

# SERVICES TRADE GOVERNANCE IN THE DIGITAL ECONOMY

Hildegunn Kyvik Nordås

---

## AUTHOR

Hildegunn Kyvik Nordås is a Senior Associate at CEP. She also holds a position as visiting professor at Örebro University in Sweden and research professor at the Norwegian Institute of International Affairs (NUPI) in Norway. Prior to that she was leading the OECD's work on services trade policy analysis, developing the Services Trade Restrictiveness Indices and database and related analytical activities (2005-2019). She also spent two years at the research department at the WTO (2002-2004).

# 1. SERVICES – THE UNFINISHED BUSINESS IN MULTILATERAL TRADE GOVERNANCE

Services have always been traded. Indeed, without trade in transport and communications, insurance, and other financial services, trade in goods would not be possible. Today, services – in particular telecommunications and computer services – are at the heart of the digital transformation. Not only are these services widely traded they also provide a channel for other digital products and data flows to reach all corners of the world. Furthermore, in addition to lubricating trade in goods, services are an integral part of all value chains and play an essential role in making them more sustainable. For example, R&D services and design can contribute to sustainable material technology, more energy-efficient production processes, less waste, product durability and repairability as opposed to design for obsolescence. Finally, access to services such as telecommunications and finance are critical to reach the Sustainable Development Goals. If capacity to regulate such services is in place, trade can contribute to better access.<sup>1</sup>

The first major trade agreement that included services was the North American Free Trade Agreement (NAFTA) in 1994. At the same time, services were part of the Uruguay Round negotiations of the General Agreement on Tariffs and Trade (GATT), which led to the establishment of the WTO in 1995, of which the GATS is a part.

Negotiating a comprehensive multilateral agreement on trade in services turned out to be a tall order. Most services could not be stored and could therefore not cross borders independently of the services provider. Rather, services were typically produced in direct interaction between the services supplier and customer. Trade in services thus often implies that either the supplier must enter the territory of the customer or the other way around. To deal with this, the GATS includes four modes of supply. The first is cross-border trade where a service can be shipped independently of the supplier, for instance over electronic networks.<sup>2</sup> If the customer enters the territory of the supplier to buy the service, it is mode 2. If the supplier enters the territory of the customers through establishing a commercial presence there, it is mode 3. Finally, if the supplier enters the territory of the customer by travelling there, it is mode 4.

Because of the nature of services, regulation in the sector tends to fall on the services supplier rather than the product. A trade agreement involving movement of services suppliers across borders brought regulatory issues, such as licensing of professionals, recognition of qualifications and establishment of a commercial presence into the trade rulebook. Before even starting to negotiate market access, national treatment, and trade liberalization for services, it was necessary to agree on an architecture for the agreement, including classification of services and a definition of trade in services.

GATS negotiations on trade liberalization commenced through a process of requests and offers where the outcome was, for each WTO member, a schedule of bindings by sector, mode of supply and by market access and national treatment. By the time the GATS entered

---

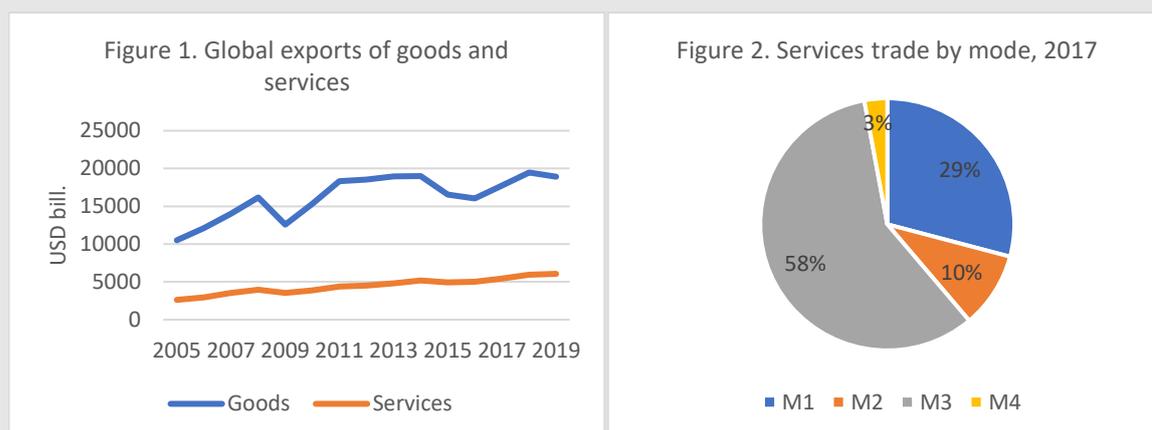
<sup>1</sup> See for instance Fiorini and Hoekman (2018).

<sup>2</sup> Mode 1 accounts for about 30% of global services trade. See Box 1.

into force, most WTO members had submitted a schedule of commitments. However, the schedules did not represent meaningful services trade liberalization.<sup>3</sup> Together with disciplines on domestic regulation, trade liberalization was left for future negotiations.

