

ECIPE Bulletin No. 07/2013

## Why Are Services Commitments in RTAs Stronger than in the GATS? Trade Policy Implications for TTIP

By Erik van der Marel, a Senior Economist at ECIPE, ([erik.vandermarel@ecipe.org](mailto:erik.vandermarel@ecipe.org))

**Recent studies demonstrate a clear pattern in services commitments. They show that commitments in most services RTAs around the world are stronger than those in the General Agreement of Trade in Services (GATS) at the WTO. Although this gap in commitments is of course not surprising, the question of why it exists seems more puzzling. The political economic reasons underlying this pattern can provide policymakers and trade negotiators with a number of insights into the contours of a potential TTIP deal for services.**

Commitments can be regarded as the bound level of restrictiveness in services and form the legal bindings negotiated in any trade agreements. Higher commitments signal a greater degree of liberalization. But, as in goods agreements, these bindings can actually differ from the applied state of trade liberalization or openness. Trade negotiations are centred on the bound level of restrictions.

When taking stock of all existing RTAs with a services element, the average gap between services commitments in RTAs and those in the GATS accounts for almost 25 per cent, measured on a scale from 0–100. There is substantial variation, however, when looking at commitments gaps across sectors: Distribution, Transport and Business Services each show around 25 per cent, whereas Construction and Finance show much lower rates at 17 and 12 per cent respectively when measured on similar scale. There are also significant differences across the modes of supply: on average Mode 1 and 2 have high gaps of around 24 per cent each while both Mode 3 and 4 show lower commitments of around 16 per cent.

Overall, these figures show that trade negotiators commit more easily in some areas than others. One of the usual outcomes of any services RTA is that Mode 3 and 4 are still very restricted in comparison with Modes 1 and 2. However, this is not always the case. RTA Services commitments in Mode 4 are relatively high for Distribution, Transport and Business Services while those for Mode 2 are relatively low when it comes to Construction and Finance. What explains this variation in commitments between RTAs and the GATS? Are there any specific political economic sources that could clarify these patterns in commitments?

To a large extent there are. Firstly, trade costs play an important role. Countries which are situated close to one another are inclined to make deeper commitments when negotiating a services RTA, as they are with goods RTAs. On the one hand this is because many services are directly related to goods trade, i.e. Transport, Insurance and Logistics. The higher trade creation effects in goods become, the more motivated countries are to ensure complementary services, and thus higher commitments are made. On the other hand, trade costs are also partially covered by differences in doing business and, more importantly for services, by differences in regulatory regimes. Countries that are closer to each other tend to have similar regulatory practices which imply lower trade costs and hence higher commitments.

Other economic factors also play a role in explaining higher commitments in RTAs. When a partner country has a larger market size it often translates into higher commitments because larger welfare gains can be reached. This is

especially true for Financial Services. A country's endowments are equally important because services are relatively intense in labour, whether it's skilled or less skilled. Liberalization would therefore have an effect on workers in the possession of these types of labour. Generally, high-skilled labour workers are in favour of further liberalization of services. Many services are comprised of mid-skilled labour, so high-skilled workers from partner countries do not feel threatened by commitments in RTAs. However, this is not in the interests of the mid-skilled labour group at home, who form an opposition group – this is especially the case when developing countries are included in an RTA. Developing countries are becoming increasingly competitive in the production of services. Moreover, these forces opposing liberalization are reinforced when countries have solid democratic institutions through which mid-skilled labour groups can voice their concerns. This reduces high commitments in services.

A last important aspect links commitments gaps to national regulators. The liberalization of services can erode their regulatory power, restraining them from setting standards and enforcing rules. Therefore it appears that countries which share high-quality regulatory practices have a tendency to increase the commitments gap in RTAs. In this way regulatory competition from regulators in countries with lower standards is excluded by choosing a high-quality partner.

What do all these factors imply for the TTIP services negotiations? Although the extents to which both the EU and the US commit beyond GATS are roughly similar, there are notable differences across modes and sectors in services RTAs. Generally speaking, the US is much more defensive about its Mode 4 commitments across most sectors except Finance. The EU appears to be reluctant to commit itself further in Mode 1 and 2 relative to the US's commitments, especially in Finance. Business Services also show a clear difference with, on the whole, higher commitments taken by the US in each RTA.

The prospects of pushing through a significant services deal should be good. Both the EU and the US are large trading partners, so welfare gains would be very high when forming an RTA. They are relatively "close" to each other in terms of their business practices and the quality of their national regulators. Furthermore, both are likely to have a comparative advantage in services since they have large GDPs per capita and each of them have well-developed domestic services markets. Moreover, both countries also appear to have a relatively large skilled labour force.

However, expectations should not be confused with enthusiasm. For instance, stark differences in commitment patterns are visible between Mode 1/2 and 4 – precisely the modes where regulators will traditionally feel threatened. The EU and the US are therefore locked in opposing positions which will be hard to resolve. Secondly, the pool of high-skilled labour is much bigger in the US, even in comparison to the EU's 15 most developed countries. This is reflected in the RTAs each country has accorded: by and large the US shows far higher commitments in sectors which are high skilled-labour intense, such as Professional Services and Finance. These are sectors where the EU is still very protectionist, especially for Mode 1. Thirdly, each of them also has a large pool of mid-skilled workers who are relatively well represented in services sectors such as Construction, Communication and Transport. Recent commitments undertaken in these areas are still modest for both the EU and the US, and mid-skilled labour workers are expected to strongly defend their status quo in both countries.

As much as political players would like to create a meaningful Transatlantic Agreement, the commitment patterns for both the EU and the US lead one to think that it will be a hard nut to crack in services. Commitments negotiations in this field are likely to concentrate on freeing high-skilled labour sectors in the EU on the one side, and possibly increasing commitments in Mode 4 for the US on the other. Commitment patterns for Mode 3 seem to follow a different logic: both the EU and the US show roughly similar patterns across all sectors with the exception of Business Services, where the US has generally committed more in its RTAs. Perhaps this could be traded off with Transport Services in Mode 3 – where the EU still has high-applied policies.