31] As part of its enlargement strategy the European Community has implemented so called “Europe Agreements” with Central and Eastern European countries seeking access to the EU, namely: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, and Slovenia. Europe Agreements provide the framework for bilateral relations between the European Communities and their Member States on the one hand and the partner countries on the other. All these agreements follow the same basic structure.

[32] See The European Commission, Accession Partnership papers.

[33] See the “Accession Partnership” papers (ibid) for a detailed description of the type of technical assistance provided by the European Commission to countries seeking access to the EU.