### Box 1. Trade in Goods, Services – and Data Flows

Figure 1 reports global exports of goods and services over the past decade or so. We notice that services exports are less volatile than goods exports and that services exports grow faster than goods exports, increasing its share of total exports from about 20% in 2005 to 24% in 2019. Figure 2 shows services trade by mode of supply. Commercial presence (M3) accounts for more than half. Sales through such commercial presence are, however, not considered trade in balance of payments statistics and are thus not included in Figure 1 neither for goods nor services. Figure 3 reports services as a share of value added exports, which hovers between 50% and 55%. Table 1 provides historical data as well as forecasts for global internet traffic, as reported by Cisco, a US-based technology firm. The latest data are from 2018 and may be dated, but nevertheless give a good idea of the exponential increase in global data flows.



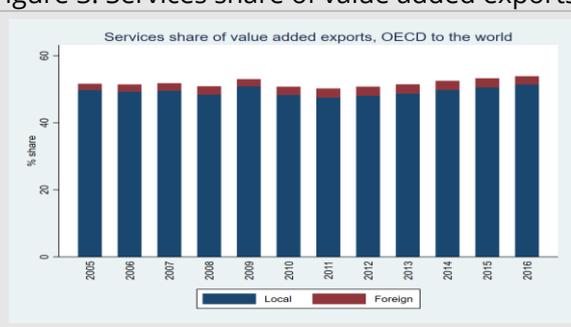
Source: WTO

Table 1. Global internet traffic

1992	100 GB per day
1997	100 GB per hour
2002	100 GB per second
2007	2 000 GB per second
2017	46 600 GB per second
2022 (forecast)	150 700 GB per second

Source: Cisco

Figure 3. Services share of value added exports



Source: OECD

<sup>3</sup> See for instance Adlung and Roy (2005).

To cut a long story short, the GATS negotiations on trade liberalization never came to fruition. An attempt to move forward through a plurilateral Trade in Service Agreement (TISA) based on the GATS architecture, started in 2013, but stalled in 2016. Nevertheless, the WTO has brought services into the multilateral trading system with binding rules on most favored nation (MFN) treatment, transparency, and non-discrimination. These principles apply to all services, also those that are not committed in the schedules.

## 2. SERVICES TRADE GOVERNANCE IN FREE TRADE AGREEMENTS

Meanwhile countries have negotiated free trade agreements (FTAs) at an unprecedented pace. Let us consider the largest and most recent ones: The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada, the Regional Comprehensive Economic Partnership (RCEP) and the US Mexico Canada Agreement (USMCA). Table 2 gives an overview of the differences between the services related chapters in these agreements and the GATS. It is not meant to give a complete record of the agreements, but rather to compare the FTAs to the GATS on key metrics.

The table shows that the architecture of the FTAs is quite different from the GATS. The first notable difference relates to the way countries make reservations to the general obligations in the trade agreements. Three of them use a negative list of reservations and non-conforming measures to carve out sectors or to retain policy measures that do not conform to the provisions in the FTA. Simply put, this implies that everything that is not explicitly exempted is subject to the rules and obligations of the agreement. The GATS applies a positive list of commitment, which implies that only the sectors explicitly committed are subject to market access and national treatment provisions. RCEP applies a mixed approach with a positive list for mode 4 and a negative list for investment, while countries may use either for trade in services.

A second important difference is that services are ringfenced from the rest of the economy in the WTO rulebook while they are more integrated with the rest of the economy in the FTAs:

Rules on investment apply only to services in the WTO.<sup>4</sup> The four FTAs, in contrast, have investment chapters that cover all sectors of the economy. The chapters include an economy-wide set of rules that restricts the use of performance requirements and mandate investment protection, among other provisions. Performance requirements are obligations to source locally or give preference to local suppliers, export a certain amount, or share of output, restrict imports by linking imports to export performance, and to transfer technology to local persons, to mention the most important. The GATS does not mention performance

---

<sup>4</sup> Investment was one of the so-called Singapore issues raised at the WTO Ministerial in Singapore in 1996, but the WTO did not arrive at a resolution on trade and investment. Instead, a multilateral agreement on investment was established under the auspices of the OECD.

requirements explicitly, but they probably fall under the catch all national treatment obligations.<sup>5</sup> The GATS is silent on investment protection.

Rules on movement of people (mode 4) only apply to services sectors in the GATS, while the four FTAs have chapters on temporary movement of people that apply horizontally to all sectors. This difference need not be very significant since natural persons on business travel usually provide a service. For example, a person sent abroad by a manufacturing firm to install, maintain, or repair equipment in a manufacturing plant provides a service. In any case, very few, if any, countries have made commitments in mode 4, so for practical purposes the GATS does not have much impact on temporary international movement of people.

As noted, barriers to trade in services, particularly in relation to modes 3 and 4, are mainly found behind the border where foreign services suppliers meet domestic regulation in the host country. The right to regulate is explicitly stated in both the GATS and the FTAs included in Table 2, with the provision that regulation shall not unnecessarily undermine market access and national treatment commitments. Health, safety, and the environment are mentioned as areas where the right to regulate applies even if regulation has a negative effect on trade.

Beyond this, the GATS and the FTAs differ both in scope and depth of regulatory provisions. Domestic regulation is placed under the GATS in the WTO rulebook and thus only applies to services. While three of the FTAs have articles on domestic regulation in the cross-border services trade chapter, except for RCEP they also have chapters on domestic regulations that apply economywide. Moreover, while the GATS article on domestic regulation has a general provision stating that measures in committed sectors should be applied in a reasonable, objective, and impartial manner, disciplines on domestic regulation are left to future negotiations. Such negotiations were launched by WTO members as a Joint Statement Initiative (JSI) on Services Domestic Regulation at the 11<sup>th</sup> WTO Ministerial Conference in 2017. The JSI currently involves 63 countries negotiating the text of a reference paper on domestic regulation to be added to Members' schedules of commitments if they so wish. The objective is to deliver the outcome at the 12<sup>th</sup> Ministerial in 2021. Disciplines on domestic regulation are already in place in the FTAs.

All four FTAs have a chapter on digital trade. Digital trade is not explicitly included in the GATS, but neither is it explicitly excluded. Scholars argue that GATS obligations and specific commitments are technology-neutral and therefore apply to digital trade as well.<sup>6</sup> However, some WTO members, particularly developing countries, argue that digital services are new services and therefore not committed in the GATS. Recall that the GATS applies a positive list, so countries only have obligations in sectors explicitly committed.<sup>7</sup>

---

<sup>5</sup> Performance requirements are included in the Trade Related Investment Measures (TRIM) in the WTO, which applies to goods only. In the GATS, market access is defined by an exhaustive list of measures that cannot be maintained unless they are scheduled. National treatment, in contrast, is all-encompassing stating that "[...] each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers."

<sup>6</sup> See Willemys (2018; 2019) and Tuthill (2017).

<sup>7</sup> See Mitchell and Mishra (2017).

The dispute between the US and Antigua and Barbuda on cross-border gambling and betting supports the view that digital trade is covered by GATS commitments. Antigua and Barbuda started marketing digital gambling and betting services to the US, which swiftly closed its market for digital cross-border gambling. Antigua and Barbuda brought the case to the WTO Dispute Settlement Body, which found in its favor on the grounds that the US did not prohibit digital gambling and betting and it had no reservations on mode 1 trade in this sector.<sup>8</sup>

**Table 2. Services in Recent FTAs – Compared to the GATS**

Agreement	GATS	CPTPP	CETA	RCEP	USMCA
Sector coverage	All services except air transport	All services except air transport for cross-border trade, all sectors for investment	All services sectors except air transport and audiovisual and cultural services	All services except air transport for cross-border trade, all sectors for investment	All services except air transport for cross-border trade, all sectors for investment
Listing	Positive	Negative	Negative	A hybrid. Positive for mode 4. Some members have a positive list for services in all modes, others have a negative list of non-conforming measures for all modes. Some have a positive list on all modes plus a negative list of non-conforming measures on investment.	Negative
Mode 1	MA and NT for all modes of supply. Covers all services sectors except air transport	Chapter on cross-border services. MA, NT, domestic regulation, recognition.	Chapter on cross-border services. MA and NT	Services chapter that follows the GATS. MA, NT, domestic regulation, recognition.	Chapter on cross-border services, MA, NT, domestic regulation*, recognition
Mode 2		Not explicitly mentioned	Not explicitly mentioned	Included in the services chapter as in the GATS	Not explicitly mentioned
Mode 3		Chapter on investment covering all sectors in the economy. MA, NT, PR, investment protection	Chapter on investments covering all sectors covered by CETA. MA, NT, PR, investment protection	Chapter on investment covering all sectors in the economy. MA, NT, PR, investment protection	Chapter on investment covering all sectors in the economy. MA, NT, PR, investment protection
Mode 4		Chapter on temporary entry for business persons covering all sectors of the economy.	Chapter on movement of natural persons. Follows GATS in definition of natural persons covered. Chapter on mutual recognition.	Chapter on movement of natural persons covering all sectors of the economy. Subject to positive list of commitments.	Chapter on temporary entry for business persons covering all sectors of the economy.
Regulation chapter	No, but Article VI in the GATS address regulation	Chapter on regulatory coherence.	Chapter on domestic regulation on licensing and qualification requirements. Chapter on regulatory cooperation.	No horizontal chapter on regulation. The services chapter includes similar, but more elaborate provisions as the GATS article VI.	Chapter on good regulatory practices.
E-commerce	No	Yes	Yes	Yes	Yes

*Note: CPTPP members are Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Viet Nam. RCEP members are Australia, Brunei, Cambodia, China, Indonesia, Japan, Korea, Laos, Malaysia, Myanmar, New Zealand, The Philippines, Singapore, Thailand, Viet Nam. MA means market access, NT national treatment and PR performance requirements. \* The term is “development and administration of measures” in this agreement. Source: Author’s elaborations based on the text of the agreements*

<sup>8</sup> The decision on the case came in December 2007. See [https://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds285\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds285_e.htm).

In any case, the view that the multilateral trading system needs updating to offer global governance in the digital economy is widespread. Modern 21<sup>st</sup> century trade agreements do include digital trade, and several long-lasting trade agreements have added a digital trade chapter or negotiated a separate agreement on digital trade in recent years. Building on the experience and insights from FTAs, WTO members agreed on a JSI on e-commerce, and initiated plurilateral negotiations in 2017. A consolidated text was agreed in December 2020 and results are expected for the 12<sup>th</sup> WTO Ministerial in 2021. We discuss e-commerce in more detail in Section 4.

### 3. SERVICES TRADE GOVERNANCE AND DOMESTIC REGULATION

Unlike physical goods that enter foreign markets through customs, services typically arrive in the foreign market behind the border. Therefore, trade barriers are also behind the border in the shape of domestic regulation. This can be professional qualifications requirements and licensing, pro-competitive regulation in telecommunications, or standards for the provision of financial services, to take a few examples.

With the proliferation of global value chains, it became clear that regulations affecting the services links in the chain have repercussion on the effectiveness and competitiveness of the entire supply chain.<sup>9</sup> Furthermore, the additional costs of complying with regulatory diversity across jurisdictions have become apparent even when the regulation per se is non-discriminatory and reasonable.<sup>10</sup> Since the administrative costs of conforming with domestic regulation are typically independent of the export value, small and medium sized enterprises (SMEs) are particularly hard hit by regulatory differences across jurisdictions. In fact, study after study have found that services exporters are on average much larger and more productive than non-exporters and only the largest companies export to and invest in more than a few countries.<sup>11</sup> To reduce trade costs, FTAs have provisions on regulatory cooperation, mutual recognition of qualifications and standards, regulatory equivalence, regulatory coherence and in some cases even regulatory harmonization.

Regulatory harmonization between countries has proven unrealistic except in cases of countries with similar regulatory and legal traditions, such as the Nordic countries.<sup>12</sup> This is because regulatory measures are part and parcel of a regulatory system that is intertwined with the fabric of society at large. For instance, some countries choose to regulate services providers, while others regulate services outputs. An example is the building industry where some countries regulate the professionals, e.g., architects, engineers, and other technical occupations, while others regulate mainly through building codes combined with rigorous processes for issuing building permits and inspections at the building sites. Furthermore,

---

<sup>9</sup> Miroudot and Cadestin (2017).

<sup>10</sup> Nordås (2016).

<sup>11</sup> See Wagner (2012) for a review.

<sup>12</sup> Nordås (2018).

countries with a strong public social safety net and scant tradition for litigation, tend to regulate insurance and legal services lightly compared to more litigious societies.

Therefore, FTAs have shifted focus from preparing the ground for regulatory convergence of content towards convergence of regulatory processes. Best regulatory practices are characterized by transparency, objectivity, accountability, and predictability.<sup>13</sup> CETA, TPCPP and the USMCA all include chapters on regulatory cooperation aiming at coherence or good regulatory practices. However, as stated in the good regulatory practices chapter in the USMCA, best practice processes can reduce or eliminate unnecessarily burdensome, duplicative, or divergent regulatory requirements – indicating that ultimately the agreement aims for regulatory convergence.

The benefits of common substantive standards were well understood long before regulation entered international trade agreements. Indeed, for the services that form the backbone of international trade and commerce – transport, telecommunications, and finance – international standard setting bodies have agreed on global standards that are indispensable for the workings of the global trading system. For example, the International Telecommunications Union (ITU), established in 1865, developed international standards for a seamless global communications network which has allowed every individual on the planet to reach every other individual by telephone or over the Internet in real time. Today we take this for granted, but it is really an extraordinary achievement.

As standards enter international trade agreements, it raises the question about the division of labor between the WTO and major FTAs on the one hand and specialized international organizations and standard setting bodies on the other. A common approach is to focus on regulatory processes in trade agreements while referring to – or committing to adopt – international substantive standards where relevant.

There is extensive collaboration between the WTO and other international organizations on global governance. The WTO, the World Bank and the IMF are obliged to work together for global economic policy coherence.<sup>14</sup> The WTO also has formal agreements of collaboration with other international organizations including ILO, ITU, OECD, WHO and WIPO to mention the most relevant for services trade. While the other organizations largely set substantive standards, the OECD plays an important role in developing standards for regulatory processes through recommendations and guidelines as well as benchmarking and reviews.<sup>15</sup>

Regulatory cooperation at the OECD and other international organizations is a dynamic process where regulators draw on advances in academic research on regulation, adjust regulation to technological changes and learn from each other. It is true that countries have interests in setting standards close to their own in such standard setting bodies. But they also have an interest in developing joint global standards that are fit for purpose.

In contrast, trade negotiations are by design a bargain over requests and offers. In such a setting, regulatory reform in one area may become a bargaining chip and traded for

---

<sup>13</sup> Ortino and Lydgate (2019).

<sup>14</sup> This is mandated in the GATT Declarations adopted by the Trade Negotiations Committee on 15 December 1993. [https://www.wto.org/english/docs\\_e/legal\\_e/legal\\_e.htm](https://www.wto.org/english/docs_e/legal_e/legal_e.htm)

<sup>15</sup> See <http://www.oecd.org/regreform/regulatory-policy/recommendations-guidelines.htm>. In some areas of relevance to services trade the OECD also provides guidelines. Examples are the OECD Privacy Guidelines and the Transfer Pricing Guidelines.

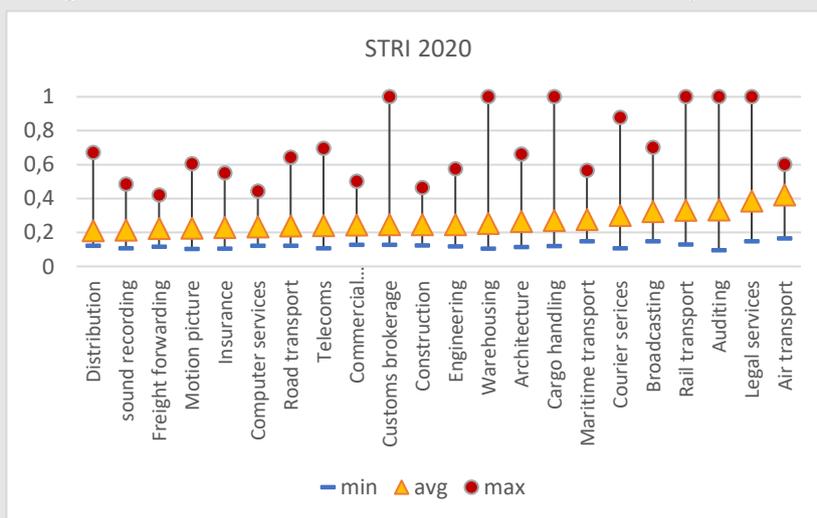
concession in other areas. Furthermore, domestic regulation may become subject to dispute settlement in trade agreements, while this is usually not the case at the OECD and international standard setting bodies. Regulatory content is ill suited for such bargaining and for deliberations where regulatory reform may be held back or serve other interests than its initial objectives.<sup>16</sup>

Against this backdrop, limiting the scope of the multilateral trading system’s disciplines on domestic regulation to regulatory processes seems appropriate. Disciplines on regulatory processes are particularly important for professional services. In most countries licensed professionals have exclusive rights to offer a defined set of services. Process-oriented disciplines do not question the need for a license, or the qualification requirements needed

**Box 2. Measuring Barriers to Trade in Services.**

The OECD measures barriers to trade in services by gathering data from the laws and regulations of 48 countries in 22 sectors. The qualitative database is updated every year and the information is scored and weighted to yield services trade restrictiveness indices (STRI) by sector, country, and year. The indices take values between zero and unity, where zero represents full openness to trade and investment, while unity represents a sector closed to foreign participation. Figure 4 shows the minimum, average and maximum score over countries and sectors in 2020. The indices are not perfectly comparable across sectors but are calibrated to give an idea of which sectors are the most open, and in which sectors there is the largest spread. Air transport is on average the most restrictive and there is also little spread across countries. A score of one reflects either a statutory monopoly in the sector, or a license requirement where licenses are reserved for nationals of the country. We note that no country is completely open to trade in services in any sector.

**Figure 4. Services Trade Restrictiveness Indices by Sector**



Source: OECD

<sup>16</sup> The FTAs discussed in this note to some extent avoids this problem by establishing committees for regulatory cooperation at arms-length from the negotiations as well as limiting the extent to which regulation is subject to dispute settlement.

to obtain it. They do, however, require that the qualification criteria as well as the application process are transparent and non-discriminatory. Since a license is necessary for entering the market, there is a case for subjecting licensing procedures and administration of recognition of qualifications to dispute settlement.

## 4. SERVICES TRADE GOVERNANCE IN THE DIGITAL ECONOMY

The GATS was established before the commercialization of the Internet, before bundling goods, services, and data into integrated solutions for customers became common, and before digital platforms became global and ubiquitous. Furthermore, IT and AI-based services that did not exist when GATS entered into force have raised new policy issues not foreseen in 1995.

The WTO established the Work Program on Electronic Commerce in 1998. Its purpose was to investigate the relationship between existing WTO agreements for goods, services and intellectual property rights and e-commerce. The work program made little progress until the JSI on e-commerce was launched at the 11<sup>th</sup> WTO Ministerial in 2017. The consolidated negotiation text agreed in December 2020 addresses five broad issues: enabling e-commerce, openness, trust, telecommunications, market access, and in addition cross-cutting issues. The measures being discussed are commonly found in modern FTAs (Table 3).

The measures subject to hard law in FTAs are picked up in the JSI consolidated text using similar language.<sup>17</sup> As Table 3 illustrates, the trickier issues, including, privacy, cross-border data flows and data localization requirements are far from resolved in the FTAs and the same lack of consensus is reflected in the JSI consolidated text.

The lack of progress on the higher-hanging fruits reflects the fact that the digital economy cannot be ringfenced from the rest of the economy for trade purposes – or any purpose for that matter. Digitization and artificial intelligence have created new economic activities, moved activities out of the market and into the sharing economy – e.g., a significant part of the photo development industry – blurred the distinction between goods and services, between trade, investment, and non-equity relationships between firms, as well as decoupled payment flows from economic activities, for instance over multi-sided markets.<sup>18</sup> Furthermore, digitization has led to scale without mass and close to zero marginal cost of digital products, leading to huge economies of scale and related challenges for competition policy, taxation, and income distribution both within and across countries. Consequently, product and sector classification has changed drastically, and many products created by traditional services sectors are no longer categorized as services (see Box 3).

---

<sup>17</sup> The consolidated text of the JSI on e-commerce of December 2020 contains several versions of language for each measure.

<sup>18</sup> When a firm, for instance a platform, serves at least two distinct group of customers between which there are indirect network effects, it is a multi-sided market. An example is a newspaper or a social network platform that offer content to one group of customers and sell advertising to another group of customers. Often it is only one side of the market that pays for the service.

**Table 3. Measures commonly found in FTA e-commerce chapters.**

<b>Measure</b>	<b>Nature of commitment*</b>
Moratorium on customs duties on delivery of products by electronic means	Hard
Non-discrimination of digital products	Hard
Legal framework adopting UNCITRAL Model Law on Electronic Commerce 1996	Hard
Recognizing electronic authentication and electronic signature	Hard
Access to source code cannot be requested	Hard
Limiting unsolicited commercial electronic messages	Hard
Online consumer protection	Consumer protection is mandated, but no common standards. Regulatory cooperation.
Personal information protection	Protection of privacy is mandated, but no common standards.
Paperless trading	Best endeavor
Regulatory cooperation	Best endeavor
Access to and use of the Internet	Recognize its importance
Obligations to negotiate Internet connection and charge sharing with foreign providers	Recognize its importance
Cyber security	Recognize its importance, capacity building, cooperation
Cross-border data flows	Parties shall in principle allow data flows for the conduct of business, including personal data. Countries may restrict data flows to pursue legitimate policy objectives.
Location of computing facilities	Parties shall in principle not require use of local facilities. Countries may require data localization to pursue legitimate policy objectives.

*Source: Own elaborations from analyzing the four FTAs presented in Table 2. \*A hard commitment means that the agreement uses the word "shall" or similar and that the agreement is subject to dispute resolution. CETA does not have hard commitments in the e-commerce chapter. In none of the FTAs reported in Table 2 does dispute settlement cover cases where a party considers that benefits that could reasonably be expected are being nullified or impaired because of a measure of another party that is inconsistent with the agreement. Dispute settlement on electronic commerce in RCEP is on a voluntary basis.*

Regulation in the digital economy is a multifaceted work in progress. As gatekeeping portals, privacy concerns and social cohesion have grabbed the headlines and attracted attention in the popular debate, finding solutions has become a priority. Competition policy measures addressing possible abuse of market power by gatekeeping portals are on the table both in the EU and the US.<sup>19</sup> The Inclusive Framework for Base Erosion and Profit Shifting (BEPS)

<sup>19</sup> The EU's approach is ex-ante regulation of gatekeeper platforms, while the US applies existing anti-trust legislation. See the draft Digital Markets Act <https://ec.europa.eu/info/strategy/priorities-2019-2024/europe-fit-digital-age/digital-markets-act-ensuring-fair-and-open-digital->

hosted by the OECD seeks to find a solution to tax avoidance, improve transparency and advance the coherence of international tax rules. A consensus solution to the tax challenges arising from the digitalization of the economy is expected in July 2021.<sup>20</sup> Neither competition issues nor taxation are on the table in the multilateral trading system.

### **Box 3. What is a Service?**

A technical point related to services trade is the distinction between sectors and products. Sectors are economic activities while products are the outcome of such activities. For goods, this distinction is straight forward. For instance, the apparel sector makes products such as dresses, suits, t-shirts etc. It is the products, not the sector, that are traded.

For services, in contrast, the activity cannot be distinguished from the product. For this reason, the GATS is anchored in a *sector* classification, the W/120. For consistency with trade statistics, the WTO Secretariat provided a concordance between the W/120 and the UN Central Product Classification (CPC) 1991 version. The scheduled commitments in the GATS are for the most part based on the W/120 classification. However, the CPC has been updated several times to capture technical development, the emergence of new products and services, and the obsolescence of other products and services, resulting in a widening gap between the W/120 and the CPC.

The UN Standard National Accounts from 2008, distinguishes between goods, services, and knowledge-capturing products. These are defined as follows:

“Goods are physical, produced objects for which a demand exists, over which ownership rights can be established and whose ownership can be transferred from one institutional unit to another by engaging in transactions on markets”.

“Services are the result of a production activity that changes the conditions of the consuming units or facilitates the exchange of products or financial assets.” The SNA goes on to describe two types of services: change effecting services and margin services. For both applies that they “are not separate entities over which ownership rights can be established. They cannot be traded separately from their production. By the time their production is completed, they must have been provided to the consumers.”

“Knowledge-capturing products concern the provision, storage, communication and dissemination of information, advice and entertainment in such a way that the consuming unit can access the knowledge repeatedly.”

In the digital economy, many sectors classified as services produce knowledge-capturing products that can be stored, ownership rights can be established, and they can be traded separately from their production. For these products what is traded is the right to use them and payments are royalties and license fees.

---

[markets\\_en#documents](#), and [https://www.ftc.gov/system/files/documents/cases/051\\_2021.01.21\\_revised\\_partially\\_redacted\\_complaint.pdf](https://www.ftc.gov/system/files/documents/cases/051_2021.01.21_revised_partially_redacted_complaint.pdf) (FTC case against Facebook) and <https://www.justice.gov/atr/case/us-and-plaintiff-states-v-google-llc> (DOJ case against Google).

<sup>20</sup><https://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.pdf>

Regulatory reforms could generate strong welfare gains in sectors producing knowledge-intensive products such as professional services. Digitalization has left information less asymmetric while artificial intelligence allows automating some tasks safely making them more accessible and affordable. This helps e.g., SMEs to adopt sustainable technology and to enter new markets.

Against this backdrop, the original purpose of the WTO Work Program on Electronic Commerce – to investigate the relationship between existing WTO agreements for goods, services and intellectual property rights and e-commerce and streamline e-commerce into existing agreements makes sense. This, however, will take time.

## 5. A NEW ARCHITECTURE FOR TRADE AGREEMENTS

We are in the midst of a technological revolution which manifests itself as a digital transformation of economic and social activities. At the same time, we face a global pandemic and a looming climate crisis. Services are at the core of the digital transformation. Access to state-of-the-art services is part of the solution to limit the damage from the pandemic, develop treatment and vaccines to stop it, and build back better towards an inclusive and sustainable future. Services are also essential means for obtaining the Sustainable Development Goals (SDGs). Access to services such as education, health, finance, ICT, transport, and telecommunications is part and parcel of reducing poverty and improving well-being. The most frequently mentioned services sector in the SDGs is financial services.<sup>21</sup>

So, how could global governance of services trade be reformed to ensure that the potential for services to contribute to an inclusive, sustainable global economy comes to fruition?

This note has shown that the distinction between goods and services and modes of supply has become blurred with digital transformation. Even the concept of what is a service is changing. Such structural changes need to be reflected in the rulebook of international trade agreements. Furthermore, globalization of trade, investment, dataflows, and social interactions have resulted in regulatory spillovers across borders, while regulatory diversity has become a major concern for firms with international production networks – or ambitions to establish in international markets. Bringing down the cost of regulatory diversity and solving common regulatory problems while maintaining national regulatory autonomy to pursue national policy objectives have become a challenge in trade negotiations.

With this in mind, in the following, we propose core building blocks for the future architecture of services trade governance, starting at the national level and then moving up to the bilateral, regional and multilateral level.

### The National Level

Domestic regulation is anchored in the legal system and the fabric of society, reflecting values and preferences in each country. Furthermore, although regulatory measures change from time to time, the legal and regulatory system persists for decades if not for centuries and was born long before services trade policy issues became a concern. Nevertheless,

---

<sup>21</sup> See Fiorini and Hoekman (2018)

common problems and cross-border regulatory spillovers imply that countries must work together to obtain their individual and shared objectives.

- Ensure that unilateral regulatory reforms are forward-looking, apt for a digitally transformed services economy and with a view to adopting international standards where relevant.
- Ensure that competition policy addresses barriers to entry and contestability in digital markets.
- Ensure that policies on data flows are strong on security and privacy while holding firms accountable for compliance without restricting where data is stored and processed (“data flow with trust”).
- Work with trading partners on mutual recognition of qualifications.
- Work with domestic professional bodies, the OECD, the ITU, other relevant standard setting bodies, and stakeholders to develop ethical standards for the use of AI.
- Modernize copyright and related rights legislation and implementation for a digital economy.
- Work with trading partners and the OECD to stay abreast with best practice regulatory processes and procedures.
- Engage in the OECD/G20 inclusive BEPS framework initiative and follow the agreed guidelines when reforming the domestic tax system.

## The Bilateral and Regional Level

The WTO rulebook exempts FTAs from the MFN requirements provided that they fully liberalize essentially all sectors among themselves and do not raise trade barriers towards third countries. FTAs are typically motivated by aspirations to forge deeper economic relationships between countries that are already major trading partners. Thus, FTAs almost by design go beyond the multilateral system both in depth and scope of economic integration.<sup>22</sup> FTAs offer opportunities for exploring new issues such as regulatory cooperation aiming for regulatory coherence in the digital economy. Furthermore, as discussed above, FTAs can explore alternative architectures for trade agreements. For example, the Australia Singapore Digital Economy Agreement, which entered into force in December 2020 goes beyond other agreements both in depth and breadth – depth by extensive use of hard commitments, breadth by including provisions on cooperation on competition policy, artificial intelligence, and fintech among other areas.

Against this background, FTAs should:

- Develop technology-neutral rulebooks and architecture that works for the digitally transformed services economy.
- Establish regulatory collaboration that aims for interoperability between different systems of regulating privacy and cyber security.
- Negotiate disciplines on regulatory processes and procedures related to standards, licenses, and qualification requirements – compatible with international guidelines where relevant.

---

<sup>22</sup> In practice this was not always the case for services as studies have documented so-called GATS minus provisions in FTAs. See for example Adlung (2012).

- Collaborate on regulation with international spillovers such as competition policy in markets dominated by a few global firms – compatible with international guidelines where relevant.
- Ensure that collaboration on the development of regulatory content is at arms-length from negotiations over market access and national treatment and contributes to and be consistent with international standards and guidelines where relevant.
- Welcome new members that share the founding members’ objectives and ideas and facilitate multilateralization of successful policies.

## The Multilateral Level

The multilateral trading system rarely generates services trade liberalization. Rather, countries bind already implemented trade liberalization in the GATS – at best.<sup>23</sup> Given the novelty of negotiating market access and national treatment for services at the time, this is not surprising and may not be a bad thing. However, after 25 years with meagre progress on the built-in agenda of progressive services trade liberalization, the gap between commitments in the GATS and actual applied trade policy has widened. Over the past decade only three cases have been filed with the WTO Dispute Settlement Body on services. At the same time, the OECD STRI shows that services trade barriers have been rising in the past few years.<sup>24</sup> To bring the GATS back from obscurity and fill its role in governing global services trade, profound reforms are needed, including to:

- Streamline digital economy aspects into the rulebook and apply horizontal rules where feasible. These should include hard law on the measures under the heading “enabling e-commerce” suggested in the JSI on e-commerce.
- Apply negative listing of reservations and non-conforming measures.
- Where rules inevitably are specific to certain sectors, the definition of the sector should be future proof, for example by defining the activity or function to which the rules apply.
- Focus on improving the rulebook for market access and national treatment. National treatment in the area of performance requirements needs clarification. Lack of clarity leaves too much space for the dispute settlement body to define the agreement.
- New issues could be introduced through plurilateral negotiations open to all countries that wish to engage.
- Agreements on domestic regulation should focus on regulatory procedures and processes. Transparency and predictability are particularly important for services firms operating in many jurisdictions. Core principles of non-discrimination,

---

<sup>23</sup> See Miroudot and Pertel (2015) for estimates of “water in the GATS”, i.e., the distance between commitments in the GATS and unilaterally applied trade policy. It is a big lake indeed.

<sup>24</sup> The three dispute settlement cases were: USA complaint against China on electronic payment (2010); Panama complaint against Argentina on financial services (2012) and India complaint against USA regarding increased fees for non-immigrant visa (2016). In addition, three cases which involved alleged breaches of the GATS related to economic sanctions were filed (Venezuela against USA, 2019; Qatar against Saudi Arabia, 2017 and Russia against Ukraine, 2017). See OECD (2021) and Benz et al. (2020) for information on development in trade restrictions.

objectivity and reason in domestic regulation should be subject to the WTO dispute settlement mechanism.

- The content of domestic regulation should be developed by the relevant standard setting bodies. Where applicable, the WTO rules could refer to international standards. Focusing on regulatory principles and processes may seem lacking in ambition, but developing common regulatory content is better dealt with outside a trade negotiation setting e.g., by international standard setting bodies.

To conclude, nations face challenges that cannot be solved at a national level. Climate change, inequality, cyber security, competition policy in sectors characterized by scale without mass are cases in point. Services and trade in services are an important part of the solution.

---

## REFERENCES

- Adlung, R. and Roy, M., 2005. Turning Hills into Mountains? Current Commitments under the General Agreement on Trade in Services and Prospects for Change. *Journal of World Trade*, 39(6).
- Adlung, R. (2012). Poison in the Wine? Tracing GATS-minus Commitments in Regional Trade Agreements. *Journal of World Trade*, 46(5).
- Benz, S., J. Ferencz and H.K. Nordås (2020). Regulatory Barriers to Trade in Services: a New Database and Composite Indices. *The World Economy*, 43, 2860-2879 <https://doi.org/10.1111/twec.13032>
- Fiorini, M. and B. Hoekman (2018). Services Trade Policy and Sustainable Development. *World Development* 112, 1-12.
- Miroudot, S. and K. Pertel (2015), "Water in the GATS: Methodology and Results", *OECD Trade Policy Papers*, No. 185, OECD Publishing, Paris, <https://doi.org/10.1787/5jrs6k35nnf1-en>.
- Miroudot, S. and C. Cadestin (2017), "Services in Global Value Chains: From Inputs to Value-Creating Activities", *OECD Trade Policy Papers*, No. 197, OECD Publishing, Paris, <https://doi.org/10.1787/465f0d8b-en>.
- Mitchell, A. D., & Mishra, N. (2017). Data at the Docks: Modernizing International Trade Law for the Digital Economy. *Vand. J. Ent. & Tech. L.*, 20, 1073.
- Nordås, H. K. (2018). What Drives Trade in Services? Lessons from the Nordics. *Applied Economics*, 50(33), 3532-3545.
- Nordås, H.K. (2016). Services Trade Restrictiveness Index: the Trade Effect of Regulatory Heterogeneity. OECD Trade Policy Paper no 189.
- OECD (2021), OECD Services Trade Index: Policy Trends up to 2021. Paris: OECD. <https://issuu.com/oecd.publishing/docs/oecd-stri-policy-trends-2021?fr=sMGVIMjI5ODk2NDE>
- OECD (2017). *Services Trade Policies and the Global Economy*, Paris: OECD Publishing. <https://www.oecd-ilibrary.org/sites/9789264275232-en/index.html?itemId=/content/publication/9789264275232-en>
- Ortino, F., & Lydgate, E. (2019). Addressing Domestic Regulation Affecting Trade in Services in CETA, CPTPP, and USMCA: Revolution or Timid Steps? *The Journal of World Investment & Trade*, 20(5), 680-704.
- Sheargold, E., & Mitchell, A. D. (2016). The TPP and Good Regulatory Practices: An Opportunity for Regulatory Coherence to Promote Regulatory Autonomy? *World Trade Rev.*, 15, 587.
- Tuthill, L. L. (2017). Implications of the GATS for Digital Trade and Digital Trade Barriers in Services. *Communications & Strategies*, (107), 95-115.
- Wagner, J. (2012). International Trade and Firm Performance: a Survey of Empirical Studies since 2006. *Review of World Economics*, 148(2), 235-267.
- Willemys, I. (2018). The GATS (In) Consistency of Barriers to Digital Services Trade. In *European Society of International Law (ESIL) Conference, Location: Manchester, United Kingdom*.
- Willemys, Ines. "GATS Classification of Digital Services—Does 'The Cloud' Have a Silver Lining?" *Journal of World Trade* 53, no. 1 (2019).